5.3. Corporate governance and international management (Zoltán Csedő and Máté Zavarkó)

5.3.1. Introduction

Corporate governance systems fundamentally impact firms' performance, e.g., through orienting corporate strategies or monitoring functions, the national or regional patterns of corporate governance codes and impacts could vary, though (Troilo et al., 2024). Cultural and industrial contexts of different regions and corporate governance systems could determine the forms of efficient and effective international management tools (Vaszkun & Koczkás, 2018), e.g., for internal communications (Sinitsyna et al., 2024), human resource development (Zavyalova et al., 2018), improved competitiveness (Stocker & Várkonyi, 2022), internalization (Szabó, 2023), or directing already international companies (Dobák & Tari, 2021) or international new ventures (Stocker, 2019).

Nevertheless, maintaining or increasing economic growth through these tools, i.e., increasing shareholder value is often challenged by the goal of mitigating climate change, which is a global issue (Astuti et al., 2024). Accordingly, sustainability and stakeholder perspectives affect many areas which must be directed and controlled at the corporate governance level, such as business models (Csedő et al., 2024), strategic ambidexterity (Magyari et al., 2023), or new technology development and innovation directions for green transformation (Csedő et al., 2023; Magyari et al., 2022). Consequently, understanding the underlying concepts and factors of international corporate governance systems is necessary to find efficient management tools for balancing shareholder and stakeholder interests.

At the international level, three different basic types of corporate governance can be distinguished according to the external institutional background of corporate governance, mainly due to legal and cultural factors:

1. Anglo-Saxon (predominantly UK, USA) corporate governance system (Mueller, 2006),

2. Continental European (predominantly German) corporate governance system (Du Plessis et al., 2017),
3. and in many ways a different, more relationship-oriented and less rule-oriented corporate governance system in Asia (Koczkás, 2024).

The basic context of the institutional framework for corporate governance can be understood based on the Anglo-Saxon, shareholder-based (outsider-oriented) and continental European, stakeholder-based (insider) model; what is more, synthesising opposing approaches is also a major advance in management and organisational theory.

In this chapter, first, the shareholder-based system, and then the stakeholder-based model will be discussed. We will then provide an insight into the diversity of international corporate governance systems. In addition to the specific features of corporate governance in Southern Europe and the Far East, we will also discuss the possible convergence of the international institutional framework and its management implications.

5.3.2. Shareholder-based corporate governance system

Ownership structure

The shareholder-based system is typical in the United States of America and the United Kingdom, but it is also dominant in Australia and New Zealand. Traditionally, in the Anglo-Saxon system, shares of companies were held by a variety of actors, but nowadays an increasing proportion of shares are held by institutional investors such as insurance companies, pension funds and investment funds. In parallel with the growth of institutional investors, the highly diversified shareholding structure has started to consolidate in recent decades. Regarding the ownership structure of public companies, a significant proportion of shares is now concentrated in a few institutional investors. Institutional investors have a responsibility to manage the financial assets they manage in such a way as to ensure that the beneficiaries receive the maximum return available. While previously they have been trying to achieve this goal only with a diversified portfolio (by owning shares in many companies with different profiles) and less impact on

corporate operations, recently they have been increasingly active in the latter area. Active participation in corporate governance is rising due to voting rights based on the increasing number of shares owned. Voting rights are realized by the institutional investors' investment managers or portfolio managers. Portfolio managers deal with several companies at the same time, so portfolio managers must be informed, communicate with the company directors, monitoring the performance of the directors and the company, for example by proposing new directors or acting as a proxy for other shareholders. (Clarke, 2017; Bebchuk et al., 2017)

Compared with the stakeholder-based system, where banks play a dominant role in the ownership structure and corporate financing is often provided through bank loans, the Anglo-Saxon system has traditionally had more developed securities markets. As a consequence, bank loans are less common and financing comes mainly from shareholders.

Information and shareholder behaviour

Anglo-Saxon corporate law puts the interests of shareholders first, and the prevailing view in the US is that companies are essentially subordinate to the interests of the owner. For example, shareholders in Anglo-Saxon systems usually have a formal right to appoint members of the board of directors or to decide on major issues affecting the life of the company.

This power in practice is not typically exercised by investors, partly because of a fragmented ownership structure and partly because of better-informed (and assertive) management. The response of shareholders when they disagree with the management of a company is rather to sell their shares, thus, affecting the share price and indirectly the performance of management and the company. Consequently, in the Anglo-Saxon systems, the success of the company and its management is intertwined with short-term profit maximisation. Corporate governance decisions favour choices that maintain or increase the level of earnings and share price in quarterly and annual reports. (Salvioni et al., 2016)

The laws regulating the securities market generally emphasise the protection of the interests of minority shareholders, in particular, by guaranteeing minority shareholders' access to information. In the Anglo-Saxon system, strict requirements were introduced for the continuous disclosure of corporate information, to ensure that the market is properly informed about companies' activities. This is essential in market-based corporate governance systems because, in a dispersed ownership structure with a large number of investors, investors need reliable and relevant information to make the right investment decisions. Regulation for all investors aims to create equal access to information and avoid that a few majority, privileged owners exclusively access to corporate data and thus, be one step ahead against the other owners. (Clarke, 2017)

One-tier governance system

In the Anglo-Saxon model, there is a one-tier governance structure, where the unitary board is responsible for overseeing the company's operations in the interests of shareholders. The Board of Directors (headed by the president) does not deal with day-to-day operational decisions, this is the responsibility of management (headed by the CEO). The main difference between one-tier and two-tier governance systems is that while decisions and monitoring of decisions are integrated in the former (which requires external directors to be on the board), this is separated in the two-tier system. The literature is not consistent in its use of the terms board or management board. In this study, this governing body of the one-tier governance structure is called a board of directors, and we use the terms management/executive board and supervisory board in the case of the two-tier system. This can be linked to the divergence of traditional approaches, since the stewardship theory presented earlier suggests that directors will not misuse their information surplus opportunistically, even if they are not supervised by an external body; whereas the agent theory suggests that this is a serious risk. (Yasser et al., 2017)

One of the problems with the Anglo-Saxon system is that management, which is supposed to be lower down the formal hierarchy, is often more dominant than directors. Although the regulations require a majority of non-"manager" (non-executive, i.e.,

external) directors to ensure management accountability, external directors generally do not have the time, knowledge and experience to perform this role properly.

Maintaining this status-quo is the interest of the current management, and sometimes external directors even feel under pressure to identify with the values of the company and senior management. To remedy this problem, a solution that started to spread in the 1980s was to have only external directors in the various committees of the board to discuss certain cases, including the review of annual reports and management (e.g., audit committee, remuneration committee, nomination committee for the election of board members and management). In many companies, the dominance of management is still present, whether because of informal power or formal power, for example, if the CEO is also the chairman of the board. (Clarke, 2017)

Some failures of US corporate governance and responses

In the 1990s, this power of management was coupled with an extremely dangerous trend: public company management became increasingly focused on increasing share prices, as it serves the interests of shareholders and, in a share-price-linked remuneration system, the interests of managers themselves. At the same time, less attention has been paid to improving production in the longer term (Kantár, 2019). However, the stock price was sometimes driven up only by fraud, causing the biggest bankruptcies in US history. After the Enron debacle, several other investigations revealed irregularities in accounting practices and/or conflicts of interest at other leading companies (Unerman & O'Dwyer, 2004). These corporate governance failures have contributed significantly to the volatility of the international securities market and have led to a significant loss of confidence in accounting practices. But this was not the end of the series of major failures, with the collapse of Worldcom in 2002 being even bigger than the fall of Enron. In response to these frauds, the US passed the stringent Sarbanes-Oxley Act, which included external and internal compliance requirements and made the protection of investors' interests more assured and verifiable by requiring and strengthening, for example...

1. the personal responsibility of the CEO and the CFO for the financial data,
2. the wider range of data to be disclosed,

3. the need for an audit committee,
4. the independent audit. (Kantár, 2019)

However, corporate collapses and governance failures are not only caused by or can be caused by fraud and breaches of conflict of interest rules. A critical corporate governance function is also risk management, which was partly responsible for the onset of the 2007-2008 financial crisis (along with other macroeconomic factors such as loose monetary policy). During the financial crisis, many financial institutions failed (or had to be rescued by national governments). Several studies have shown that risk management at the corporate governance level and the funding mechanism had a profound impact on how a financial institution was affected by the crisis. Empirical studies suggest that crisis management requires specific corporate governance practices in several aspects.

1. In the evolution of corporate governance, both regulators and researchers have stressed the importance of having as many external directors as possible in the independent audit, for example, during the financial crisis, more independent boards fared worse, as external directors were more inclined to encourage capital increases. In the end, the crisis meant that capital increases effectively led to the transfer of assets from shareholders to creditors.
2. Ownership dominated by institutional investors was also harmful for companies, as those companies took more risks before the crisis than where institutional ownership was less strong. (Erkens et al., 2012)

It is important to see that it is the responsibility of the directors at the top to determine the strategy and thus the actual level of risk-taking, which is a serious challenge, also because they should (should have) resisted pressure from investors while receiving their mandate from them.

The UK and the Cadbury reforms

The UK, as another pillar in the development of Anglo-Saxon corporate governance, also faced some of the systemic problems experienced in the US in the second half of the 19th century, including:

1. Poor accountability of management performance by the board,

2. Excessive increases in management pay, despite the fact that the performance of UK companies tended to decline in the 1970s and 1980s.

Corporate governance practices needed systemic reform, especially because in 1991, for example, more companies went bankrupt even though finances were on a sound basis, according to audit reports (Maxwell Communications Corporation, Bank of Credit and Commerce International, Polly Peck). The recommendations have also been implemented by the London Stock Exchange, requiring public companies to comply with the recommendations or explain the reasons for the deviation and to disclose this in their annual report. To solve the problems, an independent committee was created, led by Sir Adrian Cadbury, which resulted in the report that still defines corporate governance practice today, the Cadbury Code of Best Practice. The authors have collected and developed a number of good practices and proposed the principle of "comply or explain": if a company does not follow the recommendations, it must explain why. The majority of companies have adopted the recommended practices, the core elements of which also include a large number of organisational and management recommendations. (Cadbury, 1992)

It is clear that Cadbury's recommendations relate primarily to the selection and conduct of external directors, who, as independent actors

a) can judge the work of management (and thus internal directors),
b) can assess the performance of the company,
c) they are given enough leeway to do this, for example in the audit committee.

The recommendations were also a response to the problems of the Anglo-Saxon one-tier corporate governance system, such as the management-dominated board of directors, the lack of substantial director control, and the a passive director role, which led to the corporate and economic collapses described earlier. Finally, it is worth noting that the Anglo-Saxon system has made advances in stakeholder view as the 2006 Companies Act introduced the so-called "enlightened shareholder value" (ESV). Accordingly, directors' good faith activities are aimed at ensuring the success of the company in line with the

interests of shareholders, while other stakeholders, such as employees and the interests of consumers should also be taken into account (Keay, 2019).

5.3.3. Stakeholder-based corporate governance system

Funding

In the European stakeholder-based approach to corporate governance, the banks and the business networks have a more important role, than in the Anglo-Saxon system. At the same time, it is also important to note that institutional investors do not dominate in Europe and that Anglo-Saxon pension funds and investment funds are less common on the continent. Funding is mostly provided by banks and debt-to-equity ratios are high. The banks as financiers and as owners in general help keep the company survive, planning for the long term, as they have an interest in the company repaying the loans it has taken out. At the same time, compared to the market-based system, the stakeholder-based system ownership structure is much more concentrated, and the main shareholders have traditionally families, financial institutions, and very often other companies for example, through a holding company or cross-ownership. (Aguilera & Crespi-Claderac, 2016)

Emphasis on stakeholders' perspectives

Although the 1990s saw the strengthening of the stock market in Europe, and the rise of shareholder value creation, traditional practices still dominate. Notable among these is the fact that, compared to the Anglo-Saxon system, corporate governance practices better reflect the interests of a much wider range of stakeholders, including: employees, the partner companies, consumers, local communities, the banks, the government. Most European countries' corporate governance systems place a strong emphasis on the interdependence and interconnection between four key elements. Compared to the Anglo-Saxon model, employee representation is much more dominant in continental European corporate governance. (Du Plessis et al., 2017) For example, in Austria, Denmark, Germany, Luxembourg, and Sweden employees can delegate members to the

supervisory board above a certain number of employees. In this stakeholder-based corporate governance model, power is widely shared. As we have seen, the ownership of the management and control are also separated, and in addition to the employees, other stakeholders such as representatives of suppliers, customers and banks are often involved in decision-making. This 'balancing' role of corporate governance between stakeholder interests is critical because different stakeholder groups have very different interests. For example, while shareholders would like to see costs reduced and even personnel costs frozen, there is constant pressure from employees to increase wages. The situation is further complicated by the fact that reconciling the interests of stakeholders can be difficult not only because of inter-stakeholder conflicts but also because of intra-stakeholder conflicts. (Carney et al., 2011)

Two-tier corporate governance system

The stakeholder-based model has a two-tier governance system

a) with an Executive Board, which manages the company's operations and makes decisions at the highest level with internal members; and
b) a Supervisory Board, which has external members to oversee the company's governance, and management, ensure accountability and provide professional advice to the board, but cannot independently manage the company. The members of the executive board are usually appointed or removed by the supervisory board, while the members of the supervisory board are elected by the general meeting of shareholders. The supervisory board often includes representatives of banks and other companies in inter-organisational networks. (Angyal, 2001; Auer, 2017)

While in the case of the unitary board, the regulators emphasize the number of external directors and independent supervising, the two-tier system separates the management and supervision functions within the organisation. The differences in structure lead to different strengths: while the one-tier system gives an excellent opportunity for efficient information flow between directors and management (executive directors), the two-tier system separates more the control from management itself. (Clarke, 2017)

The dominant role of majority owners and the risks of the system

In the continental European system, companies are usually owned by old and large investors who protect hostile takeovers (which is more common in a shareholder-based system, for example, due to fragmented ownership). It is also a defence mechanism that company information is not disclosed in such detail as in a shareholder-based system, so information is exchanged much more selectively, rather only between insiders. But it also follows that the minority shareholders are not protected by publishing information widely. As majority shareholders are often closely linked to management as members of the executive board or supervisory board, the risk of collusion is relevant. So, the development point of the European system is clearly the protection of minority shareholders. This is currently handled in the following ways:

a) Where there are several classes of shares, one group of shareholders may have more voting rights than others or may have a decisive influence on the outcome of a vote.
b) Minority shareholder groups can agree with each other to form a majority.

The active role of majority owners in corporate governance and their close relationship with management also highlights the fact that addressing management opportunism is less of a pressing problem in Europe, as ownership control is much closer to operational control than in Anglo-Saxon countries. It is also important to note that not only the ownership structure but also the "type" of owners is also decisive in the success of the company, especially in Europe, where there is usually a concentrated ownership structure. For example, companies with a majority of shares in family ownership are less likely to invest in research and development, as they have a lower risk appetite. Investment in innovation has also been adversely affected by the emergence of foreign investors, and investment funds, in the ownership structure of some European companies, as they have "brought with them" the need to focus on the short term from overseas. (Munari et al., 2010)

In countries with a stakeholder-based corporate governance system, such huge failures experienced in the Anglo-Saxon type system have not happened in recent decades (but

neither has the growth that Tesla has shown in the US, for example). The Volkswagen scandal in 2015, however, highlighted the need to address the development potential of stakeholder-based corporate governance as well, beyond the protection of minority shareholders. (Crête, 2016; Li et al., 2018)

5.3.4. Other types of international corporate governance systems

The two basic models presented in international practice vary in appearance. Even continental Europe is not entirely homogeneous from the point of view of corporate governance, as legal systems are influenced by different cultural, political and social traditions. For example, in Germany, there can only be a two-tier board, while in Portugal, Belgium, Italy, Sweden and Switzerland some internal directors (who are also executive directors) can be part of a supervisory board of external (non-executive) members. In the following, insights into corporate governance in Southern Europe and the Far East will be provided.

Latin-type corporate governance

Latin-type corporate governance is predominant in Italy, France, Belgium and Spain (Weimer & Pape, 1999). This approach differs from the traditional German model, as

a) there is a very strong network orientation between companies,
b) ownership by predominantly public, family, or industrial groups is common,
c) high concentration of ownership provides protection, stability, and long-term orientation,
d) there is an emphasis on continuous capability development, which has led companies in some industries to become highly competitive internationally (e.g. high-tech train manufacturing in France, fashion items in Italy),
e) the system, which is based on networked and often pyramid-like corporate structures, has weak accountability and transparency requirements and is a barrier to the emergence of a developed stock market and to foreign investment. (Clarke, 2017)

Another illustration of how the Latin-type system differs from what has been discussed so far is that in Spain, for example, ownership is very concentrated and the owners themselves can control the company (i.e., there is less separation between ownership and control, more in line with continental Europe), but there is a one-tier corporate governance structure (more of an Anglo-Saxon corporate governance feature). (Ruiz-Barbadillo et al., 2007)

However, Latin-type corporate governance cannot be considered as completely homogeneous. In France, for example, the choice between a one-tier and a two-tier system of corporate governance has been possible since 1966. (Belot et al., 2014)

Corporate governance in the Far East

While both shareholder-based and stakeholder-based corporate governance systems can be described as a "rules-based" approach, corporate governance in the Far East can be rather characterised by building on relationships (i.e., relationship-based approach). This is because, in East Asia, despite the rich cultural diversity similar to that in Europe, it is typical that

1. most companies have a single dominant majority owner, concentrated ownership, very few large owners,
2. the company is controlled by one family, with frequent overlap between family ownership and family control,
3. there are business (inter-organisational) networks closely embedded in the local society, including creditors, customers, and suppliers,
4. the company often has close links even with regulators and public authorities,
5. state ownership is also decisive, as is direct political influence on the selection of managers,
6. the use of qualified managers in top management is relatively rare. (Globerman et al., 2011; Vaszkun, 2013)

Specifically, Japanese corporate governance is considered by some researchers to be the fourth basic model, alongside Anglo-Saxon, German, and Latin. In this governance structure, in line with the above list, the predominance of informal relationships makes

it similar in practice to the Anglo-Saxon one-tier board structure, despite the existence of an office of representative directors and an office of auditors in addition to the board of directors. (Weimer & Pape, 1999)

Based on the above, the separation of ownership and control, which defines Western corporate governance thinking, is not fully interpretable in Asia. Control is exercised by the majority owners, and therefore, corporate governance mechanisms in the Western sense are also traditionally informal and weak. The board has no real power, and even filling directorships are often rather symbolic, and the chairman of the board is sometimes not controlled by anyone in Far Eastern companies. Despite all these weaknesses, the region has shown exceptional economic growth in the second half of the 20th century, as there are cultural differences in the background of the corporate governance system which can seem weak from a Western, European perspective. In addition, leadership practices are also influenced by Eastern ideologies such as Confucianism, Daoism, or Buddhism (Koczkás, 2023; Vaszkun et al., 2022; Vaszkun & Koczkás, 2018; Vaszkun & Saito, 2022).

1. For example, the principal-agent conflict and the phenomenon of opportunism that dominate Anglo-Saxon thinking are not relevant because the interests of the individual are usually subordinate to those of the community in Far Eastern cultures (and therefore the interests of the company). (Vaszkun, 2013)
2. In the case of relationships, the power of the superior over the subordinates is typically not questioned, and the supervisor always takes care of his subordinates. (Angyal, 2001)

The growth was followed by a systemic financial crisis (sweeping through countries such as Indonesia, Malaysia, Singapore and South Korea) caused by a loss of trust in financial markets and against those corporate governance practices, which was characterised at the time by crony capitalism, opaque accounting and audit systems, and often excessive intertwining of state and business relations. In other respects, the protection of small shareholders from majority shareholders has also traditionally been weak in Far Eastern corporate governance, which has also had an impact on the rapid decline in share prices. In the aftermath of this crisis, the export-led recovery eventually led to a boom that meant that Far Eastern markets were less affected by the 2007-2008 global financial crisis.

(Vaszkun, 2014) There have also been corporate governance reforms (e.g., in Japan and China) that have started to integrate elements of the Anglo-Saxon approach (e.g., improving transparency), but the fundamentally different cultural and institutional backgrounds are clearly limiting. (Clarke, 2017; Johnson et al., 2000)

5.3.5. Convergence debate and management implications

Globalisation, and thus the international integration of product and capital markets, foresees a convergence of corporate governance systems, whereby a stakeholder-based system could increasingly become a shareholder-based system, or vice versa. Although the convergence debate has been going on in professional communities for decades, driven by the idea that the more economically competitive system will eventually converge with the less competitive model, the regulatory changes have been aimed more at promoting the efficiency of the system and legitimacy in the capital markets, but no significant convergence has occurred. While those arguing for convergence say that the globalisation of markets makes the changes necessary globally towards shareholder-based Anglo-Saxon corporate governance, others, given the serious cultural differences, consider unrealistic the viability of just one model in the world (Yoshikawa & Rasheed, 2009; Ntongho, 2016). Even if the vision of a single system can be not fulfilled, the choice between a one-tier and a two-tier corporate governance structure is now possible in several European countries: Bulgaria, Denmark, France, The Netherlands, Luxembourg, Hungary, Italy, Portugal, Romania, Slovenia) (Belot et al., 2014).

Regarding the two fundamentals models, the main difference between shareholder-based and stakeholder-based corporate governance systems is that while stakeholder-based practices emphasise cooperative relationships and consensus building, shareholder-based systems are more competition- and market-driven (Nestor & Thompson, 2000). The difference between these two corporate governance systems is partly based on the underlying cultural differences, (Breuer & Salzmann, 2012). One should also note that there are differences within continental Europe as well, for example, French corporate governance - situated between the basic Anglo-Saxon and

German models (literally) - has long given companies a lot of flexibility to choose between a one-tier and a two-tier structure (Belot et al., 2014).

From a management and organisational theory perspective, corporate practices relating to one or other corporate governance system are usually taught together in textbooks, and the research often drafts attention to the need for parallel, often conflicting features of corporate governance systems:

1. Organic growth is often favoured by financial markets (Dalton & Dalton, 2006), and while acquisitions and mergers often fail, they can be beneficial if the right strategy is in place:
    a. if there is no complete transformation of the core business, a company must be acquired which have the resources the company needs, these must be used to strengthen the core business and to wind up the business of the acquired company.
    b. If there is a complete transformation of the core business, the existing core business must be transferred to the acquired company, relocated the most valuable resources and used there. (Christensen et al., 2011)
2. In making strategic decisions, the interests of the owners (shareholders) and the other stakeholders must be taken into account. (Tricker, 2012)
3. According to the theory of strategic ambidexterity, companies should operate efficiently in their current business areas, focusing on the short term, (exploitation), and at the same time, renew their activities, and innovate, for long-term effectiveness (exploration). (Duncan, 1976; March, 1991)
4. In terms of innovation, opposite effects prevail in both systems:
    a. In a market-based system, the short-term orientation does not encourage firms to invest in risky, high-uncertainty innovations that may generate competitive advantage only years later, but the highly competitive environment provides an incentive for rapid innovation;
    b. The long-term orientation of the stakeholder-based system allows for investment in innovation, but there is no competitive pressure on companies to do so anyway. (Csedő & Zavarkó, 2021)

5.3.6. Conclusions

Based on the analysis, shareholder-based and stakeholder-based corporate governance systems are different from multiple perspectives, for example, regarding the dominance of financing mechanisms (stock market-based or bank-based), the number of shareholders, and cultural values (e.g., excellence and autonomy or harmony and embeddedness). These differences affect international management tools as well. For example, mergers and acquisitions are more frequent in the shareholder-based system, while organic growth is more emphasized in the stakeholder-based system. Nevertheless, both emphasise external legal and market rules as well as internal, organisational rules, unlike the more relationship-based Far-Eastern model. Consequently, in both rule-based systems, external legal and internal policies can be key drivers for the board of directors to integrate stakeholder and sustainability perspectives into corporate governance decisions. Future research could explore how pressures from the market, investors, state administration, and other stakeholders affect corporate governance decisions concerning sustainability ambitions in different international contexts.

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