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Models of Corporate Governance

Pavel Körner *

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Abstract

This paper sheds the light on five different perspectives of corporate governance understandings, namely corporate financing, shareholder rights execution, ownership stakes patterns, corporate objective functions and management structures. Not only their key characteristics, limitations and implications are to be delivered but also some pros and cons are to be discussed. Attention is also paid to their normative states of departure. The red string of the principal agent problem meanders through all these five concepts, stewardship theory as its alternative approach is also discussed.

Keywords: corporate governance, agency theory, stewardship theory, bank-based and market-based financial system, voice and exit rule, insider and outsider model, shareholder and stakeholder firm, one-tier and two-tier model

JEL Classification: D21; D80; G34

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Introduction

Corporate governance is a highly appealing field of economic theory. Its origins can be traced all the way back to Adam Smith, who states in his Wealth of nations that 'being the managers of other people's money … it cannot be expected that they should watch over it with the same anxious vigilance…'. The true research on corporate governance issues began with Jensen and Meckling (1976), who introduced the idea of separation of ownership and control, consequent agency problem and who draw the picture of a corporation as a nexus of contracts. And as the separation of ownership and control is inherent in the modern corporate, the issues of corporate governance have not lost relevance.

The paper presents a descriptive analysis of the agency theory as the state of departure for all corporate governance analyses and further it differentiates the corporate governance models from five perspectives. It proceeds as follows. Section two defines the term of corporate governance, section three handles the principal agent problem as the key issue of corporate governance, section four discusses the stewardship theory as an alternative to the agency theory, sections five to nine present various approaches to distinguishing of corporate governance models and section ten concludes.

Definition of corporate governance

The origins of the word 'governance' can be found in the Latin word 'gubernare' meaning the steer or to rule. Seeking the right definition of corporate governance it shall be worth to take this thousand-year-old substance into consideration. The most traditional definition is, that corporate governance "deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment" (Shleifer and Vishny, 1997:737). This is not a precise definition of the term in the broadness of contemporary meaning, as the corporate governance (as we shall see later on) does not take into account only suppliers of finance but also other interest groups in corporation. Very similar definition of La Porta et al. (2000: 4) that corporate governance is "a set of mechanisms through which outsider investors protect themselves against expropriation by insiders" also considers the term in a narrower sense arguing that corporate governance is only an insider-outsider relationship.

According to Hart (1995), governance structures can be seen as a mechanism for making decisions that have not been specified by contract. Corporate governance in our terms also

deals with issues defined by the contract (such as supplier-buyer relationship or creditor-debtor relationship), thus this definition also does not hold enough.
The comprehension of Denis (2001) is more accurate in terms of the right emphasizing of institutional and market mechanisms. "Corporate governance, then, encompasses the set of institutional and market mechanisms that induce self-interested managers … to maximize the value of the residual cash flow's of the firm on behalf of its shareholders…" (Denis, 2001:192) But again as we shall see, self interest of managers and maximization of residual cash flow in favor of shareholders is only a fraction of the corporate governance environment.
Similar shortage demonstrates the statement that "…corporate governance can be viewed as a set of arrangements internal to the corporation that defines the relationships between managers and shareholders". (Iskander and Chamlou, 2000:3)
To sum up, corporate governance is an 'umbrella' term (Cochran and Wartick, 1988) considering not only the insiders and outsiders or shareholders and stakeholders or principals and agents but also free riders, financers and managers and all other entities involved in modern corporate governance environment. To use precise terms but to comprehend its full range, corporate governance shall be for us 'an institutional set of formal and informal relations among interest groups in the corporation'. It has been depicted by profound literature (North, 1991; La Porta et al., 1998) that not only the institutions are crucial but also their enforcement is of at least the same importance, which has been shown in transition countries (Körner et al., 2002). Hence, we can write corporate governance definition as follows

$$CG = f(IS, E) \quad (1)$$

where CG is corporate governance, IS is institutional set of corporation and E is its enforcement.

Principal agent problem

The principal agent problem is the key issue of corporate governance. The agency relationship is a contract in which one or more persons (the principal/s) engage another person (the agent) to take actions on behalf of the principal(s). This engagement involves the delegation of some decision-making authority to the agent. Naturally as the nature of the agents and principals differ, there are some costs connected with the relationship that need to be spent in order to limit the misengagement as much as possible.
Jensen and Meckling (1976) define the agency costs as

$$AgC = MC + BE + RL \quad (2)$$

where AgC are agency costs, MC are monitoring and controlling expenditures spent by the principal in order to control and monitor the activities of the agent, BE are bonding expenditures spent by the principal in order to bond the activities of the agent to motivate the behavior of the agent to shield and increase the wealth of the principal and RL is residual loss which is caused by divergence of the real agent decisions and optimal decisions according to principal's interests (e.g. costs of imperfect monitoring, controlling and motivation).
Fama and Jensen (1983b) argue that the agency problem is mainly controlled by the decision systems that separate the management and control. This separation of management and control is more accurately separation of residual risk bearing from decision functions. Here the residual risk is understood as the risk of the corporation owners in the actual value of the corporation after all its liabilities are dully settled. As the fulfillment to all counterparties of the corporation except for the owners is set in contracts, the owners are exposed to the risk that remains within the corporation after all these liabilities are settled. And the residual claimants in the corporation are defined as the residual risk bearers.
Fama and Jensen (1983a) distinguish the residual claimants as those with unrestricted claims and those with restricted ones. The unrestricted residual claims appear in joint stock

companies (open corporations in their terms). They are understood as freely transferable onto third parties, timely unlimited for the whole corporation time being and not connected with other required roles of the shareholders in the corporation.
As opposite, there are also restricted residual claims in corporations constructed as proprietorships, partnerships[1] and other types of closed corporations. Here the residual claims are restricted to important decision makers. According to Fama and Jensen (1983a), these types of corporations are likely to be effective in activities where the separation of decision management and decision control brings to high costs.

Sources of agency costs

The sources of agency costs are two-fold. They can be defined as driven by the nature of agents involved or they can be driven by the nature of nature surrounding the playground of these agents. The agents generally differ in their *objective function, risk aversion* and *free cash flow reinvestment motivation*. The nature fundamentally shapes the playground in terms of *information asymmetry* and *incompleteness of the contracts*.

Differing objective function

The principals and the agents usually differ in their objective function. This is an inherent feature of this relationship because the agents follow their own goals (utility, decision power etc) which need not be in line with the goals of the principals. As Denis (2001) states, the managers are willing to hold and increase their power, which is inherent behavior of major managers. This must not be worrying in the times when the managers represent value added for the company. But in the times when the current managers do not represent value added any more and should be replaced, they utilize their advance in information asymmetry. This leads to the case that the managers are able to prolong their presence longer than shareholders would wish to be.

Differing risk aversion

The risk aversion of the principals and agents also seems to be different. The key difference is mainly depicted on shareholder – management relationship. Denis (2001) argues that since shareholders have typically their investments diversified into more corporates they also loose only part of their total wealth if the corporate project fails. This has lead him to conclusion, that shareholders are less risk averse than managers, because managers are more closely tied up in the firm since almost their whole human capital is invested in the particular corporation. Thus, managers are willing to enter less risky projects of the corporation than shareholders and consequently the agency problem arises.
But the Denis's conclusion must not necessarily hold under all circumstances. It can also easily happen that the managers would be much less risk averse if they acted in the environment, where there were many other employers willing to employ them as managers and if they handled the shareholders assets (e.g. the corporation) in the terms of moral hazard. This can be the case if the managers are convinced that they will not bear the losses of the projects as they are facing soft budget constraints. At this time the managers are willing to enter risky projects knowing that they will share the profits but not the losses. Here, managers are less risk averse than shareholders and the agency costs are again enhanced. This outcome is opposite to the Denis's conclusion therefore more general statement is proposed: As the

[1] The limited partner who is not active in the business is unrestricted residual claimant and general partner who is active in the business decision making is restricted residual claimant in this Fama and Jensen terminology.

risk aversion of managers and shareholders certainly differ, the conflict of goals lifts the agency costs in the corporation.
But the managers and shareholders are not the only players with differing risk aversion. Shleifer and Vishny (1997) also point out the different risk aversion of equity holders and debt holders. As the debt holders get interests paid from the principal they are not motivated to finance risky projects of the corporation because profits of the project are received by shareholders. At the end the shareholders receive profits that are not upper bounded and if the project fails, the financers bear the costs.

Differing motivation in free cash flow reinvestment

The third key source of agency costs stems from reinvestment of free cash flow of the firm[2]. If the company has enough projects with positive NPV, it does not face the free cash flow distribution problem. But in case the company does not have enough projects with positive NPV to place all its available funds, it needs to seek for solution of free cash flow redistribution. The interest of the shareholders of the company is to pay out the free cash flow (being it via dividends or in other transfers) in order to enable placing these funds into projects with positive NPV that are outside of the particular corporation. But as managers usually maximize the volume of assets under their control, they need not be keen to distribute the free cash flow out of the company and they can even be willing to enter the projects with negative NPV (e.g. projects deteriorating the future assets of the corporation) in order not to decrease the volume of the assets at the current stage.

Differing access to information

The term of asymmetric information is generally connected to Arrow (1963) and Akerlof (1970). In that conception the corporation environment encompasses several information asymmetries. Most attention has been paid in the literature to the management-shareholders relationship. This information asymmetry is in the main focus for shareholder oriented firm economists. Nevertheless there are several other asymmetric relationships in the corporation environment with impact of the same importance. These asymmetries are present not only between insiders (employees, management) and outsiders (shareholders, suppliers, auditors) but also among particular insiders groups.
The common feature of these asymmetries is that the decision making counterparty is facing the information asymmetry as it is supplied by information necessary for the decision by the decision takers. This leads to the fact that decision takers can easily influence the information flow (in terms of their completeness, non-deflection and promptness) towards the decision makers in order to lead the decisions to their own interests. The final impact of the asymmetries stems from the nature of the relationship between the asymmetry counterparties, but it is always in the favor of the counterparty with better access to information.
The overall typology of information asymmetries is depicted in Scheme 1.

[2] Free cash flow is defined according to Jensen (1986) as a cash flow generated by the firm above the level of amount necessary to fund all the projects with positive net present value (NPV).

Scheme 1: Typology of information asymmetries in the corporation

Information asymmetry		Relationship	Impact
From insiders	Towards outsiders		
employees	management body	management	managerial slack, corporate decision failure
management body	control body	control	control failure
management body	debtholders	financing	investor risk
management body	government	regulation	business environment setup
management body	suppliers	trade credit	suppliers risk
management body	buyers	supplies	product quality
management body	auditors	control	information opaqueness
control body	shareholders	ownership	owners expropriation

The particular corporations differ in the extent of the information asymmetries between the interest groups. Here the assets structure seems to play an important role. It is widely accepted that corporations with higher share of intangibles produce more information asymmetries (Aboody and Baruch, 2000; Dedman et al., 2004). This is caused by the fact that the intangible assets are much more difficult to be valued than the tangible assets. For some corporations (such as biotechnology sector) the intangible assets in form of R&D[3] or patents and licenses are the key factor for their long-term success. But their true value is hard to asses not only for the investors and but also even for the management of the corporation.

Incomplete contracts

Since the contracts between managers and shareholders are imperfect (which means they are not able to handle all possible circumstances in managers-shareholders relationship), there are raised some residual control rights (e.g. rights for decision making in circumstances not specified in the contract), that need to be allocated. At the first glance the residual control right should be allocated to the shareholders. But since the managers face information asymmetry at the time of decision making under the non-specified circumstances, it is in fact the case, that the residual control rights end in the hands of the management. At the end these residual control rights enable the managerial expropriation of funds.

Reducing agency costs

As the sources of agency costs were defined as agents driven and nature driven, the tools for their reduction shall be followed in the terms of the impact on the two main causes. The agents driven agency costs are to be reduced by bonding solutions, monitoring solutions, incentive alignment and by cutting of residual cash flows. The nature driven agency costs are to reduced by reputation building, large investor involvement and transparency enhancement.

Bonding solution

The bonding solution (Denis, 2001) dwells in the shareholder-managers contract instructing the managers to maximize the shareholder value. But as the real world is infinitely complicated, there can be no written contract (besides the fact that some orders of shareholders towards managers can not be in written form) comprehending all possible states and defining relating decision rules. Therefore all the contracts between managers and shareholders shall be incomplete and thus can serve as a partial solution only.

Monitoring solution

The second solution dwells in monitoring activities in order to increase the managerial responsiveness (Denis, 2001). Here the monitoring conducted by shareholders is the first choice. But as the major shareholders are much diversified, they are exposed to free rider problem in monitoring as a problem of shareholders collective action. This is caused by the fact, that the costs of monitoring exceed the possible gains of proper management of the corporation (as the stake in the company is minor and thus also stake in the profit is minor) which further leads to monitoring unwillingness of the major minority shareholders. This free rider problem can be partially settled in the corporations with a large number of shareholders. There the shareholders with major stakes face much higher possible losses that outweigh the costs of monitoring. This pressure leads later on to their involuntary involvement in management monitoring. And finally next to the shareholders monitoring there are also present the monitoring functions of creditors (mainly represented by banks or capital markets) or supervisory boards (in dual systems only) which also play an important role.

Incentive alignment

The third solution of decreasing the agency costs stems in alignment of incentives of shareholders and managers (Denis, 2001). These alignments are willing to streamline the interests of shareholders and managers (or more accurately to set the managerial interests equal to shareholders ones). Since shareholders are maximizing the shareholder value in terms of share price, the willingness of the managers to follow also this goal can be increased by management shareholdings (or shareholdings options) as the major tool of the incentive alignment. The managerial shareholdings should ensure the managerial sense that shareholder's gains are also managerial gains and that shareholder's losses are also managerial ones.

Shleifer and Vishny (1997) also find highly contingent incentive contract among managers and shareholders as a possible solution of solving principal agent problem. But they perceive substantial need for some measurable proxy of the manager's value added in favor of the corporation. The major problem of the incentive contract is the process of the negotiation sometimes enabling the managers to many degrees of freedom over the corporate assets. This holds especially in case if the incentive contract is negotiated by a poorly motivated corporate representative, rather than by a representative of major shareholders. "While it is a mistake to jump from this evidence to the conclusion that managers do not care about performance at all, it is equally problematic to argue that incentive contracts completely solve the agency problem" (Shleifer and Vishny, 1997: 745).

The empirical evidence supports the positive impact of the managerial shareholdings on managerial performance. Brown and Maloney (1999) find that managerial shareholdings do effectively combat the agency problems and they also find that these effects are weaker when managerial shareholdings become larger and enable 'entrenchment' of the management at their positions.

Reducing residual cash flows

Denis (2001) or Shleifer and Vishny (1997) also called attention to the ability of debt financing to reduce agency costs via reducing residual cash flows. In profit distribution via dividends the management has some degrees of freedom in decision making. But this is not the case for debt financing since the corporation is obliged to meet the due repayments. Here the debt service decreases free cash flow and therefore decreases the conflict of interests between shareholders and managers.

Reputation building

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[3] Research and development

Shleifer and Vishny (1997) also suggest reputation building as a further possible tool for reducing agency costs. This mechanism is effective at the time when a corporation needs to raise funds on the capital markets (debt or equity). The most powerful argument in signaling its creditworthiness is the due repayment of its current liabilities which further reduces the agency costs (lower need for monitoring).

Large investors

As the legal protection does not provide sufficient tools for restriction of agency costs, there are often large investors employed on this matter. "… large shareholders play an active role in corporate governance" (Shleifer and Vishny, 1997: 754). The role of large shareholders was already mentioned in the monitoring solution section for their positive impact on solutions of free riding problem among shareholders. "A more fundamental problem is that the large investors represent their own interests, which need not coincide with the interests of other investors in the firm, or with the interests of employees a managers. In the process of using his control rights to maximize his own welfare, the large investor can therefore redistribute wealth – in both efficient and inefficient ways – from others." (Shleifer and Vishny, 1997:758) As it can be instantly seen the large shareholders can serve as a double-edged tool as it on one side reduces the monitoring costs by partially solving the free rider costs but on the other side they represent some potential (and in the real world very much present) risks for returns of minority shareholders. "With large minority shareholders, matters are more complicated, since they need to make alliances with other investors to exercise control. The power of the managers to interfere in these alliances is greatly enhanced, and the burden on courts to protect large shareholder rights is much greater. For this reason, large minority share holdings may be effective only in countries with relatively sophisticated legal systems, whereas countries where courts are really weak are more likely to have outright majority ownership." (Shleifer and Vishny, 1997: 754)

Jensen (1993) defined three types of mechanisms narrowing the gap between managers' and shareholders' interests. Firstly, there are *legal and regulatory mechanisms*. This is meant as a system of laws and regulations governing the firm's environment. In this term not only the governing regulations but also the enforceability of these measures are of crucial importance. Secondly there are *internal control mechanisms* such as BoD[4] issues (involvement of BoD, CEO[5] duality, non-executive directors, see Hermalin and Weisbach, 2001) and executive director shareholdings or executive compensation (see Core et al, 2003). Thirdly there are *external control mechanism*s, where market for corporate control is of the highest importance. Empirical evidence shows, that financially poor corporations are more likely targets of a takeover and also the management of these corporations is more likely to be a candidate for being made redundant. These two effects are the two main driving forces for narrowing the gap. The market for corporate control tool is extremely costly not only for all stakeholders (managers, shareholders, employees of the targeted company), it is also costly for the acquiring company since in many cases the acquirers pay too much for the acquired (usually the synergy effects are being overvaluated). "Thus for the average acquirer an acquisition becomes exactly what its shareholders wish to avoid: a negative NPV project" (Denis, 2001:207). Not only the takeovers are costly and the bidders are often overpaying. The market for corporate control implicitly assumes that the firm efficiency is positively correlated with the firm market value (Manne, 1965) and as a consequence it strongly requires advanced capital markets (with high liquidity) and it is also a hot political issue and a subject of political pressures.

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[4] Board of directors

[5] Chief executive officer

Transparency enhancement

The only way of tackling the information asymmetry seems to be to make the information as much open as possible. In these terms transparency is “another name for information” (Stiglitz, 2000:1466). Here the auditing is the key device in reducing information asymmetries and enhancing the corporation credibility. Despite the fact that even auditors face serious information asymmetries their mediatory role for restriction of information asymmetries of other interest groups (or stakeholders) such as debtholders, suppliers and buyers is irreplaceable. Several auditing failures in the past few years (which were an interesting mix of a) misauditing in terms of close relationship between auditor and customer and of b) misanalysing in terms of small attention paid by the investor’s general public to the auditor’s reports) can not substantially undermine the key auditing role in making financial accounting open and transparent.
The overall typology of agency costs is depicted in Scheme 2.
Scheme 2: Typology of agency costs

	Nature of nature	Nature of agents
Sources of agency costs	information asymmetry incomplete contracts	objective function risk aversion free-cash flow reinvestment
Reducing agency costs	reputation large investors auditing	bonding solutions monitoring incentives
Types of mechanisms	legal and regulatory internal control external control	

Stewardship theory as an alternative approach to the agency theory

Although the agency theory seems to be a dominant paradigm of a corporate governance, increasing attention is also being paid to an alternative theory developed in psychology and sociology field. In the stewardship theory, which was firstly developed in Donaldson and Davis (1989), the manager is self motivated to act in favor of principal’s interests and hence serves as a steward of their needs and wishes. The model of a man in the stewardship theory perceives organizational and collectivistic actions and interests of higher priority than the individualistic self interest actions. The collectivistic utility is of higher priority than the individual utility even if these interests are not aligned. This is in a strict contradiction to the agency theory assumptions, thus the conclusions of the stewardship theory also very much differ to the agency theory ones. “According to stewardship theory, the behavior of the steward is collective, because the steward seeks to attain the objectives of the organization… A steward protects and maximizes shareholders´ wealth through firm performance, because, by so doing, the steward’s utility functions are maximized.” (Davis et al, 1997: 24-24)

The major difference between the agency theory and the stewardship theory can be found in psychological and situational factors (Davis et al, 1997). As psychological factors are concerned, the key difference between the two theories stems from the motivation of actors. Whereas in the agency theory the actors are expected to be best motivated via extrinsic motivation (extrinsic rewards such as salary, bonuses, shares options etc) the actors in stewardship theory are best motivated via intrinsic motivation which is not easily quantifiable (personal growth, achievement etc).

The second psychological factor is the degree of identification with the company. In the stewardship theory the managers are supposed to attribute the success of the company to themselves. In the agency theory the managers are said to externalize the company's problems; these managers do not feel to be identified with the company and responsible for its issues and try to pass the responsibility to others.

The third psychological factor which differentiates the theories is the use of power; institutional and personal ones. The institutional power stems from the manager's positions that he or she occupies and consequently disappears as the person leaves the position. The managers are said to use the institutional power in the agency theory. On the other hand personal power stems from the expertise and individual characteristics of the manager and thus does not disappear after the person leaves its position. This power is said to be used in the stewardship theory.

There are also situational factors differentiating the agency theory and the stewardship theory. The first factor takes into account the approach to management and coaching. Here control oriented and involvement oriented approaches are contrasted. The control oriented approach is based on the assumption that the control, management and thinking functions need to be separated from performing functions. Naturally this approach is said to be employed in the agency theory. In contrast the involvement approach gives the employees high degree of responsibility, is based on self-management, self-coaching and self-control and thus does not separate the management and performing functions. This approach is said to be employed in the stewardship theory.

The second factor takes into account the cultural differences. The agency theory is more likely to be present in individualistic culture where the personal goal (and utility) is of higher priority than the group ones. On the contrary the stewardship theory is more likely to be present in collectivistic culture which puts higher priority to the common goals. Here the personal goals are subordinated and the person is defined as a part of a group.

The strength of the stewardship theory should be taken into account as this theory has grown on field of psychology and sociology with link to empirical evidence on behavioral decision making. For instance Donaldson and Davis (1989) found empirical evidence for the argument of the stewardship theory, that CEO duality has positive impact on shareholder value, which is in strict contradiction to the agency theory expectations. Muth and Donaldson (1998) and Lin (2005) found further empirical evidence for the stewardship theory assumptions.

As every human being is a mixture of altruism and self interest and as its priorities seem not to be consistent in time, it can be the case that every manager has inherent controversy of the agency theory and the stewardship theory in his mind. Some empirical evidence studies support this intuitive finding (for survey of the empirical evidence see Davis et al, 1997).

The key agency theory and stewardship theory features are summarized in Scheme 3.

Scheme 3: Typology of agency theory and stewardship theory corporations

Characteristics		Agency costs theory	Stewardship theory
Psychological	Motivation	extrinsic	intrinsic
	Company identification	absent	present
	Use of power	institutional	personal
Situational	Management	control oriented	involvement oriented
	Culture	individualist	collectivistic

Models of corporate governance by financing

There can be specified two major ways of financing in the models of corporate governance. In the first one the banks are the major finance providers therefore these are called bank-based financial systems. In the second one the corporations raise the funds on the capital market via equity or debt, therefore these are called market-based financial systems.

In the bank-based system the banks serve as the major financial intermediaries of the free funds from the net depositors (households) to net debtors (corporations). Clearly the efficient banking systems are a necessary condition for these systems. As the financing is provided directly from the creditor (bank) to the borrower (corporation), the banks are expected to conduct thoroughgoing in-depth analyses of the corporation in order to know the borrower. Due to this fact the bank based systems are said to provide better long-term financing than the market based systems as the creditors know better the long-term value of the corporation and thus do not necessarily need to respond quickly on the short-term fluctuations of the company. As the banks are very closely connected to the corporations either personally or via the stakes in form of large borrowings, they often tend to hold some equity stakes of the customers or at least to be personally present in their supervisory bodies. This fact raises the threat that the advantage of the better ability to provide long-term financing turns into a disadvantage stemming in the too close bank-corporation relationship. At this stage the banks are in fact forced to provide further financing even if the corporation prospects are very bad; the bank stakes in the corporation are too high to be smoothly written off. As Rojo and Garrido (2000) argue, "the problem of separation of ownership and control is remarkably intense in the Anglo-Saxon model … but the corporate governance problem in the continental system lies with the power accumulated by banks." (Rojo and Garrido, 2000:6-7)

The bank based systems are also said to be appropriate for the corporations of all size being it SME[6] or large corporations. The transaction costs of the funding from banks have generally a small share of fixed costs and are mainly variable costs depending on the debt volume as the flat fees for bank loans are mainly charged as percentages of the loans. Thus there is no specific level for loan where the transaction costs would be impassable to disqualify some corporation types from bank funding.

In the market-based systems the lenders and the borrowers meet on the capital market. The lenders are placing their free funds and the borrowers are satisfying their cash needs. The corporations in the market based system finance their needs either by equity raising or by bond issues. Clearly here the efficient capital market is again a necessary condition. The borrowers need to share all the necessary information about the corporation with the market. In addition the capital market needs to be sufficiently transparent (lacking interferences),

[6] Small and medium enterprises

credible (lacking suspicion) and liquid. The liquidity of the capital market is crucial in both its types e.g. depth and width. The wide capital market offers the lender wide range of products to buy (bonds and shares) and the depth of the market assures the lenders to find anytime a counterparty willing to purchase its stakes if the lender decides to quit the investment. As the placement on the capital market is costly for the borrowers both in terms of resources and also in terms of time, there are considerable transaction costs connected with this way of funding. Therefore the capital market is said to be more convenient for transactions of larger volumes e.g. for larger corporations. In addition to it there are also some monitoring costs that need to be spend by the lenders in order to assure their investments and these costs are also to a large degree of fixed nature. Thus there is also some unwillingness of the lenders to invest into too small stakes (typically small companies shareholdings). Thus the SME corporations face both high transaction costs and an investor disfavor. The banks play important role also in the market-based financial systems. They are typically important providers of financial services for households or SME corporations and they also provide "liquidity security" in form of back-up credit facilities for large corporations.
Generally the main origins of the market-based and the bank-based systems are accounted to the timing of industrialization (TOI). The TOI thesis states that the key differences of the particular country financial system can be seen in the respective industrialization phase. In the countries with earlier industrialization start (such as United Kingdom) the firms were able to finance their own growth either by internally generated funds gradually cumulated together with the industrialization process or by IPO[7] on the relatively developed financial markets. On the other hand the countries lagging behind with the industrialization (such as Germany) faced undeveloped financial markets and lated internal funds generation. Therefore the banks were the only financial partners able to provide sufficient volume of funds for a fast catch-up of the competitors in advanced industrialized countries. This development has led in Germany to tight relationships between corporations and banks, where the corporations typically cooperated with one bank (home bank or Hausbank) and the banks typically held stock stakes in these corporations and possessed some places in the supervisory boards. All of these features have supported the long-term character of the relationship. This has also later led to the fact that the banks were very active in German industrial policy.
The the bank-based and market-based systems of corporate financing are also very much connected with the pattern of the retirement systems. In the countries with the market-based financial systems the retirement systems are mainly funded by pension funds that collect the contributions of the labor force and reinvest them on the capital markets. The pensions are later on paid from the profits of these capital investments. On the contrary the bank-based systems typically finance the retirement systems on PAYG[8] basis where the contributions are consumed by the pensions on the spot and thus no capitalization happens.

Corporations
The market-based system seems to be less suitable for SME corporations. The main reason is that the financing via capital markets raises some fixed costs that are too high for the smaller volumes. Another reason can be the unwillingness of the investors to finance these corporations in small volumes, as they also face fixed costs in terms of monitoring. The propriety of the market-based system for large corporations varies according to their indebtness. Heavily indebted corporations face serious problems in finding new investors in the market-based system, but in the bank-based systems the financing banks are often forced to provide additional loans in order to retrieve also the preceding ones. On the other side the

[7] Initial public offering

[8] Pay-as-you-go

large firms with low debt are attractive for investors on the capital market. Hi-tech corporations (including SME) are able to finance via capital markets more easily than others as they are able to utilize the investor over-optimism. De novo firms have serious financing problems in the bank based model as they have no track record necessary for the bank. The banks are excessively exposed to downside risk, they face the risk of defaulting credit in case of a start-up failure (they are not floored in losses) but they are capped in revenues by the amount of the interests and the fruit of the fortunate start-up is picked by the shareholders. "Bank based systems appear to have an advantage in terms of providing a long-term stable financial framework for companies. Market-based systems, in contrast, tend to be more volatile but are better able quickly to channel funds to new companies in growth industries". (Vitols, 2001:1)

Households

High income households typically prefer the market-based system, as they utilize the advantage of the possibility to invest into bonds or shares with higher revenues than bank deposits (be it directly or via financial intermediaries). They are also able to bridge the short term market risk of yield volatility. Low income households have little to save and seek mainly short term financing (consumer loans) and thus prefer bank-based model. Middle income households are able to save but are more risk averse than the high income households and thus prefer bank products and thus also the bank-based system.
The investigations of the impacts of the financing models on the economic growth are mixed. None of the models is particularly more effective in promoting growth than the other one. "…if one accepts that Germany and Japan are bank-based and that the United States and the United Kingdom are market-based, then this implies that the financial structure did not matter much since the four countries have very similar long-run growth rates… There is no cross-country empirical support for either the market-based or bank-based views." (Levine, 2000:4)
The key bank based and market based financing features are summarized in Scheme 4.

Scheme 4: Typology of bank based and market based corporations

Characteristics	Bank based	Market based
Major external finance provider	banks	capital market
Financing time horizon	long-term	short term
Creditor debtor relationship	tight	mediated
Creditor shareholder unification	often	rarely
Debtor typical size	all sizes	large corporates
Financing transaction costs	smaller	higher
Retirement system	PAYG	fond-based

Models of corporate governance by execution of shareholder rights

Another way of distinguishing between the corporate governance models is the way the investors execute their shareholder rights. Generally they have two options, either to try to push through some actions in the corporation or simply to sell the shares.
The first model is called voice (or vote) rule. Here the investors play an active role and assert their own concepts and visions in the corporate affairs and actively monitor the agents. This

approach is therefore called an investor activism. Clearly there are some (often substantial) costs connected with these actions, therefore the investments need to be of sufficient volume in order to justify these costs. In addition to the costs this approach does not bring fruits instantly but it takes some time after the active actions are implemented. Thus the voice rule has some time lag of effects following the actions. Typically this approach is applied by the investors who are both shareholders and creditors of the corporation since their stakes are multiplied, the exposure is under higher risk and thus their motivation for active monitoring is more encouraged.
The second model is called the exit rule or the Wall street rule or voting with their feet rule. Here the investors take passive actions in the monitoring and sell the shares on the capital market, therefore it is considered as a market for the corporate control solution. "When the management of a corporation deteriorates, the first reaction of the best-informed stockholder is to look around for the stock of better-managed companies" states Hirschman (1970:46), who firstly introduced the general concept of voice and exit to economic agents decision making. Naturally the liquid capital market is a necessary condition for the exit rule. As the sale of the shares can follow the decision very quickly, it is an instant solution having no time lag. It is also less costly since there are no spendings on the active monitoring actions. The only costs of this approach stem from the difference between the purchase and sale prices of the shares (if the difference is negative) and from the non-avail of the opportunity to either take active actions in order to reverse the negative trends of the corporation or not to take active actions and to continue in the passive monitoring with the hope for improvement (opportunity costs). The institutional investors typically favor the exit rule over the voice rule (Rojo and Garrido, 2003 or Coffee, 1991). In addition to it Bhide (1993) argues that in liquid capital markets the exit of the investors is too easy. In this term this can be a barrier for the active corporate governance as the investors are more encouraged for this option than for the active monitoring by the vote rule. The key voice and exit options characteristics are summarized in Scheme 5.

Scheme 5: Typology of voice and exit corporations

Characteristics	Voice rule	Exit rule
Company monitoring by the investors	active	passive
Costs connected with the monitoring	substantial	minor (mainly opportunity costs)
Typical investors	banks	institutional investors
Time lag of the actions	present	absent

Models of corporate governance by ownership stakes patterns

We also distinguish corporate governance models according to the ownership stake patterns or in other words "according to the degree of ownership concentration and the identity of controlling shareholders" (Maher and Andersson, 1999:12). Again, there are two main models, outsider and insider one.
In the outsider model, the ownership stakes are very much diversified among a large amount of investors. The stakes of these shareholders are generally very small so the shareholders can exercise their rights mainly by voting with their feet. As they have no direct impact on the corporation, these shareholders are called outsiders (with arm's length relationship). As already noted, the outsider model is connected with dispersed equity ownership which is typically owned by widely dispersed groups of investors (both individual or institutional) and there is also present a high turnover of these shareholders. Naturally these outsiders are

typically not present in the management and control bodies of the corporation. As the ownership is mainly of large amount of small shareholders and these exercise their shareholder rights via exit, the outsider model requires both liquid capital market and also strong rules on company disclosure and on minority investors protection. Clearly, the outsider model is very much close to the market based model with common main characteristics of a better risk diversification for investors and also a weaker shareholder motivation for corporation monitoring.

Opposed to the outsider model, the ownership in the insider model is more concentrated in the block holdings. These block holders are insiders for the corporation, as their investment is usually long-term and they prefer to possess their representatives in the decision and/or control bodies of the corporation. These insiders are typically families, banks, government, holdings or industrial concerns. As there is a considerable lower amount of the shareholders of a particular corporation in the insider model and their communication and coordination is much easier than in the outsider one, the agency problem seems to be much less present. Due to the fact that the investment horizon of the shareholders is typically long-term, there is a much lesser shareholder turnover than in the outsider model and therefore a lesser demand for effective and liquid capital market is present. In addition, there is also more tolerance for selective exchanges of information among particular insiders also characterized as lower disclosure (Nestor and Thomson, 1999). But consequently this can in turn lead to an increase of the cost of capital as minority shareholders can request a premium for holding the shares (if they have no influence on the corporation). Again the insider model is very much close to the bank based model mainly by the common features of a low capital market liquidity, a low company disclosure and a low minority investor protection.

For insider and outsider purposes, there is an essential need to distinguish between the ownership control and the voting control or in other words between the ownership (cash flow) rights and control (voting) rights. For some reasons, these two terms do not mean the same. The ownership control and the voting control are not identical in systems, where some deviations from one-share-one-vote rule are present. These can be voting caps, dual or multiple class shares, proxy voting, shareholder coalitions, golden shares or even pyramidal ownership and cross shareholdings (both vertical and horizontal). All of these mechanisms are generally enabled by particular regulatory systems.

For a corporation with a dispersed ownership and one-share-one-vote rule, the dispersed voting power is present. These are typical outsider model corporations with the main agency conflict between managers and shareholders. They typically suffer from weak monitoring incentives for shareholders and from the free rider problem among shareholders and therefore they are called strong managers, weak owners corporations (Roe, 1994).

The corporations with the dispersed ownership and violated one-share-one-vote rule are characterized by a concentrated voting power. This concentrated voting power is generally enabled by proxy voting where the dispersed small shareholders pass the right to vote to a third party. As the amount of the third parties is much lower than the amount of the dispersed small shareholders, these third parties are insiders for the corporation. Since the incentives for the monitoring by the blockholders are much higher, the management strategy is generally in line with the blockholders strategy. Therefore the main agency conflict in these corporations stems in the blockholders and the minority shareholders relationship. In Roe's terminology, they could be determined as corporations with strong owners and weak managers.

The corporations with concentrated a ownership and violated one-share-one-vote rule (typically via voting rights restrictions) are characterized by a dispersed voting power. Here again the main agency conflict is among the management and the shareholders and the shareholders are again dismotivated in company monitoring. The managers are strong and the

owners are much weaker than in the dispersed ownership-dispersed voting power corporations. But in real life, this kind of corporation is very rare.
Finally the concentrated ownership corporations with one-share-one-vote rule are characterized by a concentrated voting power leading to the typically insider model corporations. Here the main conflict is again among the blockholders and the minority shareholders which leads again to strong owners and weak managers.
As it can be observed the takeovers (e.g. market for corporate control devices) are possible only in one type of corporations – with the dispersed ownership and the dispersed voting power. In other types either the concentrated ownership or the one-share-one-vote violation disable this monitoring device. The typology of the insider and the outsider corporations is summarized in Scheme 6.

Scheme 6: Typology of insider and outsider corporations

Characteristics		Dispersed ownership	Concentrated ownership
Dispersed voting power	definition	outsider model	outsider model
	agency conflict	management x shareholders	management x shareholders
	takeovers	possible	rare
	monitoring	weak, free rider problem	weak, free rider problem
	portfolio diversification	present	low
	one-share-one-vote	present	violated (voting rights restrictions, minority shareholders protection)
	Roe's terminology	strong managers, weak owners	strong managers, weak owners
Concentrated voting power	definition	insider model	insider model
	agency conflict	block holders x minority shareholders	block holders x minority shareholders
	takeovers	rare	rare
	monitoring	stronger	stronger
	portfolio diversification	present	low
	one-share-one-vote	violated (proxy voting)	present
	Roe's terminology	strong owners, weak managers	strong owners, weak managers

Models of corporate governance by firm objective function

The corporate governance models also differ in terms of the objective function of the corporation, e.g. general target of the corporation and its interest groups. The theory defines two various types, a shareholder oriented firm and a stakeholder oriented firm.
The shareholder oriented firm objective function (OF)can be defined as

$$OF_{shareholder} = \max f(\Pi) \tag{3}$$

where $\prod$ is the company's profit. As it can be seen, it is a neoclassical profit maximizing firm, however in our corporate governance framework the company is maximizing rather the

residual cash flow than the profit as such[9]. The term of a shareholder value has been originally introduced by Rappaport (1986) and this model evaluates the corporation from the shareholders´ point of view where the value is understood as a cash value of all the surplus funds potentially distributable to the shareholders in the future.

The arguments in favor of a shareholder oriented firm are strong. Gregg (2001) argues "that the business corporations are not athletic associations or even social welfare organizations" (Gregg, 2001: 33) which corresponds with "Aristotelian notion that institutions should be primarily understood in terms of their purpose" (Gregg, 2001: 33). "But once a business corporation loses sight of its corporate objective or forgets that its primary responsibility is maximization of shareholder value, then it has effectively betrayed its telos." (Gregg, 2001: 34) He further states that "the stakeholder theory undermines private property… that the assets utilized by corporations should be used for the balanced benefits of all stakeholders".

Shleifer and Vishny (1997) also argue in favor of the shareholder value oriented firm. They state that the investment by the shareholders is largely sunk, which is much less the case of the stakes of employees, creditors or local community. "The employees, for example, get paid almost immediately for their efforts, and are generally in a much better position to hold up the firm by threatening to quit than the shareholder are." (Shleifer and Vishny, 1997: 751) In addition, they also argue that the stakes and interests of other stakeholder groups are better legally defined than those of the shareholders. "Legal protection of creditors if often more effective than that of the shareholders, since default is a reasonably straightforward violation of a debt contract that a court can verify." (Shleifer and Vishny, 1997: 752)

The objective function of the stakeholder value oriented firm can be written as follows

$$OF_{stakeholder} = \max f(\Pi, E, S, C, G, LC, CC, CR) \tag{4}$$

where the $\prod$ is the company's profit (residual cash flow more accurately) as a shareholders interest, E is the employees interest (being it in the form of wages or employment), S is the suppliers´ interest (being it in the form of appropriate purchase prices or short payments terms), C is the customers´ interest (being it in the form of low prices, high quality, long guarantee or long payment terms), G is the government interest (being it in the form of a tax levy or low public services), LC is the local community interest (being in the form of the financial support of the community or of the nice surroundings of the corporation), CC is the chamber of commerce interest (being it in the form of a coordinated approach towards other stakeholders) and CR is creditors interest (being it in the form of full and timely repayment of the due liabilities).

"The stakeholder theory is general and comprehensive, but it is not empty; it goes well beyond the descriptive observation that organizations have stakeholders." (Donaldson and Preston, 1995:70) The stakeholders of a corporation are broadly defined as "those groups without whose support the organization would cease to exist" (Stanford Research Institute, quoted in Freeman, 1984:31). The list of stakeholders in our form is not full and complete, it also naturally depends on the stakeholder willingness to call attention to their stakes. However our definition of the stakeholder value oriented firm objective function has shown the key difference between the shareholder value and the stakeholder value firm. As it can be understood from the form of the objective function, the interests of particular stakeholders can be in an inherent conflict (for instance those of suppliers and buyers of the company). The stakeholder oriented firm is therefore facing substantial coordination costs. In addition the

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[9] In accounting language the profit of a firm is computed as revenues subtracted by costs, but the accounting profit and the accounting loss can be reached also by autotelic accounting entries without real economic background. Therefore in our framework the profit is understood as de facto a residual cash flow, e.g. what's left in the company after repaying the liabilities. The accounting profit does not necessarily lead to a positive residual cash flow and equally the accounting loss does not necessarily mean a negative residual cash flow.

stakes or the interests of particular stakeholder groups also vary according the their nature. They can be of a shareholding nature (shareholders or managers with share options) or an economic nature (suppliers, buyers, creditors, employees) or a social nature (local community, government).

Particular groups of stakeholders can be defined based on certain i) interests in the corporation, ii) resources employed in the corporation (be it in form of capital or skills) and iii) rights and obligation towards the corporation. They are not easily fully separable and thus they can overlap to a large extent. Naturally there can be an unlimited number of stakeholder types which means these claims can not be fully satisfied at the end. Therefore the concept of critical stakeholders has been introduced in order to choose the interest groups that can hardly or too costly be replaced.

The key difference of the stakeholder value oriented firm compared to the shareholder value oriented one is the stratification of the interests. Whereas in the shareholder value oriented firm the key objective is the profit maximization the stakeholder value corporation accepts the goals of all legitimate interest group with the same priority. "The stakeholder corporation is responsible to a wider constituency of stakeholders other than shareholders." (Maher and Anderson, 1999:8)

The stakeholder approach was firstly introduced by Freeman (1984). "Just as the separation of the owner-manager-employee required a rethinking of the concept of control and private property as analyzed by Berle and Means (1932), so does the emergence of numerous stakeholder groups... require a rethinking of our traditional picture of the firm." (Freeman, 1984: 24) The bottom line of the Freeman stakeholder approach is the Kantian one in terms of his second categorical imperative: 'Act so that you treat others whether in your own person or in that of another always as an end and never as a means only'. This categorical imperative is expressed towards the shareholders and the 'others' stands for the stakeholders.

Donaldson and Preston (1995) introduced the stakeholder approach as a three-level theory. The first level is a descriptive (or empirical) one that clarifies characteristics of the corporate, its processes and behavior. In their comprehension, the stakeholder corporation is a set of cooperative and competitive interests. The second level is an instrumental one that bridges the stakeholder approach and commonly used corporation objectives such as profit or production maximalization or stability. It establishes the framework for such a linking of the stakeholder management and the achievement of traditional corporate objectives. The third level is a normative one based on the assumption that the interests of all stakeholders are of intrinsic value. "That is each group of stakeholders merits consideration for its own sake and not merely because of its ability of further the interests of some other group, such as shareowners." (Donaldson and Preston 1995:67)

In this sequencing it is easy to demonstrate, that the stakeholder theory is normative. It is not a value-free theory, in other words "stakeholders ought to be given consideration for their own sake" (Moore, 1999:118) It is not absolutely necessary that the three levels of the Donaldson and Preston stakeholder theory terminology shall be in line under all circumstances. It could easily happen that the descriptive and instrumental levels would observe processes and incentives increasing the utility of stakeholders. But these incentives can be in conflict with the normative level, which is of the highest priority among them. The final solution shall be based on the normative recommendations; therefore we are facing a sort of normative theory of the firm.

If we employed the Donaldson and Preston three-level terminology on the shareholder theory we would see a full agreement on the descriptive level. If the true description is a set of value-free statements, then concept can be used both in describing a corporation which is at the end maximizing the shareholder value or a corporation maximizing the stakeholder value. Both corporation concepts face differing incentives of different interest groups. In addition also the

instrumental level can face a partial agreement among the stakeholder and the shareholder theory. Despite the fact that the shareholder theory admits the profit maximization as an overriding objective and that the other objectives are subordinated, the importance of the secondary objectives for the profit maximization is largely accepted. In this concept the utility of the stakeholders as a subordinated goal is being increased only provided that this consequently means that the utility of the shareholders as an overriding goal is improved.
There are also strong arguments against the stakeholder theory. The fact that an interest group is affected by corporate activities does not necessarily mean they have a legitimate stake in this corporation. Moore (1999) disagrees on the basics of the stakeholder approach when he states "that a stakeholder firm would achieve, almost as a by-product, what a profit-maximizing firm would achieve as an objective". (Moore, 1999:118)
Thus the main disagreements of the stakeholder and the shareholder value theory is in the normative level. In these terms we are facing the challenge of decision making: Is it normatively wrong the subordinate the stakeholder interests to the profit maximization? Or is it normatively wrong to set all stakeholders´ interests (including shareholders) with the same priority? The answer shall differ based on the normative background of the particular decision maker and can by no means be subject of this essay. The key typology of stakeholder and shareholder value firms is depicted in Scheme 7.

Scheme 7: Typology of stakeholder value and shareholder value corporations

Characteristics	Shareholder value firm	Stakeholder value firm
Main conflict	principal-agent	stakeholder-agent
Main goal of objective function	shareholder utility maximalization	stakeholder utility maximalization
Nexus of contracts	relationships with stakeholders are via implied or legal contracts	relationships with stakeholders are not only via implied or legal contracts but also via moral imperatives
Social welfare function	utilitarianism	social justice

The main conflict among the shareholder value and the stakeholder value concepts is in the view of property rights. In this term the stakeholder approach undermines the traditional threefold property right concept of usus, usus fructus and abusus. The shareholder value concept argues that the corporation was founded through the (risky) investment of the capital by the shareholders. Therefore they in turn have the right to put the highest priority to their interests. "The stakeholder doctrine necessarily undermines private property because it denies owners the right to determine how their property will be used" (Sternberg, 1997:82). The corporation in this context is fully owned by the shareholders irrespective of the assets funded by other than own funds.
The stakeholder value concept in turn does not understand the corporation in the optics of invested capital only. It considers the corporation as an organic set of placed capital from shareholders, placed financial funds from creditors (being it through credits in form of bank loans or bonds or being it through trade credits in form of account payables) or placed interests of employees (being it in form of specific skills or wages due). In other words "… the firm should internalize the externalities on the various stakeholders." (Tirole, 2001:31) From this point of view the interests of stakeholders have also unquestionable right to be treated with the same priority as the shareholder interests. Since the assets are usually funded by mixture of own funds (being it equity or quasi-equity) and external funds (payables or loans), the assets can not be treated as a property of shareholders only.

Both concepts accept the corporation as a nexus of contracts which seems to be the best metaphor for the relationships between the firm and the stakeholders (descriptive level of theory). But their conflict is in the nature of the contract setting. The shareholder value concept is closer to libertarian free contracting where all the actors (e.g. stakeholders) voluntarily enter particular contracts. In this term any kind of favoring of particular interest groups departures from the originally balanced free contract. On the other side the stakeholder value concept employs the Rawlsian veil of ignorance for its fair contracting approach. Here, the contract is treated as fair if parties of the contract (e.g. stakeholders) would agree to it in ignorance of their actual stakes.

Stakeholder value theory further develops the classical principal-agent problem into the stakeholder- agent problem (Hill and Jones, 1992). The classical principal (shareholder or also residual claimant[10]) and agent (manager) relationship is broadened into a generalized theory of agency. In this concept the management is the agent of all the stakeholders and not of the shareholders only. Hill and Jones accept that the interests of the stakeholders are of differing priority and also stress the varying negotiation power of particular stakeholders towards the agents-managers. The negotiation process of their stakeholder-agent framework face considerable friction costs leading to the ability of some stakeholder groups to fully encumber the optimization process (such as labor union in wage setting negotiations). The stakeholder-agent theory reaches the optimal set on a fairly exceptional basis and even if the optimum is reached, certainly it would not be a stable one. In this context the focus of the analyses should be in the stakeholder group interactions rather than in the equilibrium process.

As it is in the case of the shareholder value corporation also the stakeholder value firm faces information asymmetry. In every corporation there are various sets of information asymmetries present; suppliers control the stream of information towards buyers, employees control some information stream towards employers, debtors control information stream towards creditors. But the largely accepted main information asymmetry is between managers and other stakeholders whereas the managers are the ultimate decision makers on the level of information openness towards other stakeholders in the corporation.

One step further behind the stakeholder theory there is the corporate social performance theory[11] which incorporates ethical dimensions into the corporate decision making (see Huse and Eide, 1996). It considers principals of social responsibility and emphasizes the impact of environmental stakeholders. This theory can be defined as "a business organization's configuration of principles of social responsibility, processes of social responsiveness, and policies, programmes, and observable outcomes as they relate to the firm's societal relationships" (Wood, 1991:693). As it can be instantly seen, its conclusions are even of much stronger normative propositions than it is the case of the stakeholder corporation theory.

There are highly interesting interlinks between the theory and the empirical evidence. Low (1991) conducted a study of a sample of 47 corporations active in steel distribution. He found out they have four key internal groups regardless of the corporation size: management, sales, clerks and shop workers. He also found out 14 key corporate goals: profit, customer satisfaction, service, cost reduction, team spirit, employee promotions, investment into shop equipment, investment in office equipment, sales growth, supplier relations, fair salaries, employee development, safe working conditions and efficient plant lay-out. The respondents from the corporations were asked for evaluation of the importance of these goals. The consensus of the internal groups on the priority of the goals was calculated as comparison of the standard deviations among the answers of the particular internal interest groups. The

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[10] Shareholders have in case of the default of the corporation the so called residual claims, e.g. their claims are satisfied after all other claims of other stakeholders.

[11] Corporate social performance (CSP) or corporate social responsibility or ethical investing.

research followed two hypotheses: 1) The more is the management shareholder value oriented, the lower the goals consensus between internal groups and 2) The more is the management oriented on employee interests, the greater the goals consensus between the internal groups. The results not only rejected the first hypotheses but they confirmed the opposite thus the more managers follow the shareholder value the greater the goal consensus between groups. The second hypothesis was supported only on a low significance level.
One of the reasons can be that if the managers follow the shareholder value (and thus profit maximization), they have a clear goal and rules for decision-making. In this case the profit maximization serves as a gravitation of the various interest groups. On the contrary this can lead to a conclusion that if the management shall follow the stakeholder value the goals are competing and the consensus of the internal groups dwindles. It has been widely accepted that only corporations with clear goals (and thus with goal consensus between internal groups) can be successful in a long-term period. Until now the shareholder value is the only centripetal power for the internal groups interests. If the stakeholder value firm theory introduces a goal that would be of a sufficient gravitation for the various goals of stakeholders, it could replace the shareholder value profit maximization as the centripetal power of the interests. Clearly, this shall be a challenge for future research.
The mechanism of selection between the shareholder value oriented firms and the stakeholder value oriented firms has not been known until now. It can be the case that in financially better times for the corporation the management is keen to behave more stakeholder oriented simply because they can afford it. Consequently in financially worse times the management turns back to the shareholder value orientation as there is no room for being stakeholder oriented any more.
On the other hand the mechanism can also be fully converse. In financially worse times the management can be forced by stakeholders to behave more stakeholder oriented based on their increased negotiation power. In financially better times the managers again resign from the stakeholder orientation in favor of the shareholder orientation based on the assumption that the cooperation of the stakeholders is not necessary any more.

Models of corporate governance by management structures

The key difference among the existing corporate governance models of management structure is in the way of tackling the executive actions and the control actions and their possible separation. As the joint stock companies are the most common legal forms of the corporations, the differences of these models are mostly depicted on these forms. In the joint stock companies the owners will is enforced on the shareholders meeting that appoint control and/or executive bodies of the corporation. The executive body is the Board of directors (BoD) in both models. The control functions are conducted either also by the Board of directors or separately by the Supervisory board (SB).
The first model is called a one-tier or a single model or an Anglo-saxon model. Here the management and control tasks are unified in the Board of directors. In addition to it the Chief executive officer (CEO) is often also the Chairperson of the BoD. If this happens the function of the highest representative of the management is unified with the function of the highest representative of the control, which is than called a CEO-duality (Maassen, 2002). The BoD members are both representatives of management (executive directors, insiders) that are mainly determined for the executive functions of the BoD and also representatives outside the company (non-executive directors, outsiders) that are mainly determined for the control functions of the BoD. Empirical evidence does not support the idea that more outside directors improve the corporate performance (Hermalin and Weisbach, 2001) but it has found out, that the probability of adding an independent director to the board is more likely to appear in an poorly performing corporation.

Hence, as can be observed the executive and the control functions are personally and functionally unified in the BoD. There are generally no strict rules on the composition of the BoD, therefore some are dominated by executive directors, some are dominated by non-executive directors, some separate the positions of the CEO and the Chairperson and some unify these positions. But generally the members of the BoD are often dependant on the CEO mainly in the terms of information asymmetry as the CEO has the ultimate power over the information streams towards the BoD members. This is even emphasized if the CEO-duality is present. The key issue in the principal agent problem of BoD and CEO is that a CEO has some say over who is the BoD. Hermalin and Weisbach (2001) find strong empirical support for the statement that the longer the CEO in the chair, the lower is the independence of the board.

Based on the fact that a BoD unifies the management and control functions of the company, which is very demanding concerning the capabilities of the BoD, some of the functions are further transferred to the board committees. The management support (operating) committees are mainly dominated by executive (insider) directors and their main aim is to implement the BoD decisions on management. Usually they consist mainly of an executive committee (management implementation), a finance committee (financial management), a strategy committee (strategic issues) or a risk management committee (risk mitigation). The monitoring committees aim to support the control function of the BoD and thus are mainly dominated by non-executive (outsider) directors. They are usually represented by an auditing committee (accounting supervision), a compensation committee (management salary packages) and a nominating committee (human resources functions). As the value added of these committees was proved by evidence, later on they become mandatory for some corporations (mainly market listed) or at least strongly recommended for the others.

The second model is called a two tier or a dual model or a continental model. Here the management and the control functions are separated. The management actions are performed by a Management board (MB) and the control actions of the MB are performed in a Supervisory board (SB). The position of the SB is passive ex definicione as it is intended for ex-post control of the MB and not for ex-ante actions preceding the MB actions. The SB members are elected by a shareholders meeting, the MB members are either also elected by the shareholders meeting or by the SB and naturally the MB members can not be simultaneously also the SB members. The SB members are to be non-executive supervisory directors, they typically represent large or institutional shareholders, employees or government. In some countries also representatives of employees in the SB are mandatory for a corporation from a certain level, they occupy up to one half of the SB members. The motivation for the two-tier model is to enhance the four-eyes principle in the corporation activities, to prevent moral hazard of management and also to protect the public interest. Therefore this model is more appropriate for the stakeholder model oriented firms as it enables the representation of stakeholders (such as employees) in the control (but not management) body.

But the information asymmetry of the control bodies with respect to management bodies has not been fully solved even in the two tier model. The SB members are still again dependant on the information from the MB, in addition the former MB member often moves after retirement into SB which firstly makes the SB less independent and secondly enhances the decision power of these former MB members over other SB members such as other stakeholders representatives. As the empirical evidence supports (Hermalin and Weisbach, 2001), the CEO turnover is more likely to be sensitive on performance of the corporation in independent boards (supervisory body). This concerns mainly involuntary turnovers (based on poor CEO results) than the voluntary turnovers (retirements). It is also the case that for the

outsiders dominated boards the CEO turnover after poor performance times is more likely than in the insiders dominated boards.
As the control and management functions are believed to be efficiently separated in the two-tier model, the presence of board committees is not so emphasized as it is the case for the one-tier model. Nevertheless the popularity of the board committee increases also in the two-tier model and especially the audit committees are becoming more often present to support the SB functions.
But not only the division on the one-tier or two-tier management functions or the division on the CEO duality are of high importance. Also the size of the boards plays a very important role. The empirical evidence strongly supports the idea that in larger boards the agency costs are swiftly increasing (Hermalin and Weisbach, 2001; Brown and Maloney, 1999), which is mainly caused by free riding of some directors, more common communication failures and higher costs of motivation streamlining. It has also been found out that a board composition is not related to the corporate performance while the board size is negatively related to the corporate performance (see again Hermalin and Weisbach, 2001).
The typology of one tier and two tier corporations is summarized in Scheme 8.

Scheme 8: Typology of one tier and two tier corporations

Characteristics	One tier	Two tier
Management and control functions	Unified	separated
CEO-duality	Permitted	impossible
Stakeholder representation	Disabled	enabled
Committees	mandatory or recommended	recommended

Concluding remarks

This paper shed the light on five different perspectives of corporate governance understandings, namely corporate financing, shareholder rights execution, ownership stakes patterns, corporate objective functions and management structures. Not only their key characteristics, limitations and implications have been delivered but also some pros and cons have been discussed. Attention has also been paid to their normative states of departure. The red string of the principal agent problem meanders through all these five concepts and also the competing approach of the stewardship theory has been discussed.
In order to fully concentrate on the descriptive part of the corporate governance theories, intentionally less attention has been paid to the empirical evidence. We believe that before delivering a deep empirical evidence and policymaking implications it is necessary to fully understand the various differing characteristics of the corporate governance term.
Knowing the specific characteristics of the corporate governance now it is the right time to present a thorough empirical evidence on the functioning of the five corporate governance models in reality, their overlaps and interlinks and also their contradictions. More precise empirical evidence of the five corporate governance perspectives shall be the subject of the future effort.

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