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What is (still) wrong with corporate governance ?

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I would like to thank the organizers of this plenary session for inviting me to present my thoughts on the impact of corporate government crisis. I'll be talking today from the perspective of a researcher, more specifically, as the Director of a highly respected research center in France . But I'll also be talking as someone who was involved in the development of a French mid-Cap corporate Governance code as well as having worked on the governance aspect of the European Small Business Act. In this short speech, I'll focus on the French case, primarily because I know this case well, and secondarily because I believe the examples I have based my analysis on could be generalized to other European countries and not only be applicable to France.

We can make the following statement: since the 1990s, codes and laws/regulations have increasingly sought to normalize Corporate Governance. Never before in the history of capitalism have so many rules been enacted to constrain CEOs to behave according to common regulations. For instance, in France, 6 texts refer to soft law of Governance between 1995 and 2010 and 3 fundamental laws do exist.

Normalization leads to similar results across the board: in France, independent directors represent 40% of positions on the boards of large companies; 100% of these companies have set up remuneration and nomination committees to control the corporate executive; shareholder transparency has strongly developed thanks to the compulsory publication of an annual report, a report from the Executive Board on corporate risks, and also a report on corporate policy about social responsibility. This year, a law was passed to force gender equality on mid-cap boards from 2015.

Therefore, we researchers in corporate governance, must take into account that the last two decades have been extraordinary with respect to redefining corporate governance. We went through the support by the soft or the hard law of the organization of power within companies. In

some way, the recent period may be compared to the beginning of the twentieth century when labor law was imposed to western companies.

However, these developments have not prevented us from going through a crisis, one of the most serious in economic history. Further to the point, these evolutions did not prevent corporate governance from becoming the target of social criticism: the role of governing boards, CEOs compensation systems and their influence on their strategic choices, the lack of a real representation of the different categories of shareholders or of participants, etc. they all became targets of public controversy. Given the large number of reforms already imposed on companies, it is legitimate to ask: What remains wrong with corporate governance?

Two questions arise from researchers:

- Why has Corporate Governance become such a touchy political subject?
- Why the current reforms, already passed, not considered satisfactory by those involved in corporate governance? Due to a lack of time, I won't be able to tackle these two questions very deeply, however, I would like to provide you with some thoughts on how I see the outline of corporate governance research programs in years to come.

1. Why has Corporate Governance become such a touchy political subject?

It has now been well-documented that the 1980s went through a significant transformation of the capitalist system. A new kind of large company emerged, global enterprise. The former period was characterized, from a governance point of view, by what Berle and Means called the modern corporation, that is to say the separation of ownership and control with supremacy of managers over shareholders. We must consider that questions we ask in Corporate Governance are the consequence of a deep transformation of the modern corporation into the global enterprise. What do these transformations mean within the field of corporate governance?:

Global financial markets have the power to influence the legitimacy of the economic decisions made by corporate executives. In the 1980s, we witnessed a decline of the managerialist system defined by Berle and Means in favor of a new governance system that provides capital ownership with a strong legitimacy to influence the future of corporations. Looking forward, not only will there be billions of shareholders scattered all over the world, but financial markets will enable these shareholders to voice their demands and make them be heard. Contrary to certain preconceptions, this is a very new phenomenon within capitalist history. Yet, Governance Institutions are not adapted to this situation. For instance, and this is true for any other country in the world, the general meeting of shareholders has become obsolete compared to mass shareholding. Pragmatically, consider the implications of gathering shareholders once a year that are now far more numerous (tens of thousands) than they used to be? Moreover, do we perceive these individuals faithful shareholders or mere investors? Ultimately, we must consider the fact

that global enterprise is significantly different from the modern corporations previously defined by Berle and Means.

What is essentially new about global enterprise is not a new kind of ownership but rather a new way of holding property. On the one hand, shareholders from large companies are numerous and only represent an increasingly smaller part of a fragmented capital in the public domain; on the other hand, these shareholders are mainly household investors or financial intermediaries who handle household savings (pension funds, investments, etc.). It is the first time in the History of Capitalism that we have noticed what Peter Drucker defines from 1975 as a kind of socialization of capitalism. The largest corporations in industrial countries are ownerships, not only the property of the whole population but a that of a part that becomes very significant. Mass ownership has irreversibly modified political and social stability in the West by creating, in particular, a dependence of retirement funding and company profit. The politicization of questions on corporate governance also arise because of this. We must work towards societal involvements that go beyond corporate social responsibility.

In this context, corporate ownership has been divided into 2 categories: Investors and shareholders. Shareholders are people involved in a corporation because of their investment of a significant part of their capital and because the withdrawal implies a potential loss that may trigger a strong impact on his or her wealth. This is the classical vision of shareholders on which agency theory is initially based. Investors only possess a slight portion of capital that represents only a small fraction of their estate. If investors are economically rational, there is no point for them to control the company as agency costs would be excessive compared to expected returns. Their aim is to command a great result, that is to say, the return of equity (ROE). They manage the realization of this promise as quarterly results are delivered. It has nothing to do with a real involvement in corporation management. Shareholder and investor behavior towards corporations are therefore very different. From my experience and point of view, this is a serious mistake which I believe has triggered a real gap between research and practitioners of corporate governance. The latter consider that it is very different to understand a company owned by shareholders or investors or by a small proportion of either. We also have to refine our analysis tools and our way to speak about shareholders as they are no longer a homogenous population of economic players.

Finally, the balance of powers between economic players involved in corporate governance is not the one initially pointed out by agency theory. This balance does not oppose ownership against managers. In reality, this balance of powers is much more complicated and interesting. Sometimes, some alliances are created between directors and investors against shareholders, for instance, when a potential risk emerges around a takeover bid. Executive boards are not only boards of control. They also embody places where the balance of powers is controlled between the different participants of the company as well as between social elites. Practitioners are aware of this fact and it seems to me that researchers have to go further into their observations with a wider vision than the systematic one which is based on the opposition between directors and shareholders managed by boards. The political configurations and struggles regarding corporate control anticipated by Fligstein in the 1990s offer some fascinating research perspectives for our field.

We can observe that the governance structures emerging from the 1980s are much more complex than a would-be new “shareholders ‘power’” may otherwise imply. Regulators had to reply with institutional arrangements to more complex performances than the ones depicted by agency

theory. We can therefore introduce more theoretical diversity in our references to take practical diversities into account.

2. From these statements, we can now ask the second question:

Why the already passed reforms are not considered satisfactory by people involved in governance? I suggest 2 interpretations among others.

First of all, corporate governance reforms have almost never taken into account the difference between shareholders' and investor's behaviors. Laws and codes are very often based on the defense of investors as if corporate ownership was seen as a whole. It is extremely rare that codes define responsibilities and duties of the ownership. They are much more interested in investors 'rights' and their defense but find it difficult to codify their duties towards corporation and even more difficult to define their rights and respective duties as pure investors compared to shareholders. This struck me when I wrote the "French referential on corporate governance". I realized when I met directors but also shareholders that they were not opposed to the rules of a good governance even when they are restrictive. However, they are fiercely opposed to the implementation of codes and laws that don't take the characteristics of corporation into account. In particular, when the corporation is owned by a majority shareholder, a company's systems of internal control must be adapted to the interests of shareholders. It does not mean that minor investors do not need any support. But we have to take into account that governance codes or laws that are strongly oriented towards the defense of minor parties don't consider the reality of a corporation.

Moreover, most of the texts that reform corporate governance have been written for large global companies. These companies have indeed become more dominant in economic activity and their governance is therefore a very important political issue, as I said previously. But it only concerns a small number of companies (less than tens of thousands in the world out of tens of millions companies). In every country, including the United States and Great Britain, corporations owned by a major shareholder do exist and it is clearly the more common category of corporations. In France, for instance, only 5% of listed companies match the characteristics of global enterprise. 65% of mid-caps implies a shareholder who owns at least half of the capital. Great-Britain and the United States are exceptions: the general rule in the world is the strong concentration of capital. Yet, if we, as researchers, assimilate corporate governance to large dispersed ownership, our studies are in vain for most companies. It does not mean that these companies do not imply any questions regarding governance, on the contrary. In the "referential for a reasonable governance of French companies", I focus on 5 political regimes of corporation from observations of diversity of governance cases : the exclusive entrepreneurial autocracy , the inclusive entrepreneurial autocracy, the domination of directors and entrepreneurial democracy. These ideals enable one to (a) pinpoint the specific corporate governance issues that may arise and (b) to reply with appropriate solutions. The way this referential has been welcomed by practitioners and directors of mid-caps brings me ultimately to the conclusion that a wide and political approach of corporations, far from scandalizing, was somewhat expected because it made it possible to apprehend the complexity as well as the diversity of situations. In this context, Corporate Governance rules must be adapted and not generalized from the case of global enterprises. This is what we did in France when we produced a specific code in 2009 for mid-caps. This code reduced some unnecessary

obligations but it points out issues of governance peculiar to these companies. The future will then be dedicated to the creation of adapted rules, and Europe seems to be interested with the Small Business Act. For our researchers, it means that it becomes necessary to redefine questions of governance which arose due to different categories of companies according to the ownership structure, their patterns of governance and also their own history. Research will be more pragmatic and more realistic and will be better used by legislators.

I would like to conclude by drawing the attention of our research community to the tendency of the democratization of corporate governance, which as you are probably aware, lies at the heart of my research. Noticeable since the outset of capitalism, this tendency towards democratization has progressed to the next stage during recent times. In liberal societies, democracy is considered as the most efficient regime of governance for complex organizations. However, corporations are becoming more and more complex. Despite their limits, governance rules have become more transparent and more oriented towards debates and formal controls of directors. They have also taken a step towards a more important involvement of public opinion in governance issues. Secrecy in business gave way to public forums. The quality of corporate governance and more particularly of global enterprise is increasingly assessed according to a democratic ideal. However, according to the famous analysis of Montesquieu, if a monarchy is based on loyalty and aristocracy on honor, then democracy implies virtue. The evolution of the regimes of global corporate governance towards greater transparency, control of decisions in favor of social responsibility, and debates, won't be possible if the role of the players virtue is not pointed out in an aristocratic regime. In 2008, the crisis reminded us that ethics is not an arbitrary nor a decorative decision for complex corporations to function. To give way to democracy, a real emphasis should be made on the virtue of people involved in governance, even in the company. We seriously need to take into account, as Montesquieu, that there is no point in considering democracy without virtue. We are facing the classical belief that the contemporary era, obsessed by the financial sphere and individualism, has made us blind: a sustainable company implies the share of a general interest, trust in many promises made and loyalty. If the 2008 crisis enables us to use reason properly, the following decade will have to go through serious reforms in the training of economic players in general, and of corporate governance in particular. Otherwise, we would be obliged to notice again in the future that 'something remains wrong in corporate governance'.

Thank you