Theories of Corporate Governance

The philosophical foundations of corporate governance

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Preface

It is a pleasure to be asked to contribute a preface to this magisterial work. Its importance and usefulness lie in the way in which Professor Clarke has selected his material to present a comprehensive survey of the theoretical foundations on which the practice of corporate governance has been, if not always consciously, based. He has done this by allowing those who have played a key part in the thinking on corporate governance to have their say. More than that his excellent Introduction explains how the different governance theories relate to each other and how they have contributed to the development of corporate governance in practice.

Each of the separate theories discussed throws light on some aspect of governance, but is limited to that aspect alone and thus cannot capture the theoretical basis of corporate governance as a whole. The trusteeship model arrives perhaps at the nearest we yet have to a general governance theory, since it addresses the basic question of corporate purpose in relation to society. The Introduction, however, clearly illustrates the difficulty of arriving at any general theory of corporate governance, given the inherent complexity of the subject.

One feature of its complexity is that companies combine economic and social roles. Insights from the social sciences, therefore, have their place alongside those from economics. Governance structures are important, in the sense that they have to be clear and understood to be effective, but their precise forms are less so. What matters in practice is the way in which individuals put these structures to work, so people, their selection and their motives count.

Another feature of complexity is the diversity of governance systems and processes around the world. Forms of corporate governance are shaped nationally by their economic, political and legal backgrounds, by their sources of finance, and by the history and culture of the countries concerned.

Beyond all this, we are studying a process in motion and the practice of corporate governance has developed dramatically in the last two decades. The pace has been set by the introduction of governance codes, first nationally and then internationally. These codes have usually been drawn up in reaction to events and have been composed by practitioners, pressed for time and responding to immediate political and public concerns. Ideally, we would call a halt to codes, laws and regulations in this field to give time for theory to catch up with practical experience and illuminate it. This is a vain hope, but at least this book provides access to the relevant writings on corporate governance, against which to analyse and assess the theoretical foundations on which so much has been built so rapidly.

In addition, to changes in structure and process, the balance of power between the lead players in the corporate field has shifted in the last half-century. At the start, boards of directors were generally weak, executive management was in charge and shareholders were dispersed. Gathering investor pressure on the directors of under-performing companies, however, led to a strengthening of boards at the expense of management. This in turn developed into the present position whereby the concentration of shares in the hands of institutional investors has increased their power in relation to boards and management and, at the same time, drawn attention to their responsibilities in matters of governance. While these specific changes relate to countries where capital is raised through the issue of shares, the balance of power is also shifting in countries where banks are the primary source of corporate finance. Here the focus is now on the governance of banks themselves and in turn on their responsibilities for the governance of the companies which they finance.

The forces driving these changes have been mainly market based, a point which is relevant to the issue of convergence internationally. It leads on, however, to another question of balance, this time the balance between market and statutory regulation. That again is a moving picture, as was demonstrated by regulatory reactions to Enron, and it is one which varies country by country.

A further source of movement and of complexity relates to the wider implications of corporate governance. Governance codes began by focusing on the role of boards of directors, as the bridge between the providers of corporate funds and those who put them to work. Their contribution to better governance was real, but limited to the purposes for which they were designed. National codes were followed by international ones, whose aims were more inclusive. They were designed to encourage investment to flow where it could be most productive by raising national corporate governance standards to acceptable international levels. This chimes with my own view of the overall purpose of corporate governance, which is to align as nearly as possible the interests of individuals, corporations and society.

At whatever level corporate governance is studied and reviewed, there can be no doubt about the value of Professor Clarke's book in bringing together and clarifying the theories which have contributed to, and have relevance for, the development of corporate governance. For students of the subject it is a one-stop shop, which sets corporate governance squarely in its historical and theoretical context. For practitioners and policy-makers it should be compulsory reading.

Sir Adrian Cadbury
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