

Chapter 1: Moral relativism and corporate governance convergence – a research agenda

“Whatever each city judges to be just and honourable really is just and honourable for that city, as long as this remains that city’s custom and belief”

- Protagoras (paraphrased by Kahn (2003, p.4))

Moral¹ philosophy is the branch of philosophy in which questions of good and evil, right and wrong are raised. Moral relativism is that area of moral philosophy in which the question of whether what is good or right varies from person to person, from society to society, or from culture to culture is considered. As the quotation above, paraphrased from Plato’s *Theaetetus* of the fourth century B.C., suggests, moral relativism is not a recent idea. When societies and cultures have come into contact with each other through conquest or trade, the question has often been raised and in the twentieth century anthropological studies (such as those of Ruth Benedict (1934a, 1934b), Franz Boas (1940) and Melville Herskovits (1948)) significantly questioned the plausibility of a single, universal morality. Amongst philosophers, however, moral relativism has more often been discussed in the context of metaethics, and with regard to moral judgements in general, although Gowans (2008) does note some recent application of moral relativism to medical ethics. The present study investigates how moral relativism can be applied to a single issue of business ethics: that of corporate governance convergence. South Africa is presented as a case study of how moral relativism can be applied to this issue.

Moral relativism is one of many topics in business ethics. To date, the concept has found application in cross-cultural business studies that have identified cultural differences, and with regard to the responsibilities of multinational corporations (see, for example, Bowie (1993), Donaldson & Dunfee (1999), Hofstede (2001) and Donaldson & Werhane (2008)). Some consideration of how moral relativism can be applied to the issue of corporate social reporting has been provided by Lewis & Unerman (1999), while Licht and others have raised cultural relativism as an issue within the corporate governance literature (Licht, 2001; Licht *et al.*, 2005). However, where Licht and his co-authors apply some of the theories of cross-cultural business studies to the issue of corporate governance, a more structured application of moral relativism to corporate governance has not yet been performed. In this context, the present

study makes its primary contribution to the field of business ethics - through the provision of a detailed and structured application of the claims and arguments of moral relativism to the specific issue of corporate governance convergence with regard to South Africa.

The purpose of this chapter is to introduce the theoretical concepts that underlie the study and to articulate the research agenda that is followed in subsequent chapters. The first section provides the theoretical introduction by (1) describing the different claims of moral relativism, (2) providing a brief overview of what is meant by corporate governance, and how moral relativism can be applied to corporate governance convergence, and (3) introducing the South African context in which this study is situated. The second section provides detail concerning the research agenda itself and presents the research objectives, the research philosophy, approach and strategy, as well as a brief consideration of the methods used. The last section provides a brief outline of each chapter, identifying their respective contributions.

1.1 Theoretical background

Moral relativism

The problem of moral relativism is considered by Holmes (2007, p.150) to be “the central problem in ethics, one to which virtually all others eventually lead”. Gowans (2008) describes the three claims of moral relativism as follows²:

Descriptive moral relativism: As a matter of empirical fact, there are deep and widespread moral disagreements across different societies, and these disagreements are much more significant than whatever agreements there may be.

Metaethical moral relativism: The truth or falsity of moral judgments, or their justification, is not absolute or universal, but is relative to the traditions, convictions, or practices of a group of persons.

Normative moral relativism: We should not interfere with the actions of persons that are based on moral judgments we reject, when the disagreement is not or cannot be rationally resolved.

Descriptive moral relativism refers to the existence of “deep and widespread disagreements” as empirical fact (the statement on significance is largely tautological), and a body of evidence has been accumulated through anthropological studies to support this. Metaethical

and Normative moral relativism, however, present claims that fall largely within the realm of philosophical analysis. Although there are differences in terms of the academic discipline involved, there are clear connections between these claims. These can be summarised as follows (Gowans, 2008):

- Empirical support for Descriptive moral relativism is not sufficient to justify Metaethical moral relativism;
- If Descriptive moral relativism is rejected, there would be little support for Metaethical moral relativism;
- Support for Descriptive moral relativism and Metaethical moral relativism, together with a value of tolerance or accommodation, can support the claim of Normative moral relativism.

The path from Descriptive, through Metaethical, to Normative moral relativism cannot be established as logically necessary. If it is established that there are significant moral disagreements concerning certain issues, it does not necessarily follow that there is no absolute or universal moral truth on these issues. Similarly, if it is established that there is no absolute or universal moral truth on an issue, it does not by necessity mean that we should refrain from interfering with the actions of those that express moral judgements that differ from our own.

This study is an application of these three claims of moral relativism to the issue of corporate governance convergence. The next section considers the concept of corporate governance, and how moral relativism can be applied.

Application of moral relativism to corporate governance convergence

Definitions and descriptions of corporate governance are varied, and amongst others, include:

- “Corporate governance is the system by which business corporations are directed and controlled” (OECD, in Clarke (2004, p.1));
- “Corporate governance is about the exercise of power over corporate entities” (Tricker, 2000, p.xiii);

- “corporate governance is a fancy term for the various influences that determine what a company does and does not do or should and should not do” (Clifford Nelson, President of the American Assembly, quoted in Tricker (2000, p.xviii));
- “a major purpose of the corporate governance system is to provide legitimacy to those who manage corporations” (Weiss, quoted in Tricker (2000, p.xviii));
- “Corporate governance is concerned with holding the balance between economic and social goals and between the individual and communal goals.” (Sir Adrian Cadbury, quoted in Clarke (2004, p.2)).

Appealing largely to the first of the above definitions, the subject has often dealt with the internal structures of corporations. This includes the composition of the Board of Directors, the structure of the various committees, the responsibility for accounting reports and systems of internal control, and the management of risk. The focus on internal structures can sometimes mask the underlying relationship between the corporation and other groups in society. The internal structures referred to above are themselves often implemented (or at least recommended) in order to govern the relationship between the corporation (specifically management and the executive directors) and its shareholders. In some jurisdictions, the structures also regulate the relationships with other parties, such as employees and/or significant creditors.

An external corporate governance environment has developed alongside the internal structures, and provides the legal and regulatory framework within which corporations are governed. This framework includes corporate law, accounting standards, securities exchange listing requirements, labour and capital markets and even social norms (Rossouw, 2009). Within this framework the possible activities of corporations are limited, and the interests of different parties protected in different ways (see Rossouw (2009) for a more detailed discussion). The various corporate governance reports that have developed in recent decades around the world could be considered to be part of this external corporate governance environment, but with a specific focus on the internal structures of corporations required for good corporate governance.

The manner in which corporations are governed can also be viewed in terms of its relationships with society, as Rossouw (2009, p.6) observes: “the principles, regulations and directives associated with corporate governance ultimately constitute a view of the role,

responsibilities and obligations of corporations within a given society”. This broader view of corporate governance includes issues such as Corporate Social Responsibility (CSR), which deals with the relationship that the corporation maintains with its local communities and the environment. It also brings into question the *raison d’être* of the corporation itself. Instead of an unquestioning adherence to the maximisation of shareholder wealth, other possible responsibilities of the corporation are brought to light. These can be seen at a macro level, in terms of how the corporation contributes to national economic and social goals, and at meso and micro levels, in terms of how the corporation relates with all parties that are affected by it.

Clarke (2004, p.205) states that the “greatest contemporary theoretical and policy debates in corporate governance are whether there is global convergence towards the Anglo-Saxon market-based *outsider* model of corporate governance” (emphasis in original). This descriptive question is clearly of importance (and as discussed below, a review of the corporate governance convergence literature is undertaken in chapter two). However the normative question of whether there *should* be such convergence remains unanswered, and is typically not even raised. As indicated above, corporate governance models reflect the relationships between corporations and society. Implicit in these relationships are values that effectively prescribe the objectives and obligations of corporations. Convergence of such models across societies thereby entails convergence of these values, and convergence of the objectives and obligations of corporations. The normative question is then of particular importance in developing countries such as South Africa, which has inherited corporate structures that resemble those in Anglo-American jurisdictions (principally the USA and UK) that are geared towards the maximization of shareholder wealth, and yet must deal with calls for increased corporate responsibilities to other parties, based on concepts such as social justice and traditional African values.

In the context of this convergence debate, the claims of moral relativism become relevant, and can be reformulated as follows:

Descriptive moral relativism: There is moral disagreement with regard to the relationship between the corporation and society, including the objectives and obligations of corporations, and as expressed in differing models of corporate governance.

Metaethical moral relativism: There is no absolute or universal moral truth regarding the relationship between the corporation and society. That is, differing models of corporate governance can each claim to be morally right.

Normative moral relativism: It is morally wrong to impose a model of corporate governance on a society that maintains widespread moral disagreement with the values underlying that model. This would also apply to interference with another society's corporate governance model. This is subject to the disagreement being unable to be rationally resolved³.

As mentioned above, the reasoning is not deductive and hence any argument for the normative claim that is based on support for the Descriptive and Metaethical claims is not conclusive. However, the following important relationships can be identified:

- If Descriptive and Metaethical moral relativism can be justified, then Normative moral relativism is significantly strengthened.
- Similarly, if either Descriptive or Metaethical moral relativism cannot be justified, then Normative moral relativism is significantly weakened.
- If Descriptive moral relativism cannot be justified, this not only weakens Normative moral relativism, but renders it redundant.
- If Descriptive moral relativism can be justified, but Metaethical moral relativism cannot, the claim that one can interfere in the actions of those that are based on differing moral judgements may still be justified.

The purpose of this study is to summarise and evaluate evidence relating to Descriptive and Metaethical moral relativism as applied to corporate governance in South Africa, and to examine the extent to which the claim of Normative moral relativism can be applied the South African context.

Criticism of moral relativism

A number of significant criticisms have been levelled against moral relativism (Williams, 1972; Rossouw & Van Vuuren, 2004, p.91; Gowans, 2008)), which require particular consideration. Firstly, there is an implicit contradiction in the argument for Normative moral relativism: the prescription that one should not interfere with the actions of those with different moral judgements is intended to be a universal moral principle, but is premised on

Metaethical moral relativism that insists that there are no universal moral principles. This contradiction is taken by some to be the death-knell for moral relativism, and some philosophers (such as Williams (1972, p.32)) consider moral relativism to be one of the most absurd views to have been put forward.

Any defence of a universal Normative moral relativism must then show why the prescription not to interfere with the actions of those with different moral judgements should be regarded as an exception to the claim that there are no universal moral principles. Regarding the application of moral relativism to corporate governance convergence it can, however, be argued that the Metaethical position does not claim that there are no universal moral principles at all, only that there is no universally morally superior model of corporate governance. In this more limited version of moral relativism, the implicit contradiction within Normative moral relativism falls away - it is possible to claim that there are universal moral principles in certain areas, but not in the area of corporate governance.

Wong (1984) provides an alternative approach, arguing that Normative moral relativism is not a universal moral principle, but is nevertheless binding when one subscribes to a value of tolerance, whereby interference is not morally permissible unless it can be justified to the other party. In a more recent (2006) work, he has suggested a value of accommodation, essential to any morality, that could provide justification for the Normative claim. In this view Wong is implicitly acknowledging a limited moral relativism to the extent that he posits certain values that are universally essential to any morality.⁴ If tolerance or accommodation is accepted as a universal principle, then the Normative prescription not to interfere with corporate governance systems based on different moralities can be consistently held.

The second major criticism of moral relativism is that it stifles debate. The acceptance of Metaethical moral relativism can imply that one should not consider and debate the merits of conflicting moral judgements (Williams (1972, p.40), for example, notes that “it is possible for someone persuaded of subjectivist views to cease to care about moral issues”). This lack of debate can be seen to negate, or at least hinder the possibilities of finding solutions to moral problems. Similarly, a lack of debate and an acceptance of different moral judgements could result in the acceptance of tyrannical practices (however defined), and a rigid adherence to the status quo (particularly where a group’s morality is determined by reference to the majority, see Levy (2002, p.80)).

There are however, a number of ways in which debate need not be stifled, and where considerations of moral relativism may in fact provide further insights. Firstly, regarding social or cultural moral relativism, the morality that is characteristic of a particular society or culture is not considered ‘finalised’, and is consequently open to debate and analysis. Secondly, regarding the application of moral relativism to corporate governance where the existence of certain universal moral principles is accepted, debate over whether or not the moral principles underlying corporate governance fall within this set of universal moral principles must surely follow. Thirdly, if tolerance or accommodation is accepted as an important or necessary value, then, when faced with different moral judgements in differing circumstances, one must consider the extent to which such tolerance or accommodation is binding⁵. Lastly, to the extent that moral judgements are based upon empirical data (such as in a consideration of the consequences of an action), any assessments of these moral judgements is contingent upon the interpretation of the empirical data. The prescription of Normative moral relativism is therefore open to continual re-assessment as the empirical data, and the interpretation of the empirical data, change.

It is apparent then that although there are significant criticisms of Normative moral relativism, these are most effective when applied to an extreme moral relativism, in which claims concerning all morality are made. When dealing with a specific area of morality it is possible to maintain an argument for Normative moral relativism, albeit in a limited form. This study adopts such a limited moral relativism in its consideration of corporate governance convergence.

The South African context

The limited moral relativism adopted in this study is applied to the issue of corporate governance convergence with regard to South Africa. There are a number of ways in which South Africa provides a useful case study for the application of moral relativism. Firstly, it is racially and culturally heterogeneous. The eleven official languages (Afrikaans, English, Ndebele, Pedi, Sotho, Swazi, Tsonga, Tswana, Venda, Xhosa and Zulu) provide an indication of the country’s cultural diversity. These languages, however, only reflect Black and White racial groups, and there are significant Coloured (of mixed race) and Asian (predominantly Indian) populations. The 2010 mid-year population estimates (Statistics South Africa, 2010) estimate the population to be 79% Black African, 9% Coloured, 3% Indian / Asian and 9%

White. As a country with significant cultural diversity, investigation into how values may be relative to different cultural groups is appropriate.

Secondly, from the first European settlement in 1652 the country (or parts of it) had been administered as a Dutch and then British colony, and in 1910 became a dominion of the British Empire. Racial segregation was practiced throughout the colonial period, and became increasingly formalised in the twentieth century. From 1948 until 1994 a policy of separate racial development (apartheid) was official policy and strictly enforced. Accordingly, at the end of apartheid in 1994, South African society remained racially and culturally divided. Eze (2010, p.104) refers to South Africa prior to 1994 as being a “state without a nation”, and the years since 1994 have seen substantial efforts at promoting inter-racial reconciliation, unity, and a focus on ‘nation-building’. In 1998, then deputy-president Thabo Mbeki described South Africa as a country of two nations:

“One of these nations is white, relatively prosperous, regardless of gender or geographic dispersal. It has ready access to a developed economic, physical, educational, communication and other infrastructure ... The second and larger nation of South Africa is black and poor, with the worst affected being women in the rural areas, the black rural population in general and the disabled” (Mbeki, 1998b).

While there is evidence of a growing Black middle class, the basic inequalities identified by Mbeki in 1998 persist in 2010. Where White South African society has a European heritage that has influenced the legal and economic infrastructure of the country, the heritage of Black South African society is one of resistance and struggle against White dominance. The system of corporate governance that has been adopted in South Africa reflects the British legal heritage as well as concerns that can be associated with Black South African society (see West (2006), and section 2.4 in chapter two).

In this context of historical conflict and tension, consideration of the claims of Descriptive and Metaethical moral relativism, and the implications for the normative argument are both important and relevant. Answering the question of how the values that underlie corporate governance vary, both within South Africa, and between South Africa and Anglo-American jurisdictions can provide support for or against the claim of Descriptive moral relativism. Answering the question of whether or not a single corporate governance morality can be justified addresses the claim of Metaethical moral relativism. Consideration of the evidence

and arguments for both Descriptive and Metaethical moral relativism, together with other values such as tolerance and/or accommodation addresses the claim of Normative moral relativism. Ultimately, evidence and arguments that address the claim of Normative moral relativism have a practical relevance in the ongoing development of corporate governance in post-apartheid South Africa.

The discussion above illustrates both how the claims of moral relativism can be applied to corporate governance convergence, and how South Africa provides a useful case study for such application. The following section presents the research agenda that is followed in this study.

1.2 Research agenda

This section presents the research objectives, followed by an overview of the research philosophy, approach and strategy, and lastly a brief consideration of the research methods used in the study.

Research objectives

As noted above, this study is an application of moral relativism to corporate governance convergence, with regard to South Africa. Considering the different claims of moral relativism discussed above, as well as the South African context, the primary research objective can be formulated as follows:

Primary research objective

To summarise and evaluate the evidence relating to Descriptive and Metaethical moral relativism as applied to corporate governance in South Africa, and to examine the normative claim that it is morally wrong to prescribe the Anglo-American corporate governance model in South Africa.

Secondary research objectives

This primary research objective can be broken down into a number of secondary objectives. The claim of Descriptive moral relativism is concerned with the existence of moral disagreement, and there are many approaches that can be taken in investigating this claim. The secondary objectives below reflect several of these approaches, and include both an

investigation into existing evidence of moral disagreement, as well as an empirical investigation into the views of South African professional accounting students⁶.

Professional accounting students were chosen for several reasons. Firstly, there is a close relationship between professional accountants and corporate governance that is evident in the inclusion of audit committees and rigorous systems of internal control in corporate governance reforms, and the overriding concern for accountability and transparency, much of which is addressed through the development of appropriate accounting standards. The spectacular corporate failures of recent years have also frequently involved accountants, both in their perpetration and discovery. Secondly, professional accounting students represent a fairly homogeneous group as their education is tightly regulated and they typically share similar career prospects. As such, the group is amenable to investigations into moral differences and allows for effective analysis of differences between subgroups.

A single, separate research objective addresses Metaethical moral relativism and Normative moral relativism. The secondary research objectives are as follows:

1. *Descriptive moral relativism.*
 - 1.1 To study the relevant literature and summarise existing evidence of distinct or different moral judgements in South Africa regarding the objectives and obligations of corporations;
 - 1.2 To identify the extent to which professional accounting students in South Africa of different racial groups agree regarding the objectives and obligations of corporations;
 - 1.3 To identify the extent to which professional accounting students in South Africa agree with the Anglo-American model of corporate governance regarding the objectives and obligations of corporations;
 - 1.4 To understand how Black professional accounting students in South Africa perceive the objectives and obligations of corporations.
2. *Metaethical moral relativism.* To study the relevant literature and summarise existing evidence that there is no universally moral form of corporate governance.

3. *Normative moral relativism.* To examine the claim that it is morally wrong to prescribe the Anglo-American corporate governance model in South Africa. (Based on the outcome of secondary research objectives 1 and 2).

More detail on the choice of respondents for research objectives 1.2, 1.3 and 1.4 is provided in chapter four, which deals with the methodology adopted to achieve these objectives. Note that where research objectives 1.2 and 1.3 focus on identifying agreement (and, by implication, disagreement) in moral judgements, research objective 1.4 focuses on how a specific group perceives the objectives and obligations of corporations in more detail. The following section considers the research philosophy, approach and strategy that underlie the achievement of these research objectives.

Research philosophy, approach and strategy

Saunders *et al.* (2000, p.85) depict the research process in five layers: Research philosophy, Research approaches, Research strategies, Time horizons and Data collection methods. The first three of these are considered in this section and the last two in the subsequent section on Research methods.

Research philosophy

Research philosophy refers to the epistemological stance and assumptions of the researcher. In this study, it is assumed that it is possible to objectively evaluate the strengths and weaknesses of the relevant claims and evidence, and to arrive at a conclusion regarding the claim of Normative moral relativism. The researcher is thus considered independent of the claims and their supporting evidence, able to come to objective conclusions.

The view that emphasises the independence of the researcher and the objectivity of knowledge is typically referred to as positivist research philosophy (Saunders *et al.*, 2000, p.85). Referring to positivist philosophy in social science, Neumann (2003, p.71) describes it as “an organized method for combining deductive logic with precise empirical observations of individual behaviour in order to discover and confirm a set of probabilistic causal laws that can be used to predict general patterns of human activity”. With regard to the claim of Descriptive moral relativism in particular, it is assumed that independent moral views exist, that individuals hold such views, and that they are accessible and can be assessed through questioning. Although the current study is concerned with describing rather than predicting

moral perceptions, the aim is to be able to generalise the results within the limits of the methods used. A positivist research philosophy is therefore considered appropriate and is adopted in addressing research objectives 1.2 and 1.3.

There are, however, significant weaknesses in a purely positivist research philosophy. In the process of collecting and analysing data, the concepts under study need to be operationalised, and the data collected must be converted to numerical scores before statistical comparisons can be made. These processes do not necessarily address the concept under study adequately. A deeper view of moral agreement and disagreement would take into account the ways in which individuals deal with potentially conflicting moralities, and avoid attempts at reducing moral perceptions to numerical scores. Accordingly, a more interpretive research philosophy is also adopted (in addressing research objective 1.4) which pays more detailed attention to how the individual perceives the morality underlying corporate governance and how he/she deals with any potential moral conflicts.

Research approach

Saunders *et al.* (2000, p.87; see also Neuman, 2003, p.51) present two research approaches: deductive and inductive. In the deductive approach, consideration of the relevant theory and the formulation of research objectives lead to the generation of research hypotheses. The data collected is then used to empirically test the hypotheses. In the inductive approach the process is reversed and the data collected (based upon relatively undefined theoretical concepts) is used to generate viable theories.

Both Descriptive and Metaethical moral relativism present claims that can be confirmed (or rejected) by the consideration of appropriate evidence. Accordingly, although the claims do not amount to theories, a deductive research approach is adopted in the sense that the results of the investigations carried out will inform the claims of Descriptive and Metaethical moral relativism. As noted in section 1.1 above, the overall argument for Normative moral relativism is not a sound deductive argument. However, the argument nevertheless follows the rules of deductive logic, and the results of the investigations into Descriptive and Metaethical moral relativism will then inform the claim of Normative moral relativism.

Research strategy

Saunders *et al.* (2000, p.92) list the following eight different research strategies: experiment, survey, case study, grounded theory, ethnography, action research, cross-sectional and

longitudinal studies, and exploratory, descriptive and explanatory studies. Following Mouton (2001), literature studies and philosophical analysis are also considered elements of research strategy. The research strategies adopted are indicated below, along with a consideration of the empirical / non-empirical, and quantitative / qualitative nature of the study.

Before addressing the research objectives directly, the morality of the various models of corporate governance is analysed and summarised by means of a descriptive and explanatory literature study.

Research objectives 1.1 and 2 are both non-empirical as they refer to existing evidence that can be summarised and evaluated in support of certain claims. They are achieved through the use of literature studies and philosophical analysis that link the relevant literature to the claims of Descriptive and Metaethical moral relativism.

Research objectives 1.2, 1.3 and 1.4 refer to the determination of the moral views of professional accounting students, and are descriptive and empirical in nature. Primary data that relates to the claim of Descriptive moral relativism was gathered through the use of surveys, involving a quantitative questionnaire and qualitative interviews. The combination of quantitative and qualitative methods provides a form of triangulation to the extent that they both contribute to providing evidence for the same overall research objective (that of Descriptive moral relativism).

Research objective 3 involves non-empirical philosophical analysis that draws on the results of the studies conducted in the achievement of secondary objectives 1 and 2 above. The achievement of this objective also identifies practical implications and possibilities for further research.

The other strategies identified by Saunders *et al.* were not considered relevant as they either draw upon an inductive research approach (grounded theory) or do not correspond well with a descriptive study (experiment, action research).

Research methods

Following the research philosophy, approach and strategy outlined above, this section presents an overview of the actual techniques employed.

In order to achieve research objectives 1.1 and 2, thematic literature studies were conducted. Details regarding the sources consulted and the relevant time horizons are provided in the relevant chapters (see section 1.3 below).

In order to achieve research objectives 1.2, 1.3 and 1.4, both quantitative and qualitative empirical studies were undertaken, involving samples of professional accounting students in South Africa. These studies were synchronic rather than longitudinal. Although the latter are undoubtedly relevant, the focus is on the extent of current moral disagreements, rather than possible changes over time. Longitudinal studies are consequently considered to fall beyond the scope of this study. Further details on the research methods, including population and sampling, variables, research instruments and methods of data analysis are provided in chapter four.

1.3 Chapter outline⁷

This section provides an overview of the different chapters and the contributions made therein. A visual representation of the research strategy and chapter outline is presented in Appendix one.

This chapter has provided the theoretical basis that underlies the application of moral relativism to corporate governance convergence presented in this study. This was followed by an articulation of the research agenda, outlining the research objectives, philosophy, approach, strategy and methods adopted.

The next chapter provides a review of the predominant models of corporate governance around the world and the issue of corporate governance convergence. The moralities, and the moral differences, that underlie the principal models are identified. The chapter enables a more thorough understanding of how moral relativism is relevant to the issue of corporate governance convergence, providing a background for subsequent chapters. It also contributes to the existing literature by considering corporate governance and corporate governance convergence in terms of its underlying morality.

Chapter three presents the findings from a literature study concerning existing evidence of moral disagreement regarding corporate governance in South Africa. As such, it addresses research objective 1.1, as presented in section 1.2 above.

Chapter four presents the detailed research methods used in both of the empirical studies involving professional accounting students in South Africa. This provides the context for the findings of the empirical studies that are presented in subsequent chapters. The chapter also contributes to the existing literature through the development of a questionnaire survey instrument concerning moral differences related to corporate governance.

The results of the quantitative survey of professional accounting students in South Africa are presented in chapter five. This specifically addresses research objectives 1.2 and 1.3, as presented in section 1.2 above.

The results of a series of qualitative interviews with professional accounting students in South Africa are presented in chapter six. This specifically addresses research objective 1.4, as presented in section 1.2 above.

In chapter seven, the claim of Metaethical moral relativism regarding corporate governance convergence is considered in detail, through a literature study and philosophical analysis. This chapter addresses research objective 2, as presented in section 1.2 above.

The final chapter summarises the findings of chapters three to seven, which provide evidence for or against the claims of Descriptive and Metaethical moral relativism regarding corporate governance convergence in relation to South Africa. The implications for the claim of Normative moral relativism are then considered and the applicability of this claim in the South African context is evaluated, thereby addressing research objective three, as presented in section 1.2 above. This chapter also notes some limitations of the study, and highlights possible areas of further research.

Chapter 2: Corporate governance models and their morality

For 10 years, the United States enjoyed the longest economic expansion in the country's history. What could go wrong? Morality went wrong.

- William J. McDonough, Chairman of the USA Public Company Accounting Oversight Board, 2005.

This comment by William McDonough was made in relation to the 2001 stock market crash and the corporate scandals of Enron, WorldCom and others. It suggests that deficiencies in morality can have serious economic consequences, and that therefore the successful functioning of corporations and the economy has some sort of moral foundation. While the principles of responsibility, accountability, fairness and transparency (identified by the Millstein report presented to the Organisation for Economic Cooperation and Development (OECD) on 27 March 1998) are commonly held out as corporate governance 'virtues', differences prevail in how these are applied, to whom, and to what extent. The purpose of this chapter is to review the various models of corporate governance around the world, identifying and highlighting the moral aspects of these models and how the models may differ in moral terms. Moral judgements that can be related to corporate governance models can then be identified. These judgements, in turn, become the focal points for the claims and arguments of moral relativism. As indicated in chapter one, for the purposes of this study the concept of corporate governance is considered in its broader sense: the relationship between the corporation and society. The wide nature of the topic, together with the considerable academic interest that it has attracted (across a variety of disciplines), ensures that it is not possible within the space of a single chapter to adequately review all of its aspects⁸. Accordingly the review is limited to those aspects of corporate governance models that are relevant for an assessment of their morality.

The corporate governance literature frequently refers to corporate governance models as Anglo-American, European or Japanese. These terms, however, do little more than denote a geographic location. Other terms that are frequently used to differentiate models of corporate governance include shareholder / stakeholder, exclusive / inclusive, and outsider / insider. As these terms have more conceptual content, an understanding of these is necessary before an appreciation of the different models is possible. The chapter therefore begins with a review of

the theoretical distinctions applicable to corporate governance models. This is followed by overviews of the Anglo-American model and the Continental European and Japanese models. In each case this is accompanied by an identification of the moral principles implicit in the models. A brief discussion of other models from transitional economies and developing nations follows. The convergence debate is then presented and the chapter concludes with a summary of the moral judgements relevant to corporate governance models.

2.1 Theoretical distinctions

Shareholder / Stakeholder

In the spheres of ethics and management, the most common distinction between corporate governance models is the degree of their orientation towards either shareholders, or all stakeholders (Freeman & Reed, 1983; Goodpaster, 1991; Donaldson & Preston, 1995; Turnbull, 1997; Letza *et al.*, 2004). Within corporate governance models with a shareholder orientation the corporation can be considered to amount to no more than an extension of its owners, who are identified as the shareholders. Executive management are employed (as agents) to act on behalf of the shareholders (as principals), and are expected to follow their ultimate objectives for the corporation. Although the relationship between shareholders and executive management is not explicitly governed by any contract, the priority given to shareholder interests is justified with reference to the financial risk borne by shareholders, who participate in the net assets of the corporation only after all obligations are accounted for, as well as by the shareholders' power to appoint and remove directors. There is a potential conflict between the interests of executive management and the shareholders, which is often the focus of corporate governance reforms (see the discussion of the agency problem on p. 21 below).

Within such a shareholder model the goal of the corporation is to maximise shareholder wealth through the provision of goods or services, and responsibility and accountability is both required and limited to the shareholders alone. The primacy of shareholder wealth is evident in the fact that financial reporting is typically addressed to the shareholders (or 'members'), and in management's focus on earnings per share figures and share prices. Decision-making should always be to the ultimate benefit of the shareholders and unless corporate activities can generate benefits for the shareholders they should not be undertaken.

This has significant implications for activities that fall within the domain of Corporate Social Responsibility (CSR), including donations, community upliftment projects, and environmental impact and restoration. Milton Friedman (1970) took issue with calls for increased CSR and in *The social responsibility of business is to increase its profits*, argued that the role of the corporation should be solely economic. Friedman argued that when executives spend resources on social concerns to the detriment of company profits, they are effectively both imposing and allocating a tax on the shareholders. This tax administration is conducted outside established political processes that are set up to ensure that the interests of the general public are considered as far as possible. Tax collection and social expenditure should thus rather take place through these established political processes. Friedman also argues that while executives may be experts in business they cannot necessarily be considered qualified to effectively discharge social responsibilities. He insists that the responsibility of business should therefore be limited to maximising profits, within the legal and ethical rules of society.

In contrast, the stakeholder model is based on a view of the corporation as a social entity that has responsibility and accountability to a variety of stakeholders. Freeman & Reed (1983, p.91) propose a wide sense of the term ‘stakeholders’, which includes all those that may affect or are affected by the corporation’s objectives, and a narrow sense which includes any group or individual that is dependent upon the corporation (including shareholders / owners, some suppliers, customers, and employees). The stakeholder view holds that the role of the corporation is not merely financial, nor solely economic, but includes social and environmental objectives and that the corporation should be more accurately described as a “vehicle for coordinating stakeholder interests” (Evan & Freeman, 1993, p.82). The concept of ‘triple-bottom line’ reporting (Elkington, 1997) has developed along these lines widening corporate accountability to include reporting of social and environmental activities alongside the full economic impact of the corporation. Concepts of corporate citizenship, CSR, and Socially Responsible Investments, as well as the integration of normative ethics within corporate relationships are all closely allied to the stakeholder view of the corporation. Unsurprisingly, this wider view of the corporation is critical of Friedman’s view that social responsibilities are not the responsibilities of business. Stone (1992, orig. 1975), for example, argues (1) that executive management have not at any point actually made any promise to shareholders and are accordingly not bound by any such promise (and even if there was such a promise, this would not preclude breaking the promise when faced with issues of significant

social concern), (2) that the principal-agent description is inaccurate as this is not supported in law, and the agents do not actually seek to determine the principals' wishes, (3) that there is no reason why their role within the corporation exempts businesspeople from exercising moral concerns and responsibilities, and (4) that there are significant limitations in the market and the legal system which reduce the effectiveness of relying solely upon these institutions to ensure socially desirable behaviour.

The stakeholder model has itself been further divided into descriptive, instrumental, and normative theories (Donaldson & Preston, 1995). Descriptive stakeholder theory refers to the empirical observation that corporations have multiple stakeholders. Instrumental stakeholder theory justifies the widening of corporate responsibility and accountability by appealing to the improved efficiency, and/or ultimately greater shareholder wealth that is generated. Normative stakeholder theory refers to motivating forces for widened responsibility and accountability based on a consideration of stakeholders as having "intrinsic value" (Donaldson & Preston, 1995, p.67), which is ultimately based on certain moral philosophies, community values and traditional beliefs. Donaldson & Preston (1995) insist further that the descriptive and instrumental aspects of stakeholder theory require the normative form as their foundation.

One of the principal problems of stakeholder theory lies in how to prioritise and manage the competing interests of various stakeholders (particularly if the stakeholder groups are considered to have equal status) and make decisions that are beneficial to the corporation. Goodpaster (1991) made a distinction between a 'strategic stakeholder synthesis' in which stakeholders are considered in so far as this assists in achieving the corporation's strategic objectives, and a 'multi-fiduciary stakeholder analysis' in which stakeholders are considered as ends in themselves, worthy of a fiduciary duty similar to that owed to the company and its shareholders. Goodpaster's conclusion is that while stakeholder interests should be considered, shareholders must be given priority.

There is some overlap then between the shareholder model and instrumental stakeholder theory, in that both regard shareholders' interests as the primary goal. In practice, this is evident in the adoption of 'triple-bottom line' reporting, CSR and corporate citizenship practices in countries with a traditionally shareholder orientation, where these activities are seen as a means to enhancing shareholder wealth. In this sense there is more of a critical

difference between normative and instrumental stakeholder theory than between the shareholder model and instrumental stakeholder theory.

In some circles, notably the South African corporate governance arena, ‘exclusive’ and ‘inclusive’ corporate governance models have been referred to (for example, Institute of Directors, 2002, Introduction, para. 41). This distinction is closely allied, if not identical, to the shareholder / stakeholder distinction, where the term denotes the extent of corporate responsibility and accountability. In an exclusive model, responsibility and accountability is limited to the shareholders only. In an inclusive model, all parties that affect, or are affected by the corporation are included in issues of responsibility and/or accountability.

Outsider / Insider

The outsider / insider distinction is used most commonly with reference to the legal structures and financing arrangements of corporations. The relationship between the owners and managers is central in this analysis.

In an outsider model managers direct corporations, but the equity capital is largely owned outside the corporation, by shareholders other than management. In some cases share ownership is widely dispersed across large numbers of individual shareholders, in other cases certain institutions maintain large shareholdings. Based on the assumption that each party involved with the corporation seeks to maximise their self-interest, the corporation itself is seen as a *nexus of contracts* (based on the work of Coase, 1937; Jensen & Meckling, 1976). These contracts, both implicit and explicit, are implemented to restrain self-interested behaviour, and direct it for the benefit of the organisation (typically referring to the interests of shareholders). Management are contracted to maximise shareholder wealth and are considered to act as agents for the shareholders as principals (Jensen & Meckling, 1976). However, as they have control over corporate resources, they are also expected to maximise their own benefits to the detriment of shareholders’ interests. This could occur through self-dealing, shirking or increasing their perquisites, as well as through decision-making based upon a desire to remain in power, different time horizons and different risk aversion (Denis, 2001; Lambert, 2001). Accordingly, attention overwhelmingly falls on this conflict between the interests of management and the interests of the shareholders.

Corporate governance strategies that are developed within the outsider model are thus aimed at resolving (or at least, monitoring and controlling) this ‘agency problem’ (Watts and Zimmerman (1986, p.184) note that management ultimately bear these agency costs, and are thus motivated to implement corporate governance measures themselves). Strategies to achieve this include an effectively established and functioning Board of Directors, aligning the interests of shareholders and management through the development of innovative remuneration schemes (such as share option plans), and curtailing managerial excesses with the establishment of rigorous internal control systems (Denis, 2001). Ultimately, managerial deviance can also be controlled through the market for corporate control (takeovers) and the managerial labour market (Fama, 1980); in the outsider model there is consequently a firm belief in the necessity of efficient markets.

The insider model is characterised by both ownership and control residing with a small number of shareholders and other stakeholders (Van den Berghe, 2002, p.11; Solomon & Solomon, 2004, p.149). Even for large, listed corporations, banks rather than securities markets are the principal sources of finance, and shareholdings are typically highly concentrated. Consequently, a small number of dominant shareholders are able to play an active role in the governance of the corporation, and this proximity of ownership and control should ease the agency problem that is so characteristic of the outsider model. The insider model can, however, go beyond closely-held shareholding, and other groups, such as creditors, other corporations, employees, family groups and government may contribute to the ‘insider’ group in controlling the corporation. A two-tier board structure with representation by employees and creditors is one example of how this can be implemented. The close involvement of these different groups can then shift the focus from shareholders’ interests to include the interests of other stakeholders, and/or direct the directors’ duties towards the corporation rather than shareholders. At the same time, however, this proximity can provide opportunities for abuse by powerful individual shareholders (or other stakeholders), may create conflicts between shareholder and other interests (particularly where banks play a dual role as shareholder and creditor), and minority shareholders can suffer from minimal transparency and accountability (Van den Berghe, 2002, p.11).

These models have also been referred to as market-based (outsider) or relationship-based (insider) (Solomon & Solomon, 2004, pp.149-50). ‘Market-based’ refers to the belief in the capacity of efficient labour and capital markets to resolve the agency problem; and

‘relationship-based’ refers to the close relationships between the corporation and the key stakeholders.

Summary

There are clear similarities between these different terms. The shareholder / stakeholder distinction can be equated to the exclusive / inclusive distinction. There is also a strong, although not a logically necessary link, between the shareholder and outsider descriptions (where the corporation’s obligations to shareholders reflect the fact that they have contributed the capital and bear the financial risk), and, to a lesser extent, between the stakeholder and insider descriptions of corporate governance (where creditors may for example be involved in decision-making through a two-tiered board structure).

All of these descriptors, however, represent extremes on continua. As such, it is simplistic to categorise corporate governance models as exclusively outsider oriented or shareholder dominated, and in practice, all models display elements of both extremes. This is not to say, however, that all models fall into the same position along the continua, and significant differences between corporate governance models around the world can be identified. It is possible, then, to categorise the various models as being predominantly shareholder or stakeholder dominated, and outsider or insider oriented. Solomon & Solomon (2004) have indeed performed such an exercise (using the insider / outsider categories) for 28 countries.

The following section summarises some of the key differences in corporate governance models worldwide and identifies moral principles that can be related to these, beginning with the Anglo-American model.

2.2 The Anglo-American model

The approach to corporate governance that is dominant in the USA and the UK (as well as several other countries such as Australia and New Zealand) can be described as being predominantly shareholder (or exclusive) and outsider oriented. Originally, the corporation was a means of raising capital for endeavours that were either too risky or too expensive for individuals. In these jurisdictions, the combination of increased industrialisation (and its demand for funds) with more permissive corporate laws gave rise to rapidly increasing numbers of corporations from the mid-nineteenth through the twentieth century. As

conglomerates grew, and began to wield substantial economic power, the number of their shareholders increased, with progressively smaller ownership stakes. In 1932, Berle & Means identified the separation of ownership (shareholders) and control (management) that had arisen with increasing shareholder dispersion as a significant problem⁹. Through the use of various corporate structures (such as pyramidal ownership) and mechanisms (such as proxy committees), control of the economic powerhouses was held either by a few, minority shareholders, or by executive directors themselves (who need not have held any shares).

From the 1970s in particular, corporate governance in the USA has focused on how the agency problem, resulting from this separation of ownership and control, can be resolved. Key developments include the work of Jensen & Meckling (1976) that emphasised efficient contracting and Fama (1980) who emphasised the role of efficient markets in reducing agency costs and resolving the problem of conflicting interests. These seem to have had some effect from the 1980s, which saw a rapid increase in takeover activity and the use of 'junk' bonds in leveraged buy-outs, as well as increased attention to aligning executive and shareholder interests through the use of executive share option schemes. Executive remuneration, particularly in the USA, increased steadily through the 1990s and 2000s, and Clarke (2007) considers the gap between executive remuneration and average worker remuneration to be one of the central concerns in American corporate governance.

The attention given to corporate governance in the USA and UK in recent decades can be linked to a series of corporate failures. In the UK, the committee chaired by Adrian Cadbury which produced the *Report of the Committee on the Financial Aspects of Corporate Governance* in 1992 (the forerunner of a range of corporate governance reports worldwide) followed the collapses of Maxwell and the Bank of Credit and Commerce International. In the USA, the scandals of Enron, WorldCom, Tyco, Adelphia and others led to the Sarbanes-Oxley Act of 2002. In both countries the corporate governance reforms have been aimed at improving the monitoring, supervision and transparency of the directors on behalf of the investors who do not have access to the corporation's activities. Accordingly, the reforms have dealt with topics such as the role and structure of the Board of Directors, the need for independent and non-executive directors, the separation of the positions of Chief Executive Officer and the Chairman, the approval of directors' remuneration, the adequacy of internal control systems, the role and structure of the audit committee and the need for a nomination committee.

Although the focus has been overwhelmingly on the agency problem and thus the interests of shareholders, wider issues of stakeholder responsibility have not been absent from debates in the USA and UK. Friedman's 1970 article specifically relates his concern at calls towards increased social responsibility as a legitimate corporate objective. *The Corporate Report*, produced by the Accounting Standards Steering Committee of the Institute of Chartered Accountants in England and Wales in 1975, called for reporting and accountability to all those affected by the decisions of directors (Tricker, 2000, p.xvii). Tricker (2000, p.xvii) notes, however, that political implications and the threat to managerial power resulted in the report being shelved. Although there has still been interest in stakeholder concerns, 'triple-bottom line' reporting, CSR and corporate citizenship in recent decades, the shareholder orientation remains dominant. A particularly vivid example can be seen in the statement made by the Australian Shareholders' Association after the 2004 Asian tsunami, that directors do not have the right to donate corporate funds for tsunami relief without the prior approval of their shareholders (ABC News online, 2005).

Although the Anglo-American model is referred to as a single model, there are differences in the corporate governance systems of the UK and USA (Institute of Chartered Accountants in England and Wales, 2005). These include differences in shareholder dispersion, a reluctance to separate the role of CEO and Chairman on American boards, and a commitment to corporate governance 'principles' in the UK, compared to a 'rules-based' approach in the USA. While these differences may be valid, and particularly apparent when investigating at the level of individual corporations, the significance of the similarities between these countries ensures that study of the Anglo-American model remains most useful at a macro level.

Morality

Collier and Roberts (2001, p.68) approach the ethics of the Anglo-American model as follows:

“Within the agency view of governance there is in principle no ethics and hence no ethical problem. Instead we are confronted with an atomized self-seeking individual, who must be closely watched and can only be frightened or incentivized into taking account of the interests of others. The only ethical imperative at work here is a Friedmanesque dictum to pursue profit maximization.”

This approach comments on the view of human behaviour upon which agency theory is based: that of the rational individual, who, given competing choices, will always choose that which optimises his/her economic benefits. Such a view does not permit altruism or selflessness, and if ethics essentially involves a consideration of the ‘good’, the ‘self’ and the ‘other’ (see Rossouw & Van Vuuren, 2004), then indeed there would not seem to be room for any ethics. The Anglo-American model, as an extension of this view by virtue of its basis in agency theory, and which expressly limits consideration of the interests of stakeholders other than shareholders, could then be thought of as having ‘in principle no ethics’.

However, despite the assumption of self-interested behaviour, it does not necessarily follow that the Anglo-American model has no connection with the human ‘good’. There could, for example, be ‘good’ consequences of such a system, the system could be instituted with ‘good’ intentions and imbued with ‘good’ principles (such as fairness and honesty), and there could be ancillary ethical implications associated with its implementation (such as the achievement of individual freedom and/or self-fulfilment). Limited corporate responsibility and accountability does not necessarily render the model either immoral or amoral.

One aspect of the morality of this ‘Friedmanesque’ profit maximisation refers to the classical economic models espoused by Adam Smith’s (1776) *An Inquiry into the Nature and Causes of the Wealth of Nations*, and David Ricardo’s (1817) theory of comparative advantage, in which the greatest economic benefits are to be generated with increased competition and increased international trade. Rational economic models demonstrate how aggregate wealth is maximised in economic conditions of perfect competition, in which buyers and sellers can enter and exit the market freely, and in which there is no, or minimal, government intervention. The corporate law reforms of the nineteenth century, particularly the introduction of companies in which the liability of shareholders is limited to their investments, contributed significantly to such economic competition and trade.

Coelho *et al.* (2003a) use the hypothetical example of mousetrap production to show how the public interest is served through open markets and the prioritisation of shareholder wealth. They consider how competition in the marketplace aims to entice consumers through three legal means: “(1) by offering better ‘mousetraps’ at attractive prices; (2) by offering equivalent ‘mousetraps’ at lower prices or more conveniently; (3) by offering products that substitute for ‘mousetraps’” (p.17). The authors then argue that “customers benefit through

either better traps, less expensive traps, or trap substitutes ... suppliers of mice control products benefit because they have higher incomes than they would have had otherwise ... even people who are not bothered by mice benefit from improved mice control” (p.17), the last group benefiting from general improvements in public health and in more efficient allocation of resources. The example concludes as follows:

“if we accept the notion that serving the public interest is the *sine qua non* of social responsibility, then it follows logically that legal profit seeking (with neither fraud nor deception) is socially responsible. Consequently, ethical corporate agents are being socially responsible in their efforts to fulfill their fiduciary obligations to the shareholders” (p.17).

In as far as improved economic efficiency through competition and increased aggregate wealth serve the public interest and reflect the socially desirable ‘good life’, and to the extent that the Anglo-American model, through the dominant position of the market, the primacy of shareholder wealth and the limited role of other stakeholders, achieves this, the model can claim to achieve the greatest good for the greatest number. Moral support for this approach can accordingly be provided along traditional utilitarian grounds. Referring to the development of the limited liability company, Tricker (1990, p.253) indeed suggests that “only the invention of the wheel, it might be argued, has added more to the development of human well-being”.

As seen in the Coelho *et al.* example above, the primacy of shareholder interests can be linked to the fiduciary duties of directors. Although legally this duty may actually be to the corporation itself, the existence of a special, moral, duty to shareholders can be supported by the observation that that unlike stakeholders such as employees, suppliers and customers, the interests of shareholders are not explicitly guaranteed through any contract. To avoid exploitation of this group a special duty to prioritise the interests of shareholders is necessary.

Another moral aspect of the model can be identified in its political context. Historically, the USA and the UK have emphasised individual freedom, and have limited the degree to which the state can and should interfere in the lives of individuals. The preservation of individual freedom is considered to have high moral value, and the state is accordingly concerned largely with preserving individual freedom, and in creating conditions in which this freedom can flourish. These political views can be traced through some of the ‘Founding fathers’ of the

USA (particularly Thomas Jefferson and James Madison) to the social contract theory and limited role of government advocated by John Locke and Thomas Hobbes. The ‘enabling’ corporate reforms of the mid-nineteenth century can then be seen as an example of how the state has played its role of facilitating the expression of individual freedom.

An ethical defence of individualism can also be found in notions of self-fulfilment, self-realisation and authenticity. Humanistic and existentialist psychologies and philosophies, from Carl Rogers to Abraham Maslow to Jean-Paul Sartre, all emphasise the individual and his/her development (See Sartre, 1946; Craighead & Neneroff, 2001). Charles Taylor (1991) also argues for an individualistic ‘ethic of authenticity’, and regards the self-centred aspects of individualism in Western culture as “deviant and trivialized modes [of the ideal of authenticity]” (p.55). He calls instead for a “work of retrieval, that we identify and articulate the higher ideal behind the more or less debased practices” (p.72) and claims that “like other facets of modern individualism ... authenticity points us towards a more self-responsible form of life” (p.74). *Prima facie* judgements of the Anglo-American model as immoral, by associating it with the “malaises” (Taylor, 1991, p.1) of modern Western individualistic culture may therefore be premature.

Other moral aspects of the Anglo-American corporate governance model can also be identified. Much of the focus in recent reforms is on making management accountable to the shareholders; this can be linked to moral virtues of fairness, honesty and transparency. Maitland identifies a number of moral aspects to free-market economics, including the morality of self-interest (2002), communitarian ethics (1998), moral virtues in the market (1997), the right to self-determination (1994) and the right to free voluntary contracting (1989). The last two of these draw specifically on the notions of the corporation as a *nexus of contracts* and efficient voluntary contracting that underlie Anglo-American corporate governance. Finally, the apparent immorality of the prioritisation of shareholders, to the neglect of other stakeholders, can be mitigated when one considers the possibility that shareholder wealth can be increased through greater attention being paid to customers and employees (instrumental stakeholder theory), and the fact that social concerns are increasingly addressed through powerful institutional investors (Ryan, 2005, p.59).

2.3 The Continental European and Japanese models

The two models that have provided the strongest alternatives to the Anglo-American model are the Continental European and Japanese models. Although geographically distant, there are some similarities in these models. Despite the variety of countries that comprise Continental Europe, the corporate governance literature tends to highlight Germany, and sometimes France and Italy, as specific examples of successful non-Anglo American models. This discussion consequently focuses on these countries.

In contrast to the minimalist role of the state in the USA and the UK, the state has traditionally played a much stronger role in Continental European society. One key difference with Anglo-American countries is in the legal model of Continental Europe and Japan. Unlike the system based on English common law that has developed in the USA (with some exceptions, such as Louisiana), the UK, Australia and New Zealand, the system in Continental Europe is one of civil law. This can be further categorised as French, German and Scandinavian civil law, with most European countries (excluding the UK) adopting or being heavily influenced by one of these. The Civil Code of 1804 (renamed *Code Napoléon* in 1807) represents the foundation of French civil law¹⁰, which then greatly influenced the development of the German code (*Bürgerliches Gesetzbuch*) in 1900. In contrast to common law systems in which case law and the opinions of judges play a dominant role, these codes and statutes provide the prescriptions through which society is regulated. The role of judges is consequently in applying the code.

Significant corporate reforms did occur in Continental Europe in the nineteenth century, but following the nature of their legal systems, corporations were more tightly regulated than in the USA or the UK. One major difference was in the German requirement for a supervisory board in addition to the managerial board of directors (instituted in the 1870 company law (Fohlin, 2005, p.261)). This supervisory board was entitled to supervise and scrutinise the affairs of the business and the conduct of the directors and specific provision was made for employee representation. This two-tiered board structure remains dominant in Germany, and was even proposed as a Europe-wide reform through the draft Fifth directive of the European Economic Commission in 1972. This was unsurprisingly not well received in the UK (Tricker, 2000, p.xvi).

Another significant difference lies in the ownership and financing structures of corporations (Solomon & Solomon, 2004). In France, the state has ownership or control interests in many companies, particularly those in the financial services sector. Across Continental Europe capital markets have played a reduced role as many companies raised finance through loans rather than through a public listing (Clarke, 2007). Creditors (banks and insurance companies) are consequently significant stakeholders (and shareholders) and play more important roles in the governance of companies. There are also significant cross-holdings and pyramidal corporate ownership structures, which contrasts significantly with the more dispersed share ownership now prevalent in the USA, and in Italy family interests (with varying degrees of ownership) have played a dominant role in the control of corporations (Aganin & Volpin, 2005). The concentrated share ownership and stakeholder representation on supervisory boards mean that for dominant shareholders there is no real separation of ownership and control. This has required a different focus in some European corporate governance reforms, with particular attention being paid to enhancing the rights of minority shareholders (Clarke, 2007, p.172).

Japan's corporate environment reflects many of the structures of the German system, and its legal system was heavily influenced by the German civil code. From the 17th century, Japan's economy was dominated by a group of family-run businesses known as the *zaibatsu*, which, with close relationships through several banks, has evolved into the *keiretsu* (Solomon & Solomon, 2004, p.171). The high growth period from the 1960s was characterised by significant cross-holdings, cross-directorships, involvement from credit providers, and a high level of cooperation between executive management and employees (evidenced in the lifetime employment common amongst Japanese businesses). Capital markets have played a reduced role in raising finance when compared to the Anglo-American model, and significant stakeholders (particularly banks) are more intimately involved with company management. Government has also played a role in protecting some industries and oligopolies, accompanied by various barriers to non-Japanese businesses (Clarke, 2007, p.209). The economic recession of the 1990s has, however, resulted in a reduction in cross-holdings, and a significant increase in foreign (specifically Anglo-American) ownership of Japanese businesses has focused attention on improving accountability and transparency towards shareholders.

In terms of the categories discussed above, the models of corporate governance that predominate in Germany and Japan (and which are also evident in varying degrees in countries such as France, Italy, Taiwan and South Korea) can be considered to be stakeholder (or inclusive) and insider oriented. Wieland (2005) provides further detail, noting that some European countries do adopt a shareholder orientation in the Anglo-American mould, and that within the stakeholder orientation a further distinction can be made between countries which view the organisation as an exercise in cooperation between stakeholders and those which set the organisation's objectives apart from those of all stakeholders (including shareholders)¹¹. Developments in European corporate governance that suggest a move towards the Anglo-American model can also be identified (Clarke, 2007) and attributed partly to corporate scandals such as Ahold and Parmalat, and partly to the need to attract international investment, given the strength of financial institutions in the USA and UK.

Morality

The morality of this approach is perhaps more directly evident than that of the Anglo-American approach. The formal inclusion of stakeholder groups such as employees and creditors in the system of corporate governance through the supervisory board can be considered to have moral value. Theoretically, at least, it should be more difficult for employees and creditors to suffer at the expense of shareholders' interests. As the dominant shareholders have direct access to management, the agency problem that is such an issue in the Anglo-American model should also be alleviated. Accountability and transparency of executive management should thereby be facilitated. While these moral advantages may hold for significant shareholders and those with direct representation, minority shareholders without such involvement could be exploited. Demise (2005, p.216) also notes that problems of death from overwork (*karoshi*) and harassment of employees persist in Japanese companies, which suggests that the moral benefits of an employee orientation are not clear cut.

The strongest moral argument for the Continental European and Japanese models emphasises their incorporation of stakeholder interests and identifies the 'stakes' of the various stakeholder groups with moral worth. Evan and Freeman (1993) consider the various types of 'investments' that different stakeholder groups make in the corporation (both financial and non-financial) and the ways in which all stakeholders are affected by the corporation and each

other. Although working from an Anglo-American perspective, their proposal is a wholesale reinterpretation of the corporation along the lines of Kantian deontological morality. They consider traditional managerial capitalism to give insufficient weight to stakeholder interests, and identify legal and economic areas in which the shareholder approach has already come under attack and been compromised. Their reinterpretation requires that the interests of stakeholder groups are included *as ends in themselves* rather than as a means to increased shareholder wealth. This further entails redefining the purpose of the corporation as a “vehicle for coordinating stakeholder interests” (1993, p.82), and the authors envisage the introduction of stakeholder representation at board level and changes to corporate law in order to bring this into practice. The corporate governance models of Continental Europe and Japan, which, to varying extents, already incorporate the active involvement of stakeholders other than shareholders, could therefore be justified under a Kantian deontological morality.

In a similar vein, Donaldson and Preston (1995) consider the ‘stake’ of the various stakeholder groups to represent a “moral interest” (p.85), but justify this with reference to property rights and distributive justice, in its “modern and pluralistic form” (p.88). This acknowledges various characteristics of distributive justice, such as “need, ability, effort, and mutual agreement” (p.84) and observes that the stakeholder conception of the corporation gives form to these potentially competing aspects of distributive justice (such as where employee interests may be worthy of consideration based on their long-term effort, whereas the interests of members of the local community may be warranted based on their need (p.84)). A corporate governance model that actively brings these various stakeholder interests into consideration, rather than leaving them as a function of the market (assumed to be efficient) would therefore appear to have moral justification.

A case can also be made in which moral support for this model is provided by appeal to utilitarianism. The economic successes of Germany and Japan can arguably be linked to their stakeholder, insider approach to corporate governance. Clarke (2007, p.183) notes that the German economic success involved “[investing] in high quality production with a highly skilled workforce. Companies substantially invested in their employees and offered security of employment, and workers reciprocated with commitment and ingenuity”, a process enabled through the supervisory board mechanism. Siebert (2004, p.41) considers the German approach to be well oriented to incremental improvements in established industries such as the automobile industry, but “deficient in leapfrogging to new approaches and new products”

when compared to the USA. Similarly, recent developments which suggest a move towards the Anglo-American corporate governance model in Japan have raised the question whether “Japan can continue with its unrivalled manufacturing expertise and commitment to innovation and research and development” within this new framework (Clarke, 2007, p.214). Where the ‘good’ takes the form of increased loyalty, commitment, security and/or innovation and development of high quality products (rather than increased returns to shareholders), the insider, stakeholder model could be considered to achieve the greatest good for the greatest number.

Despite the moral worth that can be associated with the consideration of stakeholder interests in Continental Europe and Japan, there is some evidence that shareholder interests carry a favoured position. With regard to Continental Europe, for instance, Wieland (2005), notes both that “stakeholder approaches and approaches focused on the firm do, of course, mention the paramount importance of shareholder interest” (p.84) and that “[stakeholder-oriented codes] put the interest in social welfare, prosperity, the creation of jobs, as well as taking social and ecological responsibility at par with shareholders’ profit interests” (p.86). It is not possible to categorise the stakeholder orientation of Continental Europe and Japan as simply either instrumental (justified by appealing to improved economic efficiency and greater shareholder wealth) or normative (justified by beliefs that wider stakeholder concerns are important as ends in themselves). There is perhaps evidence for both, although the moral distinctiveness of this approach (particularly when compared to the Anglo-American model) lies in its normative depth.

2.4 Other models

The models of corporate governance discussed above cover the developed, industrialised nations. These nations have, by and large, developed their own formal corporate governance structures over time, and during the 1990s and 2000s have been engaged in extensive reforms to address weaknesses that have been exposed through corporate failures and market collapses, and to attract international investment for further growth. The majority of the world’s population, however, are located in developing, emerging or transitional economies with significantly different politico-economic histories and immediate concerns. Characteristics of the corporate landscape in these nations frequently (but not always) include the presence of dominant shareholders (often family groups) who control the company

through various means, relatively weak financial markets and weak regulatory environments (Claessens, 2006). These nations also differ significantly from the USA, UK, Continental Europe and Japan in that socio-economic development is of paramount importance (Reed, 2002). The relationship between corporations, governance and development is key, and in many of these countries corporate governance reforms are geared to encourage development (Reed, 2002, p.231). This section briefly considers the corporate governance structures of some of these countries; as the study will focus specifically on South Africa more detail is provided on South African corporate governance structures.

The countries of the former Soviet Union are frequently referred to as transition economies, reflecting their state of transition from communist to democratic politics and from a command economy to some sort of market economy since the end of the Cold War and the demise of the Soviet Union in 1991 (see, for example, Clarke, 2007, p.197). The transition is obviously extreme, and rather than a gradual process of reform, has involved a wholesale adoption of corporate and free market structures. The geographic proximity to countries in Western Europe with an insider corporate governance model, together with the presence of dominant parties in the wake of political change may suggest adoption of an insider model. However, the need to attract foreign investment requires an emphasis on accountability and transparency to all shareholders that is characteristic of Anglo-American structures. Judge and Naumova (2004, p.305) acknowledge that in Russia there is support for both approaches, although there has been a recent shift from insider to outsider sources of finance. Since 1991 there have been a significant number of failures, scams and abuses, often involving high-placed bureaucrats, which reinforces the need for a comprehensive, enforced corporate governance structure.

The growth during the second half of the twentieth century of the East Asian economies of South Korea, Hong Kong, Singapore and Taiwan, together with Newly Industrialised Economies (NIEs) of Malaysia, Thailand and Indonesia, is often considered an economic miracle. The corporate governance systems in this region were characterised by strong family groups and related parties, the use of cross-holding and pyramidal group structures to control a variety of corporations (regardless of their shareholding), and poor regulation and protection for minority shareholders (Claessens & Fan, 2002). In these respects the corporate governance structures could be considered to be relationship-based and insider oriented. However, the Asian financial crisis in 1997 exposed significant weaknesses in regulation and existing

corporate governance practices, and there have since been attempts to strengthen these, often incorporating Anglo-American guidelines.

As the most populous country on Earth, the development of China's economy is of particular importance. Although politically communist, commitments to moving towards a market economy have been made since the late 1980s; a number of state-owned enterprises have converted to public companies, and individuals are allowed to trade shares. Traditionally, Chinese economic activity has been governed by Confucian values and *guanxi* (a network of personal connections) (Koehn, 2001). This reflects a strong relationship-based system, and given the political context, a dominant role played by government and highly-placed political individuals. Kimber & Lipton (2005, p.188) note how the high level of government involvement facilitates related-party transactions to the detriment of minority shareholders, and inhibits the development of good corporate governance. The rapidly expanding economy, however, requires international investment and consequently there is increased pressure to develop Anglo-American style corporate governance structures to ensure accountability and transparency to international investors. The weak role of banks has also been noted as a potential weakness in the Chinese economy and an area for reform (Clarke, 2007, p.217).

Like China, the Indian economy has grown significantly in recent decades, although structured very differently. Poor creditor protection and a painstaking insolvency system have been identified as significant factors in allowing management to get away with irresponsible behaviour and consequently hampering growth (Kimber & Lipton, 2005, p.182; Clarke, 2007, p.219). The country inherited a common-law legal tradition from the UK and has a strong stock market, although less liquid than Anglo-American markets. Kimber & Lipton (2005, p.182) note, however, that "the Anglo-American model has been superimposed over a cultural framework built up over millennia. Family and government-controlled companies are very common". Nevertheless, the 1990s has seen corporate governance reforms aimed at improving accountability and transparency to shareholders, again with the objective of attracting international investment. Growth in the Indian economy is restricted to certain centres and industries however, and the country remains faced with massive poverty and underdevelopment.

Reddy (2009) reviews the corporate governance approach of the Asian region as a whole, and identifies several structural commonalities amongst Asian economies that influence their

approach to corporate governance, including the role of family controlled corporations, state-owned enterprises, small and medium enterprises, and increasing internationalisation. He maintains that while corporations may have adopted the form of Western corporate governance, satisfying the “market economists and international agencies” (2009, p.25), there remains an underlying relationship-based system of governance that can be linked to the traditions and customs of the region. Reddy concludes that this dualistic approach “can neither be described as ‘inclusive or ‘exclusive’ but as ‘expansive’” (2009, p.25).

Latin American and African countries have yet to experience the sustained growth achieved and projected in Asia. This lack of growth is reflected in an absence of significant stock markets (with some exceptions, such as Brazil and South Africa) and is accompanied by weak regulatory systems in a number of countries. Corporate structures in Latin America are characterised by dominant controlling shareholders and strong family interests, and the protection of minority shareholders is of significant concern (Bedicks & Arruda, 2005, pp.218-19). This suggests that the region follows a model most similar to the insider, relationship-based models of some Continental European countries and/or South-East Asian nations (as the civil law systems were inherited from the colonial powers, the former appears more likely). Corporate governance issues have attracted interest across both Latin America and Africa, leading to the formation of various corporate governance networks and forums, and the publication of a number of corporate governance guidelines. Rossouw’s (2005) analysis of corporate governance reports across Africa (mostly sub-Saharan Africa) reveals that all but the Nigerian report advocate an inclusive, stakeholder oriented corporate governance. The fact that they all recommend a unitary board indicates, however, that this is not a simple adoption of the German model (although the emphasis in the Malawian code on including employees in decision making is notable (Rossouw, 2005, p.99)). The influence of governments and powerful political figures may indicate a resemblance to South-East Asian economies; the emphasis on engaging with stakeholders such as community groups does, however, suggest a more uniquely African approach.

South Africa

As noted in chapter one (section 1.1), the history of South Africa includes several centuries of colonisation by Dutch and English settlers, followed by more than four decades of apartheid, all of which was characterised by continual conflict between settlers of European descent and

indigenous Africans. By 1994, when the first non-racial democratic elections were held, South African society was consequently split along racial and economic lines. Unsurprisingly, the corporate landscape in South Africa reflects the centuries of colonialism and apartheid. Corporate law and corporate practice have been adopted mainly from the UK (sharing its common-law legal tradition¹²), and control over corporations remains largely within the hands of the minority White population. Research conducted by the Johannesburg Stock Exchange (JSE) (Johannesburg Stock Exchange, 2010) revealed that Black ownership of the JSE amounted to approximately 36% of the share capital available to South Africans (that is, excluding foreign investors) in 2010. A survey conducted by Business Unity South Africa indicated that 91% of the chief executive officers of JSE-listed corporations were White, and 92% of chief financial officers were White (Business Unity South Africa, 2009, pp.4-5).

South Africa's corporate structures tend towards those of the Anglo-American model. The single-tiered board structure is standard for South African companies, the stock exchange is active and dominant, relationships with credit providers are kept at arm's-length, and the financial reporting framework is oriented towards shareholders¹³. The government intervenes in the labour and capital markets through the Employment Equity Act of 1998 and the Broad-Based Black Economic Empowerment Act of 2003 in order to redress the economic inequities of apartheid. These interventions can be seen as adjustments to the Anglo-American model, a means by which some stakeholder concerns are imposed upon what is predominantly a shareholder oriented system.

South Africa's corporate governance reforms have been presented in the *King Report on Corporate Governance* (King I) published in 1994, the *King Report on Corporate Governance for South Africa – 2002* (King II), and the *King Code of Governance for South Africa 2009* (King III). A review of the topics covered by these reports and corporate governance reports issued in the UK (culminating in the UK Corporate Governance Code of 2010) reveals that very similar issues are addressed. Topics dealt with include boards of directors, directors' remuneration, internal control and risk management, and accounting and audit. There have, however, been some notable differences.

King II itself advocated an 'inclusive' approach to corporate governance (Institute of Directors, 2002, Introduction, para. 5.3) and could be distinguished from traditional Anglo-American approaches in its recommendation that directors be responsible to all stakeholders,

and in the section on Integrated Sustainability Reporting (for which there is no counterpart in the UK reports). These differences support the claim that South Africa's corporate governance is stakeholder oriented, and closer analysis of the report has identified support for both instrumental and normative stakeholder theory (Rossouw, 2002; West, 2006). References are made to the economic benefits of stakeholder considerations, the socio-economic necessities of post-apartheid South Africa as well as traditional African values such as collectiveness, helpfulness and interdependence (*ubuntu*¹⁴).

The third King report (King III) was released in 2009 and came into effect on 1 March 2010. The report specifically notes that companies are considered to be "as much a citizen of a country as is a natural person who has citizenship. It is expected that the company will be and will be seen to be a responsible citizen" (Institute of Directors in Southern Africa, 2009, p.11). While both King II and King III required integrated sustainability reporting, King III emphasises the need for such reporting to be integrated with financial reporting, and also calls for a focus on integrated sustainability performance (Institute of Directors in Southern Africa, 2009, p.11). Regarding its theoretical approach, and considering how elements of both instrumental and normative stakeholder theory were evident in the previous report, King III specifically advocates a 'stakeholder inclusive' approach and contrasts this with the instrumental approach of an 'enlightened shareholder' model. The 'stakeholder inclusive' approach is described in terms that correspond closely to Freeman's stakeholder theory:

"... in the 'stakeholder inclusive' approach, the legitimate interests and expectations of stakeholders are considered when deciding in the best interests of the company. The integration and trade-offs between various stakeholders are then made on a case-by-case basis, to serve the best interests of the company. The shareholder, on the premise of this approach, does not have a predetermined place of precedence over other stakeholders" (Institute of Directors in Southern Africa, 2009, p.12).

In terms of reporting, King III's integrated report includes reporting on "environmental, social and governance issues" (Institute of Directors in Southern Africa, 2009, p.12) and is seen as a means by which stakeholders can assess a corporation's 'economic value'. To some extent, this could be seen as an attempt to ameliorate the shareholder orientation that is implicit in International Financial Reporting Standards (IFRS).

There is very little explicit recognition of traditional African values or culture in King III, the only areas that this is mentioned is with regard to *ubuntu* being an expression of the values that underlie good leadership and moral duties associated with corporate citizenship, and where an alternative dispute resolution mechanism that considers the needs of different parties, rather than their legal rights and obligations only is recommended (Institute of Directors in Southern Africa, 2009, p.14). The stakeholder approach of King III appears to be based more on an increasing awareness of the importance of sustainability globally, as well as a recognition of the socio-economic imperatives facing contemporary South African society.

It may be tempting to group the approaches of developing, emerging and transitional economies to corporate governance into a third category alongside the Anglo-American and Continental European / Japanese models. There are indeed, some definite similarities across these countries, notably a tendency to adopt Anglo-American principles as a means of facilitating access to international capital markets and attracting foreign (particularly Anglo-American) investment, along with the desire to use corporate governance mechanisms to leverage development and economic growth. At the same time, however, there are significant differences: in terms of the legal systems that underpin corporate activity, the political environments and attitudes towards Western economic systems, and in some cases the appeals made to cultural identities (such as Confucian values and *ubuntu*) which may influence economic activity. The depth of these differences renders any group classification of these countries' corporate governance models overly simplistic. Alongside the observation that corporate structures and systems have frequently been inherited from Western countries, a simple analysis of the morality of corporate governance in these countries becomes impossible. The question of whether these countries will entirely adopt, and eventually mirror, either Anglo-American or Continental European / Japanese approaches to corporate governance remains unresolved however, and the issue of corporate governance convergence is thus of particular importance in these parts of the world.

2.5 Convergence

During the economic boom of the 1990s, in which rapid technological advance played an important role in enhancing global communication and integration, one could perhaps be forgiven for associating globalisation with progress. This is particularly true in the realm of finance and capital markets which during the 1990s and 2000s have seen technological

advancements enabling 24-hour trading across world markets, the development of complex financial instruments such as futures and options, and improved access to trading resources online. Both market capitalisation and trading volume of major stock exchanges around the world have increased dramatically over this period, although Anglo-American stock exchanges maintain an overwhelmingly dominant position. In terms of market capitalisation, the New York Stock Exchange (NYSE Euronext) was over three and a half times the size of its nearest rival (Tokyo) at the end of 2009, and the NYSE Euronext and Nasdaq maintained the highest number of shares traded, followed by the exchanges in Shanghai and Shenzhen (World Federation of Exchanges, 2010). As corporations in Anglo-American jurisdictions rely upon stock markets for financing and discipline, there is debate over whether this growth in capital markets marks the global ‘roll-out’ of Anglo-American corporate governance, with wholesale adoption of Anglo-American corporate governance institutions in other jurisdictions simply being a matter of time.

Hansmann & Kraakman’s (2001) *The End of History for Corporate Law* presented an argument that not only advocated convergence towards the Anglo-American model, but also asserted that such convergence has already occurred. Their argument for convergence followed three stages. Firstly, the shareholder model is shown to be superior to ‘manager-oriented’, ‘labour-oriented’, or ‘state-oriented’ models. Secondly, the superior shareholder model will dominate over competing models, as it is considered to be more efficient in an environment in which the internationalisation of markets is increasing. Thirdly, the shareholder model will be upheld by political change, in which a shareholder class (represented by dispersed share ownership) will ensure that claims from other factions (such as employee groups and powerful individual shareholders) are resisted.

The debate, however, is not so clear cut. Firstly, Hansmann & Kraakman’s paper was written before the corporate governance failures of the Anglo-American model, in the form of the stock market crash and the failures of Enron, WorldCom and others. Based on the growth of the 1990s, it could perhaps be over-optimistic and caught up in the same ‘irrational exuberance’¹⁵ that afflicted investors before that crash. The failures in corporate governance point instead to the fallibility of the Anglo-American market-oriented model and serve as a warning to other countries in which capital markets are becoming more prominent. Secondly, Hansmann & Kraakman’s simple analysis of the superiority of the shareholder model can be criticised. Clarke (2007, p.261) notes how companies such as Toyota and Airbus, within

stakeholder, insider oriented systems, have outperformed their rivals in the USA in recent years. Similarly, the economic growth of Germany, Japan, South-East Asian countries and more recently China and India, all of which occurred within non-Anglo-American corporate governance models, illustrates how growth and competitiveness is certainly not the preserve of Anglo-American companies. The fact that American companies were looking to emulate successful German and Japanese business practices in the 1980s reiterates how economic ‘superiority’ can swing from decade to decade. Schleifer and Vishny’s (1997) comprehensive survey of corporate governance practices (although focused exclusively on the agency problem) concludes that both legal protection and large investors characterise good corporate governance systems, and that it is not possible to identify one particular model as the ‘best’. La Porta *et al.* (1998) examined the legal and financing structures of 49 countries, and conclude that legal families (such as common versus civil law) and legal rules cause different financing (and, by implication, corporate governance) regimes. Coffee (2001) suggests, however, that the correlation between legal families and financing patterns can rather be explained by postulating the legal arrangements as a consequence of the financing arrangements.

In contrast to Hansmann & Kraakman’s argument for a strong form of convergence, Bebchuk and Roe (1999) presented a theory of path dependence to explain why certain corporate practices (particularly legal and ownership structures) differ and persist across different countries. They present two kinds of path dependence, structure-driven and rule-driven, both of which serve to restrict the process of corporate change and convergence. In addition, so-called ‘institutional complementarities’, referring to the wider elements of socio-economic systems, need to be considered when adopting elements of different corporate governance models (Gordon & Roe, 2004, p.6; Clarke, 2007, p.259). Jacoby (2002, p.20) notes that it would be difficult to transfer a particular corporate governance practice from one context to another and expect it to function effectively. He suggests, for example, that introducing US-style takeover mechanisms of disciplining management in Germany or Japan would be “highly disruptive of managerial incentive and selection systems presently in place. Hostile takeovers also would be disruptive of relations with suppliers and key customers, a substantial portion of which exist on a long-term basis” (p.21).

The convergence debate is also more complex than simply analysing trends towards the Anglo-American model. Thomsen (2003) argues a ‘mutual convergence hypothesis’ claiming

that alongside convergence towards the Anglo-American model, corporate governance in the USA and UK has moved towards the European model in some ways. The increase in share ownership concentration, financial deregulation, greater attention to wider stakeholder concerns, and how the increased emphasis on independent non-executive directors could be seen to reflect aspects of the two-tiered board structure are provided as examples. He acknowledges however, that differences will remain for decades, and Jacoby (2002, p.31) notes that just as path dependence and institutional complementarities reflect the persistence of European and Japanese models, these factors make it extremely unlikely that Anglo-American jurisdictions would eventually adopt a stakeholder, insider orientation.

McDonnell (2002, p.342) suggests that not only have academics “converged too quickly on the convergence answer”, but that the focus has been directed at efficiency, with other values being excluded. As an alternative, he considers both historical and future corporate governance scenarios with reference to efficiency, equity and participation. Efficiency refers to the ability of one model to outperform another, either at macro or micro levels; equity refers to distributional equity (the converse of economic inequality), although he acknowledges other aspects of equity such as where high remuneration is justified by high performance; and participation generally refers to the involvement of employees in decision-making, although the ability of the general population to form companies and thus enter the corporate arena is also identified as a form of participation. McDonnell suggests four historical and four future scenarios, which, combined, present 16 alternative versions of corporate governance convergence and/or diversity, and notes that convergence towards a single system does not necessarily mean that the ‘best’ system has ‘won’.

Bratton & McCahery (1999, p.30) also suggest four alternative scenarios that arise from both the homogenising tendencies of Anglo-American capital markets and the resolute commitment to national structures: a ‘unitary system’ that combines the good elements of both major systems, a ‘universal market based system’ reflecting the worldwide adoption of the Anglo-American model, an ‘improved variety of systems’ in which systems learn from each other but without achieving significant convergence, and a number of ‘viable distinctive governance systems’ in which the uniqueness of individual systems is maintained, drawing on different institutional complementarities. In Clarke’s opinion (2007, p.265) the last two of these are both robust and useful and the most likely to continue, despite predictions of convergence. McDonnell (2002, p.382) also emphasises the benefits of diversity, drawing a

comparison to the benefits of biodiversity in species: “We gain from preserving even those species which do not seem to add much to the world at this point, because at some point in the future those species may become more valuable”.

There are alternatives to considering the globalisation of corporate governance as the convergence (or persistent diversity) of various legal and economic models. Roe (2000), for instance, suggests that there are ‘deeper’ social norms that underlie different governance structures, noting European managers who consider employee concerns even when not required to do so, and links this to underlying social democratic norms. Branson (2001) takes issue with the traditional approaches to corporate governance convergence and notes that most of the convergence advocates base their arguments upon observations of corporate governance and economic systems of the USA, the UK, Germany and Japan, ignoring most other nations. He argues (2001, p.325) that it is “the culture beneath law and economic systems that is as or more important than law or capitalism itself”, and that “Cultural diversity militates against convergence”.

Licht (2001) supports this view, suggesting that culture is the “mother of all path dependencies” (p.149) and argues that corporate governance models worldwide should be mapped according to culture rather than legal system in order to give a more accurate and useful picture. He advocates applying the cross-cultural psychology of Hofstede (1983, 2001) and Schwartz (1999) to comparative corporate governance. Links between Hofstede’s and Schwartz’s cultural value dimensions and aspects of corporate governance are postulated and a relationship between corporate governance laws and culture identified (Licht *et al.*, 2005). This then provides support for ‘harmonising’ corporate governance structures with the prevailing culture in different countries. Following Hofstede’s and/or Schwartz’s cultural value dimensions, however, adds complexities and assumptions: the adoption of an underlying theory of culture and values, the ambiguous concept of ‘culture’ and the tentative links between Hofstede’s and/or Schwartz’s values and corporate governance models. As Licht (2001, p.202) notes, empirical studies test not only the links between cultural value dimensions and aspects of corporate governance, but the underlying theory of culture and values proposed by Hofstede and/or Schwartz. The results could thus be ambiguous.

The idea that it is culture that gives rise to the legal structures and economic norms that constitute corporate governance systems, and that therefore corporate governance models can

justifiably be expected to differ across cultures, can be linked to cultural relativism. Although the current study adopts a similar stance in that it regards the moral judgements of groups of people that underlie different corporate governance models as central, the difficulties of Licht's proposal are avoided by referring directly to the claims and arguments of moral relativism.

2.6 Conclusion

Business and morality are not always considered to be easy bedfellows. Few would suggest, however, that business dealings would be possible without some modica of trust and honesty. Similarly, it is not unreasonable to contend that directors have certain moral obligations to those who provide finance, regardless of their legal requirements or the capability of enforcement. In turn, the corporation can be seen as a mechanism which has contributed significantly to the development of society in the past and has the potential to continue to do so, in all parts of the world. As suggested in the quotation by William McDonough at the beginning of this chapter, failures in the governance of these corporations can be seen as failures in morality. Despite differences in both the theoretical approaches and practical application of corporate governance in various jurisdictions, there is to some extent a common corporate governance morality. The successful operation of corporations is generally considered beneficial in their provision of various socio-economic 'goods'. The four corporate governance 'virtues' of responsibility, accountability, fairness and transparency, as presented to the OECD in the Millstein report, are accepted as characteristics of good corporate governance not only in the 30 OECD member countries, but in many others as well.

Although corporate governance can be seen as a fundamentally moral endeavour, different models remain, and there are particular differences in how far and to whom the corporate governance 'virtues' apply. The most obvious distinction is at the theoretical level, between the shareholder and stakeholder models, where the former insists that obligations should be limited to shareholders alone, and the latter requires an extension to include (to varying degrees) other stakeholders. This distinction is particularly useful as it is played out through the various corporate governance structures around the world, with those countries with an outsider based system typically adopting the shareholder primacy model, and those with an insider system accommodating the interests of stakeholders (to varying extents). It is possible

then to postulate differences in moral judgements relating to the extent to which corporations are considered obliged to consider the interests of various stakeholder groups.

There are other differences between corporate governance models that also have moral relevance. Advocates of different models can point to successes in areas such as efficiency, employee commitment and product quality. Unlike the shareholder / stakeholder orientation, these different forms of success cannot be so easily allied to particular corporate governance models and different claims may reflect differences in fact rather than differences in moral judgement. For example, where two models may both claim to result in higher product quality, this difference can (at least hypothetically) be resolved by examining the empirical data and does not therefore reflect different moral judgements between the two models. Nevertheless, differences in the perceived importance of different ‘types’ of success may reflect differences regarding which corporate objectives are considered morally appropriate. These constitute differences in moral judgement that could be linked to aspects of corporate governance. McDonnell’s (2002) categories of efficiency, equity and participation can be considered useful here as they can be related to corporate governance issues such as executive remuneration and employee board representation. It is conceivable, for example, that certain people could consider the achievement of efficiency to be a greater moral good than the achievement of employee participation, and one could then envisage a corporate governance model without mandatory board representation for employees. Although McDonnell’s categories can be interpreted in several different ways, differences in moral judgements may be highlighted by restating these categories as: ‘economic efficiency’, referring to optimum allocation of resources and the achievement of financial and operational performance measures, ‘distributional equity’, referring to the level of economic inequality between executive management and certain other stakeholders (particularly employees and the community), and ‘stakeholder participation’, referring to the degree of involvement of various stakeholders in corporate decision making and including concepts of corporate citizenship. Differences in moral judgements regarding the relative importance of different corporate objectives (corresponding to the different ‘types’ of corporate success) can be postulated. These, in turn, may be reflected in different corporate governance characteristics.

The identification of areas of difference in moral judgement that encompass both obligations to interested parties and different corporate objectives, and that can be linked to features of corporate governance systems provides the foundation for the application of moral relativism

to the debate on corporate governance convergence. As noted above, South Africa's mixed adherence to shareholder and stakeholder models, together with its focus on 'nation-building', makes the country a useful case study. The next chapter considers existing evidence for Descriptive moral relativism regarding corporate governance in South Africa, with particular reference to possible differences in moral judgements regarding the obligations and objectives of corporations.