

Book Reviews

Jay Lorsch, Leslie Berlowitz and Andy Zelleke, eds, *Restoring Trust in American Business*, Cambridge MA: MIT Press, 2005, ISBN 0-262-74027-3

WHAT YOU SEE DEPENDS ON WHERE YOU SIT

The American Academy of Arts and Sciences has brought together a formidable assemblage of sitters to address the important problem of restoring trust in American business.

Mark Roe, who has single handedly enriched the dialogue of corporate governance through adding the mode of history, begins the compilation of articles with a theme both clear and subtle: ". . . the regulated often affect how they are regulated" (p. 32). With a light hand, but with precision, Roe identified no less than 13 recent situations in which corporate management has dominated every effort to hold them accountable to anyone:

1. "Target firm managers disliked takeovers. So they lobbied state legislatures to bar them, often successfully." (p. 23)
2. "Judges are picked after vetting by bar associations and law firms, after their corporate loyalty is tested." (fn. 22)
3. "[Congress'] members run for election, and they need campaign contributions." (p. 24)
4. "Lobbying by the Business Roundtable – big firms' lobbying organization – probably affected the outcomes of what passed, or more accurately, didn't pass." (p. 24)
5. "Managers who face a loss with the SEC can lobby Congress to rein the SEC in." (p. 24)
6. "The SEC withdrew its proposed rule and . . . came back with a weaker but still viable version. . . ." (p. 25)
7. "Reformers trying to draft the ALI Corporate Governance rules 'were opposed by a cohesive group of corporate counsel and the companies who employed them. The ALI ultimately adopted a vague rule that permitted directors and state courts to do what they had previously been doing'." (p. 25)

8. "The Business Roundtable opposed the rule. When the SEC promulgated it anyway, the Roundtable attacked the SEC's ruling as exceeding the SEC's authority under the securities laws. They won." (p. 26)
9. "One reformer – John Biggs {whose fine article we will mention shortly} – was blocked from taking over the regulating of the accounting gatekeepers. And managers and their regulatory allies have thus far stopped the SEC from tightening up corporate governance in a way that would heighten shareholder oversight." (p. 27)
10. "But the accountants lobbied Congress to stop [SEC Chairman] Levitt. They succeeded. Levitt's abortive effort here is instructive. Congress, in effect, told Levitt not to go forward, threatening both to cut SEC funding further and to reduce SEC authority." (p. 27)
11. With respect to stock options, "The board [FASB] backed down [and thus with that] . . . official attempt to control corporate avarice came to an end." (p. 28)
12. "In the 1990s, Congress sharply cut funding for the SEC." (p. 29)
13. "But thus far managers have stymied the SEC, pressuring it to back off 'in the face of opposition from the Chamber of Commerce and the Business Roundtable, an organization of chief executives from the nation's largest companies'." (p. 30)

Mark Rowe is coming from the place where the challenge to effective corporate governance – to the restoration of trust in American business – is the power and inclination of corporate management to dominate any and all efforts to hold it to effective account. Seventy years ago, Berle and Means in *The Modern Corporation and Private Property* concluded: "We

may grant the controlling group free rein, with the corresponding danger of a corporate oligarchy coupled with the probability of an era of corporate plundering."

Many of the other pieces in this compilation are focused on improving the functioning of the various identified gatekeepers – directors, lawyers, auditors, investment bankers, journalists and legislators – without any focus on the extent to which each of them is a creature of management, upon whose favour they depend for their livings. If you are sitting in the same place as Michael Roe, you might view many of the other contributions to this volume with the purported attitude of Otto von Bismarck on being advised of religious disapproval of his policies: "How many troops does the Pope have?" Roe so persuasively poses what is the question that it is difficult to evaluate responses that plainly are addressed to different problems.

Damon Silvers, with an almost magical command of language and metaphor, is the exception. He summarises the various suggestions in the volume: "This is like trying to solve the problem of slavery without actually freeing the slaves. You can spend all day exhorting them to be free – you can call them independent, or even professionals, and demand that they run free – but at the end of the day, they are still in chains" (p. 85). For Silvers and Roe the loss of trust in American business is based on systemic flaws, many of the other sitters believe that what problems do exist are ephemeral – "a few bad apples" – and susceptible of fine tweaking.

Maybe, the various sitters epitomise the philosophical problem of how a glass with water at a particular level can be perceived by some as half full and others as half empty. The realities of power are compellingly evoked in Chancellor Allen and Geoffrey Miller's elegy for the legal profession. People of a certain age – like me – tend to hark back to the Golden Age of their youth, in this case to a day when lawyers had a transcending sense of their public responsibilities. Allen and Miller bring us back to earth with the charming anecdote attributed to William Whitney: "I have had many lawyers who have told me what I cannot do. Mr Root is the only lawyer who tells me how to do what I want to do." (p. 129). And so it will be. Several contributors raise questions that should themselves be the subject of a book. Marty Lipton and Jay Lorsch elicit the fascinating conundrum: "It is not an exaggeration to say

that directors operate in a vacuum as to the purposes boards ought to be pursuing." (p. 74). Plainly, this question must be answered before one can begin to have an opinion as to the organisation and staffing of boards; what level of "independence" is appropriate; and the extent to which board power is incompatible with the level of management control necessary for optimum performance. John Biggs' comment on William Kinney's article says it all: "There is a dangerous gap between what the investing public expects in an audit of a public company and the auditing profession considers feasible to deliver." We need much tuition on the difficult questions as to what information we are trying to provide to which constituency and for what purpose and with what accountability.

John Reed attempts to formulate the universal goal of *evolutionary success* and usefully states the ultimate challenge "is to surround the enterprise with a self evaluating and self correcting process to ensure continuity across time" (p. 38). The modern corporation is too powerful to be regulated from without; it must develop the institutions and mechanisms for self control from within. Management must be accountable to somebody, which is why there needs to be urgency in the effort – in Damon Silvers' words – "to make long-term investors a real counter-balance to management power . . ." (p. 85). I cannot take comfort in Michael Klausner's statement that there exists in the United States the practical capacity to "allow shareholders to replace directors whom they view as having failed to act in their own interest" (pp. 91–92). My own experience encourages me to believe that the straightforward provisions in the UK Companies Act permitting 10 per cent of the shareholders to call an Extraordinary General Meeting at which a majority can discharge any or all of the directors with or without cause is the "magic potion" that creates meaningful accountability and the possibility of the restoration of trust. Such a "national law" would be a good place for the United States to begin to restore trust.

Reviewed by Bob Monks

Reference

Berle, Adolph A. and Means, Gardiner C. (1991) *The Modern Corporation and Private Property*. London: Transaction Publishers.

Julian Roche, *Corporate Governance in Asia*, Oxford and New York: Routledge, 2005, ISBN 0-415-33975-8

Books on corporate governance tend to fall into three categories: explanatory texts, written by lawyers or other professional experts, explaining the latest regulations, rules and codes affecting governance; theoretical treatments, written by academics, attempting to prove rigorous relationships and provide insights into governance processes; and "how to do it" texts, written by retired chairmen or consultants pedalling their nostrums.

This book fits none of these categories. It is, perhaps, best described as a personal commentary on the development of corporate governance in Asian countries. Some might describe it as "journalistic": yet in drawing on widespread sources, including the business press, comments from business people and academic research, the author has produced a comprehensive view of both national and international institutions involved in governance and the organisations which attempt to promote it. This provides an authoritative overview of the subject with a connecting summary that is insightful. It should prove useful for business and finance students with an interest in corporate governance in an Asian context.

The author, Julian Roche, is a trainer in corporate finance based in Singapore, a consultant to professional bodies including the ICAEW, and VP of a firm specialising in corporate responsibility issues. His viewpoint is that of the professional observing governance practices in Asian countries.

The book is not organised, as one might expect, country by country (for such a text see Lau and Barham, 1994) but by topic. The chapters focus on the board, accounting standards, corporate governance and corporate strategy, transparency (predictably the shortest chapter!), codes of corporate governance, the role of active shareholders, measuring corporate governance (a particularly interesting chapter), compliance, enforcement, and future developments.

In a valuable appendix the author summarises and contrasts the current corporate governance situation in Bangladesh, China, Hong Kong (China), India, Indonesia, Malaysia, Pakistan, Philippines, Singapore, South Korea, China Taipei, Thailand and Vietnam. Japan and Russia are not included in this survey, although there are some useful comments on corporate governance experiences in these countries.

This is a stimulating book and, predictably therefore, many of the author's assertions

prompt a challenge. For example, a theme throughout the work is that corporate governance processes are converging. Certainly this is a reasonable thesis, given the development of international governance codes, such as the OECD Principles, the drive towards international accounting standards and the globalisation of financial markets and securities regulation. But surely that only applies to listed companies.

The author also believes that corporate governance is becoming a political game. He predicts that one day there will be one set of governance rules for everyone, like the rules of the World Trade Organisation, and that they will be the ones that apply to firms doing business in the United States. This assumes that companies around the world need access to American capital and are forced therefore to adhere to American corporate governance regulation and accounting principles. The rationale for such economic imperialism may not last all that long. The UK's MG Rover car company has already sought outward investment from China. Some foreign companies listed in New York are also seriously considering delisting rather than accepting US corporate governance demands. Companies might find the demands of corporate governance compliance deterring them from seeking public finance in the first place or encouraging public companies to privatise. This could especially be the case in those Asian countries where business people resist constraints to entrepreneurial freedom.

Further, there is some evidence that recent events have actually resulted in a divergence of corporate governance, even in the oft-related Anglo-Saxon approach to corporate governance. The American SOX Act (2002), which requires Federal oversight of corporate governance under the law, has driven a wedge between the British and Commonwealth approach, which calls for corporate self-regulation through reporting compliance with a code or explanations if not.

Scholars of Asia-Pacific culture will be disappointed that research into the effect of the Chinese Diaspora on family businesses throughout Asia is not mentioned, even though this has had a fundamental impact on corporate governance attitudes throughout the region. Business life in most countries in East Asia is still dominated by the overseas Chinese (even though some families have adopted local names). Their business culture, with its dominant family shareholdings,

emphasis on hierarchy, business relations based on trust rather than law, still takes precedent over the Western world's perception of corporate governance norms.

The author accepts that "there are some critical differences in the way in which Asian corporations acknowledge and confront governance issues, and in the political and legal frameworks under which they operate". But the central thrust of his work is that "corporate governance issues in Asia are fundamentally similar to those in the rest of the world".

At a high level of abstraction this may be true, but it gives insufficient weight to the differences between Asian countries. Take company law. A primary issue in successful corporate governance is whether the jurisdiction has adequate company, contract and bankruptcy law, courts that are free of political influence and can be trusted, and systems that obtain results once a judgement has been awarded. This is not the case throughout Asia. The legal systems of some Asian countries – Singapore, Hong Kong, India, Malaysia, Pakistan (and Australia, New Zealand and South Africa for that matter) benefited from their origins in the British Empire, although the author gives this legacy short shrift, dismissing it as "European colonialism".

The style of the work is serious and thoughtful, yet readily readable. Though occasionally, the author might have restrained his prose.

For example, your reviewer had difficulty with the meaning of this discussion of corporate responsibility:

At root is an argument about legitimacy: the extent of congruence between what the firm does and what society as a whole expects it to do – which is why the "stakeholder" debate is so closely linked to corporate governance and why the shape, ownership and management of a firm is relevant to its legitimacy, which is at root a political question. And about legitimation, the way in which a firm, and the financial system in general, seeks to achieve that legitimacy. Both, of course, change over time, and perhaps nowhere more so than in Asia in the coming decade where political opinion is being expressed more freely than hitherto and more demands are being placed on corporations to be legitimate, in this sense, p. 3.

Yet this is a book written with enthusiasm and the conviction that Asian countries are "catching up with the West". Whether this is a good place to be is open to question.

Reviewed by Bob Tricker
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Reference

Lau, G. and Barham, S. (eds) (2004) *The Practitioner's Guide to Corporate Governance in Asia*. Hong Kong: ISI Publications.

Mark Hirschey Kose John and Anil K., Makhija, eds, *Corporate Governance, Advances in Financial Economics Volume 9*, Amsterdam: Elsevier, 2004, ISBN 0-7623-1133-9

This book is a collection of 14 research papers which discuss corporate governance issues from both an empirical and an international perspective.

If I were a PhD student starting research on how companies should be owned and governed, the book would definitely be on my reading list. It provides readers with a shortcut to overviews of governance studies in terms of the scope of research, the intricacies of arguments and the extent of previous studies that have been seen to be seminal largely due to the rigour of their debate on the subject.

Each contribution is well structured in terms of the doctrinal form of academic presentation: consisting of a background introduction, literature review, theory or model, data, statistical analysis, interpretation and conclusions drawn. The data or cases employed are rich and informative, providing readers with quantitative or real-case perceptions of the

arguments that each paper intends to put forward. So, from an informative point of view, the book editors have done a good job in selecting papers that discussed research issues rigorously and internationally.

The book starts by opening a discussion on a research topic at the forefront of the corporate governance debate, namely related party transactions. This is a relatively new but challenging topic for study, since the difficulty lies not only in acquiring data but also in searching relevant literature. On the basis of a distinct definition of what is a related party transaction, the study explores the number of transactions in terms of board members, company owners and company subsidiaries, respectively. One surprising finding from the American company sample of the study is a considerable number of the transactions made by non-executives who are supposed to be independent from company business but are

actually involved in it. Despite this paper being statistically descriptive in its discussion, it is, however, at the forefront of research in this field and is thus guaranteed to stimulate further research, interest and debate on the subject. The paper thus provides a valuable contribution, at least for those who are interested in research on related party transactions.

Another interesting paper is Sarah W. Peck's work on whether larger outside shareholders are concerned about improving the governance of the corporations that they control. Peck documents evidence that large shareholders are not interested in governance unless they invest in a company for longer than a year. This finding suggests an interesting conjecture that the duration of ownership can be an important factor in influencing company performance, because the shorter the ownership the less pressure will be expected on the board to change for the better. Although the study does not examine the relationship between performance and ownership time, it will be interesting to see a future investigation on this subject.

What are differences of corporate governance between the US, the UK and Australia? Bonnie Buchanon takes three cases to illustrate the differences. The author argues that there are differences amongst the three countries, but my perception from the information provided in the book is the opposite: they are fundamentally similar. For example, when the author compares the governance structures of three collapsed companies: Enron, WorldCom and Adelphia (one of the largest insurance companies in Australia), one common feature is that none of them had one independent director on the audit committee. Does this finding mean anything? This may be a good question for class discussion on an MBA course.

The strength of the monitoring role of the board of directors can be indicated by the number of independent directors sitting on the board, shown by M. Ameziane Lasfer's paper. But effective monitoring needs good information. Executive directors have an advantage in information, so that the problem of information asymmetry between non-executive directors and executive directors shapes the

optimal structure of the board. How should the board be mixed, more independent directors or fewer? Lasfer argues that this depends on the stage of business growth. On the basis of a sample of UK companies, Lasfer found that fewer executive directors are shown in the board of companies with a high growth, when compared with ones of low growth, because at the high growth stage executive directors are happier to provide non-executive directors with more information for their advisory opinions, therefore, there is no need for more executive directors in the board. Although this explanation by Lasfer can be argued or questioned, the evidence on the board structure with growth is an interesting phenomenon for further exploration.

Ownership concentration decreases with the effectiveness of investor protection, as argued by Baozhi Qu. The argument is well reflected by international evidence shown in this book (Jim Gang Wei *et al.*, and Fazilah A. Asmad) that ownership concentration is much higher in emerging markets, like China and Malaysia, than in the US and in the UK. On average, Chinese and Malaysian corporations have the largest shareholder ownership, more than 30 per cent of the shares. If Qu's argument is correct, then we shall expect that with the improvement of the legal system in emerging markets, ownership concentration will gradually decrease over time. How to test this expectation in a dynamic context will be very challenging work for future research.

The above papers highlight the value of the book: leading readers to understand an issue, to think of an issue and to ask more questions for further research. From this perspective, despite some weaker papers which have technical flaws in applying econometrics, such as using OLS to estimate panel data (see Jim Gang Wei *et al.*, and Baozhi Qu), the recommendation of book shall not be reserved. From my point of view, the book is a very helpful document for any researcher interested in starting research in the area of corporate governance studies.

Reviewed by Guy Liu
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