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Re-theorising the Law on Corporate Governance for Modern Public Listed Companies in their Multi-investors Context: Existing Lacks and Development Needs

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Abstract

Modern public listed companies involve the multivariate interests of different type investors. The shareholders in them are diverse in respect to their interest motivation upon investment and attachment to the business of company. But the existing legal framework of companies provides only a 'general accountability and participation scheme' to that multivariate interests which does not properly fit to the context of modern public listed companies. This paper thus argues that, the ongoing legal reformations that advanced at the post corporate collapse events of 1990—2008 and found a shape of international pattern in the present globalised economy, for not reflecting that said diversified investor context of modern companies, fall short to be effective. This article probes into the cause for such lacks into the existing legal framework, the dimension of effect in the treatment of modern companies caused upon that lack, necessity for theoretical revise in the existing framework, and proposal thereupon. In formulating a guideline, this paper analyses the definitional changes in respective issues of modern companies, reformation needs, inherited fault-line in theoretical development, resultant effects, areas of non-conforming the rationality under it, and hence what ought to be done.

Keywords: Re-theorising company law, Accountability of Companies, Corporate Governance Codes, Company Law Reformations, Modern Companies, Protection of Investors, Public Listed Companies.

Introduction

At the post corporate collapse events (1990-2008) in many countries of the world, some of the leading of those are, the Polly Peck (1990), HIH Insurance (2001), One. Tel (2001), WorldCom (2001), Enron (2001), Adelphia Communications (2002), Arthur Andersen (2002), Lehman Brothers (2008), AIG (2008), a Corporate Governance Accountability

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reformation programme emerged led by the reports of Investigating Committees of those events. The said reformation programme, thereafter assumed a global trend for a number of forces, e.g. the reports produced by highly empowered committees of those induced the reformation committees of many other countries, globalised economy, influence of the UK Common law over a large number of common law countries, role of international organisations like EU, OECD in their member countries, and copying of those models pervasively by the States, etc.

Respective to the said reformation trend, this research finds that, there is an important bypassed consideration to the context of modern public listed companies which is characterized by the presence of multivariate interests of different types of shareholders, who are fundamentally different in their investment motives and on consideration of their attachment or detachment to the company's business. Thus shareholders are classifiable in two types— the shareholders who have the business attachment to the company (and thus may be termed as "entrepreneur shareholders") and the free rider shareholders from the public who actually have no real attachment to the business of the company (hence, may be termed as "non-entrepreneur shareholders"). Added to this fact, the legal framework relating to the governance of companies based on the traditional theories relating to "corporate entity" produced a type of "political governance" amidst those multivariate interests that failed to provide the rational treatment of those in the modern public listed companies. This paper describes that, the present legal framework of companies and its ongoing reformations is defective from the basic theoretical misconstruction relating to company's "corporate entity" that obviated considering the multivariate interests in the company to their rational participation and accountability scheme.

Theoretical underpinning of the 'proposed model' of this paper:

The proposed model of this research paper is based on the "interest-centric corporate governance model" for participation and accountability scheme of different type investors in modern public listed companies, who may be categorized as — the entrepreneur shareholders, and the non-entrepreneur free-rider public shareholders of stock markets.

In introducing its proposed model, this paper points out some conceptual problems pertaining to the "legal entity" of the company. In this respect here is analyzed the two dominant theories relating to business in its modern corporatism— one is the "legal entity" discourse of company in law, and another is its economic counterpart "enterprise as the nexus of contracts of multi-party actors" theory. Both the theoretical discourses have coincided to a similar result, though arrived on different interpretive approach in their respective fields. Thus both the theories have the same problematic output in the ongoing corporate governance model for modern companies.

The legal theory relating to company

The fundamental legal theory relating to Company is that, the incorporated company is a legal entity, separate from its members, has the perpetual succession of its entity independent of the changes in its members, have the functional capacity of its own, is run by an elected Board called the "Board of Directors" elected by the shareholders or members, and the shareholders have the right to have annual accountability or other periodic accountability set by law. The most dominant feature of the legal theory relating to company is the "separation of the legal entity of the business organization" from its members; the result is that, "ownership" of business organisation becomes an irrelevant concept with "firm entity". Such a legal theoretical discourse is continuing in company law from the very ancient time up to the present. On this legal separation of company' entity, the most cited case is the *Salomon* **v** *A Salomon & Co Ltd.* [1896] UK HL 1, [1897] AC 22. In this case Lord Halsbury, one of the judges, explained the relationship of the shareholders with the corporate body as follows:

> *Dealing with them in their relation to the company, the only relation which I believe the law would sanction would be that they were corporators of the corporate body. I am simply here dealing with the provisions of the statute, and it seems to me to be essential to the artificial creation that the law should recognise only that artificial existence, quite apart from the motives or conduct of individual corporators.*

For an earlier example of such theoretical discourse, may be quoted Clark (1866, p. 36) commenting as bellow:

> Corporations, being in law proper persons, are entitled to hold not only movables, but lands, in the corporate name — in which name they are infeft. The members have no right in the corporate property, either joint or several. It is vested solely and exclusively in the person of the corporation.

The consequence deriving on such "entity theory" have consistently been upheld in many legal literatures on corporate law, as well as, upheld by the courts in deciding cases involving question on the rights and liabilities of the members and governance remedial issue in a company (e.g. may be seen the well known *Foss v Harbottle* principle).

To refer to its modern application, may be quoted the decision of the House of Lords, *JH Rayner Mincing Lane Ltd. and Others vs. Department of Trade and Industry and Others* [1990] 2 AC 418; [1990]

BCLC 102, HL; affirming (1989) Ch 72 and [1987] BCLC 667, wherein Justice Staughton quoting from Lindley on Partnership (3rd edn. 1873), vol. 1 expounded the consequence of entity theory as follows:

> A corporation, it is true, consists of a number of individuals, but the rights and obligations of this individuals are not the rights and obligations of the fictitious person composed of those individuals; nor are the rights and obligations of the body corporate exercisable by or enforceable against the individual members thereof, either jointly or separately ….

Thus a clear separation is drawn between the members and their company. The similar consequence has been arrived by the Economic counter part of this theory which is discussed below.

The theoretical discourse in the field of Economy

In the economic counterpart of the above stated legal theory, the entity of the business corporation is explained on the "contractual conception". Corporation is seen as the "nexus of contracts between different parties" connected to its function. Thus the shareholders, directors, managers, creditors, bondholders, suppliers, dealers all are connected with different contractual bondages with the business enterprise. The business enterprise in its corporate form is "a legal fiction that serves as a nexus for a set of contractual relationships among individual factors of production" (Bratton 1989, p. 1471).

The economic theoretical discourse also produces the similar impact upon entrepreneurship like the "legal entity" concept of the business enterprise. In the economic theory, the "firm" being seen as "a series of contracts covering inputs being joined so as to become output", the "separation of ownership and control" is the characteristic feature, the "ownership" become an irrelevant concept in its management, "Capital" and thus "the traditional legal situs of ownership, devolves into one of the many types of inputs" (Bratton 1989, p. 1499). Bratton further stated that, in such a character "the management of the firm assumes a political picture on the context of describing all the internal relationships of the business entity in terms of 'market transactions' between investors, creditors, suppliers, dealers, and all others. Like government authorities, managers exercised their powers by means of a system of control and administration; like the government, the 'public' firm was a 'political' entity" (Bratton 1989, p. 1497). He citing the author Melvin Aron Eisenberg (1989) further stated that in this political picture of the business enterprise, the role of corporate law is "constitutional"— that is, it "regulates the manner in which the corporate institution is constituted" (Bratton 1989, p. 1497, at f.n. 132). The role of management body in such a political character of the company is simply as negotiating between the contracting parties. The dissatisfied party in that negotiation can always terminate its dealings with the firm (Bratton 1989, p. 1478). From this central feature, the corporate law has been provided to deal

with 'the behavior of marketplace actors and the nature of market place contracts', as explained by Bratton:

> The parties make complete choices, dealing with unknown factors in the exchange price.
>
> … … The process works as follows. Risk-allocating contracts have winners and losers. Maximizing losers tend to "shirk"—that is, take actions to avoid having to perform their promises fully. Agency costs are the costs of shirking. Since rational economic actors know about shirking, they charge agency costs against their contracting partners (i.e. managements) ahead of time. (Bratton 1989, pp. 1478-79)

In such a situation of the choice of 'economic actors', Bratton explains the role of 'corporate law' is only as follows:

> With this model the theorists have rationalized, *inter alia,* the positive law of relations among shareholders, boards of directors, and officers; the internal decision-making structures, policies, and procedures of corporate bureaucracies; and the contracts firms make with employees, suppliers, and creditors. Jensen and Meckling set out the basic themes. Managers act as agents to shareholder principals. When securities are sold publicly by management groups to outside shareholder principals, the purchasing shareholders assume that the managers will maximize their own welfare; the purchasers therefore bid down the price of the securities accordingly. Management thereby bears the costs of its own misconduct and has an incentive to control its own behavior. It achieves self-control, increasing the selling price of its securities by offering monitoring devices. These include common features of the corporate landscape such as independent directors and accountants, and legal rules against self-dealing (Bratton 1989, pp. 1478-79).

The problem presented by the existing theoretical discourse

From the above explained theoretical discourse in conceptualizing the business enterprise in its modern corporatism, particularly two problems arises:

First is the product of irrational theoretical interpretation and application of the 'corporate entity' concept of business enterprise. Under the existing legal framework, company rather to appear as a vibrant functional entity of a 'group of entrepreneurs' and their self-monitored enterprise where other interests of different groups are accommodated

surrounding their role, appeared as mere artificial 'legal functional entity' in all respects removing the concept of 'classic entrepreneur' as the life of business entity. This situation is particularly attributable to the irrational theoretical interpretation relating to the corporate entity of the company.

Second is the problem, the by-product of the first stated problem, that is the overburdened legal rules employed in order to enforce the corporate performance, its accountability and transparency to the whole body of 'corporate actors' in a general term without any special interest-centric focus of those different actors, and thus it is less likely to produce an effective corporate governance model.

In respect of first stated problem, this paper, does not deny the merit of the application of the 'legal entity theory' to the business enterprise in its corporate form. But only demands the rationalized interpretation and application where such application will produce the legal conveniences for which the theory was imported to the business enterprise. The invention and application of this theory in relation to company's entity had some practical necessity to ease the business in organizational structure, particularly to the continuance of the business deals unaffected by the time to time changes in its shareholders, simplifying the dealing with contractual obligations by or with the company, company's capacity to sue and be sued, rights in the property held in the name of the business entity of the company avoiding complexity of such rights in the name of great number of members, and such other conveniences. The 'entity theory' then associated with the 'limited liability' theory also provided the benefit of parting the corporate liability from the personal liability of shareholders facilitated aggregation of capital from large number of investors joined with their small units in the company's capital (called shares) and became personally safe from bearing the entire liability of the business enterprise, and by this way enabling the spreading of the risk of business among the large number populations bearing risk only to the extent of the value of their shares individually held but nothing more.

This theoretical discourse in relation to the company's business entity was not the origin of its own field, rather it was an imported concept from another field– the 'corporate personhood concept' which was in application to the public function bodies of the State (e.g. the City Corporation, Statutory Bodies, and Road Transport Corporations etc.) A research by James Treat Carter (1919, pp. 22-24), in describing this historical base of corporate legal theories in USA commented as follows:

> The significance of the changes that have taken place in the application of old theories of the corporate entity in modern times can only be fully understood when it is remembered

> that earliest — in fact, practically all corporations from the thirteenth to the end of the eighteenth centuries— were of the nature of public corporations.
>
> The phenomenal growth of the industrial corporation is a feature of the second half of the century, and was fostered by the general incorporation laws… lending impetus to new business and industrial enterprises within their respective territories.

Such a historic account of the 'corporate legal entity' discourse is abundant.

The said importation of theoretical discourse was not by itself the problem. The problem occurred thereafter in the adaptation of the said 'entity discourse' to the business context of the company. The wholesale application of entity theory and its legal attributes, failure to its reasonable adaptation to the business context of company have created problems thereafter. One of those problems is the legal conceptual detachment of entrepreneurs in the functional life of the company and the introduction of its rule-directed political type governance.

Ross Grantham (1988) in his article "The Doctrinal Basis of the Rights of Company Shareholders" described this conceptual shift as one of restricting the shareholders collective interest in the companies' substantial business to some rights and obligations attached to their shares. He described the historic course of such theoretical shift as follows:

> From the 19th century, however, the courts began to treat shareholders as having no direct, severable interest in the company's assets.
>
> In the years following, however, in describing the shares the courts increasingly omitted reference to the share as an interest in the company and defined the share exclusively in terms of the rights to a dividend, to return of capital on winding up and to vote (Grantham, 1988, pp. 562-63).

Thus from the theoretical transformation and transposition relative to the treatment of rights of respective parties to the company, the important question can be raised, "Do the modern companies have 'entrepreneurs'? If they do, then who are those? What governing relationships has the law defined for them and others? The modern corporate law in its development up-to-date left untreated those fundamental questions.

There is another important accountability problem arising from the entity discourse in relation to the treatment of the companies in their

'corporate groups'. The discussion of it is outside the scope of this paper. For an analysis about this matter may be seen Blumberg, Phillip; Strasser, Kurt; Georgakopoulos, Nicholas; and Gouvin, Eric J. (2007), "Law of Corporate Groups: Jurisdiction Practice and Procedure".

In respect of the **second stated problem**, this paper argues that, because of the continuance of the said theoretical discourse and the failure to its rational adaptations to the business reality of the companies, a path deviated 'corporate governance restructuring program' continued in the post-corporate collapse events of 1990-2008. The problem created on such ongoing reformation is the overburdened rules without any proven evidence of success on the accountability establishing program under them.

As mentioned above, the legal theoretical construct of the 'company's entity' does not allow, the company's business function to be considered attaching to the interest of any particular entrepreneur group (thus in theory a company cannot have any entrepreneur). Whether from unconscious or conscious wholesale importation of such 'legal theoretical attributes' in relation to company, the law followed a 'general accountability' pattern of corporate entity, i.e., the Board of Directors shows accountability of the company's function in its periodic financial disclosure to the general body of shareholders and outsiders to the company; but lacked any effective accountability enforcement, supervision by or on behalf of the related particular groups for which the accountability is due. Accountability becomes simply a matter of legal form and structure, not a live participatory one.

The Enhanced Regulatory Burden but Unworkable participation scheme of Shareholders

The ongoing restructuring the accountability framework of modern companies imposed a considerable degree of accountability disclosure burden (periodic and annual) upon public listed companies complying a great number international accounting and financial standards. Easterbrook and Fiscchel (1983, p. 420) criticizes the supporters of such regulatory burden who holds that if more information were disclosed, and shareholders were given a more 'meaningful' opportunity to participate, they would assume their proper role as decision maker. Refuting this view Easterbrook and Fischel states that,

> The far more plausible explanation for the disparity between the rhetoric of shareholders' democracy and the conduct of shareholders, however, is that the behavioral assumptions underlying the proxy system are unfounded. … Because of the easy availability of the exit option through the stock market, the rational strategy for dissatisfied shareholders in

> most cases, given the collective action problem, is to disinvest rather than incur costs in attempting to bring about change through the voting process. (Easterbook, and Fichel, 1983, p.420)

Easterbrook and Fischel, specially indicates the two reasons for the shareholders apathy to vote in corporate decision making— (i) the greater the availability of the sale or exit option, the less desirable is the voting or voice option; and (ii) secondly they refer to a comment of the US SEC Staff Report on Corporate Accountability, (Committee Print, US Senate Committee on Banking, 96th Cong., 2nd Sess. (1980), pp. 66-68) stating that, indifference toward voting is attributable to lack of "meaningful ways for shareholders to participate in the past," and that shareholders' apathy is "a reflection of frustration with the powerlessness of the role of shareholder/investor," and that shareholders would welcome "meaningful participation" if they believed that their votes or views would have any effect on corporate policy (cited in their paper at foot notes 70, and 69 respectively).

In another research titled "the Economic Structure of Corporate Law" Easterbrook and Fischel commented on the voting impact by public investors as follows:

> The process of voting controls adverse terms to a degree but not perfectly. Investors are rationally uninterested in votes, not only because no investor's vote will change the outcome of the election but also because the information necessary to cast an informed vote is not readily available. Shareholders' approval of changes is likely to be unreliable as an indicator of their interests, because scattered shareholders in public firms do not have the time, information, or incentives to review all proposed changes (Easterbrook & Fischel, 1991, in press, p.33).

Mistreatments interposing outside monitors within the Board

The legal framework of company law traditionally, required that the company shall be governed by the 'Board of Directors' elected by shareholders. To this pre-existing legal arrangement, the modern reformations with an aim to establish the Board's accountability and performance, recommended that this governing body of the company be composed with two types Directors namely— (i) the Executive Directors to perform the executive function (i.e. the governing function) of the company elected by shareholders in their General Meeting, and (ii) the monitoring directors termed as 'Non-Executive Independent Directors (NEDs)' appointed by the said Board to perform as independent monitors over their performance.

Placing of outside monitors over the Board is the result of perceived fact that, in its modern corporatism the general body of shareholders of public listed companies is not in a position (and in the traditional legal theoretical disposition also not allowed) to exercise regular monitoring or raise voice in the function of their elected Board (in this respect may be seen decisions of the House of Lords in the cases *Quin and Axtens v Salmon* [1909] 1 Ch. 311, CA; [1909] A.C. 442 HL, *Shaw & Sons (Salford) Ltd v Shaw*, [1935] 2 K.B. 113 CA). Whatever arguments about legal or factual reality of modern corporatism might be placed, the interposition of outside monitors, the NEDs, within the Board's composition can be rationally disputed for several reasons, such as, it replaced the monitoring function of the 'classical entrepreneurs' with the super imposed monitors who are rule-directed, not self-motivated. Thus the business rather to appear as monitored by a group of entrepreneur fostering the long term sustainability of the business, appeared as a mere rule directed legal-instrumentality. Besides this fundamental theoretical mistreatment, the provisions of the 'corporate governance codes' are also defective on certain other considerations which are discussed below.

Other Flaws in the Codes' provisions regarding the NEDs

The aim of introducing the NEDs within the Board may be appreciated from the following comment contained in a policy paper of the Commission of the European Communities (2005, p. 52, para 7):

> The presence of independent representatives on the board, capable of challenging the decisions of management, is widely considered as a means of protecting the interests of shareholders and other stakeholders.

In discharging the said role the NEDs have the duty to ensure that the shareholders are properly informed as regards the affairs of the company, its strategic approach, and the management risks and conflicts of interest [The EC Policy Paper (2005), Clause 9.1, 9.2, Section II (Recommendations)].

About preserving the independence of NEDs, it further provided that, a director should be considered independent only if he is free of any substantial business link, family or other tie with the company [Clause 13.1, Section II of the EC Recommendations)]. The guidelines in it further enumerated a number of situations reflecting the circumstances which are likely to produce material conflict of interest impairing independence of NEDs. The Corporate Governance Codes of most of the countries (the EU or non EU countries) of the world have the similar type provisions on the NEDs. Such provisions are also included in Condition-1 of the Corporate Governance Code, 2018 issued by the

Securities of Exchange Commission of Bangladesh (SEC)). The Codes' provisions regarding NEDs can be questioned from several perspectives—

Firstly, the "incentive debate" issue— the NEDs who are recommended to be independent of any substantial financial or any other interest link with the company, the question then arises as to the incentive upon which they would perform this tiresome analysis and monitoring of corporate function. **Secondly**, the modern 'corporate governance codes' do not contain any provisions on the accountability of the NEDs. The persons for whom no accountability exists, the risk always remains of their being corrupted, non-performing or deviated behavior. The further risk is that the corporate misdeeds would find safe harbor in the disguised security feel among the public investors placed upon the NEDs. **Thirdly**, the interposing of their role in the UK type 'unitary board' structure of companies, which is prevailing in common law countries, is greatly flawed and likelihood of non-performing. *Gower and Davies' Principles of Modern Company Law* in this respect pointed out that, in a unitary board structure, the NEDs seating with the Executive Directors, have the every possibility of their supervisory role captured by the executive directors in the Board. The clash is obvious if the "executives set the strategy together with the monitors" (Gower and Davies, 2003, pp. 325-26).

The empirical studies are also too short to prove any positive connection between the role of the NEDs and corporate performance (Hill, 2005). The report of the Special Investigative Committee of the Board of Directors of WorldCom, Inc. (2003, March 31, pp. 29-30) described that, "the Board and its Committees did not function in a way that made it likely that they would notice red flags. The outside Directors had little or no involvement in the company's business other than through attendance at Board meetings…. Ebbers (the CEO of the WorldCom) controlled the Board's agenda, its discussions, and its decisions. He created, and the Board permitted. The outside Director sat as dummy viewer.

The evidence in the Enron corporate collapse shows that, the outside independent auditor of the Enron did not fulfill its professional responsibilities in connection with its audits of Enron's financial statements. In addition, the Enron's Independent Auditor helped structuring many of the transactions Enron used to improve the appearance of its financial statements inflated (The Special Investigative Committee of the Board of Directors of Enron Corporation. (2002, pp. 24-25,187).

Search for an Effective Corporate Governance Model: A Comparison between the Western and its China Counterpart

In China, a system of *guanxi* (meaning 'personal connections or relationships') is an influential component of governance culture that governs different interactions man to man within groups, family or social life. It remains at the central of "the durable social connections and networks a firm uses to exchange favours for organizational purposes" (Keay and Zhao, 2017, p. 381).

Tsang (1998) in his paper, to describe the nature of *guanxi* refers to the definition of Lucian Pye, stating *guanxi* as "friendship with implications of continued exchange of favours" (Tsang, 1998, p. 65). Thus *guanxi* is something more than a pure interpersonal relationship; it is a reciprocal obligation to respond to requests for assistance. It may exist at different levels of relationship, from individual to organizational (Tsang 1998, p. 65). In its organizational level, several types *guanxi* may exist, such as among the shareholders *inter se*, company's Board of Directors to shareholders, employer to stuff, company to customers, etc. In respect of *guanxi* between entrepreneurs, is the personal relationship among the members of the group that produces trust, interdependence towards applying their collective skills for successful business.

To compare the guanxi-based business of China model with the Western Counterpart, a research by Susanne Ruehle (2010, p. 6) states that:

> (In the Western model) due to the increasing professionalization, the organization of a corporation becomes dissociated from the character of managers and entrepreneurs but is subject to other imperatives. "Commercial honesty" equals "contract morality" and thus, "status has given place to contract" and "economic relationships" lost their "personal touch". Once a corporation is established, it is not the owner and not even the manager that is recognized as important factor to evaluate a company. … This means that "business relations in the West are more technical and company orientated with early recognition of the possible need for contractual formality". … "In the West, deals have to be secured through formal contractual arrangements that can be enforced through law if necessary [but] can incur high transaction costs. Due to the Western orientation to such arrangements, the reduction in transaction costs achievable through a formalized system of trust such as provided by *Guanxi* is not recognized."

While the Western corporate governance model is rule-directed, a *guanxi*-based business strategy has a profound and favorable impact on

market performance through the positive function of good functional *guanxi* (Keay and Zhao, 2017, p. 398). The logic of relationships and business performance differs in China when compared with Western countries (Keay and Zhao, 2017, p. 398).

A research by Buttery and Leung (1998, p. 377), compared the Western and China model describing as follows:

> Clearly the most significant Sino-Western cultural differences occur in terms of individualism, power distance and long-term orientation. The three dimensions are likely to impact on the way each side elects to conduct their negotiations. The Chinese countries tend to be group-based economies and have a clearer hierarchical structure in their decision process whereas their Western counterparts are more individualistic and loosely organised. … The fact that Chinese negotiators prefer to consult and act collectively may explain why *Guanxi* is a phenomenon found in Chinese countries.

Buttery and Leung in describing the impact of *guanxi* based culture refers to an empirical research by Hofstede (1991). Hofstede's research (1991) compared data from some countries of Western model with Chinese Model (the USA, Great Britain and Australia as the Western model and Hong Kong, Singapore, and Taiwan as its China culture dominated counterpart). The research of Hofstede (1991) did analysis on the following factors to describe the cultural impacts upon business quoted by Buttery and Leung (1998, p. 375):

(1) power distance (measured from small to large);

(2) collectivism versus individualism;

(3) femininity versus masculinity;

(4) uncertainty avoidance (from weak to strong);

(5) long term orientation in life versus a short-term orientation

The following table shows the data of Hofstede's research:

Dimension	**Power Distance**	**Individualism**	**Masculinity**	**Uncertainty avoidance**	**Long-term orientation**
Hong Kong	68	25	57	29	96
Taiwan	58	20	45	69	87
Singapore	74	17	48	08	48
Average	67	21	50	35	77
USA	40	91	62	46	29

Australia	36	90	61	51	31
Great Britain	35	89	66	35	25
Average	37	90	63	44	28

Table: Hofstede's work for Chinese and Western countries. (Source: Buttery and Leung, 1998, p. 376, quoting from Hoftsede (1991))

As to the data relative to the 'individualism index' (i.e., the extent to which the ties between individuals are loose) (factor-2 above), the research of Hoftstede shows that, Chinese countries record much lower average scores, compared to it the Western countries show relatively high scores. This indicates that human ties leading to group, rather than individual, effort in business are more common in the Chinese based countries than in Western countries (Buttery and Leung, 1998, p. 376).

With regard to long-term orientation index (factor-5 above), the Western countries reflect a much lower average score than the Chinese countries. The "long-term" orientation reflects the way in which Chinese cultures incorporate, in their values, the teachings of Confucius and in particular the importance of perseverance and thrift (Buttery and Leung, 1998, p. 377).

Referring to the influence of *guanxi* as fundamentals of doing business in China, Buttery and Leung (1998, 378) to indicate the contrasts between the functioning of business upon a group's "entrepreneurial instinct" vs "rule-driven force" commented as follows:

> *Guanxi* is driven by deep rooted cultural beliefs stemming from the teachings of Confucius, and from the pragmatic demands of living in fairly self-supporting communities. Such communities neither expected nor received much in the way of support from Government, but relied on trust and reciprocal behavior between the members of a tight-knit community. *Guanxi* is deemed very important because it has been enshrined in the way that the Chinese have chosen to do business since the times of Confucius, and is a durable characteristic of the way the Chinese choose to do business in modern times.

The Recommended Theoretical and Legal Framework for Modern Public Listed Companies

The proposal of this paper stand on the point that, there should be a clear distinction in the legal framework for public listed companies in respect of the participation scheme for the public investors in one hand (the stock market actors) and one the other hand, the group of shareholders actually connected to the real business of the company (the entrepreneurs). The public investors of the stock market in their nature

and motive on investment and attachment or detachment to the company are no more than like the bondholders or creditors to a bank or to a company. Moreover, they are the market participants seek the favourable deals on their shares and exit when they find convenient to do so. They have no long-term attachment and participation to the actual business of the company with the motive of entrepreneurs. The treatment of the company based on such proposed legal theoretical disposition corresponds to the description of Easterbrook and Fischel (1991, p.8) in their book, *The Economic Structure of Corporate Law*, that "markets" are economic interactions among people dealing as strangers and seeking personal advantage, and viewing the entrepreneur shareholders of the company in the traditional "firms conception"—an aggregation of people bonded together for a longer period—permits greater use of specialization, in which people can organize as teams with the functions of each member identified, so that each member's specialization makes the team as a whole more productive than it would otherwise be. In this respect, this paper supports the *guanxi* based corporate governance model of China.

The proposed model would require the thorough revise of the "entity theory" of the Company Law with all its theoretical byproducts and subsets (e.g. separation between entity of the company and its shareholders, or the nexus of contracts theory, and its politico type governance under law).

The rational construction to the legal theories relative to the corporate entity should be given, so as to preserve its enterprise value. This should be done in the way that the modern corporation will be the integration of the role of both traditional "entrepreneurs" and the "public investors", and that the modern corporation will be the assimilation of multi-party contractual bondages within the classical entrepreneur business model. The accountability and participation scheme of the company for multi-party actors should be provided based on the nature of their investment motive, attachment and detachment to the company. Thus when it is **in one hand** the question about providing for participation and accountability relative to the entrepreneurs, the legal framework should provide for their meaningful participation in the corporate decision making, its profit and loss sharing, access to information, remedy against wrongs or ill-performances of directors and management, etc.; **secondly** when it relates to the "stock market" participants, the legal framework be made providing for the true and timely disclosure of relevant price sensitive information upon which the share price fluctuates (e.g., corporate performances, earnings, transactions, upon which market-price fluctuates differently from the book-value of shares, the information relative to price-to-book ratio (P/B ratio) etc.). A mechanism of corporate accountability enforced and monitored by or on behalf of them

relative to their interest-focus, and scrutinizing those information by special body or officials of the Regulatory Body of the Government, provisions for remedial measures against corporate misdeeds, and such others would accordingly be arranged.

The provisions relating to the NEDs' under the ongoing corporate accountability restructuring programme has been faulty which is already discussed in the preceding part of this paper. Accordingly this paper proposes their monitoring role should be replaced as— **firstly**, so far as the monitoring and supervision is concerned with the interests of entrepreneur group of shareholders (who are generally the small group), it might well be performed by themselves. Requiring the elected Board to place the corporate performance reports on some periodic basis to the general body of shareholders (like quarterly and annual basis), arranging for rectification mechanism in law will do well. The present legal scheme contains such type of accountability provisions, but it is in the pattern 'general accountability' showed to multiparty actors which this paper argued as 'faulty scheme'. **Secondly**, so far as the monitoring function concerns to the corporate integrity and performance issue to protect the interests of the outside investors, the requirement is the true and timely disclosures upon which share-market reacts. In this respect the role of NEDs could be arranged and be placed with the role of government regulatory bodies, such as, the Securities and Exchange Commission (SEC), Certified Accounting Bodies, or may be arranged with the combined role including the Association of Public Shareholders to it. In this respect the UK instance may be a guide to adopt with necessary modifications. The UK Financial Reporting Council (FRC) established "the Recognized Supervisory Bodies (RSB) or Recognized Qualifying Bodies" to perform the independent oversight function over the UK listed Companies besides the stated NEDs role, and further that the RSBs' activities also made subjected to the independent oversight by The FRC (Financial Reporting Council Limited, UK, 2016, p. 9). To remunerate their service an amount may be deducted by the listing authority at a fixed ratio from the dividends of the shareholders and from the working capital of the company annually. This may resolve the "incentive debate issue" on their role, their independence quality. The revised consideration for total replacing the role of NEDs will remove the likelihood of any clash with their presence in the unitary Board structure, the issue which is discussed in this paper above referring to Gower and Davies (2003).

Lastly, the attention must be paid that, the regulatory framework, must not create undue regulatory burden upon the companies. As an example of such overburdened regulatory prescription, may be referred to the Condition-1(5) and its sub-clauses (I-XXV) contained in the Corporate Governance Code, 2018 issued by the Securities and Exchange Commission of Bangladesh. The increase of regulatory

prescriptions may result in detraction by the companies from listing their shares to the 'security market'. This in turn might produce negative impact on investment in stock markets and production environment of the companies, and will cause the spending the valuable time of the Board in preparing and planning the disclosures at the cost of their times that is essential to frame business decisions and performances. Further that, if the volume of corporate disclosure and explanations under law is high, the possibility of issuing distorted public disclosure of corporate performances by the companies and the difficulty to check out the real issues from the mass of such information might be the problem.

Conclusion

The proposed theoretical revision of this paper is not towards attacking the 'corporate entity theory' in law relative to the treatment of the incorporated companies, nor this is the proposition of this paper that the well-established centuries old 'entity theory' that has been the instrumentality of business in its corporate form, should be removed in its entirety. It is accessed that, certainly the application of 'the corporate personhood' or 'entity theory' has been the revolutionary in dealing with the business in its corporate form providing greater benefits. Some of those benefits have already mentioned above in this paper. What this paper proposes, is to give rational and purposive application of this theory and its sub-sets where such theoretical application will uphold the benefits for which it was originally imported to the business organization, but no more than what is necessary. Particularly the theoretical discourse respective 'the corporate entity theory' that rendered considering the company on pure legal lane detaching its life from the 'classical entrepreneur' is problematic. This issue is discussed in this paper above, and it is probably the main cause that obviated to frame any rational accountability framework for modern companies, and address their complex investment reality. The legislature, the courts, the lawyers, the academicians, the economists and commercial experts with the knowledge of their respective fields should come to a consensus to reach on a harmonious construction in that respect. Special attention should be given to the historic path in its theoretical application and development process, and discover the path deviations from the original purpose, the reasons for that historic accident, subsequent abuse, effects and unsuitability to the conditions of the applied field, rationality, reality and technicality, all these are the relevant factors to find the right direction towards formulating the appropriate legal discourse to the treatment of modern companies.

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