

Dear Readers!

The recent issue of the journal is devoted to several aspects of corporate governance. First of all, we keep the hand on the pulse of corporate social responsibility.

Theodore Syriopoulos, Anna Merikas, George S. Vozikis achieved a conclusion that the development of CSR stock index benchmarks could become a very valuable tool for CSR asset valuation and the appraisal of SRI shareholder decisions.

Ryuuichiro Kurihama clarifies the relationship between CSR, corporate governance and auditing, and reexamines a role for auditing in CSR and corporate governance through the discussion of the relationship between corporations and society as recently brought up concerning CSR.

Magdi El-Bannany investigates the determinants of the social disclosure level in UK banks over the period 1981-1996. The results show that market structure, investment in information technology and risk factors, which have not been considered in previous studies, have a significant impact on the social disclosure level. In addition, bank size and profitability are significant but the listing status and the age of the bank are insignificant.

For the second, we introduced a new country to explore corporate governance we had never explored before, i. e. France. Authors investigated the relationship between ownership structure and voluntary earnings disclosures under high ownership concentration of French-listed firms. The findings show that French managers are less likely to make voluntary disclosures when they are controlled by a large shareholder or by a family, suggesting that low legal protection leads to expropriation of minority shareholders. The results also show that the proportion of foreign institutional investors in capital is likely to mitigate this relationship since institutional investors signal good minority shareholders' protection to the market. Moreover, authors researched external debt financing in controlling minority structures (CMSs), a very pervasive corporate organizational structure in France outside CAC 40 firms. Authors show that firms featuring a substantial likelihood of expropriation (higher discrepancy between cash flow rights and control rights or group-affiliated), present lower leverage ratios than others due to debt supply restrictions. The presence of second large controlling shareholder is perceived by external finance suppliers as a pledge against expropriation.

Besides that our contributors tried to do their utmost to develop the academic investigations and concepts through publishing papers on shareholder and stakeholder models, independent auditing involvement with corporate governance issues, separation of control rights and cash-flow rights in emerging economies with application to Mexico, corporate governance ratings, the ASX corporate governance council's principles of good corporate governance and best practice recommendations.

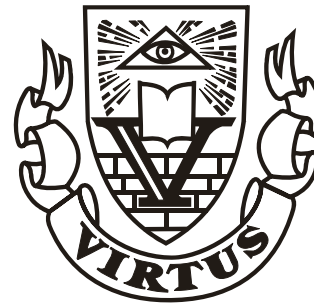
We hope that our practitioner's corner with the paper „Why do directors feel so separate when they are interconnected?“ by Darlene Andert will be welcome both by practitioners and academics.

We would like to remind that all our efforts are directed to develop corporate governance through intensive research and in this way your contribution is welcome by us.

CORPORATE OWNERSHIP & CONTROL

Volume 5, Issue 1, Fall 2007

CONTENTS



Editorial 5

SECTION 1. ACADEMIC INVESTIGATIONS AND CONCEPTS

**A Review of the Two Main Competing Models of Corporate Governance:
The Shareholdership Model Versus The Stakeholdership Model** 9

Tony Ike Nwanji, Kerry E. Howell

This paper reviews the impact of the shareholdership and stakeholdership models in guiding managers through the most appropriate way of delivering business objectives. The shareholder model is the traditional Anglo-American system of corporate governance, which focuses on the maximisation of shareholder wealth, while the stakeholder model is considered to be exemplified by the German system of corporate governance and focuses on meeting the needs and expectations of a wider range of stakeholder groups. The results from this study indicate that a combination of both models could enable management to deliver the needs of stakeholders groups, while in the long term maximising wealth for the shareholders..

**Independent Auditing Involvement with
Corporate Governance Issues** 24

Waymond Rodgers, Helen Choy, Andres Guiral-Contreras

This research paper supports the notion that the independent auditing function tied to corporate board actions can influence accountability of corporate social responsibility strategy and implementation. We present a Throughput Model that depicts independent auditors' reporting to firms' board of directors may improve its market valuation against the backdrop of an ever more complex global economy with continuing economic, social and environmental inequities.

**Value Management in Weakly Growing Industries
An Empirical Analysis Using the Chemical Industry as an Example** 31

Ulrich Pidun, Michael Wolff

In the literature, growth is discussed as a key value lever within the framework of value-based management as it creates opportunities to generate additional free cash flow and thus to increase the value of the company. However, opportunities for high growth rates, for example through technical innovations or the creation of new customer groups, are not equally distributed across industries. Using 61 companies from the chemical industry as an example, it is shown that above average capital market performance is possible also in industries with below average growth rates. The requirement for this to take place is the consistent exploitation of all available levers of value management. In contrast, a pure focus on increasing profitability has not proven to be a sustainable value creation strategy.

Separation of Control Rights and Cash-Flow Rights in Emerging Economies: Theory and Mexican Evidence **38**

Richard Fairchild, Alma Garro Paulin

We argue that factors in emerging markets, such as large private benefits of control, extreme risk, low investor protection, inefficient capital markets, and governments sympathetic to incumbent management at the expense of outside investors, all contribute to insiders' incentives to create a separation of cash flow and control rights. We present evidence from Mexico that supports our results.

Corporate Governance Ratings: General Concerns and Specific Problems in the European Context **58**

Daryl Koehn, Joe Ueng

Recent corporate scandals have led investors to monitor corporate governance more closely. Corporate governance ratings by independent agencies have become popular with investors seeking indicators of good market returns. We present empirical data showing that such CG ratings show no significant correlation with European firms' stock price appreciation. We conclude with a few thoughts concerning possible dangers associated with the use of CG ratings.

One Size Does Not Fit All: Small Companies and ASX Corporate Governance Compliance **66**

Ray da Silva Rosa, Dane Etheridge, Izan H Y Izan

The ASX Corporate Governance Council's Principles of Good Corporate Governance and Best Practice Recommendations (Released March 2003) has been criticised as unduly prescriptive and potentially costly, particularly for small firms. Using a sample of 518 West Australia and Queensland based ASX listed companies, we show that small companies are less likely to comply with several of the ASX recommendations than large companies. We also show that some agency controls largely ignored in the recommendations, such as substantial shareholders, may substitute for some of the corporate governance mechanisms recommended by the ASX.

Overinvestment and Underinvestment Problems: Determining Factors, Consequences and Solutions **79**

Maurizio La Rocca, Tiziana La Rocca, Alfio Cariola

The potential conflicts of interest between managers, stockholders and debtholders influence capital structure, corporate governance activities and investment policies, which, in turn, could give rise to inefficient managerial decisions and "suboptimal" investments that generally fall under the categories of problems of underinvestment and overinvestment. This paper intends to discuss these problems by identifying their causes, determining factors and the consequences on the value production processes, as well as to point out possible solutions to them.

SECTION 2. CORPORATE SOCIAL RESPONSIBILITY

Corporate Social Responsibility and Shareholder Value Implications **96**

Theodore Syriopoulos, Anna Merikas, George S. Vozikis

The study assesses the implications for shareholder value induced by investing in companies promoting corporate social responsibility (CSR) among members of the Greek CSR Firm Network which consistently pursues CSR strategies. Alternative dynamic volatility models to identify the best fit that adequately describes the risk-return profile of these stocks were estimated, while the EGARCH model which takes into account asymmetric volatility effects was found to be statistically satisfactory in explaining CSR risk and return. The impact of volatility appears to be persistent though varying across

Greek CSR companies and shareholder value hence may fluctuate considerably, as CSR stocks may not necessarily present a low risk asset class.

Role for Auditing in Corporate Social Responsibility and Corporate Governance: under New Corporate View **109**

Ryuuichiro Kurihama

This paper clarifies the relationship between CSR, corporate governance and auditing, and reexamines a role for auditing in CSR and corporate governance through the discussion of the relationship between corporations and society as recently brought up concerning CSR. This is necessary in order to think the view of how corporations and auditing should be toward rebuilding public trust.

A Study of Determinants of Social Disclosure Level in UK Banks **120**

Magdi El-Bannany

This paper investigates the determinants of the social disclosure level in UK banks over the period 1981-1996. Content analysis is used to measure the social disclosure level. The regression results show that market structure, investment in information technology and risk factors, which have not been considered in previous studies, have a significant impact on the social disclosure level. In addition, bank size and profitability are significant but the listing status and the age of the bank are insignificant.

SECTION 3. NATIONAL PRACTICES OF CORPORATE GOVERNANCE: FRANCE

Ownership Structure and Voluntary Disclosures: The Case of French-Listed Firms **131**

Faten Lakhel

This paper investigates the relationship between ownership structure and voluntary earnings disclosures under high ownership concentration of French-listed firms. The findings show that French managers are less likely to make voluntary disclosures when they are controlled by a large shareholder or by a family, suggesting that low legal protection leads to expropriation of minority shareholders. The results also show that the proportion of foreign institutional investors in capital is likely to mitigate this relationship since institutional investors signal good minority shareholders' protection to the market.

On the Relationship Between Ownership-Control Structure and Debt Financing: New Evidence From France **139**

Sabri Boubaker

The paper deals with external debt financing in controlling minority structures (CMSs), a very pervasive corporate organizational structure in France outside CAC 40 firms. Using a sample of 377 French firms, we show that firms featuring a substantial likelihood of expropriation (higher discrepancy between cash flow rights and control rights or group-affiliated), present lower leverage ratios than others due to debt supply restrictions. Contrariwise, the presence of second large controlling shareholder is perceived by external finance suppliers as a pledge against expropriation.

SECTION 4. PRACTITIONER'S CORNER

Why Do Directors Feel So Separate When They Are Interconnected? **155**

Darlene M. Andert

Instructions to authors/Subscription details **158**



A REVIEW OF THE TWO MAIN COMPETING MODELS OF
CORPORATE GOVERNANCE: THE SHAREHOLDERSHIP MODEL
VERSUS THE STAKEHOLDERSHIP MODEL

*Tony Ike Nwanji**, *Kerry E. Howell***

Abstract

This paper reviews the impact of the shareholdership and stakeholdership models in guiding managers through the most appropriate way of delivering business objectives. The shareholder model is the traditional Anglo-American system of corporate governance, which focuses on the maximisation of shareholder wealth, while the stakeholder model is considered to be exemplified by the German system of corporate governance and focuses on meeting the needs and expectations of a wider range of stakeholder groups. The results from this study indicate that a combination of both models could enable management to deliver the needs of stakeholders groups, while in the long term maximising wealth for the shareholders.

Keywords: corporate governance, shareholdership model, business objectives, stakeholdership model, business ethics, profit maximisations

* Senior Lecturer in Corporate Governance, Holborn Business School, Kaplan Holborn College London, Woolwich Road Charlton, London SE7 8LN, United Kingdom

Tel: (44) 020 8801 3087, Fax: (44) 020 88010627. MB: 07786 233030, nkosa21@aol.com

** Professor of Governance & Leadership, Plymouth Business School, Plymouth University United Kingdom, Kerry.e.howell@plymouth.ac.uk, www.plymouth.ac.uk

Introduction

The aim of this study is to review the two main competing models of corporate governance – the shareholdership and the stakeholdership models. The Anglo-American Corporate Governance system is based on the Shareholdership Model while the European corporate governance System is based on

the German's Stakeholdership model. In this study we assess the importance of both models to the corporate governance system that guides managements towards the best way of managing the affairs of their company to deliver returns to its wider stakeholders. Corporate governance is an area that has steadily been growing in importance over the past twenty five years. The Cadbury Report issued in the UK in 1992 laid the

foundations of corporate governance not just in the UK, but the US and other countries both with developed and developing economies. Most of these economies have incorporated the main principles of the UK Combined Code into their own corporate governance systems. Following the collapse of Enron and WorldCom in 2001 in the US, corporate governance gained a much higher profile and is now a frequent topic in the financial press and academia. There are growing numbers of research projects and literature on both the general areas of corporate governance and on different mechanisms including directors' remuneration, accountability, non-executive directors (NEDs), audit committees and board evaluations. Following the collapsed of Enron and WorldCom in 2001 corporate governance has gained a much higher profile and is now a frequent topic in the financial press and in academic research.

Shareholdership versus Stakeholdership

The issue of corporate governance has centred on shareholder v stakeholder and which of the two models is best for corporations, and therefore, the board should follow in managing the affairs of the business. Ever since the Friedman's (1970) view that the modern corporation has no social responsibility to society only to its shareholders who are the owners of the business, interest on shareholder value has increased. Influences such as globalisation of capital markets, increase in institutional investors, greater shareholders activism, stakeholders expectations and growing importance of corporate governance issues have all been stated as factors (Omran *et. al.* 2002; Mills 1998, Fera 1997).

Whereas the Shareholdership Model claim that corporate governance is about two things – accountability and communication - Accountability is about how those entrusted with the day-to- day management of company's affairs are held to account to shareholders and other providers of finance. The second aspect is how the company communicates that accountability to the wider world: to shareholders; to potential investors; to employees; to regulators; and to other groups with a legitimate interest in its affairs. (Pricewaterhousecoopers 2003)

The **Stakeholdership Model** claims that corporate governance is about directors and managements managing for stakeholders which involved attention to more than simply maximising shareholder wealth. The attention to the interests and well-being of those who can assist or hinder the achievements of organisation's objectives is the central admonition of the theory, (Phillips 2003).

The idea that companies should behave in a responsible way, is one of the considerable discussions after events like the Maxwell Corporation, Polly Peck, BCCI, Barings Bank, and Paddington Train Accident in the UK in the 1990s. In addition, the collapsed of Enron, WorldCom and Accountancy firm, Andersen in the US in 2001 have all increased interest on corporate governance both within academia and business environments. There are growing number of researches on the kinds of

behaviour that might constitute corporate social responsibility and the extent to which such activities are legally permissible under English Company Law.

In the UK, corporate governance is fundamentally based on the shareholder model, which is a result of capitalism with the objective of profit maximisation and the protection of shareholders interests. The Combined Code should have been able to provide creditability and accountability in the management of companies. But even with all the recommendations on audit committees and auditor independence, effective internal financial controls and the effectiveness of non-executive directors there are still ethical problems on how this is achieved in practice under the shareholder model. It can be said that the main problems are not that corporate governance is not effective as a guide to management in running their companies. Some of the problems may be due to the fact that in the light of scandals such as the Enron and WorldCom (2001) in USA, any changes in the nature of corporate governance requires changes in the nature of shareholders theory of profits maximisation as the main business objective, to include the interests of the stakeholder groups.

Literature Review on Corporate Governance

The collapse of four organisations in the 1990s in the UK, (Maxwell Corporation, Polly Peck, Bank of Credit and Commerce International BCCI, and the Barings Bank) led to the setting up of three major committees to look into the effectiveness of corporate governance practices. These were:

- (i) The Cadbury Committee Report (1992), on the Financial Aspects of Corporate Governance.
 - (ii) The Greenbury Committee Report (1995), on the Remuneration of Executive Directors.
 - (iii) The Hampel Committee Report (1996), which reviewed the above two codes and consolidated them into one corporate governance principle leading to the publication of the Combined Code in June 1998.
- These were followed by three other Committee Reports in 1999 and 2003.
- (iv) The Turnbull Committee Report (1999), on Internal Control and Financial Reporting. (This was reviewed in 2005 in the light of the new Combined Code, though it is not part of the Combined Code).
 - (v) Derek Higgs' Report (2003), which was a Review of the Role and Effectiveness of Non-Executive Directors, (NEDs) and their Responsibilities in Corporate Governance Practice.
 - (vi) Robert Smith's Report (2003), on Audit Committees and Combined Code Guidance.

The first three committees recommendations resulted in the first Combined Code on corporate governance in 1995 which was up-dated in July 2003