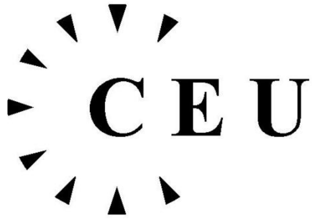

CORPORATE GOVERNANCE, ECONOMIC GROWTH AND SUSTAINABILITY: LESSONS FOR BULGARIA

By

Alexander Mirchev

Submitted to

Central European University

Department of Economics and Department of Legal Studies

In partial fulfillment of the requirements for the degree of Master of Arts

Supervisors: Ugo Pagano and Tibor Tajti

Budapest, Hungary

2011

© Central European University June 6, 2011.

CEU eTD Collection

Abstract:

The present research takes a look at the main building blocks of corporate governance from the point of view of their potential impact on economic growth and sustainability. By comparison of the two major corporate governance systems – the one-tier versus the two-tier system – the aim is to analyze which one of them is more orientated towards sustainable economic growth in post-2008 global economic crisis period. Moreover, in order to get a clear answer to this question the thesis specifically examines the role, as well as the rights, the responsibilities and the liabilities of different stakeholders; to wit, shareholders, creditors, labor and the society. Additionally, this thesis will try to answer the following concrete questions: first, what are the structural differences between the one-tier tier and two-tier system?, secondly, what are the differences between them in regard to sustainable economic growth?, and finally, what important lessons can be withdrawn for Bulgaria? The article vouches for more neoinstitutional[1] approach and regulations concerning corporate governance systems; arguing that the two-tier system is more economic growth friendly and sustainable because the co-determination process combines the economic interests of the above-mentioned parties in a more balanced manner. This system creates equality between them which is in a tight relationship with sustainable economic growth and efficiency. On the basis of the American common law system and the German civil law system, the research provides reasonable recommendations to the developing countries such as Bulgaria. The main findings are that the Bulgarian legislators should adopt more detailed corporate governance regulations and to bolster the more growth sustainable and efficient two-tier system.

CEU eTD Collection

[1] See Dam, Kenneth W. 2006. *The Law-Growth Nexus: The Rules of Law and Economic Development*. Brookings Institution Press. p. 3-5.

Table of Contents

Introduction 1
1. On the Role of Corporations in Capitalist Systems 1
1.2 Corporate Governance v. Sustainable Economic Growth 4
1.3 The Roadmap to the Thesis 6
Chapter I - Concepts and General Problems 8
1. Corporations 8
1.2 Enron Case 15
1.3 Corporate Governance 17
1.4 Problematic issues 22
Chapter II – One-Tier v. Two-Tier system 28
1. Structural Difference 29
1.2 Sustainable Economic growth 37
1.3 Findings 45
Chapter III – Lesson for Bulgaria 48
1. The Existing Corporate Governance Model 48
1.2 Lessons 54
Conclusion 58
Acknowledgements 63
Bibliography 64

CEU eTD Collection

Introduction

1. On the Role of Corporations in Capitalist Systems

Since the establishment of the first business organizations, called "societates"[2], by the Romans, followed later on by the "world's first joint-stock limited liability company with freely transferable shares"[3] - Dutch East India Company (The Verenigde Oostindische Compagnie or VOC) - in 1602, those "legal innovations" still constitute a vital role in the economic and legal spheres nowadays. "Based upon the highly abstract concept of a 'legal personality,' the emergence of the corporation has opened new doors for market interaction and economic growth."[4] In short, the corporation was conglomerate of people ready to invest, and share ownership and risk in pursuit of economic benefit. The characteristics[5] of nowadays-called corporation that enable investors to accumulate huge amount of capital and invest it in the economic system have been a vital source of economic growth and efficiency.

On the other hand, corporations can 'make us or brake us'. "Abuse of market power; corporate greed; […] the 'irrational exuberance' of the financial markets; and the

---

[2] See Ulrike Malmendier. "Roman Shares" (2005) *The Origins of Value. The Financial Innovations that Created Modern Capital Markets*. Ed. W. Goetzmann and G. Rouwenhorst, Oxford University Press, p. 31-42.

[3] "World's oldest share". Web: http://www.worldsoldestshare.com/# consulted on April 2011.

[4] Malmendier, Ulrike . "Roman Shares" (2005) *The Origins of Value. The Financial Innovations that Created Modern Capital Markets*. Ed. W. Goetzmann and G. Rouwenhorst, Oxford University Press, p. 31.

[5] As Lynn A. Stout points out the most important characteristics of a corporation are limited shareholder liability, centralized management, perpetual life, free transferability of shares and capital "lock-in". See Stout, Lynn A., (2005) "On the nature of Corporations". *University of Illinois Law Review. Vol. 2005, No.1, p. 253.*

CEU eTD Collection

destruction of traditional economies", those "common complaints against late 20th- and early 21st-century capitalism" have been shadowing the history of the corporation over the centuries."[6] Therefore, come the questions. To what extent the economic growth provided by corporations is sustainable in a market economy of a country? Who and how is in control of one of the most important economic agents - corporations? What are the forces that drive to a good or bad corporate governance? Which corporate governance system (one-tier or two-tier) is more appropriate to the creation of sustainable economic growth after the global economic recession in 2008?

At the end of the 20th century and begin of 21st century, scholars such as the Nobel laureates Ronald Coase and Douglas North established the neoinstituitonal[7] approach as the basis of the Economics of Law discipline.[8] Well understood the significance of the relationship between economic incentive and the role of law, they claim for strong institutions able to regulate different economic agents such as corporations. According to them, sustainable economic growth is spurred through legal and institutional reforms which should consequently lead to stable corporate governance systems. Moreover, in his book *"The Firm, the Market and the Law"* (1988)[9], Coase

---

[6] Robins, Nick. (2004). "The World's First Multinational". *NewStatesmen.* Available electronically at <http://www.newstatesman.com/200412130016>; last visited on 16th of May 2011.

[7] According to Kenneth Dam the neoinsitutional approach is the next stage of economic development preceded by a simple capital transfer (from developed countries to developing countries) and neoclassical economic policy approach. It is concerned with the way rules, contracts, and property function in the economy. See Dam, Kenneth W. 2006. *The Law-Growth Nexus: The Rules of Law and Economic Development*. Brookings Institution Press. p 1-2.

[8] As described by Antony Dnes, the Economics of law is the application of economic principles to legal instruments, questions, and procedures. See Dnes, Anthony W. 2005. *The Economics of Law: Property, Contracts and Obligations*. Thompson South-Western.

[9] Coase, R.H., (1988)"The Firm, the Market, and the Law", The University of Chicago Press.

CEU eTD Collection

introduces the significance of transaction cost in order to analyze the corporations' existence and behavior. "Outside the firm, price movements direct production, which is co-ordinated through a series of exchange transactions on the market. Within a firm, these market transactions are eliminated, and in place of the complicated market structure with exchange transactions is substituted the entrepreneur–co-ordinator, who directs production."[10] Therefore, as a major engine of economic growth and efficiency, corporations also require a stable corporate governance system and regulations.

After major corporate and accounting scandals, in the beginning of 2000s, concerning corporation such as Enron, Worldcom and Tyco, corporate governance issue attracted many economic and legal discourses. Furthermore, in the end of 2001 when the infamous Enron Corporation collapsed, the former Chairman of U.S. Federal Reserve, Alan Greenspan, wrote to the Senate concerning the regulation of derivatives the following: "We do not believe a public policy case exists to justify this government intervention".[11] It was a statement that clearly indicates that the U.S. Federal Reserve do not want to engage into any regulation policies. In 2008 before the U.S. Hearing Committee, Alan Greenspan stated even bolder conclusions that he "made a mistake in presuming that the self-interest of organizations, specifically banks and others, were such is that they were best capable of protecting their own shareholders and their equity in the firms; I found a flaw in the model that I perceived is the critical functioning structure that

CEU eTD Collection

[10] Coase, R.H., (1988)"The Firm, the Market, and the Law", The University of Chicago Press. p. 388.

[11] The Financial Crisis and the Role of Federal Regulators. House of Representatives, Committee on Oversight and Government Reform.Washington, D.C. 2008.

defines how the world works."[12] Moreover, "Smith's vision of free trade entailed firm controls on corporate power. And, as did his own times, subsequent history shows how right he was. If it is to contribute to economic progress, the corporation's market power has to be limited to allow real choice, and to prevent suppliers being squeezed and consumers gouged. Its political power also needs to be constrained, if it is not to rig the rules of regulation so that it enjoys unjustified public subsidy or protection. Internal and external checks and balances must curb the tendency of executives to become corporate emperors. And clear and enforceable systems of justice are necessary to hold the corporation to account for any damage to society and the environment. These are tough conditions, and have rarely been met, either in the age of the East India Company or in today's era of globalization."[13] It becomes clear that corporations have significant impact on development of market economy in a country and that governments have a vital role in regulating their corporate governance in order to provide sustainable economic growth.

1.2 Corporate Governance v. Sustainable Economic Growth

As concluded in the previous sub-section, the corporations are very important players in market economies and corporate governance issue is still 'on the table'. It becomes clear that a firm corporate governance control is required in order corporations to provide sustainable and efficient growth to the free-market economy systems. The perpetual 'agency problem' between different stakeholders which are involved in

CEU eTD Collection

---

[12] The Financial Crisis and the Role of Federal Regulators. House of Representatives, Committee on Oversight and Government Reform.Washington, D.C. 2008.

[13] Robins, Nick. (2004). "The World's First Multinational". *NewStatesmen.* Avaible electronicly at <http://www.newstatesman.com/200412130016>; last visited on 16th of May 2011.

corporation life created a gap in their relationship. In a nutshell, Adam Smith describes this corporate governance problem:

"The directors of such companies, however, being the managers rather of other people's money 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. […] Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company" [14]

The directors of a corporation have fiduciary obligations only to the corporation not to the shareholders.[15] Even more, those fiduciary obligations was relatively easy to escape as long as taken decisions are proven to been made in "reasonable business prudence".[16] They are liable for gross negligence which is in most cases very difficult to prove.[17] The management has less legal obligations to the shareholders, creditors, suppliers and workers. This situation creates a huge possibility for directors of dishonest behavior. Once directors are appointed in a one-tier corporate system they become a real "corporate emperors"[18]. On the other hand, the shareholders have less and fewer powers

---

[14] Smith, Adam. (2005). "An inquiry into the Natures and Causes of the Wealth of Nations. A Penn State Electronic Classics Series Publication. The Pennsylvania State Univeristy. p.606-607

[15] Messman, Stefan. Power point presentation slides presented for the Corporate Governance class at CEU in 2011.

[16] Ibid.

[17] Ibid.

[18] Take for example the article of Dan McCrum how is stating that there is a willingness of the Apple's investors for greater shareholders' rights. They would like to introduce the majority voting systems on the election of directors. In short, the CEO of Apple, Steve Jobs, is in position to determine the future of the company. See. McCrum, Dan. (2011) "Apple vote to test waters on investors' rights". *Financial Times*. New York.

CEU eTD Collection

presented in the corporation. In U.S. common law system, the shareholders have the right to vote on election of directors, fundamental transactions (mergers and acquisitions, charter amendments) and proxy rules. Also, right to sell their shares and decide on default rules. The self-controlling corporation turns out to be controlled by greed, self-interest and natural self-preservation instincts, perishing the existence of sustainable growth and efficiency in a global economy scale. A prerogative of sustainable growth and efficiency dispersed by a corporation seams to be the creation of a close relationship between different stakeholders based on responsible behavior to each other and more importantly equality between them.

For this reasons, the nexus between corporate governance and sustainable economic growth is even more important today. Is it the one-tier system or the two-tier system which provide the right ingredients towards more sustainable economic growth and efficiency? What are the structural differences between the one-tier tier and two-tier system? What are the differences between them in regard to sustainable economic growth? What important lessons can be withdrawn for Bulgaria? The thesis claims for more neoinstitutional approach and regulations (which provide predictability) concerning corporate governance systems. The major claim is that the two-tier system is more economic growth friendly and sustainable because the co-determination process combines the economic interest of the above-mentioned parties in a balance.

1.3 The Roadmap to the Thesis

The first Chapter is concerned with general concepts such as corporation, corporate governance and sustainable economic growth and efficiency which are of

CEU eTD Collection

importance to understand the major main categories and principles in this thesis. Moreover, those definitions will expand the understanding of the relationship of corporate governance and sustainable economic growth. Who and how is in a control of a corporation in order to produce sustainable growth? What are the conditions to create it? Also, major problems of the corporate governance structures are examined. What are the "burning points" in corporate governance field?

The second Chapter examine in details the advantages and disadvantages of one-tier and two-tier system in accordance of sustainable economic growth. The different structure pre-supposes different problems and different answers between the stakeholders. Which of them is more oriented to a sustainable economic growth?

The last third Chapter analyzes the above-mentioned findings according to the existent Bulgarian corporate governance model. The thesis draws some lessons to legislators and corporation in Bulgaria in order to establish a good path in the Bulgarian economy. The thesis concludes with some general findings and recommendation about important aspect of corporate governance with the concern of sustainable economic growth and efficiency in market economy.

CEU eTD Collection

Chapter I - Concepts and General Problems

1. Corporations

A corporation is "an entity (usu. a business) having authority under law to act as a single person distinct from the shareholders who own it and having rights to issue stock and exist indefinitely". [19] Those legal entities are created and governed by state law (different from state to state). There are many different types of corporations depending on their location (domestic, foreign, alien), purpose (public, private, non-profit) and ownership (publicly held, closely held).[20] In the United States the following types of corporations exists: public versus private corporations, close corporation and non-profit corporation. The Continental law system equivalents of a corporation are Stock Corporation (Germany-AG ("Aktiengesellschaft")[21]) and Limited Liability Company (Germany-GmbH ("Gesellschaft mit baschrankter Haftung")[22]) In Bulgaria exists the

---

[19] Black's law dictionary 9th ed. 2009

[20] See. Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry B. Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda and Edward B. Rock, (2009)"The Anatomy of Corporate Law: Comparative and Functional Approach, Oxford University Press 2nd ed., 2009.

[21] According to Christian Tyler Campbell the AG is "the traditional corporate form used by companies that wish to raise very large amount of capital from a great number of individuals." He also mentioned the characteristics of AG such as possibility to split stock into shares, transfer them, and shareholders play very limited role in decision-making process of the AG. See Campbell, Christian Tyler. 2002. "The Limited Liability Company". *Bussiness transactions in Germany.* Ed. Ruster, Bernd. Looseleaf, Mathew Bender, New York first published 1983.

[22] According to Christian Tyler Campbell the GmbH is a more flexible and less procedurally demanding form of company than the AG. The GmbH with its simple formation and easy administration permits investors to establish a company with a small share capital. See Campbell, Christian Tyler. 2002. "The Limited Liability Company". *Bussiness Transactions in Germany.* Ed. Ruster, Bernd. Looseleaf, Mathew Bender, New York first published 1983.

CEU eTD Collection

following types: limited liability company (дружеството с ограничена отговорност), joint stock company (акционерното дружество) and partnership limited by shares (командитното дружество с акции).[23]

Despite the fact that these different types of corporation are not the clear equivalent of the US term "corporation", they share, more or less, the same important characteristics and purpose in market economy[24]. "The five core structural characteristics of the business corporations are: (1) legal personality, (2) limited liability, (3) transferable shares, (4) centralized management under a board structure, and (5) shared ownership by contribution of capital."[25] The legal personality of a corporation is expressed by the fact that the corporation has the same legal characteristics as a natural person does. It can sue and be sued. It can buy and sell assets. A corporation's assets are owned by the corporation and not by its equity investors (they own the corp. not the assets of the corp.) As a result, those assets cannot be unilaterally withdrawn from the corporation by either its shareholders, or the creditors of its shareholders. [26] The limited liability represents the

[23] For clear definitions see Bulgarian Commercial Code last amended 2002 art. 113 (limited liability company), art. 158 (joint stock company) and art. 253 (partnership limited by shares).

[24] In their article John Armour, Henry Hansmann and Reinier Kraakman they stated the following: "In virtually all economically important jurisdictions, there is a basic statute that provides for the formation of firms with all of these characterisctics"(mentioned afterwards in the thesis) Moreover, "Business corporations have fundamentally similar set of legal characteristics – and face a fundamentally similar set of legal problems – in all jurisdictions. See. Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry B. Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda and Edward B. Rock, (2009)"The Anatomy of Corporate Law: Comparative and Functional Approach, Oxford University Press 2nd ed., 2009 p. 1-5.

[25] Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry B. Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda and Edward B. Rock, (2009)"The Anatomy of Corporate Law: Comparative and Functional Approach, Oxford University Press 2nd ed., 2009 p. 5

[26] Ibid.

CEU eTD Collection

fact that the equity shareholders of the corporation are not liable with their own assets before corporation's creditors. The creditors have claim only to the assets of the corporation but not to the assets of the individual shareholders (except cases involved piercing the corporate veil[27]). Transferable shares means that the shares of the company can be bought and sold by different investors. On the other hand, "fully transferable shares do not necessary mean freely tradable shares. Even if shares are transferable, they may not be tradable without restriction in public markets, but rather just transferable among limited groups of individuals or with the approval of the current shareholders or of the corporation. Free tradability maximizes the liquidity of shareholdings and the ability of shareholders to diversify their investment. It also gives the firm maximal flexibility in raising capital."[28] Centralized management under a board structure could be metaphorically called "the head"[29] of the corporation. It represents the fact that shareholders are delegating managerial powers to a Board. Here, is to be mentioned that there are different ways to delegate powers from shareholders to a Board through different corporate governance systems (one-tier and two-tier). Most "burning points" in corporation analysis are also to be found here because of the different interests and incentive structures between shareholders and management. "Corporate law typically vest principal authority over corporate affairs in a board of directors or similar committee

CEU eTD Collection

---

[27] "The judicial act of imposing personal liability on otherwise immune corporate officers, directors, or shareholders for the corporation's wrongful acts." See def. in Black's law dictionary 9th ed. 2009.

[28] Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry B. Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda and Edward B. Rock, (2009)"The Anatomy of Corporate Law: Comparative and Functional Approach "second edition"", Oxford Press p. 11

[29] Some authors should say that the CEO or the chairman of the BoD is the real head of the company but here term is used in its broader sense meaning that the BoD is exercising the real management power of the corp.

organ that is periodically elected, exclusively or primary, by the firm's shareholders. More specifically, business corporations are distinguished by a governance structure in which all but the most fundamental decisions are delegated to a board of directors that has four basic features."[30] The shared ownership by contribution of capital simply expresses the fact that investors (equity shareholders) are owners of the corporation. "There are two key elements in the ownership of a firm: the right to control the firm, and the right to receive the firm's net earnings. The law of business corporations is principally designed to facilitate the organization of investor-owned firms – that is, firms in which both elements of ownership are tied to investment of capital in the firm. More specifically, in an investor-owned firm, both the right to participate in control – which generally involves voting in the election of directors and voting to approve major transactions – and the right to receive the firms residual earnings, or profits, are typically proportional to the amount of capital contributed to the firm."[31] These are the rights of the shareholders in a corporation.

As long as the basic characteristics of the corporation are mentioned it could be easier to understand the corporation's purpose and how it contribute to economic growth to market economies. "In the economic literature, a firm is often characterized as a 'nexus

CEU eTD Collection

[30] Note that the partnerships, limited liability companies or business trust can also have Board structure but they do not presume a board of directors as a matter of law. Also the four basic features of the BoD are: separate of the operational managers and shareholders, elected and has multiple members. See Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry B. Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda and Edward B. Rock, (2009) "The Anatomy of Corporate Law: Comparative and Functional Approach "second edition"", Oxford Press p. 12-14

[31] Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry B. Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda and Edward B. Rock, (2009)"The Anatomy of Corporate Law: Comparative and Functional Approach "second edition"", Oxford Press p. 14

of contracts'."[32] As discussed in the introduction of the thesis, according to Ronald Coase the firm is an easy way to internalize transaction cost, therefore, to be more efficient and productive. Moreover, modern economies very much rely on corporation to contribute to the gross domestic product (GDP)[33] of a country by its ability to accumulate vast amount of capital and resources. The partnership form turns out to be more inflexible and primary used for small-scale businesses. "The use of companies to pool large sums of capital and therefore to raise capital for large new commercial ventures has been increasingly common since the Dutch and English East India companies were organized at the beginning of the seventeenth century. By the twentieth century corporations had become the dominant organizational vehicle for commercial ventures almost without exception throughout the world."[34] Moreover, the goal of a corporation is to maximize the shareholder value, more specifically, to maximize the market price of the corporation's shares. "The pursuit of shareholder value is generally an effective means of advancing social welfare."[35] Therefore, "the appropriate goal of corporate law is to advance the aggregate welfare of a firm's shareholders, employees, suppliers, and customers with undue sacrifice – and, if possible, with benefit – to third parties such as local communities and beneficiaries of the natural environment. This is what economist would

---

[32] Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry B. Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda and Edward B. Rock, (2009)"The Anatomy of Corporate Law: Comparative and Functional Approach "second edition"", Oxford Press p. 6

[33] "The total market value of all final goods and services produced in a country in a given year, equal to total consumer, investment and government spending, plus the value of exports, minus the value of imports." See http://www.investorwords.com/2153/GDP.html

[34] Dam, Kenneth W. (2006). "The Law-Growth Nexus: The Rules of Law and Economic Development". Brookings Institution Press. p. 163

[35] Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry B. Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda and Edward B. Rock, (2009)"The Anatomy of Corporate Law: Comparative and Functional Approach "second edition"", Oxford Press p. 18

CEU eTD Collection

characterize as the pursuit of overall social efficiency."[36] These goals would be possible with balanced relationship between all stakeholders in a corporation.

On the other hand, instead of being concerned about the overall social welfare courts and legislatures are concerned in the particular financial interests of some influential corporate managers, shareholders or even workers. Despite the fact that corporations are the source of economic efficiency and growth they can also distress not only local but global economy. Because some multinational corporations accumulate much more money than some countries (e.g. General Motors - 176,558.00 ($ mil. sales) v. Denmark - 174,363.00 ($ mil. GDP) or Poland - 154,146.00 ($ mil. GDP))[37] they can be the source of economic crisis, therefore the corporate governance of such multinational corporations should be well regulated in order to corporations to provide sustainable economic growth and efficiency.

In this relation, a recent study, under the field of neuroeconomics[38], tries to explain why people don't always act in their best interest when it comes to economic decisions, as economic models suggest they should. "People with certain kinds of brain damage may make better investment decisions. Players with undamaged brain wiring, however, were more cautious and reactive during the game, and wound up with less

---

[36] Ibid.

[37] "Of the world's 100 largest economic entities, 51 are now corporations and 49 are countries." Source Sales: Fortune, July 31, 2000. GDP: World Bank, World Development Report 2000. Web: http://www.corporations.org/system/top100.html consulted May 2011.

[38] "Neuroeconomics is an interdisciplinary field that seeks to explain human decision making, the ability to process multiple alternatives and to choose an optimal course of action. It studies how economic behavior can shape our understanding of the brain, and how neuroscientific discoveries can constrain and guide models of economics" See http://en.wikipedia.org/wiki/Neuroeconomics consulted May 2011.

CEU eTD Collection

money at the end."[39] After the economic crises in 2008, the US Financial Crisis Inquiry Commission stated the following:

"We conclude dramatic failures of corporate governance and risk management at many systemically important financial institutions were a key cause of this crisis. Too many of these institutions acted recklessly, taking on too much risk, with too little capital, and with too much dependence on short-term funding. Our examination revealed stunning instances of governance breakdowns and irresponsibility. Executive and employee compensation systems at these institutions disproportionally rewarded short-term risk taking."[40] It becomes clear that people with brain damages make better short-term investment decisions but at long-term they are exposed to collapse creating pathological cases.

Although, the above-mentioned is mostly concerned with the financial institutions such as investment banks and others, the same conclusion could be applied for multinational corporations. Pathological cases such as Enron, WorldCom, Tyco International in the United States, Parmalat in Italy, Vivendi Universal and France Telecom in France, the New Market in Germany, and HIH Insurance and One.Tel in Australia[41] shows that stable corporate governance is in constant peril, moreover, it could also affect the sustainability of the economic growth and efficiency provided by

CEU eTD Collection

---

[39] Spencer, Jane. (2005) "Lessons From The Brain-Damaged Investor". *Wall Street Journal*. New York.

[40] United States. (2011). The Financial Crisis Inquiry Commission. "The Financial Crisis Inquiry Report. Final Report of the national Commission on the Causes of the financial and Economic Crisis in the United States." Washington D.C.

[41] Hopt, Klaus (2011). "Comparative Corporate Governance: The State of the Art and International Regulations". *American Journal of Comparative Law, Vol. 59, p. 16*

companies.

1.2 Enron Case

During the years, Enron have become a $100 billion-a-year giant, the stock market of Enron's shares at almost $48 billion (in 2001) and was going even bigger, moreover, George W. Bush's administration received $2 million in political contributions and three quarters of the U.S. congressmen had taken also Enron campaign contributions.[42] Enron was providing one-quarter of the gas and electricity traded and it was big enough to shock energy prices in United States. In other word, Enron was a true multinational company contributing millions of dollars to the United States economy. It was one of the biggest "engines" to economic growth and efficiency in the U.S. During the period 2000-2002 corporate businesses at whole (including closely-held private corporations) contributed $6.2 trillion, or about 60% of the $10.4 trillion GDP.[43]

After the Enron scandal United States faced its biggest-ever bankruptcy case[44] and lost its seventh-biggest company leaving workers, investors and regulators more than puzzled.[45] "The drip-feed effect has been devastating for investors' confidence, helping to

---

[42] Pearlstein, Steven and Peter Behr. 2001 "At Enron, the Fall Came Quickly: Complexity, Partnership Kept Problems from Public View." *Washington Post*.

[43] See Bureau of Economic Analysis, U.S. Department of Commerce. National Income and Product Accounts Tables No. 1.1.5 and 1.14. Web: http://www.bea.gov/national/nipaweb/SelectTable.asp?Selected=Y

[44] Enron case was the biggest bankruptcy case until 2001 with $63 billion. In 2002 WorldCom was even bigger with $103 billion, followed later on by General Motors with $91 billion, in 2009. In 2008 the collapse of Lehman Brothers Holdings put the record very high causing the biggest bankruptcy case in the US history to date with $691 billion. See "Largest Bankruptcy Cases" Web: http://www.bankruptcylawfirms.com/Largest-Bankruptcies.cfm consulted on May 2011.

[45] It is also important to mention that despite the fact that bankruptcies are generally considered as source of undermining economic growth (ex. Enron's creditors was expected to received around 20 cents for every

CEU eTD Collection

prolong the longest and deepest bear market since the Second World War. And it has cast a shadow over the economy: enronitis has been a big contributor to the past year's economic ills in America and the rest of the world."[46] Enron's collapse dragged down also world's oldest and most respected accounting firm Arthur Andersen. Moreover, 21 000 employees have lost much of their retirement savings because their pensions accounts were stuffed with worthless Enron stock, and many lost their jobs; big national companies such as Alliance Capital, Janus, Putman and Fidelity lost billions of dollars in value.[47] Enron faced $690 billion in debt. "Over 60% of Enron's 744 million shares were owned by institutional investors, mostly pension funds and mutual funds in which many working families have invested their savings."[48] It turns out that Enron was "channeling billions of dollars of capital into a socially worthless, speculative operation. The 'hidden hand' of the market turns out to be a nexus of fraud and theft."[49] As a result, "bosses will always be greedy, auditors will always be fallible, boards will always miss things."[50] For

---

dollar after bankruptcy procedures), "Bankruptcies are a net positive for the economy because more productive competitors are rewarded by opportunities to buy up remaining assets at bargain prices to strengthen their operations. In an economy that allows this kind of growth and change, any jobs lost by bankruptcy are soon replaced by new ones as the most efficiently managed businesses gain access to more assets and expand. More bankruptcies would clean out malinvested resources and enable economic growth again." They are important element to market economy. See Paul, Ron. (2009) "Bankruptcy is Economic Stimulus." Capitalist digest. Web: http://www.capitalistdigest.com/bankruptcy-is-economic-stimulus-1537/ as well as Paul, Ron. (2008) "Pillars of Prosperity: free markets, honest money, private property" Ludwig von Mises Institute.

46 "Enron a year on. Investor self-protection: The biggest lesson from Enron is that investors must look after themselves." (2002) *The Economist.*

47 Pearlstein, Steven and Peter Behr. 2001 "At Enron, the Fall Came Quickly: Complexity, Partnership Kept Problems from Public View." *Washington Post.*

48 Walsh, Lynn. (2002) "The Enron Scandal". *Socialism Today.*

49 Ibid.

50 "Enron a year on. Investor self-protection: The biggest lesson from Enron is that investors must look after themselves." (2002) *The Economist.*

CEU eTD Collection

this reasons, there is a need of a stable corporate governance regulations to provide market economies with sustainable and efficient economic growth.

1.3 Corporate Governance

Once the definition and characteristics of corporation, and its importance for market economies are emphasizes the next natural step leads to the field of corporate governance and its relationship to the economic growth and efficiency. "Economic liberalization has increased the economic power of many firms, which may have had a negative impact both on the welfare of society and economic efficiency. Consequently, this has enhanced the need for an appropriate legal and regulatory framework, which would help to protect capital providers and safeguard consumers"[51]. Moreover, according to the same source, the corporate governance issue must become one of the most important priorities for policy makers in developing countries. The examples of major corporate governance scandals (such as those mentioned in the previous section) provoke low investment and affect seriously the economic growth of a country as well as the lives of thousands of peoples such as investors, creditors, employee suppliers, etc.

One of the earliest definitions of the term "corporate governance" can be found in the UK Cadbury Report which simply states the following: "Corporate governance 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

CEU eTD Collection

---

[51] Arun, Thankom Gopinath and John Turner, (2009) "Preface". *Corporate Governance and Development: Reforms, Financial Systems and Legal Frameworks*, Ed. Arun, Thankom Gopinath and John Turner. Edward Elgar.

governance structure is in place."[52] According to Klaus Hopt there exists internal and external corporate governance. The internal "corporate governance is focused on the internal balance of powers with a corporation. The main questions of this internal balance – in contrast to external corporate governance – concern the relationships between the board, be it a unitary or two-tier; shareholders, both controlling and minority; labor, especially if codetermination is a factor; and of course the audit system."[53] The external corporate governance is concern with managerial influence on markets, various products, transparency of corporate affairs, disclosure to shareholders and takeovers.[54] Moreover, in their article "Gains and Losses of Adopting New Standards of Corporate Governance", Omar Chisari and Gistavo Ferro, described the term "corporate governance" as the "available system of institutions or mechanisms that induce incentives in listed business firms, so as to distribute benefits between stakeholders, restricting discretion on such distribution (in a context of asymmetric information and incomplete contracts). Those institutions and mechanisms are structured to solve conflicts of interests, and if this process is successful, the risk faced by investors and creditors of the firm will be lower. 'Good' corporate governance is defined as the subset of those practices that are welfare

CEU eTD Collection

[52] Cadbury, Adrian. (1992) "Report of the Committee on The Financial Aspects of Corporate Governance", Gee and Co. Ltd., London, UK. p. 14

[53] Hopt, Klaus (2011). "Comparative Corporate Governance: The State of the Art and International Regulations". *American Journal of Comparative Law, Vol. 59, p. 8*

[54] Ibid.

enhancing for the economy."[55] Such are some of the definitions of the term corporate governance.

On the other hand, one of the most cited definition of the term 'corporate governance' is the definition given by Mathiesen 2002 stating the following: "Corporate governance is a field in economics that investigates how to secure/motivate efficient management of corporations by the use of incentive mechanisms, such as contracts, organizational designs and legislation. This is often limited to the question of improving financial performance, for example, how the corporate owners can secure/motivate that the corporate managers will deliver a competitive rate of return."[56] Another very influential definition is the definition of Sir Adrian Cadbury in the Global Corporate Governance Forum in 2000 stating "Corporate Governance is concerned with holding the balance between economic and social goals and between individual and communal goals. The corporate governance framework is there to encourage the efficient use of resources and equally to require accountability for the stewardship of those resources. The aim is to align as nearly as possible the interests of individuals, corporations and society."[57] Moreover, according to Simon Deakin "Corporate governance is about how companies are directed and controlled. Good governance is an essential ingredient in corporate

CEU eTD Collection

---

[55] Chisari, Omar O. and Gustavo Ferro. (2009) "Gains and losses of adopting new standards of corporate governance: a CGE analysis of Argentina." *Corporate Governance and Development: Reforms, Financial Systems and Legal Frameworks*, Ed. Arun, Thankom Gopinath and John Turner. Edward Elgar.

[56] Mathiesen (2002) Definition of Corporate governance" web: http://www.encycogov.com/WhatIsGorpGov.asp consulted in May 2011.

[57] Cadbury, Adrian Sir. (2002) "Foreword". *Corporate Governance and Development*. Athr. Stijn Claessens. Global Corporate Governance Forum.

success and sustainable economic growth."[58] These are the some of the most popular definitions of the term corporate governance.

The 'OECD Principles of Corporate Governance' is the real framework of corporate governance standards and definition stating the "corporate governance is one key element in improving economic efficiency and growth as well as enhancing investor confidence. The presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy. As a result, the cost of capital is lower and firms are encouraged to use resources more efficiently, thereby underpinning growth."[59] This is the definition which this thesis will use as a framework.

Despite the fact that there are so many definitions for the term 'corporate governance' some core components and principles could be extracted. As core components, the definition of corporate governance entangled the process of controlling management, the consideration of interest of different stakeholders, the responsibility of corporation and the achievement of maximum efficiency and profitability.[60] As long as principles of corporate governance are concerned the Australian Stock Exchange Corporate Governance Council identified 10 important principles of good corporate governance as followed: "1. Lay solid foundations for management and oversight

CEU eTD Collection

---

[58] Definition of Corporate Governance by Simon Deakin web: http://www.ifc.org/ifcext/cacgp.nsf/Content/HomeCG consulted in May 2011.

[59] Organisation for Economic Co-operation and Development OECD (2004), "OECD Principles of Corporate Governance", Paris: OECD

[60] See Du Plessis, Jean Jacques, James McConvill and Mirko Bagaric. (2005). "Principles of Contemporary Corporate Governance". Cambridge University Press.

(Recognise and publish the respective roles and responsibilities of board and management) 2. Structure the board to add value (Have a board of an effective composition, size and commitment to adequately discharge its responsibilities and duties.) 3. Promote ethical and responsible decision-making 4. Safeguard integrity in financial reporting (Have a structure to independently verify and safeguard the integrity of the company's financial reporting.) 5. Make timely and balanced disclosure (Promote timely and balanced disclosure of all material matters concerning the company.) 6. Respect the rights of shareholders 7. Recognise and manage risk 8. Encourage enhanced performance (Fairly review and actively encourage enhanced board and management effectiveness.) 9. Remunerate fairly and responsibly, ensure that the level and composition of remuneration is sufficient and reasonable and that its relationship to corporate and individual performance is defined.) and 10. Recognize the legitimate interests of stakeholders."[61] Those are the principle which are of importance for the any corporate governance system.

In short, the term 'corporate governance' is relatively new and still debatable among scholars; moreover, there is not a clear definition of what "good corporate governance" means. The term 'corporate governance' is elaborate mixture of psychology, strategy, economics, politics, law and ethics.[62] On the other hand, becomes clear that a big part of the definitions mentioned above agreed that corporate governance is of a big

CEU eTD Collection

---

[61] The Australian Stock Exchange Corporate Governance Council. (2003). "Principles of Good Corporate Governance and Best Practices Recommendations." Sydney.

[62] Tajti, Tibor. (2005) "Corporate Governance: An Oversold Elitist Idea of No Interest to or for the Central European Transitory Economies? *Corporate Governance Law Review*. Vol. 1 No.1

importance to the sustainable economic growth and efficiency. There are couples of important principles (mentioned above) which constitutes the very core of the term. The purpose of corporate governance is more or less to control the external and internal relationships between different stakeholders in a corporation and to reduce the amount of problems (discussed in the next section) between them in order to contribute to a greater purpose - sustainable economic growth and efficiency at world level.

1.4 Problematic issues

One cannot overemphasize the importance of today's corporation, and respectively its corporate governance in relation to economic growth and efficiency in market economies. Moreover, in recent days, it is even more important not only for developing countries (fear of low economic growth) but also for developed counties (lack of economic growth). In United States and United Kingdom, after the economic crises in 2008, there are strong tendencies for regulations, and specifically regulations including the level of involvement of shareholders in the corporation. In other words, the shareholders are to be blamed because they do not 'pay attention' in what the management is doing in their own corporation. "The Stewardship Code sets out seven principles[63] intended to encourage better scrutiny of companies by the investors who own them. Shareholders activism has to play a part in addressing moral hazards […]

CEU eTD Collection

[63] "Stewardship Code Jul. 2010, Investors must: Publicly disclose their policy on stewardship responsibilities, have a robust policy on managing conflicts of interest in relation to stewardship, monitor their investee companies, establish clear guidelines on when and how they will escalate their activities to protect shareholder value, be willing to act collectively with other investors, have a clear policy on voting, report periodically on their stewardship and voting activities." See Smith, Alison. (2011). "Crisis shows a need for wider governance net." *Financial Times,* New York.

shareholders are beneficiaries of the implicit subsidy […] and arguably with those benefits should come some duties. We need to rebuild the critical mass of shareholders with a long-term perspective"[64] In short, "there is one major lesson to draw from the financial crisis, it is that corporate governance matters. Directors, regulators and shareholders, but also policymakers and the general public, need to pay more attention to corporate governance."[65] On the other hand, "Corporate governance is important for the success of long-term development in developing, transition and emerging-market economies. The quality of a country's governance institutions – of which those of corporate governance now constitute an integral part – matters greatly for development as a whole. In all countries, and for all segments of a country's population, including the poor, the ability to move from heavily relationship-based to predominantly rules-based institutions of corporate, as well as public, governance is essential."[66]

But the way to the top is not always a straightforward line. Usually, it is a curve; never smooth, full with huge variety of obstacles, many of them very difficult to overcome. The ultimate goals of corporate governance – to achieve sustainable economic growth and efficiency, facilitate and stimulate performance of the corporation, limit insiders' abuse of power, monitor managers' behavior and accountability, protect investors and society interests – are constantly shadowed by the never-ending problem of stewardship mentioned by Adam Smith around 235 years ago. As prof. Tibor Tajti stated

CEU eTD Collection

[64] Smith, Alison. (2011). "Crisis shows a need for wider governance net." *Financial Times,* New York.

[65] "Corporate governance: Lessons from the financial crisis" (2009) *OECD Observer* See also Kirkpatrick, Grant. (2009), "The Corporate Governance Lessons from the Financial Crisis", OECD. Paris.

[66] Oman, Charles, Steven Fries and Willem Buiter. (2003) "Corporate Governance in Developing, Transition and Emerging–Market Economies" Policy Brief No. 23. OECD Development Centre, Paris.

in one of his articles: “Corporate governance – as discipline relying uniquely on both written law and unwritten practices – is absolutely a territory where the number of gaps to be filled or inconsistencies to be remedied is far from negligible.”[67] In this regard, size matters; trust matters; greed matters. It goes without saying that the size of the corporation[68] is an important factor according to number and variety of problems which could occur in a corporation. Nowadays, corporations have huge numbers of employees and very dispersed shareholders but at the same time small management boards. This situation is a premise for the existence of many corporate governance issues because the number of contractual and non-contractual relationships augmented simultaneously. The binding elements in this situation are in most cases trust and greed which are very often at the core of each problem because of the nature of human beings. Most of the time, trust is eroded[69] and greed is predominant.[70] In order to provide sustainable economic growth driven by the good corporate governance practices in a corporation, the level of trust

[67] Tajti, Tibor. (2005) “Corporate Governance: An Oversold Elitist Idea of No Interest to or for the Central European Transitory Economies? *Corporate Governance Law Review*. Vol. 1 No.1

[68] Note: There are minimum legal capital requirements in US common law system (Model Business Corporation Act) and European Civil Law system (German and Bulgarian Commercial Code) but there are not minimum requirements for the number of employees in a corporation.

[69] According to Francis Fukuyama the erosion of trust in US during recent years may peril its economic position and performance. “The decline of trust and sociability in the United States is also evident […]” See Francis Fukuyama. (1995) “Trust: the social virtues and the creation of prosperity”. A Free Press Paperbacks Book. p.11

[70] According to David Sarna greed have been shadowing human history since the beginning of humanity, it become, more or less, a part of our nature but people are concern about it only when problematic issues arise. “Greedy Financial crime that has become widely prevalent, […] greed have long and storied history” See Sarna, David E. Y. (2010). “History of Greed: Financial fraud form tulip mania to Bernie Madoff.” John Wiley & Sons, Inc., Hoboken, New Jersey.

CEU eTD Collection

should be high and the level of greed low[71]. "The most important lessons we can learn from an examination of economic life is that a nation's well-being, as well as its ability to compete, is conditioned by a single, pervasive characteristic: the level of trust inherent in the society."[72] Moreover, "[greed] is commonly blamed for the financial crash in 2008 […] At least ($11 trillion) was lost from the U.S. economy in 2008 […] fraud and greed had a lot to do with it."[73] Those are the important factors which influence the most a corporate governance in a corporation.

From the roots of the problems, it is relatively easy to extract the most discussed corporate governance issues which are related to the performance of a company and therefore to the economic growth. Irrespectively, the system of corporate governance, one-tier or two-tier, the following issues are most of the time present: the agency problem, failure of reasonable management problem, audit and misleading accounts problem, avoidance of liability problem, conflict of interest problem, disclosure problem, insolvency problem, co-determination problem, specific investment and 'lock-in' problem, distribution of rights problem, expropriation problem, social responsibility problem, control and balance of power problem and compensation problem.[74] The agency (a.k.a principal-agent or stewardship) problem is the most central problem of them all. In

---

71 Note: As some authors argue, "without greed our current economic and social structures would implode" Therefore, level of trust and greed is important not the lack or the abundance of one of them. See Schumaker, John F. (2004) "In Greed We Trust". *New internationalist magazine*. issue 369. Oxford.

72 Francis Fukuyama. (1995) "Trust: the social virtues and the creation of prosperity". A Free Press Paperbacks Book. p.7

73 Sarna, David E. Y. (2010). "History of Greed: Financial fraud form tulip mania to Bernie Mandoff." John Wiley & Sons, Inc., Hoboken, New Jersey. p.1

74 United Nations, (2003) Conference on Trade and Development. "Selected Issues on Corporate Governance: Regional and Country Experiences." New York and Geneva.

CEU eTD Collection

most general sense, it is concerned with the transfer of welfare from the ‘principal’ to the discretion of the ‘agent’. The problem itself becomes visible when there is a lack of incentive (motivation) for the ‘agent’ to act in the best of interest of its ‘principle’. In this case, the ‘agent’ simply acts in his own interest. The problem often occurs in any contractual relationship[75] because there is a disproportion in the information between the two parties; usually the ‘agent’ is more knowledgeable than the ‘principle’. There are three dimensions of the agency problem: conflict between owners and management, conflict between majority and minority shareholders, conflict between owners (the corporation itself represented by BoD) and third parties such as creditors, employees and customers.[76] In this regard, “E.U. has given more rights to shareholders generally than the U.S., although not to minority shareholders. The U.S. gives more rights to directors.”[77] Moreover, “the most striking fact about blockholdings in Europe is that they are so much higher than in the U.S.A […] Within Europe, the level of concentration of voting is by no means uniform; […] In the UK, the largest 250 listed companies report a very modest median value (a size of a share blocks) of 9.9%; while at the other extreme, Germany, Austria, and Italy all exceed 50%”[78] All the others issues which occur in corporate governance are more or less related to the agency problem. The failure of reasonable

---

[75] Note: The contractual relationship is central in corporate governance field as most of the relationships in a corporation are contractual. One cannot overemphasize the importance of the Article of Association in relation to good corporate governance principles.

[76] Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry B. Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda and Edward B. Rock, (2009)“The Anatomy of Corporate Law: Comparative and Functional Approach “second edition”, Oxford Press p. 35-36

[77] Scott, Hal S. and Philip A. Wellons. (2009) “International Finance: Transactions, Policy and Regulation.” Foundation Press. New York. p. 243

[78] Becht, M., and A. Roell. (1999). “Blockholdings in Europe: An International Comparison.” *European Economic Review* p. 43

CEU eTD Collection

management problem is concerned with the opportunistic behavior of the management involving too much risky operations such as exorbitant financial transactions. In order to create high shareholders value by investing money, before the management are many incentives to invest in derivates (such as options, swaps, futures) which are in most cases riskier than common types of securities (such as bonds and shares).[79] On the other hand, issuance of big number of different type of securities could also devaluate the price of the corporation. Not to mention the credit money offered by banks and other financial institutions. Therefore, many account and audit problems occur (e.g. Enron case). To 'cook' accounting books is not a yesterday's practice and not only in U.S. (e.g. Parmalat case). As a result many liability questions arise. Is the management liable because of breach of fiduciary duties and/or unsophisticated disclosure? In this case conflict of interest problems also followed. To argue that the management decisions were not made in the 'interest' of shareholders is challenging task. Consequently, the shareholders evoke the capital lock-in problem as well as distribution of rights, compensation and expropriation problems. These are the 'burning points' in corporate governance.

CEU eTD Collection

[79] Note: it is very debated question whether derivatives are riskier than non-synthetic (common type) of securities. It is wide spread premise among scholars that they are riskier because of the involvement of systematic risk and speculation. On the other hand, "Derivatives can, however, isolate and concentrate existing risks, thereby facilitating their efficient transfer. Indeed, it is precisely this ability to isolate quite specific risks at low transactions costs that makes derivatives such useful risk-management tools." See Hentschel, Ludger and Clifford W. Smith, Jr. (1995) "Risks in Derivatives Markets" University of Pennsylvania.

Chapter II – One-Tier v. Two-Tier system

Until the moment, it becomes clear that corporation, leaded by its corporate governance system, is a vital element for economic growth. As mentioned above the path to the ultimate goals (profit and expansion of the corporation which leads to economic growth) is a never smooth line. Many problems are lurking, ready to undermine the presence of growth and efficiency in a market economy. Moreover, as described by Mitchell "the overwhelming power and influence of American capital are changing everything, creating nearly irresistible pressures on corporate systems throughout the world to replicate the U.S. model for the benefit of American investors."[80] He elaborates the thesis that U.S. corporate governance system are not superior to European ones, and that the U.S. corporations are more irresponsible than others. The stock price maximization pursuit by short-term decision and limited liability characteristic of a corporation turn out to be creating the corporation in a "perfect externalizing machine."[81] On the other hand, Mitchell's book provoked many debates and skepticism. Is it really the American corporate governance system which is problematic? The question is more universal and complex than it appears. "Is there something endemic in the governance and operation of large modern corporations which causes them to trample other non-shareholder constituencies, such as labor, consumers, the environment, local economies,

CEU eTD Collection

---

[80] Mitchell, Lawrance E., (2001). "The Corporate Irresponsibility: America's Newest Export." Yale University Press.

[81] Ibid.

and so on?"[…] "what, as a legal and policy matter, can governments, 'best practices' governance working groups, and other relevant actors do about it?"[82] Therefore, the central question of this thesis is which corporate governance system is more adapted to provide not only growth but also sustainable economic growth and efficiency?

1. Structural Difference

Highlighting the structural difference between one-tier and two tier systems will allow to amplify the difference which are related to sustainable economic growth and efficiency discussed in the next section. In a more broad sense, "'outsider' systems are those in which the owners of firms tend to have a transitory interest in the firm and do not have close relationships with those in senior managerial positions […] Rather, these systems are characterised by relationships between management and shareholders being fluid and arms-length […] also characterised by the existence of an active 'market for corporate control'- takeovers, particularly hostile ones, are seen as both a remedy for managerial failure and a disciplinary mechanism on managers, ensuring that they act in the best interests of shareholders […] a further feature of this system in the primacy of shareholder rights over those of other organisational groups (particularly employees). This system is said to be characteristic of 'Anglo-Saxon' countries"[83] On the other hand, "in 'insider' systems the owners of firms tend to have an enduring interest in the company and often hold positions on the board of directors or other senior managerial positions.

CEU eTD Collection

---

[82] Branson, Douglas M. (2003) "Lawrence E. Mitchell, Corporate Irresponsibility – America's Newest Export (Yale University Press, New Haven, Connecticut, 2001)," *Bond Law Review*: Vol. 15: Iss. 1, Article 16.

[83] Edwards, Tony. (2002). "Corporate Governance Systems and the nature of indistrial restructuring." European Industrial Relations observatory. Web: http://www.eurofound.europa.eu/eiro/2002/09/study/tn0209101s.htm consulted in May 2011.

These systems are characterised by stable and close relationships between management and shareholders. This stability of ownership, often coupled with legal or institutional barriers to takeovers, means that there is little by way of a market for corporate control. […] insider systems are characterised by the existence of formal rights for employees to influence key managerial decisions, often through supervisory boards or works council-type bodies. The insider system is said to be found in varying forms in continental Europe."[84] Moreover, the outsider system has more dispersed ownership in contrast to the concentrated ownership in the insider system. As a result, there is little incentive to outside investors to participate in the control of the corporation in an outsider system. In the insider system, on the contrary, there is much incentive for banks and employees, mostly, to participate in the control of the corporation. As long as the finance structure of both systems is concerned, the outsider one has low debt/equity ratio as a result of highly developed and diversified financial market. The insider system could be characterized with the total opposite situation. In this respect, the later is related with more organic growth and the former with growth produced mostly by mergers and acquisition procedures. The "management mission is the performance of assets to release shareholder value"[85] in the outsider system and in the insider "stewardship of business institution to achieve long-term stakeholder value."[86] Respectively, the orientation of the first one is short term and the second one is long-term. Therefore, the business strategy of the outsider system is characterized by "low commitment of outsider investors to long-term

CEU eTD Collection

---

[84] Ibid.

[85] Clarke, Thomas. (2007). "International Corporate Governance: A comparative approach." Routledge. p.10

[86] Ibid.

strategies"[87] on the contrary to the insider system where "interested parties contribute to strategy."[88] More importantly, the stakeholder's interests are not represented in the management of the corporation in the outsider system which is not true in the insider system. As one important weakness of the outsider system is the fact that managers can become more self-interest orientated and that mergers can create monopoly in a market economy. On the other hand, in an insider system one of the most important weakness is the fact that social obligations and variety of interests presented in the corporation can slow necessary restructuring.[89] Having more broad sense about the corporate governance systems it would be clearer what are the structural differences between the one-tier and two- tier system. The one-tier system should be qualified as an outsider system and the two-tier system as insider system.[90]

The one-tier system is more commonly used in Anglo-Saxon common law countries such as United States of America, United Kingdom and Canada. In this corporate governance system, "executive directors and nonexecutive directors operate together in one organizational layer (the so-called one-tier board)."[91] It depend of the Articles of Association of the corporate what kind of majority of directors there will be in the boar – executive or non-executive directors. The same will be true for the position of

87 Ibid.

88 Ibid.

89 Ibid.

90 See Klaus Gugler, Dennis C Müller and B Burcin Yurtoglu, (2004) "Corporate Governance and Globalization" Oxford Rev. Econ. Pol. p. 130–134.

91 Maassen, Gregory Francesco. (2002) "An International Comparison of Corporate Governance Models. Spencer Stuart. p.15

CEU eTD Collection

the Chief Executive Officer (CEO) of the corporation and the chairman of the Board of Directors (BoD), the same person could occupy both positions or two different persons for each of those positions. One-tier system also uses different board committees such as audit committee, remuneration committee and nomination committee, to assure better governance of the corporation.

The two-tier system is more commonly used in Continental Civil law countries such as Germany, Finland, Netherlands. "In this model, an additional organizational layer has been designed to separate the executive function of the board from its monitoring function. The supervisory board (the upper layer) is entirely composed of non-executive supervisory directors who may represent labor, the government and/or institutional investors. The management board (the lower layer) is usually composed of executive managing directors."[92] Generally, in the two-tier system, the law does not accept the possibility that the same person occupies the function of CEO and Charmain of BoD. The CEO position is not represented in the Supervisory Board (SB) and "its board leadership structure is formally independent from the executive function of the board."[93] Moreover, executive directors are not allowed to have a position in the SB of the corporation.

Another structural difference between one-tier and two-tier system concerns the board organization. As one of the important roles of BoD is to balance the diverging interests of different stakeholders (mangers, shareholders, employees, suppliers, creditors) the effectiveness of the BoD is highly dependent of the so-called 'formal

CEU eTD Collection

---

[92] Maassen, Gregory Francesco. (2002) "An International Comparison of Corporate Governance Models. Spencer Stuart. p.15.
[93] Maassen, Gregory Francesco. (2002) "An International Comparison of Corporate Governance Models. Spencer Stuart. p.15.

independence of boards'. According to Fama and Jensen, formal independence of boards refers to 'decision management' and the 'decision control'[94]. "Decision management refers to the tasks of executive directors to initiate and implement strategic decisions. Decision control refers to the tasks of non-executive directors to ratify and monitor executive decisions."[95] It is important to mention that and independent board structure clearly separates the functions of executive and non-executive directors in a corporation. According to Davis "an independent structure is one in which an autonomous board of directors is established to monitor organizational strategic decisions and performance. [...] Thus, in its purest form, management plays an extremely minor role in the independent structure."[96] Therefore, in an independent board model of a corporation, the role of management in the ratification and monitoring of corporate decisions should be minimized.

In the Anglo-Saxon common law, directors operating under one-tier system are strongly criticized by different stakeholders of lack of formal independence. Exorbitant remunerations of directors and business failures indicated that clear distinction of 'decision management' and the 'decision control' is hardly present in one-tier system. Moreover, one-tier system is also criticized because its BoD is composed by a majority of executive directors putting a lot of pressure on minority of non-executive directors. As a consequence, "directors who operate with a board that is composed of a majority of

---

[94] Fama, E.F. and Jensen, M.C. (1983). "Separation of Ownership and Control." *Journal of Law and Economics,* p. 301-325.

[95] Maassen, Gregory Francesco. (2002) "An International Comparison of Corporate Governance Models. Spencer Stuart. p.15-16.

[96] Davis, J.H. (1991). "Board Leadership Roles and Shareholder Returns: An Examination of Agency Theory." Doctoral dissertation. The University of Iowa. p. 73.

CEU eTD Collection

executive directors who are also chaired by the CEO are under pressure to modify the composition and the structure of their boards in Anglo-Saxon countries."[97]

On the other hand, "two-tier boards represent a board model that clearly separates executive directors' management tasks from supervisory directors' monitoring tasks."[98] Two-tier board system represents a board structure in which the 'decision management' and 'decision control' are formally separated. This system allows transparency of responsibility between executive managing directors and non-executive supervisory directors. The supervisory board is created entirely by non-executive supervisory directors and the management board entirely by executive managing directors. The two-tier system also provides clear separation of the CEO function from the chairman function.

According to Andrews "a responsible and effective board should require of its management a unique and durable corporate strategy, review it periodically for its validity, use it as the reference point for all other board decisions, and share with management the risks associated with its adoption."[99] Moreover, non-executive directors should have the ability to judge critically the performance and the decisions of executive directors as part of their decision control role. In order to achieve that goal the board structure should provide independence of judgment. "To reduce the danger of managerial

CEU eTD Collection

---

[97] Maassen, Gregory Francesco. (2002) "An International Comparison of Corporate Governance Models. Spencer Stuart. p.17.

[98] Maassen, Gregory Francesco. (2002) "An International Comparison of Corporate Governance Models. Spencer Stuart. p.17.

[99] Andrews, K. R. (1980) "Director's Responsibility for Corporate Strategy", *Harvard Business Review*, p. 30.

opportunism and to mitigate agency problems, corporate boards are understood to be most effective when they operate independently of management when they perform their control roles."[100] It becomes clear that the structural difference between one-tier and two-tier system formally provide more balanced relationship between executive and non-executive directors because in the two-tier system, the Supervisory Board is in charge of decision control and the Management Board is in charge of decision management; contrary to the one-tier system where the Board of Directors is in charge of decision management and decision control. Moreover, in the United States corporation laws hardly make a difference between the role and position of executive and non-executive directors, they both share same responsibilities and liabilities. "Corporate boards composed of a majority of executive directors are frequently associated with structures in which potential conflicts of interest can arise between management and shareholders."[101] According to Kesner and Johnson there are three main reasons why one-tier boards should be composed by majority of non-executive directors: "the breadth of their experience and knowledge; the contacts they have which may enhance management's ability to secure external resources; the independence they have from the CEO. Non-executive directors are considered better able to provide independent assessment of actions taken by the firm and insure that there are proper checks and balances on management."[102] Moreover, "the agency theory suggests that due to the assumed

CEU eTD Collection

[100] Maassen, Gregory Francesco. (2002) "An International Comparison of Corporate Governance Models. Spencer Stuart. p. 46.

[101] Maassen, Gregory Francesco. (2002) "An International Comparison of Corporate Governance Models. Spencer Stuart. p. 50.

[102] Kesner, I.F. and Johnson, R.B. (1990). "An Investigation of the Relationship Between Board Composition and Stockholder Suits", *Strategic Management Journal*, p. 328.

opportunistic behavior of the CEO and other executives, a concentration of power and strong leadership is expected to result to sub-optimal top management behavior. As such, there is a strong consensus in the agency literature that one-tier boards should be directed by independent non-executive chairmen."[103] It is important to notice that one-tier system usually involve oversight board committees in order to protect "shareholders' interests by providing objective, independent review of corporate decisions. The primary function of these committees is to separate decision management from decision control." Examples of such committees are the audit, compensation and nominating committees, which are also of a significant importance for the well functioning of the on-tier system. Most of the time, these oversight committees are composed by executive directors which is a reason agency issues to arise. "Oversight board committees can be effective mechanisms to separate decision management from decision control when these committees are composed primarily of non-executive directors who are independent of senior management."[104] On the other hand, the "independence of two-tier system has hardly been disputed in the international corporate governance debate." [105] The responsibilities and liabilities are different between the Supervisory Board and the Management Board.

In summary, the one-tier system have board structure which is more unstable and conflict-providing than the two-tier system because of the following reasons: in a one–

CEU eTD Collection

---

[103] Maassen, Gregory Francesco. (2002) "An International Comparison of Corporate Governance Models. Spencer Stuart. p. 56.

[104] Maassen, Gregory Francesco. (2002) "An International Comparison of Corporate Governance Models. Spencer Stuart. p. 57.

[105] Maassen, Gregory Francesco. (2002) "An International Comparison of Corporate Governance Models. Spencer Stuart. p. 56.

tier system the supervisory function and management function are exercised by one board when in the two-tier system they are separated (supervisory function by Supervisory Board (SB) and management function by Management Board(MB)); accountability, supervision, direction and executive action exercised only by one body in one-tier system on the contrary to two-tier system where MB is exercising direction and executive action and SB is exercising accountability and supervision functions; decision management and decision control are also separated in two-tier system on the contrary to the one-tier system as well as strategic and financial control. All these important characteristics become clear of the structural difference between one-tier and two-tier system that provide a reason to say that the two-tier system is more stable and therefore formally should lead to more sustainable economic growth and efficiency in a market economy.

1.2 Sustainable Economic growth

After examine of the structural difference between one-tier and two-tier corporate governance system, it is the most important to examine the differences between the two system in relation to sustainable economic growth. As mentioned in the first chapter of the thesis the financial performance of the corporation is closely related to economic growth in a market economy. The question therefore is which system provides not only growth but also sustainable growth? On the other hand, there are two simple methods to solve the problem of mismanagement in a corporation if it affects its economic performance: either by not re-electing the managers or by dismissing them. In reality, it is hardly so easy to take such decision for the reasons mentioned in the following section.

In the one-tier system there is only one board. All of its members, executive and

CEU eTD Collection

non-executive, are elected by shareholders which also have the power to remove them. "However, this remedy would be the last resort and is only used in cases of serious misconduct or extreme underperformance. Usually, the board takes decisions to reorganise the management, and the shareholders, as well as the creditors, have only a limited capacity to exercise pressure on the board members and thereby indirectly affect the board composition"[106] In a result, it is the Board of Directors who is managing the corporation. It is important to mention, "disciplinary function of the board increases if the monitoring role of non-executive directors is strengthened."[107] In fact, the company is managed not by the Board as a whole but by senior managers. Moreover, "in contrast to the two-tier board system, there is no black or white distinction between the functions, neither between the separate organs nor within an organ of the company itself"[108] which is a factor agency problems to appear more frequently than in the two-tier system.

In the German two-tier system, shareholders' representatives and labor representatives compose the supervisory board.[109] Being a member in the same time of the supervisory board and management boar is not permitted. The Supervisory board has "The main tasks of the supervisory board are to appoint and dismiss the members of the management board and to monitor them. The supervisory board also represents the corporation in all affairs concerning the management board, especially by initiating court

---

[106] Jungmann, Carsten. (2006) "The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany." *European Company and Financial Law Review*, p. 435.
[107] Ibid.
[108] Ibid.

[109] Germany. (1976). "Co-determination Act." Part two – Supervisory Board. § 7, 1-3.

CEU eTD Collection

actions against the board members."[110]Moreover, the supervisory board must approve the annual accounts and can intervene in cases where the company's interests are seriously affected."[111] Certain important and fundamental changes and decision in the corporation also required the approval of the supervisory board. Sec. 5.1.1 of the German Corporate Governance Code expressly clarifies that it is the task of the supervisory board to "advise regularly and supervise the Management board in the management of the enterprise"[112] and that it must be "involved in decisions of fundamental importance to the enterprise."[113] The so-called networking process with stakeholders is also of the functions of the Supervisory Board. On the other hand, the management board is autonomous body and "is not bound by orders of the shareholders or the supervisory board."[114] Its member are appointed and removed not by the shareholders but the supervisory board. The management board to not only mange day-to-day affairs of the corporation but also set the long-term goals of the corporation. Nowadays, there is a tendency "the monitoring task of the supervisory board has become more and more permanent and future-oriented, as the intended business policy has also to be controlled by the supervisory board." The fact that banks are holding large amount of corporate shares has been "regarded as a

---

110 Jungmann, Carsten. (2006) "The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany." *European Company and Financial Law Review*, p. 432.

111 Jungmann, Carsten. (2006) "The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany." *European Company and Financial Law Review*, p. 432.

112 Germany. (2007). "German Corporate Governance Code." Part five – Supervisory Board. Section 5.1.1.

113 Ibid.

114 Jungmann, Carsten. (2006) "The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany." *European Company and Financial Law Review*, p. 433.

CEU eTD Collection

major advantage for effective corporate control"[115] Also hostile take over's are rarely the case in Germany.

On the European level, according to the European Commission there is strong tendency to strengthen the collective responsibilities of board member in relation to financial and non-financial statements as well to enhance them.[116] Therefore, The Commission aims to foster efficiency and competitiveness and to strengthen shareholders' rights and inventors' confidence. In this perspective, employee-elected management members could by a way to increase the effectiveness of the Board by providing more equal standards between labor and management. Moreover, as equal members "the employee representatives have the full voting rights as the shareholder representatives."[117] They have the same rights and obligations as well as they are obliged to act in the interest of the corporation. In addition to that, "pro-employee laws mitigate holdup problems"[118] because they creates incentives to protect specific investment which created the real value of the corporation. They also provide the incentive to management

---

115 Jungmann, Carsten. (2006) "The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany." *European Company and Financial Law Review*, p. 434.

116 See. Belgium. (2003). Commission of European Communities. "Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward. p. 10-17

117 Schubert, Claudia. (2008). "The national Implementation of Employee Participation in the Administrative Board of the SE in the One-tier Model: A legal Comparison on the Basis of Germany, Austria, Sweden, and France." *European Company and Financial Law Review*, p. 432.

118 Gelter, Martin. (2009). "The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance." *Harvard International Law Review*, vol. 50, No. 1 p. 129.

CEU eTD Collection

to act in corporation best interest reducing the agency problems and cost as well as increasing wealth maximization process in the corporation.[119]

Another important difference related to sustainable economic growth between the one-tier and two-tier system is the fact that "concentrated share ownership mitigates free-rider problems and is thus superior to dispersed ownership, as far as questions of effective corporate control are concerned."[120] Moreover, dividend cuts are far more likely to occur on the two-tier system than in the one-tier system which affects the performance of the corporation. German corporation are building up and reduce hidden reserve which is also a factor influence the good performance of the corporation.

According to Jungmann, the German corporations are having less loss for the financial year and less loss of profit than the corporation in United Kingdom: 3.53% loss for financial year and 27.31 % loss of profit in German jurisdiction and 5.88% loss for financial year and 38.82 % loss of profit in United Kingdom jurisdiction.[121] These facts could be regarded as true orientation of two-tier system towards sustainable economic growth and efficiency. On the other hand, it is important to notice that in order supervisory board in two-tier system to be able to judge on the performance of the management there is need of adequate disclosure which is not every time present. All the

CEU eTD Collection

---

[119] See. Gelter, Martin. (2009). "The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance." *Harvard International Law Review*, vol. 50, No. 1 p. 129-134.

[120] Jungmann, Carsten. (2006) "The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany." *European Company and Financial Law Review*, p. 434.

[121] Jungmann, Carsten. (2006) "The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany." *European Company and Financial Law Review*, p. 444.

important information is in the hands of the management board such as future project, business opportunities, budgetary and strategy information, etc. The management board presents the information available to the supervisory board. "They are not permitted to collect information on their own, and employees are not obligated to report to the supervisory board directly. Thus, the access of the members of the supervisory board to sensitive information is limited." However, the rule and regulation have been strengthened and disclosure rule should be "without delay" according to German Corporate Governance Code.[122]

Another difference between one-tier and two tier in relation to sustainable economic growth is the fact that the two-tier board structure positive effect on operating performance an effect of the concentration of ownership. "Blockholders can strengthen monitoring and reduce conflict of interest"[123] as this role has been played by bank owners. Moreover, "these institutional investors provide useful internal monitoring, improve access to debt and mitigate conflicts of interest between shareholders, creditors and managers"[124] as mentioned already. It is also important to state that there is a positive association between institutional ownership and corporation value in the two-tier system. Banks are usually regarded as well informed, active and long-term orientated investors which provide access to capital markets to the corporation in order to increase corporation's value and to contribute to the economic growth in a country.

According to Maury and Pajuste, corporate value is affected positively when

CEU eTD Collection

---

122 Germany. (2007). "German Corporate Governance Code." Part six – Transparency. Section 6.1. – 6.8

123 Millet-Reyes, Benedicte and Ronald Zhao. (2009) " International Differences in Board Structure."ASBBS Annual Conference: Las Vegas. p. 3

124 Ibid.

voting powers are distributed equally and protection of investors is strengthened. This situation reduces the factors of expropriation and can lead to higher value of the corporation.[125] As a result, this affects the growing potential in the corporation. In the sample statistic analysis, scholars have concluded that relationship between one-tier and two-tier system in relation to some economic indicators is positive for the later. For example, the indicator such as growth NI (Net Income time 1 - Net Income time 0/ Net Income time 0) is positive in the two-tier system then in one-tier system as well as indicators such as OCF (Net Income + Depreciation Expense/Total Assets), Debt/Assets (Total debt/ Total assets) and ROA (Net Income/Total assets.)[126] Those indicators, shows that the two-tier system is more orientated towards sustainable economic growth as it keeps income higher than expenses, total debt lower than total assets and net income – total assets ratio relatively high as well as the price of a shares is higher than in the one-tier system.

As long as the liabilities of directors are concerned in the one–tier and two-tier system the general rule that directors are liable only towards the corporation applies. One the other hand, the one-tier system creates more liability court case than the two-tier system. "In the landmark case ARAG, […] the Germany's federal court of last instance, held that the supervisory board had the duty to bring suit against management board directors who violated their duties and damage the corporation"[127] while in one-tier system the directors are liable only for gross negligence and supervised by a small

CEU eTD Collection

[125] Maury B. and A. Pajuste, (2005), "Multiple large shareholders and firm value." *Journal of Banking and Finance*. p. 1813-1834.
[126] See Millet-Reyes, Benedicte and Ronald Zhao. (2009) " International Differences in Board Structure."ASBBS Annual Conference: Las Vegas. p. 7.

[127] Hopt, Klaus (2011). "Coporative Corporate Governance: The State of the Art and International Regulations". *American Journal of Comparative Law, Vol. 59, p. 43.*

quantity of independent board members. Moreover, in order to prevent agency conflict between shareholders and directors, and the co-called tunneling by controlling shareholders, the two-tier system impose judiciary duties on controlling shareholders and duties between shareholder more generally on the contrary to the one-tier system where there are no such rules.

Another important element that differentiates one-tier system than the two-tier system in relation to sustainable economic growth is the participation of the labor in the decision control of the corporation. As the workers of the corporation are consider one of the most obvious creditors, the two-tier system is not only shareholder-orientated but also stakeholder-orientated trying to keep balance between stakeholders interests. Moreover, "labor representatives on the board serve as an additional check on management, not only as far as labor interests are concerned, but more generally to suppress excessive risk-taking and other activities that are potentially disadvantageous to the enterprise and therefore to jobs."[128] In addition to that, codetermination in a corporation is considered as one of the difficult obstacles to hostile takeovers. In Germany, decisions related to the remuneration of directors are taken away from the remuneration committees and given to the discretion of the supervisory board in order to limit excessive payment to management. That's how the relationship between labor and shareholders are strengthened which increase productivity in a corporation and provide more sustainable

CEU eTD Collection

[128] Hopt, Klaus (2011). "Coporative Corporate Governance: The State of the Art and International Regulations". *American Journal of Comparative Law, Vol. 59, p. 54.*

economic growth.[129]

1.3 Findings

After examined the structural and growth-orientated differences between the one-tier and the two-tier system it is to conclude that to difficult to establish superiority between them.[130] The effectiveness, appropriateness and sustainability towards economic growth of those two prominent corporate governance systems are highly dependent of "factors related to legal, cultural, social and economic developments of a particular country."[131] However, as mentioned in the introduction, the natural characteristics of a human being, more specifically those of which are oriented towards greed and trust, are universal. No matter, what cultural, legal, social or economic differences are standing between one-tier and two-tier corporate governance systems, the stakeholders in a corporation will always act in their best interest guided by their level of greed and trust. Moreover, these same principles and understanding of human nature have been a guideline of the establishment of numerous theories such as the liberal theory which is deeply rooted in the writing of John Locke and Adam Smith. Those two authors influence later on the 'founding father of United States' as well as authors such as John Keynes and Milton Friedman who promoted Adam Smith's fundamental ideas through out the world.

CEU eTD Collection

---

[129] Hopt, Klaus (2011). "Coporative Corporate Governance: The State of the Art and International Regulations". *American Journal of Comparative Law, Vol. 59, p. 54.*

[130] See Jungmann, Carsten. (2006) "The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany." *European Company and Financial Law Review*, p. 431.

[131] Schneider, Jüergen and Siu Y. Chan. (2001). "A Comparison of Corporate Governance Systems in Four Countries." Hong Kong Baptist University.

The ‘invisible hand’ of the market guided by free competition, self-interest, and supply and demand have been guiding the modern capitalism which is pursued by many countries nowadays. However, those principles are efficient whenever the markets are complete, competition is perfect and information is symmetric which is hardly the case in any country.[132] In addition to that, Adam Smith expresses the idea that regulations are needed when it comes to efficient and sustainable corporate governance.[133] It becomes clear that Germany has more corporate governance regulations than United States; the two-tier system is exposed to more supervision and control than the one-tier system.[134] Moreover, the German Corporate Governance Act, which was last amended in 2008, stresses openly for transparency and increase in shareholders rights in order to strengthen the trust in the investors. The code’s “comply-or-explain principle” helps to foster transparency by requiring an explanation from those corporations not complying with the provisions of the code.”[135] As a result, the two-tier system become a hybrid system combining shareholder-oriented system as well as stakeholder-oriented system which provide more balanced relationship and flexibility in the corporation and therefore more

CEU eTD Collection

132 See Odenius, Jürgen. (2008) “Germany’s Corporate Governance Reforms: Has the System Become Flexible Enough?” International Monetary Fund, Working Paper 08/179.

133 See Robins, Nick. (2004). “The World’s First Multinational”. *NewStatesmen.* Web: http://www.newstatesman.com/200412130016

134 See Schneider, Jüergen and Siu Y. Chan. (2001). “A Comparison of Corporate Governance Systems in Four Countries.” Hong Kong Baptist University.

135 Odenius, Jürgen. (2008) “Germany’s Corporate Governance Reforms: Has the System Become Flexible Enough?” International Monetary Fund, Working Paper 08/179.

sustainable economic growth.[136] In addition, more and more one-tier system are developing dualistic corporate governance structure by "creating committees and delegating majorities of directors' monitoring duties to those committees"[137] in order to separate executive and monitory functions in the Board.

It becomes clear that separation of executive and monitoring function, consideration of different stakeholders interest, extent of regulation, information to the board, external auditors, selection and removal procedures for board members, liabilities and compensation rules are at least formally better established in the two-tier system. One-of the most important factors to escape low performance of the company is the disclosure of the future plans of the management. "Discussions of future plans by management may provide an early warning signal of possible crisis and represent direct recognition of it."[138] As a result, the German is more effective against mismanagement; in general emphasize more accountability and consistency, therefore, more oriented towards sustainable economic growth.[139]

---

136 Odenius, Jürgen. (2008) "Germany's Corporate Governance Reforms: Has the System Become Flexible Enough?" International Monetary Fund, Working Paper 08/179.

137 Schneider, Jüergen and Siu Y. Chan. (2001). "A Comparison of Corporate Governance Systems in Four Countries." Hong Kong Baptist University. p. 13.

138 Schneider, Jüergen and Siu Y. Chan. (2001). "A Comparison of Corporate Governance Systems in Four Countries." Hong Kong Baptist University. p. 34.

139 Schneider, Jüergen and Siu Y. Chan. (2001). "A Comparison of Corporate Governance Systems in Four Countries." Hong Kong Baptist University. p. 4.

CEU eTD Collection

Chapter III – Lesson for Bulgaria

As long as the important structural and suitable economic-growth-orientated dereferences between one-tier and two-tier system was analyzed, it is time to asked the following questions: What is the situation in Bulgaria and what are the lessons in relation to corporate governance and suitable economic growth? As mentioned in the introduction, corporate governance is of a significant importance of developing country because corporations are the engines of development; therefore, good corporate governance principles should be present in order to have sustainable economic growth in Bulgaria.

1. The Existing Corporate Governance Model

There are couple important phenomena that determine the corporate governance model in Bulgaria. First of them is the "delay of regulatory mechanism forming"[140] and the second one is the "asynchronous within them"[141]. Pyramid structure enterprises as well as mass privatization developed in a similar way, destroyed the trust of investors and left numerous unprotected citizens on the street. "These fraudulent schemes were obvious even for a junior economist, however not for the state governance. It was also obvious that the state, presented by its governing elite did not learn from the foreign experience

CEU eTD Collection

[140] Keremidchiev, Spartak (2004). "Towards modernization of the corporate governance in Bulgaria." Institute of Economics, Bulgarian Academy of Sciences. p. 2.
[141] Ibid.

and that the learning curve effects are not evidenced in the country."[142] This situation was represented by numerous weaknesses in the corporate governance systems in relation to sustainable economic growth.

For example, some of the most important weakness are as followed: lack of distinction between corporate governance and management of the corporation; presence of 'transitional shareholders'; high level of conflicts of interest between stakeholders; abuse of minority shareholders' rights; lack of sufficient legal protection, developed capital markets and incentives for investors to improve corporate governance practices;[143] More specifically, as long as protection of shareholders right are concerned, there is "no obligation for written notification of the shareholders of personal shares for General Assembly of Shareholders (GAS) convening."[144] Minor shareholders are most of the time excluded in the preparation of general assembly agenda and there are no minimal quorum requirements for the adoption of significant decisions during shareholders' meeting. The procedures and rules in the corporation are unnecessary complicated which present obstacles for minor shareholder, employees and investors to understand their rights when violated; lack of reliable legal protection for all stakeholders the corporation. In addition to that, "No specified simplified procedure and established organization for authorization

CEU eTD Collection

[142] Keremidchiev, Spartak (2004). "Towards modernization of the corporate governance in Bulgaria." Institute of Economics, Bulgarian Academy of Sciences. p. 3.

[143] Germanova, Ralitza. (2008). "Corporate Social Responsibility as Corporate Governance Tool: The Practice by the Business in Bulgaria." Hanken School of Economics and Business Administration.

[144] Keremidchiev, Spartak (2004). "Towards modernization of the corporate governance in Bulgaria." Institute of Economics, Bulgarian Academy of Sciences. p. 9.

of banks to represent the interests of the petty shareholders."[145] It is of significant importance to a corporation in order to create sustainable growth in a country to have well regulated and relatively straightforward procedures in order to get registered in the stock exchange. In Bulgaria, it is the opposite situation, which affects the interest not only to the minority shareholders but also to all stakeholders in a corporation. It is also important, as stated in the previous chapter of the thesis, labor's interest to be presented in a corporation in order to decrease conflicts of interest. Bulgarian legislation does not give any legal opportunity "for the staff of the corporations to be represented at the GAS."[146] Moreover, there is no legal distinction in the functions between the chairman and the chief executive manger of the corporation. Usually, there are also not legal restrictions for directors to participate in others corporations' boards as well as any mandatory characteristics such as education or profession experience in order to be elected. There is not any "built functioning system for strategic corporate governance, effective monitoring of the activity of the corporations and regular reporting the results of this activity to the shareholders"[147] which is of significant importance in relation to sustainable economic growth. The lack of effective and specialized committees is also present in the Bulgarian legislation which is yet another factor affecting the performance of the corporation. The rating agencies are also not functioning as expected. There are not also clear disclosure rules of the remuneration of the directors and management during

CEU eTD Collection

---

[145] Keremidchiev, Spartak (2004). "Towards modernization of the corporate governance in Bulgaria." Institute of Economics, Bulgarian Academy of Sciences. p. 10.

[146] Keremidchiev, Spartak (2004). "Towards modernization of the corporate governance in Bulgaria." Institute of Economics, Bulgarian Academy of Sciences. p. 10.

[147] Ibid.

the year as weal as their participation in partnerships or other companies. In general, there is “lack of entire vision for the development of the country corporate governance, as well as structures that would deal with its reformation.”[148] This current situation of corporate governance model present many challenges and lessons to be learn before the Bulgarian legislation.

In 2007 Bulgaria was accepted in the European Union. In the same year, Bulgarian National Code Corporate Governance was adopted and considered as “a step forward towards the establishment of modern rules and norms for the good governance.”[149] The Code itself was based after Principles of Corporate Governance of the Organization for Economic Cooperation and Development (2004) and namely it structure was the following: “the accountability and independence of corporate boards; the protection of shareholders’ rights; the equitable treatment of international and minority shareholders; the disclosure of information; and the integration of stakeholder interests.”[150] The code clearly stated: “Good corporate governance requires corporate boards to be accountable, loyal, responsible, transparent and independent in order to act in the best interest of the company and society.”[151] Presently in Bulgaria, foreign and domestic investors can choose between one-tier and two-tier corporate governance

CEU eTD Collection

---

148 Keremidchiev, Spartak (2004). “Towards modernization of the corporate governance in Bulgaria.” Institute of Economics, Bulgarian Academy of Sciences. p. 10.

149 Bulgaria. (2007). “Bulgarian National Corporate Governance Code”. p. 3.

150 Ibid.

151 Bulgaria. (2007). “Bulgarian National Corporate Governance Code”. p. 4.

system when establish a joint stock company.[152] Moreover, the following Bulgarian laws also includes corporate governance provision which strengthen the legal framework of corporation: Commercial law, law for independent financial audit, accounting law, law on public offering of securities, act on special investment purpose companies, market and financial instruments act, law on measures against market abuse with financial instruments.[153] This strengthening of legal regulation concerning the companies fixed lots of gap in the existing corporate governance model in Bulgarian. The reality regarding the implementation of Bulgarian Code of Corporation Governance was optimistic. Currently 52 corporations in Bulgaria accepted the Bulgarian National Corporate Governance Code and half of them voluntarily.[154] Many directors and managers of Bulgarian Corporation developed clear understanding of corporate governance and adopted good practices and principles in their corporations. Level of ownership concentration decrease and the public traded shares in Bulgarian capital market increased. As a result, the Bulgarian GDP rapidly growth with average of 5.7% for the period 2004-2006 went up to 6.2% in 2007 with average 2.4% for the other 27 EU member states; moreover, unemployment rate gradually decreased for the last seven years, falling from 16% in 2000 to 6.9% in 2007.[155]

---

[152] Bulgaria. (1991). "Commercial Law." Article 219. Last amended in 2002.

[153] Note: the first three laws are available in English at www.lexadin.nl or www.fifoost.org and the following four are available at www.bse-sofia.bg.

[154] Note: full list of companies is available at http://bse-sofia.bg/?page=CorporateGovernance.

[155] Note: it was not exclusively for the adoption of corporate governance regulation that the Bulgarian economy marked improvement. Other economic factors also were present. But one of the most important was the increase in consumption as well as FDI and FPI which occurred through well governed corporations. See Germanova, Ralitza. (2008). "Corporate Social Responsibility as Corporate Governance Tool: The Practice by the Business in Bulgaria." Hanken School of Economics and Business Administration. p. 23-26.

CEU eTD Collection

Unfortunately, as mentioned in the begging of this subsection the lack of regulations is not the real problem, but their enforcement as well as other social and economic factors. Corporate social responsibility is still new not only in Bulgaria but around the world. Milton Friedman "measured social responsibility in earnings per share"[156] disregarding any other social responsibility of corporations. The Bulgarian national Corporate Governance Code is to be implemented by all public companies in Bulgaria as well as state owned enterprises and recommended for those who are planning to become public in the near future. As the Code is based on the "comply or explain" principle, many companies do not even explain why they to not comply with the Code. "Information for this noncompliance has not been presented at their Annual Reports as the "comply or explain" principle of the National Code requires. Some of the reasons for unwillingness of the companies to disclose information are grounded in the business culture in Bulgaria, which is still in process of changing from inward-oriented, closed and high-concentrated ownership system to transparent and external-oriented structure with diverse ownership."[157] Moreover, most of the public corporations have one-tier system not two-tier system, and do not disclose properly the following information as required by the Code: number of the independent directors at the board; division of functions among the members of the corporate management; conflict of interest problems; remuneration of directors and managers; identification of stakeholders and clear defined policy towards them; participation of director in other corporation's boards; annual

CEU eTD Collection

[156] Germanova, Ralitza. (2008). "Corporate Social Responsibility as Corporate Governance Tool: The Practice by the Business in Bulgaria." Hanken School of Economics and Business Administration. p. 35.

[157] Germanova, Ralitza. (2008). "Corporate Social Responsibility as Corporate Governance Tool: The Practice by the Business in Bulgaria." Hanken School of Economics and Business Administration. p. 33.

reports. Not all companies have corporate web site where they have to publish such information as required by the Code. Moreover, small amount of corporations identify their stakeholders and establish clear rules to them.[158] In short, "twenty five of the companies do not comply entirely with the principles for the disclosure of information at the National Code."[159] In addition to that a small amount of companies have good rules for regular and extraordinary shareholder meetings. "These rules grant equal treatment of all groups of shareholders and rights to every shareholder to express its opinion on the issues at the agenda of the meeting, as recommended by the Corporate Governance Code."[160] In addition to that many corporations keep their auditors for more than five years which increases the changes of conflict of interest and insider trading. This leads to the conclusion that there is a need for stable internal control and supervision in a corporation.

1.2 Lessons

As mentioned in the previous chapter, the appropriateness and the effectiveness of the one-tier and two-tier system in concern to sustainable economic growth largely depend on factors related to legal, cultural, social and economic developments of a particular country. The existing corporate governance model in Bulgaria is, before all, in need of a stable enforceable regulations and supervision on the level of corporate

CEU eTD Collection

---

158 Peeva, Daniela. (2008). "Corporate Governance in Bulgaria – History, Development and Tendencies." Bulgarian Association of the Investor Relations Directors.

159 Germanova, Ralitza. (2008). "Corporate Social Responsibility as Corporate Governance Tool: The Practice by the Business in Bulgaria." Hanken School of Economics and Business Administration. p. 33.

160 Germanova, Ralitza. (2008). "Corporate Social Responsibility as Corporate Governance Tool: The Practice by the Business in Bulgaria." Hanken School of Economics and Business Administration. p. 32.

governance in a corporation. Bulgarian business mentality needs more control and supervision which can be achieve by recommendation investors to create more two-tier system corporation. After the analyses of differences between the two major corporate governance systems in relation to sustainable economic growth, it become clear that there are some important factors to be considered in Bulgaria.

"Concentrated shareholdings by institutions or by blockholders could increase managerial monitoring and so improve firm performance."[161] This situation is mainly represented in the two-tier system and could be efficient in the case of Bulgaria. The treat of hostile takeovers is more and more present. The Bulgarian corporation should be able to protect themselves efficiently, which is also important advantage of the two-tier system. In addition to that, the equity/debt ratio has to be kept reasonable due to lack of sophisticate bankruptcy law in Bulgaria; therefore, hurting creditors and investors. Banks monitoring is important in respect of corporate governance.[162] The board activity, either in one-tier or in two tier system, should be sufficiently high. This is strengthening the interaction between board members and therefore reducing the agency cost. It also approves relations between shareholders and board members. Moreover, "shareholder activism is very important governance mechanism which encourages interactions among shareholders and thus fights the agency problems between managers and shareholders and between minority and controlling shareholders."[163] Yet another advantage of two-tier

CEU eTD Collection

---

[161] Germanova, Ralitza. (2008). "Corporate Social Responsibility as Corporate Governance Tool: The Practice by the Business in Bulgaria." Hanken School of Economics and Business Administration. p. 14.

[162] Berglöf, Erik and Stijn Claessens. (2004) "Enforcement and Corporate Governance" World Bank Policy Research Working Paper No. 3409. p.10-11.

[163] Germanova, Ralitza. (2008). "Corporate Social Responsibility as Corporate Governance Tool: The Practice by the Business in Bulgaria." Hanken School of Economics and Business Administration. p. 15.

system, which could be used in case of Bulgaria, is the employee monitoring. Employee monitoring is very important corporate governance mechanism as well as in medium sized countries such as Bulgaria.[164] "Corporate governance is not only about mitigating the commitment problem, but often also about balancing the rights and interests of multiple stakeholders. Employee monitoring can be an effective mechanism to enhance corporate governance as its interests are largely aligned with good firm performance and fair treatment of all stakeholders."[165] It increases competition and therefore corporation's performance. Appropriate amount of executive compensation and its disclose is also important factor for a good corporate governance. In general, transparency is needed in all levels of a corporation. It is closely related to monitoring which is formally better structured in the two- tier system. Transparency mitigate conflicts of interest and create more equal the distribution of information between all stakeholder in a corporation; therefore increasing performance of the corporation which from its part create more sustainable economic growth in a country.

In short, it is important in the case of Bulgarian to follow and enforce strictly its current legislation in relation to corporate governance and to amend it accordingly the changing conditions. It is important to corporate governance to redefine its mission and to oriented itself not only in short-term maximization of shareholders value but also in long-term. Corporate governance should create durable value for its shareholders as well as its stakeholders through: sustainable performance, sound risk management and high

CEU eTD Collection

---

[164] Berglöf, Erik and Stijn Claessens. (2004) "Enforcement and Corporate Governance" World Bank Policy Research Working Paper No. 3409. p.7-10.

[165] Berglöf, Erik and Stijn Claessens. (2004) "Enforcement and Corporate Governance" World Bank Policy Research Working Paper No. 3409. p. 34.

integrity.[166] It other word, corporate governance in a corporation should have for a goal "high performance which means: strong, sustained economic growth; through the continuous provision of high quality goods and services; which in turn provide durable benefits for shareholders and other stakeholders (creditors, employees, customers, suppliers, communities, regulators) upon whom the company's health depends."[167] Those factors and many others more are more or less combined in the two-tier corporate governance structure.

CEU eTD Collection

[166] Policy and Impact Committee of the Committee for Economic Development. (2010). "Restoring Trust in Corporate Governance: The Six Essential Tasks of Boards of Directors and Business Leaders" Policy Brief. p. 1-2

[167] Policy and Impact Committee of the Committee for Economic Development. (2010). "Restoring Trust in Corporate Governance: The Six Essential Tasks of Boards of Directors and Business Leaders". Policy Brief. p. 3.

Conclusion

Until the moment when corporation do not diminish their significant influence over economic and social life, corporate governance will continue to be an important and vividly discussed issue. It becomes clear that the effectiveness and appropriateness of both chief-existent corporate governance systems in relation to sustainable economic growth is hugely dependable of legal, cultural and socio-economic background in a particular country. Moreover, it is difficult to establish concrete superiority between one-tier and two-tier system.[168]

On the other hand, "some studies find the U.S. governance structure may lead to higher overall value for shareholders but it is hard to control the exogenous variables."[169] Therefore, after comparing the structural and sustainable-growth related differences between one-tier and two-tier system, it become clear that the later combines more sustainably the interests of all stakeholders in a corporation. It creates formally more monitoring function provided by supervisory board (including labor) as well as distinguishes between 'decision management' and 'decision control'. The disclosure mechanism is also well presented in the two-tier system proving all stakeholders with sufficient information in order to mitigate conflict of interest issues and increase equality between them. In addition to that, rights and liabilities between shareholders and

CEU eTD Collection

---

[168] See. Jungmann, Carsten. (2006) "The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany." *European Company and Financial Law Review*, p. 426.

[169] Scott, Hal S. and Philip A. Wellons. (2009) "International Finance: Transactions, Policy and Regulation." Foundation Press. New York. p. 243

managers are better balanced, creating incentives for better performance in a corporation. Co-determination process is minimizing the potential conflicts in a corporation.[170] The probability of strikes and hostile takeovers also diminish with the co-determination process.[171] "Labour representatives typically have a sound knowledge of the company and can thus help the supervisory board to control management with regard to a number of questions that are unique to that company."[172] In addition to that " co-determination is useful for long-term policies."[173]In general, co-determination provide balance and equal combination of socio-economic interest of all stakeholders which guides a corporation towards sustainable performance; therefore, sustainable economic growth in a country. In regard to these findings, Bulgaria has to promote more investors to establish their corporation under two-tier system model. It turns out that the one-tier system is more efficient and stable when there is a majority of shareholders as well as no real conflicts between shareholders and management is present, which is hardly the case.[174] On the other hand, two–tier system is efficient in all other cases such as: low trust between stakeholders, disperse ownership, unstable economic and legal conditions. All these

---

170 See. Jungmann, Carsten. (2006) "The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany." *European Company and Financial Law Review*, p. 468.

171 See Hopt, Klaus J. and Patrick C. Leyens. (2004)."Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy." *European Company and Financial Law Review*, p. 135-140.

172 . Jungmann, Carsten. (2006) "The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany." *European Company and Financial Law Review*, p. 469.

173 Hopt, Klaus J. and Patrick C. Leyens. (2004)."Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy." *European Company and Financial Law Review*, p. 165.

174 See Bajuk, Jože. (2005). "One-tier or two-tier governance: Which is better?" Socius Consulting Network. Web: http://www.socius.si/si/knjiznica/.

CEU eTD Collection

factors more or less characterize the business environment in Bulgaria. Moreover, "supervision by the separated body is better in quality and more transparent […] which is in the key interest of the shareholders."[175] In addition to that, "An advantage of a two-tier approach is that it can logically comprehend the cost-benefit approach of welfare economics as well as other options, and encourage public discussion of what criteria to apply in sustainability calculations and measures. Two-tiered system might prove a useful beginning point for finding a more unified and interdisciplinary approach to decision making."[176] These are the reasons why two-tier system is not superior but better oriented towards sustainable economic growth in a country then the one-tier system. Domestic and foreign experience established the lesson for Bulgaria in relation to corporate governance and provided ground for a wider use of two-tier system.

On a broader sense, concern about a financial and social sustainability of a corporation is in a early stage of development and "challenged many of the fundamental goals and assumptions of the conventional, neoclassical economics of growth and development."[177] The Bruntland Commission defines sustainable development as the one which "meets the needs of the present without compromising the ability of future generations to meet their own needs."[178] A study made by the magazine 'The Economist'

CEU eTD Collection

---

[175] Bajuk, Jože. (2005). "One-tier or two-tier governance: Which is better?" Socius Consulting Network. Web: http://www.socius.si/si/knjiznica/. p. 2.
[176] Norton, Bryan G. and Michael A. Toman. (1997). "Sustainability: Ecological and Economic Perspectives." *Land Economics*, Vol. 73, No. 4, p. 553-558.

[177] Pezzey John C. V. and Michael A. Toman. (2002). "The Economics of Sustainability: A Review of Journal Articles". Resources for the Future. Washington. p. 1.
[178] World Commission on Environment and Development. (1987). "Our Common Future: Report of the World Commission on Environment and Development." The Concept of Sustainable Development point 1.

"called sustainable those policies and processes which enhance the financial, environmental, societal, human, and other resources on which the company involved depends for its long-term health. Sustainability is the result of having such sustainable policies and processes, and aligning them so that goals in one area are not compromised in favour of those in another."[179] This approach is of one of the most fundamental one in the human development. It helps life to continue and flourish. Yet "management frequently lacks an understanding of what sustainable development means for the organization."[180] According to the same study made by 'The Economist' many corporation do not have any or have bad sustainable policies towards stakeholders and society as well. In addition to that "only 22% of executives say their firms have formal Triple Bottom Line reporting"[181] although "most executives (57%) say that the benefits of pursuing sustainable practices outweigh the costs."[182] Moreover, "attention to sustainability is consistent with, and may cause, higher share price growth and profits."[183] According to the same study, governmental policy and employees have the greatest effect over sustainability of a corporation and therefore to sustainable economic growth in a

---

179 Kielstra, Paul. Ed. Gareth Lofthouse and James Watson. (2008). "Doing good: Business and sustainability challenge". Economist Intelligence Unit. p. 4.

180 Kielstra, Paul. Ed. Gareth Lofthouse and James Watson. (2008). "Doing good: Business and sustainability challenge". Economist Intelligence Unit. p. 5.

181 Kielstra, Paul. Ed. Gareth Lofthouse and James Watson. (2008). "Doing good: Business and sustainability challenge". Economist Intelligence Unit. p. 5.

182 Kielstra, Paul. Ed. Gareth Lofthouse and James Watson. (2008). "Doing good: Business and sustainability challenge". Economist Intelligence Unit. p. 5.

183 Kielstra, Paul. Ed. Gareth Lofthouse and James Watson. (2008). "Doing good: Business and sustainability challenge". Economist Intelligence Unit. p. 31.

CEU eTD Collection

country. Also, CEO and Board of directors have the primary responsibility for sustainable performance in a corporation. Therefore, they have to combine equality with economic interest and incentives which is the case in a two tier system.

In short, it becomes clear that more governmental regulations are necessary in order to positive and sustainable growth to be visible in a country. Better transparency, motioning, and distribution of rights and liabilities are key elements to sustainable corporate governance system. The two–tier system combines those elements better than the one-tier system and it characteristics promote not only growth but also sustainable economic growth. Therefore, in the case of developing country such as Bulgaria it is important the two-tier system to be promoted and used more often. Corporate governance issue in relation to sustainable economic growth is a important issue which if not be treated respectfully can hurt not only all stakeholders in a corporation but also can change legal, socio-economic and environmental conditions worldwide.

CEU eTD Collection

Acknowledgements

I would like to thank prof. Tibor Tajti (director of the doctoral (S.J.D.) program in Central European University), prof. Ugo Pagano (director of the Ph.D. program in economics in University of Siena), prof. Stefan Messmann (head of the legal studies department in Central European University), Mrs. Lilia Alexandrova (public notary in Republic of Bulgaria), Mrs. Zaharinka Mazneva (lawyer-linguist in European Court of Justice), Mr. Marco Becht (executive director of European Corporate Governance Institute), Mr. Kalin Kanev (secretary general at European Financial Stability Facility), Mr. Florian Zinoecker (corporate governance officer at European Investment Bank) who's support contributed in preparation to my thesis.

CEU eTD Collection

Bibliography

Books:

Clarke, Thomas. (2007). "International Corporate Governance: A comparative approach." Routledge.

Coase, R.H., (1988)"The Firm, the Market, and the Law", The University of Chicago Press.

Dam, Kenneth W. (2006). "The Law-Growth Nexus: The Rules of Law and Economic Development". Brookings Institution Press.

Dnes, Anthony W. (2005). "The Economics of Law: Property, Contracts and Obligations". Thompson South-Western.

Du Plessis, Jean Jacques, James McConvill and Mirko Bagaric. (2005). "Principles of Contemporary Corporate Governance". Cambridge University Press.

Francis Fukuyama. (1995) "Trust: the social virtues and the creation of prosperity". A Free Press Paperbacks Book.

Maassen, Gregory Francesco. (2002) "An International Comparison of Corporate Governance Models. Spencer Stuart.

Mitchell, Lawrance E., (2001). "The Corporate Irresponsibility: America's Newest Export." Yale University Press.

Paul, Ron. (2008) "Pillars of Prosperity: free markets, honest money, private property" Ludwig von Mises Institute.

Reinier Kraakman, John Armour, Paul Davies, Luca Enriques, Henry B. Hansmann, Gerard Hertig, Klaus J. Hopt, Hideki Kanda and Edward B. Rock, (2009)"The Anatomy of Corporate Law: Comparative and Functional Approach "second edition"", Oxford Press

Sarna, David E. Y. (2010). "History of Greed: Financial fraud form tulip mania to Bernie Madoff." John Wiley & Sons, Inc., Hoboken, New Jersey.

Scott, Hal S. and Philip A. Wellons. (2009) "International Finance: Transactions, Policy and Regulation." Foundation Press. New York.

Smith, Adam. (2005). "An inquiry into the Natures and Causes of the Wealth of Nations. A Penn State Electronic Classics Series Publication. The Pennsylvania State Univeristy.

CEU eTD Collection

Articles:

Andrews, K. R. (1980) “Director’s Responsibility for Corporate Strategy”, *Harvard Business Review*.

Arun, Thankom Gopinath and John Turner, “Preface”. *Corporate Governance and Development: Reforms, Financial Systems and Legal Frameworks*, Ed. Arun, Thankom Gopinath and John Turner. Edward Elgar, 2009.

Bajuk, Jože. (2005). “One-tier or two-tier governance: Which is better?” Socius Consulting Network. Web: http://www.socius.si/si/knjiznica/.

Becht, M., and A. Roell. (1999). “Blockholdings in Europe: An International Comparison.” *European Economic Review* p. 43

Berglöf, Erik and Stijn Claessens. (2004) “Enforcement and Corporate Governance” World Bank Policy Research Working Paper No. 3409.

Branson, Douglas M. (2003) "Lawrence E. Mitchell, Corporate Irresponsibility – America’s Newest Export (Yale University Press, New Haven, Connecticut, 2001)," *Bond Law Review*: Vol. 15: Iss. 1, Article 16.

Cadbury, Adrian Sir. (2002) “Foreword”. *Corporate Governance and Development*. Athr. Stijn Claessens. Global Corporate Governance Forum.

Campbell, Christian Tyler. (2002). “The Limited Liability Company”. *Bussiness transactions in Germany.* Ed. Ruster, Bernd. Looseleaf, Mathew Bender, New York first published 1983.

Chisari, Omar O. and Gustavo Ferro. (2009) “Gains and losses of adopting new standards of corporate governance: a CGE analysis of Argentina.” *Corporate Governance and Development: Reforms, Financial Systems and Legal Frameworks*, Ed. Arun, Thankom Gopinath and John Turner. Edward Elgar.

“Corporate governance: Lessons from the financial crisis” (2009) *OECD Observer.*

Davis, J.H. (1991). “Board Leadership Roles and Shareholder Returns: An Examination of Agency Theory.” Doctoral dissertation. The University of Iowa.

“Enron a year on. Investor self-protection: The biggest lesson from Enron is that investors must look after themselves.” (2002) *The Economist.*

CEU eTD Collection

Fama, E.F. and Jensen, M.C. (1983). "Separation of Ownership and Control." *Journal of Law and Economics,* p. 301-325.

Gelter, Martin. (2009). "The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance." *Harvard International Law Review*, vol. 50, No. 1 p. 129-194.

Germanova, Ralitza. (2008). "Corporate Social Responsibility as Corporate Governance Tool: The Practice by the Business in Bulgaria." Hanken School of Economics and Business Administration.

Hentschel, Ludger and Clifford W. Smith, Jr. (1995) "Risks in Derivatives Markets" University of Pennsylvania.

Hopt, Klaus (2011). "Coporative Corporate Governance: The State of the Art and International Regulations". *American Journal of Comparative Law, Vol. 59, p. 3-71*

Hopt, Klaus J. and Patrick C. Leyens. (2004)."Board Models in Europe – Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy." *European Company and Financial Law Review*, p. 135-168.

Jungmann, Carsten. (2006) "The Effectiveness of Corporate Governance in One-Tier and Two-Tier Board Systems: Evidence from the UK and Germany." *European Company and Financial Law Review*, p. 426–474.

Keremidchiev, Spartak (2004). "Towards modernization of the corporate governance in Bulgaria." Institute of Economics, Bulgarian Academy of Sciences.

Kesner, I.F. and Johnson, R.B. (1990). "An Investigation of the Relationship Between Board Composition and Stockholder Suits", *Strategic Management Journal*.

Kielstra, Paul. Ed. Gareth Lofthouse and James Watson. (2008). "Doing good: Business and sustainability challenge". Economist Intelligence Unit.

Kirkpatrick, Grant. (2009), "The Corporate Governance Lessons from the Financial Crisis", OECD. Paris.

Klaus Gugler, Dennis C Müller and B Burcin Yurtoglu, (2004) "Corporate Governance and Globalization" Oxford Rev. Econ. Pol. p. 130–134.

Malmendier, Ulrike. (2005)."Roman Shares". *The Origins of Value. The Financial Innovations that Created Modern Capital Markets*. Ed. W. Goetzmann and G. Rouwenhorst, Oxford University Press, p. 31-42, 361-365.

CEU eTD Collection

Maury B. and A. Pajuste, (2005), “Multiple large shareholders and firm value.” *Journal of Banking and Finance*. p. 1813-1834.

McCrum, Dan. (2011) “Apple vote to test waters on investors’ rights”. *Financial Times*. New York.

Millet-Reyes, Benedicte and Ronald Zhao. (2009) “ International Differences in Board Structure.”ASBBS Annual Conference: Las Vegas.

Norton, Bryan G. and Michael A. Toman. (1997). “Sustainability: Ecological and Economic Perspectives.” *Land Economics*, Vol. 73, No. 4, p. 553-568.

Odenius, Jürgen. (2008) “Germany’s Corporate Governance Reforms: Has the System Become Flexible Enough?” International Monetary Fund, Working Paper 08/179.

Paul, Ron. (2009) “Bankruptcy is Economic Stimulus.” *Capitalist digest*. Web: http://www.capitalistdigest.com/bankruptcy-is-economic-stimulus-1537/ consulted in May 2011.

Pearlstein, Steven and Peter Behr. 2001 “At Enron, the Fall Came Quickly: Complexity, Partnership Kept Problems from Public View.” *Washington Post.*

Peeva, Daniela. (2008). “Corporate Governance in Bulgaria – History, Development and Tendencies”, Bulgarian Association of the Investor Relations Directors.

Pezzey John C. V. and Michael A. Toman. (2002). “The Economics of Sustainability: A Review of Journal Articles”. Resources for the Future. Washington.

Robins, Nick. (2004). “The World’s First Multinational”. *NewStatesmen.* Web: http://www.newstatesman.com/200412130016 consulted in April 2011.

Schumaker, John F. (2004) “In Greed We Trust”. *New internationalist magazine*. issue 369. Oxford.

Schneider, Jüergen and Siu Y. Chan. (2001). “A Comparison of Corporate Governance Systems in Four Countries.” Hong Kong Baptist University.

Schubert, Claudia. (2008). “The national Implementation of Employee Participation in the Administrative Board of the SE in the One-tier Model: A legal Comparison on the Basis of Germany, Austria, Sweden, and France.” *European Company and Financial Law Review*, p. 422-452.

CEU eTD Collection

Smith, Alison. (2011). “Crisis shows a need for wider governance net.” *Financial Times,* New York.

Spencer, Jane (2005) “Lessons From The Brain-Damaged Investor”. *Wall Street Journal*. New York.

Stout, Lynn A., (2005) “On the nature of Corporations”. *University of Illinois Law Review. Vol. 2005, No.1 , p. 253-267*

Tajti, Tibor. (2005) “Corporate Governance: An Oversold Elitist Idea of No Interest to or for the Central European Transitory Economies? *Corporate Governance Law Review*. Vol. 1 No.1

Walsh, Lynn. (2002) “The Enron Scandal”. *Socialism Today.*

Others:

Belgium. (2003). Commission of European Communities. “Modernising Company Law and Enhancing Corporate Governance in the European Union - A Plan to Move Forward. p. 10-17.

Black’s law dictionary 9th ed. 2009

Bulgaria. (1991). “Commercial Law.” Last amended in 2002.

Bulgaria. (2007). “Bulgarian National Corporate Governance Code”.

Bureau of Economic Analysis, U.S. Department of Commerce. National Income and Product Accounts Tables No. 1.1.5 and 1.14. Web: http://www.bea.gov/national/nipaweb/SelectTable.asp?Selected=Y.

Cadbury, Adrian. (1992) “Report of the Committee on The Financial Aspects of Corporate Governance”, Gee and Co. Ltd., London, UK. p. 14

Edwards, Tony. (2002). “Corporate Governance Systems and the nature of indistrial restructuring.” European Industrial Relations observatory. Web: http://www.eurofound.europa.eu/eiro/2002/09/study/tn0209101s.htm consulted in May 2011.

GDP definition in http://www.investorwords.com/2153/GDP.html consulted May 2011.

Germany. (1976). “Co-determination Act.”

Germany. (2007). “German Corporate Governance Code.”

CEU eTD Collection

House of Representatives, Committee on Oversight and Government Reform. (2008) *"The Financial Crisis and the Role of Federal Regulators"*. Washington, D.C.

"Largest Bankruptcy Cases" Web: http://www.bankruptcylawfirms.com/Largest-Bankruptcies.cfm consulted on May 2011.

Mathiesen (2002) Definition of Corporate Governance web: http://www.encycogov.com/WhatIsGorpGov.asp consulted in May 2011.

Neuroeconomics definition in http://en.wikipedia.org/wiki/Neuroeconomics consulted May 2011.

"Of the world's 100 largest economic entities, 51 are now corporations and 49 are countries." Source Sales: Fortune, July 31, 2000. GDP: World Bank, World Development Report 2000. Web: http://www.corporations.org/system/top100.html consulted May 2011.

Oman, Charles, Steven Fries and Willem Buiter. (2003) "Corporate Governance in Developing, Transition and Emerging–Market Economies" Policy Brief No. 23. OECD Development Centre, Paris.

Organisation for Economic Co-operation and Development OECD (2004), "OECD Principles of Corporate Governance", Paris: OECD

Policy and Impact Committee of the Committee for Economic Development. (2010). "Restoring Trust in Corporate Governance: The Six Essential Tasks of Boards of Directors and Business Leaders". Policy Brief.

Simon Deakin Definition of Corporate Governance web: http://www.ifc.org/ifcext/cacgp.nsf/Content/HomeCG consulted in May 2011.

The Australian Stock Exchange Corporate Governance Council. (2003). "Principles of Good Corporate Governance and Best Practices Recommendations." Sydney.

United Nations, (2003) Conference on Trade and Development. "Selected Issues on Corporate Governance: Regional and Country Experiences." New York and Geneva.

United States. (2011). The Financial Crisis Inquiry Commission. "The Financial Crisis Inquiry Report. Final Report of the national Commission on the Causes of the financial and Economic Crisis in the United States." Washington D.C.

World Commission on Environment and Development. (1987). "Our Common Future: Report of the World Commission on Environment and Development." The Concept of Sustainable Development point 1.

"World's oldest share". Web: http://www.worldsoldestshare.com/# consulted in April 2011.

CEU eTD Collection