NEW TRENDS ON CORPORATE GOVERNANCE

by

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"The price of leadership is responsibility"[4]

FIRST: INTRODUCTION

"The importance of corporate governance lies in its contribution both to business prosperity and to accountability" [5]

I. Definition of Corporate Governance (CG)

"CG is the system by which companies are directed and controlled"[6]

CG is a generic term which describes the ways in which rights and responsibilities are shared between the various corporate participants, especially the management and the shareholders.

There have been a number of different, yet significant definitions of the term CG. In 1976 Harold Wilson's book, The Governance of Britain appeared. In that same year, Tricker, the "father of CG" was already using the term CG. He famously stated: "CG… is concerned with the way corporate entities are governed, as distinct from the way businesses within those companies are managed. CG

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[2] The opinions in this paper are the personal opinions of the author and not necessarily of the organizations he represents.

[3] I would like to thank Karen Heath and James Atton for their assistance in the preparation of this paper.

[4] Sir Winston Churchill.

[5] The Hampel Report.

[6] The Cadbury Report.

addresses the issues facing boards of directors, such as the interaction with top management, and relationships with the owners and others interested in the affairs of the company…" [7].

The Cadbury Report 1992 highlighted that "CG is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meetings" [8].

The Organisation for Economic Cooperation and Development (OECD) has defined the meaning of CG as: "A set of relationships between a company's management, its board, its shareholders and other stakeholders. CG… provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance… Good CG should provide proper incentives for the board and management to pursue objectives that are in the interest of the company and shareholders and should facilitate effective monitoring, thereby encouraging firms to use resources more efficiently" [9].

CG is mainly concerned, therefore, with issues such as:

- effectiveness and efficiency of operations
- reliability of financial reporting
- compliance with laws and regulations
- safeguarding of assets

CG has driven many changes on boards of directors and shareholders. The factors which have driven such changes are the concentration of ownership, from individuals to institutions; the worldwide move towards privatisation; the changing expectations that society has of the purpose of companies and investment. All of these forces have their impact against the background of the world which is being transformed by globalisation and information technology, which in turn act as acceleration of change [10].

II. History of CG

> *"The directors of such companies…., being the managers of other people's money rather than of 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 copartnery frequently watch over their own. Like the stewards of a*

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[7] Tricker, 2001, quoted in Andrew Chambers, Corporate Governance Handbook , 2002, p. 4.
[8] The Cadbury Report.
[9] OECD, 1999.
[10] Adrian Cadbury, speech to the Hermes sponsored Howardship and Performance Seminar, London, 20 October 2000.

rich man, they are apt to consider attention to small matters as not for their master's honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company. It is upon this account that joint stock companies for foreign trade have seldom been able to maintain the competition against private adventurers" [11]

1. Origins

CG principles first emerged in the US as far back as the 1930s, as a result of the 1929 crash. However, it wasn't until the 1970s that research really began. Shortly after this time, the UK suffered the turbulent Thatcher years. In this period, under the impressive umbrella of a free market philosophy, state subsidies and the 'nanny state' were spurned. It has been noted that, at this time: "Too much government and too much red tape were identified as curses to be exorcised: determined attempts were made to roll back the frontiers of the state with the intention of liberating the entrepreneurial spirit and leading to the creation of more wealth. Self regulation was seen as better than state control"[12].

Thus it was accepted that the market should regulate itself and government should provide merely a playing field.

2. UK codes

A. The Cadbury Report. The application of CG principles had its debut in the UK in the 90s. Following the harsh economic climate suffered in the late 80s and early 90s, particularly heightened by the breakdown of Polly Peck, Brent Walker and particularly Maxwell and BCCI, the concerns regarding CG were pushed into the public domain. Because of this, the Cadbury Committee was set up in May 1991 by the Financial Reporting Council, the London Stock Exchange, and the accountancy profession with the aim of addressing the financial aspects of CG. A final report incorporating a Code of Best Practice was published on December 1992.

What the Cadbury Code established was:

a. The need for boards to be crystal clear over there responsibilities
b. The need for checks and balances in the governance structure especially at board level
c. The extent of the board's responsibilities for financial reporting and financial controls
d. The need for independent-minded outside directors of calibre and for communities of the board largely made up of outside directors
e. Above all the need for openings about company performance and governance; disclosure is the fundamental plank in which the code rests[13].

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[11] Adam Smith, The Wealth of Nations, 1776, Book 5, Chapter 1, Part 3, art 1.
[12] Andrew Chambers, op.cit., 2002 p. 23.
[13] Adrian Cadbury, speech at the Hermes, op.cit.

B. The Greenbury Report. The Combined Code: Following the Cadbury Code of Best Practice came the Greenbury Report on directors' remuneration with its own code on executive remuneration. This was followed by a report from the Hampel Committee which was set up in November 1995. The report consolidated, amended and added to the Cadbury and Greenbury codes in the form of the new Combined Code named as such as it combines the Cadbury and Greenbury Codes along with Hampel's own additions and changes.

C. The Higgs Report: Instigated by recent corporate failures, the Higgs Report has produced a draft of proposals for law reforms The report says that: a) the role of chairman and chief executive should be separated and a chief executive should not become chairman of the same company; b) a full time executive director should not take on more than one non-executive director (NED), nor become chairman, of a major company; c) no individual should chair the board of more than one major company; d) at least half the board should be independent, as should all members of the audit and remuneration committees and a majority of the nomination committee; e) a senior independent director should be identified and be available to shareholders if they have concerns that have not been resolved through the normal channels of contact with the chairman or chief executive; f) the pool of candidates for NED appointments should be broadened, including more executive directors and senior executives from other companies and directors of private companies, as well as advisers and those from other backgrounds; g) NEDs should meet once a year in the absence of the chairman; h) an independent NED should chair the nomination committee; i) no one individual should sit on all three principle board committees at the same time [14].

Other incentives like the Smith Report, Patricia Hewitt's consultation paper "Rewards for Failure" and the Financial Reporting Council's consultation paper should also be mentioned.

3. Other European Codes

Other European countries followed the UK's initiative: the Vienot Report in France; the Code of the Milan Stock Exchange in Italy; the Recommendations for the Regulators Commission in Portugal; the Code of Corporate Governance and the Law on Transparency and Publicity in Germany; the Código Olivencia and the Aldama Report in Spain [15]; recently, the Dutch Tabakslat Committee released a new draft Dutch CG Code applicable to listed companies registered in the Netherlands; etc.

All of these codes are of voluntary application, although in some cases listed companies are obliged to present a report explaining the areas in which they did not observe the codes' rules. They have also influenced law reforms in their respective countries.

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[14] Linda Tsang, "Corporate governance", Independence Day, p. 13
[15] Juan Fernández-Armesto, "Criterios de buen gobierno", Economistas, November 2002.

SECOND: CORPORATE GOVERNANCE. PRINCIPLES AND CRISIS

> *"La mejora del buen gobierno es un proceso en el que no vamos a llegar nunca a la meta final y en el que las reglas son sólo una parte de la solución... [al final] todo depende de las personas"* [16]

I. Main principles of CG

> *"Taking further steps to strengthen the business by reaffirming our commitment to transparency, accountability and shareholders involvement is essential to restore investor confidence* [17]*"*

The already recognised principles of CG are that of fairness, transparency, accountability and responsibility. These principles have been expanded on by the non binding principles laid down by the OECD in the spring of 1999. The main expansions are as follows[18]:

a. Fairness: There has been an expansion on the concept of fairness by an introduction of two principles: Principle I states that, "The CG framework should protect shareholders' rights". In this way there is an emphasis that shareholders are property owners and as such, they are owners of a legally recognised share of a company, in this way, they have the right to hold or convey their interest in the company, and to participate on key corporate decisions for example the election of directors as well as the approval of major acquisitions. Principle II deems that "The CG framework should ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights" This emphasises the need to protect against misappropriation of assets or of self dealing by controlling shareholders, managers or directors.

b. Transparency: Principle IV stated that: "The CG framework should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership and governance of the company." This principle recognises that as well as investors and shareholders needing information about the company, its financial and operating results, they also need information about corporate objectives and material foreseeable risk factors in order to monitor their investment. Also important to potential investors and shareholders is information about the company's governance, including share ownership and voting rights, identity of board members and key executives and executive compensation.

c. Accountability: Principle V states: "The CG framework should ensure the strategic guidance of the company, the effective monitoring of management by the

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[16] Francisco González, President of BBVA, Unversidad Internacional Menéndez y Pelayo, Expansión, 26 June 2003.
[17] William Donaldson, op.cit
[18] Holly J Gregory, op.cit. 2002, p. 5.

board, and the board's accountability to the company and the shareholders." Directors, as elected representatives of shareholders, are generally held to be in a fiduciary or trust relationship to shareholders and/or to the company and have a duty to avoid self interest in their decisions and to act diligently and on a fully informed basis. In general, a director would represent the entire body of shareholders and does not serve a particular constituency. Also, in order for the board to serve as an effective monitor of managerial conduct, it must be sufficiently distinct from management to be capable of objectively evaluating management. Normally this would require that some directors are neither members of the management team nor closely related to them through family or business affairs.

d. Responsibility: Principle III translates responsibility as meaning that: "The CG framework should recognise the rights of stakeholders as established by law and encourage active cooperation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises." Corporations must abide by the laws of the countries in which they operate, however every nation has to decide for itself the values which it wishes to express in law and the corporate citizenship requirements it wishes to impose. Although, law and regulation impose only minimal expectations as to conduct. Outside the boundaries of law and regulations, all corporations should be encouraged to act responsibly and ethically.

Many people around the world see the value to businesses, consumers and ultimately themselves if good CG practice is achieved in a company. It is widely agreed that the need within a corporation for transparency, honesty and accuracy is paramount. 46% of senior executives say that CG is one of their organisations top three priorities, 14% say it is one of their top priorities [19].

Those four basic principles of CG - fairness, transparency, accountability and responsibility - which have been expanded into the OECD's five principles of CG require both regulation and private sector initiatives for implementation. Regulation ensures that minimum standards are met; codes of best practice should, rise above the minimum legal requirements.

II. Main factors of CG's crisis

1. Current CG crisis

The CG throughout the second part of the 20th century was based on a model that evaluates the performance of the company and bases the company's decisions on the quotation of the stock of the company. Today this model is in crisis [20].

2. Main factors of crisis [21]

[19] The Economist, "Corporate Governance-The New Strategic Imperative", 2003
[20] Roland Pérez, La gouvernance de l'enterprise, La Découverte, 2003, p. 80.
[21] On the crisis, see f.i. Roland Pérez, op. cit. Bernanrd Taylor, "Corporate Governance: The crisis, investors' losses and the decline of public interest".

A. Explosion of the dot.com bubble. The companies of the new technology, media and communication sectors, made aggressive mergers and acquisitions. The bubble of companies associated with the Internet exploded in 2001 and the stock exchange was affected. To this one can add the explosive over expansion of the telecommunication industry and the availability of cheap capital due to the historically low interest rates and high equity evaluations. As a consequence many citizens lost there jobs, much of them savings or both [22].

B. S.11 attack on the Twin Towers. The S.11 tragedy was not only a terrorist attack, a reaction of the have-nots against the capitalist establishment, an emanation of the clash of cultures. It had also important economic and financial consequences on crucial sectors: aviation and transport industry, travel and tourist sector, insurance sector, etc.

C. Stock market crash. All together, CEOs at the 23 firms under investigation took home $1.4bn from 1999 to 2001. At the same time these companies laid off 162,000 employees and the value of their shares fell by $530bn – about 73% of their market value [23].

D. Abuse of the stock options. Stock options were created to align the interest of the directors and the shareholders. But the directors abused this financial instrument in prejudice of the interests of the shareholders. Directors had an executive interest in increasing the value of the shares even manipulating the accounts of the company[24].

E. Risky strategies. A primary cause of the crisis was the boards of directors allowing CEOs to pursue risky strategies. CEOs of media companies like Jean-Marie Messier of Vivendi Universal, Robert Pitman of AOL Time Warner and Thomas Middlehoff of Buttermann destroyed billions of dollars in shareholder value in pursuit of the expected synergies between media and the internet which never materialised. Other media companies also speculated on internet securities News Corporation entered into an unsuccessful $2bn online partnership with MCI, and Walt Disney Corporation lost $790 m when they launched Go Network.

F. Greed. The cause of many of CG irregularities was similar to the greed of high executives at Enron to obtain bonuses (rewards for meeting targets that dwarfed the employees salaries) and stock options (a longer time incentive), which breached insider trading rules, conflicts of interest and national limits to self-enrichment, making fortunes for such executives.

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[22] William Donaldson. op. cit

[23] Study by United for a Fair Economy, quoted by Julia Homer, Edition in Chile CFO, in 2003: CFO Global Outlook, December 2002, p. 7.

[24] According to Millberg Weis class action law suit against Enron from 1998 to 2001 Enron´s chairman, Kenneth Lay obtained $184 m from selling Enron stock, Jeffery J. Skilling the COO, $70m and other executives like Lon Pai $270 m Robert Beefer $111 m etc.

III. CG scandals

> *"... the main dangers to the success of capitalism are the very people who would consider themselves its most ardent advocates: the bosses of companies, the owners of companies and the politicians who tirelessly insist that they are "pro business"* [25].

1. Enron [26]

> *"When the house of Enron came tumbling down, it exposed the worst of corporate greed, misbehaviour and citizenship. Enron betrayed US employees, it betrayed its clients, and, by inflaming the public's widely perceived notion that companies can not be trusted any longer other than to serve their own ends and line their own pockets, Enron betrayed all of corporate America"*[27]

Enron, in its prime was America's seventh largest company[28]. However, it suddenly hit an all time low and shocked the world when it suddenly went into liquidation.

The Enron fall has been the most catastrophic corporate collapse in human history. As Steve Sabu says, perhaps the most startling of this case is the schism between the values Enron proclaimed and the story of the real facts [29].

The main irregularities of Enron were the swelling of the accounts taken on the basis of contracts executed and not the cashed commission (as normal in broker companies accounts), the off balance sheet partnerships, the special purpose entities and transactions which were never disclosed in the financial statements, and the improper or at least aggressive accounting practices. In summary, Enron's balance-sheets were fake: assets were overvalued and the liabilities undervalued. The system was designed to make people rich without making real profits.

Enron was known to have prestigious political connections. It has been estimated, that in the last decade, Enron gave roughly $5m to federal candidates. According to the Centre for Responsive Politics, 71 senators and 186 House members reported taking contributions from Enron over the last decade [30].

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[25] The Economist, "capitalism and democracy", 28 June 2003.
[26] On Enron, see for instance, Brian Cruver, Enron, Anatomy of Greed, Arrow, 2002
[27] Bradley K. Googins, Newsday, cited by Steve Salbu at the foreword of Brian Cruver, op.cit, p. xii.
[28] Fortune 500 listed Enron as No 7 for the year 2000, with revenues over $100bn, $40bn ahead of Exxonmobil. Enron was also ranked 31 as the fastest growing and the 25 most admired companies in the world.
[29] Steve Sabu, op. cit., p. xi.
[30] http://www.commoncause.org/publications/enron/enronhome.htm

"I would like to think people will learn from this (Enron scandal), and take those lessons with them; but I'm afraid that some people will just plant new Enron seeds wherever they go" [31].

2. Arthur Andersen

Arthur Andersen (AA) was one of the big 5 accounting firms and probably the most prestigious. AA audited Enron.

From the subsequent investigations it is clear that AA was involved in the process that brought Enron to bankruptcy. The accounting irregularities were not only known but advised by AA, and many AA ex-employees were key employees in Enron. AA's conflict of interest and complicity went even to the destruction of incriminating documentation.

AA was not only a serious incident but a demonstration that the CG control system was inoperative and untrustworthy.

3. Other failures

Enron and AA were only the pioneers and many mega corporations followed suit: Adelphia, Eron, Global Crossing, Imclone, Merck, Tyco, QuestCom, WorldCom, Xerox, AOL Time Warner, etc. In Europe the scandals were with BCCI, Guinness, Metalgetsellschaft, Maxwell, Banesto, Vivendi, Ahold, etc.

Enron and other scandals exacerbated the $7tn collapse in the aggregate market value of US corporations over the past 3 years.

All of them incurred in different proportions under the same irregularities: account manipulation, unduly increasing the value of the assets and hiding liability and serious conflict of interest based on a greedy culture.

4. Banesto

A. In brief

In Spain, a good example of bad CG was the near collapse of Banco Español de Crédito (Banesto) in 1993. Banesto's former chairman, Mario Conde, and nine other directors were charged with defrauding the bank. Mario Conde has since been sentenced to a term in prison. What Mr Conde and his directors did was to buy Banesto-owned properties which the bank later repurchased at inflated prices and carryout unjustified financial transactions. Banesto was acquired by Banco Santander in April 1994 after a $6.3bn rescue operation.

[31] Mr. Blue, cited Brian Cruver, op. cit. p. 181.

B. What happened to Banesto

The fraud occurred by the manipulation of commercial documents and through irregular accounting entries hiding the truthful value of Banesto's assets, making it appear that they were worth more than in fact they were.

C. Bad CG

Transactions were made in order to benefit third party companies linked to the executives of Banesto or their family members or persons linked to them in order for them to be resold at an increase price.

The mechanism for doing so was the following: Banesto lent money to a company which was in the process of liquidation, it became a shareholder and afterwards it bought the company at an increased price benefiting the selling shareholders and prejudicing the bank. For example, a credit of €5 million would be given to a company with financial difficulties, the shareholding in the company was then given to relatives, friends or linked third parties and later Banesto would buy the company for €15-20 million, and the losses would be assumed byBanesto.

The fraud also included the withholding of amounts, which should have passed through the accounts of Banesto but were in fact passed through intermediary companies, which were the property of various members of the board of directors.

5. Vivendi

A. Background

In 1853 Compagnie Generale des Eaux (CGE), the forerunner to Vivendi Universal, was created by imperial decree, enabling CGE to win its first public service concession to supply water to Lyons. Between 1980-1996, CGE expanded and diversified in international operations (waste management, energy, transport, construction, etc.). In 1996, CGE appointed Jean-Marie Messier as group president. He transformed a French sewage utility into a global media and telecommunications giant, second only to AOL Time Warner.

From 1996 onwards, M. Messier launched a round of aggressive business acquisitions including TV and film company Canal Plus, online music firm MP3.com and educational publisher Houghton Mifflin. He also stepped across the Atlantic to snap up Hollywood's Universal Studios and Universal Music Group from Canada-based Seagram. During the expansion period, Vivendi's stock more than doubled to almost $300 a share at the beginning of 1999.

In 1998, the group changed its name and became Vivendi. In 2000 Vivendi Universal (VU) was created following the successful merger with Canal Plus and Seagram.

B. What happened to Vivendi Universal

The series of takeovers carried out by VU left the company with a large debt pile. The hi-tech bubble burst and economic growth began to falter. That meant that many of the businesses that bought were only worth a fraction of the value the firm paid for them. VU unveiled a €13.6bn loss for 2001, weighed down by a colossal downward revision in the value of its assets and in 2002 it reported losses of €23.3bn (highest losses in France ever). The losses in the first quarter of 2003 amount to €17bn.

VU's board fired Mr Messier after finding that the company was skating close to filing for bankruptcy, a situation brought about by serial acquisitions and massive stock buy backs to prop up VU's share price. The new President, M. Fourtou, has so far sold 10 subsidiaries for €8bn and plans to sell more for €7bn in 2003. VU has reduced its debt from €37 to €12bn.

C. Bad CG

The primary cause of VU's crisis was due to executives pursuing risky strategies. VU is an extraordinary example of diversification by acquisition. From a water utility it was transformed into the world's second largest media company through the acquisitions of: Havas (media advertising for €4.75bn), Seagram (music for €32.6bn), Canal Plus(pay-TV for €12.5bn), Publisher Houghton Mifflin (for €2.2bn). This was all in pursuit to combine distribution vehicles (telephone, internet and cable TV networks) with content providers such as publishers and film studios.

VU cheated the market and provided false financial information in order to cosmetize its financial situation. Liberty Media holds that VU was going through a great crisis while negotiating with Liberty were ongoing for the purchase of its participation in USA Networks (cable TV) for a purchase price of €11bn which were paid with VU's shares. Liberty argues that the purchase agreement is fraudulent and null and void since VU was aware of the company's difficulties.

D. Restructuring of VU

The utility arm has since been spun off and is now known as Veolia Environnement. Veolia Environnement has broken links with VU. Veolia hard core (20%): AGF, Axa, BNP Paribas, Crédit Lyonnais, CNP, Electricité de France and Generali).

M. Fourtou's strategy consists in selling non-strategic assets (particularly Vivendi Entertainment assets including Universal Studios) in order to generate cash to pay debt. VU sold the US chain of 700 Spencer Gifts shops to Gordon Brothers and Paladin Capital (Investment funds), Veolia and Vivendi Universal Publishing, an office tower in Los Angeles. VU intends to sell its participation in Xfera (Spanish 4th mobile operator), and its 16.3% participation in Spanish Sogecable. VU is concentrating in domestic (French) business, Key pieces in VU future: strategic assets: Canal Plus and Cegetel (telecommunications operator). VU wishes to increase participation in Cegetel (fixed telephone). and SFR (mobile telephone),

Edgar Bronfman (former owner of Seagram including Universal Music (records) and Universal Studios (cinema)) is planning to repurchase Universal Music and Universal Studio. Bidders for VU's US entertainment assets (videogames, cinema, cable TV, theme parks) estimated in $15bn: Bronfman (former CEO of Seagram), Marvin Davis (oil), Viacom, Liberty Media, MGM, GE (24.6.03).

6. Royal Ahold (RA)[32]

A. Background

RA opened as a small grocery store in Holland in 1887. In 1990, Mr. Cees Van der Hoeven (RA's CEO) bought 50 firms for €19bn. This made RA a company serving 40 million customers in 27 countries across the world employing over 460,000 people. Earnings soared by 15% per annum, and shares became popular with Dutch retail investors.

B. What happened to RA

RA was christened by the Economist as "Europe Enron". On February 2003, RA's executives admitted that they had overstated RA's earnings in the US and Argentina by at least $500m in 2001 and 2002.

Mr. van der Hoeven and the CFO resigned. RA bonds were downgraded to junk status and RA's market value plunged to €3.3bn -a fall of nearly 90% from peak value of €30bn in 2001. Further investigations revealed accounting fraud that at the latest count saw profits at its US Foodservice unit overstated by $909 million over the past 3 years.

In 2002, the US retail operation was overstated by $29m mainly stemming from wrongful accounting of vendor rebates at Top Markets. Although the Center for Financial Research and Analysis in Maryland published RA's questionable accounting going back to 1999, it was not until much later that RA's auditors uncovered the irregular accounting.

C. Bad CG

At the heart of the fraud is US Foodservice, a company that RA acquired in 2000. The accounting irregularities carried out by US Foodservice mainly consisted of: manipulation of supplier rebates, accrued vendor receivables, promotional allowances and diverse information given for tax and competition purposes.

How the above works is that manufacturers provide retailers a discount for buying goods in bulk or for meeting certain targets in sales volumes. These reduce the cost of sales and hence boost profits because accounts are often drawn up before cash actually changes hands and retailers sometimes book these sums in advance. If an expected level of sales fails to materialize, no rebate is due and the retailers profits will have been falsely inflated.

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[32] See, among others, Jan van der Horst, "Shaky future for Dutch supermarket chain", The European Lawyer, May 2003, p.10.

The most likely reasons attributed by analysts why RA resorted to such accounting tricks are: pressure to meet earnings targets, (either internally or imposed by outside analysts) earnings based bonus plans, or incentives to keep the stock price high due to stock based compensation plans.

The second major issue was the consolidation of the results of some of its subsidiaries. RA has announced that it will proportionately consolidate the results from these subsidiaries commencing from the fiscal year 2002. It has also announced that it will restate historical financial statements using proportionate consolidation.

Another major issue is the accountancy standards used by RA. The figures when reported as per US GAAP standards are different from those as reported under Dutch GAAP standards and RA is blamed for not disclosing all relevant information to investors. Under the Dutch standard, the company in 2001 posted earnings of $1bn, however, under US standards the figure would have read nearer $100m. Also, RA highlighted the Dutch GAAP net earnings in the front of its annual report, whereas the figures as per the US standard were placed in small print at the back of the report. All in all, there was lack of transparency in the figures reproduced.

Noone is alleging fraud, but RA is under investigation by the Amsterdam stock market regulator and the US SEC.

D. Conclusions

Investors are anxious for news on whether RA will meet the extended Aug.15 deadline to hand fully audited accounts to banks. This is a condition to receive second tranche of $915m of emergency credit to repay loans

In the Netherlands, for instance, there is no equivalent to the U.S. SEC, which has broad regulatory and enforcement power over financial markets. The Netherlands Authority for the Financial Markets, a governmental organization, polices market activity such as insider trading, but companies' financial reports are monitored by a self-regulatory body consisting of market participants.

The corporate scandals of VU and RA are the two largest to rock Europe. Although, the outcome of the scandals are the same, (loss in market value, breaking up of large conglomerates etc.) the scandals highlight the lack of CG measures in Europe. Whereas, the collapse of RA was mainly due to accounting irregularities, VU demise is primarily due to an over ambitious President, who over acquired too many assets at too higher prices, which ultimately led to an unserviceable debt.

7. Alstom

Earlier this month, Alstom, one of Europe's largest engineering groups, revealed accounting irregularities at one of its American subsidiaries. Alstom makes trains, ships and power-generation equipment and employs 110,000 people world-wide.

An internal review at Alstom, sparked by letters received from ATI employees "alleging accounting improprieties" revealed that Alstom had deliberately understated costs in its books on a rail car contract and would need to take a €51m charge in its tax accounts for 2003. Two senior executives have been suspended from its subsidiary in New York.

The reason for improprieties seems to be pressure on executives due to the company's dire financial position. The company reported a €1.4bn loss for the year ended in March and has been selling key profitable businesses in order to meet debt repayments. The group is €5bn in debt.

8. Actividades de Construcción y Servicios

A few days ago ACS, Spanish fourth large construction group, made a third take-over for the remaining 2/3 of Dragados, a larger rival. ACS had acquired a dominant stake paying € 22.22 a share. It then offered the same price in January when it upped its stake to 33.5 %. But today it is offering just 33 of its shares for 68 Dragados (equivalent of €18.39).

Although the transaction is perfectly legal, it has received criticism from some quarters. For instance, the FT [33] said "This is the accepted Spanish practice: pay cash for a stake big enough to exert de facto control over your target, but small enough to convince a complaisant regulator that you do not in fact possess control; then merge your own company, complete with the debt incurred to buy your initial stake, into the target on far less favourable terms… it defies believe any investment bank … should feel justified in calling these terms "fair"".

III. Current situation of CG in the US

Shearman & Sterling conducted a survey on "CG practices of the Fortune 100 Publicly Listed Companies" [34] with the following results: 56 % have public available charters for their nomination committee; 30 % require greater than a majority of independent directors; 38 % have defined director independence; in 86% the same person services as CEO and chairman of the board; 57 % have a mandatory retirement age for their non-employee directors (ranging form 68 to 75); 38 % address the topic of term limits; 15 % have publicly disclosed the means by which interested parties may confidentially contact their non-managing directors; 84 % hold 6 or more board meetings per year; 24 % require a minimum number of board meetings each year (ranging from 4 to 10); 58 % have adopted new audit committee charters that comply with NYSE rules; 37 % currently expense the value of stock options; 41 % have publicly available compensation committees charters; 65 % have reported stock ownership guidelines for directors

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[33] Financial Times, "Spanish practices", 4 July 2003.
[34] Shearman & Sterling, "CG Practices of the Fortune 100 Public Listed Companies, 15 May 2003.

and executives; 82 % have publicly disclosed how board compensation is determined; 70 % grant stock options as part of directors compensation.

THIRD. LEGAL REMEDIES

> *"Nearly a year after the Enron revelations first surfaced, CG dominates the political and business agenda. After a slew of scandals, most of them centred in the US, politicians and regulators, executives and shareholders are all preaching the governance gospel"* [35].

I. Change of attitude regarding CG

The huge corporate giant breakdowns have led to action around the world in a bid to increase and ensure the effectiveness of CG in companies.

II. Sarbanes Oxley Act 2002

> *"[The Sarbanes Oxley Act is] the most important securities act since the New Deal [1932]* [36].

1. The act

> *"Sarbanes signifies an about-face from the wink-and-nod approach to corporate governance of the 1990's"*[37]

On 30 July 2002, President Bush signed the Sarbanes-Oxley Act (SOX) with the view to stopping Enron-like scandals happening again in the future and returning investor trust confidence. SOX represents the end of the absolute free market, supply and demand and deregulation theories [38].

> *"(Sarbanes) is very ambitious on a lot of levels, and it is certainly going to ensure that everyone strives towards the same goals"* [39]

In essence, SOX imposes the directors the obligation to formally sign financial statements, increases the control of auditors and submits them to a supervisory body and increases the penalty for criminal fraud.

2. SOX's provisions

SOX aims to establish a framework for a new regime of accountability by public companies in the areas of financial reporting and disclosure, audits, conflicts of

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[35] The Economist, "Corporate Governance-The New Strategic Imperative", 2003

[36] Harvey Goldschmid, SEC Commissioner.

[37] ABA Journal, Sorting out Sarbanes-Oxley, Jenny B. Davis, February 2003

[38] Jeff Skilling, Enron's chairman, "California needs to get deregulation right, and the rest of the country needs to get deregulation right…Markets are powerful, and they work", cited by Brian Gruver, Enron. Anatomy of greed, 2002, p.108.

[39] Jean M. Davis of Gray Plant Mooty, Minneapolis, quoted in the ABA Journal, "Sorting out Sarbanes-Oxley", February 2003.

interest and governance. It imposes the responsibility of meeting such requirements on CEO's and CFO's. SOX also draws attorneys and accountants more tightly into its web of responsibility by requiring them to report evidence of material violations of federal securities laws.

Under section 302 SOX, corporate financial disclosure is a personal matter for the principle executive officers and financial officers of public corporations. It makes it a requirement that CEO's and CFO's personally certify the information contained in the quarterly and annual reports that their companies publish. The process involves certification by the CEO and CFO that the company maintains and regularly reviews internal controls, which are generally financial in nature.

In a change to past regulations, the SEC's new rules spell out explicitly what the SEC wants to know about a company's internal controls. Specific information is sought by the SEC about how the internal controls work, how their effectiveness is reviewed, and whether there are to be any significant changes followed the review of their effectiveness.

Disclosure controls and procedures are explained by the SEC as an internal reporting system to assure that material information is reported to corporate officers. It is stated that, as well as adoption, a company must maintain and regularly evaluate its disclosure controls and procedures. It has been said that this is intended to be broader than the existing concept of internal controls, in order for it to also encompass both financial and non-financial considerations. Again, the onus is put onto the CEO and the CFO to certify that such controls and procedures are in place for the company. As was commented on by Peter M. Menard: "Disclosure procedures and controls is a new term, but the concept is not new… Since the very beginnings of federal securities laws, it's been unlawful to have material misstatements or omissions in filings, so most companies have already developed procedures to ensure the accuracy of information" [40].

3. SOX and US companies

Within 6 months after SEC regulations approval, companies must adopt and disclose (in their website and annual reports) CG guidelines which must address: director qualification standards, director responsibilities, director access to management and independent advisors, director compensation, director orientation and education, management succession and annual performance evaluation of the board.

4. SOX and EU companies

There are some problems under debate on the extraterritorial application of SOX to EU auditors and companies listed in the US.

[40] Peter M. Menard, a partner in the Los Angeles office of Sheppard Mullin Richter & Hampton. As quoted in the ABA Journal, Sorting out Sarbanes-Oxley, Jenny B. Davis, February 2003

5. SOX and lawyers

It is anticipated that lawyers, when dealing with the disclosure requirements affecting them under SOX are faced with a special dilemma. Section 307 SOX stipulates that lawyers are to report evidence of a material violation of federal securities law or a breach of fiduciary duty to a client company's general counsel or chief executive officer. If they do not appropriately respond to the information, the lawyer must report the matter to the company's board of directors or audit board. Under the proposed rules, a private attorney who reports the evidence "up the ladder" of corporate leadership without any appropriate response must make a "noisy withdrawal" from representation. That step must include a written disavowal to the SEC of any document the lawyer helped prepare that was filed with the commission containing questionable information. In-house counsel must take similar steps to disavow such filings [41]. This raises important problems for the lawyer's confidentiality obligations which is one of the core values of the legal profession.

III. European Commission Action Plan

> *"By increasing transparency and generating shareholders power we will help to restore confidence in the markets. This is the European way forward, different from the US, but with the same objective"* [42]

1. The Action Plan

Last May, the European Commission presented an action plan with the aim of "Modernising Company Law and Enhancing Corporate Governance in the EU" [43]. The plan highlights CG initiatives aimed at boosting confidence on capital markets, by strengthening shareholders', employees' and creditors' rights and also by fostering the efficiency and competitiveness of business, with special attention to cross-border issues. The action plan is based on a prioritised set of proposals for action covering the next 10 years.

The Action Plan along with EU and national legislative or regulatory forms that will be enacted to implement the Action Plan will apply primarily to public limited liability companies incorporated in the EU. The legislative forms however will not have an effect as far reaching as that of SOX and will not apply to non-EU companies listed on an EU securities market. The Action Plan however, does prove to focus on transparency and related disclosure procedures and requirements to be complied with by issuers listed on EU securities markets. For US companies listed on a securities market in the EU, this may mean future disclosure obligations.

[41] Jenny B. Davis, op. cit, February 2003
[42] Fritz Bolkenstein, EU Internal Market Commissioner, keynote address at Federation of European Securities Exchange Commissions, London, 13 June 2003
[43] In paralel with the Action Plan a communication on statutory audit has been presented.

2. The Action Plan's main proposals[44] :

a. Corporate Governance

- Annual CG statement to be included in the annual documents of listed companies[45];
- Increased role of (independent) non-executive or supervisory directors with minimum standards on creation, composition and remuneration;
- More transparency and influence on directors' remuneration, including disclosure or individual remuneration;
- Legislative framework to help shareholders across the EU exercise various rights (e.g. voting in absentia, participation in general meetings).

b. Corporate Restructuring and Mobility:

- Facilitating mergers between EU companies and transfer of registered offices from one Member State to another;
- European Private Company Statute to be studied.

The Plan also includes proposals on groups of companies and pyramids to limit risks for shareholders as well as creditors, along with capital maintenance and a alteration under which a number of rules related to contributions in kind, limitation/withdrawal of pre-emption rights, and squeeze-out and sell-out rights would be relaxed or adopted.

Following a 3 month public consultation period, relevant comments will be published by the Commission and taken into account in the implementation phase of the Action Plan, through recommendations, directives, and other legislative proposals.

The Council of Bars and Law Societies of the EU (CCBE), has warned that the Action Plan runs the risk of over-regulation. In a letter sent to Internal Market Commissioner Frits Bolkestein on June 11, the CCBE welcomed the technical approach of the proposals and its distinctions between short, medium and long-term measures, but it says the EU authorities should not go the way of the US authorities in the wake of the Enron collapse and other financial scandals.

3. EU companies modernization of information

> *"These changes will make life easier for companies, for investors and for other parties which need quick and easy access to company information. I am very pleased that the European Parliament and the Council have been*

[44] Gibson, Dunn & Crutcher LLP Update, European Commission Presents Action Plan on Corporate Governance and Company Law, 2 June 2003.

[45] Fritz Bolkenstein, op.cit. said that his first policy line was to enhance CG disclosure. In the Action Plan there are two disciplines: a) all listed companies will be requested to include in there annual documents a coherent and descriptive statement covering the key elements of their CG structure and priorities the operation communities and a reverence to a code of conduct; and b) the institutional investors should be obliged to disclose there investment policy and there policy in the exercise of their voting rights.

> *able to adopt the modified Directive almost a year to the day since the Commission first proposed it, with all of the main elements put forward by the Commission retained"* [46]

The European Commission has welcomed the Council's definitive adoption of modifications to the First Company Law Directive (68/151/EEC) [47]. These will make company information more easily and rapidly available to the public while at the same time simplifying the disclosure formalities required from companies. The modifications will allow full advantage to be taken of modern technology. Companies will be able to file their documents and particulars either by paper means or by electronic means. Interested parties will be able to obtain copies by either means.

4. Some EU member states initiatives

> *"Good regulation in the UK meant that we only needed a code of practice to prevent directors being corrupted and turning balance sheets into works of fiction"* [48].

a. Italy. Legislative Decree 231/2001 aims to induce companies to adopt codes of ethics and internal rules to prevent top managers, executives, employees and external from committing crimes against the state, as well as various other corporate criminal offences [49].

b. Spain. The Financial Act (*Ley Financiera*) of 23 November 2002 introduces modifications to the Stock Market Act, the Saving Banks Act, the Private Insurance Regulation and Supervision Act, the Accountancy Act, etc.

c. France The draft of a Financial Security Act (*Loi sur la Securité Financière*) addresses the strengthening of the control authorities treaty, an Autorité des Marchés Financièrs and the creating a new High Council for Auditors.

d. United Kingdom. A new CG Code comes into effect on 31 July 2003. The Code is based on the Higgs Report. Although generally it has been welcomed by businesses, it has already seen some concerns. Will the code be compulsory or voluntary bearing in mind the "explain or comply rule"[50]. With the independent directors who will act as a channel for shareholders to spy on the camp? And what about the requirement that non-execs serve no longer than 6 years when in some companies it takes that long to understand the business.

5. What has been done, what remains to be done in Europe?

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[46] Internal Market Commissioner Frits Bolkestein.

[47] The First Council Directive 68/151/EEC of 9 March 1968 sets out the main European level requirements in respect of the filing and disclosure of documents and particulars by limited liability companies.

[48] Linda Tsang "Independence Day".

[49] Sian Bruno Brum

[50] This rule means that the companies must either adopt the recommendation or explain why not to the shareholders.

a. Has been done. Last year saw the adoption of the regulation on International Accounting Standards, so that EU companies shall be subject to a world-class set of accounting rules by 2005; a Financial Conglomerate Directive, which will improve the oversight of groups in the EU; the Market Abuse Directive, aimed at underpinning the interpreting of financial markets, keeping them from abuse and fraud; the Pension Funds Directive which will give citizens a more efficient non-European pension funds.

b. Needs to be done. A Prospectus Directive, which will give issuing companies access to all investors with just one document instead of 15-25; Investment Finance to establish a true single market that an investment series bound in home country repressions, a transparency document which will improve the flow of financial information from informers to investors; and a Take Over Directive, which has been disclaimed for such a long time, etc.

FOURTH. EFFECTS ON LAWYERS

I. CG and lawyers

Although, the biggest impact resulting from the development of CG has been felt by directors and shareholders, this has had a knock on effect on the supporting professions of accountancy and law [51].

There has been great discussion as to what is now expected from lawyers in their role in the field of CG. Many discussion have particularly come about following SOX. Initially, it seemed that the SOX would make lawyers and bankers legally liable for their involvement in corporate scams. This is particularly difficult for lawyers as it questions with whom their loyalties should lie, to confidentiality for their clients, or to the public at large if they are made aware of a "corporate scam".

Since 1994, lawyers and bankers have been protected from prosecution by a US Supreme Court decision that they could not be held liable for merely "aiding and abetting" a fraud [52]. This ruling proved to have economic benefit also, as lawyers were freed from direct legal consequences, an adviser's primary incentive is now objective rather than self-preservation [53].

Big law firms started to realise that if the decision is allowed to stand, they, along with the investment banks, will become in effect insurers of the good conduct of their clients. Judge Harmon commented that, instead of ignoring the Central Bank decision, it should be worked around. It was suggested that lawyers who prepare public statements, or bankers who arrange public offerings of securities, for a company involved in a fraud had moved beyond merely aiding and abetting and

[51] Adrian Cadbury, op. cit, October 2000.
[52] Central Bank of Denver v. First Interstate Bank of Denver.
[53] Charles Elson, Law professor at the University of Delaware.

become "primary violators", with the company itself-and were therefore subject to the legal sanctions [54].

The SEC by its introduction of the SOX, implemented the requirements for "up-the-ladder" reporting required by lawyers who appear and practice before the SEC. However the proposed rules, of August 2003, faced much contempt. The SEC's altered parts of the original rules particularly relating to lawyers. The final rules are as follows Attorneys who appear and practice before the SEC in the representation of an issuer are required to report evidence of material violations of the US securities laws or a breach of fiduciary duty by an issuer to the chief legal officer and chief executive officer of the issuer, or alternatively to report such evidence to a qualified legal compliance committee of the issuer. Attorneys (other than those who report directly to a qualified legal compliance committee) must then report "up-the-ladder" to the audit committee, another committee of directors not employed by the issuer, or directly to the board of directors in the event that the chief legal officer of chief executive officer or chief executive officer fails to respond appropriately [55].

II. CG and in-house counsel

In November 2002, a workshop was held with the aim of discussing "The role of in-house lawyer in the 21st century". Five particular in-house lawyer roles were identified as: a) an employee and therefore owing a duty of fidelity to his or her employer, b) a director and therefore owing fiduciary duties to the company, c) a company secretary with statutory duties in relation to the company, d) the 'conscience' of the company, e) a 'trusted adviser' acting as the first port of call for colleagues. This role has brought into conflict the need to retain people's trust as well as maintaining independence [56].

In discussing the above roles, a number of points were raised as regards professional conduct and whistle blowing. Those points being: a) should the in-house lawyer be the "conscience" of the company or should he have the same duties and responsibilities as directors of the company? b) in relation to business ethics - the duty to work ethically is held by everyone, it is not limited to solely the lawyer simply because he or she is a lawyer.

The rules to be applied to in-house lawyers are not very different from those rules applied to senior executives. Senior executives and other advisors are also part of the business, and as such, have a commitment to both the business, employees and shareholders.

A recent survey showed that 50% of companies had no whistle blowing policies. Following this there was a further discussion on what type of whistle blowing issues were involved. If it concerned a legal issue it would be easy as an in house

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[54] http://www.economist.com/business/PrinterFriendly.cfm?story_ID=1560622
[55] Fried Frank Harris Shriver & Jacobson, Feb 10, 2003. SEC issue final rules under the Sarbanes Oxley Act 2002 on implementation of standards of professional conduct for attorneys ; SEC defers consideration or "noisy withdrawal" requirements.
[56] Janet Gaymer, Senior Partner at Simmons & Simmons

lawyer to act. If it was a quasi legal issue, it might prove more difficult to act. It was again highlighted that ethics was everybody's responsibility, not just that of the lawyers alone.

A brief talk on the issue of communication was given to discuss whether a lawyer was seen as an instrument of justice. This was followed by a discussion of the role of the in-house lawyer as the recipient of "whistle-blowing" information and as a "whistle-blower" and in relation to oversight and implementation of a company's code of ethics. A discussion on privilege was also given. From this discussion, the following main points were ascertained: it is considered that privileged communication is one of the key cornerstones of the solicitor/client relationship and should be enshrined in legislation or regulations; it was held that the debate in Europe may shortly be brought to a result in favour of in-house lawyers. An argument exists that says in-house lawyers of appropriate qualification should also have the possibility to claim this right.

Another survey was conducted by the ACCA. There is a strong consensus among the respondents to the survey that in-house counsel should play a prominent and expanding role in preventing financial and accounting fraud and other illegal and unethical behaviour. When asked of the relationship between in-house counsel and the most senior level management on matters related to financial and accounting issues, 49% felt that the in-house counsel is generally kept informed but is still kept out of the loop on some important developments; an additional 12% said that in-house counsel is kept poorly informed; only 39% said that in-house counsel is kept very well informed. It was shown that if given a choice of actions to take in reporting possible mis-conduct, 78% would choose to report the concern to appropriate corporate officials; 20% say they should report it to the audit committee or other independent entity, a mere 10% believed it should be reported to the entire board. In-house counsel are divided over whether existing laws, regulations and rules of professional conduct are sufficient to prevent future financial and accounting frauds. Nearly half of in-house counsel indicate support for new legislation and/or regulations. Only 54% of in-house counsel surveyed said the law is unnecessary because self-regulation - in the form of the Model Rules of Professional Conduct - is working as intended; 47% believed that the law is necessary because lawyers representing public companies have responsibilities that require government definition; 71% believe that clearly defining by law instances of mandatory reporting, regardless of attorney-client privilege, would help ensure the well-being of their company. In other words, clarifying attorneys' responsibility to report unethical or illegal behaviour, in some circumstances despite the privileged nature of the communications, could in these counsel's view do more to ensure their companies' well-being than establishing laws to protect attorney whistleblowers or than providing better in-house counsel access to the board of directors.

FIFTH. FUTURE OF CORPORATE GOVERNMENT

I. Worries about CG

There are many concerns regarding the new shift in CG. It sometimes appears that CG standards which have worked for decades are now portrayed as being old fashioned or immoral while other practices that have raised questions are becoming totally acceptable. Concerns have been shown by often asked questions such as: what is going to happen next in CG? How can corporations use CG to restore confidence and protect themselves against tomorrow's headlines? What will be the new "Gold Standard" for CG and business ethics? How much further than legal minimum requirements for CG should corporations go to ensure sustainable success? The new codes of CG have also brought about other concerns such as:

- When CG goes wrong who gets blamed?
- Impact of media allegations of dishonesty, fraud or corruption of senior executives or directors - and how to protect business ethics reputation using robust CG
- Urgent need for all CG to be whiter than white, with unquestionable business ethics and risk management
- Why we have to separate board scrutiny role from management power
- Ethical / society responsibilities of directors and large investor "owners"
- Independence of audit, nomination and remuneration committees?
- "Duty of Curiosity" by directors to ask very awkward and sensitive questions
- Improving quality and flow of information within a corporation's governing structure.
- There are questions from the employees too; who do they serve? their boss? the boss of the boss? CEO? board? shareholders? customer interests? general public? courts of law? their own conscience?
- If problems are discovered, who would be the consultant or adviser accountable? Again would accountability be placed on: the individual who set up the arrangement and is asking for the advice, even if they may be considered part of the problem? his or her boss? the CEO? the board? the shareholders? the government? consumers? the public?
- Media investigation has the power to be a powerful, corrective force potentially exposing wrong-doing but media depends on advertising, which brings about the danger of alienating big funders of media companies.
- The new term of "success plus", doing right things in the right way, puts extra pressure on companies that real success will be everything which was taken for granted previously in high performing companies plus they will have to show the highest ethical standard in all areas. Corporations have been given the huge task of "building a better future" not only for their shareholders but also for their customers, workers, business partners, community, nation and the wider world.
- However, those fortunate to be able to successfully incorporate CG in their management systems will benefit from an added competitive advantage:

attracting and retaining talent and generating positive reactions in the market place [57].

II. Aid available to help companies attain CG standards

Since the change in attitude regarding CG and the tightening up of its requirements, a number of organisations have also been set up with the aim of helping companies achieve the required standards. The principle organisation, as has already been discussed, is the OECD. The OECD have published a set of Guidelines for multinational enterprises [58] which offer recommendations addressed by governments to multinational enterprises. The Guidelines although only voluntary principles and standards, aim at ensuring that the operations of the enterprises are in harmony with government policies. The European Corporate Governance Network (ECGI) has issued guidelines through articles such as "Improving CG through independent scientific research and related activities" [59]. The International CG Network (ICGN) also offers accessible advice and information, particularly through it's website[60]. Even an online forum exists, with regular changing of subjects in order to get a clear overview of different, up-to-date areas of CG[61]. There is also a website[62] completely devoted to the providing of news, internet links and a small reference library regarding CG. It works as a discussion forum and network for shareholders and stakeholders who have the joint belief that active participation by concerned shareholders in governing corporations will enhance their ability to create wealth

However, its not only specific organisations who work with this aim, there have been lots of publications offering advice and counsel to corporations. The Times of Oman published its article "Ten ways for CEO's to improve corporate governance"[63] There have been surveys carried out such as Corporate Governance-The New Strategic Imperative by the intelligence unit of the The Economist, etc.

III. The crisis

The current CG system is based on the stock market system, a system in which the quotation of the stock of a company encapsulates all the company's performance and supports all decisions and conduct of the company's actors [64] .

This model characterized itself for an almost exclusive objective of the shareholder value and the high remuneration of the directors (including the stocks

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[57] http://www.global change.com/corporategovernance.htm
[58] The OECD guidelines for multinational enterprises are part of the OECD Declaration on international investment and multinational enterprises.
[59] http://www.ecgi.org/overview.htm
[60] http://www.icgn.org/
[61] http://gcgf.org/
[62] http://www.corpgov.net/
[63] http://www.timesofoman.com/newsdetails.asp?newsid=28430&pn=business, Ten ways for CEO´s to improve corporate governance, by Palazhi Ashok Kumar
[64] Roland Pérez, La gouvernance de l'enterprise, La Découverte, 2003.

options [65]). According to a survey [66], the best paid American directors earned from $ 2.3 to 5.7m in 1991 and from 64 to 706m in 2001 and their average remuneration was 20 times the remuneration of a middle employee in1980, 83 times in 1990 and 531 in 2000 [67].

The disfunctioning behavior of the financial scandals follows a pattern in internal devices (with at the head an omnipotent chairman –more a monarch than a manager, according to W. Donaldson, chairman of SEC-, a subjugated board of directors unable to control the managers and an inefficient shareholders community manipulated by the charismatic leader); a failure of the supporting devices (the accounting auditors and the financial analysts [68]) and even the regulatory devices (the SEC may not carry out its function adequately and its president Harvey Pitt resigned in November 2002, some public authorities being also involved in the scandals and even the judiciary authorities).

A recent study of the University of Maryland [69] scrutinized 71 companies that the SEC prosecuted for accounting irregularities through misleading financial statements between 1992 and 1999 with the following conclusions: a) an environment of excessive stock options, deteriorating financial conditions preceded by a history of growth through acquisitions provides conditions for accounting fraud; b) "violator" companies acquired an average of two concerns during the three years before their accounting fraud (the record was 21 takeovers); c) the larger the number of acquisitions, the lower the cash flow the following year; facing short-lived benefits for takeovers, violator concerns resorted to the more extreme measures of accounting fraud to maintain persistent growth. d) on average, the CEO of a violator company owned options valued at more that three times his salary and bonus with such larger amounts of CEO's personal wealth tied to company stock price, the incentives for overtaking profits and financial conditions became clear; e) the average CEO of a violator company was 51.7 years old; and f) the board-audit committees of violator companies had a smaller proportion of independent members than non-violator companies.

In view of the situation, some important questions arise: Is it possible to change the traditional CG principles excessively centered upon the immediate stock exchange performance for another one principled on larger and global objectives? does the 3rd Millennium capitalism require a substantial reform?, are the scandals of the 2000 s just hiccups in the free economy's health or are they symptoms of the end of an era? etc.

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[65] The remuneration derived from stock options represented over 80% of the total average remuneration, Le Monde 9 July 2002.

[66] Business Week survey, cited by Le Monde, 29 November 2002

[67] The combined effect of all the recent scandals produced a fall in the stock exceeding half the exchange rates from March till the end of 2002 with a fall of the NYSE of $ 7tn, so that the same observers see a durable crisis of a bear market cycle. Corporate America developed a short-term focus, fuelled by an obsession with quarter-to-quarter earnings and the pervasive temptation inherent in stock options

[68] A few weeks before the Enron's collapse, 15 out of 18 most influent analysts recommended to buy Enron's shares to their clients. One of such analysts referring to such stock as "the best of the best".

[69] Joann S. Lublin, "Study ties fraud at US concerns to takeover fever", The Wall Street Journal, 4 July 2003.

Is not clear if and when retail investors and institutions will return to the "equity culture" nor is it clear what action will be necessary to persuade investors to risk their money by investing again in equities [70]. In addition, the crisis of confidence in boardrooms is an important reason for the decrease in the number of deals carried out and without the use of external financial advisors and using the companies in-house corporate finance teams [71].

SIXTH: CORPORATE GOVERNANCE AND CORPORATE SOCIAL RESPONSABILITY

> *"Creating wealth, which is business expertise, and promoting human security in the broadest sense, the UN's main concern, are mutually reinforcing goals. Thriving markets and human security go hand in hand. A world of hunger, poverty and injustices is one in which markets, peace and freedom will never take root"* [72]

I. Responsibility to shareholders or to stakeholders

> *"The 21st century company will be different.*
> *Many of the world's best-known companies are already redefining traditional perception of the will of the corporation.*
> *They are recognising that every customer is part of the community, and that social responsibility is not an optional activity"* [73]

Today corporations are not only concerned on following good CG practices to protect the company's shareholders but also the company's stakeholders. In addition there is an important trend to move up from ethical investment to social investment.

During the second part of the 20th century two prominent positions have been held in regards to whom a corporation is responsible. Are corporations exclusively responsible to their shareholders and therefore their only objective is to make profits for them or are corporations responsible for all stakeholders not just shareholders but also employees, suppliers, the ecological environment and the community in general?

The most clear exponent of the first position is undoubtedly Milton Friedman, the Nobel laureate who in 1970 wrote that "the one and only social responsibility of

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[70] Bernard Taylor, "Corporate governance: the crisis, investors' losses d the decline in public trust"
[71] Lina Saigol, "In-house mergers rule the roost, Financial Times, 4 July 2003.
[72] Kofi Annan, UN Secretary-General.
[73] Tony Blair, UK Prime Minister.

business is to use its resources and engage in activities designed to increase its profit" and that "few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much money for their stakeholders as posible [74].The second position is Corporate Social Responsibility (CSR). Today, while there are still remnants of Friedman's thinking around[75], most business leaders consider that, in addition to making profits for the shareholders, companies also have duties to the stakeholders, sustainable development and human rights.

II. <u>The concept of CSR</u>

> *"The main purpose of the board of directors is to seek to ensure the prosperity of the company by collectively directing the company's affairs, whilst meeting the appropriate expectations of its shareholders and relevant stakeholders"* [76]

Peter Drucker says that an important task for top management in the Next Society's corporation will be to balance the three dimensions of the corporation: as an economic organisation, as a human organisation, and as an increasingly important social organisation [77].

The continued existence of companies is based on an implied agreement between business and society. In effect, companies are licensed by society to provide the goods and services which society needs. The freedom of operation of companies is, therefore, dependent on their delivering whatever balance of economic and social benefits society currently expects of them [78].

CSR is referred to by a variety of different terms, including: CSR, responsible business conduct, voluntary corporate initiatives, corporate citizenship[79], etc. CSR can be defined as a concept whereby companies voluntarily decide to respect and protect the interests of a broad range of stakeholders and to contribute to a cleaner environment and a better society through active interaction with all. CSR is the voluntary commitment by business to manage its role in society in a responsible way[80]. In its Green Paper of 2001, the Europena Commission defined CSR as "a

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[74] Milton Friedman, "The Social Responsibility of Business is to Increase Its Profits," <u>New York Times Magazine</u>, 13 September 1970.
[75] Geoffrey Owen, "Time to promote trust, inside the company and out", <u>Financial Times</u>, 30 August 2002: "One of the responsibilities of managers is to defend the role of profit as the best available measure of the contribution which business makes to society".
[76] Institute of Directors, <u>Standards for the Board</u>, 1999.
[77] Peter F. Drucker, <u>Managing the next society</u>, 2002, p. 287, who adds "Each of the three models of corporation developed in the past half-century stressed one of these dimensions and minimised the other two. The German world of the "social market economy put the emphasis on the social dimension, the Japanese one on the human dimension, and the American one ("shareholder sovereignity") on the economic dimension".
[78] Adrian Cadbury, <u>Corporate Governance and Chairmanship,</u> Oxford, 2002, p.161.
[79] Malcom McIntosh and al, <u>op.cit,</u> p.16, argues that corporate citizenship is a form of CSR and a fuller understanding of the role of business in society. Some research organisations have adopted this name: Deakin Univeristy's Corporate Citizenship Research Unit in Australia, Catholic Univeristy of Eichstate's Centre for Corporate Citizenship Research in Germany, etc.
[80] ICC, <u>A business vision for the 21st century</u>, 11 January 2002.

concept whereby companies integrate social and environmental concerns in their business operations and in their interaction with their stakeholders on a voluntary basis" [81]

The key issues of CSR are then: workers' rights, environmental protection, community involvement, supplier relations and human rights.

At the moment, CSR is not an issue for regulation and cannot imposed against the will of enterprises, but is promoted under involvement of their shareholders [82]

III. The precedents of CSR

> *"Corporate social responsibility is*
> *now in every reasonable chief executive agenda*
> *not always at the top but it's there"* [83]

CSR is not a new phenomenon. An early example of CSR was the emergence of the sugar boycott in England. In 1790, Elizabeth Heywick whipped up the housewives of Leicester into a passionate protest against capitalist exploitation. Leaflets were distributed outside shops announcing that "we the people can over-throw slavery". The target was that "bloody-stained luxury": sugar. In those days sugar was brought into Britain from plantations in the Caribbean, harvested and produced by slaves. Within thirty years, the East India Company was satisfying the sweet tooth of British housewives with free-grown sugar from Bengal, and by mobilising public opinion behind anti-slavery. This common boycott was the precedent of other recent ones like Chilean Chardonnay, Nike trainers, Shell petrol, Nestlé baby milk, etc.[84].

Socially responsible investors have changed, with new people coming to the concept to make it less a protest movement and more an investment philosophy which, while not wanting to lose money today, allows management teams the opportunity to think, plan and act for long-term success, sustainable success. However, the themes that have shown through the history of ethical money remain the same themes of decency, honesty, consideration and adding real value that were derived from the religious beliefs of early proponents of the idea [85].

Globalisation and the information technology revolution have resulted in increased competition, greater shareholders activism and wider access to information world-wide. The result is that many employees are seeking assurances that the goods and services they are producing, financing or purchasing are not damaging the workers, the environment or the communities by whom and where they live [86] [87].

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[81] European Commission, Green paper on CSR, 2001.
[82] Erikki Liikonen, MEP responsible for Enterprise and the Information Society, speech at Centre of European Reform, 3 July 2003.
[83] Steve Hilton and Giles Gibbons, Good Business, p. 55.
[84] Steve Hilton and Giles Gibbons, opcit, pp. 53 and 54.
[85] John Hancock, Ethical Money, 2002, p. 3.
[86] Viewpoint: beyond compliances. Social accountability can protect businesses and profits, 13 April 2001, cited by Joseph Weiss, Business Ethics, 2002, p. 157.

IV. Different attitudes about CSR

Today businessmen still adopt different attitudes towards CSR. Some corporate leaders may see CSR as a bit of a joke although they will quite happily put their name to corporate statements of social responsibility, share backslapping platforms with politicians and sanction community projects or charitable donations. At the other end of the scale are those businessmen who have embraced CSR with all the zeal of the convent, spending large sums in "social audits", "environmental consciousness" and "stakeholder dialogues". Curiously, these are the ones that attract the most frequent attacks from anti-business critics. In between the sceptics and evangelists lie the majority, those who feel that they probably ought to de doing something about CSR but don't know quite what[88].

V. The modern drivers of CSR

> *"Now will come the era of corporate image,*
> *in which economies will increasingly make purchases*
> *on the basis of a firm's whole role in society:*
> *how it treats employees, shareholders and social responsibilities"*[89]

The debate about CSR is not new but it developed in the last half of the 20th century. There are 5 drivers of this re-emphasis:

- The globalisation markets;
- The establishment of the knowledge economy;
- The rise of global communication;
- The coalescence of power, and therefore responsibility, in the hands of a relative small number of international global corporations;
- The need for new social partnerships between corporations, states and civil society seeking solutions to local and global problems[90].

Globalisation is one of the reasons for the unprecedented interest in CSR[91]. In recent years, the scale of private sector involved overseas has increased dramatically. Foreign direct investment has expanded 20 times in 25 years and is currently worth more than $400bn. To put this into perspective, in 1970, there were 7,000 companies operating internationally and today there are more than

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[87] Business Ethics, a media company, ranks corporations in terms of citizenship. Variables in the ranking include how companies treat stakeholders: customers, employees, stock owners, the community environment, and non-US shareholder. High ranking ethical companies included Proctor and Gamble, Hewlett-Packard, Fannie Mae, Motorola, IBM, etc. Cited by Joseph Weiss, op. cit, p. 157.
[88] Steve Hilton and Giles Gibbon, op cit, p.65
[89] The Economist, 19 June 1993
[90] Malcom McIntosh and al, Living the corporate citizenship, 2003, p.15
[91] Bennett Freeman, "Corporate Responsibility and Human Rights", Global Dimensions Seminar, New York, 1 June 2002: Anthony G. McGrew, "Human Rights in a global age: coming to terms with globalisation" in Tony Evans, Human Rights fifty years on, 1999, p. 188.

50,000[92]. Transnational companies (TNCs) account for 30% of world output and up to 70% of world trade[93]. Business enterprises that operate across national boundaries have a tremendous influence on the modern world. 29 of the world's 100 largest economic entities are TNCs[94]. If we compare the revenues of the 25 largest TNCs with the revenues of states, we see that only 6 states have revenues larger than the first 9 TNCs[95].

VI. Levels of corporate responsibility[96]

It is possible to distinguish three levels of company responsibility. The first level is the company's responsibility to its shareholders, employees, customers, suppliers, and creditors and to its duty to meet statutory or legal obligations. This primary responsibility is what is commonly known as "corporate governance" and is what the company must fulfil to avoid recognised sanctions, which are provided by law and by competition.

The next two levels go hand in hand and are what is commonly known as CSR. The second level is the company's responsibility to the environment and making the most of its community's human resources when carrying out its functions of the first level. There is no legal requirement at this level for the company to meet, however, due to the competitive nature of the capitalist system, it can be quantified and the boards of directors can define the issues in question and decide where to strike the balance between the different interests involved.

The third level is harder to define. While the fist two levels are internally specific to the company and estimates can be made of the costs/ benefits of the decisions taken in this area by the company's board, the third level is much more open. It is the interaction between business and society in a wider sense. It is the responsibility of business to envisage the wider consequences of their decisions and to build that awareness into their decision making process.

While the second level is now being recognised and embraced by companies, through CSR statements, it is this third level, which companies must aim to achieve. The first two levels are internally focused on the current performance of the company, but more importantly is the company's future impact on its stakeholders. Long term decisions and goals on the direction of a company must be taken in this aspect if CSR is going to become a reality and not just a mode or short-term fashionable expression of the late 20th century.

VII. Guidelines to be socially responsible

> *"Markets are good at creating wealth*
> *but are not designed to take care of other social needs.*

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[92] Andrew Wilson, op. cit.
[93] David Held, A McGrew, D. Goldblatt and J. Perraton, Global Transformations, 1999, p. 282.
[94] UN Conference on Trade and Development (UNCATAD), Financial Times, 13 August 2002.
[95] David P. Forsythe, Human rights in international relations, 2000, p.191.
[96] Adrain Cadbury, Corporate Governance and Chairmanship, pp. 160-161.

The needless pursuit of profit
can worsen the environment and conflict with other social values"[97]

Keith Davis[98] discuses five guidelines business professionals should follow to be socially responsible:

- Business have a social role of "trustee for society's resonance's;
- Business shall operate as a two way open system with open receipt of input from society and open disclosure of its operatives to the public;
- Social costs as well as benefits of an activity, product or service shall be thoroughly calculated and considered in order to decide whether to proved with it;
- The social costs of each activity, product or service shall be priced into it so that the consumer pays for its consumption in society;
- Business institutions as citizens have responsibility for social involvement in areas of their competence when major social needs exist.

VIII. Four social responsible roles

Joseph Weiss discusses social orientations of business towards society and distinguishes the stockholder model (the primary responsibility of the corporation is to its economic stockholders) and the stakeholder model (the responsibility to its social stakeholders outside the corporation). Two sets of motives underlay these two orientations: self interest and social duty. The two stockholders orientations are productivity (which holds a free market ethic and views the corporation's social responsibility in terms of rational self-interest and the direct fulfilment of stockholder interests) and philanthropy (who also has a stockholder view of the corporation and hold that social responsibility is justified in terms of a world duty toward helping low-advantaged members of society through organised, tax-deductible charity and stewardship. The two social responsibility model in the stakeholder model are progressivism (which between corporate behaviour is justified from a motive of self-interest but also holds that corporations should take a broader view of responsibility toward social change) and ethical idealism (which believes that CSR is justified when corporate behaviour directly supports stakeholders interests from model duty motives) [99].

SEVENTH. SOME CONCLUSIONS

"I remain amazed at the pace of change and see no evidence of it slowing down. Performance and accountability will continue to be the watchwords underwritten by disclosure. Watch the balance of power and bear in mind what is known as the Iron Law of responsibility, 'In the long run those who

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[97] Georges Soros, On globalisation, 2000, p. 5.
[98] Keith Davis and R. Blomstrong, Business and its environment, 1966.
[99] Joseph Weiss, op. cit, p. 91.

do not use power in a manner which society considers responsible will tend to lose it'[100]

In my view, any prediction of CG's future needs to consider the following:

1. Investors, companies, regulators and society in general are ashamed and disconcerted that at the very advanced world of the turn of the 3rd Millennium so many and calamitous scandals could happen and how poorly the directors and their private and public controllers acted and reacted and how big the hiatus between the hypocritical sermon and the actual conduct was.

2. The debate on CG has created a new environment where the principles dominate the opinions of businessmen, legislators and professionals. As William Donaldson, the SEC Chairman, has recognized "the intense discussion of CG and increased scrutiny of business has led to changes in corporate behaviour and philosophy that go beyond the new laws and regulations [101]. As a result of this debate, we have entered another activist economy policy regime similar to that of the 1930's, which resulted in the founding of the SEC and the 1933 and 1934 securities and exchange acts".

3. Companies which are fighting to introduce strategic changes must take into consideration the company's own perception on the company's identity although often companies do not address their identity until facing crises which oblige them to introduce changes. Nissan, Danone, Aventis (merger of Rhone Poulenc and Hoechst) introduced changes contemplating their identity while Vivendi Universal and Hewlett-Packard started to have problems at not giving their own identity the necessary importance [102].

4. The trend is not still convergent in the two sides of the Atlantic. In the New Continent SOX has established new comprehensive and stringent rules. In the Old Continent, the Action Plan tends to provide a dynamic and flexible company law and corporate framework, a mixed of legislative ad non-legislative measures, firm on the principles but flexible on their application[103].

5. There is an overproduction or legal rules to organize the market. Rules need to merge, unify and settle down. Peter Middleton, Barclays chairman[104] , exclaimed recently: "We had to deal with 18 different government reviews over the last 3 years". For banks, that meant SOX, Higgs, the Smith review of audit committees, as well as more rules from the Financial Services Authority in Brussels, and the emergence of price control from the Competition Commission inquiry

[100] Adrian Cadbury.
[101] William Donaldson, Remarks at the 2003 Washington Economic Policy Conference, 24 March 2003
[102] Knoelege Wharton, "Un cambio estratégico debe tener en cuenta la identidad corporativa", Expansion, 19 June 2003
[103] Frits Bolection, EU Internal Market Commissioner, address at Roundtable on Corporate Governance and Company Law, European Policy Forum, London 13 June 2003.
[104] Linda Tsang, "Independence day",

6. The CG principles which have been established up to now will strengthen and become mere vigorous. As Adrian Cadbury[105] put it, it is expected the movement towards more committed and better trained directors to continue with a growing proportion of independent outside members of boards; more direct contacts between shareholders, analysts and commentators and boards; more and faster disclosure will be demanded; shareholder will ask what added value individual nominees will be adding to the board; shareholders should be able to interview candidates via their TV sets. Cadbury has underlined two aspects of the future also: the first is the rise of employee share ownership whose interests may be at times in conflict with those of less involved investors; the second is the accountability of investing institutions to those who have entrusted their funds to them.

   The key objectives of CG in the 3rd Millennium will be: enhance corporate governance disclosure[106], increasing transparency, generating shareholders powers and strengthening shareholders' rights to ask questions, to table resolutions, to vote in absentia, to participate in meetings via electronic means, establishing a, more accountable relationship between directors and shareholders. With respect to board composition, in key areas where executive directors clearly have conflicts of interests (remuneration of directors, supervision of the audit of the company's accounts) decision should be made exclusively by non-executive directors who are in the majority independent.

7. Companies, their management, their directors and gatekeepers who serve them must look beyond just conforming to the letter of the new laws and regulations. They must redefine CG with practices that go beyond mere adherence to new rules and demonstrate ethics, integrity, honesty and transparency.

8. The reaction to the CG that has been in force up to now is the CSR with a three bottom line: financial, labor and environment, whereby companies voluntarily decide to respect and protect the interests of a broad range of shareholders and to contribute to a cleaner environment and a better society through the active interaction with all. CSR is the commitment of business to contribute to sustainable development working with employees, the local community and society at large to improve their quality of life. CSR is cooperation between government, civil society and business.

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[105] Adrian Cadbury, speech at the Hermes sponsored Stewardship and Performance Seminar, Chartered Accountant Hall, London 20 October 2000.

[106] In the EU Action Plan, f.i., all listed companies will be required to include in their annual documents a statement covering the key elements of their CG structure and practices and the institutional investors will be obliged to disclose their investment policy and their policy in exercise of their voting rights.