



ACADEMY OF ECONOMIC STUDIES OF MOLDOVA

Faculty of *General Economy and Law*

Department of *Law*

Elena CIOCHINA

Course Support for
INTERNATIONAL CORPORATE AND
GOVERNANCE LAW

CHISINAU, 2025

CZU 347.7:339.9(075.8)

C 51

Approved by the Master School of Excellence in Economics and Business, minutes no. 7 of 23 June 2025

The course notes International Corporate and Governance law are intended for students majoring in International Business and Law. The general objective of the coursework is to train/develop competences/skills according to the standard of adult vocational training, derived from the European and National Qualifications Frameworks, with a higher degree and complexity of the subject matter for both lecture and seminar classes, knowledge of regulations in the field of international trade law in order to use the acquired knowledge in practice in the future professional career.

**DESCRIEREA CIP A CAMEREI NAȚIONALE A CĂRȚII DIN
REPUBLICA MOLDOVA**

Ciochina, Elena.

Course Support for International Corporate and Governance Law / Elena Ciochina ; Academy of Economic Studies of Moldova, Faculty of General Economy and Law, Department of Law. – Chișinău : SEP ASEM, 2025. – 227 p.

Cerințe de sistem: PDF Reader.

Referințe bibliogr. la sfârșitul cap.

ISBN 978-9975-168-68-7 (PDF).

347.7:339.9(075.8)

C 51

ISBN 978-9975-168-68-7 (PDF).

Author : ©*Elena CIOCHINA, dr., university lecturer*

©*Editura ASEM, 2025*

Preliminary Remarks

The course *International Corporate and Governance Law* is an essential part of the academic curriculum for undergraduate students enrolled in the *International Business and Law* program. It is specifically designed to provide a structured and in-depth understanding of the legal frameworks that govern corporate entities, international business structures, and systems of corporate governance in the globalized economic environment.

In the current context of cross-border economic expansion, regulatory complexity, and the growing emphasis on ethical and sustainable business practices, the knowledge of corporate and governance law has become a core competency for business professionals. This discipline equips students with both theoretical foundations and practical tools to analyze and apply legal norms related to the creation, functioning, supervision, and accountability of business entities in diverse jurisdictions.

Key topics covered in this course include corporate legal personality, shareholders' rights and duties, the structure and powers of governing bodies, international corporate compliance standards, and models of corporate governance. Students will explore the interaction between national regulations and international principles (such as those established by the OECD, the EU, and other bodies), which shape modern standards for transparency, control, and strategic direction in corporate management.

The content of the course is aligned with the academic standards set by the Academy of Economic Studies of Moldova and reflects both national legislation and relevant international legal instruments. Emphasis is placed on enhancing legal reasoning, critical analysis, and the practical ability to navigate complex legal-business scenarios across jurisdictions.

By completing this course, students will not only gain a solid understanding of international corporate structures and governance mechanisms, but also develop the capacity to apply this knowledge in roles requiring responsible decision-making, legal compliance, and ethical conduct in international business contexts.

In this sense, *International Corporate and Governance Law* serves not merely as an academic subject, but as a professional foundation for students aspiring to lead and manage within legally compliant and ethically governed organizations.

TABLE OF CONTENT

CHAPTER 1: INTRODUCTION TO INTERNATIONAL BUSINESS LAW	7
1.1 Definition and Scope of International Business Law	8
1.2 Public vs. Private International Law in Commerce	9
1.3 Main Sources of International Business Law: Treaties, Customary Law, Soft Law, and Lex Mercatoria	11
1.4 Role of International Organizations: UNCITRAL, UNIDROIT, WTO, and ICC	15
1.5 Application in Moldova: Multilevel Legal Framework and Dualist System	18
CHAPTER 2: CORPORATE GOVERNANCE MODELS – ANGLO-SAXON, CONTINENTAL, AND HYBRID	26
2.1 Classification of Corporate Governance Models	27
2.2 The Anglo-Saxon Model	28
2.3 The Continental European Model	32
2.4 The Hybrid Model	41
2.5 Comparative Analysis of the Models	48
2.6 Current Trends in the Choice of Governance Models	53
CHAPTER 3: CORPORATE STRUCTURE: SHAREHOLDERS, BOARD OF DIRECTORS, AND EXECUTIVE MANAGEMENT	61
3.1. The Concept and Importance of Corporate Structure in International Governance	62
3.2. Rights and Responsibilities of Shareholders	63
3.3. Board of Directors: Composition, Functions, and Responsibilities	67
3.4. Board Committees: Audit, Remuneration, and Nomination	73
3.5. Executive Management: CEO and Other Directors – Roles and Liability	77
3.6. Structural Models: Unitary vs. Dual Board Systems (International Comparison)	82
3.7. Interaction and Balance Between Shareholders, Board, and Management	89
CHAPTER 4: RIGHTS AND OBLIGATIONS OF SHAREHOLDERS	96
4.1. Fundamental Rights of Shareholders	97
4.2. Right to Information and Access to Corporate Documents	98
4.3. Voting Rights and Participation in General Meetings	99
4.4. Right to Dividends and Share of Assets in Liquidation	101
4.5. Right to Sue: Individual (Direct) and Derivative Actions	103
4.6. Obligations of Shareholders to the Company	105
4.7. Protection of Minority Shareholders and Prevention of Abuse of Power	107

CHAPTER 5. RESPONSIBILITIES AND LIABILITIES IN CORPORATE GOVERNANCE	112
5.1 The Concept of Responsibility and Liability in Corporate Law	113
5.2 Liability of Board of Directors Members	113
5.3 Executive Management Liability	115
5.4 Shareholders' Liability in Cases of Abuse	116
5.5 Mechanisms of Prevention and Detection of Violations	118
5.6 Civil, Criminal, and Administrative Liability in Corporate Governance	120
5.7 International Case Studies of Governance Failure and Liability of Parties Involved	122
CHAPTER 6: TRANSPARENCY, DISCLOSURE, AND ETHICS IN CORPORATE GOVERNANCE	128
6.1. The Importance of Transparency in Corporate Operations	129
6.2. Financial and Non-Financial Reporting Obligations	130
6.3. International Reporting Standards (e.g., IFRS, GRI)	132
6.4. Role of Internal and External Audits in Ensuring Transparency	135
6.5. Business Ethics and Corporate Codes of Conduct	138
6.6. Anti-Corruption and Compliance Policies	140
6.7. Whistleblower Protection	144
CHAPTER 7: THE ROLE OF INTERNATIONAL ORGANIZATIONS IN CORPORATE GOVERNANCE	150
7.1. The Role of the OECD in Establishing International Governance Principles	151
7.2. The Involvement of the United Nations and Global Initiatives (e.g., UN Global Compact)	153
7.3. The Contribution of the European Union to Corporate Governance Regulation	157
7.4. The Impact of Other Organizations (e.g., World Bank, IMF)	161
CHAPTER 8: INTERNAL AND EXTERNAL AUDIT IN CORPORATE GOVERNANCE	168
8.1. Distinguishing Between Internal and External Audit	169
8.2. The Role of Audit in Ensuring Transparency and Accountability	174
8.3. The Audit Committee and Its Functions Within the Board of Directors	177
8.4. International Audit Standards and Applicable Regulations	181
CHAPTER 9: TRANSPARENCY, ETHICS, AND CORPORATE SOCIAL RESPONSIBILITY	191
9.1. The Principle of Transparency in Corporate Governance	192
9.2. Ethics in Corporate Conduct and Codes of Conduct	194
9.3. Corporate Social Responsibility (CSR): Concept and Applicability	196
9.4. Non-Financial Reporting and International Standards (GRI, ESG, etc.)	201

CHAPTER 10: RECENT TRENDS AND REFORMS IN CORPORATE GOVERNANCE	209
10.1. Recent International Trends in Corporate Governance	210
10.2. Corporate Governance Reforms in the Republic of Moldova	213
10.3. The Role of Governance in State-Owned Enterprises	216
10.4. Corporate Governance in the Financial Sector	220

CHAPTER 1: INTRODUCTION TO INTERNATIONAL BUSINESS LAW

International business law encompasses the legal principles, rules, and practices that govern commercial transactions and trade across national borders. In an age where goods, services, and capital flow rapidly from one country to another, virtually every nation and company is touched by international commerce. Whether it's **public** laws set by governments (like treaties on trade between states) or **private** legal frameworks (like contracts between companies in different countries), international business law provides the structure that enables global business to function. Over the past decades, this field has evolved into a distinct branch of study and practice, reflecting the globalization of trade and investment. In this chapter, we introduce the definition and scope of international business law, distinguish between its public and private dimensions, examine its main sources (from formal treaties to informal customs), and discuss the role of key international organizations in shaping the rules of international commerce. We also consider how these international norms are applied within the Republic of Moldova, illustrating the multi-level legal framework and the country's approach to integrating international law into its domestic system. Real-world case studies and legal decisions are included to demonstrate how principles are applied in practice, ensuring an engaging and practical understanding for Master's level students.

Learning Objectives: By the end of this chapter, students should be able to:

- **Define** *international business law* and describe its scope, including what types of cross-border activities and legal issues it covers.
- **Differentiate** between *public international law* and *private international law* in the context of commerce, and provide examples of each in international business scenarios.
- **Identify and explain** the **main sources** of international business law – including treaties, customary international law, soft law instruments, and the *lex mercatoria* – and understand how they function and interact.
- **Recognize** the **roles of major international organizations** (such as UNCITRAL, UNIDROIT, the WTO, and the ICC) in developing, harmonizing, and enforcing the rules of international business law, and give examples of their key contributions.
- **Understand** how international business law is applied in **Moldova's legal system**, including the multi-level framework of international, regional, and domestic norms, and Moldova's dualist approach to treaty implementation (requiring parliamentary ratification) alongside efforts to harmonize with international standards.

1.1 Definition and Scope of International Business Law

International business law (sometimes called *international commercial law* or *international trade law*) can be defined as the body of legal rules and principles that govern cross-border commercial transactions and international trade relationships. It covers the laws and agreements that facilitate and regulate the exchange of goods, services, money, and intellectual property across national boundaries. In simpler terms, international business law sets out the “rules of the game” for global commerce – from how contracts between distant business partners are formed and enforced, to how countries trade with one another on the world stage. Importantly, international business law operates at **two interrelated levels**: it includes **public law** rules (like treaties between states) and **private law** rules (like norms for contracts between private companies). Because of this dual nature, the scope of international business law is broad – it ranges from inter-governmental trade agreements (for example, treaties on tariffs or trade in services) to the private law of international sales, finance, and dispute resolution.

: The scope of international business law spans multiple legal domains that come into play when business goes global. It is often considered a subset of *international economic law*, alongside areas like international monetary law and international investment law. However, international business law itself focuses on the legal aspects of international commerce and trade. This includes: international **trade law** (the rules for trade in goods and services between nations), international **commercial transactions** (contracts for sale, shipping, insurance, financing that cross borders), international **corporate law** aspects (such as the operations of multinational companies), and aspects of international **investment and finance** (like foreign direct investment protections or cross-border banking regulations). With the establishment of global institutions like the World Trade Organization (WTO) in 1995 and the proliferation of regional trade agreements, international business law has grown into a prominent field of practice and scholarship. It draws on principles of economic liberalism – for example, the idea that free trade and the free flow of capital benefit nations – but it also must balance commercial freedoms with other values like consumer protection, environmental regulation, and national security.

In essence, international business law ensures that cross-border business activities have a legal framework that is predictable and fair. It addresses questions such as: When two companies from different countries make a contract, which country’s law applies if there’s a dispute? How can a business have confidence that a contract will be enforced abroad? What laws prevent unethical practices like bribery in international transactions? How do international agreements lower trade barriers and what happens if a country breaks the rules? All these issues fall within the scope of international business law. In our daily lives, everything from the imported food on supermarket

shelves to the smartphones assembled across multiple countries is made possible by this web of international legal rules that facilitate global trade and investment.

1.2 Public vs. Private International Law in Commerce

International business law sits at the intersection of public international law and private law, bridging the gap between the laws made by nations and those governing individual commercial transactions. It is important to understand the distinction between public and private international law as they relate to global commerce:

A. Public International Law (in Commerce)

This aspect deals with the rules that states (countries) agree upon to regulate international economic relations. It is “public” because it involves sovereign states as the primary actors. In the commercial context, public international law includes *treaties and agreements between states* on trade, investment, and related matters. For example, when countries negotiate a trade agreement to reduce tariffs or establish common standards, they are creating public international law. The World Trade Organization agreements (like the General Agreement on Tariffs and Trade, GATT, and others) are classic examples – they are treaties among governments setting the terms of international trade in goods, services, and intellectual property. Public international law in commerce also covers bilateral investment treaties (BITs) where states commit to protect investors from other states, and international financial regulations through bodies like the International Monetary Fund or World Bank. Enforcement of public international economic law typically occurs through state-to-state mechanisms: for instance, if one country breaches a trade agreement, another country can bring a case in the WTO dispute settlement system. A real example of public international law in action is the WTO dispute “Japan – Alcoholic Beverages”, where one state challenged another’s taxes on imported spirits as violating trade treaty obligations. In summary, the public international law side of international business law is about how countries govern trade and economic exchange among themselves on the global stage.

B. Private International Law (in Commerce)

The private side, often called *international commercial law* or *transnational business law*, concerns the rules that govern cross-border dealings between private parties (companies or individuals). This includes international contract law, international sales of goods, cross-border payment and finance, shipping law, and arbitration of commercial disputes. Here, the term “private international law” can also refer to conflict-of-laws rules – i.e. the rules determining which country’s laws or courts have jurisdiction over a private international dispute. For example, if a U.S. company and a

Moldovan company have a contract dispute, private international law principles help decide whether U.S. law or Moldovan law (or perhaps an international convention) applies, and whether the dispute should be resolved in a U.S. court, a Moldovan court, or through international arbitration. A key feature of private international law in commerce is the use of **harmonized substantive rules** that many countries adopt to govern transactions. The most famous is the United Nations Convention on Contracts for the International Sale of Goods (CISG), a treaty that provides uniform rules for international sales contracts and is adopted by over 90 countries including Moldova. When applicable, the CISG allows parties from different states to operate under one set of contract rules, rather than each party's national law. Other examples include the **Uniform Customs and Practice for Documentary Credits (UCP 600)** published by the ICC for letter-of-credit transactions, or the **Incoterms rules** (International Commercial Terms) that are standard definitions of shipping terms (like FOB, CIF, DDP) used in contracts worldwide. These are not treaties among states, but rather private standardized rules that merchants voluntarily incorporate into contracts – part of what is known as the *lex mercatoria* (law of merchants), discussed further below. Enforcement of private international law primarily happens through **courts or arbitration tribunals**. For instance, an international arbitration case between two companies might apply transnational contract principles or the law chosen by the parties. A concrete example on the private side would be an ICC arbitration between a Moldovan wine exporter and a U.S. importer: if their contract didn't specify an applicable law, the tribunal might apply the CISG by default (since both states are CISG members) and interpret trade terms using Incoterms and banking rules like UCP 600, to resolve their dispute.

In practice, these public and private dimensions often **intersect**. International business law often requires understanding both sets of rules. For example, a company exporting goods needs to know about **public law** (like what tariffs or quotas a country's laws or trade agreements might impose) *and* **private law** (like how to draft a contract and arrange payment via international banks). An importer might rely on a public international law agreement (say a free trade agreement) to benefit from lower tariffs, while also relying on private law (such as the CISG and an arbitration clause) to ensure the contract with the exporter is enforceable. In short, **public international law sets the framework conditions** for global trade (the laws of nations, treaties, and interstate dispute processes), whereas **private international law fills in the details of individual commercial relationships** (contract terms, rights, and remedies between the parties). International business law as a field encompasses both, requiring a combined understanding of treaty obligations and domestic commercial law norms.

1.3 Main Sources of International Business Law: Treaties, Customary Law, Soft Law, and Lex Mercatoria

The rules of international business law come from a variety of sources, ranging from formal binding laws to informal practices. The main sources include **international treaties, customary international law, soft law instruments, and the lex mercatoria** (merchant law). Each source contributes to the legal framework governing international commerce:

- **Treaties (Conventions and Agreements)**

Treaties are *written agreements between states* and are the most important source of binding international business law. They create obligations at the international level, and often those obligations are implemented in domestic law. There are two broad categories of relevant treaties: **multilateral agreements** (many countries) and **bilateral/regional agreements** (a few countries). On the multilateral side, the **World Trade Organization (WTO) agreements** form a cornerstone: for example, the WTO's founding treaty (1994) includes the **GATT 1994** for trade in goods, the **GATS** for services, and the **TRIPS** agreement for intellectual property, among others. These multilateral trade treaties, with 160+ member countries, provide uniform rules on tariffs, trade barriers, non-discrimination (like the most-favored-nation principle), and trade dispute settlement. Virtually every major trading nation (164 members as of 2025, including Moldova) is bound by WTO rules. In addition, numerous **bilateral and regional trade agreements (FTAs)** supplement the WTO system. Examples include the **United States-Mexico-Canada Agreement (USMCA)** in North America, the **European Union's network of association and free trade agreements** (such as the one between the EU and Moldova, discussed later), the **Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)** in the Asia-Pacific, and the emerging **African Continental Free Trade Area (AfCFTA)**. These treaties often go further than WTO rules (covering deeper tariff cuts or issues like investment, e-commerce, and labor standards) and are binding on their parties. Another key treaty for private commercial law is the **United Nations Convention on Contracts for the International Sale of Goods (CISG)** (1980), which as noted provides a uniform law for international sales contracts and is in force in many countries (Moldova joined in 1994). Likewise, the **New York Convention (1958)** on the Recognition and Enforcement of Foreign Arbitral Awards is a crucial treaty in international business law, ensuring that arbitration awards made in one country can be enforced in courts of other member countries (over 170 states, including Moldova, are party to it). In sum, treaties form the *backbone* of international business law by formally binding states (and indirectly businesses) to certain standards of behavior in trade and commerce.

- **Customary International Law**

Customary international law consists of legal norms that have developed from the consistent practice of states followed out of a sense of legal obligation (*opinio juris*). In international business contexts, purely *customary* law is less prominent than in other areas of international law, because so much of trade and commerce is now governed by written agreements. However, some general principles and customs still play a role. For example, the principle of **pacta sunt servanda** – that agreements must be kept – is a foundational norm recognized as customary law, and it underpins all treaty obligations and contracts. Another example is the customary law principle of **sovereign immunity** (states are immune from jurisdiction of foreign courts) which can affect international business if, say, a state-owned enterprise is involved in a commercial transaction – though many countries now distinguish sovereign acts from commercial acts (restrictive immunity). In the arena of investment law, the requirement for “**prompt, adequate, and effective**” compensation for expropriation of foreign investments has been argued to form part of customary international law (though it’s also often codified in treaties). Additionally, some **trade usages** could be seen as creating international custom among states – for instance, the general acceptance that *freedom of transit* should be allowed for landlocked countries might be considered an emerging customary norm. Overall, while customary international law is not the first source one thinks of in international business law (due to the dominance of treaties), it provides certain **general principles** that fill gaps. Notably, Article 38(1) of the Statute of the International Court of Justice (which is often cited as the authoritative list of international law sources) lists international custom as a source of law. One can say that in the background of the detailed treaties and laws, basic customary law principles (like good faith in treaty performance, non-discrimination, etc.) inform the interpretation and application of international business law.

- **Soft Law**

Soft law refers to rules or standards that are not directly binding like a treaty or statute, but which can influence and shape behavior, often serving as precursors to binding law or guiding its interpretation. In international business law, there are many soft law instruments produced by international organizations and expert groups that harmonize practices without formally imposing obligations. Examples include **model laws, guidelines, and principles**. A key institution here is UNCITRAL (the United Nations Commission on International Trade Law), which develops model laws and legislative guides on topics such as commercial arbitration, electronic commerce, insolvency, secured transactions, etc. For instance, the **UNCITRAL Model Law on International Commercial Arbitration (1985, amended 2006)** is a template that countries can adopt to modernize their arbitration laws; as of 2025, over 85 jurisdictions have based their arbitration statutes on it – Moldova did so with its Law

on International Commercial Arbitration in 2008, closely mirroring the UNCITRAL Model Law. Using such a model law is voluntary (hence soft law), but widespread adoption leads to a *de facto* uniformity. Another example is the **UNIDROIT Principles of International Commercial Contracts (PICC)** developed by the International Institute for the Unification of Private Law (UNIDROIT). These Principles (latest edition 2016) are a non-binding restatement of general contract law rules, covering issues like formation, performance, breach, and remedies. While parties can choose to incorporate the UNIDROIT Principles into their contracts, even when they don't, arbitrators and courts sometimes use them as reflections of "international best practices" or to fill gaps in the law. This makes them influential soft law in contract disputes. Other soft law instruments in international business include guidelines by organizations like the **Organisation for Economic Co-operation and Development (OECD)** (e.g., the OECD Guidelines for Multinational Enterprises on responsible business conduct) and standards by bodies such as the **International Organization for Standardization (ISO)** which, while not "law", can become industry norms that businesses are expected to follow. The **International Chamber of Commerce (ICC)** also produces widely-adopted rules that are technically soft law – for instance, the **Incoterms** rules (most recently Incoterms 2020) for standard trade terms and the **UCP 600** for letters of credit are ICC publications without legal force on their own, but they are incorporated by reference in the vast majority of international sales contracts and trade finance transactions. Thus, they effectively govern those transactions unless the parties decide otherwise. Soft law can also take the form of policy principles (like the WTO's non-binding guidelines or codes of conduct for customs authorities, etc.) which over time can solidify into binding rules. In summary, soft law provides flexibility and innovation in global commerce by allowing new norms to be tested and refined before states decide to formalize them. It plays a crucial role in *harmonizing* international business practices in areas where formal treaties might be too slow or difficult to negotiate.

- **Lex Mercatoria (Transnational Commercial Custom)**

The "lex mercatoria," Latin for "law of merchants," refers to the body of commercial customs, practices, and principles developed by merchants and business communities themselves, rather than by governments. It is essentially *non-state law* that governs international commercial transactions. The lex mercatoria is an ancient concept (medieval merchants had their own universal law) that has modern resonance in international business. Today, it encompasses things like **trade usages, standard contract terms, and the general principles of law recognized in international commerce**. Unlike treaties or statutes, lex mercatoria norms are not written in one single authoritative document; they are reflected in the recurrent practices of traders, the clauses they routinely use in contracts, and the decisions of arbitral tribunals that

often apply these general principles when national laws are absent or excluded. Some elements of the *lex mercatoria* overlap with “soft law” as discussed above – for example, the **Incoterms and UCP rules** can be seen as part of *lex mercatoria* because they originated from private trade practice and are used universally by traders. Likewise, the **UNIDROIT Principles and CISG case law** contribute to a kind of transnational commercial legal order. The *lex mercatoria* also includes broad principles like **good faith in business dealings**, **pacta sunt servanda** (agreements are binding), and **damages should compensate the loss** – principles that many legal systems share and which arbitrators often cite as “general principles of international commerce.” A question often posed is whether *lex mercatoria* is truly “law” if it isn’t enacted by any state. Many scholars and practitioners argue that it is a genuine form of *anational law*, deriving its authority from the consent of parties (for instance, if two companies specify in their contract that their agreement is governed by general principles of international trade law, they are effectively choosing *lex mercatoria*) and from the repeated recognition of these customs by arbitral tribunals and courts. In fact, arbitral tribunals have in numerous cases applied *lex mercatoria*. **For example**, in an ICC Arbitration Case No. 10022 (2001), where the contract was silent on applicable law, the arbitrators applied general principles of *lex mercatoria* – such as reasonableness and good faith – to resolve the dispute. In another ICC award (No. 8331 of 1995), the tribunal listed principles like good faith, duty to cooperate, and obligation to mitigate damages as part of the applicable *lex mercatoria* when the parties chose “general principles of law” as the governing clause. These cases show that *lex mercatoria* is not abstract theorizing; it is used in real dispute resolution. The *lex mercatoria* is especially prominent in **international arbitration**, where parties often opt out of any particular national law in favor of “rules of international trade” or similar formulations. Arbitral awards themselves, though usually confidential, occasionally get published and reveal the application of transnational norms. Over time, this builds a kind of jurisprudence that reinforces those norms (e.g., published awards discussing how a principle of hardship or force majeure should be handled in international contracts contribute to general expectations in the business community). It should be noted that *lex mercatoria* primarily affects **private commercial transactions**, not so much the relations between states. For state-to-state trade issues, treaties and public international law play the dominant role. But even there, one can find influences of commercial practice (for instance, standard clauses in commodity trade that later get reflected in inter-governmental agreements). In conclusion, *lex mercatoria* represents the **bottom-up creation of law by the marketplace** itself. It complements the top-down regulations of states by filling in practical details and providing common ground for parties from different legal backgrounds. Any student of international business law should be aware of *lex mercatoria* because it underscores that not all rules come from legislatures or diplomats – many come from the habits and innovations of the business people and lawyers engaged in cross-border commerce.

1.4 Role of International Organizations: UNCITRAL, UNIDROIT, WTO, and ICC

International organizations play a **pivotal** role in the development, harmonization, and enforcement of international business law. Different organizations focus on different aspects of international commerce – some create model laws and principles, others establish multilateral trade rules or provide dispute resolution forums. Here we highlight four key organizations and their contributions:

- **UNCITRAL (United Nations Commission on International Trade Law)**

UNCITRAL is a core institution of the United Nations system dedicated to the modernization and unification of international trade law. Established in 1966, UNCITRAL's mandate is to help reduce legal obstacles to international trade by preparing legal texts (treaties, model laws, and guidelines) that states can adopt. UNCITRAL has been behind many of the most important harmonization initiatives in commercial law. For example, UNCITRAL drafted the **CISG (Contracts for the International Sale of Goods)** in 1980, which as discussed is a widely adopted treaty providing uniform sales law. It also developed the **UNCITRAL Model Law on International Commercial Arbitration** (1985, revised 2006) that has been influential worldwide, as well as the **UNCITRAL Arbitration Rules** (used in many arbitral proceedings, including investor-state cases). Other notable texts include the **Model Law on Electronic Commerce (1996)** and **Model Law on Cross-Border Insolvency (1997)**, among others. While UNCITRAL itself doesn't enforce laws, its work *indirectly shapes* the legal environment for international business by encouraging countries to align their national laws with global standards. For instance, when countries adopt the UNCITRAL Model Law on Arbitration (as Moldova did in 2008), they make international arbitration in those countries more familiar and acceptable to foreign businesses, thus facilitating trade and investment. UNCITRAL also keeps track of jurisprudence applying its conventions (through a system called CLOUT) to help promote uniform interpretation. In summary, UNCITRAL's role is largely **law-making (legislative)** in nature – it provides the legal templates and tools for countries to create a harmonious global legal framework for commerce.

- **UNIDROIT (International Institute for the Unification of Private Law)**

UNIDROIT is an intergovernmental organization based in Rome, founded in 1926 (and reconstituted after WWII), with the mission to harmonize and coordinate private law among states, particularly commercial law. UNIDROIT's approach is often to formulate *soft law* principles and model rules, rather than multilateral treaties (though it has sponsored some treaties as well). One of UNIDROIT's flagship achievements is

the UNIDROIT Principles of International Commercial Contracts (most recently updated in 2016). These Principles provide a comprehensive set of contract law rules reflecting the best of different legal systems, essentially offering a “neutral” law for international contracts. They cover general contract issues from formation to termination, and also specific doctrines like hardship (changed circumstances) and set-off. Parties can agree to use the UNIDROIT Principles as the governing law of their contract, or arbitrators might apply them when appropriate. Although the Principles are non-binding, they have been **highly influential** – many arbitral tribunals and even national courts have cited them as articulating general concepts of contract law in international cases. Apart from the Principles, UNIDROIT has worked on specific areas: for instance, it was behind the **1995 UNIDROIT Convention on Stolen or Illegally Exported Cultural Objects** and (with ICAO) the **Cape Town Convention (2001)** on international interests in mobile equipment (like aircraft financing). In commercial law, UNIDROIT also produced model laws like the **Model Law on Leasing**. The **importance of UNIDROIT** lies in its academic and technical expertise in drafting rules that balance different legal traditions. It gives life to the concept of a *transnational commercial law*. In effect, UNIDROIT complements UNCITRAL: while UNCITRAL often focuses on hard law treaties or models to be enacted by states, UNIDROIT often formulates principles and guidelines that can be directly taken up in contracts or inform judicial decisions. Both ultimately aim to create more certainty for businesses engaged in cross-border dealings.

- **WTO (World Trade Organization)**

The WTO is the central international organization for **public international trade law**. Established in 1995 as the successor to the GATT 1947, the WTO provides a *global forum* for member governments to negotiate trade agreements and a *binding dispute settlement system* to adjudicate violations. The WTO’s scope covers trade in goods, services, and intellectual property, enforced through a set of core agreements that all members sign onto. The WTO’s contribution to international business law is enormous on the *public law* side: it administers agreements that set rules on tariffs, quotas, subsidies, technical regulations, intellectual property standards (through TRIPS), etc., and it requires transparency and adherence to principles like **Most-Favored Nation (MFN)** (treating all trading partners equally) and **National Treatment** (treating foreign goods no less favorably than domestic goods once they enter the market). Through its **Dispute Settlement Body (DSB)**, including panels and what used to be an Appellate Body, the WTO can actually authorize retaliatory trade sanctions if a country fails to comply with its rulings – a strong enforcement mechanism by international standards. For example, if the EU imposes an illegal quota on an import, a WTO panel could rule against the EU and authorize the affected exporting country to impose counter-tariffs

if the EU doesn't fix its measure. The existence of this system gives businesses confidence that trade rules are not just political statements but *enforceable*. However, it's worth noting that as of the late 2010s and early 2020s, the WTO's dispute system faced challenges – notably the Appellate Body ceased to function after 2019 due to the United States blocking new appointments over concerns about the system. Efforts to reform and restore a two-tier dispute mechanism are ongoing (members missed a 2024 target for fully reviving it). Despite this, interim solutions (like ad hoc arbitration between willing members) have been used, and the WTO remains the key forum for negotiating new trade rules on issues like digital trade, investment facilitation, and fisheries subsidies. For international business law, the WTO sets the **baseline rules of global trade**: national laws on customs, export regulations, and trade remedies are all constrained and guided by WTO obligations. Moreover, the WTO oversees periodic trade policy reviews and serves as a data repository, improving transparency which is vital for companies operating globally. In summary, the WTO's role is to **set and police the multilateral trade rules** that governments must follow – in doing so, it indirectly protects businesses and investors by curbing protectionism and providing legal predictability in international trade relations.

- **ICC (International Chamber of Commerce)**

The International Chamber of Commerce, headquartered in Paris, is not an intergovernmental treaty-based organization but rather a global business association founded in 1919. Its mission is to promote international trade and commerce and to represent business interests worldwide. The ICC's role in international business law is unique because it operates from the **private sector side** to create rules and services that facilitate international transactions. One of its most visible contributions is the creation of **standard rules and practices** that have become ubiquitous in trade, which we have mentioned earlier: for instance, the ICC's **Incoterms** – a set of standardized definitions for trade terms like FOB (“Free on Board”), CIF (“Cost, Insurance & Freight”), DDP (“Delivered Duty Paid”), etc. These Incoterms are updated periodically (Incoterms 2020 is the current version) and are used in contracts to clarify when risk and costs transfer from seller to buyer. Though Incoterms have no legal force by themselves, they are incorporated by reference in countless sales contracts and thereby become binding on the parties. Similarly, the **UCP 600 (Uniform Customs and Practice for Documentary Credits)** is an ICC set of rules that governs how letters of credit are handled by banks in international trade; virtually every letter of credit issued by a bank will be subject to UCP 600 by reference, making it a crucial part of trade finance law. Another major function of the ICC is its **International Court of Arbitration**, which is one of the world's leading institutions for administering commercial arbitration. The ICC Court of Arbitration doesn't “judge” disputes itself, but it administers arbitrations (under the ICC Arbitration Rules) and scrutinizes draft

awards. Many international business contracts include an *ICC arbitration clause*, meaning if a dispute arises, it will be resolved under ICC Rules by arbitrators, rather than in national courts. The ICC has thus provided a trusted forum for neutral dispute resolution, with thousands of cases handled over the years, covering everything from construction and infrastructure projects to international sales and joint ventures. The ICC also works closely with UNCITRAL and others; for example, the **ICC arbitration rules are often used in ad hoc UNCITRAL arbitrations**, and the ICC was involved in promoting the New York Convention's adoption in the 1950s. Beyond these, the ICC has committees that issue **business guidelines and codes**, such as anti-corruption guidelines (the ICC's rules on combating corruption, which businesses use to self-regulate) and advertising/marketing codes that have been taken up in national laws. The ICC even represents business in international forums – it has observer status at the UN and was dubbed the “world business organization.” In summary, the ICC's role is to **set private-sector driven standards and provide services** (like arbitration) that complement the legal frameworks set by governments. Its rules like Incoterms and UCP have become an integral part of the *lex mercatoria* and daily commercial practice. Without the ICC, traders would lack universally accepted standard terms, and resolving cross-border business disputes would be more daunting. Thus, even though the ICC doesn't make “law” in a formal sense, its contributions are practically indispensable to international business law's functioning.

1.5 Application in Moldova: Multilevel Legal Framework and Dualist System

Having outlined general principles of international business law, we turn to how these play out in a specific national context – that of the Republic of Moldova. Moldova provides an instructive example of a small, trade-dependent country that operates within a **multilevel legal framework** (international, regional, and national laws) and follows a **dualist system** for integrating international law into its domestic order. In this section, we examine how international business law is applied in Moldova, including the country's treaty commitments, domestic legal adaptations, and the process by which international norms take effect internally.

Multilevel Legal Framework: Moldova's legal environment for international business is shaped by obligations and laws at **multiple levels**:

- **Global Level – WTO and Multilateral Treaties**

Moldova has been a member of the World Trade Organization since 2001. Upon joining the WTO, Moldova agreed to abide by the entire suite of WTO agreements, which cover trade in goods, services, and intellectual property. This required Moldova to align

many of its trade-related laws (customs tariffs, import licensing, standards, etc.) with international rules. For example, as a WTO member, Moldova grants Most-Favored Nation (MFN) treatment to imports from all other WTO countries (meaning it does not discriminate by imposing higher tariffs on some and not others). Moldova's customs tariffs and trade remedy laws (anti-dumping measures, etc.) have been brought into conformity with WTO disciplines. In addition to the WTO, Moldova is party to numerous multilateral business law treaties. We already noted that Moldova is a contracting state to the CISG (since 1995), which means that a contract for sale of goods between a Moldovan company and, say, a German company will automatically be governed by CISG rules unless the contract opts out. Moldova is also party to the **New York Convention (1958)** on arbitral awards (which it joined in 1998), ensuring that international arbitration decisions can be enforced by Moldovan courts and vice versa. Moreover, Moldova has joined conventions on intellectual property (administered by WIPO), transport (like CMR for road carriage of goods), and finance (like IMF Articles, etc.) which all feed into the broad legal framework for doing business internationally. Compliance with these multilateral treaties often necessitates updates to domestic legislation, which Moldova has undertaken over the past two decades.

- **Regional/Bilateral Level – Free Trade Agreements**

At the regional level, Moldova has actively pursued free trade agreements to integrate its economy with neighbors and key markets. Notably, Moldova is part of the **Central European Free Trade Agreement (CEFTA)** since 2007, a trade pact among several Southeast European countries that aims to eliminate duties and quotas among members. Another cornerstone is the **Association Agreement with the European Union**, signed in 2014, which includes a Deep and Comprehensive Free Trade Area (DCFTA) that fully came into force in July 2016. The DCFTA is particularly significant: it not only removes most tariffs on trade with the EU (Moldova's biggest trading partner), but also requires Moldova to gradually adopt or approximate many EU standards and regulations in areas like product safety, customs procedures, competition law, and intellectual property. Essentially, the DCFTA pulls Moldova's commercial laws closer to EU law, enhancing access to the EU market for Moldovan businesses but also raising regulatory requirements. Moldova has also concluded other bilateral FTAs, for example with **Turkey** (effective 2016) and most recently with the member states of the **European Free Trade Association (EFTA)** – namely Switzerland, Norway, Iceland, and Liechtenstein. The EFTA-Moldova Free Trade Agreement was signed in 2023 and entered into force by 2024-2025. Under this agreement, roughly 98% of Swiss exports to Moldova became tariff-free and vice versa, and it also covers services, investment, and even digital trade provisions. Additionally, Moldova has participated in the **CIS (Commonwealth of Independent States) Free**

Trade Area agreement (signed in 2011 by several post-Soviet states), which simplifies trade with countries like Russia, Ukraine (though geopolitical events have complicated some of those trade relations). This network of FTAs means that Moldovan companies benefit from preferential access to many markets, but it also means Moldova must juggle various rules from different agreements (for example, different rules of origin or standards requirements). All these treaties are part of Moldova's international business law framework and take precedence over conflicting national rules in those areas.

- **National Level – Domestic Legislation**

At the domestic level, Moldova has enacted laws to implement its international commitments and to regulate foreign trade and investment. A key piece of legislation is the **Law on State Regulation of Foreign Trade Activity No. 1031-XIV (dated 08.06.2000)**, which lays down the legal basis for foreign trade operations in Moldova. Notably, this law explicitly incorporates international law into the domestic framework: Article 3 of the law states that foreign trade in Moldova is regulated not only by Moldovan legislation but also by “the rules of international law and international treaties to which the Republic of Moldova is a party”. Furthermore, if an international treaty of Moldova provides rules different from those of the domestic law, the provisions of the international treaty prevail. This clause is very important – it means that in the realm of trade, Moldova gives direct effect and priority to its international obligations. For example, if Moldova's law imposed a tariff higher than what was committed in a WTO schedule or an FTA, the treaty obligation (lower tariff) would override the domestic law, and the higher tariff would not be applied. In addition to this general foreign trade law, Moldova's Parliament has passed specific implementing laws, such as customs codes aligned with WTO standards, intellectual property laws aligned with TRIPS, a competition law in line with EU norms (post-DCFTA), and an investment promotion law aligning with international investment principles. Another significant piece of domestic legislation is the **Law on International Commercial Arbitration (No. 24/2008)** which, as mentioned, was based on the UNCITRAL Model Law and facilitates neutral resolution of cross-border disputes in Moldova. The arbitration law's adoption signaled to foreign investors and trading partners that Moldova's legal system is arbitration-friendly (e.g., it upholds arbitration agreements and enforces foreign arbitral awards per the New York Convention). Moldova's civil code and civil procedure code have also been updated over time to accommodate international contracts and judgments. All these domestic laws represent the *implementation layer* of international business law in Moldova – they operate within the bounds set by treaties and are interpreted, where possible, consistently with international obligations.

Moldova's approach to international law can be characterized as **dualist**, with a twist of monist tendencies in practical effect. In international law theory, a *dualist system* is one in which international treaties are not directly applicable internally unless they are translated into national legislation; a *monist system* allows treaties to become part of domestic law automatically upon ratification. Moldova's Constitution and practice show elements of both, but largely follow the dualist process for treaty adoption. According to Article 86(1) of the Moldovan Constitution, the President negotiates and concludes treaties and then submits them to the Parliament for **ratification**. This means that parliamentary approval is required for major international agreements to be binding domestically – a hallmark of dualism, as the act of ratification (often via a law) is what gives a treaty force internally. For instance, Moldova's Parliament ratified the WTO Agreement in 2001 and the EU Association Agreement in 2014, through specific laws. Without those ratifications, the executive's signature alone wouldn't make those treaties operative at home. Additionally, if a treaty is found to conflict with the Constitution, the Constitution must be amended before the treaty can be ratified (Constitution Article 8(2)), underscoring the supremacy of the Constitution in the hierarchy of norms.

However, once a treaty is duly ratified, **Moldovan law tends to give it direct effect and even supremacy** over ordinary legislation. We saw this in the 2000 Foreign Trade Law which says treaty provisions prevail over conflicting domestic provisions. Moreover, the Constitution in Article 8(1) commits Moldova to respect the UN Charter and treaties to which it is party, and Moldovan courts have generally accepted properly ratified treaties as part of the law of the land. This approach is sometimes described as "moderate monism." In practical terms, Moldova's system means: **Step 1:** Parliament passes a law ratifying the international treaty (this is the dualist "translation" step); **Step 2:** Thereafter, the treaty's rules are considered integrated into domestic law and can be invoked by individuals or companies in Moldovan courts, and if there's any conflict with a prior domestic law, the treaty wins out (this reflects a monist outcome). For example, a Moldovan court hearing a dispute with an international element might directly apply the CISG if relevant, or acknowledge WTO rules when reviewing a trade measure, because those treaties have been ratified and are part of the domestic legal framework.

In the decades since independence, Moldova has increasingly woven itself into the fabric of international business law. Joining the WTO in 2001 was a major step that required legislative reform but also gave Moldovan exporters the security of the WTO's rules. There have been instances where Moldova utilized international law for its benefit. One notable case often cited in trade discussions is when **Russia banned Moldovan wine and spirits imports** in 2006 and again in 2013 (officially over "quality concerns," but widely viewed as pressure due to Moldova's EU-leaning policies). In

response, Moldova turned to international rules: in 2006, Moldova levered its position in the WTO by making approval of Russia's WTO accession contingent on lifting the wine ban. This was a strategic use of the WTO framework by a small country to address a trade barrier imposed by a much larger neighbor. Eventually, Russia did join the WTO in 2012, and such politically motivated bans became challengeable under WTO rules (indeed, Georgia later brought a WTO case against a similar Russian embargo). The 2013 ban occurred as Moldova was preparing to sign the EU Association Agreement; the EU and other partners helped mitigate it (the EU temporarily lifted import duties on Moldovan wine), illustrating how international and regional arrangements can provide remedies and support. This *case study* shows Moldova's multilevel strategy: it relied on bilateral diplomacy, WTO legal leverage, and EU market integration to safeguard its economic interests.

Internally, Moldovan businesses and courts are gradually becoming more accustomed to international legal concepts. Moldovan courts have applied CISG in relevant cases (for cross-border sales contracts) and recognize foreign judgments and arbitral awards in line with international commitments. The government often consults international models (UNCITRAL laws, EU directives under the DCFTA, etc.) when drafting new commercial legislation. Challenges remain – implementation and enforcement of laws can lag, and not all international norms are well understood by practitioners – but the trajectory is toward deeper integration. In summary, Moldova exemplifies a country operating under a **multi-layered system**: it must simultaneously adhere to global rules (WTO, etc.), regional rules (EU DCFTA, FTAs), and develop its domestic law capacity. Its **dualist constitutional setup** ensures democratic oversight of entering into international obligations (treaties go through Parliament), while its **monist practice** of giving treaties direct effect ensures it can live up to those obligations and provide certainty to trading partners and investors that international law will be honored within Moldova. For a Master's student, understanding Moldova's approach highlights the practical realities of international business law – it's not abstract, but rather something that operates through national systems, requiring countries to constantly align domestic laws with international commitments and to use international legal tools to advance national economic interests.

Case Study: Trade Measures and International Law – The Moldovan Wine Ban Dispute: In September 2013, Russia announced a ban on imports of wine and spirits from Moldova, citing alleged quality issues. This move was widely seen as a political response to Moldova's planned signing of an EU association agreement. The ban threatened a key Moldovan export industry. Moldova, a WTO member since 2001, considered invoking its WTO rights because such an import ban could violate WTO rules against unjustified restrictions on goods. The timing was critical: Russia was in the final stages of joining the WTO itself. In

fact, back in 2006, when a similar ban was imposed, Moldova used WTO procedures to apply pressure – it signaled it might block Russia’s WTO accession until the ban was lifted. By 2013, Russia was already a WTO member, so Moldova could potentially file a formal dispute. In the end, the European Union stepped in by increasing Moldova’s duty-free wine import quota and later temporarily removing all import duties on Moldovan wines, softening the blow. This case study shows how international business law mechanisms (WTO rules, accession negotiations) and regional agreements (EU-Moldova trade ties) provided leverage and remedies for a small country in the face of economic pressure. It underscores that for Moldova, being part of multilateral and regional trade systems isn’t just a legal formality – it has tangible implications for national industries and can serve as a shield against unfair trade practices.

Chapter 1 has introduced the foundational concepts of international business law. We defined the field and saw that it straddles public and private law – involving both treaties among nations and contracts among businesses. We explored the sources of international business law, from hard law like treaties and customary principles to soft law guidelines and the mercantile customs of *lex mercatoria*. We identified key international organizations that create and enforce these rules: UNCITRAL and UNIDROIT help harmonize private law across borders, while the WTO and institutions like the ICC regulate and facilitate global trade and dispute resolution. Finally, by examining how Moldova navigates international business law, we observed the multi-level nature of the system – how global and regional agreements are implemented within a national legal order, and the balance Moldova strikes as a dualist country that actively incorporates international norms. With this groundwork, we can proceed to more specific topics, knowing the general legal architecture in which international business operates. The takeaway is that international business law is a **living framework** – shaped by diplomatic negotiation, judicial decisions, and commercial practice – all aimed at fostering a stable and equitable environment for cross-border commerce.

Self-Assessment Quiz:

1. What is international business law and which areas does it cover? Describe in your own words the kinds of activities and legal issues that fall under international business law.
2. Explain the difference between public international law and private international law in the context of international commerce. Give one example of a public international law rule relevant to business, and one example of a private international law rule or instrument.

3. List the main sources of international business law. How do treaties differ from soft law instruments? In your answer, mention at least one example of a treaty and one example of a soft law or *lex mercatoria* instrument that are important for international business.
4. What roles do UNCITRAL and the WTO play in international business law? How is their influence on global commerce different? Also, briefly describe how the International Chamber of Commerce (ICC) contributes to the rules of international trade.
5. Moldova is described as having a dualist system but with monist tendencies in practice. What does this mean in terms of how international treaties become law in Moldova? Additionally, name two international trade agreements that Moldova is a part of and explain how they impact Moldovan law or business.

Sources:

- Aceris Law LLC. (2020, June 18). *Incoterms in International Trade*. (Explains the role of ICC Incoterms in international sales contracts and their near-universal usage).
- **Constitution of the Republic of Moldova, 1994 (as revised 2016)**. (Notably Article 8 and Article 86, which outline Moldova's stance on international treaties and the requirement of parliamentary ratification).
- International Chamber of Commerce. (2019). *ICC Uniform Customs and Practice for Documentary Credits, Publication No. 600 (UCP 600)*. (Widely adopted rules governing letters of credit in international trade, published by the ICC).
- International Institute for the Unification of Private Law (UNIDROIT). (2016). *UNIDROIT Principles of International Commercial Contracts 2016*. Rome: UNIDROIT. (A set of soft law principles covering major aspects of contract law, often used as a reference in international contract disputes).
- International Trade Administration. (2024, March 8). *Moldova – Trade Agreements*. In *Moldova Country Commercial Guide*. U.S. Department of Commerce. (Summarizes Moldova's free trade agreements, including CEFTA, DCFTA with the EU, Turkey, and the 2023 FTA with EFTA, illustrating Moldova's regional trade commitments).
- Reuters. (2013, September 10). *Russia, unhappy with Moldova's EU drive, bans its wine and spirits*. (News report on Russia's 2013 ban of Moldovan wine, widely interpreted as politically motivated; provides context for trade pressures Moldova faced).
- United Nations Commission on International Trade Law (UNCITRAL). (n.d.). *UNCITRAL Model Law on International Commercial Arbitration (1985, with amendments*

as adopted in 2006). United Nations. (Basis for Moldova's 2008 arbitration law; an example of UNCITRAL's harmonization role).

- World Trade Organization. (2023). *Member Information: Republic of Moldova*. WTO Official Website. (Notes that Moldova has been a WTO member since July 2001 and outlines its commitments; confirms Moldova's alignment of trade regime with WTO rules).
- World Trade Organization. (n.d.). *Understanding the WTO: Principles of the Trading System*. (Overview of fundamental WTO principles like MFN and National Treatment which underpin international trade law).
- **WTO Dispute Settlement – Appellate Body crisis:** Ungphakorn, P. (2024, December 19). "WTO members fail to meet their year-end 2024 target for dispute reform." *Trade & Blog*. (Discusses the status of the WTO dispute settlement mechanism and efforts to restore the Appellate Body as of end of 2024).
- **Moldovan Legislation:** Law of the Republic of Moldova No. 1031-XIV of 08.06.2000 "On State Regulation of Foreign Trade Activity" (as amended through 2022). (Establishes that international treaties of Moldova are directly applicable and prevail over conflicting domestic provisions, exemplifying Moldova's integration of international trade law).
- Wikipedia. (2025). *International Trade Law*. (Background information defining international trade law as rules governing trade between countries with both public and private dimensions, used as a secondary source for general definitions).
- Wikipedia. (2023). *Principles of International Commercial Contracts*. (Provides an overview of the UNIDROIT Principles, their nature as soft law, and their role in harmonizing contract law).
- WTO Panel Report, *Japan – Alcoholic Beverages II* (WT/DS8/AB/R, 1996). (A WTO case exemplifying the national treatment obligation, mentioned as a real-world instance of public international trade law in action).
- ICC Arbitration Case No. 8331/1995, reported in *Journal du Droit International (Clunet)* 1997, p.1076. (Illustrates the application of *lex mercatoria* principles by arbitrators, listing general principles of law when parties chose no specific national law).

CHAPTER 2: CORPORATE GOVERNANCE MODELS – ANGLO-SAXON, CONTINENTAL, AND HYBRID

Introduction: Corporate governance refers to the system of rules, practices, and processes by which companies are directed and controlled. Around the world, corporate governance practices take different forms, influenced by legal traditions, market structures, and cultural values. Two historically dominant models are the **Anglo-Saxon (Anglo-American) model**, prevalent in common law countries like the United Kingdom and United States (emphasizing shareholder primacy and market mechanisms), and the **Continental European (Rhineland) model**, found in civil law countries such as Germany and France (emphasizing a broader stakeholder orientation, bank financing, and concentrated ownership). Understanding these models is crucial in a globalized economy where investors and companies operate across jurisdictions. Comparative analysis highlights how each approach influences corporate accountability, decision-making, and investor confidence. International standards – notably the *G20/OECD Principles of Corporate Governance* (OECD, 2015) – provide a benchmark that bridges these models by identifying common elements of good governance (transparency, board accountability, equitable treatment of shareholders) while allowing for national variations. The European Union, through directives and regulations, has also driven convergence in certain practices (e.g. strengthening shareholder rights and transparency across member states), even as fundamental structural differences (like one-tier vs. two-tier boards) persist by design.

In addition to the two main paradigms, many countries operate **hybrid models** that combine elements of both Anglo-Saxon and Continental systems. These often appear in emerging markets and transition economies (including parts of Eastern Europe and Asia), where legal reforms and market pressures introduce Anglo-American practices into traditionally insider-dominated systems. This chapter examines the features of the Anglo-Saxon and Continental models and explores the hybrid approaches. We analyze how each model affects governance quality, investor protection, and board dynamics, with real-world case studies (such as the Enron scandal in the US and the Volkswagen case in Germany) illustrating model-specific governance issues. We also discuss relevant legal frameworks – from international principles and EU directives to national laws and codes – that shape corporate governance in each context. Through a comparative approach, the chapter underscores the importance of adapting governance practices to legal and cultural environments while striving for international best practices.

Learning Objectives:

By the end of this chapter, students should be able to:

- **Distinguish the key characteristics** of the Anglo-Saxon (Anglo-American) model vs. the Continental European model of corporate governance.
- **Describe different board structures** (unitary vs. two-tier boards) and explain how they operate in the Anglo-Saxon and Continental models. **Understand shareholder primacy vs. stakeholder orientation** and how these philosophies manifest in different governance systems.
- **Identify legal frameworks and codes** governing corporate governance in representative countries (e.g., the US/UK for Anglo-Saxon; Germany/France for Continental; Romania/Moldova for hybrid systems).
- **Explain the influence of international standards and EU directives** (such as the OECD Principles, EU Shareholder Rights Directives) on national corporate governance practices.
- **Analyze the impact on investor protection and board dynamics** in each model, including how minority shareholders are protected and how stakeholders (e.g., employees) are involved in governance.
- **Evaluate real-world examples** to link governance failures or successes (e.g., major corporate scandals or reforms) with model-specific governance features.
- **Apply a comparative approach** to discuss why different countries adopt hybrid models and the challenges/benefits of such systems.

2.1 Classification of Corporate Governance Models

Corporate governance models are commonly classified into two broad categories – **Anglo-Saxon vs. Continental** – with a spectrum of **hybrid** systems in between. The Anglo-Saxon (or **Anglo-American**) model, typical of the US, UK and other common law jurisdictions, is often described as an “**outsider**” system: ownership is dispersed among many shareholders, markets play a central role in control, and corporate law strongly protects shareholder rights. In contrast, the Continental European model (sometimes called the “**Rhineland**” model or “**insider**” system) prevails in many civil law countries, where ownership tends to be concentrated (family groups, banks, the state), and corporate governance emphasizes the interests of a broader set of stakeholders alongside shareholders. This insider system features mechanisms like bank oversight and employee participation that reflect a stakeholder orientation. Empirical research supports this dichotomy: for example, La Porta et al. (1998) found that common law countries generally have stronger legal protections for minority investors and more diffuse ownership than civil law countries, which historically led to more concentrated ownership structures.

Beyond these two poles, **hybrid models** have emerged in many countries. A hybrid system blends elements of both approaches, often due to transitional conditions or deliberate legal choices. Some hybrids appear in **emerging markets** and post-socialist economies that inherited concentrated ownership structures but are implementing Anglo-American style market regulations to attract investment. Other hybrids can be found in developed economies like Japan, which historically had an insider-dominated, network-oriented governance system but in recent decades adopted certain Anglo-Saxon practices, creating a mixed model. In practice, there is considerable diversity and **no one-size-fits-all model** – each country’s governance system reflects its legal origins, culture, and economic history. Nonetheless, classifying systems into these models is a useful analytical tool for comparing how corporations are controlled and whose interests are prioritized.

2.2 The Anglo-Saxon Model

The Anglo-Saxon corporate governance model – also known as the *Anglo-American model* – is characterized by a unitary board structure, dispersed share ownership, and a strong emphasis on **shareholder primacy**. This model is prevalent in countries with a common law tradition such as the United States, United Kingdom, Canada, Australia, and others influenced by British/American practices. In these systems, the primary objective of the corporation is often defined as maximizing shareholder value, and governance mechanisms are designed to align management’s interests with those of shareholders (the shareholders are viewed as the owners of the company).

Key Features: The Anglo-Saxon model has several distinctive features reflecting its shareholder-centric, market-oriented approach:

- **Single-Tier Board of Directors**

Companies have a one-tier (unitary) board that includes both executive directors (managers) and non-executive directors on the same board. The board of directors holds both strategic and supervisory responsibilities in the company. It is elected by and accountable to shareholders, serving as the ultimate decision-making authority for major corporate actions. This streamlined structure facilitates direct communication and quick decision-making, as there is no separate supervisory board. (In contrast, as we will see, Continental models often separate these functions into two boards.)

- **Shareholder Primacy & Dispersed Ownership**

The Anglo-American system typically features **widely dispersed share ownership** among many investors – hence an “outsider” system without a controlling insider block. Shareholders (often including large institutional investors like mutual funds and pension funds) collectively hold power, and managers must answer to the board and

ultimately to these shareholders. Corporate law and regulators explicitly protect shareholder rights – for instance, requiring robust disclosure and giving shareholders voting power over board elections and major transactions. If management underperforms, shareholders can either vote to replace the board or sell their shares; the ever-present threat of a **hostile takeover** in the active market for corporate control disciplines managers. This focus on shareholder primacy means other stakeholders' interests are generally considered only insofar as they affect shareholder value.

- **Market-Oriented Financing**

Firms in Anglo-Saxon economies rely heavily on **capital markets** (equity and bond markets) for financing. Stock prices serve as a central performance indicator, and corporate success is often judged by share price appreciation and quarterly earnings. This market orientation incentivizes a focus on short-term financial metrics, which can align management with shareholder interests but also risk encouraging short-termism. Executive compensation is frequently tied to stock performance (e.g. via stock options or bonuses linked to earnings targets), aligning managers' wealth with shareholders' wealth. Likewise, companies tend to use arm's-length debt financing (bonds or bank loans from dispersed lenders) rather than relying on a single "main bank," meaning oversight by creditors is also via market mechanisms.

- **Frequent Shareholder Engagement & Transparency**

Shareholders in Anglo-Saxon markets are engaged through formal channels like annual general meetings, where they vote on electing directors and key corporate decisions. Strong securities regulations ensure **extensive disclosure** of financial and operational information. For example, U.S. law mandates quarterly financial reports and prompt disclosure of material events, and UK listed firms must issue detailed annual reports. High transparency reduces information asymmetry and enables shareholders to monitor management. Shareholders also often have say-on-pay votes (on executive compensation policies) or must approve major mergers/acquisitions. The culture of shareholder activism is well-developed: if shareholders are dissatisfied, they openly agitate for changes (or quietly sell their shares). Overall, the model presumes that **efficient markets** and informed shareholders will hold management accountable.

- **Board Committees & Independent Directors**

Although the board is unitary, internal structures are in place to enhance oversight. Key board committees – Audit, Remuneration (Compensation), Nominations, etc. – are composed largely or entirely of **independent non-executive directors**. Independence (meaning directors who are not part of management and have no significant ties to the company) is a cornerstone of Anglo-American governance best

practice. The idea is that independent directors are better able to monitor and challenge management objectively. Notably, reforms such as the U.S. *Sarbanes–Oxley Act of 2002* (enacted after major scandals) and stock exchange listing rules require that audit committees consist solely of independent directors. This was a response to high-profile corporate failures like *Enron*, and is intended to strengthen financial oversight by ensuring the auditors are overseen by independent board members rather than the executives being audited.

Legal Framework Example – United States and UK

The U.S. *Sarbanes–Oxley Act of 2002* (SOX) was a landmark reform to the Anglo-American governance model’s regulatory framework, passed in response to the accounting scandals of the early 2000s (e.g., *Enron* and *WorldCom*). SOX imposed stricter responsibilities on corporate officers and boards: for instance, CEOs and CFOs must *certify* the accuracy of financial reports, and companies must establish robust internal controls. The law created the Public Company Accounting Oversight Board (PCAOB) to regulate auditors, and required publicly traded firms to have independent audit committees and enhanced whistleblower protections. These changes aimed to improve board oversight and restore investor trust after the failures of firms like *Enron*. The *Enron* scandal in 2001 – a quintessential collapse under an ostensibly “good” governance system – revealed how severe conflicts of interest and weak board scrutiny could lead to catastrophic outcomes, highlighting the need for such reforms. The response demonstrates the Anglo-Saxon model’s capacity for **self-correction**: when market discipline and existing checks proved insufficient, new laws and regulations were enacted to bolster accountability.

In the United Kingdom, rather than a single statute like SOX, governance reform has largely taken the form of evolving **corporate governance codes**. Starting with the *Cadbury Report* (1992) and through subsequent iterations (*Greenbury*, *Hampel*, and combined now as the *UK Corporate Governance Code*, updated most recently in 2018), the UK developed a principles-based code of best practices. Listed companies are required on a “**comply or explain**” basis either to adhere to the Code’s recommendations or explain publicly why they do not. The UK Code covers board leadership (e.g. it recommends separating the roles of Chair and CEO to avoid excessive concentration of power), board effectiveness (annual board performance evaluations), accountability (strong audit and risk controls), remuneration, and shareholder relations. Though not hard law, the London Stock Exchange mandates disclosure of compliance, and institutional investors use the Code as a benchmark to evaluate companies. This flexible approach has been influential globally and complements formal company law (e.g., the UK Companies Act 2006). Notably, Section 172 of the UK Companies Act 2006 even codifies a duty of directors to promote the success of the company *for the benefit of members*

(shareholders) while having regard to broader stakeholders like employees, suppliers, community and the environment. This legal provision, although still shareholder-centric, introduces an explicit consideration of stakeholders – an example of how even Anglo-Saxon jurisdictions have gradually acknowledged wider corporate responsibility.

Investor Protection and Performance

Common law systems like the US and UK traditionally offer very strong protections for minority investors. Shareholders typically enjoy extensive rights: voting rights on important matters, rights to sue for breaches of duty or fraud (including class-action lawsuits in the US), rights to equitable treatment during takeovers, and so on. These protections give investors confidence to invest despite being small stakeholders, contributing to deep and liquid equity markets. The diffuse ownership in part results from this legal environment: because small shareholders feel relatively safe from expropriation, shareholding is widespread. The market for corporate control (e.g., the threat of takeovers if a company underperforms) and active institutional investors (like activist hedge funds or large pension funds) add additional layers of discipline. However, one criticism of the Anglo-Saxon model is that its single-minded focus on shareholder returns can sometimes neglect other stakeholders (employees, communities, environment) and long-term sustainability. For example, companies might prioritize short-term stock price gains over long-term investment in innovation or might engage in mass layoffs to boost earnings, generating social backlash. In response, even Anglo-American countries have begun to encourage consideration of ESG (Environmental, Social, Governance) factors and long-term value creation. The emergence of stewardship codes (e.g., the UK Stewardship Code for institutional investors) and revisions to directors' duties (like the UK's emphasis on long-term success including stakeholder interests) reflect this trend.

***Example – Board Dynamics in Action:** A notable case illustrating Anglo-Saxon governance in practice is the attempted hostile takeover of Cadbury PLC (UK confectionery company) by Kraft Foods in 2009–2010. Cadbury's board initially resisted Kraft's bid, seeking to maintain the company's independence. However, many of Cadbury's shareholders – especially short-term investors like hedge funds who bought shares during the takeover battle – were enticed by Kraft's sweetened offer and voted to accept the acquisition. This episode demonstrated how, under the Anglo-Saxon model, management and boards ultimately serve at the pleasure of the shareholders: if owners decide a sale is favorable, management cannot easily block it. The takeover raised debates in the UK about whether short-term shareholders (who had no long-term stake in Cadbury) unduly influenced the outcome to turn a quick profit, perhaps at the expense of the company's long-term strategy. These concerns led to the UK's Kay Review (2012) on long-term decision-*

*making in equity markets. Another example is the rise of **shareholder activism** in the U.S., where activist investors (like hedge fund managers) accumulate shares in underperforming companies and agitate for changes – such as spinning off divisions, replacing CEOs, or altering capital allocation (dividends/buybacks) – to boost shareholder value. Boards in the US and UK increasingly engage with such activists or face proxy fights (contests for board seats). This dynamic, market-driven environment for corporate control contrasts sharply with Continental European systems, where hostile takeovers and open shareholder revolts have historically been less common.*

The Anglo-Saxon model provides an **efficient, investor-driven framework** that has proven effective at mobilizing capital and holding management accountable through market mechanisms and legal duties. It strongly champions shareholder rights, transparency, and performance, contributing to high levels of investor protection and broad stock ownership. At the same time, it relies on active, informed shareholders and robust regulatory oversight to check managerial excesses. The model's strengths include agility in decision-making and clear accountability to owners; its weaknesses can include tendencies toward short-termism and relative neglect of non-shareholder interests. Ongoing reforms and best-practice codes continue to evolve the model – for example, curbing excessive short-term incentives for executives and encouraging boards to consider sustainability – all while preserving the fundamental principle of shareholder primacy in corporate control.

2.3 The Continental European Model

The Continental European model of corporate governance (sometimes called the “*Rhineland model*” or **insider system**) is prevalent in countries such as **Germany, France, the Netherlands**, and many other parts of continental Europe. This model is characterized by a **stakeholder-oriented approach**, more **concentrated ownership structures**, and frequently a **two-tier board structure** that separates supervisory and management functions. In Continental systems, corporations are not viewed purely as instruments of shareholders, but rather as community institutions that should balance the interests of various stakeholders – including employees, creditors (especially banks), suppliers, customers, and the broader society – alongside the interests of shareholders. Long-term enterprise stability and social responsibility tend to be emphasized over short-term shareholder returns. This reflects a cultural viewpoint that corporations have social obligations and that collaborative relationships (between companies, labor, banks, etc.) are crucial to economic success.

Key Features: The Continental model has distinct governance features setting it apart from the Anglo-Saxon approach:

- **Two-Tier Board Structure**

A hallmark of many Continental European companies is the dual-board system: a **Management Board** (executives who run day-to-day operations, often called a Vorstand or Directorate) and a separate **Supervisory Board** (non-executives who oversee the management, often called an Aufsichtsrat or Conseil de Surveillance). The Management Board is responsible for executing the company's strategy and managing affairs, while the Supervisory Board is responsible for monitoring and guiding the Management Board's decisions. The two boards are strictly separate: an individual cannot simultaneously serve on both, and the Supervisory Board appoints (and can remove) members of the Management Board. This structure is *mandatory* for public companies (Aktiengesellschaften) in countries like Germany and Austria, and optional in some others (France allows firms to choose between a unitary or two-tier board). The rationale is that having an independent supervisory layer improves oversight and prevents excessive concentration of power. Major corporate decisions (e.g., large investments, mergers, annual budgets) often require Supervisory Board approval. While this can slow decision-making, it adds a check-and-balance that a unitary board might lack – the management is being watched by a separate body devoted solely to oversight.

- **Stakeholder Representation (Co-Determination)**

Many Continental European countries formally incorporate stakeholder representation in governance, especially **employees**. The most prominent example is Germany's *Mitbestimmung* (co-determination) system. Under Germany's Co-Determination Act of 1976 (*Mitbestimmungsgesetz*), large companies (generally those over 2,000 employees) must allocate up to half of the seats on the Supervisory Board to **employee representatives** elected by the workforce. For instance, a German stock corporation with over 2,000 employees will typically have a Supervisory Board where 50% of members represent employees (including union representatives) and 50% represent shareholders; a shareholder-elected chairman breaks any tie votes. This arrangement gives labor a direct voice in high-level corporate decisions. The philosophy is one of social partnership – workers are seen as partners in the enterprise, fostering cooperation between labor and management. Other countries have their own versions of stakeholder inclusion: e.g., recent French reforms require large companies to include employee directors on boards (at least one or two, depending on board size). The Netherlands has a system of *works councils* and a structure where the Supervisory Board co-opts its members but must consult with a works council representing employees. Banks and creditors historically also had influence: in Germany, banks often held significant stakes and sat on boards (or voted proxies on behalf of many small shareholders), reflecting a more bank-centered financial system than the Anglo reliance on markets. Overall, stakeholder representation in governance aims to ensure that decisions consider impacts on employees and other groups, not just shareholders.

- **Concentrated Ownership and Cross-Shareholdings:**

Continental companies often have a more **concentrated ownership** structure compared to their Anglo-American counterparts. It is common to have one or a few major shareholders (insiders) who exert significant influence – these might be founding families, the state (government ownership is notable in certain European industries), banks, or other corporations in a cross-holding network. For example, historically many German and French firms were part of conglomerate groups or alliances with cross-shareholdings (companies owning shares in each other, creating interlocking relationships). This *insider control* means a large portion of shares is not freely traded, and minority shareholders have less sway. While this can provide stability and a long-term orientation (a dominant owner can pursue steady growth without worrying about short-term market pressure), it raises concerns about protecting minority investors. Without proper checks, controlling shareholders might make decisions that favor themselves at the expense of minority (outside) shareholders – for instance, funneling benefits to their other companies or entrenching their management. Traditionally, legal protections for minorities in such systems were weaker, but as we'll note, reforms (often EU-driven) have gradually improved minority rights in Continental Europe.

- **Long-Term Orientation and CSR**

The Continental model places a strong emphasis on **long-term corporate sustainability** and social responsibility. Companies are often expected – implicitly by culture or explicitly by law – to consider the interests of employees, communities, and creditors, not just immediate profit for shareholders. This aligns with societal values in many European countries that stress consensus-building and avoiding shortsighted decisions. For example, firms might be slower to undertake mass layoffs during downturns, preferring solutions that preserve employment (sometimes facilitated by state work-sharing subsidies or agreements with unions). Managers may prioritize steady growth, R&D investment, and stakeholder loyalty over volatile short-term gains. The concept of the enterprise as a *social institution* is more pronounced: corporate decisions (like closing a plant) are weighed against social consequences. Indeed, during the 2008–09 financial crisis, German and French companies were often praised for not resorting to layoffs as quickly as American firms, arguably due to employee influence in governance and stronger social safety nets. Additionally, many Continental countries have legal provisions reinforcing stakeholder interests – e.g., requirements for works councils (employee consultative bodies in medium/large firms), strong labor protections, or even allowing companies to adopt a formal *social purpose*. France's 2019 *Loi Pacte*, for instance, enabled firms to enshrine a “raison d'être” (social purpose) in their charters beyond profit maximization. The broader outcome is that Continental firms often pursue strategies that balance profitability with social cohesion.

- **Regulatory Framework and Civil Law Tradition**

Continental European governance operates within **civil law** systems, where corporate governance rules are typically codified in detailed statutes and commercial codes (as opposed to common law systems that rely more on case law precedents). For example, Germany's Stock Corporation Act (*Aktiengesetz*) and France's Code de Commerce lay out the structure and duties of corporate organs, shareholder rights, etc.. Historically, scholars (e.g., La Porta et al.) observed that many civil law countries provided weaker legal protections to minority shareholders than common law countries. For much of the 20th century, minority shareholders in countries like Germany and France had fewer means to challenge management or controlling shareholders, and enforcement relied less on private litigation and more on regulatory oversight or large blockholders policing management. Over the past few decades, however, the gap has narrowed: the European Union and national reforms introduced measures like derivative lawsuits (so minorities can sue on behalf of the company), stronger disclosure rules, and takeover regulations to protect minorities (e.g., **mandatory bid rules** requiring an acquirer of control to offer to buy out remaining shareholders at the same price). Still, enforcement in Continental Europe tends to rely less on shareholder lawsuits (which remain rarer than in the US) and more on government regulators or the oversight by major shareholders/banks. Notably, the role of banks in countries like Germany historically filled some governance functions: a bank that was a major creditor and shareholder (often holding proxies from dispersed investors) would monitor management and influence strategy through board seats, acting as a counterweight to managerial discretion. This reflects a **bank-centered system** in contrast to the **market-centered** governance of Anglo economies.

- **Board Size and Composition**

Two-tier systems often result in larger overall board sizes since there are two bodies. A German large company might have, say, a 16-member Supervisory Board (half elected by shareholders, half by employees) and a Management Board of 5–10 members, totaling over 20 people involved in governance. This allows representation of diverse perspectives (employee delegates, major shareholders, perhaps community or creditor representatives in some cases). By contrast, Anglo-American boards typically have 8–12 directors in total. Larger boards can bring more expertise and stakeholder input, but they may be less nimble in decision-making. To maintain effectiveness, many Continental Supervisory Boards also form committees (audit, remuneration, etc.) similar to those in Anglo companies, though these committees operate at the Supervisory Board level. The concept of “independent” directors exists in Europe as well, but independence criteria may differ. Corporate governance codes in Europe (e.g., the German Corporate Governance Code) recommend that a certain number of

Supervisory Board members be independent of controlling shareholders or management. However, it is still common (and accepted) for major shareholders or their appointees to occupy many board seats – the logic being that their interests are aligned with the firm’s long-term prosperity. This is viewed less suspiciously than in an Anglo context, given the tradition of shareholder blocs actively overseeing management.

Governance Quality and Board Dynamics

The two-tier structure is designed to create robust oversight: the Management Board runs the company, while the Supervisory Board provides an independent check on management’s performance. Ideally, the Supervisory Board’s diverse composition (shareholder reps, employee reps, possibly others) means decisions account for various stakeholders and long-term consequences, potentially avoiding the myopia that critics ascribe to the Anglo model. For example, with employee representatives present, boards receive direct input on workforce sentiments and may pursue strategies that maintain labor peace and productivity (e.g., negotiating adjustments in tough times rather than resorting to layoffs). However, the dynamics of a two-tier system can be complex. If not handled well, an “*us vs. them*” mentality might arise between the Management and Supervisory Boards. A passive Supervisory Board might simply rubber-stamp management’s decisions (especially if insider representatives dominate and have cozy relations with executives). Conversely, an overzealous Supervisory Board might micromanage or conflict with Management, potentially stifling agile decision-making. Cultural norms in many Continental countries encourage consensus and extensive deliberation, which, while promoting buy-in, can slow down major strategic moves. For instance, a German company considering closing a factory may face strong pushback from employee reps and local political interests on the board, forcing exploration of alternatives (like phased closures or retraining programs) that take more time. The upside of this process is more socially acceptable outcomes (mitigating unrest and preserving firm-specific human capital); the downside is potentially slower adaptation to market changes. In summary, Continental boardroom culture tends to value consensus and stability, which can contribute to long-term resilience but may occasionally impede rapid shifts.

Investor Protection and Minority Shareholders

Because control in Continental systems often rests with large shareholders or coalitions, minority shareholders have historically been less powerful. They have typically relied on the integrity and fiduciary responsibility of controlling insiders (or intervention by banks/regulators) for fair treatment. Over time, legal protections for minority investors have been significantly strengthened. For example, most

Continental jurisdictions now have rules ensuring **equal treatment** of shareholders (if a controlling stake is sold, the acquirer must offer the same price to all shareholders – a principle enforced by EU takeover law). Pre-emptive rights are common, allowing existing shareholders to buy new stock first to avoid dilution. EU directives like the *Shareholder Rights Directive* (2007, amended 2017) have harmonized certain rights across Europe, giving shareholders say-on-pay votes for executive compensation, votes on related-party transactions, and easier mechanisms for cross-border voting at general meetings. As a result, the gap in formal minority protection between Anglo-Saxon and Continental systems has narrowed. Still, enforcement styles differ: European investors use class-action lawsuits far less than Americans; instead, they often depend on regulators (securities commissions, stock exchange oversight) to enforce rules, or they rely on the presence of large institutional investors who can pressure management behind the scenes. In many European countries, corporate governance codes (similar to the UK Code) have been adopted to supplement hard law, operating on comply-or-explain basis to encourage best practices like independent audit committees and limited board mandates.

Legal Framework Examples – Germany and France: In Germany, the *Aktiengesetz* (Stock Corporation Act) codifies the two-tier board structure and delineates the duties of both the Management and Supervisory Boards. It also imposes fiduciary duties on directors to act in the interest of the corporation as a whole (often interpreted as the enterprise and its stakeholders, not just the shareholders). Germany's *Mitbestimmung* laws (e.g., the 1976 Co-Determination Act) require large companies to implement the worker participation on boards described above. Additionally, since 2002 Germany has had a national **Corporate Governance Code** (*Deutscher Corporate Governance Kodex*) that provides non-binding best practice recommendations (e.g., suggesting limits on how many boards an individual can serve on, advocating for some truly independent members on Supervisory Boards, transparency in executive pay, etc.). Companies must declare annually whether they comply with this code or explain their deviations (similar to the UK's approach). In France, companies may choose between a *unitaire* (unitary) board or a *dualiste* (two-tier) board structure – a flexibility introduced to French law in the 1960s and carried into the modern *Code de Commerce*. Regardless of structure, French law and codes have increasingly included stakeholder considerations. For example, as of 2019, large French firms are required to have employee directors on the board (at least one or two, depending on board size) even if they have a unitary board. The French state historically has been a significant shareholder in industries like energy, transportation, and defense, which means the government (or its appointees) sometimes sits on boards or holds special “golden” shares with veto powers for strategic decisions. This adds another

stakeholder influence (the public interest) to governance, exemplifying how in Continental Europe corporate governance can intersect with industrial policy.

Comparative Perspective (Insider vs. Outsider Control)

One way to contrast Anglo vs. Continental governance is by the concept of “outsider” versus “insider” control. In the Anglo-Saxon outsider system, companies are broadly held and managers are monitored by independent boards, market prices, and the possibility of takeovers by outside investors. In the Continental insider system, companies have dominant inside owners (families, banks, etc.), and managers are monitored through those large shareholders and stakeholders integrated into governance. Each system has strengths and potential weaknesses. The outsider model’s strength is evident in strong minority investor protection and deep capital markets that provide companies with access to finance. The insider model’s strength lies in commitment to stakeholders and potentially more patient, long-term capital – for instance, companies may invest more in employee training or endure short-term losses to achieve long-term goals, with loyal blockholders supporting them. On the flip side, the outsider system can suffer from short-term pressures and a disconnect between owners and managers (the classic principal-agent problem), whereas the insider system can suffer from entrenchment of controlling interests and neglect of minority shareholder rights. Real-world outcomes can reflect these differences: e.g., U.S. firms might have higher market valuations and liquidity, whereas German or Japanese firms (often cited as insider systems) have historically had lower market valuations but perhaps greater stability in employment or supplier relationships.

***Example – The Volkswagen Case:** A notable case illustrating challenges of the Continental model is the 2015 Volkswagen AG emissions scandal. Volkswagen (VW), a German automaker, had a governance structure typical of the German system: a two-tier board with half the Supervisory Board seats held by employee representatives (per co-determination law) and the other half by major shareholders, notably members of the Porsche/Piëch family (the founding family and controlling shareholders) and representatives of the State of Lower Saxony (a German state government which held a significant ownership stake). In 2015, it was revealed that VW had installed software in its diesel cars to cheat emissions tests, a massive corporate fraud with huge legal and reputational fallout. Post-scandal analyses pointed to governance issues: despite VW’s formal two-tier structure and stakeholder representation, the board did not adequately challenge management or detect the wrongdoing. Commentators noted that VW’s Supervisory Board was filled with powerful insiders – the controlling family members, local politicians, and labor leaders – creating a clubby environment with perhaps insufficient independence. Employee representatives were focused on preserving jobs (VW*

was expanding and hiring at the time), the political representatives aimed to protect a regional “champion,” and the family was focused on growth and industry dominance. These priorities aligned to support management’s ambitious expansion goals, and there were few truly independent voices to ask hard questions about how VW was achieving seemingly stellar diesel performance. In essence, the combination of stakeholder representation and controlling shareholder dominance may have bred complacency and groupthink: everyone on the board had some vested interest in the company’s short-term success, and the usual Anglo-Saxon watchdogs (e.g., independent directors, activist investors) were largely absent. The VW saga underscored that ***no model is immune*** to governance failure. In its aftermath, German authorities and VW’s board itself took steps to strengthen compliance and oversight – for example, bringing in independent experts to review practices, and the scandal sparked discussion in Germany about mandating more financial expertise and possibly term limits for Supervisory Board members to ensure fresh, critical perspectives. It highlighted the need for robust independent oversight even in stakeholder-rich systems, and the importance of an ethical corporate culture alongside structural checks.

On a more positive note, the Continental stakeholder approach can yield benefits in times of crisis. As mentioned, during economic downturns such as the global financial crisis of 2008–2009, German and French companies were sometimes lauded for sustaining employment levels better than their Anglo-American counterparts. With employees and sometimes governments having a seat at the table, companies pursued solutions like work-sharing or temporary pay cuts instead of immediately resorting to layoffs. This can preserve morale and institutional knowledge, arguably allowing a faster recovery when conditions improve. Additionally, some studies suggest that stakeholder-focused firms may invest more in long-term projects like R&D, since they are shielded from short-term shareholder pressure – potentially contributing to innovation (though the evidence on this is mixed).

It is important to note that the European Union (EU) has had a significant harmonizing influence on corporate governance across both Anglo and Continental European countries. The EU has generally taken a “flexible convergence” approach: it allows diversity in national governance structures (for example, EU law permits both one-tier and two-tier board structures – the European Company (SE) statute explicitly gives firms the choice), but it also sets *minimum standards* that push all systems toward greater transparency, accountability, and shareholder rights. Key EU directives include the *Shareholder Rights Directive* (2007, revised 2017) which strengthens shareholders’ say on pay and related-party transactions and eases cross-border voting, the *Transparency Directive* (2004) which mandates regular financial reporting and disclosure of major

holdings, and the *Takeover Directive* (2004) which provides a framework for takeover bids and minority protections across Europe. These measures have introduced more Anglo-Saxon-like elements into Continental systems (e.g., encouraging more active institutional investor engagement and protection of minority shareholders during takeovers). At the same time, EU regulations have not dismantled unique stakeholder features; for example, EU law itself supports employee involvement (the European Company statute requires negotiations on employee participation, and separate directives mandate European Works Councils for multinationals). In sum, the EU serves as a balancing force: promoting market transparency and shareholder empowerment on one hand, while allowing and even encouraging stakeholder participation on the other, thereby blending the models to some extent across Europe.

The Continental European model presents a more **inclusive, stakeholder-oriented approach** to corporate governance, where controlling shareholders and stakeholders such as employees (and sometimes creditors or the state) have formal influence on corporate decisions. This model prioritizes long-term stability, consensus, and social responsibility in corporate affairs. Its strengths lie in aligning companies with broader societal interests – potentially reducing social conflict, fostering loyal workforces, and encouraging investment in firm-specific human capital (like worker skills). For example, companies may be more inclined to retain and retrain employees during hard times, or invest in projects with longer payback periods, knowing that patient capital supports them. The weaknesses of the model can include lower capital market liquidity (since ownership is tied up with controlling holders), potential entrenchment or nepotism by insiders, and historically less protection for minority investors (though, as discussed, this gap has been narrowing through reforms). The dual-board structure adds a clear delineation between management and oversight, which can enhance accountability if the Supervisory Board is composed effectively and does its job diligently. However, it also adds complexity to decision-making and requires a governance culture of cooperation and transparency between the two boards. As global capital markets integrate and competitive pressures mount, Continental firms have gradually embraced some Anglo-Saxon practices – such as greater transparency, adoption of international accounting standards, and inclusion of independent directors – in order to attract investors, all while **maintaining the fundamental stakeholder-oriented philosophy** at the heart of the model. In summary, the Continental model offers an alternative paradigm where corporations serve a coalition of interests, and it illustrates the trade-offs between shareholder democracy and stakeholder engagement.

2.4 The Hybrid Model

Definition and Context: The term “**hybrid model**” in corporate governance refers to systems that blend elements of both the Anglo-Saxon and Continental models. This often occurs in **emerging markets and transition economies** that are in the process of moving from state-controlled or family-controlled systems toward more market-oriented ones. Many countries in Eastern Europe (post-Communist economies), parts of Asia, Latin America, and elsewhere have adopted hybrid governance structures. These countries often inherited an **insider-dominated legacy** – for example, state ownership or family conglomerates leading to concentrated ownership, limited transparency, and stakeholder-style relationships – but in recent decades they have introduced **market mechanisms, legal reforms, and investor protections inspired by Anglo-American practices** to develop their capital markets and integrate with the global economy. Hybrids may also arise where the law explicitly permits multiple governance structures, allowing companies to choose or combine features. For instance, some jurisdictions allow firms to opt for either a one-tier or two-tier board, effectively letting the company tailor its governance model. The result is a variety of mixed systems that don’t fit neatly into one category – hence “hybrid.”

Examples of hybrid governance systems are seen in countries like **Romania, Poland, Turkey, India, South Korea, and Brazil**, among many others. Even within the European Union, newer member states often exhibit hybrid characteristics: they have updated their laws to EU standards (adding shareholder rights and disclosure rules), but their corporate ownership structures remain concentrated and stakeholder networks from the past persist. We also find hybrids in some advanced economies that historically followed one model but have evolved over time (for instance, **Japan** is frequently cited as a hybrid model, as discussed below).

Key Characteristics of Hybrid Models:

- **Flexibility in Board Structure**

Hybrid systems often allow **both one-tier and two-tier board structures** by law, providing flexibility that reflects a blend of governance traditions. For example, Romania’s company law (Law No. 31/1990, substantially reformed in 2006) permits joint-stock companies to choose between a unitary Board of Directors or a dual board (Directorate + Supervisory Council) structure. This legal flexibility is itself a hybrid feature – aiming to accommodate international investors who might prefer the familiarity of a one-tier board, while also retaining a two-tier option rooted in Continental European tradition. In practice, many Romanian companies (especially those listed on the stock exchange or seeking foreign investment) have opted for a **unitary board** with committees (mimicking UK/US practice), whereas some

companies with strong Continental influence (e.g., subsidiaries of German or Austrian firms, or certain banks) use the **two-tier board** model. Similarly, other Central and Eastern European countries like Poland, the Czech Republic, and Hungary introduced reforms in the 1990s–2000s to allow more flexible board structures or moved from mandatory two-tier systems to permissive ones as they integrated into the EU. This flexibility can lead to variation even within the same country – some firms in these markets have Anglo-style governance, others look more Continental.

- **Concentrated Ownership *with* Market Reforms**

A typical feature of hybrid economies is that they still have **concentrated ownership patterns** – major shareholders such as founding families, the state, or a few large investors often hold controlling stakes – *but* these countries are simultaneously implementing legal reforms to encourage broader investment and protect minorities. In other words, the *reality* on the ground is closer to a Continental insider system (with control in the hands of a few insiders), while the *law on the books* is being reshaped to resemble an Anglo-American outsider system. For instance, in **Moldova**, many joint-stock companies are controlled by majority shareholders or the government (in former state-owned enterprises), and relatively few have widely dispersed public ownership. At the same time, Moldova has pursued new laws and governance codes to strengthen minority shareholder rights, mandate disclosures, and improve transparency – influences drawn from OECD principles and EU directives. The coexistence of these traits means that enforcement and **actual practice** become the critical factors: having Anglo-style laws doesn't automatically change entrenched insider behavior or power dynamics. Thus, hybrid systems often experience a gap between formal rules and informal practices. Concentrated owners might still run companies in a personalized way, but now they must navigate new rules like tender offer requirements or financial reporting standards. Over time, some controlling shareholders adjust and even embrace these reforms (especially if they want to attract foreign capital), while others might seek ways around them. The presence of controlling insiders combined with emerging market institutions can also mean that **minority protection is only as good as enforcement** – corruption or weak courts can undermine the best-written laws.

- **Adoption of International Best Practices**

Hybrids are usually eager to **signal adherence to global governance norms** to build credibility with investors. They often voluntarily adopt **corporate governance codes** modeled after the OECD Principles or the codes of developed markets. For example, the *Bucharest Stock Exchange Corporate Governance Code* (first introduced in 2001, updated 2015) in Romania outlines recommendations on board composition (e.g., independent directors), shareholder rights, transparency, etc., using a comply-or-explain

mechanism. Similarly, Moldova's National Commission of Financial Markets issued a Corporate Governance Code in 2007 (revised 2016) encouraging companies to meet higher governance standards, even if not legally required. These codes often borrow heavily from UK or OECD templates – for instance, urging companies to establish audit committees, conduct board evaluations, and ensure equitable treatment of shareholders. Compliance in practice is mixed in many hybrids (some companies formally endorse the code but do little, while others genuinely implement changes), but over time these standards start to take root. International organizations like the OECD, World Bank, and European Bank for Reconstruction and Development (EBRD) have been active in advising and assessing governance in transition economies, further spreading best practices. In essence, hybrid systems often have *aspirational* governance policies that mirror those of developed markets, and they use these to attract foreign investment and improve their reputation.

- **Legal and Regulatory Framework**

Many hybrid jurisdictions have overhauled their **company laws, securities laws, and regulatory institutions** during periods of economic reform (often aligned with IMF/World Bank programs or EU accession processes). For example, when **Romania** was preparing to join the EU (achieved in 2007), it significantly amended its company law to incorporate Western concepts: introducing the option of a dual-board structure, clarifying directors' fiduciary duties, strengthening shareholder meeting procedures, etc., as required by EU company law directives. Romanian law now is a blend of its civil law origins and transplanted common-law style elements (like audit committees and independent directors). **Moldova**, a former Soviet republic, started with a civil law framework influenced by Soviet enterprise law (e.g., a structure with a general shareholders' meeting, a board often termed a "Council," an executive body, and an audit commission). Over time, Moldova updated its Joint Stock Companies Act repeatedly to enhance shareholder rights and align with international standards. Notably, Moldovan law effectively mandates a two-tier-like setup for many companies (a Supervisory Board elected by shareholders overseeing an executive board or directors), reflecting Continental influence, yet at the same time the country's regulations push practices like comply-or-explain disclosures akin to Anglo systems. These kinds of legal hybrids are common – the law might decree a certain board structure or stakeholder role, but also impose Anglo-style transparency and accountability measures. A key challenge is **institutional capacity**: it's one thing to pass laws, another to enforce them. Regulators and courts in some hybrid markets may be inexperienced or under-resourced, leading to a lag in enforcement. For instance, a law might give minority shareholders the right to sue or demand information, but if the court system is slow or corrupt, those rights have limited effect. We often see a period of "form over substance" where rules exist largely on paper initially.

- **State Ownership and Privatization Legacy**

In many hybrids (especially in Eastern Europe, Central Asia, and parts of the Middle East/Africa), the **state** initially owned most enterprises before privatization. Even after privatization waves in the 1990s–2000s, governments often retained significant stakes in certain strategic sectors (like oil & gas, utilities, telecommunications, banking) or in former monopolies. This means the government, or politically appointed directors, may still play a major role in corporate governance of ostensibly “private” companies – adding another layer of stakeholder influence similar to Continental models where the state is an important actor. For example, the state as a shareholder might prioritize keeping utility prices low for consumers or maintaining employment in a company, rather than maximizing profits. This can conflict with minority investors’ interests if not carefully managed. Unlike classic Rhineland systems where cross-shareholding networks and family dynasties evolved over a century, many hybrid markets have a newer and sometimes less stable governance ecosystem – the rules of engagement between the state, new private owners, and investors are still evolving. Recognizing issues in state-influenced firms, a number of countries have adopted the **OECD Guidelines on Corporate Governance of State-Owned Enterprises (SOEs)** to professionalize governance in the state sector. For instance, requiring independent directors on SOE boards, separating the state’s ownership function from its regulatory function, and ensuring minority shareholders are protected even when the state is the majority owner. South Korea’s experience is instructive: it installed more Anglo-style governance in its large formerly state-linked firms (like POSCO, a steelmaker, which was privatized and introduced independent directors and other reforms in the 2000s), but still grapples with government influence and chaebol family control.

- **Enforcement and Institutions**

A critical aspect of hybrid models is the varying strength of institutions. Many operate in environments with **developing legal institutions and regulatory bodies**. Enforcement of corporate governance rules may be inconsistent – e.g., securities regulators might lack the staff or authority to thoroughly police all listed companies, and courts may not have judges specialized in complex corporate cases. In some countries, cultural and political factors (like tolerance of certain related-party dealings or corruption) can undermine formal rules. As one analysis put it, in some regions there is a clear influence of Western frameworks “on paper,” but implementation faces challenges due to limited resources, weak rule of law, and political interference. This often results in a “**compliance gap**” – companies might tick the box on having, say, an audit committee and independent directors because the law or code says so, but in substance those might not function effectively (the independent directors could be inexperienced or not truly independent, the audit committee might meet only

formally). Bridging this gap requires broader governance reforms in society, such as anti-corruption initiatives, judicial training, and building a culture of accountability. Encouragingly, external actors like international investors and stock exchanges can drive improvements: for example, a stock exchange might require that listed companies have a minimum number of independent directors or publish governance reports, and foreign investors often insist on certain protections as a condition of investing (sometimes even nominating directors or including covenants in financing agreements). Over time, as capital markets deepen and local investor bases grow, these enforcement mechanisms tend to strengthen. But during the transition, hybrids can be volatile – some corporate scandals and setbacks are typically encountered (e.g., banking frauds, expropriation of minorities) that then catalyze further reforms.

- **Examples: Romania and Moldova (Hybrid Governance in Practice):** To illustrate, consider two Eastern European cases:
 - *Romania:* As an EU member since 2007, Romania has harmonized its company law and securities regulations with European standards, embodying a hybrid mix. Romanian law’s allowance of both one-tier and two-tier boards is itself drawn from EU influences (mirroring choices available in countries like France). Many Romanian listed companies—especially those in the BET stock index—have embraced governance improvements due to EU investors and requirements. They issue annual **comply-or-explain** reports against the Bucharest Stock Exchange Code, have brought in independent non-executive directors, separated CEO and Chairman roles, etc.. At the same time, the corporate landscape still features numerous companies with controlling shareholders: the state continues to hold large stakes in key industries (energy, utilities), and many firms privatized in the 1990s ended up controlled by investment funds or wealthy individuals. Minority investors thus rely on the legal protections introduced in the 2000s (like mandatory bids, cumulative voting rights, or improved disclosure) to safeguard their interests. Romania has also seen instances of shareholder activism; for example, *Fondul Proprietatea*, a fund managed by foreign asset managers, has actively pushed for better governance and higher dividends in partially state-owned companies, demonstrating a clash and convergence of models – a Western-style activist operating in an insider-oriented environment.
 - *Moldova:* Moldova is smaller and not an EU member, but under an EU Association Agreement it has voluntarily aligned many of its laws with EU norms. Governance in Moldova’s private sector is still heavily insider-driven – many companies are dominated by majority owners (often the

founders or politically connected figures) and the stock market is very thin. However, Moldova implemented a revised **Corporate Governance Code in 2016** and, with support from organizations like the EBRD, has been encouraging adoption of better practices. The country's major banks, after a banking fraud scandal in 2014, were forced to improve governance (e.g., fit-and-proper criteria for board members, independent audit committees mandated by the central bank). These changes illustrate a shift toward Anglo-American standards under the pressure of crises and international assistance. Still, challenges remain: enforcement of shareholder rights can be problematic if courts are slow or if powerful oligarchic shareholders circumvent rules. Moldova's experience, like that of many hybrids, underscores that progress is often two-steps-forward, one-step-back, and that sustained political will and external anchoring (like prospect of EU integration or investment) greatly influence the trajectory.

Other Hybrid Examples – Japan and South Korea: Not all hybrid models are in developing countries; some advanced economies have hybrid characteristics due to their unique blend of practices:

- *Japan* is frequently cited as a hybrid model. Traditionally, Japan had an insider-dominated governance system: boards were composed almost entirely of company executives (often former managers promoted to the board), and there were **extensive cross-shareholdings** among companies in the same *keiretsu* industrial groups (meaning companies held each other's shares to cement alliances). Banks played a central role through the **main bank system**, providing long-term financing and having close ties with corporate clients, often holding equity stakes as well. These features resemble the Continental model's stakeholder and network orientation. At the same time, Japan did have active stock markets and by the late 20th century was pressured to increase transparency and shareholder value focus. Starting in the 2000s, Japan undertook reforms introducing Anglo-Saxon elements: it allowed firms to adopt U.S.-style board committees (audit, nominating, compensation) with independent directors (2002 amendments to corporate law), and in 2015 Japan introduced a Corporate Governance Code aiming to increase the number of outside (independent) directors on boards. Many large Japanese companies, while not fully embracing the U.S. model, have added independent directors (it's now common to have at least 2) and unwound some cross-shareholdings. Yet, Japanese firms still often prioritize stakeholders (employees and partners) and consensus management, maintaining a hybrid shareholder/stakeholder approach. The result is a governance system that mixes Western-style

accountability mechanisms with Japanese relational governance. Investors consider Japan somewhere between the UK (shareholder-centric) and Germany (stakeholder-centric) in governance style.

- *South Korea* is another interesting hybrid case. Korean conglomerates (*chaebols* like Samsung, Hyundai, LG) have traditionally been family-controlled empires with complex cross-shareholding structures – akin to an insider system with founding families exercising dominant control. After the Asian Financial Crisis in 1997–98, Korea was compelled (with IMF guidance) to implement sweeping corporate governance reforms, many drawn from the Anglo-American playbook. These included mandating a percentage of **outside directors** on boards of large listed companies, establishing board committees (audit committees became required for the biggest firms), strengthening minority shareholder rights (lower thresholds to sue or call meetings), and improving financial disclosures. The government also encouraged more market-based discipline (e.g., facilitating hostile takeovers by removing some defenses, though cultural resistance remains strong). Today, Korean corporate governance is a hybrid: its legal and regulatory framework largely meets international standards (Korea ranks relatively well on investor protection indices), and many companies have independent directors and conduct regular shareholder meetings with substantial institutional investor participation. However, the reality is that the founding families often still wield outsized influence via control of holding companies or cross-ownership and can sometimes dictate company policy – as seen in high-profile succession and corruption scandals. An “activist state” and increasingly vocal minority shareholders (including foreign investors who own significant stakes in Korean companies) continue to push Korean firms toward greater accountability and genuine independence on boards. The trajectory suggests a gradual convergence with global norms, but tempered by local power structures.

In summary, hybrid models demonstrate the **dynamic evolution** of corporate governance. They show how legal frameworks and best practices can be transplanted across borders, and how local conditions mediate their implementation. For students of international corporate governance, hybrids are particularly instructive: they underscore that improving governance is not just about changing rules on paper, but also about **building institutions, enforcing laws, and sometimes shifting business culture**. The process can be uneven, but over time many hybrid jurisdictions have significantly raised their governance standards. Indeed, the global trend is that hybrids are slowly moving toward the norms of developed markets (better disclosure, more independent boards, stronger shareholder rights), even if they retain certain unique features of their traditional systems.

2.5 Comparative Analysis of the Models

To synthesize the discussion of the three models, the following is a comparative overview of key aspects of the **Anglo-Saxon**, **Continental**, and **Hybrid** corporate governance models. Each model represents a distinct approach, but hybrids illustrate intermediate cases or evolving changes:

- **Board Structure**

Anglo-Saxon systems use a **unitary (single-tier) board** that includes both executives and non-executives on one board, combining management and oversight functions. Continental systems typically have a **two-tier board**, separating a Management Board (executives) from a Supervisory Board (non-executives who oversee management). Hybrid jurisdictions often permit **flexible structures** – the law may allow either one-tier or two-tier boards, leading to a mix in practice. Some companies in hybrids choose an Anglo-style unitary board, while others (especially influenced by Continental traditions or legal requirements) use dual boards. Governance codes in hybrids frequently encourage Anglo-style features (like board committees, independent directors) even if a two-tier board exists.

- **Ownership Structure**

The Anglo-Saxon model is an **outsider system with dispersed ownership** – equity is held by many shareholders (often institutions), and no single shareholder usually has a controlling stake. This dispersed ownership underpins active stock markets and the possibility of takeovers. Continental Europe, by contrast, follows an **insider system with concentrated ownership** – large blockholders (families, banks, the state, or corporate cross-shareholders) often dominate shareholding, and cross-shareholding networks can be common. Minority shareholders traditionally had less influence, though legal protections have been improving. Hybrid models show **mixed ownership patterns**: many firms still have controlling shareholders (similar to Continental models), for example founding families or the state owning majority stakes, but there is also a growing presence of dispersed minority shareholders and foreign investors due to privatizations and market liberalization. In effect, a controlling insider might be balanced by new legal rights for minority investors.

- **Shareholder vs. Stakeholder Focus**

Anglo-Saxon governance is rooted in **shareholder primacy** – the corporation's goal is maximizing shareholder value, and boards are primarily accountable to shareholders. Other stakeholders' interests are considered mainly as a means to that end (e.g., corporate social responsibility is often voluntary or for reputational benefit). Short-

term financial performance carries significant weight. Continental governance, on the other hand, embodies a **stakeholder orientation**: companies are seen as serving not just shareholders but also employees, creditors, and society at large. Laws and board structures (like co-determination) give stakeholders formal influence, and long-term sustainability and social welfare are explicit concerns. Hybrid systems often **officially endorse shareholder value** (having adopted laws that assert shareholder rights and primacy in corporate law), but in practice, controlling owners or political interests may steer companies with broader considerations (e.g., maintaining employment or political relationships). Many hybrids are increasingly acknowledging stakeholder importance – for instance, introducing corporate governance codes that emphasize ethics and sustainability – while still improving protections for shareholders. In short, hybrids are evolving toward the shareholder model but retain some stakeholder-centric behaviors.

- **Legal/Regulatory Framework**

Anglo-Saxon countries typically have a **common law tradition** and rely on a combination of case law and regulatory rules (e.g., SEC regulations in the US, stock exchange listing rules). Shareholder rights are strongly protected by law (e.g., shareholders can sue for breaches of fiduciary duty relatively easily, class actions and derivative suits are available). Disclosure standards are strict (quarterly reporting in US, etc.), and enforcement is often through active regulators and courts. Continental Europe operates in a **civil law framework**: detailed civil codes and statutes govern companies (such as the German Aktiengesetz or French Code de Commerce). Historically, these offered narrower remedies for minority shareholders, but extensive EU-driven reforms have increased transparency and shareholder rights, moving closer to Anglo standards. Still, enforcement in Continental systems often relies more on regulatory bodies and less on shareholder litigation; cultural reliance on internal controls and large shareholders remains higher. Hybrid systems usually have **transitional legal frameworks**: they may have recently overhauled their company and securities laws to align with international (often Western/EU) standards. For example, many have adopted laws based on EU directives or recommendations by bodies like the OECD. As a result, on paper they protect investors much like developed markets. However, the challenge is **implementation**: regulators and judiciaries in hybrids may be less experienced or face issues like politicization and limited resources. Enforcement might lag behind legislation, leading to a period where laws exist but business practices take time to catch up.

- **Board Composition & Dynamics**

In Anglo-Saxon systems, boards are **unitary**, and executive and non-executive directors deliberate together, which can streamline decisions. There's a strong

emphasis on **independent directors** to provide checks on management, typically through committees like audit or compensation committees. Powerful CEOs often exist, but they are balanced by independent board members and the threat of shareholder activism or hostile takeovers, which keeps them in check. The board answers directly to shareholders (with annual elections or votes on directors in many cases). In Continental systems, **dual board dynamics** mean the Management Board handles daily affairs while the Supervisory Board meets periodically to oversee and make major decisions. Employee and shareholder representatives on supervisory boards must work together, fostering a consensus-driven style. This can lead to thorough vetting of decisions with stakeholder input, albeit sometimes at the cost of speed. The separation of roles prevents a CEO from easily dominating the entire governance structure (e.g., a CEO cannot be the chair of the supervisory board, unlike in unitary systems where a CEO could also be board chair). In hybrid boards, **variable dynamics** are observed: in companies that adopt unitary boards, they behave much like Anglo-Saxon boards (and may also introduce independent directors and committees); in firms with two-tier boards, they mirror Continental practices. However, the effectiveness of oversight in hybrids can be uneven – e.g., independent directors may lack sufficient experience or authority, or controlling shareholders might dominate nominations, making independence nominal. Many hybrid boards are still evolving in how they function; in some cases, one strong controlling voice on the board can overshadow the formal structures. External influences, such as requirements by foreign investors or multinational regulations, are often key drivers pushing hybrid boards toward more rigorous oversight and professionalism.

- **Investor Protection**

Anglo-Saxon jurisdictions generally offer **very strong formal protection for investors**. Shareholders typically have clear rights to vote on important matters, claim dividends, inspect books, etc., and legal avenues to seek redress if their rights are violated (e.g., suing directors derivatively, class-action lawsuits for securities fraud). In the US, contingency fee litigation and an active plaintiffs' bar mean that management faces serious legal consequences for misconduct. Market mechanisms add extra protection: analysts, financial media, and the possibility of hostile takeovers all act as watchdogs. As a result, minority investors tend to feel relatively confident. In Continental Europe, historically **minority protection was moderate to weak**, varying by country (for example, stronger in Germany, weaker in some Southern European countries). Controlling shareholders could potentially expropriate value through related-party transactions or other means if unchecked. Today, thanks to EU rules like the Takeover Directive and Shareholder Rights Directive, as well as national reforms, protections have improved significantly. There are now mandatory bid rules (so minorities get an equal price if control changes hands), disclosure requirements for insiders, and easier

ways for minorities to call meetings or add agenda items. Still, enforcement often relies less on private lawsuits and more on regulators or large shareholders stepping in. The culture of shareholder activism is less aggressive (though it's growing as share ownership widens). In hybrid economies, legal protections for investors have generally been **added or upgraded** in recent decades – for example, introducing clearer fiduciary duties for directors, requiring better disclosure of conflicts, sometimes granting cumulative voting or board representation rights to minority shareholders. However, enforcement is often uneven. Minority investors in these markets may remain exposed to expropriation risks by insiders due to weaker rule of law or crafty circumvention of rules. Indices like the World Bank's investor protection index usually show improvements after reforms, but on-the-ground effectiveness can lag. In practice, minority protection in hybrids might hinge on external factors like the presence of foreign strategic investors or international lenders who insist on covenants and oversight as conditions for their involvement. The trend is positive, with successive reforms slowly building more trust in these markets, but challenges remain.

- **Role of Banks and Capital Markets**

In the Anglo-Saxon model, the financial system is **capital market-centric**. Companies predominantly finance through equity (stock) and bonds, and banks serve more at arm's-length (providing loans but generally not entangled in governance). Banks in the US/UK typically do not sit on corporate boards (and in the US, banking regulations historically separated commercial and investment banking to limit conflicts). A firm's health is closely tied to its stock price, and losing access to markets (or facing a takeover) is a primary threat disciplining management. In the Continental model, historically the system is more **bank-centric and network-oriented**. Banks often held equity stakes and board positions (especially in Germany through proxy voting and in countries like France through state-influenced banks). Companies relied heavily on bank loans, and there were dense networks of cross-shareholdings where allied firms owned each other's stock (e.g., in Germany and France, but also famously in Japan's keiretsu). This reduced dependence on volatile stock markets and hostile takeovers – friendly parties held large chunks of shares that wouldn't sell out, thereby **impeding takeovers** and market discipline, for better or worse. In hybrid economies, many started with **underdeveloped capital markets** and an almost exclusive reliance on banks or state funding. Over time, they have been **strengthening stock exchanges and bond markets** to diversify funding sources. Many hybrids still see banks as crucial financiers (and those banks themselves might be undergoing governance improvements, especially if foreign banks acquired stakes). But there is a deliberate shift toward a balanced system: encouraging IPOs, establishing securities regulators, adopting international financial standards (IFRS accounting, Basel banking rules). International Financial Institutions (IFIs) like the World Bank or EBRD often play a

role by investing in companies or banks and insisting on governance upgrades. Thus, hybrids are gradually moving from purely relationship-based finance to including market-based finance, though bank and insider influence remains significant.

- **Corporate Governance Codes & Standards**

The Anglo-Saxon world pioneered governance codes of best practice, starting with the UK's Cadbury Report in 1992, which introduced the “comply or explain” model for adherence to governance standards. Such codes emphasize things like independent boards, proper financial controls, risk management, etc., and rely on market enforcement (investors and media pressuring companies to comply). International guidelines like the OECD Principles of Corporate Governance (first issued 1999, updated 2015 and 2023) closely mirror many Anglo-American governance ideals (transparency, shareholder rights, board responsibilities). In Continental Europe, most countries were **later adopters of governance codes** (often in the early 2000s, post-Enron era). These codes had to be adapted to the local context – for example, defining what “independent director” means on a Supervisory Board, or recommending limits on the number of boards a person can sit on (to avoid overly intertwined networks). Continental codes also use comply-or-explain and cover similar themes (board role, remuneration, audit quality), but historically, their enforcement via market pressure was weaker due to more concentrated ownership (a family controlling a firm might not care as much about a code). However, as investor profiles change (more institutional and foreign investors in Europe now than decades ago), these codes have gained influence. In hybrid countries, nearly all have **issued corporate governance codes** in the 2000s or 2010s, often drafted with external expert help and referencing OECD principles. The content of these codes is usually ambitious – covering shareholder rights, board structure, transparency, etc. – to signal commitment to best practices. Actual compliance varies widely: some firms (especially those seeking international investment or listing on major exchanges) follow the codes diligently, while others formally acknowledge the code but provide minimal explanations for not following it. Over time, though, these codes help establish norms, and as new generations of professionals and cross-border investors become involved, adherence tends to improve. Notably, many hybrids incorporate global standards like **IFRS accounting** and **international audit standards**, which improve financial transparency and make it easier for outsiders to trust reported information.

The comparison above highlights that while the Anglo-Saxon and Continental models differ greatly in philosophy and structure, there has been some **convergence** in recent years driven by globalization, regulatory cross-pollination, and the spread of best practices. Hybrid models are a manifestation of this convergence in progress – they mix features and illustrate how governance systems can evolve. Each model has

implications for the quality of governance (for example, how effectively boards monitor management), for investor confidence (how safe minority investors feel in committing capital), and for corporate behavior (how decisions are made and whose interests count in those decisions). Understanding these differences is essential for multinational investors, policymakers working on reforms, and scholars analyzing how corporate governance affects economic outcomes.

2.6 Current Trends in the Choice of Governance Models

In recent years, corporate governance around the world has been influenced by **major trends and a gradual convergence** of standards, even as distinctive national models persist. Some key current trends include:

- **Convergence vs. Persistence.** There is an ongoing debate about whether governance systems are converging towards a single model (typically the Anglo-American shareholder-centric model) or whether they will continue to differ. We observe a partial convergence in **formal rules and standards** – for instance, virtually all developed and many developing countries now adhere to core international benchmarks like the OECD Principles of Corporate Governance and International Financial Reporting Standards (IFRS). Practices such as having independent directors, forming audit committees, and ensuring shareholder voting rights have spread widely, bridging the gap between models. The EU has harmonized many governance aspects across Europe, and even historically insular markets like Japan and Korea have adopted Western-style reforms. However, fundamental differences remain, especially in **board structure and ownership patterns** – for example, Germany shows no sign of abandoning its two-tier boards; family conglomerates remain prevalent in Asia. Mauro Guillén’s comparative research famously concluded that despite globalization, economies still “go about corporate governance in different ways” and that convergence, if it occurs, might be toward some *hybrid between shareholder and stakeholder models* (as seen in Japan and Germany), rather than one side fully adopting the other. In practice, countries have tended to pick and choose elements: e.g., France and Japan have embraced independent directors and stronger disclosure (Anglo-style attributes) while retaining co-determination or main banks (stakeholder features). Thus, the **current trend is convergence in norms and goals** (all markets strive for transparency, accountability, fair treatment of investors) coupled with **continued diversity in institutions** (each retains some unique structural features). Companies operating internationally often voluntarily meet the highest governance standards among the countries they are in (to satisfy global investors), further promoting convergence.

- **Stakeholder Governance and ESG.** A notable trend is the rising emphasis on stakeholders and ESG (**Environmental, Social, and Governance**) **considerations** even in traditionally shareholder-focused jurisdictions. In August 2019, the U.S. *Business Roundtable* (an association of CEOs of major companies) issued a headline-grabbing statement redefining the purpose of a corporation to promote “an economy that serves all Americans,” explicitly moving away from strict shareholder primacy to **commitment to all stakeholders** (customers, employees, suppliers, communities, and shareholders). This reflects broader societal and investor pressure for corporations to address issues like income inequality, climate change, and social justice. While the legal frameworks in the US/UK have not fundamentally shifted (directors are still principally accountable to shareholders), there is clear momentum in practice: large institutional investors (e.g., BlackRock, via Larry Fink’s annual letters) are urging companies to focus on sustainable, long-term value and consider stakeholders. In the UK, as mentioned, the Companies Act 2006 already requires directors to *have regard* to employees, community, and the environment (Section 172) alongside the duty to shareholders. Continental European countries, which traditionally favored stakeholder approaches, have doubled down on ESG mandates. The EU has been at the forefront of integrating sustainability into governance – for example, the proposed Corporate Sustainability Due Diligence Directive will require large companies to conduct due diligence on human rights and environmental impacts in their supply chains, effectively embedding stakeholder concerns (societal and environmental) into directors’ responsibilities. Many European countries have also implemented **board diversity quotas**, especially for gender: France and Norway pioneered laws requiring around 40% of board seats to be held by women, and in 2022 the EU passed a directive setting a target of 33% of all directors (or 40% of non-executive directors) to be female in large listed companies by 2026. Such initiatives demonstrate an increasing belief that boards should reflect broader societal values (gender equality, inclusion) and have a wider skillset. Globally, investors too are pushing for diversity as a factor in performance (some index providers and asset managers will vote against nominating committees that don’t diversify the board). In summary, **sustainability and stakeholder governance have become mainstream topics** in corporate governance discussions across all models. This doesn’t mean Anglo-Saxon markets have abandoned shareholder primacy, but they are redefining it to be more long-term and inclusive, while stakeholder-oriented markets are finding their approach validated and reinforced by global ESG trends.

- **Strengthening of Shareholder Rights in Traditionally Insider Systems.** Concurrently, there is a trend of strengthening shareholder rights in countries that historically had weak minority protections. For instance, many Continental European and Asian markets have made it easier for minority shareholders to call extraordinary meetings, propose board candidates, or exercise *cumulative voting* to elect directors. The *Shareholder Rights Directive II* (2017/828/EU) in Europe, for example, gives shareholders a say on pay and greater oversight of related-party transactions. In markets like Japan and Korea, we've seen an emergence of domestic shareholder activism (not just foreign activists) – in Japan, the corporate governance and stewardship codes introduced in 2014–2015 emboldened institutional investors to vote against underperforming management, and as a result, Japanese companies have been increasing dividends, unwinding cross-holdings, and buying back shares to improve capital efficiency. South Korea amended its Commercial Act in 2020 to tighten rules on related-party transactions and enabled more proxy voting conveniences. These changes suggest a **convergence toward a baseline of shareholder empowerment**, even in places once dominated by controlling families or the state.
- **Technological and Market Developments.** The rise of technology has also impacted governance. Electronic voting and virtual shareholder meetings (a trend accelerated by the COVID-19 pandemic) have made it easier for shareholders globally to participate in governance, which particularly helps in cross-border voting situations (addressing a traditional barrier for shareholder engagement in multinational companies). Additionally, the growth of passive index investing means large asset managers (BlackRock, Vanguard, State Street, etc.) now own significant stakes in companies worldwide. These managers have generally advocated for governance best practices (they vote on thousands of companies, urging compliance with things like independent boards, reasonable executive pay, etc.), effectively spreading Anglo-Saxon shareholder-centric expectations to Continental and hybrid companies alike. On the other hand, **state capitalism** (exemplified by China and some others) presents a counter-trend: in China, the state has tightened its influence on corporate boards in recent years (even in publicly listed firms, Communist Party committees within firms have gained formal roles). This shows that geopolitics can also influence governance models, with some countries reaffirming state/stakeholder control even as others liberalize.
- **Board Professionalism and Evaluation.** Worldwide, there is a focus on making boards more **professional and effective** regardless of model. This includes

efforts like director training and certification programs, regular **board evaluations** (where boards assess their performance annually), and refreshing board composition to avoid stagnation. For example, the UK Code recommends annual performance evaluations and external evaluations every few years; many European codes have similar provisions. Even in hybrid markets, stock exchanges and governance institutes are providing training for board members to raise competency. **Diversity of perspective** is emphasized not just in terms of gender or ethnicity, but also in skills and international experience, as companies recognize the value of having directors who can navigate global challenges. The goal of these trends is to improve board decision-making from within – essentially to ensure that no matter what the formal model (unitary or two-tier, shareholder or stakeholder oriented), the **board culture** is one of integrity, accountability, and strategic foresight.

In conclusion, the **current trajectory** in corporate governance is toward higher standards and a blending of practices, albeit without erasing the distinctions born of legal and cultural differences. Anglo-Saxon countries are incorporating a bit more stakeholder awareness and long-term focus (e.g., ESG and workforce issues now regularly appear on board agendas in the US/UK), while Continental and hybrid countries are bolstering shareholder rights and market transparency within their stakeholder frameworks. International organizations (like the OECD and G20) and institutional investors act as convergence agents by promoting global best practices. Yet, as these changes unfold, they play out differently across models: for example, increased focus on sustainability might manifest in the US through investor pressure on boards, whereas in Germany it might come via codifying stakeholder interests in company purpose. The net effect is that **choices of governance models are becoming more nuanced** – countries and companies are more freely borrowing elements from each other. There is a greater acceptance that good governance requires a balance of strong shareholder accountability *and* regard for stakeholders. We may not get a single universal model, but all models are evolving to meet common challenges: restoring trust after corporate scandals, ensuring companies contribute positively to society, and aligning corporate strategies with the long-term interests of their investors and stakeholders. The continued diversity of governance approaches, coupled with rising global standards, offers rich learning opportunities and underscores the importance of context in corporate governance reform.

Self-Assessment Quiz:

1. Summarize the main differences between the Anglo-Saxon and Continental European corporate governance models in terms of board structure, shareholder

- vs. stakeholder orientation, and ownership structure. How do these differences influence the way companies are run in each system?
2. Explain what is meant by a *unitary board* and a *two-tier board*. Provide an example of a country or company using each type of board. What are the perceived advantages and disadvantages of each structure regarding effective oversight and decision-making?
 3. Discuss how legal tradition (common law vs. civil law) has historically impacted investor protection and corporate governance, according to scholarly research. How do the concepts of an “outsider system” and an “insider system” relate to the Anglo-American and Continental models respectively?
 4. The Continental model often includes employees and other stakeholders in governance (e.g., through co-determination). What are the potential benefits and drawbacks of stakeholder inclusion on boards? In your view, could stakeholder representation improve corporate governance in Anglo-American companies, or would it conflict with shareholder primacy? Provide reasoning or evidence for your opinion.
 5. Identify and describe at least two key challenges that hybrid governance systems (like those in Eastern Europe or emerging markets) face when combining elements of the Anglo-Saxon and Continental models. How have countries like Romania or Moldova addressed these challenges (for example, through law reforms or corporate governance codes)?
 6. Choose one corporate scandal or governance failure (e.g., Enron in the US, Parmalat in Italy, Volkswagen in Germany, or a case from an emerging market) and analyze it in the context of the country’s governance model. What model-specific weaknesses can you identify that contributed to the failure? What changes were made in response to the scandal to prevent future occurrences?
 7. How have international standards such as the OECD Principles of Corporate Governance and EU directives influenced national governance practices? Can you give an example of a governance reform in a particular country that was driven by these international guidelines? Do you think these standards promote convergence toward a single model, or do they allow for diversity of models to persist?
 8. There is a global trend toward increasing diversity (skills, gender, international experience) on boards and focusing on ESG (Environmental, Social, Governance) issues. How might these trends play out differently in the Anglo-Saxon vs. Continental models? For instance, is one model better suited for handling sustainability challenges or incorporating diverse perspectives, or are these changes orthogonal to the traditional model differences?

Sources:

1. **Cadbury Report (UK, 1992).** *Report of the Committee on the Financial Aspects of Corporate Governance*, chaired by Sir Adrian Cadbury – London: Gee Publishing, 1992. (Defined corporate governance as “the system by which companies are directed and controlled,” laying the foundation for modern governance codes).
2. **OECD (2015).** *G20/OECD Principles of Corporate Governance* – Paris: OECD Publishing, 2015. (International benchmark guidelines covering shareholder rights, equitable treatment of shareholders, stakeholder roles, disclosure, and board responsibilities; updated in 2023).
3. **La Porta, R., Lopez-de-Silanes, F., Shleifer, A., Vishny, R. (1998).** “Law and Finance.” *Journal of Political Economy*, 106(6): 1113–1155. (Pioneering empirical study showing that common law countries have stronger investor protections and less concentrated ownership than civil law countries).
4. **UK Companies Act 2006 (c.46).** (Comprehensive company law in the UK. See Section 172 on directors’ duty to promote the success of the company for the benefit of members (shareholders) while considering broader stakeholder factors).
5. **Sarbanes–Oxley Act of 2002 (USA, Pub.L. 107-204).** (U.S. federal law enacted in response to corporate scandals like Enron, imposing strict reforms to improve financial disclosures and prevent corporate fraud – e.g., mandating independent audit committees and CEO/CFO certification of financial reports).
6. **German Stock Corporation Act (Aktiengesetz, last amended 2021).** (Primary corporate law governing German Aktiengesellschaften – mandates two-tier boards and codetermined supervisory boards, details directors’ duties and shareholder rights in the German corporate governance framework).
7. **Mitbestimmungsgesetz 1976 (Germany).** (Co-Determination Law of 1976 – requires near-parity representation of employees on the Supervisory Boards of large companies with over 2,000 employees, institutionalizing employee participation in governance).
8. **French Commercial Code (Code de Commerce, Book II – Commercial Companies).** (Includes provisions governing Sociétés Anonymes (corporations) in France, allowing a choice between a unitary board (*moniste*) and two-tier board (*dualiste*) system. As of 2019, also requires employee board representation in large companies).
9. **European Union Shareholder Rights Directive (2007/36/EC) and Amendment (2017/828/EU).** (EU legislation strengthening shareholders’ rights in listed companies: covers voting rights, say-on-pay for executives, approval of related-party transactions, and transparency obligations for institutional investors).

10. **European Union Takeover Directive (2004/25/EC)**. (EU rules for takeover bids, aimed at protecting minority shareholders and ensuring transparency during corporate takeovers – includes mandatory bid rules so all shareholders can sell at the same price, and board neutrality provisions during takeover attempts).
11. **UK Corporate Governance Code** (Financial Reporting Council, 2018). (Voluntary code of best practice for UK listed companies covering board leadership, effectiveness, accountability, remuneration, and relations with shareholders, under a comply-or-explain regime. Originated with Cadbury 1992 and updated periodically).
12. **German Corporate Governance Code** (Deutscher Corporate Governance Kodex, as amended 2022). (Sets out principles and recommendations of good governance for German listed companies, including guidance on board composition, operations, and transparency; updated regularly by a government commission and followed on a comply-or-explain basis).
13. **Bucharest Stock Exchange (BSE) Corporate Governance Code (2015)**. (Governance code for companies listed on the Romanian stock exchange, aligning with EU and OECD principles. Requires annual disclosure of compliance or explanations for deviations – an example of a hybrid market adopting international best practices).
14. **National Commission of Financial Market (NCFM) Moldova – Corporate Governance Code (2016)**. (Revised code of corporate governance for Moldovan public companies and banks. Introduced comply-or-explain disclosure and aligned Moldova’s governance guidelines with international standards, as part of broader market reforms).
15. **Cernat, L. (2004)**. “The Emerging European Corporate Governance Model: Anglo-Saxon, Continental, or Still the Century of Diversity?” *Journal of European Public Policy*, 11(1): 147–166. (Analysis of corporate governance convergence in Europe amid EU integration; discusses how elements of Anglo and Continental models are blending in the European context, yet diversity persists).
16. **Peregrine, M. W. & Elson, C. M. (2021)**. “Twenty Years Later: The Lasting Lessons of Enron.” *Harvard Law School Forum on Corporate Governance* (posted April 5, 2021). (Reflection on the Enron scandal’s impact on corporate governance and how reforms like Sarbanes–Oxley have evolved over two decades).
17. **Investopedia (2020)**. “What Are Some Examples of Different Corporate Governance Systems?” (Descriptive overview of Anglo-US, German (Continental), and Japanese models, highlighting differences in board structure and focus).
18. **EBRD (2017)**. *Corporate Governance in Transition Economies: Moldova Country Report*. (Evaluation by the European Bank for Reconstruction and Development of

Moldova's corporate governance legislation and practices, noting strengths, weaknesses, and the status of implementing the 2016 governance code).

19. **King Reports on Corporate Governance for South Africa – King III (2009) & King IV (2016).** (Influential governance codes from South Africa, a country with a hybrid governance environment. Emphasize ethical leadership, sustainability, and a stakeholder-inclusive approach under voluntary principles, demonstrating an innovative blend of governance practices applicable beyond South Africa).
20. **Monks, R. A. G. & Minow, N. (2011).** *Corporate Governance* (5th Edition). Wiley. (Comprehensive textbook covering theories and global practices of corporate governance, including comparisons of different models and numerous case studies).

CHAPTER 3: CORPORATE STRUCTURE: SHAREHOLDERS, BOARD OF DIRECTORS, AND EXECUTIVE MANAGEMENT

In modern international corporate governance, *corporate structure* refers to the framework defining the roles and relationships between a company's key organs – principally the shareholders (owners), the board of directors (oversight body), and executive management (executive officers running day-to-day operations). A sound corporate structure is the backbone of good governance, delineating authority and accountability across these groups. With the right structures and systems in place, companies can foster an environment of trust, transparency, and accountability that supports long-term value creation. Conversely, weak or imbalanced governance structures have been at the heart of many corporate failures across jurisdictions. This chapter examines the components of corporate structure and their interplay in various international governance frameworks. We will compare unitary (single-board) systems and dual-board systems, discuss the rights and responsibilities of shareholders, the composition and duties of boards (and their committees), and the role of executive management, using real-world case studies and up-to-date legal developments (through 2025) to illustrate key principles.

Learning Objectives: After studying this chapter, students should be able to:

- **Identify** the main components of corporate structure (shareholders, board, management) and *explain* their roles in corporate governance across different jurisdictions.
- **Describe** the rights and responsibilities of shareholders in corporate governance, including both their powers (e.g. voting, dividends) and their duties or stewardship expectations in various legal frameworks.
- **Discuss** the composition, functions, and fiduciary responsibilities of boards of directors, and *evaluate* how board effectiveness can impact corporate performance and accountability.
- **Explain** the purpose and functions of key board committees (audit, remuneration, nomination) and how they strengthen governance, citing relevant regulatory requirements and best practices internationally.
- **Clarify** the roles of executive management (CEO and other executive directors/officers) in directing the company's daily affairs, and outline the liabilities and accountability mechanisms applied to senior executives under different legal systems (e.g. U.S. Sarbanes-Oxley certifications, German management board liability, etc.).
- **Compare and contrast** unitary vs. dual board models of governance, with examples from countries like the U.S./U.K. (unitary) and Germany (two-tier),

and *assess* the advantages, disadvantages, and recent trends (such as the convergence or choice of board models in various countries).

- **Analyze** how a balanced interaction between shareholders, the board, and management contributes to effective corporate governance, and *illustrate* what can go wrong when this balance fails (using case studies of governance failures and reforms).
- **Apply** knowledge of international governance frameworks and recent legal developments to critically examine corporate structure choices and recommend governance improvements.

3.1. The Concept and Importance of Corporate Structure in International Governance

Corporate governance broadly refers to the system by which companies are directed and controlled, and corporate structure defines the allocation of power within that system (Cadbury, 1992). In any corporation, **shareholders** provide capital and expect returns, **directors** oversee the company and ensure it pursues agreed goals, and **executive managers** run the business day-to-day. The way these roles are structured – including the checks and balances among them – is of fundamental importance to governance outcomes. A well-designed corporate structure ensures that decision-making is efficient *yet* accountable: it channels authority to managers for agility while empowering boards to monitor management and allowing shareholders to ultimately hold the board to account for long-term performance.

Why is corporate structure so important? At its core, the separation of ownership and control in modern corporations (Berle & Means, 1932) creates an *agency problem*: shareholders (principals) need managers (agents) to run the company, but managers may not always act in the owners' best interests. The corporate structure – through laws, regulations, and internal policies – provides mechanisms to align interests and prevent abuse. For example, requiring a board comprised largely of independent directors who can objectively supervise executives is a structural measure to protect shareholders. Similarly, giving shareholders voting rights on certain major decisions and board elections provides a check on both boards and management. Good corporate structure thus *mitigates risks of mismanagement and builds trust*. Indeed, international bodies emphasize that **trust, transparency, and accountability** flow from sound governance structures, which in turn encourages investment and economic growth.

Different countries have developed distinct governance frameworks historically, but there is convergence around certain core principles. The G20/OECD Principles of Corporate Governance (most recently revised in 2023) underscore that an effective governance framework requires clear role delineation among shareholders, boards, and

management, and legal protections for investors (OECD, 2023). While each jurisdiction's company law and codes may vary, all seek to ensure that corporate power is not concentrated unchecked in any single actor. Notably, the corporate governance framework in a country typically consists of **multiple layers**: hard law (statutes, regulations), stock exchange listing rules, and soft law codes of best practice (often on a “comply-or-explain” basis). This ecosystem shapes how corporate structures operate in practice and how flexible companies can be in adapting structures to their needs.

It is widely recognized that there is *no one-size-fits-all* optimal structure. For example, some economies (like the U.S. and U.K.) long favored a single-board (unitary) structure, while others (like Germany) mandate a two-tier board system – each approach has its merits and drawbacks. Increasingly, countries allow companies a choice of governance structure to suit their circumstances. Regardless of form, however, the *importance of clarity in roles and balance of power* cannot be overstated. A breakdown in governance structure can lead to catastrophic failures. To illustrate: the collapse of **Enron** in 2001 (U.S.) and **Carillion** in 2018 (U.K.) were both attributed in part to structural governance failures – Enron's board failed to restrain conflicted, reckless executives, and Carillion's board was later found to have been overly acquiescent to management's aggressive accounting and risk-taking. Such cases prompted significant regulatory reforms (e.g. the Sarbanes-Oxley Act of 2002 in the U.S. to strengthen audit oversight and executive accountability, and revisions to the U.K. Corporate Governance Code to emphasize director duties and risk management post-Carillion).

In summary, corporate structure is the **scaffolding of governance**. It sets the stage upon which the drama of corporate decision-making unfolds. Strong structures encourage ethical behavior, prudent risk management, and long-term value creation, whereas weak structures can enable fraud, mismanagement, or value destruction. The following sections break down each element of corporate structure – shareholders, boards (and committees), and executives – examining their rights, responsibilities, and interplay in an international context.

3.2. Rights and Responsibilities of Shareholders

Shareholders are the owners of a corporation, and as such they occupy a critical place in the governance structure. However, in modern corporations with numerous dispersed shareholders, they are typically **not involved in day-to-day management**. Instead, shareholders exercise governance primarily through their *rights* under law and the company's constitution – notably, voting rights – and through market actions (buying/selling shares, which can affect the stock price and thus indirectly discipline management). This section outlines the key rights of shareholders and their

corresponding responsibilities or expectations in corporate governance, highlighting differences and commonalities across jurisdictions.

Basic Shareholder Rights: All major corporate governance systems agree that certain fundamental rights of shareholders must be protected. According to international standards, basic shareholder rights include the right to:

- **Secure ownership registration and transfer of shares.** Shareholders must be able to register their ownership (e.g. via share certificates or electronic records) and freely transfer or sell their shares. This is essential for liquidity and for shareholders to exit if dissatisfied with governance.
- **Participate and vote in general meetings.** Shareholders have the right to attend annual general meetings (AGMs) and extraordinary meetings, to vote on key matters such as election of directors, approval of major mergers or asset sales, amendments to the charter, and other fundamental changes. Voting is a cornerstone of shareholder influence; for example, in *all* jurisdictions shareholders elect the board (or supervisory board) members – at least in part – and can vote to remove directors under certain conditions.
- **Share in profits.** Shareholders are entitled to a fair share of distributable profits, usually through dividends declared by the board. If the company is wound up, they have rights to residual assets after all obligations are met.
- **Approve extraordinary transactions.** Many legal systems require shareholder approval for significant corporate actions (sometimes called “fundamental changes”). For instance, issuing new shares, major acquisitions or mergers, or changes to the company’s articles/bylaws often require a shareholder vote (sometimes with supermajority thresholds). This ensures owners have a say in transformative decisions that could dilute their interests or alter the company’s direction.
- **Elect auditors and ensure integrity of financial reporting.** In some jurisdictions (like certain EU countries), shareholders formally appoint the external auditor at the AGM. More generally, shareholders have the right to accurate and timely information about the company’s financial performance and governance – annual reports, audited financial statements, and disclosures – so they can make informed voting and investment decisions.

In addition, shareholders have rights to **information and voice**. They can inspect certain company documents, ask questions at meetings, and in some regimes even propose resolutions or call special meetings (for example, U.K. law allows shareholders with 5% ownership to requisition an extraordinary general meeting). Shareholders with a specified minimum stake (e.g. 3% in EU companies under the Shareholder Rights Directive II, or varying thresholds in national laws) can also put forward

proposals or board nominations. These rights collectively empower shareholders to influence the company's governance, even if indirectly.

Equitable Treatment and Minority Protection

Good governance requires that *all shareholders of the same class are treated equally* (OECD Principle II). This is crucial in companies with controlling shareholders or dual-class shares. Many countries' laws prohibit abusive actions by controlling shareholders that unfairly prejudice minority investors. Examples include rules against insider self-dealing, oppression remedies (as in U.K. Companies Act 2006 and commonwealth laws, allowing minority shareholders to seek redress if majority conduct is unfairly prejudicial), and requirements for mandatory takeover offers if a shareholder crosses a high ownership threshold (ensuring minorities can exit at the same price the controller is paying to gain control). Such protections bolster confidence that even small shareholders will have their rights respected.

Most stock exchanges and codes also push for “one share, one vote” structures (or at least transparency if disproportionate voting rights exist) to align economic ownership and voting power. The *equitable treatment* principle is especially pertinent in markets like **South Korea** or **Japan**, where historically families or keiretsu controlled companies and minorities had little influence – reforms in recent decades (encouraging independent directors, stricter fiduciary duties for controlling shareholders, etc.) have aimed to improve protection for minority shareholders and attract foreign investment.

Shareholder Responsibilities and Stewardship

While we often focus on shareholder rights, modern governance discourse also emphasizes the *responsibilities* of shareholders, particularly institutional investors, in fostering long-term governance. The concept of “stewardship” has gained prominence – notably in the U.K. Stewardship Code (2020) and Japan's Stewardship Code – urging shareholders (like pension funds, asset managers) to actively engage with companies and vote thoughtfully, rather than remain passive. In the U.S., the Business Roundtable has highlighted that increased shareholder empowerment should come with **accountability** on shareholders' part for the company's long-term value creation. In other words, if shareholders use their rights (e.g. activist hedge funds pushing for strategic changes or short-term gains), they ought to do so transparently and with regard to the interests of *all* shareholders and stakeholders, not just their own short-term profit. This perspective is a shift from the traditional view of shareholders as purely principals with rights, to seeing them as participants in governance with some obligations to the system's health.

For example, **institutional investors** now often publish voting policies and engagement reports. Regulations in some jurisdictions (like the EU Shareholder Rights Directive II, 2019) even require institutional investors and asset managers to disclose how they exercise voting and monitor investee companies. The objective is to encourage informed voting and dialogue – e.g., large investors pressing a board on environmental, social, governance (ESG) issues or executive pay should be acting in a principled manner aligned with long-term performance, not just arbitrage.

Moreover, shareholders have a responsibility to **educate themselves** on the company's affairs (e.g., reading the annual report) and to vote their shares in an informed manner. Simply having rights is not enough if owners are apathetic – for instance, low turnout at AGMs can undermine the effectiveness of governance votes. Some markets have minimum quorum requirements to combat apathy. In contrast, *excessively interventionist* shareholders can also pose challenges – e.g., activists focused on short-term stock price can pressure boards into actions (like high dividend payouts or break-ups) that may harm long-term prospects. Thus, the balance of shareholder influence is delicate.

International Variations

The extent of shareholder rights varies worldwide. Generally, Anglo-American jurisdictions (US, UK, Canada, Australia) grant shareholders strong formal powers on paper, but with dispersed shareholding, those rights were historically underutilized, though activism has surged in the 21st century. Continental European countries often had more concentrated ownership; shareholder meetings were sometimes formalities dominated by controlling blocs. However, Europe has strengthened minority rights over time (e.g., EU directives require easier voting, say-on-pay votes, etc.). For example, in **France**, *double voting rights* exist for long-term holders (to encourage stable ownership), but any changes to bylaws or major transactions still go to shareholder vote, and minority shareholders have some rights to board representation (cumulative voting or proportional representation in certain cases). In **Germany**, shareholders of public companies primarily vote to elect the Supervisory Board members (except the ones reserved for employee representatives under codetermination) and on dividends, auditors, etc., but they traditionally did not have a direct say on management decisions – the Supervisory Board and Management Board had clear delegated domains. Recent changes (like say-on-pay, now mandatory in EU, including Germany) are giving German shareholders more voice on executive remuneration.

In many Asian economies, controlling family shareholders or state ownership is common. **South Korea** historically saw family-owned chaebols with complex cross-shareholdings; minority shareholder activism was rare. However, after governance scandals, there are signs of change: Korea introduced a Stewardship Code in 2016, and notable incidents like shareholders voting out the chairman of Korean Air's board in

2019 over governance concerns signaled rising minority assertiveness. **Japan** has moved from a largely management-insider-controlled model to one where shareholders have more influence: The Corporate Governance Code (2015, rev. 2021) pushed for independent directors and removal of anti-takeover measures, and investors (domestic and foreign) have started to successfully oppose management on certain issues (e.g., the 2019 ousting of CEO at Toshiba was driven by foreign shareholder pressure). Such developments illustrate global convergence toward empowering shareholders, though at varying paces.

In summary, shareholders are the **foundation of the corporate governance pyramid** – they provide capital and have ultimate authority on major issues, but delegate daily control to directors and executives. Their rights – voting, information, profit-sharing, etc. – are protected by law, and in turn shareholders are increasingly expected to be responsible stewards. As owners, they have the **power to shape the board** (through elections and removals) and thus indirectly the strategy and management of the company. The next sections will explore how the board of directors functions as the key intermediary between shareholders and executives, and how its composition and committees enhance governance.

3.3. Board of Directors: Composition, Functions, and Responsibilities

The **Board of Directors** sits at the apex of the company's internal governance structure (at least in a unitary system, or alongside the supervisory board in a dual system). The board is elected (wholly or mainly) by shareholders to represent their interests and is legally charged with overseeing the company's management and affairs. In the words of the Business Roundtable, the board “has the vital role of overseeing the company's management and business strategies to achieve long-term value creation”. This section examines how boards are composed, what functions they perform, and the fiduciary duties and other responsibilities imposed on directors under various legal systems.

A. Board Composition - Boards typically comprise a mix of **executive directors** (company insiders, such as the CEO or other senior executives) and **non-executive directors** (outsiders who are not part of management). Among non-executives, the gold standard in governance is to have a strong contingent of **independent directors**, meaning individuals with no material ties to the company or its management, so that they can provide impartial oversight. Best practice in many countries is that a majority of the board (or at least a significant portion) be independent. For example, U.S. stock exchange rules (NYSE, NASDAQ) require that listed company boards consist of a majority of independent directors, and that key committees (audit, compensation, nominating) be entirely independent. The U.K. Corporate Governance Code (2018) recommends that at least half the board, excluding the chair, be independent non-executives (and that the chair be independent upon appointment). Other markets have

similar codes or rules – Malaysia’s code specifies even more (a majority independent, with large companies needing two-thirds independent). **Japan**, traditionally lacking independent directors, amended listing rules to require at least two independent directors on boards (and many companies now have more, especially those that shifted to a “company with committees” structure). **South Korea** mandates that for large listed firms, at least 50% of the board consists of outside directors, and even requires one female director for public companies over a certain size by 2022 in an effort to improve diversity and independence.

The rationale for board independence is to prevent conflicts of interest and challenge management when needed. A board dominated by insiders or related individuals may become a rubber stamp for the CEO, undermining the governance role. Independent directors are expected to bring external perspectives, expertise, and a fiduciary mindset focused on the company’s and shareholders’ welfare. Diversity of background (expertise in finance, industry knowledge, international experience, gender/ethnic diversity, etc.) is also increasingly emphasized, since a homogenous board may suffer from “groupthink.” Many countries’ codes (e.g., Canada, Australia, the EU’s 2022 directive on board gender balance) encourage or mandate diversity on boards. Empirical studies and investor views suggest that a well-composed board – balanced in skills and independence – correlates with better oversight of strategy and risk, and ultimately better performance or lower incidence of scandals.

B. Leadership Structure - Within one-tier boards, there is often a distinction between the **Chairperson** of the board and the CEO. In the UK and many other countries, it is considered best practice to separate the roles of Chair and CEO (to avoid concentration of power). The Chair leads the board, setting its agenda and ensuring the board’s effectiveness, while the CEO leads management. By contrast, in the U.S. it has been common (though now slightly less so) for the CEO to also be Chair (a situation known as “CEO duality”). Many U.S. companies have moved toward splitting these roles or at least appointing a *lead independent director* when the CEO is also chair, to strengthen independent leadership on the board. In dual-board systems (like Germany’s), this issue does not arise in the same way since the CEO (or management board) cannot chair the supervisory board by law. Regardless, the leadership and dynamics of the board are crucial: a strong independent chair (or lead director) can significantly enhance board effectiveness in overseeing management.

C. Functions of the Board - The board’s functions can be summarized as **strategy, oversight, and accountability**. Key roles include:

- **Setting or Approving Strategy:** The board is involved in guiding the company’s strategic direction. While management drafts and executes detailed business strategies, boards typically review, question, and ultimately approve the long-

term strategy and major plans. They also monitor progress. For instance, the board should ensure the strategy is geared toward sustainable long-term growth and is consistent with the company's risk appetite. If the company veers off course or underperforms, the board should press for adjustments in strategy or leadership.

- **Selecting and Evaluating the CEO and Senior Management:** Perhaps the single most critical decision a board makes is hiring (and if necessary firing) the Chief Executive Officer. The board must choose a qualified CEO aligned with the company's values and goals, set their performance targets, and regularly assess their performance. If the CEO is failing or ethical issues arise, the board has a duty to act (e.g. IBM's board replacing its CEO in 2020 after sustained poor results, or Uber's board forcing out founder-CEO Travis Kalanick amid cultural scandals in 2017). Additionally, boards oversee succession planning – not just for CEO but for other top executives and even board members themselves. This ensures continuity and stability in leadership.
- **Overseeing Financial Reporting and Controls:** A core board responsibility is to ensure the integrity of financial statements and that adequate systems of control and risk management are in place. Boards (through their audit committees) work with external auditors and internal auditors to verify that financial results are accurate and accounting is prudent. Scandals like Wirecard (Germany, 2020) – where billions in supposed cash turned out fictitious – underscore the grave consequences when boards and auditors fail in this function. In Wirecard's case, the supervisory board's audit committee failed to uncover fraud for years; the aftermath led to reforms in Germany to tighten audit oversight and board accountability.
- **Risk Oversight:** The board must understand the major risks facing the company (strategic, financial, operational, compliance risks) and ensure management has appropriate risk management frameworks. Some boards set up dedicated risk committees (especially in financial institutions) or otherwise allocate risk oversight to the audit or other committees. The board should regularly discuss risk exposures (e.g., cybersecurity threats, market changes, credit risks, etc.) and ask whether these are being managed within tolerances. A failure in risk oversight can lead to disasters – e.g., boards of big banks were criticized after the 2008 financial crisis for not grasping the extent of risk-taking in complex securities. Delaware case law in the U.S. (the *Caremark* doctrine) has evolved to hold directors liable in rare cases where they utterly fail to implement any monitoring system for critical risks. A recent notable case is *Marchand v. Barnhill* (Del. Sup. Ct. 2019) involving an ice cream company, Blue Bell, which had a listeria outbreak. The court allowed a claim to proceed against directors because food safety was “mission critical” to the business, yet the board had no committee or reporting system for food safety – this was deemed a possible

breach of their duty of loyalty through lack of good faith oversight. This trend – a higher expectation on boards to actively oversee key risks – is seen not just in the U.S. but globally, especially for areas like health & safety, environmental risks, and compliance with law.

- **Monitoring Performance and Corporate Ethics:** Boards monitor company performance against goals (financial and non-financial). If performance lags, they must press management for answers and possibly change course. They also set the “tone at the top” for ethics and compliance. A board should ensure the company operates lawfully and ethically, with robust compliance programs. Scandals in companies like Volkswagen (emissions cheating scandal, 2015) or Uber (workplace misconduct, 2017) have been attributed in part to boards not being sufficiently inquisitive or informed about problematic company cultures. Around the world, there is increasing pressure on boards to consider broader **stakeholder interests** – not just shareholders – in their decision-making (more on this in section 3.7). For example, the UK Companies Act 2006 explicitly codified directors’ duty to promote the success of the company *while* having regard to employees, customers, community, environment, etc. (Section 172), thus mandating that U.K. boards think about long-term stakeholder factors. Many countries’ governance codes likewise encourage directors to balance stakeholders’ interests for the company’s long-term benefit.
- **Accountability and Reporting to Shareholders:** Boards serve as a link between management and shareholders, accountable to the owners for the company’s conduct and results. At the AGM, the board (through the Chair or CEO) answers shareholder questions. In many jurisdictions, certain decisions like executive remuneration policies or director remuneration require shareholder approval or advisory votes – boards prepare reports or policies to present for these votes (e.g., the “*say on pay*” vote now mandatory in the U.S., EU, UK, and elsewhere, which often occurs annually or triennially and is a referendum on the board’s pay decisions). If shareholders are dissatisfied (say, a string of failed say-on-pay votes or election votes against directors), a responsive board will take corrective action or engage in dialogue to address concerns. Ultimately, shareholders can remove directors (though the mechanisms vary – in the U.S. many boards are classified, meaning only part of the board is up for election each year; in the UK and many countries, all directors stand for re-election annually). Board accountability was starkly demonstrated in the **Carillion** case: after Carillion’s collapse, the UK Parliament’s inquiry concluded that the board was culpable and recommended investigation into whether the directors breached their duties and should be disqualified. Such post-mortems put other boards on notice that negligence or incompetence in oversight can lead to personal and reputational consequences.

D. Fiduciary Duties of Directors- Underpinning board responsibilities are the legal duties imposed on directors. While terminology differs, two core duties are universally recognized – a **Duty of Care** and a **Duty of Loyalty** (often encompassing good faith). The duty of care requires directors to act with the level of care that a reasonably prudent person would in similar circumstances, and to be informed and diligent in decision-making. The duty of loyalty requires directors to act in the best interests of the company (and its shareholders as a whole) and not to use their position for personal gain or to favor some stakeholders over others improperly. For instance, a director must avoid conflicts of interest – any self-dealing transaction (such as the company doing business with a director’s own business) must be disclosed and approved under strict procedures (and ideally be at arm’s length fair terms) or else the director can be liable for breach of loyalty.

Different countries enforce these duties in different ways. In the U.S., corporate law (especially Delaware law) has developed through cases: e.g., *Smith v. Van Gorkom* (Delaware Supreme Court 1985) famously held directors personally liable for breaching the duty of care by rushing into a merger without adequate information or deliberation. That case led to shockwaves and the subsequent allowance of exculpation clauses (shareholders can approve a charter amendment to shield directors from monetary liability for duty of care breaches, which most companies did). Still, duty of care violations can void decisions, and gross negligence by directors is not protected. The duty of loyalty is taken even more seriously – if directors are found to engage in fraud, bad faith, or self-dealing, they can be forced to disgorge profits, transactions can be undone, and they might face damages or regulatory penalties. For example, in a well-known case in Hong Kong, controlling shareholder-directors who tunneled benefits to themselves at the expense of the company were liable under breach of fiduciary duty.

The UK codified directors’ duties in its Companies Act 2006 (Sections 171-177), including duties to act within powers, promote the success of the company (with regard to stakeholders), exercise independent judgment, exercise reasonable care, skill and diligence, avoid conflicts of interest, not to accept benefits from third parties, and declare any interest in proposed transactions. Enforcement can include shareholder lawsuits (derivative actions) or regulatory enforcement (the Insolvency Service can seek director disqualification, as was recommended in Carillion’s case). In Germany, directors (management board members and supervisory board members alike) are subject to duties of care and loyalty under the Stock Corporation Act (AktG). Notably, Germany’s regime has historically been strict on paper – directors can be liable to the company for any negligent breach of duty – but litigation was rare. However, a milestone case (*ARAG/Garmenbeck*, 1997) changed the landscape by holding that the Supervisory Board *must* pursue damages claims against management board members for breaches of duty or else explain itself. This led to more enforcement, and after

corporate failures (e.g. some bank collapses, the financial crisis, and most recently Wirecard's implosion), German boards have indeed faced lawsuits and greater scrutiny. In one high-profile example, the former executives of Siemens AG paid substantial sums in a settlement over failure to stop a bribery scandal, reflecting enforcement of oversight duties.

Directors also face **liability risk** under securities laws (for misstatements in disclosure), and sometimes under specific statutes (e.g., environmental or health and safety laws can impose personal liability for board members in some jurisdictions for gross failures). However, a concept known as the **Business Judgment Rule (BJR)** exists in many jurisdictions (most explicitly in the U.S. and some others) to protect directors. The BJR means that courts will not second-guess honest, informed business decisions by directors even if they turn out badly, as long as the directors met their duties of care and loyalty in the process (no conflicts of interest, took reasonable steps to inform themselves, etc.). This latitude is given to encourage risk-taking and to avoid hindsight bias in judging decisions. For instance, Delaware courts will generally presume the BJR applies; only if plaintiffs show a breach (say, a conflict of interest or an egregious lack of due care) will the court scrutinize the substance of the decision. Many other countries similarly give deference to board decisions absent bad faith or gross abuse.

International Perspective on Board Roles

Despite structural differences, there is a trend of convergence in what is expected of boards globally. The **OECD Principles** state that boards should be responsible for overseeing management, providing strategic guidance, ensuring robust risk management, and being accountable to the company and shareholders (while considering stakeholder interests). In the U.S., the Delaware law doctrine and institutional investor pressures have pushed boards to actively monitor and engage (witness the rise in board time commitment and frequency of meetings in recent decades). The UK's code emphasizes a unitary board's collective responsibility for long-term success, requiring non-executives to constructively challenge and help develop proposals on strategy. **German** supervisory boards, once seen as distant overseers meeting only quarterly, are now expected to delve deeper into company strategy and risk (and the Corporate Governance Code urges things like forming committees, evaluating the board's own performance, etc., much like one-tier boards do). Japan's moves to include more outsiders is importing an Anglo-style monitoring function to their traditionally management-dominated boards. Even in **state-influenced systems** like China, there are boards of directors and supervisory boards by law, and efforts to improve independent oversight (though the presence of Communist Party committees in companies and the dominance of state shareholders can complicate typical governance practices).

In summary, the board of directors is the **linchpin** of corporate governance – it is where the oversight of the company’s direction and the monitoring of management comes together. A competent, engaged board can protect shareholders’ interests, steer the company away from risks, ensure compliance, and add significant value through their strategic input and networks. A weak or captured board, however, can be disastrous: management may run rampant (as seen in several corporate frauds), or the company may drift without clear strategic guidance. The next section will look more closely at one way boards organize themselves to be effective – through specialized **board committees** that handle complex areas like audits, executive pay, and director nominations.

3.4. Board Committees: Audit, Remuneration, and Nomination

To fulfill their wide-ranging responsibilities, boards often delegate detailed work to smaller groups of directors known as **board committees**. Committees allow focused expertise and closer oversight of specific areas, reporting back to the full board with recommendations. Virtually all large corporations internationally use committees, and many regulatory regimes mandate certain committees for listed companies (especially an **Audit Committee**). The three most common and important committees are: **Audit Committee**, **Remuneration (Compensation) Committee**, and **Nomination (Nominating/Governance) Committee**. We discuss each in turn, covering their composition, roles, and any key regulatory requirements or case examples.

- **Audit Committee**

The Audit Committee is arguably the most critical board committee. It is charged with overseeing the company’s financial reporting and disclosure process, as well as the system of internal controls and risk management related to financial matters. A typical audit committee’s duties include: reviewing annual and quarterly financial statements and accounting policies, engaging with the external auditor (selection, compensation, and receiving audit results), supervising the internal audit function, and monitoring compliance with accounting standards and regulatory requirements. The committee often meets separately with the auditors and finance management, providing a channel for auditors to convey any concerns about management’s reporting practices. Given its crucial gatekeeping role, **independence and financial expertise** are key requirements: in the U.S., Sarbanes-Oxley Act (2002) requires all audit committee members of listed companies to be independent directors and at least one to be a “financial expert.” Similarly, EU legislation mandates audit committees (for public-interest entities) to be mostly independent and at least one member with accounting/audit expertise. The UK code expects the audit committee to have at least three non-executive directors (two for smaller companies) all independent, with one having recent financial experience.

Audit committees came under the spotlight after scandals like Enron and WorldCom – in Enron’s case, the audit committee failed to detect or question the complex off-book entities used to hide debt. As a result, reforms (SOX in the US, etc.) significantly empowered audit committees. More recently, failures such as Wirecard (Germany) and Carillion (UK) have led to critiques of audit committees. In Wirecard, despite having an audit committee, serious fraud went undetected; an inquiry found that the committee lacked sufficient skepticism and perhaps expertise. Germany’s 2021 reforms in the wake of Wirecard strengthened requirements for audit committees and gave them more oversight of the external audit. In Carillion, the UK parliamentary report criticized the audit committee for being unable to rein in aggressive accounting and for over-reliance on assurances from management and auditors – all non-executives including the chair of the audit committee were accused of lacking true financial curiosity as the company headed for disaster. These cases underscore that *having* an audit committee is not enough – it must be effective. Therefore, many boards continually refine their audit committees’ functioning: ensuring private sessions with auditors, deep dives into key risk areas, and training for members on emerging issues (like new accounting rules or cyber risks impacting financial controls).

- **Remuneration Committee (Compensation Committee)**

This committee oversees compensation policies for senior executives and sometimes the broader workforce. Its primary role is to set and **review the pay of the CEO and top management**, including salary, bonuses, stock options or other long-term incentive plans, pensions, and severance terms. It usually also recommends the fees or compensation for board members (in some jurisdictions, director pay may need shareholder approval). The goal is to ensure that executive remuneration is aligned with the company’s strategy and shareholders’ interests – i.e., rewarding long-term value creation, not short-term risk-taking or failure. The committee often benchmarks pay against peer companies and uses performance metrics (like EPS growth, return on capital, etc.) to design incentive plans. Independence is crucial here too: in most markets, the remuneration committee must consist entirely or mainly of independent directors, to avoid CEOs essentially setting their own pay. U.S. exchanges require independent comp committees; the UK code requires a comp committee of independent NEDs (and the chair of the board can be on it but not chair it, if independent). Excessive executive pay and misaligned incentives have been a persistent governance issue – e.g., outrage over large bonuses in failing companies has fueled stronger “say on pay” rights. Say on pay refers to shareholders getting a vote (advisory or binding) on the remuneration report or policy. The UK introduced a binding vote on pay policy every 3 years (or when changed) and annual advisory votes on implementation; if a company loses the advisory vote, it triggers a binding vote the next year. The EU followed with say on pay in Shareholder Rights Directive II (2019).

The U.S. Dodd-Frank Act (2010) instituted advisory say on pay votes annually in most cases (and recently, new rules on clawbacks of incentive pay in event of financial restatements). These moves have made remuneration committees much more accountable – a string of failed say-on-pay votes often leads to the committee chair’s resignation or changes in pay plans. A case in point: in 2012, Citigroup’s shareholders voted against the CEO’s pay package, a rare revolt that prompted the board to revamp the pay structure. In the UK, a notable revolt was at BP in 2016 when 59% voted down the CEO’s pay – BP’s remuneration committee had to substantially cut and redesign pay awards the following year. Thus, remuneration committees now engage more with major shareholders to understand their expectations and avoid backlash. In designing pay, these committees face the challenge of balancing competitive compensation to attract talent with fairness and stakeholder acceptability (e.g., addressing wage gaps). Many committees also consider ESG factors – for instance, including safety or sustainability goals in bonus criteria (common in extractive industries to emphasize safety, or carbon reduction targets in energy companies’ executive scorecards). Scandals where pay seemed uncoupled from performance (like the former CEO of GE’s lavish exit package amid poor results, or the bonuses paid at Wells Fargo before its fake accounts scandal came to light) demonstrate how misaligned incentives can damage corporate reputation. The remuneration committee’s work, while often technical, is central to promoting an ethical “tone at the top” and avoiding perverse incentives.

- **Nomination Committee (Nominating/Governance Committee)**

This committee oversees the process of selecting new directors and evaluates the board’s composition and governance practices. Its responsibilities typically include: identifying the skills and experience needed on the board, searching for and vetting board candidates, recommending nominees for election, and managing board succession planning and evaluations. In many companies, it also monitors corporate governance principles and may take on a broader governance role (thus often called the Nominating & Governance Committee). Independence is expected here as well – one doesn’t want the CEO hand-picking pliant board members. The Business Roundtable notes that the nominating/governance committee “plays a leadership role in shaping the corporate governance of the company” and strives for an *engaged and diverse board*, also conducting succession planning for the board. Key issues for nomination committees today include increasing diversity (skills, gender, race, nationality) on boards, setting policies like age or term limits for directors, and ensuring there’s a pipeline of qualified candidates (often using professional search firms). They also typically oversee the board self-evaluation process – annually assessing the board’s performance and that of individual directors, to identify gaps or underperforming members. Some global trends influenced by nomination committees: in Japan, more

companies have established nomination committees (advisory, even if not the “committee” board structure) to add transparency in selecting new independent directors, which is an improvement from old opaque networks. In controlled companies, independent nomination committees can help reassure minority investors that board appointments aren’t solely at the whim of the controlling shareholder. For example, in *France*, the AFEP-MEDEF Code suggests that the nomination committee (largely independent) should handle appointments even if the company has a reference shareholder, to ensure broad buy-in. One famous case highlighting nomination issues was the battle at *Yahoo!* in 2008, where an activist hedge fund sought to replace the board for rejecting a Microsoft takeover offer – eventually a settlement led to new independent directors. The nomination committee’s processes were scrutinized in that saga, showing that shareholders will intervene if they feel the board is entrenched or not refreshed adequately. In South Korea’s chaebol context, new rules in 2020 require listed firms to have at least one independent director candidate recommended by an independent nominating committee, aiming to curb insider-only boards. Overall, nomination committees serve as the **gatekeepers of board quality**, directly impacting whether the board has the right people to govern effectively.

In addition to these three, many boards establish other committees suited to their needs: **Risk Committees** (especially in banks or complex firms to focus on non-financial and financial risks), **Corporate Social Responsibility (CSR)/Sustainability Committees** (to oversee ESG initiatives), **Science/Technology Committees** (in tech or pharma companies to supervise R&D and cyber risks), and so on. For example, large banks often have a separate Risk Committee because of the volume and technicality of risk oversight beyond financial reporting (Basel regulations even expect it). Some companies create an **Executive Committee** (composed of a subset of directors, sometimes including top executives) to act on urgent matters between board meetings – though this practice is less common in jurisdictions like the U.S./UK now, where special board meetings can be convened quickly if needed. In two-tier systems, since the management board handles many operational matters, the supervisory board’s committees (audit, etc.) mirror those in one-tier systems, but there might also be a **Mediation Committee** (like in France for two-tier companies) to resolve board disputes, or a **Compliance Committee** as seen in some German firms post-scandals.

Regulators and investors expect committees not only to exist but to function transparently. Committee charters are usually publicly disclosed, and since a few years ago, many jurisdictions require companies to disclose a report from key committees (audit committee report is often mandated in annual reports discussing how it fulfilled its duties; remuneration committee must publish a detailed compensation report; nomination committees often report on board appointments and diversity efforts). These disclosures improve accountability of committees. A notable regulatory

development is the push for **audit committee accountability**: for instance, the U.K.'s audit regulator (FRC, transitioning to ARGA) now scrutinizes the audit committee's effectiveness when evaluating audit quality, and could even recommend replacement of committee members if they repeatedly fail.

In sum, board committees are *extensions* of the board that allow deeper oversight and specialized focus. An audit committee focuses on **truth in numbers** (financial integrity), a remuneration committee focuses on **fair and effective executive incentives**, and a nomination committee focuses on **board caliber and succession**. If each does its job well, the board as a whole can be more effective and the company's governance stronger. Failures in committees, as we saw with some examples, often presage larger governance failures. Conversely, many corporate success stories involve boards that were proactive through their committees – e.g., some companies navigated the 2020 COVID-19 crisis better because their risk committees had scenario plans in place, or their compensation committees adjusted targets to balance stakeholder concerns (avoiding reputational damage over bonuses). Committees thus play a vital, if sometimes behind-the-scenes, role in corporate governance internationally.

3.5. Executive Management: CEO and Other Directors – Roles and Liability

While shareholders and boards establish the governance framework and oversight, it is **executive management** that runs the company on a day-to-day basis. Executive managers – typically led by the Chief Executive Officer (CEO) – are the agents who make operational decisions, implement the strategy approved by the board, and drive the enterprise forward. This section outlines the roles of the CEO and other top executives (who may also serve as board directors in unitary boards), and examines their accountability and legal liabilities under different governance regimes.

Roles of the CEO and Executive Team

The **Chief Executive Officer** is the highest-ranking executive, responsible for the overall management of the company. As per common corporate practice and law, the CEO's role includes: setting operational plans to meet the strategic and financial goals set by the board, making top-level managerial decisions (such as hiring other executives, allocating capital within the firm, entering contracts within authorized limits), and serving as the main link between management and the board. The CEO is often the public face of the company to investors, press, and business partners. In many systems, the CEO has considerable inherent authority – for example, under U.S. law the CEO (as part of management) has broad implied powers to run the business (subject to board oversight), and under German law, the **Vorstand** (management board) led by its chair (often called CEO in English) has exclusive authority to manage the company's affairs, independent of the supervisory board's direct interference

(except in defined oversight capacities). A CEO's specific powers will also be constrained or defined by the company's bylaws or governance policies; for instance, some boards require that certain major decisions (like projects above a dollar threshold, or significant investments) must get prior board approval, thus curbing unilateral executive action.

Reporting to the CEO are other **executive directors or officers**: typically a Chief Financial Officer (CFO), Chief Operating Officer (COO), business unit heads, etc. Many large firms have a C-suite (CFO, COO, Chief Marketing Officer, Chief Technology Officer, etc.) that collectively with the CEO form the executive leadership team. In a unitary board system (like the U.S. or UK), some of these executives may also sit on the board of directors (they are then called *executive directors* in UK parlance, or inside directors in U.S. terms). For example, the CEO often holds a board seat (and sometimes is chair as noted earlier), and sometimes a CFO or another key executive is also on the board. In contrast, in a dual-board system (Germany, etc.), none of the executive managers are on the supervisory board by design, but all of them collectively form the **management board**, and the CEO (often titled Vorstandsvorsitzender or Sprecher) chairs that board. Regardless of structure, the essence is that executives are charged with **running the company efficiently and effectively**, within the bounds of the strategy and risk appetite set by the board, and in compliance with laws and ethical standards.

A good executive team translates board decisions into action. For instance, if the board approves an expansion into a new market, it is the executives who will formulate the plan, allocate budgets, hire staff, and execute the expansion – while keeping the board apprised of progress and challenges. Executives also maintain the **organizational culture** – through their leadership style and policies, they influence the company's values and behavior (which the board can shape by choosing the right CEO and setting the tone).

Liability and Accountability of Executives

Executive managers, especially the CEO and CFO, hold immense responsibility and can face various forms of accountability:

1. **Accountability to the Board.** The first line of accountability is that the CEO and executive team report to the board of directors. The board conducts regular evaluations of the CEO's performance (often annually). If performance targets are not met or if there are ethical lapses, the board can take action – ranging from coaching and setting improvement plans to, in extreme cases, terminating the CEO's employment. This has happened in numerous instances globally: for example, Boeing's CEO was forced by the board to step down in late 2019

following the 737 MAX safety crisis, as the board lost confidence amid mounting problems. In 2021, Danone (the French yogurt maker) saw its board remove the CEO/Chairman Emmanuel Faber after activist pressure about the company's underperformance – a noteworthy case in stakeholder-focused France, showing that boards are willing to act when needed. The removal or forced resignation of a CEO is a dramatic exercise of board power but is a critical mechanism to hold management accountable when shareholder value or stakeholder trust is at serious risk.

2. **Fiduciary Duties and Civil Liability.** In many jurisdictions, senior officers like the CEO and CFO are considered to have fiduciary duties similar to those of directors (in some cases because they are *de facto* or *ex officio* directors, and in others through specific statutes or common law). They must act in the company's best interest, in good faith, and with due care. If they commit breaches – e.g., self-dealing, gross negligence causing harm to the company – they can be sued by the company or shareholders. Shareholders might bring *derivative lawsuits* on the company's behalf for harm caused by executive wrongdoing (for instance, shareholders of an American company might sue officers for breaches of duty following a major compliance failure that cost the company money). One famous example is the litigation against the officers and directors of Enron and WorldCom after those companies collapsed; while insurance and settlements covered much of it, some executives were personally liable or paid settlements (WorldCom's former CEO settled civil claims by paying millions out of pocket). In civil law countries like Germany, the company can sue management board members for damages caused by negligent breaches of duty – e.g., Deutsche Bank's supervisory board sued co-CEO Jürgen Fitschen and others over a costly Kirch litigation mishandling, although they were ultimately cleared. In practice, companies often hesitate to sue their own executives (except in bankruptcy or extreme shareholder pressure situations), but the possibility adds to accountability.
3. **Criminal Liability.** Executives can face criminal charges if they engage in criminal conduct in the course of their management. There are straightforward cases like fraud (e.g., cooking the books, embezzlement) – for which many executives have been prosecuted (Enron's CEO Jeffrey Skilling was convicted of fraud and insider trading, sentenced to jail; the CEO of HealthSouth, Richard Scrushy, was prosecuted for accounting fraud, etc.). Even without outright fraud, certain regulatory regimes impose personal criminal liability on CEOs/CFOs for specific failures. A notable example is the **Sarbanes-Oxley Act (SOX) of 2002** in the U.S.: Section 302 requires the CEO and CFO to personally certify the accuracy of financial reports, and Section 906 attaches criminal

penalties for knowingly certifying false financial statements. Under SOX §906, if a CEO/CFO willfully certifies a report that is not compliant (e.g., contains false statements), they can face fines up to \$5 million and imprisonment up to 20 years. This provision was used to charge a few executives in high-profile cases; it significantly raises the stakes for CEOs/CFOs to ensure financial reports are truthful. Another area is **health and safety or environmental crimes** – for instance, in some jurisdictions, if a company’s gross negligence leads to a worker’s death or environmental damage, executives might face manslaughter or environmental law charges (e.g., after mining disasters or oil spills, prosecutors have at times charged company officials). Generally, the law is increasingly clear that the “directing mind” of corporate misconduct can be held to account. South Korea, as an example, in recent years convicted top executives in chaebols for corruption (the Samsung bribery case being a prime example) and even passed legislation (such as the Serious Accidents Punishment Act, 2021) that can impose criminal liability on CEOs for failing to prevent serious industrial accidents, indicating a trend toward greater personal accountability.

4. **Regulatory and Administrative Sanctions.** Even short of criminal, executives can be banned or fined by regulators. Securities regulators (like the U.S. SEC) can seek officer and director **bar orders** to prohibit individuals from serving in leadership of public companies if they commit securities law violations. This happened to some of the Wells Fargo executives after the fake accounts scandal: U.S. regulators fined the former CEO and sought to ban him from the banking industry. In India, the markets regulator SEBI has barred some promoters/executives from the market after fraud findings (e.g., the Satyam scandal’s aftermath). In China, there have been cases where CEOs of companies involved in financial fraud were arrested and also banned from securities markets.

***Examples of Executive Accountability in Action:**– German Dual System: In Germany’s two-tier system, the supervisory board can dismiss management board members for cause (and sometimes without cause with notice), providing an internal check. A historic example: Klaus Kleinfeld, CEO of Siemens, resigned in 2007 amid a corruption scandal after pressure from the supervisory board and shareholders. More recently, in 2015 Volkswagen’s CEO Martin Winterkorn stepped down days after the Dieselgate emissions cheating scandal broke; while he claimed ignorance, the expectation of accountability led to his resignation (and he was later criminally charged in Germany, still pending as of 2025). The **liability regime** in Germany got teeth with the ARAG case requiring boards to sue misbehaving managers, and indeed after the 2008 crisis, several German bank CEOs faced lawsuits or settlements for taking excessive risks (e.g., HRE bank’s CEO was sued for*

negligence contributing to its collapse). Also, German law makes insurance (D&O insurance) carry a deductible for managers to ensure they feel some sting; since 2009, publicly traded companies' D&O policies must have managers personally bear at least 10% of the loss up to one and a half times their annual salary (though companies sometimes offset that through higher pay).

– **United States:** A signature moment for CEO liability was the Enron/WorldCom era – WorldCom's CEO Bernie Ebbers died in prison while serving a 25-year sentence for fraud. Since then, while not many CEOs of major companies have gone to jail, the threat exists. The 2002 Sarbanes-Oxley Act not only introduced certifications but also gave the SEC power to claw back incentive compensation from CEOs/CFOs if financials are restated due to misconduct (Section 304). This clawback was used, for example, against executives of Enron and more recently against Wells Fargo executives (where the board clawed back tens of millions in pay from the CEO and others after the scandal). In 2023, new SEC rules under the Dodd-Frank Act will require all U.S. listed companies to implement clawback policies to recoup executive pay in event of any material restatement (not just misconduct-related), further tightening accountability. The Delaware courts have also evolved doctrines such as *Caremark* (oversight duty) that can hold not just directors but officers accountable; in 2019, a Delaware court notably allowed a *Caremark* claim to proceed not just against directors but also against an officer (a legal first, signaling that officers have an oversight duty too in their domain). The message: executives cannot turn a blind eye to critical compliance issues either.

– **Asia and Other Regions:** In Japan, the tide turned somewhat with executives being held to account after scandals like Olympus (2011, where the CEO and others faced legal action over accounting fraud), and Toshiba (where the CEO and several executives resigned in 2015 after an accounting scandal, and some were sued). In South Korea, as noted, the chaebol leaders have historically been spared heavy punishment, but the jailing of Samsung's vice chairman Lee Jae-yong in 2017 for bribery was hailed as a "turning point" that chaebol executives *are* subject to law. He did serve some prison time (though was later given a suspended sentence and eventually pardoned, reflecting the still lenient treatment for top conglomerate leaders, but the embarrassment and process itself were significant). Similarly, the heads of SK Group and Lotte Group faced convictions in the mid-2010s. These instances suggest a global trend that **no individual is completely above scrutiny**. Even in China, high-profile cases like the arrest of the Anbang Insurance CEO (who got 18 years for fraud) or investigations into tech CEOs show increasing enforcement.

Finally, we should mention **contractual and market accountability**: CEOs usually have employment contracts that the board can terminate – often at some cost (a severance package), but the threat of termination is a key disciplinarian. Additionally,

market forces (the “market for corporate control” or threat of takeover) can indirectly hold executives accountable: if management underperforms and the stock price languishes, the company can become a takeover target, and the incoming acquirer will likely replace the executives. This dynamic is strong in jurisdictions like the U.S. and UK with active M&A markets. For example, when a company is taken over, often the CEO is swiftly replaced (unless it’s a friendly merger where they have a negotiated role). Knowing this, managements have incentive to keep shareholders satisfied to avoid being ousted via takeover.

Separation of Roles and Checks

The interactions between executives and boards are structured to maintain checks and balances. We’ve discussed separating the CEO and chair roles as one such check. Another check is the **internal control environment** – often, the CFO or Chief Compliance Officer might report not only to the CEO but also have a line to the board or audit committee, ensuring executives cannot easily hide problems. Many companies institute whistleblower systems (required under SOX for audit issues) so that even if the CEO tries to suppress an issue, the board might hear of it through protected channels. The CEO and executive management carry out the **engine work** of the corporation – making the myriad decisions that collectively determine success or failure. They wield great power but are bound by fiduciary duties and oversight mechanisms. The evolving legal landscape has made it clear that with great power comes great responsibility: CEOs and their teams will be held accountable – by boards, courts, regulators, and markets – if they betray trust or perform egregiously poorly. This ensures that the corporate structure does not devolve into unchecked managerial dominance; executives remain answerable to the board (and through the board, to shareholders and stakeholders).

Next, we compare different structural models of governance – the one-tier vs. two-tier board systems – to see how roles are organized in each, and then we will consider how the triad of shareholders, board, and management interact in balancing power.

3.6. Structural Models: Unitary vs. Dual Board Systems (International Comparison)

One of the most distinctive variations in corporate governance across countries is the board structure: some countries use a **unitary (single-tier) board** model, while others use a **dual (two-tier) board** model. There are also hybrid options and choices available in certain jurisdictions. In this section, we will explain the two models, discuss their differences, advantages, and disadvantages, and provide international examples (U.S., U.K. as unitary; Germany as dual; as well as France, Japan, South Korea, etc. and any recent convergence or legal changes).

A. Unitary Board System:

In a **unitary system**, there is one governing board of directors that includes both executive and non-executive directors. This single board is collectively responsible for all the functions of directing and overseeing the company. The U.S., U.K., Canada, Australia, Japan (in its traditional and new committee-based governance forms), India, and most other Commonwealth and Asian countries have a unitary board as the standard model. In such a board, executive directors (like the CEO, CFO) and non-executives sit together, share the same information, and jointly make decisions. Typically, as discussed, there is a non-executive chair (except in cases of CEO duality), and decisions are taken by the board as a whole (often by majority vote if consensus isn't reached).

B. Dual Board System:

In a dual system, there are **two boards** with separate roles: a Management Board (sometimes called Executive Board) that runs the business, and a Supervisory Board that oversees the management board. The hallmark of this system is a *clear separation between management and control*. The supervisory board typically does not include any current executives; it is composed entirely of non-executives (often including employee representatives in some countries) and is chaired by a non-executive. The management board consists of full-time executives (CEO, CFO, etc.) who are not on the supervisory board. The **Supervisory Board** appoints and can dismiss members of the Management Board and must approve major decisions, but it does not engage in day-to-day management itself. This two-tier structure is mandatory in countries like Germany and Austria for large companies, and it is an option or common practice in others like the Netherlands, Poland, and until recently was common in China for some state enterprises. **France** permits companies to choose either one-tier or two-tier boards; some big French companies (like Airbus, which follows German-type practices, and Société Générale for a period) have two-tier boards, though most French firms stick to one-tier with a board of directors. **Italy** also interestingly allows three models: traditional (one-tier with a board of statutory auditors in addition), two-tier, or a hybrid.

Advantages & Disadvantages: Each model has its purported strengths:

- ***Two-tier (dual) Advantages:*** The sharp separation of roles can enhance independent oversight. The supervisory board, not being involved in daily management, may have a broader, less conflicted perspective and more time to focus on long-term issues and shareholder/stakeholder interests. It clearly distinguishes those who manage from those who monitor. In Germany, this is further bolstered by **codetermination** – the requirement that employees elect

representatives to the supervisory board (almost half the members in large firms), ensuring employee interests are considered. Proponents say this leads to more balanced decisions (stakeholder model) and prevents top managers from having unchecked power since they cannot chair or dominate the supervisory board. The supervisory board's ability to fire the management board quickly if needed is a tool of discipline (e.g., Porsche's supervisory board famously ousted its CEO Wendelin Wiedeking in 2009 when his strategy imperiled the company). Dual systems might also avoid information overload for one board – executives handle operations, while supervisors focus on big picture, audit, and appointing/firing execs.

- ***Two-tier Disadvantages:*** Critics argue the two-tier system can sometimes lead to slower decision-making and potential information gaps. Because the supervisory board is not “in the trenches,” it relies on information supplied by the management board and can risk being out of touch or overly deferential if not proactive. There can be duplication or blurred accountability: if something goes wrong, is it the fault of management for doing it, or the supervisory board for not catching it? (In German law, both can be liable.) Moreover, having employees on the board (in codetermined systems) is lauded for inclusion but sometimes criticized by shareholders for possibly diluting the focus on shareholder value and creating potential conflicts (e.g., employee board members might resist layoffs needed for competitiveness, etc.). Empirical studies on codetermination's impact are mixed and hotly debated, as Hopt notes – economists often view it skeptically while sociologists praise it.
- ***One-tier (unitary) Advantages:*** The unitary board allows all directors, executives and non-executives alike, to deliberate together with access to the same information. This can ensure that independent directors are fully apprised of the company's situation (because they hear reports directly from management at board meetings). Having some executives on the board (like the CEO) can be helpful – they bring intimate knowledge of the business and industry, and the board's discussions can be better informed and more timely. It can also create a collegial team feeling that might enhance trust and quicker decisions. And if independent directors are the majority, as is increasingly mandated, they can still outvote or challenge insiders effectively. Unitary boards have been historically flexible – e.g., a strong independent chair in the UK model can more or less replicate the oversight of a separate body while still benefiting from executive input at the table. Many also argue that whether a board is one-tier or two-tier, what matters more is the *quality* of the individuals and the ethos of governance – thus there's no inherent superiority to either; they are functionally converging.

- ***One-tier Disadvantages:*** The potential downside is that management might dominate the board, especially if the CEO is also the chair or if the independent directors are not truly independent or effective. Enron had a unitary board with a majority of ostensibly independent directors, yet failed to check management – some argue that social dynamics or conflicts (the CEO often effectively “recruits” the board in many U.S. companies) can compromise oversight. Without a formal structural separation, it relies on voluntary best practices to empower non-executives. In countries without a culture of assertive independent directors, unitary boards can become perfunctory. For example, many Japanese boards pre-2000s were unitary but comprised almost entirely of executives (often 20+ inside directors and maybe 1 outside) – effectively meaning no independent oversight. That is changing now with more outsiders. Also, unitary boards may face more lawsuits directly since they bear all responsibilities in one group – but that could be seen as an advantage for accountability too.

International Comparison and Trends

Historically, the system used was determined by law in each country, but there’s been a trend toward *flexibility*. As noted by Professor Hopt, many jurisdictions now allow companies to choose their board structure – e.g., **France, the Netherlands, Belgium, Finland, Denmark** have introduced options for unitary or dual boards, and the European Union in its Statute for a European Company (Societas Europaea, SE) explicitly lets companies pick one-tier or two-tier governance when they incorporate as an SE. This reflects the view that neither system has a clear overall superiority and that companies value choice to suit their circumstances or traditions. For instance, some French companies that had scandals opted to switch to a two-tier system to rebuild trust (like Vivendi considered it after early 2000s issues), whereas some German companies have floated the idea of moving to one-tier if allowed, to simplify governance (though German law still generally mandates two-tier for AGs).

The UK and U.S. have stuck firmly to unitary boards but have imported certain “two-tier” elements informally: e.g., **lead independent directors** in the U.S. who preside over independent director sessions mimic an independent chair’s role; also, more robust board committees take on oversight akin to a supervisory function. Conversely, Germany’s two-tier boards have adopted practices like forming their own committees (audit, etc.) and doing annual evaluations – functions that unitary boards do – showing a degree of convergence in behavior if not formal structure.

Japan is an interesting hybrid now: traditionally it had a single board of directors plus separately a statutory **Board of Auditors** (kansayaku board) that oversaw auditing and legality but did not have authority to hire/fire management. This was somewhat a two-

tier element, but weaker than a German-style board. Since 2003 and especially 2015, Japan amended its laws to allow companies to either (a) stick to that statutory auditor system, (b) move to a “Company with Committees” (which is essentially a unitary board with three committees – audit, nom, comp – like a U.S. board; if they do this, they must have a majority of outside directors), or (c) a hybrid “Company with Audit Committee” (unitary board, but instead of separate statutory auditors, an audit committee of the board, and need at least 2 outsiders). Many large Japanese firms have embraced model (c) or (b), effectively moving closer to the Anglo-American one-tier system but with required committees and more outsiders. So Japan shows an example of internal evolution toward unitary/independent oversight combination.

Employee Participation (Codetermination)

One major difference not yet elaborated is the stakeholder inclusion in board structures. The classic dual system goes hand-in-hand with labor codetermination in countries like Germany and Austria – e.g., German law requires that in large companies (over 2000 employees), half of the supervisory board seats (except one tie-breaker vote) are elected by employees (including union representatives). This is not inherently a feature of two-tier (e.g., the Netherlands has workers elect some supervisory board members, but France for one-tier also now mandates a couple of worker representatives on boards of big firms). It’s more of a jurisdictional choice. However, codetermination is easier to implement in a two-tier context because employees sit on the supervisory board while the management board remains professionals – so you involve employees in high-level oversight without them directly managing. In a single-tier board, adding a large fraction of employee-elected directors could blur lines as they’d be part of the same board making all decisions. Some European countries now require even unitary boards to include workforce directors (e.g., France and Italy require at least one or two employee directors if company exceeds certain size or state ownership; the UK has since 2018 encouraged – but not mandated – either a worker director, worker advisory panel, or designated workforce NED to improve employee voice). These developments show that regardless of model, stakeholder representation is a topic – yet, a two-tier board arguably institutionalizes it more deeply (as in Germany).

Case Studies: How do these systems fare in practice? We can look at corporate failures and successes:

- **Volkswagen (Germany, two-tier):** VW’s governance is two-tier with codetermination and also a unique ownership (the state of Lower Saxony owns 20%, and Porsche/Piech family owns a big stake). The Dieseltgate scandal (2015) raised questions whether VW’s supervisory board was too cozy or insufficiently informed to catch management’s emissions cheating. The board included labor

reps who may not have expertise in emissions, political appointees, etc. Some argue the dual system didn't prevent a massive governance failure. On the other hand, after the scandal, the supervisory board did push out the CEO (Winterkorn) quickly and later installed a new chairman with an eye to compliance changes. It demonstrates that structure alone doesn't guarantee performance; board vigilance is key.

- **Enron (USA, unitary):** A unitary board with many ostensibly independent directors (including academics and ex-government folks) failed to detect fraud and allowed conflicts of interest (e.g., it waived company policies to let the CFO run off-books partnerships). That failure spurred reforms but also led some to question if a two-tier might have caught it. Possibly if a truly separate body was overseeing, the CFO's shenanigans might have been scrutinized more. But again, it was more a failure of gatekeepers and ethics than structure per se.
- **Allianz & other German firms:** Many German companies navigate the two-tier system effectively – e.g., Allianz SE (which actually adopted the European Company form and kept two-tier) and Siemens have modernized supervisory boards with international experts and robust committees. A well-functioning two-tier board can certainly oversee well – Siemens' supervisory board took strong action during a bribery scandal (dismissing executives, cooperating with authorities). However, sometimes the two-tier can mean slower moves in M&A – e.g., some German firms have complained that having to get supervisory board approval for major decisions adds complexity.
- **South Korea (unitary with controlling shareholders):** South Korea formally has unitary boards, but in chaebols they were often packed with insiders/affiliates. Reforms require outside directors (50%), but historically the unitary boards did not stop many governance failures (e.g., corruption cases, the 2014 ferry disaster case with shipping companies, etc.). There, perhaps a truly independent oversight body might have helped – or simply more independent directors with backbone within the unitary board.
- **France (optional structure):** We have examples of companies switching models: Peugeot (PSA) moved to a two-tier board for a while in mid-1990s when it took state aid, then reverted to unitary later. Each time, they argued for the benefits of whichever they chose in context. It suggests that context matters: a family firm might like a two-tier to keep family in management and have an independent-ish board above; a more diffuse firm might prefer one-tier for agility.

Klaus Hopt observes a *functional convergence* – many differences blur in practice. The key convergence points: one-tier boards have beefed up independence and committee structures (acting a bit like separate oversight units), and two-tier boards have more communication and often joint meetings (in Netherlands, sometimes some joint session of management and supervisory boards for info exchange) to ensure information flow (thus behaving a bit more like one-tier in information sharing). Also, legal changes like the European SE and national reforms have made it easier to choose. A company incorporated as an SE can actually switch between one-tier and two-tier by amending its statutes, offering flexibility that was impossible in pure national law before.

In essence, **neither system guarantees success or doom**. Both can work well if well-implemented, and both can fail if mismanaged. The choice often comes down to historical and cultural factors. The U.S. is unlikely to ever adopt two-tier broadly – it is ingrained that a unified board is the norm. Germany similarly holds onto two-tier for cultural/political reasons (especially with labor representation being politically non-negotiable). But each side learns from the other: German boards have tried to emulate the activist engagement style of U.S./UK boards (e.g., inviting major shareholders to supervisory board committees occasionally), and U.S./UK boards increasingly consider stakeholders which is an ethos long part of German two-tier model.

Finally, from an investor's perspective, understanding the board structure is important in evaluating a company. But increasingly global investors focus less on form and more on substance – e.g., “Are there enough independent voices overseeing management? Is the board accountable to owners? Are stakeholders considered appropriately?” Those questions can be addressed under either model.

To close this comparison: it's noteworthy that the European Commission at times debated harmonizing board structures but ultimately respected diversity. Companies can even arbitrage the system via incorporation choices now. For example, a German company might register as an SE in order to reduce board size or avoid some codetermination rules (some did so to go from parity codetermination to one-third employee representation if they could qualify under certain transitional rules). Conversely, some British companies that demutualized in insurance chose dual boards for a period to emphasize oversight (although UK law doesn't natively support two-tier, one can create similar structures contractually). These experiments aside, the global trend is to *allow flexibility and emphasize principles of good governance over rigid structure*.

As Hopt succinctly puts it, comparative law doesn't show an absolute superiority of either one-tier or two-tier – there's a degree of convergence and it's the implementation and “path dependencies” that matter.

3.7. Interaction and Balance Between Shareholders, Board, and Management

Having examined each component of the corporate structure separately, we conclude the chapter by considering **how these groups interact and balance each other's powers** in a well-functioning governance system. Corporate governance can be seen as a system of *checks and balances*: shareholders, boards, and executives each have distinct roles but must work collaboratively, and each can potentially constrain the others to prevent abuses and promote the company's best interests. Achieving the right balance is an art that evolves with legal norms, market expectations, and company specifics.

A. The Classic Governance Triangle

A simplified view is that shareholders *elect* the board, the board *supervises* management, and management *serves* the shareholders (by pursuing corporate success), with the board as an intermediary. Ideally, this creates a virtuous cycle: management, accountable to the board, works effectively; the board, accountable to shareholders, keeps management aligned with owners' interests; shareholders, in turn, trust the board and management, providing support and capital, but will intervene if performance falters. As the Business Roundtable describes, effective governance requires a clear understanding of each actor's role and *their relationships with each other*.

B. Shareholders ↔ Board

Shareholders entrust the oversight of the company to the board through elections. A strong, independent board can sometimes act even against the immediate wishes of some shareholders if it believes it's for long-term benefit – for instance, resisting pressure from short-term activists to sell off assets if it would harm long-term value. However, ultimately shareholders hold the trump card of being able to replace the board via votes (or via takeover). This dynamic encourages boards to keep an open dialogue with shareholders. Many jurisdictions now emphasize **shareholder engagement** as a key aspect of board responsibility. For example, UK Corporate Governance Code Provision 5 expects the board to understand shareholder views, especially if a significant percentage vote against a resolution (boards must then publicly explain how they'll address concerns). In the U.S., shareholder activism has led boards to increasingly meet with major institutional investors outside of proxy season to hear their concerns (something almost unheard of 30 years ago).

A healthy interaction is one where shareholders use their rights thoughtfully (e.g., voting on directors not as a rubber stamp but assessing their performance; using say-on-pay votes to signal issues with executive compensation) and boards respond constructively. For example, after a failed say-on-pay vote, boards often engage with

top shareholders to revise the pay plan. Or if an activist hedge fund demands changes, the board might negotiate and perhaps agree on new strategies or adding a mutually acceptable director, rather than waging war. The rise of stewardship codes means big institutional investors feel a duty to be proactive owners, which balances out managerial dominance. That said, too much shareholder power, especially by short-term investors, can push a company into short-termism. Laws often balance this by still giving boards discretion – e.g., **business judgment rule** protection in the U.S. allows boards to reject takeover offers if they have a reasonable basis to believe it undervalues the company’s long-term prospects, even if some shareholders want to sell. In the UK, however, boards are more constrained by the Takeover Code (shareholders decide on takeovers; boards cannot easily employ takeover defenses). So jurisdictional differences shape the shareholder-board power balance.

C. Board ↔ Management

The board-management relationship is at the heart of governance. It should neither be too cozy nor too adversarial. The board’s role is oversight and guidance, not day-to-day meddling. The Business Roundtable explicitly notes effective directors are “monitors, not managers” – they must exercise vigorous oversight without micromanaging. In practice, this means the board sets expectations and boundaries: approving strategy, setting risk appetite, establishing ethical standards, and then lets management execute, but requires regular reporting and has the right to question and challenge. A good CEO appreciates an engaged board that can be a sounding board and can lend outside perspective or networks. Many successful CEOs develop a strong partnership with the board, especially the chair or lead director, maintaining open communication. For example, Satya Nadella, Microsoft’s CEO, is often cited for working well with his board to drive a major strategic shift (to cloud computing) with the board’s support and input. Conversely, when boards and CEOs clash dysfunctional outcomes can arise – sometimes needed (removing a toxic CEO), but sometimes harmful if it becomes a power struggle instead of collaboration.

One critical area of board-management interaction is **information flow**. The board relies on management to provide accurate and timely information; management relies on the board for guidance and approval of key decisions. If management withholds information (as in Theranos – where the startup’s board was kept in the dark about core technology problems by the CEO), oversight fails. Thus, laws and codes often require certain information rights: e.g., German supervisory boards can directly seek information from lower management if necessary (not just the CEO), and audit committees have unfettered access to internal audit and finance staff. On the other hand, if boards inundate management with requests or override management decisions frequently, it can paralyze operations.

***Checks and Balances Examples:** There are many real scenarios showing this balance: The Wells Fargo fake accounts scandal revealed that the board had repeatedly heard rosy reports from management about sales practices, which were false. When the truth emerged, the U.S. Federal Reserve took the unprecedented step of capping Wells Fargo's growth until governance was improved – essentially forcing balance by empowering the board and new management to overhaul controls. The Fed also ousted some board members. This shows an external check ensuring the board does its checking of management.*

Another example: ***stakeholder pressures** can influence the balance. If a company's management is seen as ignoring stakeholder concerns (say environmental issues), shareholders might push the board to intervene (as seen in ExxonMobil in 2021, where activist shareholders unhappy with management's response to climate change succeeded in electing new independent directors to change course).*

D. Managing Conflicts and Aligning Interests

Governance balance also involves aligning interests among the trio: e.g., executive compensation is meant to align management with shareholder interests (hence tying pay to stock performance). But if not balanced (like if pay is excessive even when performance lags), it causes resentment and misalignment. The board (via the comp committee) is the balancing agent here – it must design pay that motivates management but also satisfies shareholders' expectations (hence the advent of performance shares, clawbacks, etc. to balance risk/reward).

Another critical balancing factor is **market discipline**: If shareholders en masse are unhappy, they sell the stock, lowering stock price, which pressures the board/management (either through a takeover threat or just reputationally and cost of capital). Management often cares deeply about stock price (due to equity-based pay, pride, etc.), so market signals serve as a check on poor management. However, boards may sometimes need to act as a counterbalance if markets overreact short-term – for instance, a board might back a CEO's long-term R&D strategy even if quarterly earnings suffer and some investors complain; if they truly believe in it, they balance short-term market pressure with long-term vision. This was seen when Amazon's board, for example, supported Jeff Bezos in years of heavy investment despite some criticism that Amazon wasn't profitable enough – ultimately creating tremendous long-term value.

E. Role of Law and Codes

Laws set boundaries for each group's powers, thereby balancing them. Shareholders get rights (vote, etc.), but boards can use mechanisms like staggered terms or certain

thresholds for calling meetings to not be too vulnerable to transient whims. Some countries (like the U.S.) allow dual-class shares where founders keep control disproportionate to ownership – this tilts balance towards management/insiders. In such cases, other checks (like independent board committees and stricter duties) need to work harder to protect minority shareholders. For instance, Facebook (Meta) has a dual-class stock giving Mark Zuckerberg majority voting power with under 20% of equity; this heavily limits shareholder ability to check him, putting more weight on the board and legal duties. Critics say this imbalance led to oversight lapses (like slow response to user data privacy issues). Hence, many investors advocate *one-share-one-vote* as a principle to keep balance (management still can run company, but if they do poorly, shareholders can vote them out – which is not the case in controlled companies until the controller decides otherwise).

Case study – a failure of balance: Theranos, the infamous blood-testing startup, had a high-profile board of directors (including ex-Cabinet members and generals) but its charismatic CEO Elizabeth Holmes controlled information and the board did not effectively check her false claims. There were no public shareholders (it was private) to raise alarms either. Employees who tried to whistleblow were silenced. This is a case where all three legs of the governance stool failed: no shareholder oversight (typical in venture startups, but investors also didn't demand board seats that could probe technology), a compliant board with prestige but no real monitoring, and an unscrupulous management. The lesson drawn is that you need at least one robust check – in public companies, shareholder lawsuits or media eventually expose frauds; in Theranos, it took investigative journalism.

Modern governance increasingly sees stakeholders (employees, customers, community, environment) **as part of the ecosystem.** Shareholders and boards are urged to consider stakeholders to ensure sustainable success. For example, the Business Roundtable's 2019 statement (signed by many CEOs) recognized delivering value to customers, employees, etc., not just shareholders, as corporate purposes. Some argue this dilutes shareholder primacy, but others say it actually *balances* extreme short-term shareholder pressure by acknowledging companies shouldn't sacrifice long-term stakeholder relationships for short-term gains. Boards are often the arbiters of this balance – they must sometimes defend decisions like increasing employee training or foregoing a quick profit to maintain quality, explaining to shareholders how this builds long-term value. In jurisdictions like Germany, stakeholder balance is formal via codetermination. In the U.S./UK, it's more voluntary but gaining ground through ESG expectations. We thus see a broader balancing act: not just among shareholders, board, management, but also with the interests of other parties. This can reduce certain risks

(for example, a board that listens to employee concerns might preempt labor problems or public scandals, aligning long-term interest of company and society).

The interplay between shareholders, boards, and management is dynamic. When all three parts operate in harmony yet with healthy tension, the company tends to flourish and avoid catastrophe. A harmonious example might be **Apple Inc.** in recent years: institutional shareholders largely support the company's strategy; the board (led by independent directors) works well with CEO Tim Cook – challenging him appropriately but also supporting innovation and long-term moves (like heavy investment in new product categories); management executes effectively, delivering value to shareholders and products to customers, which in turn keeps shareholders satisfied. The checks and balances are in place but seldom need to become confrontational because trust and alignment exist.

However, even a good system can be tested: if performance drops or a crisis hits (say a product failure or a compliance breach), then these relationships face strain. That's when the true balance is tested – will shareholders rally with management for a fix, or demand leadership change? Will the board know when to replace the CEO or resist an opportunistic takeover, or conversely when to press management to change strategy? Good governance means having the structures and the culture to make those hard decisions.

Corporate governance is not static rules alone; it lives in the *interactions* between the key corporate actors. A recurrent theme in governance up to 2025 is **engagement and transparency**: engaged shareholders (especially long-term ones) communicating expectations, transparent boards communicating both to management (what is expected) and to shareholders (what the company is doing and why), and management being transparent and accountable to the board. When each party respects the role of the others – shareholders respecting the board's need to sometimes say no, boards respecting management's expertise but verifying trust, and management respecting that it ultimately serves the company's owners and must earn their confidence – the corporation is well-positioned for long-term success and resiliency.

This completes our exploration of corporate structure. In the next chapters, we will build on this foundation to discuss specific issues in international corporate governance, such as shareholder activism, governance in groups and multinational enterprises, corporate social responsibility, and governance in special contexts (state-owned enterprises, startups, etc.). Understanding the fundamentals of shareholders, boards, and executive management positions you to analyze those advanced topics with a solid grounding in who the players are and how they should ideally interact.

Self-Assessment Quiz:

1. Why is a well-defined corporate governance structure important for a company's long-term success? Identify at least two potential consequences of a poor governance structure (e.g., unclear roles or lack of checks and balances).
2. List three fundamental rights of shareholders in corporate governance. How do these rights empower shareholders to influence a company's direction? Provide a brief example of how shareholders might exercise one of these rights.
3. What are the key functions of a board of directors? Choose one function (e.g., risk oversight or CEO selection) and describe a real or hypothetical scenario illustrating the board performing that function.
4. Match the following committees with their primary oversight area: Audit Committee, Remuneration Committee, Nomination Committee. Then explain why having independent directors on these committees is considered best practice.
5. Explain the difference between the role of the CEO and the role of the board chairman in a company with a unitary board. Why do many corporate governance codes recommend separating these two roles?
6. True or False – *“In most countries, if a company's CFO intentionally misreports financial results, only the company can be penalized, not the CFO personally.”* Correct the statement if false, and mention any law or regulation that supports your correction.
7. Compare the unitary and dual board systems. What do you see as one advantage of the two-tier system and one advantage of the one-tier system? If you were setting up a new public company, which system might you prefer and why?
8. Briefly analyze one of the case examples mentioned (such as Carillion's collapse or Samsung's bribery case) in terms of corporate structure and balance. What governance failures occurred among shareholders, board, and management, and what could have been done structurally or procedurally to potentially prevent it?
9. Describe how the concept of “checks and balances” operates in corporate governance. Who checks whom, and through what mechanisms? Use the shareholder-board-management relationship in your explanation.
10. Master's-level reflection – Stakeholder interests (like those of employees or the community) are increasingly seen as important in corporate governance. How can stakeholder representation be integrated into the corporate structure without undermining the accountability of management and the board to shareholders? Discuss any one mechanism (e.g., board employee representatives, advisory panels, ESG committees) and its pros and cons.

Sources:

- Business Roundtable. (2016). *Principles of Corporate Governance*. Business Roundtable Publication.
- Candriam. (2023). *Proxy Voting Policy* [PDF]. Candriam Investors Group.
- Hopt, K. J. (2022, December 2). *The German Supervisory Board*. Oxford Business Law Blog, University of Oxford.
- Lee, J., & Park, Y. (2017, August 25). *Samsung leader Jay Y. Lee given 5-year jail sentence for bribery*. Reuters.
- Markel, G. A., Morduchowitz, D., & Catalano, M. C. (2022, January 23). *A Director's Duty of Oversight after Marchand in "Caremark" Case*. Harvard Law School Forum on Corporate Governance.
- OECD. (2025). *Corporate Governance*. OECD Policy Topics.
- Studicata. (n.d.). *Smith v. Van Gorkom, 488 A.2d 858 (Del. 1985) – Case Brief*. Studicata Case Briefs.
- Wright, M. (2018, July 18). *Carillion Plc: A Governance Case Study from the UK*. The FinReg Blog (Duke University).

CHAPTER 4: RIGHTS AND OBLIGATIONS OF SHAREHOLDERS

Shareholders, as the owners of a corporation, enjoy important rights that protect their interests and enable them to participate in corporate governance, while also assuming certain obligations toward the company. International principles of corporate governance emphasize safeguarding shareholder rights and equitable treatment for all investors (including minorities), as well as providing effective remedies if rights are violated. Below, we outline the fundamental rights of shareholders and their key obligations, along with specific protections for minority shareholders and measures to prevent abuse of power.

Learning Objectives:

By the end of this chapter, students should be able to:

1. **Identify and explain the fundamental rights of shareholders** in various corporate governance systems, including the right to vote, receive dividends, access information, and participate in general meetings.
2. **Analyze the legal basis for shareholder rights** within international frameworks such as the OECD Principles of Corporate Governance, the EU Shareholder Rights Directives, and national corporate laws.
3. **Differentiate between types of shareholder actions**, including individual claims and derivative lawsuits, and understand under what circumstances each is applicable.
4. **Understand the obligations of shareholders**, including acting in good faith, avoiding abuse of rights, and respecting the interests of the company and other shareholders.
5. **Evaluate mechanisms for minority shareholder protection**, such as cumulative voting, pre-emptive rights, and legal remedies against abusive majority control.
6. **Apply knowledge to case studies**, identifying how courts and regulators have handled shareholder rights violations or duties in various jurisdictions.
7. **Critically assess the role of shareholder engagement** in modern corporate governance and the balance between shareholder empowerment and corporate efficiency.

4.1. Fundamental Rights of Shareholders

Shareholders' fundamental rights are the core entitlements that come with owning stock in a company. These rights ensure that shareholders can secure their ownership, receive a return on their investment, and have a say in major corporate decisions. According to global standards (e.g. OECD Principles), basic shareholder rights include the following:

- **Ownership and Transfer of Shares** - Shareholders have the right to secure ownership registration of their shares and to **freely transfer or sell their shares** to others. This means a shareholder can buy, hold, or dispose of their stock, providing liquidity and the ability to exit the investment at will (except in specific cases like contractual lock-up periods or legal restrictions).
- **Right to Timely Information** - Shareholders are entitled to obtain **relevant and material information** about the corporation on a timely and regular basis. This includes access to periodic financial reports, annual disclosures, and any information necessary to make informed decisions about their investment.
- **Voting Rights** - Shareholders typically have the right to **participate and vote** in general shareholder meetings on key corporate matters. Most common shareholders follow a “one share, one vote” principle, allowing them to vote on issues such as electing board members or approving major transactions.
- **Right to Elect and Remove Directors** - A fundamental shareholder right is the ability to **elect the company's board of directors** (and remove them) at the general meetings. Through board elections, shareholders influence the strategic direction and oversight of the company by choosing who will represent their interests on the board.
- **Rights to Dividends and Profits** - Shareholders have a right to **share in the profits** of the corporation, usually in the form of dividends, when those are declared. While dividends are not guaranteed (they depend on profits and board decisions), shareholders **receive dividends** if the company's profits are distributed.
- **Residual Claim on Assets** - In the event of the company's liquidation or dissolution, shareholders are entitled to a portion of the remaining assets **after all debts and liabilities have been paid**. Common shareholders are **residual claimants** – they have a claim to whatever assets remain once creditors and preferred shareholders are satisfied. This means if the company is solvent upon

liquidation, shareholders receive their pro-rata share of any surplus assets. (If the company's obligations exceed its assets, however, shareholders may receive nothing, reflecting the risk aspect of equity ownership.)

In summary, these fundamental rights ensure that shareholders can **secure their ownership, voice their opinions in company affairs, and receive financial benefits** from their investment. They form the foundation of shareholder protection in corporate governance. Shareholders also benefit from limited liability (their losses are generally limited to their investment, and personal assets are not at risk for corporate debts), which underpins the modern corporation by encouraging investment.

4.2. Right to Information and Access to Corporate Documents

Transparency is a cornerstone of good corporate governance. Shareholders have the right to be informed about the company's business and to access important corporate documents. This **right to information** enables shareholders to monitor management and make educated decisions regarding their shares. Key aspects of this right include:

- **Access to Financial Statements and Reports**

Shareholders can expect regular reports on the company's financial performance (e.g. annual and quarterly reports). Laws often require companies to disclose material information about finances, operations, ownership, and governance. Providing timely and accurate disclosure on all significant matters is an obligation for companies, which in turn empowers shareholders to evaluate the company's health.

- **Inspection of Books and Records**

In many jurisdictions, shareholders (especially those holding a minimum stake) have the right to inspect certain corporate documents – such as accounting books, shareholder registers, and meeting minutes. Even minority shareholders are typically guaranteed the **right to review financial records, shareholder lists, and board meeting minutes** to stay informed. For example, state laws or company bylaws may allow a shareholder to request and obtain copies of balance sheets, profit/loss statements, or minutes of general meetings.

- **Right to Request Information at General Meetings**

Shareholders can often pose questions to the board or management at the annual general meeting (AGM). For instance, **at the AGM shareholders have the right to request information from management on company matters** that relate to items on the meeting's agenda. This ensures management provides clarifications about corporate performance, strategy, or specific transactions before shareholders vote.

- **Ongoing Material Disclosures**

Companies must keep shareholders informed of major developments (mergers, acquisitions, significant management changes, etc.). The corporate governance framework obligates disclosure of all material matters regarding the corporation's financial situation and governance in a timely manner. This means shareholders should receive prompt news of any event that could affect the value of their shares or their rights.

- **Legal Enforcement of Information Rights**

If a company refuses to provide access to certain records or information that shareholders are entitled to, shareholders usually have legal remedies. They can **demand inspection** through court order – i.e. compel the company to hand over books and records they are entitled to see. This right to seek judicial enforcement ensures that the right to information is effective. In extreme cases, persistent failure to disclose or transparently share information could be a form of oppression against shareholders, giving them cause for legal action (see §4.5 and §4.7).

Overall, the information right is vital for accountability. It **allows shareholders to scrutinize management's actions**, verify that the company is being run in their best interests, and make informed decisions such as how to vote or whether to buy/sell shares. It also levels the playing field, so that minority and foreign shareholders have access to the same material facts as controlling owners, upholding equitable treatment.

4.3. Voting Rights and Participation in General Meetings

One of the most important powers of shareholders is the **right to vote** on corporate matters and to participate in shareholders' meetings. Through voting, shareholders exercise influence over the company's governance and strategic direction. Key points regarding voting rights and meeting participation include:

- **Annual and Special Meetings**

Corporations are generally required to hold an **Annual General Meeting (AGM)** of shareholders at least once a year. At the AGM, shareholders can attend (in person or via proxy) to discuss company affairs and vote on important agenda items. Shareholders also have the right to be notified of meetings with sufficient time and information (meeting agenda, resolutions to be voted on, etc.). In addition to AGMs, if urgent matters arise, **special shareholder meetings** can be called by authorized parties (the board, or a qualified percentage of shareholders) to vote on specific issues outside the regular meeting cycle.

- **Scope of Voting Matters**

Shareholders **vote on fundamental corporate issues**. Ordinary matters typically include electing the board of directors, approving audited financials, and other routine business. Critically, shareholders elect or remove directors **through voting** (often a majority vote at the AGM). They may also vote on **major decisions such as mergers or acquisitions, changes to the corporate charter/bylaws, issuance of new shares, or extraordinary transactions that significantly affect the company's structure or strategy**. In essence, shareholder voting rights center on **“certain fundamental issues, such as the election of board members, amendments to the company's organic documents, approval of extraordinary transactions”** and other basic issues specified in law or the charter. This ensures that major changes cannot occur without shareholder approval.

- **One Share, One Vote (and Exceptions)**

Generally, voting power is proportional to ownership – each share usually carries one vote. This principle of “one share, one vote” means larger shareholders have greater influence, but it also equates financial stake with voting power. Some companies may have multiple classes of shares with different voting rights (e.g. non-voting preferred shares or high-vote shares for founders), but equitable governance principles favor proportional voting rights for all shareholders of the same class. All shareholders of the same class should be treated equally in voting matters, and any deviation (such as dual-class stock structures) is often disclosed and justified to investors.

- **Proxy Voting and Representation**

Shareholders who cannot attend a meeting in person retain the right to vote by proxy. They can appoint a **proxy representative** to vote on their behalf, by following the procedures set by law or the company's regulations. The appointed proxy (often a trusted person or an independent proxy agent) must vote according to the shareholder's instructions. Proxy voting mechanisms enable wider shareholder participation, especially for dispersed shareholders in large public companies, ensuring that even those not physically present can have their votes counted.

- **Participation and Deliberation**

Beyond casting votes, shareholders have the **right to attend the general meetings and participate in deliberations**. At the meeting, they can ask questions (as noted in §4.2), engage in discussion, and express opinions on agenda items. This dialogue is a key part of corporate democracy. The company's duty is to facilitate this process – e.g. by holding meetings at convenient times/places or via accessible means (some

jurisdictions allow virtual or teleconference meetings as long as all participants can communicate and vote).

- **Voting Outcomes and Binding Decisions**

When shareholders vote, decisions are usually made by majority (or super-majority for certain items) and are **binding on the company**. For example, a passed resolution to amend bylaws or to elect certain directors must be implemented by the company's management. Shareholders are expected to abide by decisions validly taken by the majority. Equally, if shareholders reject a proposed action (like a merger), the company cannot proceed with it. This democratic process protects against unilateral actions by management or controlling parties that lack broader shareholder support.

Through these voting rights and meeting participations, shareholders collectively serve as the ultimate authority on pivotal corporate decisions. This ensures **accountability of the board and management** to the owners. As the OECD Principles state, shareholders' influence is primarily exerted by **participation in general meetings and voting on fundamental matters** in the company's life. When properly exercised, voting rights help align the company's actions with shareholder interests and serve as a check on management power.

4.4. Right to Dividends and Share of Assets in Liquidation

Shareholders invest in companies with the expectation of financial returns. Two key economic rights of shareholders are the **right to receive dividends** from the company's profits and the **right to a share of the company's assets upon liquidation**:

- Dividend Rights:** Shareholders have the right to receive their proportionate share of the company's profits in the form of dividends, **if and when dividends are declared**. Typically, the board of directors proposes a dividend based on profitability and other considerations, and shareholders approve it at the AGM. When a dividend is approved, **shareholders are entitled to that distribution of profit** according to the number of shares they hold. Importantly, dividends are not guaranteed – a company may choose to reinvest profits instead of distributing them, and no dividends can be demanded beyond what has been declared. However, if a dividend has been lawfully declared, shareholders gain a legal right to that payment (and can sue if it's wrongfully withheld). Preferred shareholders often have priority dividend rights (they get paid a fixed dividend before any dividend to common shareholders), but common shareholders benefit through dividends when the company is sufficiently profitable. In summary, the dividend right means shareholders **participate in the company's earnings**, aligning their interests with the company's long-term profitability.

- B. **Right to Assets Upon Liquidation:** If a company is liquidated (i.e. all assets are sold off and the business is wound up), shareholders have the right to receive a share of any **remaining assets after all debts and obligations are paid**. This is known as the shareholders' **residual claim on assets**. In practical terms, when liquidation proceeds are distributed: first, creditors (like banks, bondholders, suppliers) are paid; next, if applicable, preferred shareholders may get a stipulated amount; finally, **common shareholders receive whatever assets or value is left** (the "residue"). For example, if after paying all debts there is \$10 million remaining and a shareholder owns 10% of the company's stock, that shareholder would get 10% of the \$10 million. However, because shareholders are last in line, they **bear the highest risk** – if the company's liabilities equal or exceed its assets, the shareholders may receive nothing and lose their invested capital. Conversely, being last in line also means if a company is very successful and assets remain after all obligations, shareholders benefit from all the surplus. This principle of **residual claim** is fundamental in corporate finance: it underscores that **equity holders are entitled to the company's net value** (what remains after debts). Many jurisdictions explicitly state in company laws that shareholders have rights to liquidation proceeds proportional to their shareholding.
- C. **No Immediate Asset Rights During Operations:** It's important to note that shareholders' right to company assets is generally inchoate (not direct) until liquidation. They do not own any specific asset of the company and cannot claim company property at will – the company as a legal entity owns its assets. Shareholders' interest is a **fractional ownership of the corporation as a whole**, not a claim to particular buildings, equipment, or cash of the firm. Only upon liquidation is this ownership translated into a claim on the net assets. Before then, their economic rights are realized through dividends or appreciation of share value.
- D. **Appraisal Rights in Fundamental Transactions:** Related to both dividend and liquidation rights is the concept of **appraisal rights** (or the right to fair value in certain transactions). In many jurisdictions, if a company decides to merge, sell substantially all assets, or undertake another fundamental change, shareholders who vote against (dissenters) may have a right to demand the company buy back their shares at a fair value determined by an independent appraisal. This protects shareholders from being forced to go along with a major change that they do not agree with – effectively giving them an exit at a fair price. It's not exactly a dividend or liquidation, but it is a mechanism to receive cash for their share of the company's value when the company's course is drastically altered.

We mention it here because it ensures shareholders can secure the value of their investment in extraordinary situations.

In summary, the rights to dividends and liquidation proceeds ensure that shareholders **have a financial claim on the company's success and assets**. Dividends reward shareholders during the company's life cycle, while liquidation rights protect them at the end of a company's life. These rights, combined with the voting and information rights above, make up the core bundle of benefits that come with equity ownership.

4.5. Right to Sue: Individual (Direct) and Derivative Actions

While shareholders do not manage the day-to-day affairs of a company, they do have legal avenues to **protect their interests and hold insiders accountable** through the courts. Shareholders' right to sue can take primarily two forms: **direct (individual) actions** and **derivative actions**. Each serves a different purpose:

1) Individual (Direct) Lawsuits

A direct action is a lawsuit a shareholder files on their own behalf (or on behalf of a class of shareholders) to redress a harm done to them personally as shareholders. These cases typically involve **violations of the shareholder's personal rights**. For example, if a shareholder is **denied a rightful dividend** that was declared, or if their voting rights were improperly interfered with, that shareholder can bring a direct suit against the company or responsible parties. Other examples of direct claims include suing to **challenge the validity of a shareholders' meeting or resolution** (if proper procedures weren't followed or if the action violates the law or charter), or suing to compel the company to register a stock transfer. The key is that the injury is specific to the shareholder (or group of shareholders) and not just a harm to the company overall. In a successful direct lawsuit, the remedy benefits the affected shareholder(s) directly (e.g. payment of the withheld dividend, or nullification of an illegal decision, or damages awarded to the shareholder).

2) Derivative Lawsuits

A derivative action is a lawsuit filed by a shareholder on behalf of the corporation, typically against insiders (such as directors or officers), to remedy a wrong done **to the company**. It is "derivative" in that the shareholder's right to sue "derives" from the company's right – essentially stepping into the company's shoes because the company's management **failed to take action against the wrongdoers**. For instance, if directors or executives breach their fiduciary duties (through fraud, self-dealing, mismanagement, etc.) and harm the corporation, a shareholder may bring a derivative suit against those insiders **on behalf of the corporation**. Any recovery in a derivative

suit (damages, settlement) typically goes to the corporation's coffers, not directly to the suing shareholder (although legal fees might be reimbursed). The benefit to the shareholder is indirect – by holding wrongdoers accountable and potentially improving the company's value or governance, all shareholders are protected. Derivative suits are a crucial mechanism in corporate governance for addressing insider abuse, especially in situations where those in control are unlikely to sue themselves. Many jurisdictions have specific requirements for derivative actions (e.g. the shareholder must first make a demand on the board to sue, unless such demand is futile, and the plaintiff might need to own a minimum stake or have held shares for a certain duration).

3) Purpose of Legal Actions

Both direct and derivative actions enhance accountability. Direct suits ensure that **shareholder rights (voting, dividends, etc.) can be enforced** in court if violated. Derivative suits ensure that **the company's rights can be enforced when management won't act** – for example, suing a CEO for diverting corporate assets to themselves. Together, they give shareholders legal standing to combat misconduct and protect their interests as owners.

4) Other Remedies through Courts

In addition to these suits, shareholders have some other legal remedies. They might seek **injunctions** to stop or compel certain corporate actions (e.g. to block a transaction that was decided without proper shareholder approval). They can also **petition for dissolution of the company in extreme cases** – for example, if there is deadlock or ongoing abusive conduct by those in control, some laws allow minority shareholders to ask a court to liquidate the company as a remedy of last resort. Furthermore, as noted in §4.2, shareholders can go to court to enforce their inspection and information rights if the company stonewalls them. In cases of fraud or securities law violations (like insider trading or misrepresentation), shareholders might also bring or join civil and even criminal proceedings under securities laws. All these legal avenues underscore that shareholders are not without recourse if those in charge violate the law or the shareholders' rights.

It should be noted that while litigation is a powerful tool, it can be costly and time-consuming. Many jurisdictions encourage internal dispute resolution if possible, or the use of alternative mechanisms (like arbitration clauses or mediation in shareholder agreements). Still, the **right to sue is a fundamental safeguard**: it provides teeth to the various rights shareholders have. As corporate governance best practices state, shareholders should have the opportunity to obtain **effective redress for violations of their rights**, and the ability to bring individual or derivative actions is the means to that end.

4.6. Obligations of Shareholders to the Company

In addition to rights, shareholders also have certain **obligations** toward the company and other shareholders. While the day-to-day duties of running the company lie with directors and management, shareholders must fulfill some responsibilities as owners. These obligations ensure that shareholders contribute fairly to the company's capital and governance and do not misuse their position. Key obligations include:

1) Capital Contribution

A primary obligation of a shareholder is to **pay in full for the shares they have subscribed or purchased**. When someone becomes a shareholder (for instance, by subscribing to shares in a new issue or buying shares from another), they must **provide the promised capital to the company's coffers**. This payment (the purchase price or the agreed contribution for the shares) forms part of the company's equity and is used to finance the company's operations. Failing to pay for shares (if buying directly from the company) can result in forfeiture of those shares or other penalties under corporate law. In practical terms, for publicly traded shares, paying the market price completes this obligation. For private companies or new share issues, the subscriber must pay the amount due (in money or other agreed assets). This obligation ensures that the company actually receives the funding it expects in exchange for issuing ownership stakes.

2) Duty of Loyalty and Good Faith

Although ordinary shareholders are not fiduciaries of the company (unlike directors), they are generally expected to **act in good faith and not abuse their rights as owners in a way that harms the company or other shareholders**. In some legal systems, this is termed a **duty of loyalty** or a duty not to act abusively. For example, a controlling shareholder should not vote in a way that benefits themselves while knowingly inflicting damage on the company. All shareholders should **safeguard the interests of the company and refrain from using their influence to the company's detriment**. This means not engaging in fraud against the company, not extracting undue advantages at the company's expense, and generally exercising rights (like voting) with regard to the common interest. If a shareholder does abuse their power (for instance, a majority shareholder siphoning assets to themselves or a group of shareholders conspiring to harm the business for competitive reasons), they could be subject to legal action (and in some jurisdictions, held liable for damages). This principle upholds that while shareholders can vote in their own economic interest, there is an expectation of fairness and no intent to deliberately sabotage the corporation.

3) Compliance with Laws and Corporate Governance Rules

Shareholders must **comply with the company's articles of association/bylaws and the law**. By becoming a shareholder, one agrees to be bound by the company's charter and decisions made in accordance with that charter and the law. This includes respecting the outcomes of duly-called shareholder meetings (even if one voted against a proposal, once it's lawfully approved, a shareholder should accept it). Shareholders are also subject to general laws – for instance, **insider trading laws** apply to shareholders who have material non-public information, barring them from trading on that information. Similarly, large shareholders must adhere to securities regulations, such as not engaging in market manipulation or fraudulent schemes. In essence, being a shareholder is not a license to ignore rules; shareholders must act within the legal and regulatory framework governing corporate conduct.

4) Disclosure of Significant Holdings

In many jurisdictions, if a shareholder's stake exceeds certain thresholds (e.g. 5%, 10%, etc.), they have an obligation to **disclose their ownership stake** to the company and potentially to market regulators. This duty to disclose large shareholdings is intended to promote transparency of corporate control and alert other investors to the presence of any significant or controlling interests. For example, laws often require notification when passing thresholds like 5% or 10% of voting rights. The company typically must then announce this to the market. This obligation prevents stealth takeovers and **ensures all shareholders know who the major owners are**, thus preventing uncontrolled or hidden influence. Shareholders subject to this rule must promptly update their disclosures as their ownership changes.

5) Duty of Confidentiality (when Applicable)

Shareholders who, by virtue of their position or agreements, gain access to **confidential company information** must keep it confidential and not use it for personal benefit without authorization. This often applies to controlling shareholders, board member shareholders, or shareholders who obtain non-public information through shareholder agreements or inspections. For instance, a major shareholder might receive inside information during discussions with management – they are obligated not to trade on it or leak it. Also, if shareholders receive a draft proposal or negotiation details in a transaction, they must maintain confidentiality. This duty protects the company's sensitive data and inside information, similar to how directors and officers are bound by confidentiality.

6) Responsible Participation

While not always codified as a strict legal obligation, good governance practices encourage shareholders to **engage responsibly in corporate affairs**. This means attending general meetings (at least via proxy if not in person) especially when important decisions are on the agenda, voting thoughtfully, and exercising their rights in a constructive manner. Some corporate governance codes consider it a responsibility of shareholders – particularly institutional investors – to **actively participate and vote** rather than remain passive. Active participation helps keep management and boards accountable. In some jurisdictions, institutional investors even have stewardship codes requiring them to vote their shares in the best interests of their beneficiaries. Thus, while a small retail shareholder isn't legally required to vote or attend meetings, the culture of governance treats informed voting as part of a shareholder's role.

7) Tax and Regulatory Obligations

Shareholders are responsible for **paying taxes** on any dividends or capital gains they receive from their shares, according to tax law (e.g. dividend income may be taxed, as well as profits from selling shares). Though this is an obligation to the government rather than the company, it is part of the shareholder's obligations that come with the benefits of share ownership. Additionally, if a shareholder agrees to certain post-ownership commitments (like lock-up agreements for a period after an IPO, or non-compete agreements in some shareholder agreements), they are obligated to honor those as well.

In summary, shareholders' obligations are generally **limited but important**: provide the capital they committed, **adhere to the rules of the company and the law**, and refrain from actions that would unfairly prejudice the company or other shareholders. Unlike directors or executives, shareholders do not owe a broad fiduciary duty to the company (except in special cases of majority control as discussed below), but they must still act within certain bounds. These obligations help maintain a fair and functional corporate environment where rights can be exercised without abuse.

4.7. Protection of Minority Shareholders and Prevention of Abuse of Power

In companies with a dispersed ownership, majority rule is tempered by rules protecting minority shareholders. Where there's a controlling shareholder or group, **minority protection** becomes crucial. Without safeguards, those in control might make decisions that unfairly prejudice minority owners. Corporate governance principles worldwide stress the **equitable treatment of all shareholders, including minority and foreign shareholders**, and set measures to prevent abuse of power by **controlling shareholders**. Key mechanisms for minority protection and curbing majority abuse include:

- a) **Equitable Treatment Principle** - All shareholders of the same class should have the **same rights and be treated equally** in proportion to their shareholding. This is a fundamental rule that prevents the majority from, for example, giving themselves better dividend rights or more votes per share to the detriment of others. It also means corporate decisions (like mergers or asset sales) should consider the interests of all shareholders, not only the majority. Many jurisdictions enforce this via laws that void any corporate action which is clearly intended to provide unjust advantages to controlling shareholders at the expense of minorities.
- b) **Fiduciary Duties of Controlling Shareholders** - In some legal systems (especially in common law jurisdictions or via equitable principles), **controlling shareholders owe fiduciary duties to the company and minority shareholders**. This means a majority or controlling shareholder must act in good faith and not exercise control to oppress minority interests. For instance, if a majority shareholder is voting on a transaction where they have a conflict of interest (self-dealing), they are expected to act fairly or recuse, similar to a director's duty. As noted in one analysis, **controlling shareholders and directors have fiduciary duties to minority shareholders, and breaching these duties (e.g. through self-dealing or unfairly denying dividends) can give rise to legal claims by minorities**. In practice, if a majority abuses their power (say, by approving contracts that benefit themselves or by squeezing out minority at an unfair price), courts may intervene, reversing the action or awarding damages to the minority.
- c) **Minority Shareholder Remedies (Oppression and Lawsuits)** - Many jurisdictions give minority shareholders special legal remedies if they face unfair treatment. One common remedy is the **shareholder oppression lawsuit** or unfair prejudice petition. If minority shareholders are being "frozen out" – for example, excluded from information, denied their rights, or if the company's affairs are conducted in a way that is oppressive or prejudicial to them – they can **sue for relief on grounds of oppression or breach of duty by those in control**. Courts in such cases have wide powers: they might order a buyout of the minority's shares at a fair value, nullify oppressive decisions, or even dissolve the company (though dissolution is a last resort). The existence of this remedy is a strong deterrent against majority misconduct, as controlling persons know they could face legal action for crossing the line. Additionally, as discussed in §4.5, minorities can use **derivative suits** to hold insiders accountable when the company is wronged – this indirectly protects all shareholders by enforcing proper management behavior.
- d) **Access to Information for Minority Shareholders** - Denying information to minority shareholders is a classic way unscrupulous management or majority holders could disadvantage them. To counter this, laws ensure that even small

shareholders have rights to information (as covered in §4.2). For example, **minority shareholders have the right to inspect books, records, and receive financial disclosures just like any other owner.** This prevents a scenario where only the majority is “in the know.” Moreover, some jurisdictions allow a certain percentage of shareholders (often 5% or 10%) to call a special shareholders’ meeting or to propose agenda items at an AGM. This empowers minorities to raise issues (like suspected wrongdoing) before all shareholders.

- e) **Cumulative Voting and Board Representation** - To prevent majority shareholders from always controlling 100% of board seats, some company laws or bylaws use **cumulative voting** for director elections. Cumulative voting allows a minority shareholder (or coalition) holding a significant minority (say 20-30%) to concentrate their votes on a few board candidates, thereby increasing the chances of electing at least one representative to the board. This mechanism gives minority interests a voice in board deliberations. Alternatively, some companies reserve a board seat for certain minority stakeholders by agreement. Having board representation can help protect minority interests from inside the boardroom.
- f) **Supermajority Requirements** - For especially important decisions (mergers, amendments to bylaws, etc.), companies may require a supermajority vote (e.g. 2/3 or 3/4 approval) rather than a simple majority. This protects minority shareholders by ensuring that a small majority cannot unilaterally push through transformative actions without broader consensus. For instance, if the threshold is 75%, a shareholder with 51% cannot approve a merger without some support from minority shareholders.
- g) **Tag-Along Rights and Takeover Protections** - In the context of changes in control, **tag-along rights** (or co-sale rights) are often provided to minority shareholders (especially in shareholder agreements or some jurisdictions by law). A tag-along right means if the controlling shareholder sells their stake to a third party, minority shareholders have the right to join the deal and sell their shares on the **same terms**. This prevents a situation where a controlling owner sells at a premium and leaves the minority behind with a new boss and no liquidity. In many markets, takeover laws also protect minorities via the **mandatory tender offer rule**: if an acquirer buys a controlling block (over a certain threshold, like 30%), they are required to offer to purchase the remaining shares of the company at the same price per share. This ensures minorities can exit at a fair price during a change of control.
- h) **Appraisal Rights for Dissenters**: - As mentioned earlier, **appraisal rights** protect minority shareholders during mergers or major asset sales. If a minority shareholder votes against a merger but it still passes, they can demand to be bought out for cash at a fair value determined by an independent appraisal (rather than having to go along as a minority in a radically changed company).

This legal right forces the company or acquirer to pay a fair price to dissenters, preventing the majority from squeezing out minority shareholders at an unfair low valuation.

- i) **Regulatory Oversight and Enforcement** - Stock exchange rules and securities regulators also play a role in minority protection. For instance, related-party transactions (deals between the company and a major shareholder or their affiliates) often require special procedures – such as an independent committee review or majority-of-the-minority shareholder approval – to ensure the terms are fair. Insider trading prohibitions and regulations against market manipulation protect all shareholders (especially minorities who might otherwise be at an information disadvantage) by ensuring a level playing field in the market. Regulators can sanction controlling shareholders or directors who violate these rules.
- j) **Educating and Empowering Shareholders** - Finally, many corporate governance codes encourage shareholder education and the facilitation of shareholder activism. When minority shareholders are well-informed of their rights and have avenues to coordinate (e.g. via shareholder associations or proxy advisory firms), they can more effectively **band together to challenge any abuses**. For example, a group of minority investors might collectively meet the threshold to call a meeting or file a lawsuit, where individually they could not.

All these mechanisms aim to **prevent the abuse of power by majority shareholders and to ensure that minority shareholders are not disenfranchised or exploited**. A healthy corporate governance system recognizes that while majority rule is efficient for decision-making, there must be protections so that controlling shareholders (or management) do not trample on the legitimate interests of smaller investors. The ultimate goal is to maintain investor confidence that the playing field is fair – which, in turn, makes it more attractive to invest in companies knowing that rights will be respected regardless of one's ownership percentage.

In conclusion, the rights and obligations of shareholders form a balanced framework: **rights** empower shareholders to benefit financially and have a voice in the company, while **obligations** and **legal safeguards** ensure those rights are exercised responsibly and fairly. Together, they promote effective corporate governance, aligning the company's operations with the interests of its owners and protecting all shareholders from unfair treatment. By understanding and enforcing these rights and duties – from voting and dividends to loyalty and transparency – companies can achieve a governance structure that encourages investment, accountability, and long-term success.

Sources:

- OECD Principles of Corporate Governance – Shareholder Rights and Equitable Treatment
- UpCounsel, Shareholder Rights in a Private Company – overview of voting, information, dividend rights and minority protections (2025)
- Munich Business School, Shareholder – Simply Explained – summary of shareholder rights (voting, AGM, information) and obligations (capital contribution, loyalty, disclosure)
- AnyLearn Finance Dictionary – definition of shareholders’ residual claim on assets in liquidation
- Corporate Governance Texts – examples of legal remedies (direct and derivative lawsuits, oppression remedy, appraisal rights) available to shareholders
- ComplianceOnline – OECD Principle that all shareholders (including minority) should have effective redress for rights violations, and fair treatment (prohibition of insider trading and abusive self-dealing).

CHAPTER 5. RESPONSIBILITIES AND LIABILITIES IN CORPORATE GOVERNANCE

In the architecture of corporate governance, the concepts of **responsibility** and **liability** are foundational for ensuring that corporate actors—board members, executives, and shareholders—act with diligence, integrity, and accountability. While **responsibility** refers to the expected duties and ethical obligations of individuals within the governance framework, **liability** addresses the legal consequences when those duties are violated. Together, they form the enforcement backbone of effective governance systems.

This chapter explores the various dimensions of legal and ethical responsibility in corporate governance, focusing on **board directors**, **executive management**, and **shareholders**. It discusses how corporate laws in different jurisdictions (including the U.S., EU, UK, and emerging economies) define and enforce these duties, including the fiduciary duties of care and loyalty, managerial accountability, and legal recourse against shareholder abuse. It also highlights **civil**, **criminal**, and **administrative liability** mechanisms that hold individuals and entities accountable for governance failures.

Additionally, the chapter examines the systems of **internal control**, **whistleblower protection**, and **risk management** that serve as mechanisms for preventing misconduct. International case studies such as *Enron*, *Wirecard*, and *Toshiba* provide practical illustrations of how breaches of duty and governance collapse can have far-reaching implications—not only for firms but for entire financial systems.

Learning Objectives:

By the end of this chapter, students should be able to:

1. **Distinguish between responsibility and liability** in a corporate governance context and explain their significance in maintaining accountability.
2. **Describe the fiduciary duties** of board members (duty of care, duty of loyalty) and understand under what circumstances they may incur legal liability.
3. **Identify executive responsibilities and liabilities**, including managerial accountability for fraud, mismanagement, and unethical practices.
4. **Explain the conditions under which shareholders** may bear liability for corporate misconduct, including in cases of abuse of rights or veil piercing.
5. **Understand civil, criminal, and administrative liabilities** applicable to corporate actors, and recognize how these legal categories differ in scope and consequence.
6. **Evaluate mechanisms that prevent governance breaches**, such as compliance systems, internal audits, risk committees, and whistleblower protections.

7. **Analyze real-world governance failures**, identifying which duties were breached, who was held liable, and what institutional reforms followed.
8. **Apply international standards** (such as OECD Principles, SOX, and EU directives) to assess governance structures and liabilities in different jurisdictions.

5.1 The Concept of Responsibility and Liability in Corporate Law

In corporate law, **responsibility** generally refers to the duties and obligations that corporate actors (directors, executives, shareholders) are expected to fulfill in governing the company. It is about accountability and the duty to do something – for example, a board’s responsibility to oversee management or a CEO’s responsibility to run the company ethically and in compliance with the law. By contrast, **liability** refers to the legal accountability that arises when those responsibilities are breached or when laws are violated. In legal terms, liability means a party’s legal responsibility for acts or omissions, such that failing to meet one’s responsibilities can leave that party open to lawsuits or penalties. In short, responsibility is the expected obligation or role (which can be moral or legal), whereas liability is the consequence – often in the form of legal duty to compensate or face sanctions – if those obligations are not met. For example, a director has the responsibility to act in the company’s best interest, and if they fail (say by acting negligently or in self-interest), they may incur liability to the company or shareholders for any resulting harm. This distinction underpins corporate governance: assigning clear responsibilities to each governance actor, and enforcing liability when misconduct or negligence occurs, ensures accountability in the corporate structure.

5.2 Liability of Board of Directors Members

Members of the board of directors occupy a central role in corporate governance and have extensive responsibilities for overseeing the company’s affairs. They are entrusted with **fiduciary duties** – primarily the duty of care and the duty of loyalty – toward the corporation and its shareholders. The duty of care requires directors to act with reasonable diligence and prudence in decision-making (e.g. staying informed, reviewing relevant information, and deliberating carefully), while the duty of loyalty mandates that directors put the company’s interests above their own, avoiding conflicts of interest and self-dealing. If directors fulfill these duties in good faith, the “business judgment rule” typically protects them from liability for decisions that turn out poorly, as long as those decisions were informed and honest. However, if directors **breach their duties**, they can be held personally liable for the consequences.

Directors may face civil lawsuits – often by the company itself or shareholders on the company’s behalf (shareholder derivative suits) – if their actions or omissions cause

harm to the corporation or its investors. For instance, a board that approves a transaction with gross negligence or fails to supervise obvious wrongdoing could be found liable for losses. Courts generally require more than just hindsight poor outcomes; liability usually arises when directors exhibit *gross negligence* or bad faith. In Delaware (a leading U.S. corporate law jurisdiction), it's established that directors are liable for breach of the duty of care only if their conduct was “**grossly negligent**,” meaning a reckless indifference or deliberate disregard for the interests of stockholders – conduct “without the bounds of reason.” In other words, a mere mistake is not enough for liability; there must be a serious failure of oversight or an informed decision-making process. If such a breach is proven, directors can be required to compensate the company for the damage caused. Notably, many jurisdictions allow companies to indemnify directors or have D&O (Directors & Officers) insurance to cover such liabilities, but egregious breaches (especially of the duty of loyalty or fraud) are not shielded.

In cases of active wrongdoing – say, fraud, insider trading, corruption, or other illegal acts – individual board members can also face criminal charges or regulatory penalties. Good corporate governance standards emphasize that board members must ensure compliance with law; failing to do so can lead regulators to impose fines or bans on serving as director. For example, if a board knowingly allows financial statements to be falsified or ignores reports of significant legal violations, regulators (such as securities commissions) may hold those directors accountable in administrative proceedings, and prosecutors may pursue charges if laws were broken. Thus, board members are not only morally responsible but can be *legally liable* for governance failures. Major corporate governance codes worldwide stress that boards must be accountable for the company's performance and ethical conduct. This accountability means that when governance lapses occur (such as major accounting frauds or compliance failures), board members can be subject to lawsuits by shareholders and enforcement actions by authorities. In summary, the law imposes personal liability on directors as a crucial check: it incentivizes them to carry out their oversight duties diligently, under the threat of civil damages or even criminal sanctions if they abdicate those duties or engage in misconduct.

(*Short recap*: Directors must act with care, loyalty, and good faith. If they fail – for example, by gross negligence or self-dealing – they can be personally sued for losses or even face criminal/administrative penalties. Corporate governance regimes use these liability rules to ensure directors remain accountable.)*

5.3 Executive Management Liability

Executive management, particularly top executives like the CEO and CFO, also bear critical responsibilities in corporate governance and can likewise incur personal liability for failures or misconduct. While directors oversee the broad direction, **executives are responsible for day-to-day operations and implementing the board's strategy.** Executives owe duties to the company similar to those of directors – in many jurisdictions, officers (executives) are **fiduciaries** of the company, expected to act in its best interests with due care and loyalty. Modern corporate law has increasingly clarified that corporate officers must uphold oversight and compliance within their areas of authority just as directors must for the company overall. This means a CEO or other senior manager can be held liable if they consciously ignore “red flags” of wrongdoing in the business or personally engage in misconduct (such as fraud or harassment), breaching their duty of good faith.

If an executive's actions cause harm to the company or its stakeholders, that executive can be sued. For example, if a CEO intentionally misstates financial results leading to investor losses, shareholders may bring a lawsuit (including class actions in securities law contexts) against the CEO for misrepresentation. The company itself might also take action against an executive for breaching their employment contract or duty (for instance, suing a former executive who embezzled funds or engaged in negligence that damaged the firm). In some cases, executives owe duties directly to shareholders or creditors – for instance, in insolvency situations, many laws impose liability on managers who continue to incur debts when the company is insolvent (wrongful trading). As a result, **executives are not shielded from personal responsibility** simply by the corporate entity: when they act wrongfully or fail in their oversight, they may be personally liable to those harmed by their actions.

Corporate executives can face criminal charges for a range of corporate misconduct. A prominent example is financial fraud – CEOs/CFOs who knowingly falsify financial statements can be prosecuted for fraud or securities law violations. In response to scandals like Enron, laws have tightened executive accountability: under the U.S. Sarbanes–Oxley Act, chief executives and financial officers must certify the accuracy of financial reports, and **knowingly certifying false reports is a criminal offense** that can lead to hefty fines and imprisonment. In practice, this has meant that after major frauds, top managers have been indicted and sometimes jailed (e.g. Enron's CEO Jeffrey Skilling and CFO Andrew Fastow were convicted of fraud; WorldCom's CEO Bernard Ebbers was convicted, etc.). Beyond accounting fraud, executives can be criminally liable for bribery (under anti-corruption laws), insider trading, tax evasion, environmental crimes (if they direct the company to violate environmental laws), and even for **willful failure to act** (for instance, some jurisdictions apply a “responsible

corporate officer” doctrine in health, safety, or environmental law, holding executives liable if they should have prevented a violation but didn’t).

Executives may also face administrative sanctions from regulators. For example, securities regulators can impose bans preventing individuals from serving as officers or directors of public companies if they are found to have violated securities laws or governance standards. Regulatory bodies can also levy fines on executives (apart from any criminal fines) – such as the U.S. SEC imposing penalties on a CEO for misreporting, or a central bank fining bank executives for compliance failures. In sum, **executive management’s liability** in corporate governance is a crucial part of ensuring they exercise their power responsibly. Just like directors, executives are expected to proactively uphold legal and ethical standards, with personal liability as a backstop. This has been reinforced by both legislation and court rulings affirming that officers hold the **same core duties** of care, loyalty, and oversight as directors, and “are protected by limited liability only in most circumstances – egregious abuse or bad-faith conduct removes that protection”. The risk of being sued, fined, or even jailed serves to motivate executives to prioritize compliance and ethical management as part of good governance.

5.4 Shareholders’ Liability in Cases of Abuse

Shareholders are the owners of the company and enjoy the benefit of **limited liability**. Under the principle of limited liability, shareholders are generally *not personally liable* for the debts or obligations of the corporation beyond the capital they invested. In other words, if the company fails, shareholders can lose the value of their shares, but their personal assets are protected. As one source explains, the law ensures that in most circumstances, shareholders’ losses in case of business failure “**cannot exceed the amount they paid for their shares**”. This rule is fundamental to corporate law, as it encourages investment by capping risk. However, **there are important exceptions** when shareholders abuse their rights or misuse the corporate form, wherein the law will hold shareholders accountable despite limited liability.

In cases of serious abuse, courts may “pierce” or “lift” the corporate veil – a legal decision that sets aside the company’s separate legal personality to treat the acts or liabilities of the company as those of the shareholders. This is an extraordinary remedy, applied in *exceptional circumstances* typically involving fraud, illegality, or a complete domination of the company by shareholders for improper purposes. For example, if a controlling shareholder essentially uses the corporation as an alter ego to evade laws or siphon assets (turning the company into a mere façade), a court can decide that the individual and the company are one and the same. In that event, the **shareholder may be held personally liable** for the company’s debts or wrongdoings. A classic scenario is a small

business owner who undercapitalizes their company and intermingles personal and corporate funds to such an extent that observing the corporate form would sanction fraud or injustice – a court might make that owner pay creditors from personal assets. Different jurisdictions have different tests for veil-piercing, but the common thread is *preventing abuse of the corporate form*. It's a way to ensure that limited liability is not used as a shield for wrongful conduct. Notably, veil-piercing is rare and usually limited to closely-held companies; for large publicly-traded companies, it's virtually unheard of, given the diffuse ownership and regulatory oversight.

Even without piercing the veil, the law provides mechanisms to hold **controlling shareholders** liable when they abuse minority shareholders or the corporation. In many legal systems, majority or controlling shareholders cannot use their power in bad faith to oppress minority shareholders. Such abuse can take many forms – e.g. siphoning corporate value to themselves, denying minority shareholders dividends or information, or forcing minority owners out unfairly (squeeze-outs). Courts and statutes have developed doctrines like the *shareholder oppression remedy* or *unfair prejudice remedy*: minority shareholders can sue controlling shareholders (and often directors as well) alleging oppressive conduct. If proved, judges may order various remedies, including damages, a buyout of the minority's shares at a fair price, or reversal of unfair decisions. In some jurisdictions (for instance, close corporations in certain U.S. states or family companies in civil law countries), courts have even recognized that controlling shareholders owe **fiduciary duties to minority shareholders**, akin to partners in a partnership. Breaching this duty (for example, by self-dealing to the detriment of the minority) can make the controlling shareholder directly liable to the minority for losses.

Additionally, there are statutory provisions in many countries to deter shareholder abuse. For example, insolvency laws may impose “**wrongful trading**” or “**insolvency trading**” liability on shareholders who, while controlling the company, allowed it to incur debts when they knew the company was insolvent – effectively making those shareholders contribute to the unpaid debts. Corporate laws also often empower regulators to sanction shareholders in takeover scenarios (e.g. failing to treat minority shareholders equally in mandatory buyouts). And if a shareholder is actively involved in company management (as is common in small firms), they might be deemed a *de facto* director or officer, which carries personal liability for certain breaches (blurring the line between shareholder and manager liability).

In summary, **shareholders' liability** in corporate governance is limited in normal circumstances, but “**limited liability**” is not absolute. When shareholders commit abuse – such as using the corporation as a sham or oppressing other shareholders – the law provides remedies to make them answerable. Courts can pierce the veil to

attach corporate debts to shareholders, and legal actions for shareholder oppression or breach of duty can force controlling shareholders to compensate others or relinquish ill-gotten gains. These mechanisms are crucial to prevent owners from exploiting the corporate structure in unjust ways, striking a balance between encouraging investment and protecting against misconduct.

5.5 Mechanisms of Prevention and Detection of Violations

A cornerstone of good corporate governance is establishing robust mechanisms to **prevent, detect, and address violations** of laws and ethical standards. These mechanisms create a system of checks and balances that catch problems early and often deter wrongdoing outright. Key preventive and detective mechanisms include:

- **Clear Governance Policies and Codes of Conduct:** Companies should have written policies, procedures, and ethical codes that set expectations for legal compliance and integrity. When everyone in the organization understands the rules (for example, anti-fraud policies, conflict of interest policies), it reduces ambiguity about what is acceptable and puts employees on notice of their responsibilities. A strong ethical code, backed by regular training, helps create a culture where misconduct is less likely to occur or be tolerated.
- **Board Oversight and Separation of Powers:** An active, informed, and independent board of directors is one of the best defenses against corporate misdeeds. Good governance often involves separating the role of Board Chair from CEO to avoid concentrating too much power in one person. Independent directors (who are not part of management) on the board and its committees can provide unbiased oversight of management's actions. The board (and especially committees like the Audit Committee) should exercise vigilant oversight of financial reporting and compliance. Such oversight can **eliminate opportunities for abuse by creating checks and balances** at the top of the company.
- **Robust Internal Controls and Audit Functions:** Companies must implement internal control systems to monitor operations and financial transactions. This includes segregation of duties (no single individual should control a process end-to-end unchecked), approval hierarchies, and reconciliation processes. A well-functioning **internal audit department** or compliance department can regularly review practices and flag anomalies. Regular financial audits – both internal and external – are crucial. As one guidance notes, firms should have “*clear financial reporting procedures and regular audits to ensure financial statements are accurate and transparent.*” These controls help **detect and prevent fraudulent or**

corrupt activities early. For example, an automated control might detect if an executive tries to override spending limits, or an internal auditor might notice revenue recognition irregularities, prompting investigation before it spirals.

- **Whistleblower and Reporting Mechanisms:** Encouraging a speak-up culture is key to detection. Mechanisms such as whistleblower hotlines or other confidential reporting channels allow employees (and even outsiders like vendors) to report suspected misconduct without fear of retaliation. Protecting whistleblowers is vital – many major frauds (e.g. Enron, WorldCom) were ultimately exposed by insiders who spoke up. Effective corporate governance establishes that **reports of suspicious activity will be taken seriously and addressed**, which can stop wrongdoing in its tracks. Laws in many countries now require or incentivize such mechanisms (for instance, the Sarbanes–Oxley Act mandates audit committees of U.S. public companies to have procedures for whistleblower complaints). Early detection through whistleblowers or tip-offs is one of the most proven ways to catch fraud that evades formal controls.
- **Compliance Programs and Training:** Beyond passive controls, companies deploy active compliance programs. This means dedicating personnel (compliance officers) and resources to ensure the company stays within legal requirements (such as anti-bribery laws, data protection regulations, etc.). Regular training sessions on topics like anti-harassment, anti-corruption, and safety protocols help prevention by educating employees. Compliance teams also perform risk assessments to identify where violations are likely and address those proactively. For example, a compliance team might run an anti-fraud risk assessment and then institute tighter controls or oversight in high-risk areas (like procurement or sales incentives).
- **External Oversight and Transparency:** Mechanisms external to the firm also play a role. Independent external auditors review financial statements annually, providing assurance that the books are free of material misstatement. Regulatory filings and required disclosures (financial reports, governance reports) increase transparency, which in turn enables shareholders and analysts to spot red flags. Good governance encourages **transparency and accountability**, such as disclosing conflicts of interest and related-party transactions, and treating all stakeholders fairly. The knowledge that outside eyes (regulators, investors, media) are on the company can deter executives and directors from unethical behavior.

All these mechanisms work together to create a **strong control environment**. As a result, companies with good governance practices are better at **preventing fraud and**

corruption from occurring, and detecting any irregularities at early stages. For instance, a company that separates the CEO and Chair roles, implements rigorous internal audits, and fosters a culture of transparency is far less likely to suffer a major governance scandal than one without those safeguards. When governance mechanisms fail or are absent, problems fester – but when they are in place, issues can be caught “before it becomes costly or damaging”. In summary, prevention and detection tools in corporate governance include a combination of **clear rules, proper oversight structures, internal and external audits, open reporting channels, and a culture of ethical accountability**, all aimed at ensuring compliance and integrity.

5.6 Civil, Criminal, and Administrative Liability in Corporate Governance

Corporate governance failures can lead to different types of liability for the individuals and companies involved. It is important to distinguish **civil, criminal, and administrative liability**, as each arises from a different legal process and entails different consequences:

- **Civil Liability:** Civil liability refers to responsibility under civil law, typically enforced through lawsuits by private parties or, in some cases, by regulators through civil court actions. In the corporate governance context, civil liability often means the obligation to compensate for harm caused by wrongful acts or omissions. For example, if shareholders suffer losses because executives issued misleading statements, the shareholders might sue in civil court for damages (as in a securities fraud class action). Likewise, a company can sue a director for breaching his duty and causing losses to the firm. The outcome of civil liability is usually **monetary compensation or injunctive relief**, not jail time. Civil cases have a lower burden of proof (“preponderance of evidence” in common law systems). An important feature is that multiple stakeholders can pursue civil claims: shareholders, creditors, other companies, or even the company itself. For instance, after a governance scandal, shareholders might bring derivative suits on behalf of the company against board members, or creditors might sue auditors or directors for negligence. **Civil liability is thus a key mechanism for redress in corporate governance failures**, focusing on making the victims whole or correcting the wrong (e.g., voiding an unfair transaction). (*Example:* In the Enron case, shareholders and investors pursued civil claims to recover losses from banks and board members; in a smaller company, if a majority shareholder abuses minority rights, a civil court can order a buyout or damages to the minority.)*

- **Criminal Liability:** Criminal liability involves a breach of criminal law – offenses considered wrongs against society or the state, prosecuted by government authorities (e.g., a District Attorney or public prosecutor). In corporate settings, criminal liability can be imposed on both individuals *and* the corporate entity for certain misconduct. Many jurisdictions now recognize **corporate criminal liability**, meaning the corporation itself can be charged (and fined) for crimes like fraud, bribery, environmental crimes, etc., alongside or instead of individuals. For individuals (directors, officers, employees), criminal liability in governance arises if they engage in activities such as securities fraud, insider trading, embezzlement, bribery of officials, or willful violations of laws (for example, knowingly selling unsafe products leading to consumer deaths could trigger criminal charges). The consequences of criminal liability are typically **punitive**: fines, asset forfeiture, and for individuals, imprisonment is possible. The burden of proof is higher (“beyond a reasonable doubt”). **Criminal liability serves as a strong deterrent** in corporate governance. The threat of jail or heavy fines is meant to discourage willful misconduct. In practice, after major corporate scandals, it’s common to see criminal investigations – e.g., top executives being indicted. A notable instance is the prosecution of WorldCom and Enron executives for accounting fraud. Another example: laws like the **Sarbanes–Oxley Act** introduced specific criminal provisions (such as making it a crime for CEOs/CFOs to certify false financial reports, or to retaliate against whistleblowers). Similarly, anti-corruption statutes (like the FCPA in the US or UK Bribery Act) hold corporate actors criminally liable for paying bribes. In short, criminal liability in corporate governance addresses the most egregious breaches, carrying penalties intended to punish and prevent such behavior in the future.
- **Administrative Liability:** Administrative liability occupies a middle ground – it involves regulatory or administrative agencies enforcing rules, often without going through a full court trial as in civil or criminal cases. Administrative liability typically means a breach of regulatory laws or rules that is addressed by an administrative body (such as a securities commission, stock exchange, or industry regulator) via penalties like fines, license suspensions, or other sanctions. In corporate governance, **regulatory agencies frequently take administrative action** for violations of securities laws, listing requirements, or governance codes. For instance, a stock exchange might fine a company for failing to timely disclose material information (an administrative penalty). Securities regulators can impose sanctions on directors (like banning them from serving on boards for a number of years) through administrative proceedings. An example definition: administrative liability refers to actions against the person or entity’s licenses or regulatory status – e.g. monetary fines, suspension

or revocation of a business license – typically imposed by a specialized tribunal or agency. These do not involve criminal convictions, but they can have significant impact (loss of privileges, reputational damage, etc.). For corporate actors, being found administratively liable could mean, for example, a CEO being barred from the securities industry, or the company paying a civil penalty to a regulator for internal control failures. Administrative proceedings usually have more streamlined processes and can sometimes impose penalties more quickly than courts. Many corporate governance failures result in all three tracks of liability: *regulators impose fines (administrative)*, *shareholders sue (civil)*, and *prosecutors investigate fraud (criminal)*. Each track has a distinct role. For instance, after a financial misreporting scandal: the company might pay an SEC fine (administrative), compensate investors via a class-action settlement (civil), and see certain executives convicted of fraud (criminal).

In conclusion, **civil, criminal, and administrative liabilities are complementary tools** to enforce corporate governance. Civil liability focuses on *compensation and corrective justice*, criminal liability on *punishment and deterrence*, and administrative liability on *regulatory compliance and sanctions* (often tailored to industry rules). Good governance aims to avoid all of these by ensuring compliance up front, but when failures occur, understanding the spectrum of liabilities is crucial. It means corporate decision-makers not only face the loss of reputation but also legal consequences on multiple fronts – a strong incentive to uphold their responsibilities diligently.

5.7 International Case Studies of Governance Failure and Liability of Parties Involved

History provides many **high-profile case studies** where corporate governance failures led to severe consequences and legal liabilities for the parties involved. Examining a few international examples illustrates how lapses in responsibilities result in accountability:

- **Enron (USA, 2001) – Accounting Fraud and Board Failure:** Enron Corporation’s collapse remains one of the most notorious governance failures. Top executives orchestrated a complex accounting fraud, using off-balance-sheet entities to hide debt and inflate profits. This “*web of deceit and corruption*” was abetted by weak oversight – the board of directors (and external auditor Arthur Andersen) failed to detect or stop the manipulation. When the scheme unraveled, Enron’s stock price imploded, destroying over \$60 billion in shareholder value and leading to thousands of job losses. **Liability:** The fallout saw significant legal consequences. Enron’s CEO and CFO were prosecuted and convicted for fraud. The board faced numerous civil lawsuits from shareholders and creditors

alleging breach of fiduciary duty. Arthur Andersen was found guilty of obstruction of justice (related to document shredding) – a verdict that, despite later being overturned on appeal, effectively destroyed the audit firm. Enron’s case directly led to new legislation (Sarbanes–Oxley Act) to tighten corporate governance and executive liability (e.g., requiring executive financial statement certifications and stronger audit committee roles). It highlighted that a **lack of corporate governance can lead to “massive financial meltdown”** and underscored the importance of accountability at all levels.

- **Parmalat (Italy, 2003)** – *Fraud and False Accounting*: Often dubbed “Europe’s Enron,” Parmalat was an Italian dairy and food giant that collapsed after \$14 billion in fake accounts was exposed. The founder and CEO, Calisto Tanzi, had siphoned money and falsified revenues for years. The board was either unaware or complicit, and auditors failed to uncover the deception. **Liability**: Italian authorities prosecuted Tanzi and other executives for market manipulation, false accounting, and embezzlement – Tanzi was sentenced to prison. Civil actions by investors proceeded in multiple jurisdictions. Banks that facilitated Parmalat’s bond sales settled lawsuits for damages. This case led to reforms in Italy on financial reporting and auditor oversight, illustrating globally that executives and boards will be held liable for major fraud.
- **Satyam Computer Services (India, 2009)** – *Corporate Fraud and Auditor Lapses*: Satyam was a leading Indian IT company until its Chairman confessed to a \$1.5 billion accounting fraud (overstating cash and assets). The case was known as “India’s Enron.” **Liability**: The chairman (B. Ramalinga Raju) and several executives were arrested and eventually convicted of fraud. The company’s auditors (PwC’s India affiliates) were sanctioned for negligence. Shareholders in the U.S. pursued class-action suits (Satyam traded as an ADR), which were settled for significant sums. India’s regulators toughened listing rules and board requirements (including mandating more independent directors) as a result. Satyam’s case underlined the importance of board vigilance and internal controls; its independent directors were even criticized for not questioning unrealistic financial results. It showed that in emerging markets, too, governance failures meet with legal action and reform.
- **Volkswagen “Dieselgate” (Germany, 2015)** – *Emissions Cheating and Cultural Failure*: Volkswagen AG, one of the world’s largest automakers, was found to have installed “defeat devices” in millions of diesel cars to cheat emissions tests. This was a deliberate scheme by management to flout environmental regulations and make the cars appear cleaner than they were. It revealed a “*pervasive culture of*

deceit” within the company, prioritizing profit and sales over legal compliance and ethics. **Liability:** The scandal had enormous legal repercussions. VW as a company faced over \$30 billion in fines, penalties, and settlements worldwide – including criminal fines in the U.S. for conspiracy to defraud and civil penalties in multiple countries. Several VW executives were individually charged; in the U.S., multiple managers pled guilty or were indicted for fraud and Clean Air Act violations (though some remained in Germany out of extradition reach). The longtime CEO, Martin Winterkorn, resigned and later was charged in Germany for fraud (his case is ongoing as of 2025). Shareholders also sued VW – for instance, in Germany investors pursued claims for the drop in share price alleging the company’s failure to disclose the cheating in a timely way (a violation of capital markets law). Volkswagen’s board was criticized for insufficient oversight of management and a corporate culture that discouraged dissent. The case led to a shake-up in VW’s governance, including reforms to compliance systems and accountability. It also triggered broader industry scrutiny, reinforcing that **legal systems will hold companies and their leaders liable for systemic fraud**, even in countries known for strong corporate governance. VW’s brand and trust were severely damaged, illustrating how governance failures cause not just legal liability but lasting reputational and financial harm.

- **Wells Fargo (USA, 2016) – Sales Misconduct and Oversight Failure:** Wells Fargo, a large American bank, admitted that employees had opened millions of unauthorized customer accounts to meet aggressive sales targets. This was not a one-off rogue act, but a widespread problem stemming from pressure from top management and a corporate culture fixated on cross-selling. **Liability:** The bank faced civil and administrative penalties – regulators (Consumer Financial Protection Bureau, OCC) fined Wells Fargo \$185 million initially, and more fines followed for related issues. The CEO at the time, John Stumpf, was forced to resign and later personally paid civil fines (and was banned from the banking industry by regulators). The board of directors also had to claw back executive compensation and was taken to task by shareholders; in fact, Wells Fargo’s board directors were subject to a rare vote against their re-election by angry investors. Wells Fargo’s example shows that even if an issue is not “fraud” in the traditional sense, **a pattern of unethical business practices can be viewed as a governance failure** – the lack of proper oversight and a toxic incentive structure led to mass misconduct, for which the company and leaders bore liability. It served as a cautionary tale that boards must pay attention to corporate culture and compliance, not just financial metrics.

- **Lehman Brothers (USA, 2008) – Risk Management Failure:** The investment bank Lehman’s bankruptcy was the largest in U.S. history and a key event in the 2008 global financial crisis. While not a case of fraud like some others, it was a **governance failure in risk oversight**. Lehman took on excessive risk in subprime mortgages and used accounting tricks (like Repo 105 transactions) to hide true leverage. The board and executives failed to grasp or control these risks. **Liability:** Uniquely, Lehman’s collapse didn’t result in major convictions of its executives (unlike Enron or WorldCom). However, there were civil suits – Lehman’s shareholders and creditors sued executives and directors for mismanagement. Most notably, Lehman’s failure sparked regulatory reforms (such as the Dodd-Frank Act) to impose stricter risk governance on banks, and it prompted soul-searching about direct legal accountability for excessive risk-taking. Although the CEO Dick Fuld wasn’t charged with a crime, he and other leaders were subjected to public rebuke (Congressional hearings) and civil litigation. The lesson from Lehman is that *the absence of illegal conduct does not mean the absence of a governance failure*. When boards do not properly oversee risk, the outcome can be just as catastrophic, and it invites government intervention and stricter laws to prevent a recurrence.

These case studies (among others like **WorldCom**, **UK’s Carillion**, **Japan’s Olympus scandal**, etc.) reveal common themes and lessons in corporate governance: lack of ethical leadership, weak board oversight, inadequate internal controls, and cultures that discouraged transparency all played a role. The consequences were severe not only for the companies (bankruptcies, fines, and reputational ruin) but also for the individuals (prison terms, personal financial liability, and career destruction). In many of these cases, reforms and stricter regulations followed, underlining that each failure becomes a cautionary tale for the business community.

Good governance could have mitigated or prevented these disasters. For example, an active and independent board might have questioned Enron’s off-books entities or Volkswagen’s implausibly good diesel performance. A company culture valuing long-term integrity over short-term profit might have averted the Wells Fargo scandal. Across these cases, we see that **ethical leadership and a strong tone at the top are crucial**; boards must be vigilant and “*independent, active, and vigilant in overseeing management*”; transparent financial reporting and effective audits are non-negotiable; and protecting whistleblowers or dissenting voices can surface problems before they explode. When those elements are missing, companies become prone to wrongdoing and collapse. And significantly, these cases demonstrate that the legal system *does* respond: **directors and officers can be held liable and face real consequences when governance fails** – whether through shareholder litigation, regulatory action, or criminal prosecution. Internationally, this builds a consensus that strong corporate

governance is not just good practice but essential for legal compliance and corporate survival. Each scandal reinforces the imperative for companies to strengthen their governance frameworks to protect stakeholders and avoid the fate of those case studies, where governance breakdowns led to “catastrophic consequences” and subsequent accountability for those at fault.

Self-Assessment Quiz:

1. What is the difference between *responsibility* and *liability* in corporate governance.
2. Why is establishing liability important in the context of agency theory?
3. Under what conditions can members of the board of directors be held liable for their actions?
4. Describe how the “business judgment rule” protects directors in some jurisdictions.
5. What are some common legal grounds for holding CEOs and other executives personally liable?
6. How does executive liability differ from that of non-executive board members?
7. In what scenarios can shareholders be held liable beyond their investment in company shares?
8. What does “piercing the corporate veil” mean, and how does it apply to shareholder liability?
9. Identify two internal mechanisms a company can use to detect and prevent breaches of governance responsibilities.
10. How do whistleblower protections contribute to accountability?

Sources:

- Aguilera, R. V., & Cuervo-Cazurra, A. (2009). Codes of good governance. *Corporate Governance: An International Review*, 17(3), 376–387. <https://doi.org/10.1111/j.1467-8683.2009.00737.x>
- Armour, J., Hansmann, H., & Kraakman, R. (2009). Agency problems and legal strategies. In *The anatomy of corporate law: A comparative and functional approach* (2nd ed., pp. 35–71). Oxford University Press.
- Coffee Jr, J. C. (2007). *Gatekeepers: The professions and corporate governance*. Oxford University Press.
- Ferrarini, G., Moloney, N., & Chiodini, M. (2005). Executive remuneration in the EU: The context for reform. *Oxford Review of Economic Policy*, 21(2), 304–325.
- OECD. (2015). *G20/OECD Principles of Corporate Governance*. Paris: OECD Publishing.
- OECD. (2023). *Corporate Governance Factbook 2023*. Paris: OECD Publishing.

- Peregrine, M., & Elson, C. (2021, April 5). Twenty years later: The lasting lessons of Enron. *Harvard Law School Forum on Corporate Governance*. <https://corpgov.law.harvard.edu/2021/04/05/twenty-years-later-the-lasting-lessons-of-enron/>
- Solaiman, S. M. (2013). Lifting the corporate veil to impose criminal liability on corporate group members: The need to lift more than just the veil. *Commonwealth Law Bulletin*, 39(2), 276–299.
- World Bank. (2022). *Corporate governance of state-owned enterprises: A toolkit*. Washington, D.C.: World Bank Publications.
- Zetsche, D. A. (2005). Corporate governance in emerging markets. *Journal of Corporate Law Studies*, 5(2), 289–333.

CHAPTER 6: TRANSPARENCY, DISCLOSURE, AND ETHICS IN CORPORATE GOVERNANCE

Transparency and ethical conduct are cornerstones of effective corporate governance. In the wake of major corporate scandals and the evolving expectations of stakeholders, regulators worldwide have intensified requirements for disclosure and accountability. This chapter examines the role of transparency in corporate operations, the obligations for financial and non-financial reporting, international standards governing disclosures, and the critical functions of audits in upholding transparency. It also explores the integration of business ethics into governance through codes of conduct, the implementation of anti-corruption compliance measures, and the protection of whistleblowers. Through real-world case studies (such as Enron, Volkswagen, and Wirecard) and current developments (including reforms up to 2025), the chapter highlights how transparency and ethics have become integral to corporate governance frameworks internationally.

Learning Objectives: After studying this chapter, students should be able to:

- **Explain the importance of transparency** in corporate operations and how it builds trust and accountability in governance.
- **Describe financial and non-financial reporting obligations** for companies and how these disclosures are regulated in different jurisdictions.
- **Understand international reporting standards** like IFRS for financial reporting and GRI for sustainability reporting, including recent developments in integrated and sustainability disclosures.
- **Distinguish the roles of internal and external audits** in ensuring transparency and reliability of corporate disclosures, and discuss audit reforms prompted by corporate failures.
- **Discuss the significance of business ethics and corporate codes of conduct**, including how they guide organizational behavior and stakeholder expectations.
- **Identify key anti-corruption laws and compliance frameworks** (e.g. OECD Convention, FCPA, UK Bribery Act, ISO 37301) and explain how companies implement policies to prevent bribery and corruption.
- **Explain whistleblower protection mechanisms** and why protecting whistleblowers is vital for transparency and ethical corporate culture.

6.1. The Importance of Transparency in Corporate Operations

Transparency in corporate governance refers to the open and timely disclosure of all material information regarding a company's operations, performance, and governance. It is widely regarded as a hallmark of good governance practices. Transparent operations enable shareholders and stakeholders to make informed decisions and to hold management accountable. In essence, transparency helps to **foster trust, accountability, and integrity** within an organization. When companies communicate honestly about their financial health, strategic decisions, risks, and uncertainties, stakeholders gain confidence that the business is being managed in a fair and responsible manner.

A lack of transparency, by contrast, can conceal problems and enable misconduct. Major corporate collapses have illustrated the perils of opaque practices. For example, *Enron* infamously hid enormous liabilities off its balance sheet through complex special-purpose entities, creating an illusion of financial strength. This deception – essentially a failure of transparency – led to one of the largest accounting frauds in history and the company's eventual bankruptcy. Likewise, *WorldCom* executives improperly capitalized expenses to overstate earnings; the fraud went undisclosed until uncovered by internal auditors in 2002, resulting in billions of dollars in investor losses. These scandals eroded public trust and prompted sweeping governance reforms, underlining that **inadequate disclosure can facilitate fraud and scandal** with devastating consequences.

Transparent corporate operations are crucial not only to prevent wrongdoing but also to promote efficient markets. The OECD's **Principles of Corporate Governance** emphasize that timely and accurate disclosure of all material matters – including financial performance, ownership, and governance – is essential to an effective governance framework. Such disclosure reduces information asymmetry between insiders (managers, directors) and outsiders (shareholders, creditors, regulators), thereby reducing the risk of insider abuse and improving investor confidence. Research supports that transparency lowers a firm's cost of capital: investors are willing to pay a premium for companies with clear, reliable reporting, as they perceive less risk. In the long run, transparency contributes to market integrity and stability by enabling sound investment decisions and facilitating oversight by regulators and the public.

Transparency is also tied to **accountability**. When corporate decisions and their rationale are visible to stakeholders, corporate leaders are more likely to act responsibly, knowing they will be subject to scrutiny. For instance, greater transparency in board decisions and executive pay has allowed shareholders to question and influence governance practices. In contrast, opacity can shield poor

management or unethical behavior from discovery. A “**trust but verify**” mentality has taken hold among investors in recent years – stakeholders demand evidence of good governance through disclosure, rather than relying on reputational trust alone. This dynamic incentivizes boards and executives to maintain high levels of transparency to retain stakeholder trust.

In summary, transparency in corporate operations is not an abstract ideal, but a practical necessity for good governance. It builds confidence among investors, employees, and the public; it deters fraud and mismanagement by shining a light on corporate activities; and it enables accountability by equipping stakeholders with the information needed to evaluate and influence corporate behavior. Many jurisdictions have therefore embedded transparency requirements into law and listing rules, which we explore in the next section.

6.2. Financial and Non-Financial Reporting Obligations

To ensure transparency, companies around the world are subject to extensive **financial reporting obligations**. Publicly traded companies, in particular, must prepare and publish annual financial statements (and often interim quarterly or semi-annual reports) that accurately reflect their financial position and performance. These financial reports are typically required by law or regulation and must conform to recognized accounting standards (such as IFRS or national GAAP). For example, in the United States, the Securities Exchange Act mandates that public companies file annual reports (Form 10-K) and quarterly reports (Form 10-Q) disclosing detailed financial and operational information. In the European Union, the **Transparency Directive** and related regulations similarly require listed companies to publish annual audited financial statements and mid-year financial reports, ensuring a continuous flow of reliable information to the market. Most jurisdictions also oblige companies to disclose any material developments promptly (such as significant acquisitions, changes in leadership, or risks), through stock exchange announcements or current reports, so that investors are not misled by outdated information.

Financial reporting obligations usually include the preparation of a **balance sheet, income statement, statement of cash flows, and statement of changes in equity**, along with accompanying disclosures and management’s discussion and analysis. The integrity of these reports is bolstered by requirements for **external auditing** (discussed in section 6.4) and by senior management certifications. Under the U.S. Sarbanes-Oxley Act (2002), CEOs and CFOs must personally certify the accuracy of financial statements and the effectiveness of internal controls over financial reporting. This measure, introduced after Enron and WorldCom, was designed to impose direct responsibility on top executives for transparent reporting. Indeed, *Sarbanes-Oxley*

greatly increased financial transparency by prohibiting misleading off-balance-sheet arrangements and requiring firms to report on material changes in financial condition in real time.

In addition to financial results, companies today face growing **non-financial reporting obligations**. Regulators and stakeholders recognize that a company's social and environmental impact and governance practices (collectively, ESG factors) can be material to its long-term success. Many jurisdictions now mandate disclosure of non-financial information, often under the umbrella of sustainability or corporate social responsibility (CSR) reporting. For instance, the **European Union's Non-Financial Reporting Directive (2014/95/EU)** required large public-interest entities (like listed companies and banks) to include in their annual reports a non-financial statement on environmental matters, social and employee issues, human rights, and anti-corruption efforts. This directive, effective from 2018, aimed to advance the EU's sustainability and CSR agenda by making such disclosures a legal duty. By compelling companies to be transparent about their carbon emissions, diversity policies, supply chain ethics, and similar issues, regulators sought to increase corporate accountability beyond just financial performance.

The push for non-financial transparency has accelerated with new reforms. In 2022, the EU adopted the **Corporate Sustainability Reporting Directive (CSRD)**, which significantly expands the scope and detail of mandatory sustainability reporting. Under the CSRD, approximately 50,000 companies in Europe (including large non-listed firms and non-EU companies with substantial EU operations) will need to report on a broad range of sustainability topics according to rigorous **European Sustainability Reporting Standards (ESRS)**. These reports, starting from the 2024 financial year for the largest companies, must be audited or assured and will cover areas such as climate change risks, environmental impacts, social and employee matters, respect for human rights, and diversity and inclusion. This development signals that non-financial information is considered as vital as financial data for stakeholders to assess corporate performance and risk. Other jurisdictions globally – from the UK and Australia to India and Brazil – have likewise introduced or strengthened requirements for disclosing sustainability or governance information, whether through annual reports or dedicated sustainability reports.

Beyond formal regulatory obligations, **stock exchange listing rules and industry codes** often require or encourage transparency. Many national corporate governance codes (usually on a “comply or explain” basis) call for companies to disclose their governance structures, board remuneration, risk management, and related-party transactions. For example, companies may publish an annual corporate governance report detailing how they apply governance principles. In some markets, failure to be transparent (for instance, not disclosing a conflict of interest or a material risk) can

result in enforcement actions or reputational damage even if not explicitly illegal. Thus, the modern corporate norm is one of ever-increasing disclosure: financial statements supplemented by management commentary, sustainability reports, governance reports, and other narratives that together provide a holistic, transparent view of the company.

Crucially, transparency is not merely about **quantity of information** but also **quality**. Regulators emphasize that disclosures should be **accurate, timely, and understandable**. Dumping large volumes of data without clear context (sometimes referred to as “check-the-box” transparency) does not truly inform stakeholders. Effective transparency means highlighting the information that matters most: for example, risks that could affect the firm’s future (like technological disruptions or climate-related risks), assumptions underlying critical accounting estimates, or explanations for significant changes in performance. As one academic observer put it, transparency ensures stakeholders have access to accurate and timely information, which is essential for building trust in the company’s operations. Companies that master this clear communication often enjoy better relations with investors and communities, whereas those that obscure or distort information (intentionally or through poor systems) often face skepticism and a higher cost of capital.

In summary, the obligations for both financial and non-financial reporting form a dense web of requirements that drive corporate transparency. Through periodic financial reports, sustainability disclosures, and ad-hoc material updates, companies are expected – and increasingly required by law – to **paint an honest public picture** of their activities. Meeting these obligations not only keeps companies in legal compliance but also strengthens their governance by subjecting their decisions and performance to the illuminating effect of public and regulatory scrutiny.

6.3. International Reporting Standards (e.g., IFRS, GRI)

Corporate disclosures are governed by standards that aim to ensure **consistency and comparability** of information across companies and borders. On the financial reporting side, the most significant international standards are the **International Financial Reporting Standards (IFRS)**, issued by the IFRS Foundation’s International Accounting Standards Board (IASB). IFRS has been adopted as the official accounting framework in over 140 jurisdictions, including the EU, UK, and many Asian and Latin American countries, making it a de facto global language for financial statements. By requiring companies to follow uniform recognition, measurement, and presentation rules, IFRS enhances transparency: investors can more easily compare the financial results of companies from different countries, confident that the same transactions are accounted for in similar ways. For example, IFRS rules ensure that revenue, expenses,

assets, and liabilities are defined consistently, and that **material matters are disclosed** in notes to the accounts. The push for IFRS adoption (the EU mandated IFRS for all listed companies' consolidated accounts from 2005) was largely driven by the goal of improving disclosure quality and cross-border investor confidence after various accounting scandals in the early 2000s.

In the United States, companies use U.S. Generally Accepted Accounting Principles (US GAAP) rather than IFRS, but US GAAP and IFRS have converged in many areas. Both frameworks emphasize transparent reporting, although some differences remain. From a governance law perspective, IFRS is important because it is often embedded in regulations: many countries' company laws or securities laws explicitly require IFRS-compliant financial statements. Regulators, in turn, enforce these standards to ensure companies do not deviate and hide information. A notable aspect of IFRS (and GAAP) is the concept of “**fair presentation**” or “true and fair view” – financial statements must not only follow the letter of each rule but also give an overall honest picture of the company's finances. Managers who attempt to misuse accounting rules to obfuscate reality (as happened in Enron's aggressive accounting practices) can face legal penalties and restatements once uncovered. Over time, IFRS has expanded disclosure requirements (for instance, requiring detailed notes on risk management, judgments in applying accounting policies, and off-balance-sheet commitments) precisely to plug loopholes that companies might exploit to avoid transparency.

On the **non-financial side**, numerous international standards and frameworks guide sustainability and governance reporting. The **Global Reporting Initiative (GRI)** is one of the oldest and most widely used frameworks for sustainability reporting. The GRI Standards (most recently updated in 2021) provide detailed guidelines for reporting on economic, environmental, and social impacts. Companies that adopt GRI standards will, for example, disclose their greenhouse gas emissions (Scope 1, 2, and often 3), water usage, diversity metrics, community impacts, anti-corruption efforts, and so on, using standardized indicators. While GRI is technically voluntary, it has become a *de facto* international benchmark – thousands of companies worldwide issue GRI-based sustainability reports to demonstrate transparency on ESG matters. Investors and civil society increasingly expect such disclosures; in some cases, stock exchanges or regulators refer to GRI as a recommended framework. By using a common template like GRI, companies enable stakeholders to compare ESG performance across firms and sectors, analogous to how IFRS enables comparison of financial performance. GRI's materiality principle also pushes companies to identify and report the issues that are most significant to their stakeholders and business (e.g., a mining company would report extensively on environmental and safety issues, whereas a bank might focus on data security and responsible lending).

Another prominent framework is the **Sustainability Accounting Standards Board (SASB)** standards, which are industry-specific guidelines for disclosing financially material sustainability information. SASB (which merged into the **Value Reporting Foundation** and subsequently into the IFRS Foundation by 2022) provides metrics tailored to different industries (like the percentage of water recycled for beverage companies, or customer privacy breach counts for tech companies). From 2024 onward, the IFRS Foundation's new **International Sustainability Standards Board (ISSB)** has begun issuing global sustainability disclosure standards that build on SASB and other frameworks. In mid-2023, the ISSB released **IFRS S1 (General Requirements for Sustainability Disclosure)** and **IFRS S2 (Climate-Related Disclosures)** as global baseline standards. These standards, effective 2024, are designed to be compatible with GRI and others, and focus on reporting sustainability risks and opportunities that affect enterprise value. The emergence of ISSB standards marks a convergence in international reporting: where once companies faced a fragmented landscape of guidelines (GRI, SASB, Integrated Reporting framework, TCFD, etc.), the trend is toward **harmonization** of ESG reporting similar to the financial reporting harmonization achieved by IFRS.

Speaking of **Integrated Reporting**, the International Integrated Reporting Framework (developed by the IIRC) also deserves mention. Integrated reporting aims to combine financial and non-financial information into a single, coherent report to explain how a company creates value over time. Many leading companies produce integrated annual reports that discuss strategy, governance, performance and prospects in an holistic narrative, often using the “six capitals” model (financial, manufactured, intellectual, human, social, natural capital). This framework, now consolidated into the IFRS Foundation's resources, encourages boards to think broadly about disclosures and to explain how non-financial factors contribute to long-term financial performance. South Africa, for example, mandates integrated reports for listed companies, reflecting a governance philosophy (King IV Code) that emphasizes transparency on not just financial results but also social and environmental footprints and value creation.

International standards like IFRS and GRI have also been supported by cross-border collaboration among regulators and organizations. The **OECD**, for instance, while not issuing reporting standards per se, advocates for high standards of disclosure in its guidelines (for both public companies and state-owned enterprises). The **International Organization of Securities Commissions (IOSCO)** and the **Financial Stability Board (FSB)** have endorsed efforts to improve transparency – for example, the FSB's Task Force on Climate-related Financial Disclosures (TCFD) developed widely accepted recommendations for companies to disclose climate-related risks and scenarios. By 2025, numerous countries (including the UK, Japan, New Zealand, and EU members via the CSRD) have begun **mandating TCFD-aligned climate disclosures**, effectively weaving an international voluntary standard into domestic law.

In summary, a variety of international standards underpin corporate reporting: IFRS ensures transparent financial statements with global comparability, while frameworks like GRI (and emerging ISSB standards) guide companies in disclosing sustainability and ethical performance. Adherence to these standards is often not just best practice but a legal requirement or expectation of the market. Companies operating across borders particularly benefit from using international standards, as it streamlines compliance – for example, a multinational can prepare one IFRS report rather than different reports for each jurisdiction. The net effect is a world moving toward *higher and more standardized transparency*, so that whether an investor is reading a balance sheet or a carbon emissions table, they can trust the information and meaningfully compare it across companies.

6.4. Role of Internal and External Audits in Ensuring Transparency

Auditing is a fundamental mechanism through which transparency and integrity of corporate reports are maintained. Both internal and external audits serve distinct but complementary roles in a company's governance system, acting as controls on the accuracy of information and the soundness of processes.

Internal audit is an independent, objective assurance function that exists within an organization. According to the Institute of Internal Auditors (IIA), "*internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations.*" Internal auditors, who typically report functionally to the board's audit committee and administratively to senior management, evaluate the effectiveness of a company's internal controls, risk management, and governance processes. By regularly reviewing financial transactions, compliance with policies, and operational efficiency, internal audit provides an early warning system for any weaknesses or irregularities that could jeopardize transparency. If internal controls (such as approval processes, reconciliations, IT system safeguards) are deficient, internal auditors will recommend improvements before those deficiencies lead to misreporting or fraud.

The internal audit function plays a crucial **proactive role** in ensuring transparency. For instance, internal auditors test whether financial controls are working (e.g., are revenues properly recorded, are expenditures authorized and recorded in the correct period?) and whether compliance controls are effective (e.g., are anti-bribery procedures being followed, are data privacy rules adhered to?). When they find issues, they report them to management and the board, which can then take corrective action. A strong internal audit function thereby helps ensure that when financial reports and disclosures are produced, they are based on reliable underlying processes and data. Moreover, internal audit often assesses **non-financial disclosures** and ESG controls as

well, especially as companies expand their sustainability reporting – verifying, for example, the data behind a company’s reported CO2 emissions or safety statistics.

History has shown the value of empowered internal auditors. In the *WorldCom* scandal (2002), it was the company’s internal audit team – led by **Cynthia Cooper** – that uncovered some \$3.8 billion in fraudulent accounting entries that management had made to inflate earnings. The internal auditors’ persistence in digging into suspicious entries (despite resistance from a deceptive CFO) exposed what external auditors had missed, ultimately bringing the fraud to light and demonstrating accountability. This example underscores that internal auditors, by being inside the company and knowledgeable of its operations, are often well-positioned to detect problems early. However, internal auditors must have sufficient independence and support (especially from the board/audit committee) to be effective; if they are constrained by management, their oversight value diminishes.

External audit, on the other hand, is the independent examination of a company’s financial statements by an outside accounting firm. The primary aim of an external audit is to provide a professional opinion on whether the annual financial statements are presented fairly, in all material respects, in accordance with the applicable accounting standards (e.g., IFRS or GAAP). In doing so, the external auditors act as a critical check on management’s financial reporting and thus are guardians of transparency for shareholders. By law, most large companies around the world are required to have their financial statements audited by an independent auditor. This requirement creates an external validation of the company’s disclosures: investors and regulators do not have to rely solely on what management says, but can take some assurance from an impartial audit opinion that the numbers are accurate and free of major misstatements.

External auditors enhance transparency by scrutinizing accounting records, testing transactions, and evaluating the company’s own internal controls. They seek **evidence** that reported revenues are real and earned, that expenses are legitimate, that assets like cash and inventory exist and are properly valued, and that liabilities are fully recorded. If the auditors find that the financial statements as a whole are *not* free from material misstatement – whether due to fraud or error – they will modify their audit opinion or, in extreme cases, refuse to issue a clean opinion. The mere possibility of such a public outcome incentivizes management to be truthful and thorough in financial reporting. A “clean” unqualified audit opinion signals to the market that an independent party has vetted the company’s books, bolstering credibility.

However, as several scandals have highlighted, external audits are not foolproof. In the early 2000s, audit failures at firms like *Enron* (audited by Arthur Andersen) and *Parmalat* revealed collusion or negligence that allowed massive frauds to go undetected.

These events prompted reforms to shore up auditor independence and oversight. For example, the U.S. Sarbanes-Oxley Act created the **Public Company Accounting Oversight Board (PCAOB)** to regulate and inspect audit firms, and imposed stricter rules such as mandatory audit partner rotation and prohibitions on auditors providing certain consulting services to their audit clients. Similarly, the EU introduced an Audit Directive and Regulation (2014) requiring rotation of audit firms (generally every 10 years for listed companies), added restrictions on non-audit services, and gave regulators more clout to sanction audit failures. These reforms were aimed at reinforcing that external auditors must exercise **independent judgment** and skepticism, rather than being too cozy with management. An independent and professionally skeptical external auditor is more likely to challenge management's accounting and insist on corrections, thereby ensuring transparent reporting.

A recent example of audit reform driven by scandal is the case of *Wirecard*, a German fintech company that collapsed in 2020 after it was revealed that €1.9 billion in cash shown on its balance sheet did not exist. Wirecard's external auditor had issued clean audit opinions for years, missing the warning signs of fraud. The fallout led Germany to pass the **Financial Market Integrity Strengthening Act (FISG)** in 2021, which overhauled audit and corporate governance rules. FISG, among other measures, tightened audit oversight by requiring that German listed companies have more independent financial experts on their audit committees and by reducing the rotation period for lead audit partners from 7 to 5 years. It also prohibited auditors from providing most non-audit consulting services to audit clients and substantially increased auditors' liability for negligence. These changes illustrate regulators' recognition that **transparent governance relies on high-quality audits**, and when audits fail, laws must adapt to restore trust.

In practice, internal and external audits often work in tandem to promote transparency. The **audit committee** of the board (comprising non-executive directors, typically) serves as a bridge between these auditors and the board. Audit committees review internal audit reports and ensure management addresses internal control issues. They also oversee the external audit, approving the audit plan and reviewing the results. A robust audit committee can ensure that neither internal nor external auditors are ignored or unduly influenced by management. In many countries' corporate governance codes (e.g., the UK Corporate Governance Code, U.S. stock exchange rules), having an independent audit committee is a requirement, precisely to reinforce the integrity of the auditing processes.

In summary, **internal auditors** function as an internal watchdog, continuously monitoring and improving transparency from within, while **external auditors** provide an external seal of approval (or warning) regarding the truthfulness of the company's

financial disclosures. Both are essential. When either is compromised, the reliability of corporate reporting suffers – as seen in historical failures. Conversely, when both internal and external audits are strong, companies are far more likely to catch and correct errors or misdeeds early, ensuring stakeholders receive a clear and truthful account of the company’s affairs.

6.5. Business Ethics and Corporate Codes of Conduct

Laws and audits alone cannot guarantee ethical behavior – the **culture and values** of a corporation are equally critical. This is where business ethics and corporate codes of conduct come into play as integral components of corporate governance. A **corporate code of conduct (or code of ethics)** is a formal document that outlines the principles, standards, and expected behavior for all employees and representatives of the company, from the boardroom to the mailroom. Such codes typically cover areas like integrity, compliance with laws, conflicts of interest, fair dealing with stakeholders, protection of confidential information, and reporting of unethical behavior. By articulating these expectations, the code of conduct sets the “tone at the top” and guides the corporate culture towards ethical decision-making.

The **importance of business ethics** in governance has been underscored by numerous scandals where technically legal decisions were still profoundly unethical and damaging. The *Volkswagen emissions scandal* (“Dieselgate”) of 2015 is a stark example: Engineers at Volkswagen, pressured by an aggressive performance culture, installed software to cheat on emissions tests, deceiving regulators and consumers about the pollution levels of the company’s diesel cars. This unethical choice – essentially prioritizing sales over honesty and public health – wiped out billions in shareholder value, led to criminal charges, and severely hurt the company’s reputation worldwide. Investigations pointed to a *deficient ethical culture and governance* at Volkswagen, including insufficient board oversight and a climate where employees feared escalating bad news. In the aftermath, Volkswagen, like many companies caught in misconduct, pledged to overhaul its culture and implement stricter ethical guidelines. The lesson from Volkswagen and similar cases is clear: **without a strong ethical compass, even well-structured companies can veer into disastrous misconduct**, despite having compliance rules on paper.

Corporate codes of conduct are one tool to embed ethics into the governance framework. Most large companies today have a code of ethics approved by the board and often publicly available. These codes serve multiple functions: they are an *internal law* of sorts, informing employees of what is expected (and the consequences of violations), and they are a *public commitment*, signaling to investors and customers the company’s values. For instance, a typical code will prohibit bribery and corruption,

commit to non-discrimination and respectful treatment of employees, require accurate financial reporting internally, and demand compliance with all applicable laws. Many also address topics like insider trading, use of company assets, and social media conduct. Importantly, codes of conduct often establish mechanisms for guidance and reporting – such as ethics hotlines or whistleblower channels (tying into section 6.7) – so that if an employee is unsure about a situation or witnesses misconduct, they know how to seek advice or report concerns.

While simply having a code is not a panacea, it is frequently a **legal or regulatory expectation**. In the U.S., stock exchange rules require listed companies to disclose whether they have adopted a code of ethics for senior financial officers and to promptly disclose any waivers of that code for executives. This rule came about after the Enron scandal, where it was revealed that Enron had waived its code of ethics to allow the CFO's conflicted financial arrangements – a glaring red flag. Many corporate governance codes (like those in the EU, UK, and Asia) likewise recommend that boards define the company's values and strategy, and ensure a code of conduct is in place. In some sectors (banking, for example), regulators specifically scrutinize whether the institution has a culture of compliance and ethics, as evidenced by its code of conduct training and enforcement.

Beyond formal codes, **ethical leadership and culture** are crucial. The phrase “tone at the top” encapsulates the idea that the board and executives must exemplify ethical behavior and make it clear that integrity overrides short-term gains. If top management is seen cutting ethical corners, employees will believe the code of conduct is mere window dressing. Conversely, when leaders are consistent in their words and actions – e.g., turning down a lucrative deal because it violates environmental standards or disciplining a high-performing executive for harassing subordinates – it reinforces an ethical culture. This culture should cascade to a “mood in the middle” and “buzz at the bottom,” meaning all levels of the company live the values. For governance, a strong ethical culture helps **prevent misconduct before laws are broken**; employees in an ethical environment are more likely to speak up or refuse orders that conflict with company values, thereby catching issues early.

In practical terms, companies implement ethics in governance through various means: annual training on the code of conduct, requiring employees and directors to certify compliance with the code, establishing ethics committees or designating a Chief Ethics & Compliance Officer, and integrating ethical objectives into performance evaluations. Some firms incorporate ethical goals (like fostering diversity or community engagement) into executive compensation metrics to incentivize the desired behavior.

Another aspect of business ethics in governance is engagement with **external initiatives and standards**. Many companies reference international ethical

frameworks in their codes, such as the UN Global Compact's principles on human rights, labor, environment, and anti-corruption, or the OECD Guidelines for Multinational Enterprises, which provide guidance on responsible business conduct. By aligning with these, corporations signal an adherence to globally recognized ethical norms. Furthermore, companies often publicize their stance on ethics through sustainability reports or dedicated reports (e.g., a Business Ethics Report), showcasing efforts in areas like fair sourcing, community investment, and employee well-being.

Crucially, the effectiveness of a code of conduct comes down to enforcement. As part of good governance, boards should ensure that violations of the code – whether by a junior employee or the CEO – are dealt with consistently and fairly. A code that is not enforced, or only enforced against low-level staff but not senior executives, can breed cynicism and encourage unethical behavior (because people see that the “real rules” differ from the stated ones). Therefore, many companies have escalation procedures: significant code violations are reported to the audit or ethics committee of the board, and disciplinary actions (up to termination) are overseen at a high level. In some cases, external reporting may be required (for example, if laws were broken, authorities need to be informed).

In conclusion, **business ethics and corporate codes of conduct infuse the legal and regulatory framework with a moral dimension.** They help bridge the gap between what a company *can* do and what it *should* do. A robust ethical framework within corporate governance not only helps prevent legal violations (by discouraging practices that toe the line) but also enhances the company's reputation and long-term sustainability. Customers, investors, and employees increasingly favor businesses that are seen to “do the right thing,” and a well-implemented code of conduct is evidence that a company takes its social and ethical responsibilities seriously. Studies have even shown that companies known for ethical conduct often outperform in the long run, as they avoid the costs of scandals and build goodwill with stakeholders.

Most businesses now explicitly address issues like bribery and corruption, fair dealing, and respect in their codes of ethics and set out clear expectations for employee behavior. By doing so, and by backing those words with action, companies weave ethics into the fabric of corporate governance – making ethical considerations a regular part of board discussions and corporate strategy, rather than an afterthought.

6.6. Anti-Corruption and Compliance Policies

Corruption is a pervasive risk in business, and in response, a robust framework of international and national laws has emerged to combat bribery and improper conduct. Corporate governance today must encompass strong **anti-corruption compliance policies** to ensure that companies and their employees do not engage in bribery, fraud,

or other forms of corruption – and if they do, that it is detected and addressed swiftly. This section looks at key anti-corruption laws and the compliance practices companies implement to adhere to them.

On the international stage, the watershed was the **OECD Convention on Combating Bribery of Foreign Public Officials (1997)**, which committed signatory countries (including the Americas, Europe, and others) to criminalize bribery of foreign public officials. This was followed by the **United Nations Convention against Corruption (UNCAC, 2003)**, a broad treaty addressing bribery, embezzlement, and corruption both in the public and private sectors. These international agreements spurred many countries to update and tighten their anti-corruption laws. Notably, the United States had earlier set a precedent with the **Foreign Corrupt Practices Act (FCPA) of 1977** – the first major law criminalizing bribery of foreign officials and requiring companies to maintain internal accounting controls to prevent slush funds for bribery. The FCPA applies to all U.S. companies and foreign companies listed in the U.S., and it has extraterritorial reach (transactions touching U.S. territory can trigger jurisdiction). The FCPA also contains accounting provisions that mandate accurate books and records, thereby dovetailing anti-corruption with transparency in financial reporting.

In more recent times, the **UK Bribery Act 2010** has been hailed as one of the strictest anti-corruption laws globally. Unlike the FCPA, which focuses mainly on bribery of foreign government officials, the UK Bribery Act criminalizes bribery in both public and *private* sector transactions and has no exceptions (the FCPA, for instance, allows small “facilitation payments” in some cases, whereas the UK does not). Crucially, the UK Act introduced a “**failure to prevent bribery**” corporate offense: if anyone associated with a company (employee, agent, subsidiary, etc.) pays a bribe with the intent to obtain or retain business for that company, the company can be held liable, unless it can prove that it had implemented “adequate procedures” to prevent bribery. This effectively obligates companies to have active anti-bribery compliance programs – a passive stance is risky, since claiming ignorance is not a defense. The UK Ministry of Justice issued guidance highlighting six principles for adequate procedures, including top-level commitment, risk assessment, due diligence, communication (training), and monitoring and review. In sum, the UK Bribery Act pushes firms beyond mere prohibition on paper, requiring a demonstrably effective compliance program as a shield against liability.

Following these examples, many other jurisdictions have toughened anti-corruption regimes: **Brazil’s Clean Company Act (2014)**, **France’s Sapin II (2016)**, Sapin II which created the French Anti-Corruption Agency and required large firms to implement compliance measures, **China’s intensifying anti-bribery enforcement**, etc. The global trend is clear: companies are expected to actively prevent corruption,

not just refrain from it. For corporate governance, this means boards must ensure robust **compliance management systems** are in place.

A comprehensive anti-corruption compliance program typically includes: a risk assessment to identify where the company is most exposed (e.g., in obtaining government permits, in sales via third-party agents, in procurement processes), **clear policies** (such as an anti-bribery policy and guidelines on gifts, hospitality, and donations), **training and communication** so all employees and high-risk third parties know the rules, thorough **due diligence on partners and agents** (to avoid indirectly engaging in bribery through intermediaries), **financial controls** (to detect suspicious payments or off-book accounts), and procedures for **investigation and disciplinary action** when issues arise. All these elements aim to embed a culture of compliance where bribery is absolutely “off-limits” – a “zero tolerance” stance that many companies publicly commit to. Indeed, businesses increasingly recognize that a zero-tolerance approach to bribery not only keeps them out of legal trouble but also has long-term benefits: it creates a more stable, fair operating environment and protects their reputation.

Corporate governance frameworks now often explicitly include oversight of compliance. For example, some boards have a dedicated **Ethics and Compliance Committee**, or they expand the Audit Committee’s remit to cover compliance risk. Senior management may include a **Chief Compliance Officer (CCO)** who reports independently to the board. The “**tone at the top**” again plays a role – if the CEO and directors openly champion ethical business and allocate sufficient resources to compliance, it sends a message that these policies are not just formalities. In contrast, if management signals that hitting sales targets is more important than *how* those targets are met, it can encourage employees to cut corners and pay bribes to win deals, thereby undermining the compliance framework.

International standards provide blueprints for what good compliance looks like. The **ISO 37001 (Anti-Bribery Management System)** standard, first published in 2016, is a certifiable standard that organizations can adopt to ensure they have adequate anti-bribery controls. More broadly, the **ISO 37301:2021** standard for Compliance Management Systems has been introduced (replacing earlier ISO 19600) to guide organizations in establishing, developing, and continuously improving compliance programs. ISO 37301 is a **certifiable standard** (unlike its predecessor), meaning companies can be audited and certified for having an effective compliance management system in line with international best practices. While ISO certifications are voluntary, they reflect a company’s commitment to structured compliance and can be beneficial in demonstrating due diligence to regulators or business partners.

Real-world cases show both the cost of failing to prevent corruption and the benefits of strong compliance. For instance, *Siemens*, the German engineering giant, was caught in 2006-2008 in a massive bribery scandal spanning many countries. Siemens ultimately paid over \$1.6 billion in fines (to U.S. and German authorities) but then undertook one of the most comprehensive compliance overhauls in corporate history – redefining its values, overhauling its entire compliance system, and becoming a model for anti-corruption compliance by the mid-2010s. This turnaround demonstrates that while the costs of non-compliance are enormous (financial penalties, loss of contracts, debarment from public bids, and reputational damage), there is an opportunity to restore trust through genuine reforms.

Another example is the *Petrobras-Odebrecht* scandal in Brazil (Operation Car Wash), which exposed systemic corruption between corporations and public officials. It led to not only prosecutions but also legislative changes in Brazil and greater empowerment of compliance officers in Brazilian firms. In the United States, enforcement of the FCPA remains vigorous; companies like *Goldman Sachs* (in the IMDB case), *Telefônica Brasil*, *Walmart*, and many others have paid hundreds of millions to resolve FCPA violations in recent years. U.S. authorities (DOJ and SEC) have detailed guidelines on what constitutes an effective compliance program, and they consider a company's compliance efforts when deciding whether to prosecute or how much to penalize a violator. For example, under the DOJ's guidelines, a company with a strong pre-existing compliance program might get a reduction in fines or even avoidance of charges if a rogue employee commits a violation despite the company's robust efforts.

Anti-corruption compliance policies thus are not merely about obeying the law; they are integral to a company's risk management and governance. They protect the company's value by preventing the occurrence of corrupt acts that could trigger legal sanctions and by ensuring the company's people conduct business ethically. Moreover, as part of broader ESG considerations, stakeholders today scrutinize how companies make their profits, not just how much they make. A company known for clean business practices is more likely to attract investment from the growing pool of ESG-focused investors and to be seen as a trustworthy partner by governments and communities. Conversely, companies tainted by corruption can face blacklisting and loss of business opportunities (e.g., the World Bank and other development banks maintain lists of companies ineligible for contracts due to corruption findings).

In conclusion, the fight against corruption has become a core component of corporate governance. Laws like the FCPA and UK Bribery Act have international reach and serious consequences, effectively forcing corporations to actively manage and mitigate bribery risk. International frameworks and standards support these efforts by providing guidance on best practices for compliance programs. For boards and

managers, the mandate is clear: establish a strong compliance culture, implement the necessary policies and controls, and oversee their functioning. Good governance in the 2020s is transparent *and* clean; it is not enough to disclose profits if those profits were earned by unethical means. Stakeholders expect corporations to achieve results the right way, and anti-corruption compliance is how companies assure the world of their integrity.

6.7. Whistleblower Protection

Despite all preventive measures, unethical and illegal activities may still occur within organizations. Often, the first people to detect wrongdoing are the insiders – employees or others connected to the company. **Whistleblower protection** has therefore emerged as a vital component of transparency and ethics in corporate governance. Encouraging whistleblowers to speak up, and protecting them from retaliation when they do, helps surface problems that might otherwise remain hidden. In recent decades, legal frameworks around the world have increasingly shielded whistleblowers and, in some cases, even rewarded them for reporting misconduct.

The rationale is straightforward: if individuals who witness fraud, corruption, safety hazards, or other malfeasance fear that they will lose their job or be harassed for coming forward, they are likely to stay silent, and the wrongdoing continues unchecked. This “chilling effect” not only perpetuates harm but also undermines a culture of transparency. Conversely, protecting whistleblowers encourages an open environment where issues are addressed early, preventing larger scandals. Whistleblowers have been instrumental in exposing major corporate scandals – for instance, Sherron Watkins wrote a memo warning Enron’s CEO of accounting irregularities (though it was ignored, it later helped investigators), an internal auditor blew the whistle on the Olympus accounting fraud in Japan, and more recently, a whistleblower’s complaint brought to light issues at Facebook (2021) regarding its handling of user data and content.

Recognizing this, legislators have acted. In the United States, the **Sarbanes-Oxley Act of 2002** included provisions (Section 806) to protect employees of public companies who report fraud-related issues from retaliation. It made it unlawful for companies (and their officers) to fire, demote, threaten, or harass whistleblowers providing information or assisting in investigations of certain financial crimes. Violations of these protections can lead to remedies like reinstatement of the employee, back pay, and damages. Sarbanes-Oxley also required audit committees of public companies to establish mechanisms (like confidential hotlines) for employees to report concerns about accounting or auditing matters, thus institutionalizing internal whistleblowing channels.

The U.S. further strengthened whistleblower incentives with the **Dodd-Frank Act of 2010**, which, among other things, created a whistleblower reward program in the Securities and Exchange Commission (SEC). Under the SEC program, eligible whistleblowers who provide original information leading to a successful enforcement action with monetary sanctions over \$1 million can receive an award of 10-30% of the fines. This program led to an influx of high-quality tips to regulators and has paid out over \$1 billion to whistleblowers by 2025, significantly aiding in the detection of securities law violations (including FCPA cases, financial frauds, Ponzi schemes, etc.). Dodd-Frank also expanded protection, for example, allowing whistleblowers to sue in court if retaliated against.

In the European Union, a landmark development was the adoption of the **EU Whistleblower Protection Directive (Directive (EU) 2019/1937)**. This Directive requires all EU member states to implement robust protections for persons who report breaches of EU law in a wide range of areas (from financial services and anti-money laundering to public health, environmental protection, and data privacy). Key provisions of the directive include: companies with 50 or more employees (and all financial services firms, regardless of size) must establish confidential internal reporting channels; public authorities must also have channels; authorities must follow up diligently on reports; and, critically, whistleblowers (as well as those assisting them, like colleagues or facilitators) are protected from **any form of retaliation**. Retaliation includes firing, demotion, intimidation, blacklisting, etc., and member states must provide for penalties against those who retaliate. The Directive also allows whistleblowers to report externally to regulators or even to the media under certain conditions (for instance, if internal channels fail or in cases of imminent danger to the public interest) without losing protection. By late 2021, EU countries were required to transpose this directive into national law, and as of 2025, most have done so (though some with delays). The EU Directive represents a comprehensive approach, recognizing whistleblowing as a fundamental element of **enforcement of the law and corporate accountability**.

Other countries have similarly enhanced whistleblower laws: for example, the UK's **Public Interest Disclosure Act 1998** was an early law protecting whistleblowers (covering various industries), and countries like Australia, Japan, Canada, and South Korea have instituted or updated protections. Some laws focus on specific sectors (like banking) or specific types of wrongdoing (e.g., competition law violations), but the overall movement is toward broad protection for good-faith whistleblowers.

For companies, these legal developments mean that **whistleblowing should be integrated into corporate governance and compliance programs**. Leading practice is for companies to have a *whistleblowing policy* that clearly communicates how an

employee (or contractor, etc.) can raise concerns internally (or externally), what will happen when they do (investigation procedures), and an unequivocal statement that retaliation is forbidden and will result in disciplinary action. Typically, anonymous reporting is allowed (through hotlines or online systems run by third parties to ensure confidentiality). Governance codes and regulators often expect boards – usually via the audit committee – to oversee the whistleblowing system. For example, the UK Corporate Governance Code explicitly states that the board should ensure that whistleblowers have means to raise concerns in confidence and – if they wish – anonymously, and that arrangements are in place for independent investigation and follow-up.

A strong whistleblower program can actually be seen as a *safeguard for senior management and the board*: if something is going awry in the organization's lower layers (say, a plant manager falsifying safety reports or a sales agent paying bribes), early whistleblower reports allow the issue to be fixed before it causes legal liability or public embarrassment. Companies like *Volkswagen* post-scandal have instituted ombudsmen and systems where employees can report regulatory violations well up the chain, reflecting lessons learned.

It's also worth noting the cultural aspect: in some countries or corporate cultures, whistleblowing was historically stigmatized (the word “snitch” or “tattletale” comes to mind). Shifting this perception is part of the challenge. Organizations must communicate that reporting misconduct is a **duty and a courageous act** that serves the company's long-term interests, not a betrayal. Celebrating instances where whistleblowing helped the company can reinforce this positive view. Many codes of conduct explicitly encourage employees to speak up and reassure them that doing so will not have negative repercussions.

Finally, high-profile whistleblower cases remind companies of potential pitfalls. The example of *Wirecard* again: numerous journalists and short-sellers raised questions about Wirecard, and there were internal whistleblowers too, but rather than listen, Wirecard's leadership (and some regulators) tried to silence or discredit them. That failure to heed warnings prolonged the fraud and made the collapse more catastrophic. In contrast, when companies respond constructively to whistleblowers, they often can avoid crisis. For instance, when an employee blew the whistle on accounting issues at *Xerox* in the early 2000s, regulators intervened and the company restated earnings, but early action helped avoid a complete collapse.

In conclusion, **protecting whistleblowers is now recognized as essential to transparency and ethical governance**. Laws around the world provide increasing support for those who report wrongdoing, aligning with the principle that *corporate and*

regulatory systems cannot rely solely on top-down monitoring – they also need bottom-up feedback. For boards and executives, this means fostering an environment where employees at all levels feel safe to raise their hand if something's wrong, and where such bravery is met with gratitude and action, not reprisal. A company that successfully does so is far less likely to be blindsided by a scandal, and more likely to maintain the trust of its stakeholders and the integrity of its operations.

Self-Assessment Quiz:

1. **Why is transparency important in corporate governance?**
 - A. It ensures companies can keep strategic information secret from all stakeholders.
 - B. It fosters trust, allows informed decision-making by stakeholders, and holds management accountable for their actions.
 - C. It guarantees that a company will never experience a scandal or financial loss.
2. **Which of the following are examples of non-financial reporting obligations for companies?**
 - A. Publishing annual financial statements audited by an external auditor.
 - B. Disclosing environmental, social, and governance (ESG) impacts, such as carbon emissions and diversity policies, in line with frameworks like the EU's CSRD or GRI Standards.
 - C. Reporting quarterly earnings per share to stock analysts.
3. **What is the International Financial Reporting Standards (IFRS) framework, and why is it significant?**
4. **How do internal audits differ from external audits in their role and scope? Give one real-world example of a corporate scandal that led to major governance reforms related to transparency or audits. What changed as a result?**
5. **True or False: The UK Bribery Act 2010 only criminalizes bribery of foreign public officials, similar to the U.S. FCPA, and does not affect commercial (private sector) bribery.**
6. **Which of the following is *not* typically part of an effective corporate compliance program for anti-corruption?**
 - A. Regular anti-bribery training for employees.
 - B. A policy that allows facilitation payments of any amount since they are “small bribes.”
 - C. Due diligence on third-party agents and suppliers.
 - D. A confidential channel for employees to report suspected bribery or misconduct.
7. **What protections do whistleblower laws typically offer to employees who report misconduct?**

8. **Short Answer:** How do international reporting standards and compliance frameworks (like IFRS, GRI, and ISO 37301) contribute to better corporate governance?
- In light of what you learned in this chapter, discuss how the concept of “tone at the top” influences a company’s transparency and ethical behavior. What should boards of directors do to set the right tone?

Sources:

- Azlin Puteh Salin, A. S., Ismail, Z., & Smith, M. (2024). *The impact of corporate disclosure and website informativeness on enhancing corporate governance and performance*. *Journal of Governance & Regulation*, 13(4), 306–315. DOI:10.22495/jgrv13i4siart9
- G20/Organisation for Economic Co-operation and Development (OECD). (2015). *G20/OECD Principles of Corporate Governance*. Paris: OECD Publishing.
- Glass, S. G. (2021, July 28). *Wirecard Accounting Scandal Prompts Germany to Act on Financial Market Integrity*. Glass Lewis.
- Institute of Internal Auditors (IIA). (2017). *International Professional Practices Framework*. Altamonte Springs, FL: IIA. (Definition of Internal Auditing: “independent, objective assurance and consulting activity... to add value and improve an organization’s operations.”)
- International Organization for Standardization (ISO). (2021). *ISO 37301:2021 Compliance Management Systems – Requirements with guidance for use*. Geneva: ISO. (Replaced ISO 19600, provides requirements for effective compliance programs)
- Ministry of Justice (UK). (2012). *The Bribery Act 2010: Guidance*. London: UK Gov. (Explains the Act’s offenses, including Section 7 “failure to prevent bribery,” and principles for “adequate procedures” defense)
- Organisation for Economic Co-operation and Development (OECD). (1997). *Convention on Combating Bribery of Foreign Public Officials in International Business Transactions*. Paris: OECD.
- Public Company Accounting Reform and Investor Protection (Sarbanes-Oxley) Act of 2002, Pub. L. 107-204, 116 Stat. 745 (2002).
- PricewaterhouseCoopers Governance Insights Center. (2023, April 11). *Using transparency to build trust: A corporate director’s guide*. Harvard Law School Forum on Corporate Governance.
- WorldCom, Inc. (2002). *In re WorldCom: Internal Audit Report* (Cynthia Cooper’s findings).
- Volkswagen AG. (2015). *Ad hoc Release on Emissions Issue, 22 Sept 2015*. Wolfsburg: Volkswagen Investor Relations. (Admission of installing defeat devices on diesel engines to cheat emissions tests, affecting 11 million vehicles)

- European Parliament and Council. (2019). *Directive (EU) 2019/1937 on the protection of persons who report breaches of Union law* (“EU Whistleblower Protection Directive”). Official Journal of the EU, L 305/17.
- European Commission. (2021). *Corporate Sustainability Reporting Directive (CSRD) – Proposal and Adopting Release*. Brussels: EC.
- U.S. Securities and Exchange Commission (SEC). (2020). *Whistleblower Program 2019 Annual Report*. Washington, D.C.: SEC Office of the Whistleblower. Institute of Business Ethics (IBE). (2012). *Business Ethics Briefing: Anti-Bribery & Corruption Standards and Frameworks*. London: IBE.

CHAPTER 7: THE ROLE OF INTERNATIONAL ORGANIZATIONS IN CORPORATE GOVERNANCE

Corporate governance, once addressed largely within national borders, has increasingly become a global concern. As markets integrate and capital flows across jurisdictions, **international organizations have emerged as key shapers of corporate governance standards**. Global market integration, institutional investor pressures, and the influence of multinational institutions have pushed nations toward converging on international “best practices” in governance. Countries, especially developing economies seeking to attract foreign investment, have strong incentives to adopt governance codes aligned with international benchmarks.

In response, organizations such as the **Organisation for Economic Co-operation and Development (OECD)**, the **United Nations (UN)**, the **European Union (EU)**, and international financial institutions like the **World Bank** and **International Monetary Fund (IMF)** have taken active roles in **formulating and promoting corporate governance principles and policies on a global scale**. These bodies develop guidelines, principles, and regulations that encourage transparency, accountability, and protection of investors and stakeholders beyond any single nation’s laws. International codes and guidelines often find their way into national corporate governance codes – indeed, many countries explicitly reference global principles in their own governance frameworks.

This chapter examines the contributions of major international organizations to corporate governance. We will discuss how the OECD’s principles have become a cornerstone of global governance norms, how the United Nations and its initiatives (such as the UN Global Compact) have integrated sustainability and social responsibility into corporate governance, how the European Union has shaped corporate governance through directives and regulations, and how other organizations like the World Bank and IMF influence governance reforms around the world. **Real-world examples and case studies** will illustrate these influences, and we will critically analyze the effectiveness and limitations of each organization’s approach.

Learning Objectives:

- **Understand the OECD’s role** in establishing internationally recognized corporate governance principles and how these principles serve as a global benchmark.
- **Explain the involvement of the United Nations** in corporate governance, including the impact of the UN Global Compact and related global initiatives on business practices.

- **Analyze the European Union’s contributions** to corporate governance regulation and how EU directives and policies influence governance standards both within Europe and globally.
- **Evaluate the impact of other international organizations**, such as the World Bank and IMF, on corporate governance reforms, especially in emerging markets and in response to financial crises.
- **Critically assess the effectiveness and limitations** of international organizations in improving corporate governance, acknowledging successes, enforcement challenges, and the need to adapt global principles to local contexts.

7.1. The Role of the OECD in Establishing International Governance Principles

The OECD has been at the forefront of setting international benchmarks for corporate governance. Its most influential contribution is the *OECD Principles of Corporate Governance*, first issued in 1999 and updated periodically (with major revisions in 2004, 2015, and most recently in 2023). **These Principles have become the globally recognized standard for good corporate governance**, providing a framework that countries use to evaluate and improve their own corporate governance regimes. In fact, the G20 nations formally endorsed the OECD Principles – underscoring their worldwide acceptance – and the Principles are designated as one of the Financial Stability Board’s key standards for sound financial systems.

Key Features of the OECD Principles

The OECD Principles cover fundamental areas of governance in six main chapters (OECD, 2023). They outline recommendations on: (1) **ensuring the basis of an effective corporate governance framework** (the legal, regulatory, and institutional environment); (2) **shareholders’ rights and equitable treatment** (including protections for minority investors); (3) **institutional investors, stock markets, and intermediaries** (e.g. the role of institutional shareholders and proxy advisors); (4) **stakeholders’ roles in corporate governance** (recognizing the interests of employees, creditors, and other stakeholders); (5) **disclosure and transparency** (timely and accurate disclosure of financial and non-financial information); and (6) **the responsibilities of the board** (board duties, composition, and accountability). The latest 2023 revision introduced a new emphasis on **sustainability and resilience**, integrating guidance on how boards and companies should manage environmental and social risks and opportunities. This update reflects a global consensus to broaden governance beyond shareholder-focused matters to also address sustainability challenges. For example, the 2023 Principles recommend that boards consider climate-

related risks and that investors exercise stewardship with an eye to long-term sustainability.

Global Reach and Adoption

The OECD Principles have achieved remarkable global reach. Although developed by a consortium of OECD and G20 member countries, they are used far beyond this circle. The Principles serve as a reference for the World Bank's Reports on the Observance of Standards and Codes (ROSC) assessments of country corporate governance practices, and they inform other international standards. The OECD monitors implementation across 49 jurisdictions worldwide (including all OECD members and major emerging economies like China, India, Brazil, and Saudi Arabia). In many countries, national corporate governance codes have been **explicitly modeled on or influenced by the OECD Principles**. Research confirms that international codes – prominently the OECD's – have significantly shaped the content of national governance codes across the world. It is common for national code preambles to cite the OECD Principles or align with their recommendations. **For instance, Malaysia's corporate governance code, first issued in 2000, has been revised multiple times in line with OECD guidance**, and many other Asian and Latin American nations have followed suit. The OECD has facilitated this diffusion through regional corporate governance roundtables (in Asia, Latin America, etc.), which bring together policymakers and experts to adapt the Principles to regional contexts. As a result of these efforts, a broad convergence of governance standards has emerged: adopting international best practices is seen as a way to boost investor confidence and economic efficiency in both developed and emerging markets.

The OECD Principles' effectiveness lies in their **flexible, principle-based approach** that can be tailored into different legal systems. They have helped countries identify gaps in shareholder protection, transparency, board independence, and other areas, and have inspired a wave of governance reforms especially in the early 2000s and again after the 2008 financial crisis. Notably, the G20's endorsement in 2015 and again in 2023 gave the Principles additional weight, making them a de facto international "soft law" for corporate governance. The influence can be seen in real-world improvements: for example, after the Principles were introduced, many jurisdictions strengthened requirements for financial reporting and audit committees, improved minority shareholder remedies, and required boards to include independent directors, aligning with OECD guidance. The World Bank has documented that well-governed companies – those following such best practices – tend to enjoy **lower capital costs and better access to finance**, benefiting overall economic development. In sum, the OECD has established a common language and benchmark for what good corporate governance entails, which in turn fosters trust in markets and cross-border investment.

Despite their global status, the OECD Principles are **voluntary and non-binding** – their implementation depends on each country’s willingness and capacity to enforce equivalent rules. This leads to uneven application. Some countries have translated the Principles rigorously into law or stock exchange rules, while others have only partially done so or enforce them weakly. **Local context matters**: the OECD framework initially reflected an Anglo-American perspective (emphasizing conflicts between management and dispersed shareholders), which may not fully address issues in countries with concentrated family ownership or state-controlled firms. In many emerging markets, the primary governance challenge is protecting minority shareholders from controlling owners, rather than the OECD’s original focus on management-vs-owner conflicts. As a result, a **one-size-fits-all global code can overlook local ownership structures and legal traditions**. Some scholars argue that blindly imitating OECD or “Western” models may be counterproductive if they are not adapted to local conditions. There is evidence of “decoupling” in certain cases – countries adopt the language of OECD-style codes to signal conformity to investors, but true practices change slowly (“box-ticking” or superficial compliance). Furthermore, the OECD Principles rely on member countries to update and refine them; until the recent 2023 update, some critics felt the Principles had lagged behind emerging issues like technology governance or climate risk. The 2023 revision has addressed some of these by adding the sustainability chapter, but implementation will be the next test. In summary, the OECD provides a **crucial foundation and inspiration for governance reform, but its Principles are only as effective as the commitment of companies and regulators within each country**.

7.2. The Involvement of the United Nations and Global Initiatives (e.g., UN Global Compact)

The **United Nations** plays a distinctive role in corporate governance by promoting broad norms of corporate responsibility, sustainability, and ethical behavior. Unlike the OECD and EU, the UN does not impose regulations on companies; rather, it operates through **voluntary initiatives and principles** that encourage businesses globally to align with societal values and sustainable development goals. The flagship initiative is the **UN Global Compact (UNGC)**, launched in 2000 by then-UN Secretary-General Kofi Annan. Over the past 25 years, the UN Global Compact has grown into **the world’s largest corporate sustainability initiative, involving over 20,000 companies and 3,000 non-business participants across 160+ countries**. It has fundamentally reshaped expectations for corporate conduct by embedding issues like human rights, labor standards, environmental stewardship, and anti-corruption into the corporate governance agenda.

The UN Global Compact’s Principles and Influence: The UNGC asks participating companies to commit to **Ten Principles** covering the areas of human rights, labor, environment, and anti-corruption. These principles, derived from key UN declarations and conventions, serve as a foundational ethical framework. Companies pledge to “*support and respect the protection of internationally proclaimed human rights*” (Principle 1), “*uphold the freedom of association and the right to collective bargaining*” (Principle 3), “*work against corruption in all its forms*” (Principle 10), among others. While voluntary, the UNGC uses public accountability mechanisms: participants must submit annual Communication on Progress (COP) reports detailing their efforts on these principles. By fostering transparency and peer pressure, the initiative nudges corporate governance toward greater accountability for social and environmental impacts. Over time, the UNGC helped popularize the concept of “ESG” (**Environmental, Social, and Governance**) factors in business – notably, as early as 2004 the UNGC articulated ESG as a way to evaluate corporate impact. This was transformative: it broadened corporate governance beyond financial performance to include how companies manage stakeholder relationships and sustainability issues. The UNGC also catalyzed complementary initiatives: for example, it was instrumental in launching the **Principles for Responsible Investment (PRI)** in 2006, a framework encouraging institutional investors to integrate ESG considerations (today the PRI network influences over \$100 trillion in assets). Similarly, the UNGC advanced sector-specific initiatives like the **Women’s Empowerment Principles (2010)** to promote gender equality in corporate leadership, and the **CEO Water Mandate** for water stewardship.

Another major UN-driven framework is the **UN Guiding Principles on Business and Human Rights (UNGPs)**, endorsed by the UN in 2011. The UNGPs, although not a traditional “corporate governance code,” have had significant governance implications: they established that companies have a responsibility to respect human rights and should conduct *human rights due diligence* to identify and address their impacts. This concept of due diligence for social issues has since influenced corporate governance by expanding directors’ oversight duties and prompting new laws (for instance, modern slavery reporting requirements and proposed mandatory human rights due diligence laws in various jurisdictions). The UNGPs illustrate how UN initiatives shape governance norms indirectly, by defining the bounds of responsible corporate behavior that stakeholders (including investors and regulators) increasingly expect boards to ensure.

Furthermore, the UN has convened global multi-stakeholder collaborations that intertwine with corporate governance. The **UN Sustainable Stock Exchanges (SSE) Initiative**, for example, works with stock exchanges, regulators, and companies to improve ESG disclosure and corporate transparency. Dozens of stock exchanges worldwide have issued sustainability reporting guidance or listing rules aligned with

SSE recommendations, thereby embedding sustainability into the governance requirements for listed companies. Similarly, the UN's **Sustainable Development Goals (SDGs)** (adopted in 2015) have provided a global roadmap that many corporations now integrate into their strategies and governance goals – boards are increasingly expected to consider how their firms contribute to issues like climate action, equality, and good governance (SDG 16) as part of long-term value creation.

The UN's influence on corporate governance is primarily normative and agenda-setting. Initiatives like the Global Compact have been effective in **raising awareness and establishing a common language for corporate sustainability**. With over 20,000 business participants, the UNGC has created a platform for learning and diffusion of best practices – companies large and small share case studies on improving supply chain labor standards, cutting carbon footprints, or strengthening anti-bribery controls, inspired by UN principles. This has helped mainstream the idea that corporate governance must encompass social and environmental stewardship, not just shareholder profits. A striking example of impact is how **ESG metrics and reporting have moved from niche to mainstream** in the past two decades – in 2004 “ESG” was a novel term coined under UN auspices, whereas today most major corporations produce ESG reports and boards routinely discuss sustainability risks. The UNGC's call for top-level commitment has led many boards to form Sustainability or ESG committees and to tie executive compensation to sustainability targets. Additionally, the UNGC and PRI have influenced investors to become more active in governance for sustainability – large institutional investors now often vote against boards that fail to act on issues like climate risk or diversity, reflecting principles championed by these UN initiatives.

Case studies show tangible outcomes: for instance, many companies in the apparel industry, influenced by UNGC principles and facing stakeholder pressure, have improved their corporate governance by establishing stronger oversight of factory conditions and joining collective initiatives to eliminate child labor. The UNGC's anti-corruption principle (Principle 10) has pushed companies in high-risk sectors to implement more robust compliance programs and board-level audit committees focused on ethical conduct. Some empirical research even suggests that UN Global Compact participation correlates with improved financial performance in the long run, as firms that internalize sustainability often innovate and manage risks better. While findings are mixed, one study noted a **positive impact of UNGC adoption on sales growth and profitability**, although not (in that study) a significant improvement in certain social outcomes like employee welfare, indicating a complex picture of results.

Limitations and Criticisms: Despite its lofty principles, the UN Global Compact has faced criticism regarding its **enforceability and the depth of corporate commitment**. Participation is voluntary and the UNGC lacks any sanctioning power beyond public

delisting for non-communication. This has led to concerns of “*blue-washing*” – the idea that some companies join the Global Compact for public relations benefits, aligning themselves with the UN’s image, without making substantive changes to their behavior. Critics point out that the Compact’s principles are broad and companies self-report progress, so some participants may cherry-pick easy improvements while continuing harmful practices out of the spotlight. For example, a corporation might tout its UNGC membership and a charitable initiative in its COP, even as its core business operations still pollute or violate labor rights. Academic critics have argued that the Global Compact allows corporations to appear as partners in global governance without ceding any real power or being subject to binding rules – essentially a “*meek communicative, rather than legally-binding, framework*”. The LSE Business Review went so far as to call the Compact’s lack of enforcement a “moral bankruptcy of the Davos approach,” noting that corporate pledges often aren’t backed by effective accountability.

Another limitation is that **measuring impact is difficult**. While thousands of firms have signed on, their performance varies widely. The UNGC requires annual COP reports, but the quality of these disclosures ranges from excellent to superficial. Some companies have been removed from the Compact for failing to report at all – indicating a baseline level of accountability – yet there is no rigorous external verification of whether companies actually adhere to the principles. Thus, stakeholders (investors, NGOs, etc.) must rely on their own vigilance to distinguish genuine progress from greenwashing or blue-washing. The UN’s initiatives also tend to set aspirations that outpace reality: for instance, despite 15+ years of the UN’s anti-corruption principle, corruption scandals in corporations remain common, suggesting that voluntary pledges alone are insufficient to overcome ingrained unethical practices without stronger enforcement by national laws.

Lastly, the UN’s approach can be seen as **indirect** – it relies on moral authority and convening power rather than regulatory mandates. This means its effectiveness often hinges on external factors: public pressure, investor activism, or the incorporation of UN principles into binding regulations by governments. Indeed, many of the UN’s corporate governance-related norms are now being echoed in hard law (for example, several countries and the EU are developing mandatory human rights and environmental due diligence laws inspired by the UN Guiding Principles). In summary, the United Nations has been crucial in broadening the scope of corporate governance to include sustainability and ethics, creating a global movement for responsible business. Its soft-law initiatives have achieved impressive reach and helped change attitudes, but their voluntary nature and lack of enforcement mechanisms remain significant limitations. The UN’s influence is most effective when its principles are reinforced by stakeholders’ demands or translated into concrete requirements by regulators, ensuring that corporate governance truly internalizes these global values.

7.3. The Contribution of the European Union to Corporate Governance Regulation

The European Union (EU) has progressively become a powerful force in shaping corporate governance, particularly within its 27 member states, but also with spillover effects internationally. Unlike the OECD and UN, the EU has the ability to issue **binding laws (directives and regulations)** that member countries must implement, which gives its corporate governance initiatives real teeth. Historically, corporate governance in Europe was largely left to national authorities due to differing legal systems (common law vs. civil law, one-tier vs. two-tier boards, etc.). However, a series of corporate scandals (such as Parmalat in Italy in 2003) and financial crises, along with the drive to integrate European capital markets, prompted the EU to step in and harmonize key governance standards. Over the past two decades, the EU has launched a Corporate Governance Action Plan and passed numerous directives aimed at improving transparency, accountability, and shareholder rights across Europe.

Key EU Directives and Initiatives

The EU's approach has been to identify areas where minimum harmonization can strengthen corporate governance while still allowing national flexibility. A cornerstone is the **Shareholder Rights Directive (SRD)**. The original SRD (2007) and its updated version, SRD II (2017), set Europe-wide rules to empower shareholders in listed companies. They facilitate shareholders' **rights to vote** on executive pay ("say on pay"), require greater transparency around related-party transactions, and improve shareholders' access to information and the proxy voting process. The aim is to encourage long-term shareholder engagement and address the traditional passivity of investors in corporate governance.

Another major initiative is the **Corporate Sustainability Reporting Directive (CSRD)**, adopted in 2022. This directive significantly expands non-financial disclosure requirements: it compels large companies (including non-European companies with substantial EU operations) to report on environmental, social, and governance matters according to detailed **European Sustainability Reporting Standards**. By mandating ESG reporting (with requirements for independent audit/assurance of this information), the EU is effectively integrating sustainability into corporate governance – boards must oversee not only financial reporting but also sustainability performance. The CSRD builds on the earlier Non-Financial Reporting Directive (NFRD) but widens the scope to many more companies and enforces more standardized, comparable reporting. This reflects the EU's belief that transparency drives better corporate behavior and that investors and stakeholders have a right to consistent information on how companies are managing risks like climate change or human rights issues.

In tandem with the CSRD, the EU has been developing a **Corporate Sustainability Due Diligence Directive (CSDDD)** (proposal published in 2022). This proposed directive goes a step further by requiring large companies to **proactively identify and address adverse human rights and environmental impacts** in their operations and supply chains. It would also, controversially, impose a duty on directors to consider sustainability matters in their decision-making (an attempt to broaden directors' fiduciary duties beyond pure shareholder interests). If enacted, this directive will firmly embed stakeholder considerations and long-term sustainability into EU corporate governance by law, making practices that were encouraged by UN norms or voluntary codes now a legal obligation in Europe.

The EU has also tackled **board composition and diversity**. After years of debate, in November 2022 the EU adopted a directive on **gender balance on corporate boards**, often called the "Women on Boards Directive." This law requires listed companies in EU member states to have at least ~40% of non-executive director positions held by women by 2026 (or 33% if including executive directors). Companies that fail to meet the target must adjust their nomination processes (for example, prioritizing equally qualified female candidates) and report on progress. This binding quota is a significant intervention in corporate governance, aiming to accelerate gender diversity in leadership which had been improving slowly under voluntary measures. Some EU countries (France, Germany, Italy, etc.) already had national quotas, but this directive extends the principle EU-wide and is likely to influence debates in other parts of the world about board diversity as a governance issue.

Other important EU measures include the **Audit Regulation and Directive (2014)**, which tightened oversight of audit firms after the Enron-era scandals, mandating auditor rotation and stronger audit committees to enhance financial integrity. The **EU Takeover Directive (2004)** established basic shareholder rights during corporate takeovers (though it allowed opt-outs due to differing national attitudes on takeover defenses). The **Transparency Directive** and **Accounting Directive** have also been updated to improve disclosure of corporate ownership and governance arrangements (for example, requiring companies to publish an annual corporate governance statement describing their governance practices and compliance with codes). Additionally, the EU has supported a "comply or explain" regime for corporate governance codes: while it has not imposed a single European code, it requires listed companies to either follow a national governance code or explain their deviations, thereby promoting adherence to good practices while respecting national diversity.

The EU's corporate governance interventions have had substantial impact within Europe. By setting *minimum standards in law*, the EU ensures a baseline of governance quality. For example, **shareholders across the EU now enjoy stronger rights**: they

must be given a say on remuneration policy at least every four years, and institutional investors like asset managers have to disclose how they integrate shareholder engagement in their investment strategy (per SRD II). These changes have led to more dialogue between companies and shareholders and a greater focus on long-term performance. The transparency driven by EU directives has improved over time – today, European companies publish far more information on their governance structures, risk management, and sustainability efforts than they did two decades ago, which aids investors and reduces information asymmetry. The new sustainability reporting rules (CSRD) are expected to further enhance comparability and trust, as companies will report against common metrics (with many aligning to frameworks like TCFD or GRI) and auditors will provide assurance.

Real-world examples of EU influence include the rapid increase in board gender diversity in countries that anticipated or responded to the Women on Boards Directive – for instance, Germany had only about 10% women on boards in the mid-2000s; after a mix of national pressure and the looming EU action, women’s representation in large German company supervisory boards is now above 30%, with similar trends in many member states. Likewise, after the Audit Directive, all large EU banks and public-interest entities now have independent audit committees, which was not uniformly the case before. The EU’s actions often set a **global example**: other countries watch EU developments and sometimes follow suit if they see benefits. For instance, the EU’s lead on requiring ESG disclosures has influenced regulators in other jurisdictions (such as the UK, Canada, and Japan) to consider or implement similar rules for sustainability reporting, to maintain consistency with global investors’ expectations.

Furthermore, the EU initiatives explicitly encourage a shift to long-termism and stakeholder focus. The *rationale* behind many recent EU governance changes is to combat short-termism and integrate sustainability into corporate strategy. By mandating disclosures and due diligence on climate and human rights, the EU is effectively forcing boards to consider these issues seriously. This is a contrast to, say, the United States, where such sustainability-oriented governance mandates are less developed at the federal level. In this way, the EU has positioned itself as a leader in “sustainable corporate governance,” attempting to redefine what good governance means in the 21st century (to include ESG performance alongside traditional financial accountability).

Limitations and Challenges

Despite its strong influence, the EU’s approach to corporate governance is not without challenges. One issue is the **diversity of corporate governance systems within Europe** – ranging from dispersed-ownership markets like the UK to concentrated-ownership systems like in much of continental Europe. EU laws typically set only

framework requirements. Member states often go beyond them or implement them in varied ways, which can result in uneven outcomes. For example, the Takeover Directive's optional provisions led to different takeover rules in different countries, and the "comply or explain" code regime relies on national code quality and enforcement, which still vary (some countries rigorously monitor companies' explanations, others do not). The EU must respect the principle of subsidiarity, so it tends to act only where it perceives a clear benefit to harmonization. This cautious balance sometimes means rules are **watered down by the time all member states agree**. A case in point: the proposed Corporate Sustainability Due Diligence Directive has faced pushback from various national and industry groups concerned about legal liability and burden on companies. Negotiations may dilute certain provisions (such as the exact director duty or the scope of companies covered) before it becomes final.

Another limitation is ensuring compliance in practice. Passing a directive is one thing; changing corporate culture is another. For instance, while say-on-pay is now EU-wide, in some countries the vote is only advisory and boards might not truly engage with shareholder concerns unless pressure mounts. Similarly, companies may produce sustainability reports to comply with CSRD, but the **quality of disclosures** and whether boards truly integrate sustainability in decision-making will vary. There is a risk of a **compliance mentality** – firms treating new reports or due diligence as a box-ticking exercise rather than embracing the spirit of the law. The EU and national regulators will need to provide guidance and oversight to prevent superficial compliance.

There are also *transition challenges*. New regulations like the CSRD impose significant costs and learning curves on companies and auditors. Recently, recognizing the scale of change, EU authorities have considered **phasing in or adjusting some requirements**. In 2025, for example, the European Parliament voted to **delay the implementation deadlines of the CSRD** for certain companies, giving them more time to prepare for the detailed reporting standards. This delay indicates that even as the EU is ambitious, it must calibrate its pace to avoid excessive burden that could backfire (companies overwhelmed by compliance might pay lip service rather than genuinely improve sustainability). Moreover, the EU's own leadership can shift: a new emphasis on cutting "red tape" or boosting competitiveness could slow down further governance reforms. Indeed, there have been discussions in the EU about consolidating or simplifying ESG rules – one 2025 proposal (sometimes dubbed an "omnibus" directive) aimed to streamline reporting requirements amid concerns the EU was moving too fast and potentially disadvantaging its firms. This reflects a constant balancing act between raising governance standards and maintaining a business-friendly environment.

Finally, regarding global impact: while the EU often sets high standards (what's sometimes called the "Brussels effect" when EU regulations de facto become global standards), not all jurisdictions follow. For instance, the United States has taken a different path on some issues (e.g., the US has resisted mandated board gender quotas or comprehensive ESG disclosure rules at the federal level, relying more on market-led or state-led efforts). Some multinational companies end up adhering to EU rules in their global operations for simplicity, but others might partition compliance (doing the minimum in the EU and not extending it elsewhere). Therefore, the EU's contribution, though significant, is still part of a **patchwork of international governance regimes**. Its true global influence may depend on the extent to which other countries align their requirements or how much investors and civil society demand EU-level standards from all companies. In summary, the EU has materially strengthened corporate governance by turning best practices into enforceable obligations – improving transparency, rights, and inclusivity – yet the effectiveness of these measures relies on robust implementation and the continued political will to prioritize long-term, sustainable governance in the face of economic and political pressures.

7.4. The Impact of Other Organizations (e.g., World Bank, IMF)

Beyond the OECD, UN, and EU, a number of other international organizations influence corporate governance standards and reforms. Chief among these are the **World Bank** (and its private-sector arm, the International Finance Corporation, IFC) and the **International Monetary Fund (IMF)**. These institutions do not issue corporate governance codes per se, but they wield influence through their development programs, financial assistance conditions, and technical expertise. They often work in tandem: the World Bank focuses on development and long-term strengthening of institutions, while the IMF often intervenes during economic crises or through its surveillance of financial systems. Both view good corporate governance as essential to economic stability and growth, especially in emerging markets and developing economies.

A. World Bank Group

The World Bank has made corporate governance a priority in its mission to strengthen financial markets and promote investment. Through its **Corporate Governance Group**, the World Bank provides **technical assistance and policy advice to member countries** to help them build robust corporate governance frameworks. This often begins with diagnostic assessments: the World Bank, in partnership with the OECD, conducts **Reports on the Observance of Standards and Codes (ROSC)** for corporate governance in various countries. These ROSC assessments benchmark a country's laws and practices against the OECD Principles and other international norms, identifying weaknesses in areas like shareholder protection, disclosure, or board functioning. The

findings then inform a reform roadmap. For example, a ROSC might reveal that Company Law in a country lacks provisions for minority shareholders to sue directors, or that financial disclosure by listed firms is insufficient; the World Bank would recommend specific legal amendments or regulatory changes.

After diagnostics, the World Bank assists with **implementation of reforms**. This can include drafting new company laws or securities regulations (to strengthen governance requirements), helping establish **corporate governance codes** at the national level, and building the capacity of regulators, stock exchanges, and courts to enforce the rules. The World Bank often emphasizes improving governance of the financial sector (banks and insurance companies) and **state-owned enterprises (SOEs)**, knowing that governance failures in those entities can have outsized economic impacts. The OECD's specialized *Guidelines on Corporate Governance of State-Owned Enterprises* are another tool recently updated (2024) with input from the World Bank, reflecting best practices for transparency and board independence in SOEs.

Real-world examples of World Bank impact abound. In countries like *Algeria, Bangladesh, Peru, Tunisia, and Ukraine*, the World Bank has run projects to modernize state-owned bank governance – clarifying the roles of boards vs. government, setting up merit-based director nomination processes, and improving risk management. In *Georgia* and *Bosnia and Herzegovina*, World Bank teams conducted **Financial Sector Assessment Program (FSAP)** reviews (often jointly with the IMF) that included bank governance reviews, leading to reforms in banking laws and stronger bank supervision on governance issues. The IFC, for its part, has invested in companies in countries like *Vietnam* or *Kenya* on the condition that those firms implement governance improvements – such as appointing independent board members, adopting IFRS accounting, or creating audit committees – demonstrating how international finance can incentivize better governance. The IFC also publishes practical toolkits and case studies (e.g., how the Brazilian stock exchange's Novo Mercado segment improved governance of Brazilian companies with IFC support) to spread knowledge.

Collectively, the World Bank's efforts have contributed to a **global elevation of governance standards** in developing markets. Many countries that lacked basic shareholder protections in the 1990s now have updated company laws or stock exchange listing rules that echo OECD Principles, thanks in part to World Bank advisory work. Empirical data show that these reforms can have positive effects: as governance improves, markets tend to deepen. For instance, after corporate governance codes and reforms were introduced in several East Asian countries in the early 2000s (with World Bank/OECD assistance post-Asian financial crisis), those markets saw renewed investor confidence and a rebound in equity valuations. Good governance is

linked to lower cost of capital and higher firm value, which underscores the World Bank's message that this is a development issue, not just a corporate best practice.

B. The International Monetary Fund (IMF)

The International Monetary Fund approaches corporate governance from the angle of financial stability and economic health. It has increasingly recognized that **weak corporate governance in banks and corporations can undermine macro-economic stability**. The IMF does not impose corporate governance reforms in normal times, but during **crisis lending programs**, it often includes governance-related conditions as part of the structural reforms a country must undertake. A famous example is the **1997 Asian Financial Crisis**: in countries like South Korea, Indonesia, and Thailand, the IMF's rescue packages came with requirements to restructure and improve corporate governance – e.g. to increase transparency in chaebol finances, strengthen accounting standards, and reform bankruptcy laws so that failing firms could be reorganized or liquidated rather than kept afloat by political patronage. In South Korea, under IMF guidance, measures were taken to dilute the dominance of family-controlled conglomerates (chaebols) by enforcing consolidated financial reporting and encouraging outside shareholders, which were aimed at making corporate management more accountable and reducing reckless over-leveraging. These governance reforms were seen as essential to restore investor confidence during the crisis.

The IMF also works through its **surveillance and technical assistance**. Under the joint World Bank-IMF FSAP program, the IMF examines the robustness of financial systems, which includes looking at banking supervision and banks' corporate governance. The IMF has promoted internationally agreed standards (like the Basel Committee's principles on bank governance and the OECD Principles) as benchmarks that countries should meet. It participates as an observer in bodies like the OECD Corporate Governance Committee, contributing its perspective and aligning its advice with these standards. Through policy papers and dialogues with member countries, the IMF emphasizes that governance reforms – such as protecting creditor rights, enhancing board oversight in banks, and tackling corruption in both public and private sectors – are critical for economic resilience.

When the IMF conditions reforms on governance, it can achieve quick changes on paper. For example, during the Indonesian IMF program (late 1990s), new laws on corporate bankruptcy and a securities law amendment to strengthen minority shareholder rights were passed as required. Similarly, in the aftermath of the 2008 global financial crisis, IMF programs in countries like Ukraine and Greece pushed for privatization or restructuring of state-owned enterprises with governance improvements, to reduce fiscal drain and improve efficiency. The IMF's **endorsement of international governance standards has had a normative effect**, too: countries

often strive to show they are meeting these standards to signal reliability to investors. One analysis by IMF economists found that in East Asia, firms with weak corporate governance (e.g., poor minority shareholder protections) had experienced more severe capital outflows during the 1997 crisis, suggesting that bolstering governance is key to preventing future crises. This evidence has reinforced the IMF's stance that corporate governance is part of sound economic management – indeed, “*institutions of corporate governance should be at the top of the policy agenda*” for crisis prevention.

The World Bank and IMF face several limitations in their impact on corporate governance. One major challenge is that reforms they encourage must take root **locally to be effective**. Passing a new law or code under external influence doesn't guarantee actual change in corporate behavior. In some cases, countries have adopted modern corporate governance codes largely to satisfy international observers or improve their ranking (for instance, on indices of investor protection), but enforcement remains weak and companies continue business-as-usual. This can lead to a disconnect between law and practice – beautifully crafted laws that are not implemented, or nominal compliance without genuine commitment. Critics caution that reforms driven by the IMF/World Bank may lack local ownership: if domestic political will or institutional capacity is insufficient, the changes may be superficial or easily reversed once external pressure is lifted. For example, a number of countries created securities regulators and minority shareholder protection rules in the 2000s with World Bank assistance, but if court systems are slow or regulators under-resourced, controlling shareholders can still expropriate value from minorities with impunity, undermining the intent of those reforms.

There is also the concern of a **one-size-fits-all model** being promoted. The Anglo-American governance model (shareholder-centric, capital-market oriented) has heavily influenced international standards. The World Bank and IMF have been critiqued for at times championing this model in environments where it may not fully suit the stage of development or cultural context. For instance, pushing rapid privatization of state enterprises or liberalization of financial markets (with governance reforms as part of that package) was controversial in some countries because local institutions to monitor governance (independent boards, active investors, judicial enforcement) were not yet mature. In Russia and some Eastern European states in the 1990s, accelerated privatization without proper governance safeguards led to asset stripping and oligarchic control – a lesson that governance frameworks need to accompany ownership changes. The World Bank/IMF have learned from these experiences, becoming more attentive to sequencing and the “*quality*” of governance reforms, but tensions remain between standard prescriptions and local nuances.

Another limitation is the **scope of influence**: the World Bank and IMF mainly influence governance in countries receiving their loans or assistance. Many emerging markets have indeed been touched by their programs, but some larger countries (e.g., China) have been more influenced by internal policy and OECD principles than by direct World Bank/IMF intervention. Also, the IMF's leverage to enforce governance reforms is tied to crises – outside of crisis programs, it can only recommend. And during crises, although conditions might be agreed on paper, governments under stress may not faithfully implement all measures. There's an inherent difficulty in trying to reform deeply ingrained corporate practices (like entrenched business groups or corruption networks) via external conditionality; such changes often require sustained political commitment internally.

In sum, the World Bank and IMF have significantly contributed to disseminating and implementing international corporate governance standards, particularly in developing and transition economies. They have provided knowledge, funding, and impetus for reform that many countries would have struggled to achieve alone. Their efforts have helped build the legal and institutional infrastructure for better governance, which is a foundation for healthier private sectors and more stable economies. However, their success varies, and effectiveness hinges on local political will, institutional capacity, and broader economic conditions. International organizations can light the path and lend support, but ultimately each country's corporate governance culture must evolve from within. This means that international influence, while important, has limits – it must be complemented by domestic demand for good governance (from investors, minority shareholders, civil society) and by continuous enforcement. The continuing challenge is to ensure that global principles and reforms translate into real changes in how companies are governed, creating more accountable, transparent, and responsible businesses worldwide.

Across the spectrum of international organizations – from the OECD's standard-setting, the UN's ethical frameworks, the EU's regulatory mandates, to the financial and technical influence of the World Bank and IMF – we see a multifaceted global effort to improve corporate governance. These organizations often work in concert: for example, the OECD sets principles adopted by the World Bank in its programs, the UN's sustainability ideals are being codified into EU laws, and the IMF and World Bank collaborate to ensure governance is part of economic reform packages. The net effect has been a significant raising of the floor of corporate governance standards worldwide. Yet, each approach has its limitations, and gaps remain between formal rules and actual practice. Future progress will depend on how well these international efforts continue to adapt to new challenges (like digital economy governance, climate change) and how effectively they are implemented on the ground. For students of corporate law and governance, it is clear that understanding the role of international

organizations is essential – modern corporate governance is no longer just a national affair, but a product of this dynamic global interplay.

Self-Assessment Quiz:

1. What are the OECD Principles of Corporate Governance, and why are they considered a global benchmark for good corporate governance? Describe two ways in which the OECD Principles have influenced national corporate governance practices.
2. Identify the main objectives of the UN Global Compact and explain how its principles relate to corporate governance. What are some criticisms of the Global Compact's effectiveness in changing corporate behavior?
3. Discuss one key directive or regulation introduced by the European Union to improve corporate governance (for example, the Shareholder Rights Directive or the Corporate Sustainability Reporting Directive). How has this EU initiative impacted corporate governance in practice within member states?
4. Explain how the World Bank and IMF promote corporate governance reforms in countries. Provide an example of a reform these institutions have encouraged (e.g., through a ROSC assessment or an IMF program condition) and discuss its importance.
5. Critically evaluate the limitations of relying on international organizations to improve corporate governance. Why might international standards or externally driven reforms not always lead to effective changes on the ground? Include in your answer an example of a challenge faced in implementing global governance principles in a local context.

Sources:

- Aguilera, R. V., & Jackson, G. (2010). Comparative and international corporate governance. *Academy of Management Annals*, 4(1), 485–556. <https://doi.org/10.1080/19416520.2010.495525>
- European Commission. (2020). *Action Plan: European Capital Markets Union 2020 – A new way forward*. Brussels: Directorate-General for Financial Stability, Financial Services and Capital Markets Union.
- European Parliament & Council. (2017). *Directive (EU) 2017/828 of 17 May 2017 amending Directive 2007/36/EC as regards the encouragement of long-term shareholder engagement*. Official Journal of the European Union.
- International Finance Corporation (IFC). (2021). *IFC Corporate Governance Methodology and Tools*. Retrieved from <https://www.ifc.org>
- OECD. (2015). *G20/OECD Principles of Corporate Governance*. Paris: OECD Publishing. <https://doi.org/10.1787/9789264236882-en>

- OECD. (2021). *The Role of Institutional Investors in Promoting Good Corporate Governance*. OECD Publishing. <https://www.oecd.org/corporate>
- OECD. (2023). *Corporate Governance Factbook 2023*. Paris: OECD Publishing. <https://www.oecd.org/corporate/corporate-governance-factbook.htm>
- OECD. (2024). *OECD Guidelines on Corporate Governance of State-Owned Enterprises* (2024 edition). Paris: OECD Publishing.
- United Nations. (2004). *United Nations Global Compact: Ten Principles*. New York: United Nations. <https://www.unglobalcompact.org>
- United Nations. (2011). *Guiding Principles on Business and Human Rights: Implementing the UN “Protect, Respect and Remedy” Framework*. New York and Geneva: United Nations Human Rights Office.
- UNCTAD. (2021). *International Standards of Accounting and Reporting (ISAR): Guidance on core indicators for entity reporting on contribution towards implementation of the SDGs*. Geneva: United Nations Conference on Trade and Development.
- World Bank. (2014). *Corporate Governance of State-Owned Enterprises: A Toolkit*. Washington, D.C.: World Bank Publications.
- World Bank. (2020). *Doing Business 2020: Comparing Business Regulation in 190 Economies*. Washington, D.C.: World Bank Publications.
- Zetzsche, D. A. (2008). Shareholder passivity, cross-border voting and the Shareholder Rights Directive. *Journal of Corporate Law Studies*, 8(2), 289–336. <https://doi.org/10.1080/14735970.2008.11419959>

CHAPTER 8: INTERNAL AND EXTERNAL AUDIT IN CORPORATE GOVERNANCE

Corporate governance refers to the system of rules, practices, and processes by which companies are directed and controlled. It encompasses the structures and procedures for making decisions in corporate affairs and for ensuring accountability among the company's stakeholders (shareholders, boards, managers, etc.). Within this framework, **internal** and **external audits** play crucial roles in upholding transparency and integrity. Effective audit functions help ensure that management acts in the best interests of owners and stakeholders, thereby mitigating the classic agency problem (the divergence of interests between owners and managers). In essence, internal and external auditors serve as key governance mechanisms – providing assurance, monitoring, and insight that enhance transparency and trust in an organization's operations and financial reporting. They create a system of checks-and-balances: management runs the company, the board oversees management, **internal auditors** evaluate and advise on internal controls and risks, and **external auditors** independently attest to the company's financial reports for the benefit of shareholders and other stakeholders.

Internal audit is an independent, objective assurance and consulting function established **within** an organization to add value and improve operations. According to the Institute of Internal Auditors (IIA, 2017), "*internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.*" In contrast, an external audit is a legally mandated **independent examination** of a company's financial statements and related disclosures by an outside auditor, with the aim of expressing an opinion on whether those financial statements present a true and fair view of the company's financial position and performance. External auditors are typically appointed by shareholders (or an oversight body like the board's audit committee) to provide an objective check on the accuracy of financial reports prepared by management.

Both forms of audit are fundamental to good corporate governance. Internal auditors, as part of the organization, provide continuous monitoring and improvement of internal controls, risk management, and governance processes from within. External auditors, as independent outsiders, lend credibility to the organization's public financial disclosures and serve as a check on management's financial stewardship. Together, internal and external audit functions reinforce each other and give boards and stakeholders confidence that the company is being run accountably and transparently. This chapter defines in depth the roles of internal and external audit in

corporate governance, examines international standards and best practices (including frameworks like the International Standards on Auditing, PCAOB standards, the Sarbanes-Oxley Act, EU audit regulations, and IIA standards), and provides real-world examples and case studies to illustrate practical applications. We will also discuss the role of the board's audit committee in coordinating these audit functions. The chapter concludes with key takeaways and a self-assessment quiz to reinforce understanding.

Learning Objectives:

By the end of this chapter, students should be able to:

- **Distinguish** between internal auditing and external auditing in terms of their scope, purpose, independence, and reporting lines within corporate governance.
- **Explain** how both internal and external audits contribute to transparency and accountability in organizations, and why they are considered cornerstones of good corporate governance.
- **Describe** the role of the board of directors' audit committee and its key functions in overseeing internal and external auditors, financial reporting, and internal controls.
- **Identify** major international audit standards and regulations (e.g. International Standards on Auditing, PCAOB standards, the Sarbanes–Oxley Act, EU Audit Directive, IIA standards) and understand how they shape audit practices and corporate governance globally.
- **Analyze** real-world corporate cases to evaluate how effective (or ineffective) audit and oversight mechanisms impact corporate governance outcomes, and to draw lessons for best practices and reforms.

8.1. Distinguishing Between Internal and External Audit

Internal and external audits are complementary but distinct assurance functions in governance. **Internal auditing** is a function that is established within the company, whereas **external auditing** is performed by independent professionals from outside the company. Internal auditors are company employees (or an in-house department) who examine all aspects of an organization's activities – not only financial reporting, but also operational efficiency, compliance with laws and policies, and the effectiveness of risk management and internal controls. The IIA (the global standard-setter for internal audit) emphasizes that internal audit's broad mission is to help the organization achieve its objectives by systematically evaluating and improving governance, risk management, and controls (IIA, 2017). Internal audit often takes a proactive, *forward-looking* approach: it may identify emerging risks, assess whether controls will be effective for future operations, and advise management on improvements. By contrast, **external audit** has a more *historical* and focused scope: it is primarily concerned with

providing an independent opinion on the company's annual financial statements. External auditors (typically an audit firm hired by the shareholders or board) examine the financial records and supporting evidence to determine whether the statements are presented fairly in conformity with the applicable accounting framework (such as IFRS or US GAAP). The external audit thus offers assurance to outside stakeholders that the financial results are free of material misstatement and can be relied upon.

One key difference is **who the auditors work for and their independence**. Internal auditors are part of the organization's staff, but to be effective they maintain *organizational independence* by reporting functionally to the highest levels (often directly to the board's audit committee) rather than to management. This ensures they have the authority to audit any area and report findings without managerial interference. Nonetheless, internal auditors are not fully independent of the company – they are employees and do not provide a public opinion; their reports are internal. External auditors, on the other hand, are completely independent from the organization's management. They are appointed by shareholders (or by the board on shareholders' behalf) and owe their duty of care to the shareholders and the company as a whole. External auditors issue a formal audit opinion addressed to the shareholders and the board, which becomes part of the company's public financial report. Because of this public accountability, external auditors must not have conflicts of interest with the client – they are subject to strict independence rules (e.g. not owning shares in the client, not having business relationships or providing prohibited non-audit services to the client, and periodic rotation of audit partners/firms as required by law). In essence, internal auditors' independence is an *internal* matter (ensuring objectivity within the organization's governance structure), whereas external auditors' independence is a *legal/professional* requirement to ensure objective oversight on behalf of outsiders.

The **objective** of internal audit is broadly to **evaluate and improve** the effectiveness of governance, risk management, and internal controls, ultimately adding value to the organization. Internal auditors take a holistic view of the organization's processes (financial and non-financial) and often act as consultants to management by providing advice on strengthening systems and addressing inefficiencies or risks. By contrast, the **primary objective** of external audit is narrowly defined: to **verify financial accountability** by attesting to the truth and fairness of the financial statements. External auditors focus on financial reporting risks and controls related to financial accounts. They plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement, whether due to fraud or error, and then issue an audit report with their opinion (unqualified "clean" opinion if statements are fair, or modified if not). While doing so, external auditors may incidentally observe issues in internal control or governance and will report significant weaknesses to management and the audit committee in a management letter, but

improving those systems is not their primary mandate. In short, **internal audit's lens is wide** (encompassing efficiency, compliance, and effectiveness across all operations), whereas **external audit's lens is narrower** (centered on financial statement reliability).

Internal auditors report **within the corporate chain** – their findings and recommendations are reported to management and to the board of directors (usually via the audit committee). Internal audit reports are *not* made public; they are intended to prompt internal improvements and inform the board. In contrast, external auditors ultimately report **externally** – the culmination of their work is the published auditor's report which is addressed to shareholders and often included in the annual report for all investors and stakeholders to see. Additionally, external auditors communicate privately with the board (audit committee) about any issues found (for example, if they discovered serious internal control problems or fraud, they raise it with the directors). Thus, the audiences differ: internal audit's audience is internal (management/board), while external audit's audience includes external stakeholders (owners, regulators, the market).

Internal auditing is guided by professional standards set by the IIA – the *International Standards for the Professional Practice of Internal Auditing*, part of the IIA's broader **International Professional Practices Framework (IPPF)**. These standards cover internal audit's ethics (integrity, objectivity, confidentiality, competency) and performance (planning, fieldwork, reporting, quality assurance) and are followed worldwide to ensure internal audits are systematic and credible. Many corporate governance codes and laws encourage or require compliance with IIA standards for internal audit functions (Institute of Internal Auditors, 2018). However, in many jurisdictions, internal audit itself is not heavily regulated by law except in certain sectors (like banking or government) – rather, it is a recommended best practice for good governance. External auditing, in contrast, is subject to extensive regulation. External auditors must follow **auditing standards** such as the *International Standards on Auditing (ISA)* issued by the International Auditing and Assurance Standards Board (IAASB), or equivalent national standards (e.g., the PCAOB Auditing Standards in the United States). They are also subject to licensing, oversight by independent regulators, and specific legal requirements (for instance, most countries require certain companies – typically publicly listed or large entities – to undergo an external audit annually by law). External audit firms are monitored by bodies like the PCAOB (US) or national audit oversight authorities in many countries, which inspect audit quality and enforce standards. Moreover, laws such as the Sarbanes–Oxley Act (USA) and EU Audit Regulation impose rules like mandatory audit partner rotation and restrictions on non-audit services to strengthen auditor independence (Sarbanes–Oxley Act, 2002; EU Regulation 537/2014).

Internal audits are **ongoing** – the internal audit function typically executes a risk-based audit plan each year covering various areas of the organization on a rotating or continual basis. Internal auditors may perform multiple audits throughout the year (e.g., auditing different departments, processes, or subsidiaries) and can do special reviews whenever issues arise. External audits are usually **periodic** – most commonly an annual audit of the financial statements after the fiscal year-end. In some cases, external auditors also perform half-year reviews or other interim procedures, but their primary output is the yearly audit report. The internal audit’s continuous presence allows it to delve deeper into operations and follow up on whether issues are resolved, whereas the external audit’s periodic nature provides an independent snapshot of the company’s financial health at regular intervals.

Despite their differences, internal and external audit functions often coordinate with each other to enhance overall assurance. External auditors will typically evaluate the effectiveness of internal audit and internal controls as part of their planning – if internal audit is strong and reliable, external auditors may adjust their own audit approach (for example, by relying on some internal audit work in low-risk areas). Conversely, internal auditors consider external audit findings as important inputs to their risk assessments. Best practices encourage **communication** between internal and external auditors (usually through the audit committee): for instance, they might meet to discuss risk areas so that efforts are not duplicated and significant issues are not overlooked. However, external auditors must always perform their own independent testing and cannot *simply* rely on internal audit’s conclusions; they use internal audit’s work as a complementary source of insight. A well-coordinated audit effort ensures comprehensive coverage: internal audit, being inside the organization, has detailed operational knowledge, and external audit brings an outside perspective and rigorous verification of financial disclosures. Both contribute to a fuller picture of the organization’s governance and controls.

In summary, **internal audit** can be seen as the organization’s “**third line of defense**” (in the *Three Lines Model* of governance) – it is management’s internal assurance function, directly reporting to the board, focused on *improving* the organization from within. **External audit** serves as an **external line of assurance** – a check imposed from outside, focused on *validating* and certifying what the organization reports to the public. The two differ in scope, perspective, and accountability, but together they form a critical dual system of oversight. Table 1 below provides a high-level comparison:

Comparison of Internal and External Audit

- **Organizational Status:** Internal audit is **in-house** (part of the company’s own staff) and reports to management and the board (usually via the audit

committee). External audit is **independent** of the organization (an outside firm) and reports to shareholders (via the audit opinion) as well as to the board.

- **Primary Objective:** Internal audit's goal is to *evaluate and improve* internal processes (risk management, control, governance) and add value for management; external audit's goal is to *provide an opinion* on the truth and fairness of the financial statements, assuring stakeholders that the financial reports are reliable.
- **Scope of Work:** Internal audit has a **broad, ongoing scope** – covering financial and non-financial risks, operational efficiency, compliance, etc., determined by the organization's own risk assessment and priorities. External audit has a **narrower scope focused on finance** – primarily auditing the financial statements and underlying financial controls, as required by standards and regulations.
- **Reporting & Audience:** Internal audits result in **internal reports** to management and the audit committee; they are confidential and used for internal improvement. External audits result in a **published audit report** (opinion) for shareholders and stakeholders, and also a private letter to management/audit committee on any issues found.
- **Standards & Regulation:** Internal audit follows **IIA standards** and company policies; it is not usually mandated by law (except in certain sectors or by code), though it is strongly recommended by governance best practices. External audit follows **international auditing standards** (e.g., ISA or PCAOB standards) and is often required by law for public companies and regulated entities; it is overseen by professional bodies and regulators.
- **Independence:** Internal auditors are **organizationally independent** (no direct responsibility for what they audit, and protected reporting lines to the board) but *employees* nonetheless; they must remain objective and not manage the processes they audit. External auditors have **external independence** – they are a separate firm with no stake in the company and must abide by strict independence rules (no conflicts of interest, rotation requirements, etc.).

By understanding these distinctions, one can appreciate how each audit function uniquely contributes to governance. In practice, a strong internal audit function within a company will often facilitate a smoother external audit, and a rigorous external audit can reinforce the importance of internal controls that internal audit monitors. Both are needed for a robust governance system.

8.2. The Role of Audit in Ensuring Transparency and Accountability

One of the fundamental purposes of audits in corporate governance is to enhance **transparency** and **accountability** within organizations. **Transparency** in corporate governance means that stakeholders have access to accurate and timely information about the company's finances and operations, enabling informed decision-making and oversight. **Accountability** means that those who manage the company (the board and executives) are held responsible for their decisions and stewardship of the company's resources. Auditing – both internal and external – is a key mechanism to achieve these ideals. By independently reviewing and verifying what the company is doing, auditors create trust that the company's disclosures are truthful and that management's actions are being properly overseen.

The external audit directly supports transparency by providing an **external objective check** on the company's financial reports. As one analysis notes, *“the external audit is one of the cornerstones of corporate governance. It provides an external objective check on how the financial statements have been prepared and presented and a means through which shareholders monitor and control management, thus enhancing transparency in a company.”* In other words, external auditors lend credibility to the financial statements – investors, creditors, regulators, and the public can trust the numbers more because an independent expert has vetted them. Without an external audit, shareholders (especially those not involved in day-to-day management) would face **information asymmetry** and might doubt the reliability of the financial information that management provides. History has shown that when companies lack proper external auditing and disclosure, it can lead to mismanagement or fraud remaining hidden until it's too late. For example, major corporate scandals like *Enron* (USA, 2001) or *Wirecard* (Germany, 2020) involved situations where financial results were misrepresented; in both cases, failures or shortcomings in the external audit contributed to a lack of transparency that allowed issues to fester. Conversely, the presence of a rigorous external audit can deter management from trying to conceal problems, knowing that auditors could discover irregularities. By requiring companies to open up their books and having outsiders examine them, external audits significantly improve the transparency of corporate reporting.

Internal audit contributes to transparency **inside the organization** and indirectly to external transparency as well. Internal auditors continuously scrutinize the company's operations and controls, which means they often discover and address issues (errors, inefficiencies, policy violations) before they materialize in public reports. They promote *internal transparency* by reporting candidly to senior management and the board about what is happening within various departments. For instance, if there are weaknesses in how the company tracks revenues or an IT system problem that could

affect data integrity, internal audit will bring this to light. By improving the reliability of internal processes and data, internal audit ensures that the information flowing up to decision-makers – and eventually disclosed externally – is more accurate and reliable. Additionally, internal audit reviews areas like regulatory compliance and ethical conduct, which can prevent misconduct or illegal practices from being hidden. Companies with strong internal audit functions tend to have more reliable financial reporting (as studies have shown, they experience fewer restatements or surprises) and a culture that values openness and correction of problems. Thus, while internal audit reports are not public, their work underpins the **transparency** of the organization's governance by making sure there are “no blind spots” internally.

The concept of **accountability** in corporate governance is often framed by agency theory: shareholders (principals) delegate control to managers (agents), and mechanisms are needed to ensure agents do not abuse this power. Auditors are among the critical agents of accountability. **External auditors** hold management accountable to shareholders by independently verifying management's financial representations. When an external auditor issues an opinion that the financial statements are true and fair, it implicitly attests that management has responsibly reported the company's performance; if the auditors find misstatements or fraud, they can compel corrections or issue adverse opinions, thus signaling to owners that management's stewardship is in question. This dynamic creates strong incentives for management to **be accountable** and maintain truthful records – knowing that falsehoods can be exposed by the audit. In fact, external auditors have a **public interest duty**: by safeguarding the integrity of financial reporting, they protect not only shareholders but also other stakeholders who rely on those reports (creditors, employees, regulators, etc.). They act as “*protectors of stakeholders' interests*” by guarding the accuracy of disclosures, thereby ensuring management can be held to account for the outcomes under their watch.

Internal auditors, on the other hand, reinforce accountability **within the management hierarchy**. They report on whether managers at all levels are complying with company policies, applicable laws, and strategic directives set by the board. For example, if a certain division's management is engaging in excessive risk-taking or bypassing internal controls, internal audit will report this to higher authorities (senior executives or the board) and recommend corrective action. This makes individual managers answerable for their actions. Internal audit's presence often encourages a culture of accountability, as employees know that processes are subject to review. Furthermore, internal auditors evaluate the effectiveness of **internal controls**, which are the policies and procedures management puts in place to ensure good governance (like separation of duties, approval limits, etc.). By testing and improving these controls, internal audit helps create a system where it's difficult for any one individual to act without oversight – a foundational aspect of accountability.

Both internal and external auditors bolster transparency and accountability most effectively when they have a direct line to the board of directors, typically through the **audit committee** (covered in Section 8.3). The audit committee, made up of independent board members, acts as a champion of audit findings and ensures management addresses issues raised. This governance structure means that auditors can report problems honestly (transparency) and the board can then hold management accountable for fixing them. The OECD's **Principles of Corporate Governance (2015)** explicitly recognize the importance of audit in governance, stating that an annual independent audit is an essential mechanism for listed companies and that auditors are accountable to shareholders and owe a duty of care to the company and investors. The Principles also emphasize that audit committees should oversee the audit process to make sure auditors remain objective and effective. These international norms reflect the consensus that robust audit functions (backed by independent oversight at the board level) are key to transparent disclosure and accountable management.

***Real-World Examples:** There are many cases illustrating how audits ensure transparency/accountability – or the consequences when they fail to do so. A classic example is the Enron scandal: Enron's management engaged in complex accounting fraud to hide debt and losses; the external auditor (Arthur Andersen) failed to report these issues and even helped structure questionable transactions. The result was a massive loss of trust once the truth came out – shareholders and employees were blindsided, and Andersen's failure led to its collapse. In response, the U.S. Sarbanes–Oxley Act (2002) was enacted to strengthen auditor independence and accountability mechanisms (more on this in Section 8.4). Post-Enron reforms mandated that external auditors report directly to independent audit committees, prohibited auditors from performing conflicting consulting work for audit clients, and imposed criminal penalties for corporate misreporting – all measures to restore transparency and make executives and auditors more accountable for accurate reporting. Another example is the “Theft of the Century” – a 2014 banking fraud in Moldova where about \$1 billion was embezzled from three banks. Investigations later showed that internal controls were overridden and the banks' external auditors had given clean opinions despite red flags. The auditors (a local affiliate of an international firm) were accused by lawmakers of negligence for failing to detect the massive irregularities. This case underscored how a lack of effective auditing can enable corruption to stay hidden; it prompted Moldovan authorities to strengthen audit regulations, including stricter oversight of audit firms and requirements for auditor rotation and improved internal audit in banks. These reforms aim to ensure greater transparency in financial reporting and to hold auditors accountable for their gatekeeping role.*

In summary, **audits shine light** on the true state of a company's finances and operations (transparency) and create mechanisms to correct course when things go wrong (accountability). They give stakeholders confidence that they are not being misled and provide boards with tools to oversee and, if necessary, discipline management. A strong audit regime, internally and externally, thus builds trust with investors and the public, reduces the risk of fraud and mismanagement, and ultimately contributes to more sustainable, ethical corporate behavior.

8.3. The Audit Committee and Its Functions Within the Board of Directors

Modern corporate governance best practices call for a specialized committee of the board of directors – the **audit committee** – to oversee the audit function and the company's financial reporting process. The audit committee is a pivotal governance body that links the board, the internal auditors, the external auditors, and management. Its existence and effectiveness significantly enhance the integrity of financial reporting and the effectiveness of audits.

An **audit committee** is typically composed of a subset of board members, usually **non-executive** and **independent** directors (i.e. directors who are not part of company management and have no conflicts of interest). Many jurisdictions require that the audit committee have at least one member with financial expertise (such as a CPA or experienced CFO) to ensure the committee can competently oversee accounting and audit matters. For example, under U.S. regulations (Sarbanes–Oxley Act), public companies must have an audit committee of independent directors and disclose whether they have a “financial expert” on the committee. The primary purpose of the audit committee is to **assist the full board in fulfilling its oversight responsibilities** in areas of financial reporting, internal control, risk management, and audit. In effect, the board delegates detailed work on these issues to the audit committee, which then reports back and makes recommendations to the board.

Key Oversight Functions: The audit committee's functions generally include:

1. **Financial Reporting Oversight:** The committee monitors the integrity of the company's financial statements and disclosures. It reviews significant accounting policies, judgments and estimates made by management, and any major issues that could affect the financial results. Before financial statements are released, the audit committee will meet with management and the external auditors to discuss the results and any concerns. Their goal is to ensure the financial reports are accurate, complete, and in compliance with accounting standards. Essentially, the audit committee asks tough questions on behalf of the board and shareholders to hold management accountable for high-quality financial reporting.

2. **External Auditor Engagement and Independence:** A critical duty is to manage the relationship with the **external auditors**. The audit committee typically has the authority to *recommend the appointment* of the external audit firm, approve its remuneration, and pre-approve any non-audit services provided by the audit firm (to prevent conflicts of interest). The committee also oversees the auditors' performance and independence. They may set policies such as rotation of the lead audit partner every five years (as required by regulation in many countries) or even rotation of audit firms after a number of years (as required for public-interest entities in the EU). If issues arise with the external auditor's work, the audit committee has the power to take action, including recommending a change of audit firm. By taking these responsibilities away from management and giving them to independent directors, governance systems ensure that the **external auditor truly remains independent of management influence**. In fact, corporate governance codes entrust audit committees with making sure the external audit is thorough and unbiased; for instance, the audit committee in the U.S. must receive reports from the auditor on all critical accounting policies and any disagreements with management.
3. **Oversight of Internal Audit:** The audit committee also oversees the **internal audit** function. Best practice (and often regulatory requirement) is that the head of internal audit – often titled the Chief Audit Executive (CAE) – *reports functionally to the audit committee*. This means the audit committee (on behalf of the board) is involved in hiring or firing the CAE, approving the internal audit charter and plan, and ensuring internal audit has sufficient resources and access within the organization. The committee regularly meets with the CAE (without management present, to encourage free communication) to discuss internal audit findings. According to OECD guidance, audit committees should “*provide oversight of the internal audit activities and... oversee the overall relationship with the external auditor.*” This dual role positions the audit committee as the central coordinating point for **all audit activities** in the company. An effective audit committee will ensure that internal audit's recommendations are taken seriously by management and implemented on a timely basis. It essentially gives internal audit the backing of the board, which greatly strengthens internal audit's authority and independence. In companies without audit committees or independent boards, internal audit may struggle to have its voice heard if management chooses to ignore findings. Thus, the audit committee is crucial to empower internal audit and follow up on its work.
4. **Risk Management and Internal Controls:** Many audit committees are also tasked with overseeing the company's overall risk management framework and internal control systems. They often review management's processes for identifying and managing key risks (financial, operational, compliance, etc.) and

assess the effectiveness of internal controls in mitigating those risks. While some companies have a separate risk committee, it's common, especially in financial institutions, for the audit committee to handle risk oversight due to the close linkage with internal controls and audit. The audit committee might review reports from management on risk exposures, and it works with internal and external auditors to ensure that risk management processes are robust and any control weaknesses are addressed. For instance, in a bank, the audit committee will pay particular attention to credit risk controls, asset valuations, etc., often coordinating with regulators' expectations (banking laws frequently require banks to have audit committees overseeing both audit and risk).

5. **Compliance and Ethical Conduct:** In some companies, the audit committee also oversees compliance programs (like legal and regulatory compliance) and ethics or whistleblower mechanisms. Sarbanes–Oxley mandated that audit committees of U.S. public companies establish procedures for receiving complaints about accounting or auditing matters, including confidential anonymous submissions by employees (whistleblower hotlines). This responsibility recognizes that audit committees should ensure avenues exist to report fraud or unethical behavior. By supervising these channels, the audit committee adds another layer of oversight to hold management accountable if, say, employees report financial misconduct. The audit committee may also review the company's code of conduct and how violations are handled. All these efforts tie back to ensuring the **integrity** of the company's financial and governance processes.

The audit committee **typically meets regularly** (e.g., quarterly, aligned with financial reporting cycles) and also as needed if issues arise. Importantly, it should meet separately with **external auditors** and **internal auditors** without the presence of management. This allows auditors to candidly discuss any problems with the committee, such as pressure from management or difficulties encountered. The audit committee reports to the full board after each meeting, summarizing its activities and any recommendations (for example, whether to approve the financial statements, or significant audit findings). In many jurisdictions, the audit committee also provides an annual report (often included in the annual report to shareholders) describing how it carried out its duties, to give investors confidence that financial oversight is active.

The existence of an audit committee composed of independent directors has become a hallmark of good governance worldwide. It enhances the board's effectiveness by enabling more in-depth focus on audit and financial matters than the full board could typically give. After a series of high-profile corporate scandals around the world, regulators and stock exchanges strengthened requirements related to audit committees. For example, U.S. listing rules (NYSE, NASDAQ) require audit

committees for listed companies and implement many of the Sarbanes–Oxley provisions (independence, financial expertise, responsibilities for hiring auditors, etc.). The EU’s 8th Company Law Directive (as amended by Directive 2014/56/EU) requires that public-interest entities (like listed companies and financial institutions) have an audit committee that, among other duties, monitors the financial reporting process, oversees the effectiveness of internal control and audit, and supervises the statutory audit. In the UK, the Corporate Governance Code has for decades recommended audit committees of at least three independent directors for large companies, with similar responsibilities. These measures reflect a consensus that audit committees greatly improve the quality of oversight: research has found that companies with active, knowledgeable audit committees are less likely to have accounting misstatements or audit failures.

A powerful example of the audit committee’s importance was seen in the Enron case. Enron *did* have an audit committee (comprised of presumably reputable individuals), but as subsequent investigations showed, the committee did not fully grasp or challenge the complex financial arrangements that management used to conceal debt. Moreover, Enron’s audit committee was misled by both management and the external auditor, and it did not press for clarity or investigate warning signs. In response, Sarbanes–Oxley significantly expanded the audit committee’s authority and responsibilities: auditors now report directly to the audit committee (not to management), and audit committees have sole authority to approve all audit and non-audit services. Had such structures and a more skeptical audit committee been in place earlier, Enron’s deceptions might have been identified or prevented. This case underlined that audit committees need to be **active, informed, and empowered** to ask tough questions and demand straight answers – they cannot be perfunctory or passive.

The ***audit committee*** serves as the **bridge** between auditors and the board. For external auditors, the audit committee is effectively their client representative (since they represent shareholders’ interests). Auditors are required to communicate certain matters to the audit committee: for instance, any significant difficulties in the audit, any disagreements with management, and any material weaknesses in controls they found. The audit committee, in turn, evaluates the performance of the auditors annually (including obtaining reports from regulatory inspections if available) and ensures any issues are addressed. For internal auditors, the audit committee provides guidance and receives their reports on key findings. The committee often reviews and approves the **annual internal audit plan**, making sure that internal audit is focusing on the high-risk areas and has the freedom to audit anything it deems necessary. By coordinating these two audit functions, the audit committee can ensure that important issues don’t slip through the cracks. For example, if external auditors highlight a certain risk, the audit committee might ask internal audit to do a deeper review of that area in the next cycle.

Overall, the audit committee functions as a cornerstone of the corporate governance framework, upholding financial integrity and audit quality on behalf of the board. It elevates the independence of the audit processes by removing direct managerial control over audit relationships. Together, audit committees, external auditors, and internal auditors form a triad that strengthens oversight and accountability. Many regulators and institutions (OECD, World Bank, etc.) promote the establishment of audit committees precisely because empirical evidence and experience show they lead to better governance outcomes. In some countries that have more recently adopted corporate governance reforms (for example, transition economies or developing markets), making audit committees mandatory has been a key reform step to align with international standards. In Moldova, for instance, a Corporate Governance Code introduced in 2016 (voluntary for most companies, but mandatory for listed companies on a “comply or explain” basis) recommends establishing independent audit committees and internal audit functions. And following bank fraud scandals, the National Bank of Moldova now requires banks to have audit committees to oversee both internal and external audit, as part of strengthening financial sector governance.

In conclusion, an effective audit committee, composed of independent and financially literate directors, is an indispensable component of a sound governance system. Its oversight helps ensure that internal audit is empowered, that external audit is both independent and effective, and that the board is fully informed about the financial state of the company and any risks or deficiencies. This in turn protects shareholders’ interests and bolsters the credibility of the company in the eyes of investors and regulators.

8.4. International Audit Standards and Applicable Regulations

Audit practices around the world are governed by a framework of **international standards** and national regulations designed to ensure audit quality, independence, and consistency. In this section, we focus on some of the key frameworks and regulations – including International Standards on Auditing (ISA), the PCAOB standards in the U.S., the Sarbanes–Oxley Act, the European Union’s audit directives and regulations, and the IIA’s standards for internal audit – and how they impact corporate governance. These frameworks have largely developed in response to corporate failures and the need for cross-border consistency in auditing, reflecting an increasingly global consensus on what constitutes a “high-quality audit” in support of good governance.

A. International Standards on Auditing (ISA)

The **International Standards on Auditing** are a set of professional standards for external auditing issued by the International Auditing and Assurance Standards Board (IAASB), which operates under the International Federation of Accountants (IFAC). ISA are used in a vast number of jurisdictions worldwide – over 130 countries have adopted ISA or based their national auditing standards on ISA. These standards cover all aspects of the audit process: audit planning, risk assessment, gathering audit evidence, using the work of internal auditors or experts, forming an audit opinion, and communicating findings. For example, ISA require auditors to assess the risk of material misstatement and design audit procedures responsive to those risks (a risk-based approach), to understand the entity's internal controls, and to maintain professional skepticism throughout the audit. By adhering to ISA, auditors globally are expected to follow a rigorous, systematic approach that ensures important areas are examined and that the audit has a high likelihood of detecting material errors or fraud if they exist. The use of common standards like ISA also facilitates **comparability** and **consistency** – investors and regulators can have similar expectations of what an audit report means across different countries. In terms of corporate governance, the widespread adoption of ISA means that companies in many markets are subject to audits of a defined quality level, helping protect stakeholders in those markets. For instance, many emerging markets (including Moldova) have adopted ISA as their required auditing standards for statutory audits, thereby aligning local audit practices with international benchmarks.

B. PCAOB and U.S. Auditing Standards

In the United States, in the wake of accounting scandals like Enron and WorldCom, the **Sarbanes–Oxley Act of 2002 (SOX)** established the **Public Company Accounting Oversight Board (PCAOB)**, a new regulator to oversee the audits of public companies. The PCAOB sets its own Auditing Standards which apply to audits of companies listed in the U.S. While these standards initially were based on existing U.S. GAAS, the PCAOB has revised and expanded many of them, and in some areas PCAOB standards are even more prescriptive than ISA. For example, PCAOB Auditing Standard No. 5 (now AS 2201) specifically governs the audit of internal control over financial reporting (an audit requirement introduced by SOX for larger public companies). The PCAOB also conducts regular **inspections** of audit firms to enforce quality – something that was not done prior to 2002 when the profession was self-regulated. This independent oversight model has influenced other countries; now many have audit regulators that perform inspections similar to the PCAOB. From a governance perspective, PCAOB standards and oversight significantly tightened audit quality in the U.S., restoring investor confidence after the early 2000s scandals. Key elements of SOX/PCAOB regime include: mandatory lead audit partner rotation every

5 years on a client, prohibition of many non-audit services by the audit firm (e.g. auditors can no longer be a company's consultant and auditor simultaneously in areas like financial systems design), and stricter rules on auditor reporting to audit committees. The **impact** has been that auditors are more independent and more accountable – for instance, PCAOB inspection reports publicly highlight deficiencies in audits, pushing firms to improve, and companies know that any missteps in financial reporting will be thoroughly scrutinized by both auditors and regulators.

C. Sarbanes–Oxley Act (2002) and Internal Control Reporting

The U.S. Sarbanes–Oxley Act is one of the most influential pieces of legislation in corporate governance and auditing in decades. Besides creating the PCAOB and strengthening external auditor independence, SOX also placed responsibilities on **management and internal audit**. Notably, **Section 404** of SOX requires that management assess the effectiveness of the company's internal control over financial reporting *annually* and report on it, and that the external auditor independently audit and attest to management's assessment (for larger companies). This had a profound effect: companies had to formally document and test their internal controls (often using frameworks like COSO), and many that did not have internal audit departments established them or expanded them to comply with these requirements. Essentially, SOX elevated internal controls and internal audit to a board-level concern – deficiencies in internal control must be disclosed and can even lead to negative audit opinions if severe. The result is much greater accountability for internal governance processes. Countries around the world observed the effects of SOX; some implemented similar requirements (e.g., Japan's J-SOX, which has analogous internal control reporting rules). Even where not mandated by law, SOX's influence led multinational companies to voluntarily strengthen their internal control frameworks and boards to pay closer attention to internal audit's findings.

D. European Union Audit Directive and Regulation

The European Union undertook its own audit reforms, especially after the global financial crisis and some European corporate scandals (e.g., Parmalat in Italy 2003, which led to questions about auditor oversight). The EU introduced an Audit Directive (2006, updated by **Directive 2014/56/EU**) and a complementary **Audit Regulation (EU No. 537/2014)** specifically for **public-interest entities** (PIEs, which include listed companies, banks, insurers, etc.). These came into effect in 2016 across EU member states. Key provisions of the EU audit reforms include:

- **Mandatory Audit Firm Rotation:** Audit firms must rotate off a PIE client after a certain period (generally 10 years, though extensions to 20 years are possible if a tender is conducted, or 24 years for joint audits). The goal is to prevent over-

familiarity and complacency between auditors and clients and to introduce a “fresh look” periodically. This goes beyond the partner rotation rule of 5-7 years, imposing rotation at the firm level.

- **Restrictions on Non-Audit Services:** The EU regulation lists prohibited non-audit services that audit firms cannot provide to their PIE audit clients (similar in spirit to SOX). It also caps the fees for allowed non-audit services to no more than 70% of the average audit fees over three years, to limit economic dependence on consulting fees.
- **Audit Committees:** The Directive requires that PIEs have an audit committee (with at least one member with competence in accounting/auditing and a majority of independent members) responsible for, among other things, the selection of the auditor, oversight of the audit, and monitoring financial reporting. This cements the audit committee’s role in EU law.
- **Expanded Auditor Reporting:** European auditors now issue more detailed audit reports for PIEs, including describing key audit matters and how the audit addressed them (a change mirrored in ISA and PCAOB standards as well).
- **Audit Oversight:** Each member state must have an independent auditor oversight authority (many already did, but this ensured uniform coverage and cooperation among them, including with the PCAOB for cross-border audits).

These EU reforms aimed to increase auditor independence and audit quality in the wake of findings that in some cases auditors had become too cozy with long-time clients. For example, the **Parmalat** scandal revealed auditors had signed off on false bank confirmations for years; the EU responded by strengthening oversight and requiring things like rotation. Another driver was the financial crisis of 2008 – bank auditors were criticized for not flagging risks; the reforms thus also targeted systemic stability by ensuring rigorous audits for banks. The result is that Europe now has one of the stricter audit regulatory environments globally, which has influenced other jurisdictions (for instance, countries like India and Brazil have also implemented mandatory auditor rotation or similar rules in recent years).

The Institute of Internal Auditors (IIA) Standards and Codes

For **internal auditing**, the International Professional Practices Framework (IPPF) issued by the IIA serves as the de facto global standard. This framework includes:

- The **Definition of Internal Auditing** (as cited earlier),
- The **Code of Ethics** (principles of integrity, objectivity, confidentiality, and competency that internal auditors must uphold),
- The **Core Principles** for the Professional Practice of Internal Auditing (e.g., demonstrating integrity, being independent, being aligned with the organization’s strategies, exercising due professional care, etc.),

- The **International Standards for the Professional Practice of Internal Auditing** (often just “the Standards”), which are divided into Attribute Standards (governing the characteristics of internal audit functions and auditors) and Performance Standards (governing how internal audits should be conducted).

Compliance with IIA standards is not typically mandated by law (exceptions exist – for example, some countries require public sector internal audits to follow IIA standards), but it is strongly encouraged. Many organizations formally adopt the IIA Standards and undergo external quality assessments periodically to ensure conformance. In the context of corporate governance, adhering to IIA standards ensures that the internal audit function is credible and effective. For instance, the standards require internal audit to maintain independence (through organizational placement and objectivity of staff), to perform audits based on a risk-based plan, and to communicate results appropriately to management and the board. If an internal audit function does not follow such standards, its work might be less reliable or systematic, potentially missing key issues. Recognizing this, some corporate governance codes explicitly mention internal audit standards. For example, South Africa’s King IV Code recommends that internal audits be conducted in accordance with the IIA’s Standards, and Malaysian and some European codes require companies to disclose whether their internal audit function aligns with professional standards. By following IIA standards, internal audit functions around the world provide a consistent baseline of assurance to boards and regulators that internal governance processes are being rigorously evaluated.

Other International Frameworks

In addition to these, there are other frameworks that intersect with auditing and governance:

- The **IFAC Code of Ethics for Professional Accountants** (including auditors) – now largely reflected in the International Ethics Standards Board for Accountants (IESBA) Code – which sets global ethical standards (integrity, objectivity, professional competence, confidentiality, professional behavior) for auditors. Many jurisdictions incorporate this code, meaning auditors worldwide operate under similar ethical mandates.
- Industry-specific guidance, such as the **Basel Committee on Banking Supervision’s** guidance on internal audit and external audit in banks. Basel has issued papers emphasizing that banks must have an independent internal audit function and that bank supervisors should engage with external auditors. These

international banking standards often become part of national regulations for financial institutions.

- The **OECD Principles of Corporate Governance** (2015 and 2023 revisions) which, while not law, influence countries' regulations. The OECD Principles recommend independent external audits for listed companies and have spurred many countries to adopt audit committee requirements and stronger disclosure rules. The OECD's *Guidelines on Corporate Governance of State-Owned Enterprises* similarly call for state companies to have robust internal and external audit mechanisms.

Global Convergence and Ongoing Developments

There has been a clear trend toward *convergence* of audit standards globally. After Enron and other scandals, international bodies and national regulators have worked to raise the bar uniformly. For example, the IAASB's clarified ISAs and updates often incorporate learning from national experiences. The PCAOB and IAASB also have exchanged ideas (for instance, the concept of "critical/key audit matters" that auditors now include in reports originated partly in the UK and spread via international discussion). Likewise, internal auditing's role has been recognized more explicitly in governance codes around the world – many countries that historically did not emphasize internal audit (or audit committees) have been moving in that direction as they seek to attract investment and modernize their governance. For instance, following the 2014 Moldovan bank fraud scandal mentioned earlier, Moldova updated its laws to strengthen audit oversight and is in the process of aligning with EU audit regulations. Companies in Moldova designated as public-interest entities must now have independent external audits and are encouraged to form audit committees; internal audit is mandatory in banks and recommended elsewhere. This mirrors what is already standard in EU and other developed markets.

Another contemporary development is the focus on **audit quality indicators** and transparency of the audit process itself. Regulators have pushed audit firms to publish transparency reports (e.g., detailing their internal quality control systems and results of inspections), and audit committees are encouraged to evaluate and report on the auditor's quality annually. All these efforts are aimed at making the normally behind-the-scenes audit process more transparent to those who rely on it.

The international framework for auditing is multi-layered:

- **Professional Standards (ISA, IIA, ethical codes):** provide the baseline for how audits should be performed and how auditors should behave.

- **National Laws (like SOX, EU Directives, company laws):** impose requirements to ensure audits and auditors are in place, independent, and overseen.
- **Regulatory Bodies (PCAOB, audit oversight authorities):** enforce compliance and continue to update rules in light of new challenges.

For corporate governance, these standards and regulations collectively mean that there is a higher assurance than ever before that companies, especially large and listed ones, have robust audit mechanisms watching over them. While no system is foolproof (as occasional failures still occur), the alignment of international best practices has certainly raised the overall effectiveness of audits. Investors can be more confident investing across borders knowing that, say, a London-listed company and a Frankfurt-listed company both undergo audits under similar high standards and regulatory scrutiny.

Looking forward, areas of ongoing evolution include the audit of non-financial information (like ESG metrics, which stakeholders are increasingly concerned about and which may require assurance), the use of technology in audits (data analytics, AI tools to detect anomalies), and the expanding role of internal audit in areas like cybersecurity and sustainability. International standards bodies are already working on guidance in these areas. But the foundational principles of auditor independence, professional skepticism, and thorough oversight – as embodied in the frameworks discussed – will remain central to the credibility of corporate governance systems worldwide.

***Case Link:** As a final note, we can see how these international standards come together in practice by revisiting our case examples: After Enron, **SOX** (U.S.) brought U.S. practice in line with what later became global norms: independent audit committees, restrictions on services, internal control audits. After the Parmalat scandal, the **EU** mandated auditor rotation and stronger audit committees EU-wide. After the Moldovan banking scandal, alignment with **EU audit rules** and adoption of **ISA** were accelerated in Moldova. These illustrate a pattern: major failures prompt regulatory enhancements, which then diffuse internationally via organizations like the EU, OECD, and IFAC, continuously reinforcing the audit function as a cornerstone of corporate governance.*

Internal and external audits are indispensable to a sound corporate governance system. Through their distinct but complementary roles, they provide assurance that a company is being managed in a transparent, accountable, and lawful manner. Internal audit, as the “third line of defense” inside the organization, offers ongoing insight into the effectiveness of controls and risk management, helping to preempt problems and foster continuous improvements. External audit, as an independent evaluator, builds

stakeholder trust by validating the company's financial reporting and alerting the board and investors to any material issues. Both functions, when properly empowered and aligned with best practices, serve as guardians of stakeholder interests and confidence.

Experience has shown that merely having audit structures in name is not enough – their **quality** and **independence** are what determine success or failure. Effective audits require the right conditions: clear mandates, sufficient authority, competent and ethical auditors, and support from the highest levels of the organization. International standards and principles from bodies like the OECD, IFAC, and the IIA provide robust guidelines for what “good” looks like in audit and governance. Around the world, we have seen many improvements in audit practices, often catalyzed by hard lessons from corporate crises. Countries continue to update laws and codes to strengthen audit committees, enforce auditor rotation and oversight, and require internal audits in key sectors – all aiming to fortify the checks and balances that audits provide.

For corporate leaders and boards, the implication is clear: supporting strong internal audit functions (with direct access to the board and no undue restrictions), and ensuring truly independent, high-quality external audits, is an investment in long-term sustainability and reputation. An engaged audit committee that takes audit oversight seriously is now a basic expectation for good governance. And for auditors themselves, adhering to the highest standards of objectivity and diligence is not just about avoiding scandals; it is about positively contributing to the governance and success of the organizations they serve.

In the modern corporate world – where businesses are complex, stakes are high, and stakeholder scrutiny is intense – the assurance provided by robust internal and external audits is more crucial than ever. Together, they form a **twin backbone** of corporate governance that helps organizations stay on course, avoid pitfalls, and demonstrate accountability. Strengthening these functions, in line with international best practices and lessons learned from past failures, will continue to be a priority for regulators and companies alike in the pursuit of transparency, ethical management, and sustainable growth.

Self-Assessment Quiz:

1. What are the key differences between internal auditing and external auditing in a corporation? Consider aspects such as their purpose, scope of work, reporting lines, and how each contributes to corporate governance.
2. How do audits (internal or external) enhance transparency and accountability in an organization? Provide an example of how an audit might detect or prevent corporate misconduct, thereby protecting stakeholders.

3. What is an audit committee, and what are its primary functions within a board of directors? Who typically sits on the audit committee, and how does this committee strengthen the independence and effectiveness of audit processes?
4. Briefly describe the purpose of the following and how each has influenced corporate governance:
 - International Standards on Auditing (ISA)
 - The Public Company Accounting Oversight Board (PCAOB) and its standards
 - The Sarbanes–Oxley Act of 2002 (SOX)
 - The EU Audit Directive/Regulation (2014 reforms)
 - The Institute of Internal Auditors (IIA) Standards for internal audit
(You may focus on two or three of these and explain their impact.)
5. Choose a major corporate scandal involving audit or governance failure (for example, Enron in the U.S. or the 2014 Moldovan banking fraud). Summarize how weaknesses in internal and/or external audit contributed to the collapse or wrongdoing. What reforms or changes were implemented in response to prevent such failures in the future (e.g., changes in laws, regulations, or standards)?

Sources:

- Institute of Internal Auditors (IIA). (2017). *Definition of Internal Auditing*. Retrieved from <https://www.theiia.org>
- Institute of Internal Auditors (IIA). (2018). *Internal Auditing's Role in Corporate Governance* (Position Paper). Altamonte Springs, FL: The IIA.
- International Auditing and Assurance Standards Board (IAASB). (2022). *International Standards on Auditing (ISA)*. New York: IFAC. Retrieved from <https://www.iaasb.org>
- Mazars. (n.d.). *The Underpinning Roles of External Auditors in Corporate Governance*. Forvis Mazars Insights. Retrieved from <https://www.forvismazars.com>
- OECD. (2015). *G20/OECD Principles of Corporate Governance*. Paris: OECD Publishing. <https://doi.org/10.1787/9789264236882-en>
- OECD. (2023). *Corporate Governance Factbook 2023*. Paris: OECD Publishing. Retrieved from <https://www.oecd.org/corporate>
- Peregrine, M., & Elson, C. (2021, April 5). Twenty years later: The lasting lessons of Enron. *Harvard Law School Forum on Corporate Governance*. Retrieved from <https://corpgov.law.harvard.edu/2021/04/05/twenty-years-later-the-lasting-lessons-of-enron/>
- Public Company Accounting Oversight Board (PCAOB). (2023). *Auditing Standards and Rulemaking*. Retrieved from <https://pcaobus.org>

- Roșca, M. (2015, July 1). Vanishing act: How global auditor failed to spot theft of 15% of Moldova's wealth. *The Guardian*. Retrieved from <https://www.theguardian.com>
- Sarbanes–Oxley Act of 2002, Pub. L. No. 107-204, 116 Stat. 745 (U.S.).
- University of Mississippi Office of Internal Audit. (2020). *The Three Lines of Defense Model*. Retrieved from <https://internalaudit.olemiss.edu>
- World Bank. (2014). *Republic of Moldova – Financial Sector Assessment: Corporate Governance Review* (Technical Note). Washington, D.C.: World Bank Group.

CHAPTER 9: TRANSPARENCY, ETHICS, AND CORPORATE SOCIAL RESPONSIBILITY

In modern corporate governance, **transparency**, **business ethics**, and **corporate social responsibility (CSR)** have become fundamental pillars underpinning sustainable organizational success. **Transparency** refers to the openness of an organization's actions and decision-making processes to stakeholders and the public, ensuring that information is disclosed clearly and accurately. **Business ethics** encompasses the moral principles and standards guiding the behavior of a business and its employees beyond mere legal compliance. **CSR** represents a company's voluntary commitment to social and environmental well-being, balancing profit-making with responsibilities to society and the planet. These three concepts are interrelated and play crucial roles in corporate governance frameworks and organizational performance. Companies that cultivate transparency, uphold high ethical standards, and embrace CSR tend to build trust with stakeholders, comply with regulations, and achieve long-term success.

This chapter explores the definitions and principles of transparency, ethics, and CSR; their roles in corporate governance and firm performance; illustrative case studies of successes and failures (both in Moldova and internationally); and the institutional and regulatory frameworks (e.g. OECD guidelines, UN Global Compact, ISO 26000, and evolving EU directives) that promote these values in business practice. By blending theory with real-world examples, the chapter underscores why these dimensions are indispensable for responsible management and the sustainable development of enterprises.

Learning Objectives:

- **Understand transparency in corporate governance:** Define the principle of transparency and explain how open, accurate disclosure of information fosters accountability and stakeholder trust.
- **Recognize the role of ethics in corporate conduct:** Identify how ethical values and formal codes of conduct guide business decision-making beyond legal compliance, and why leadership “tone at the top” is critical for an ethical corporate culture.
- **Comprehend the concept of CSR:** Describe what corporate social responsibility entails and its applicability, including the economic, legal, ethical, and philanthropic dimensions (Carroll's CSR Pyramid), and the “People, Planet, Profit” Triple Bottom Line framework.
- **Identify international standards for non-financial reporting:** Examine key frameworks and standards for CSR and sustainability reporting (such as GRI Standards, ESG criteria, the UN Sustainable Development Goals, OECD

Guidelines, and the EU Corporate Sustainability Reporting Directive) and evaluate their significance in promoting transparency and accountability.

- **Analyze real-world applications:** Evaluate case studies where transparency, ethics, and CSR practices had a major impact on corporate outcomes – both positive examples of responsible business (e.g. companies like Unilever or Moldcell) and negative examples of governance failures (e.g. Enron or Moldova’s banking scandal) – to extract lessons for corporate governance.

9.1. The Principle of Transparency in Corporate Governance

In a corporate context, *transparency* means open, truthful, and timely disclosure of key information to stakeholders, enabling outsiders to observe and scrutinize a company’s actions. It involves providing stakeholders – shareholders, employees, customers, regulators, and the public – with reliable and understandable information about the company’s governance, financial performance, and business practices. Scholars often identify three primary components of corporate transparency: **information disclosure**, **clarity**, and **accuracy**. This implies not only that firms should disclose relevant data, but that they do so in a clear manner (avoiding unnecessary jargon or obfuscation) and with factual accuracy (ensuring no misrepresentation or material omission). For example, a transparent company will voluntarily share data on its operations (*disclosure*), communicate in plain language without “fine print” or technical smoke-screens (*clarity*), and report truthfully without bias or distortion (*accuracy*) (Schnackenberg & Tomlinson, 2016).

Transparent governance is closely linked to accountability. By openly reporting financial results, governance decisions, risks, and ESG (environmental, social, governance) impacts, companies enable stakeholders to hold management and boards accountable for their actions. Conversely, a lack of transparency can conceal improper behavior or weaknesses until it’s too late. Indeed, transparency is often considered the bedrock of ethical corporate governance. It is enshrined in codes and standards worldwide – for instance, the **OECD Principles of Corporate Governance** devote an entire section to disclosure and transparency, emphasizing that timely and accurate disclosure of all material matters (financial situation, ownership, governance, performance) is essential to investor confidence and efficient markets (OECD, 2023). In practice, transparency requirements are built into many legal and regulatory frameworks. For example, many jurisdictions mandate specific disclosures through corporate and securities laws. In Moldova, the *Law on Capital Market* and the *Corporate Governance Code* (2015) require public-interest companies to publish annual and quarterly reports, disclose material facts about the business, and announce any major corporate changes publicly. All joint-stock companies must announce shareholder meetings and report changes in share capital, to ensure investors have the information

needed to make informed decisions and to reduce information asymmetry. Internationally, initiatives like the adoption of **International Financial Reporting Standards (IFRS)** have greatly advanced transparency in financial reporting. For instance, Moldova's Law on Accounting (2007) mandated IFRS for banks, insurance companies, and other key sectors, which "*enhances the accuracy of financial information and permits international comparability*," leading to more transparent reporting. The implementation of such standards has helped curb prior opaque practices (like keeping multiple sets of books) and improved investor confidence in financial statements.

Transparency is both an ethical imperative and a strategic asset. Research suggests that high corporate transparency correlates with improved investment efficiency, a lower cost of capital, and better firm valuation (Francis et al., 2009). When companies openly share information, investors can allocate resources more efficiently (choosing well-run, transparent firms), and creditors demand lower risk premiums, which reduces financing costs. Moreover, transparent companies tend to enjoy greater investor and public trust; their stock prices reflect fundamentals more accurately and exhibit greater liquidity. Internally, transparency can boost employee morale and trust, as workers feel they are kept informed and that the company has nothing to hide. In sum, robust transparency promotes accountability and trust, helps prevent corruption and fraud, and contributes to healthier financial performance in the long run. Empirical studies in accounting and management support these links, finding that transparent disclosure practices lead to more efficient resource allocation and governance outcomes (Francis et al., 2009; Schnackenberg & Tomlinson, 2016). By contrast, the absence of transparency can enable disastrous misconduct, whereas a culture of openness can become a competitive advantage.

Unfortunately, many corporate scandals have demonstrated the consequences of poor transparency. A dramatic example was **Enron** in the early 2000s – the company's management used complex off-balance-sheet entities and convoluted financial reports to obscure the true state of its debts and risks. This intentional opacity misled investors and regulators until the problems reached a catastrophic scale, leading to Enron's bankruptcy in 2001. The Enron scandal underscored that non-transparent financial reporting can hide massive fraud; it directly spurred stricter disclosure laws (such as the Sarbanes-Oxley Act of 2002 in the U.S.) to prevent such deception in the future (Peregrine & Elson, 2021). On a national scale, **Moldova's "Billion Dollar Bank Scandal"** (2014–2015) provides another cautionary tale: the lack of transparency in bank ownership and lending practices enabled insiders to siphon off around \$1 billion (roughly 12% of Moldova's GDP) through hidden related-party loans and off-book transactions. Because corporate information was opaque and oversight was weak, the fraud went undetected until it inflicted systemic damage. In the aftermath, authorities had to strengthen disclosure rules (e.g. requiring banks to reveal their ultimate

beneficial owners and publish detailed financial reports) to rebuild trust in the financial system. These cases illustrate that transparency is not merely a formal obligation but a vital safeguard: sunlight truly is “the best disinfectant” in corporate governance. Companies with transparent governance structures are far less likely to experience such catastrophic governance failures.

9.2. Ethics in Corporate Conduct and Codes of Conduct

Business ethics refers to the application of moral values and principles to business behavior, decisions, and policies. In practice, it delineates what is “right” and “wrong” in corporate conduct, going beyond mere compliance with law to encompass integrity, fairness, honesty, and respect in all operations. A concise definition is that business ethics comprises “the moral principles, policies, and values that govern the way companies and individuals engage in business activity,” forming a code of conduct that guides decision-making at every level (Twin, 2024). In essence, ethics prompts companies to not only ask “*Can we do this legally?*” but also “*Should we do this morally?*” Key issues typically falling under business ethics include corporate governance practices, conflicts of interest, insider trading, bribery and corruption, discrimination and harassment, environmental stewardship, fiduciary duties, truthful marketing, treatment of employees and customers, and more.

Principles of business ethics often align with core virtues such as **honesty** (truthfulness in communications, no fraud or deception), **integrity** (consistency between stated values and actual actions), **fairness** (equitable treatment of stakeholders and justice in contracts and workplace practices), **responsibility** (acknowledging and being accountable for business impacts), and **respect** (for employee rights, customer rights, community and environmental well-being). Companies typically formalize these expectations in internal policies like **codes of ethics or codes of conduct**, employee training programs, and governance mechanisms. For example, many firms adopt zero-tolerance policies for giving or receiving bribes, strict rules to avoid insider trading or conflicts of interest, and procedures to ensure product safety and quality – all reflecting commitments to ethical behavior and stakeholder welfare. These codes of conduct serve as a public and internal statement of the company’s values and the standards of behavior expected of employees and management. Industry associations and stock exchange regulations often encourage or require companies to implement codes of ethics. A strong code of conduct typically covers areas such as anti-corruption, compliance with laws, fair dealing with customers and suppliers, protection of confidential information, workplace diversity and inclusion, and guidelines for reporting misconduct (whistleblowing).

Importantly, while laws “set the floor” for acceptable behavior, business ethics often urge companies to aim higher than the legal minimum. **Simply obeying the law** (for example, avoiding outright illegal fraud) is **necessary but not sufficient for an ethically responsible business**. Ethical companies voluntarily uphold **higher standards** – for instance, refraining from legal-but-aggressive tax avoidance schemes if they violate the spirit of fairness, or providing safe working conditions globally even where local regulations are lax. This proactive stance is sometimes summarized as “*doing the right thing even when no one is watching.*” By going beyond compliance, companies demonstrate integrity and build credibility. Ethical behavior helps establish a baseline of trust between the business and its stakeholders. Consumers tend to trust and remain loyal to companies they perceive as honest and fair; employees are more committed to organizations that treat them with integrity; and investors recognize that a strong ethical culture reduces the risk of costly scandals. There is empirical evidence that cultivating ethics can pay off financially: developing ethical practices and a reputation for integrity can boost a company’s revenues and share price over time, whereas ethical lapses can destroy corporate reputations and value virtually overnight (Orlitzky et al., 2003). High-profile scandals from **Enron to Volkswagen** show how deception, fraud, or cheating stakeholders lead to legal penalties, public outrage, and loss of shareholder value. By contrast, companies with a reputation for integrity often enjoy goodwill that translates into long-term profitability.

In fostering an ethical business culture, the “tone at the top” is critical. The board of directors and senior management must lead by example, embedding ethical values into the company’s strategy and daily operations. This might involve establishing ethics or compliance committees at the board level, appointing dedicated ethics and compliance officers, and encouraging internal reporting of misconduct (whistleblower programs) with protection against retaliation. Leadership’s commitment is tested when difficult choices arise that pit ethics against short-term gain. A classic example of laudable ethical leadership was **Johnson & Johnson’s** response to the 1982 Tylenol tampering incident – when faced with evidence that its Tylenol painkillers had been laced with poison by an unknown criminal, the company immediately recalled millions of bottles at great expense to protect customers. This decisive action, guided by the company’s credo prioritizing customer safety above profits, ultimately strengthened public trust in the brand. The Tylenol case is often cited in business ethics courses as an example of putting ethics first, and it shows that doing the right thing can preserve a company’s reputation in the long run. Many modern companies similarly realize that ethical behavior and long-term success go hand in hand. As one CEO famously put it, “*we cannot be sustainable in the long run if we sacrifice ethics for short-run gains.*”

Given its importance, ethical conduct is increasingly emphasized in corporate governance frameworks and international guidelines. For instance, stock exchange

governance codes and the OECD Guidelines for Multinational Enterprises (OECD, 2023) stress anti-corruption measures, protection of stakeholder rights, and compliance with not just the letter *but the spirit* of the law as cornerstones of good governance. Overall, a strong ethical foundation helps ensure that corporate decision-making prioritizes responsible, fair practices — which in turn supports transparency and engenders trust with stakeholders.

9.3. Corporate Social Responsibility (CSR): Concept and Applicability

Corporate Social Responsibility (CSR) is the concept that businesses have obligations beyond profit maximization – specifically, responsibilities toward society and the environment in which they operate. A widely cited definition, put forth by the European Commission, is that CSR is “*the responsibility of enterprises for their impacts on society*” (European Commission, 2011). In practical terms, CSR means that a company voluntarily commits to ethical and sustainable business practices that consider the interests of a broad set of stakeholders – not only shareholders, but also employees, customers, suppliers, communities, and the planet. This includes actions like protecting human rights, ensuring safe and fair labor practices, reducing environmental footprints, investing in community development, and fighting corruption. In essence, CSR reflects the idea that corporations are not isolated economic actors; they are members of society and must **self-regulate** their behavior in line with societal values and environmental stewardship.

One foundational model that explains CSR’s scope is Archie B. Carroll’s Pyramid of CSR, which describes four layers of corporate responsibility. At the base of the pyramid are *economic responsibilities* – the fundamental duty of a business to be profitable and financially viable, since economic sustainability underpins a company’s ability to fulfill other responsibilities. Next are *legal responsibilities* – the obligation to obey laws and regulations (e.g. paying taxes, following labor laws and environmental regulations), reflecting society’s minimum expectations (“required by society”). Above that are *ethical responsibilities* – the expectation that companies do what is right, fair, and just even when not compelled by law (for example, avoiding harm, respecting moral norms, and addressing stakeholders’ concerns). At the top of the pyramid are *philanthropic (discretionary) responsibilities* – voluntary activities that promote human welfare or goodwill, such as charity, community projects, or other forms of corporate philanthropy (“desired by society”). Carroll’s framework suggests that while making profit and obeying the law are foundational, truly socially responsible companies also strive to meet ethical standards and give back to society through philanthropy. In fulfilling CSR, businesses are expected to address all four levels: **economic** (be profitable), **legal** (obey the law), **ethical** (do what is right and just), and **philanthropic** (be a good corporate citizen by contributing to the community).

Another closely related concept is the **Triple Bottom Line (TBL)**, coined by John Elkington in the 1990s, which holds that companies should measure success not only by financial performance (*profit*) but also by their social and environmental performance (*people* and *planet*). Often summarized as “People, Planet, Profit,” this framework urges businesses to balance and integrate economic viability, social equity, and environmental protection in their operations (Kenton, 2025). The ideal outcome is a sustainable business model where the company thrives financially while also fostering social well-being and environmental health. In a TBL approach, for example, a firm might track its achievements in reducing carbon emissions and improving labor conditions alongside traditional metrics like earnings or return on investment. This approach has given rise to corporate **sustainability reports** where firms disclose their performance in social and environmental realms in addition to financial results. The Triple Bottom Line can be visualized as three overlapping circles (economic, social, environmental), where true sustainability lies at the intersection of all three. It highlights that a company’s long-term success is intertwined with the well-being of society and the planet.

Key CSR Principles and Themes: Several key principles underlie the practice of CSR in organizations today:

- **Stakeholder Engagement.** Companies should identify their stakeholders (employees, customers, local communities, NGOs, investors, suppliers, etc.) and actively engage with them in decision-making and operations. This stands in contrast to a purely shareholder-centric view of governance. Under CSR, the goal is to create shared value for all stakeholders, aligning with concepts like Edward Freeman’s stakeholder theory which argues that attending to stakeholder interests is essential for long-term success. Engaging stakeholders might involve dialogue, partnerships, and responding to stakeholder concerns transparently rather than making decisions in isolation.
- **Sustainability.** A core theme of CSR is sustainability – meeting present needs without compromising the ability of future generations to meet their own needs (the classic Brundtland Commission definition of sustainable development). Businesses are expected to adopt sustainable practices such as reducing waste and pollution, improving energy efficiency, using renewable resources, cutting greenhouse gas emissions, and designing products with their full life-cycle impact in mind. Sustainability in CSR also means a long-term perspective in strategy, considering how decisions today affect environmental and social conditions tomorrow.
- **Accountability and Reporting.** Just as financial reporting is required by law, CSR pushes firms to be accountable for their social and environmental performance as well. This principle has led to the rise of **sustainability**

reporting and **ESG disclosure** (Environmental, Social, and Governance reporting). Frameworks such as the **Global Reporting Initiative (GRI)** Standards provide guidelines for companies to publicly report on their CSR and sustainability activities – from carbon footprints to workforce diversity metrics. Many jurisdictions now encourage or even mandate **non-financial reporting**; for example, the European Union’s Non-Financial Reporting Directive (2014) required large companies to disclose information on environmental, social, and employee matters, anti-corruption, and human rights practices, and its new **Corporate Sustainability Reporting Directive (CSRD)** (adopted in 2022) expands these requirements further (we discuss these in Section 9.4). The underlying idea is that companies should measure and disclose their impacts on society and the environment, allowing stakeholders to hold them accountable just as with financial results.

- **Ethical Norms and Human Rights.** CSR aligns strongly with ethical business conduct and respect for human rights. Companies committed to CSR pledge to uphold human rights in their operations and supply chains – for example, avoiding child labor or forced labor, ensuring safe and decent working conditions, paying fair wages, and not engaging in corrupt practices. There are global standards reinforcing this aspect: the **United Nations Global Compact** asks companies to abide by Ten Principles in the areas of human rights, labor standards, environment, and anti-corruption (UN Global Compact, n.d.). Similarly, the **UN Guiding Principles on Business and Human Rights** provide a framework for companies to prevent and address human rights abuses linked to their business. Many firms incorporate these international norms into their own codes of conduct and supplier agreements. Adhering to ethical norms as part of CSR means a company strives to do no harm (and ideally, does positive good) to people and communities affected by its business.
- **Community Investment and Philanthropy.** A traditional element of CSR is corporate philanthropy and community development. Companies may donate to charitable causes, support schools, hospitals or cultural institutions, sponsor community programs, or encourage employees to volunteer in the community. Strategic CSR goes beyond writing checks – it involves aligning community investments with the company’s expertise or business strategy, so that these initiatives create shared value. For instance, a technology company might run free coding workshops for youth (building community skills while eventually expanding the talent pool it can hire from), or a bank might support financial literacy programs in low-income communities (developing potential new customers while aiding society). While some critics dismiss corporate philanthropy as “window-dressing” if not tied to core strategy, effective CSR programs often find an intersection between social needs and the company’s long-term interests, yielding benefits for both society and the business.

Ultimately, CSR represents a philosophy of **corporate citizenship** – seeing the company as an integral part of society with a duty to contribute positively to social welfare and environmental sustainability. Over the past decades, the business case for CSR has strengthened: many studies, including meta-analyses, have found that strong CSR performance often correlates with equal or better financial performance over the long term (Orlitzky et al., 2003). The reasons include enhanced reputation, better risk management, and operational efficiencies (e.g., reduced energy costs, improved employee recruitment and retention, brand loyalty among consumers). In other words, **“doing good” can go hand in hand with “doing well.”** For example, investments in eco-efficiency can save money, ethical labor practices can improve productivity and reduce turnover, and philanthropy can open up market opportunities or goodwill. As businesses adopt CSR, they tend to innovate and find new ways to create value for both shareholders and stakeholders.

CSR is applicable across industries and regions, though its expression may differ. Large multinational companies often have formal CSR departments and publish extensive sustainability reports, while smaller firms might engage in more informal community giving or focus on one aspect (like product responsibility or employee welfare). Importantly, CSR is **voluntary in nature** – it goes beyond what is legally required – but societal expectations are making it almost a standard part of doing business, especially for reputable firms. International frameworks guide companies in implementing CSR: *for instance*, the ISO 26000 standard (ISO, 2010) offers guidance on social responsibility practices (covering governance, labor practices, environment, fair operating practices, consumer issues, and community involvement), and the OECD Guidelines for Multinational Enterprises (OECD, 2023) provide government-backed recommendations on responsible business conduct, including transparency, labor rights, environmental stewardship, and anti-bribery measures. Many companies also align their social responsibility initiatives with the **United Nations Sustainable Development Goals (SDGs)** – a set of 17 global goals (such as Quality Education, Gender Equality, Climate Action) that governments and organizations worldwide are working toward by 2030. By aligning CSR projects to specific SDGs (for example, a clean water initiative aligning with *SDG 6: Clean Water and Sanitation*), companies can contribute to global priorities and more clearly communicate their impact.

To illustrate CSR in action, consider two real-world examples at different levels. **Unilever**, a global consumer goods company, is often cited as a CSR success story. Under CEO Paul Polman, Unilever launched its *Sustainable Living Plan* in 2010, setting ambitious targets such as helping over a billion people improve health and hygiene, sourcing 100% of its agricultural raw materials sustainably (e.g. Rainforest Alliance certified tea, sustainable palm oil to combat deforestation), halving the environmental footprint of its products, and improving livelihoods for millions through its supply

chain and community programs. Unilever integrated these sustainability goals into its core business strategy – notably, Polman even stopped issuing quarterly profit guidance to focus on long-term sustainable growth. Over the following decade, Unilever demonstrated that CSR could be profitable: by 2020, the company reported that its “Sustainable Living” brands (products with an explicit sustainability or social mission, like Dove’s campaigns for self-esteem or Lifebuoy’s handwashing campaign) were growing significantly faster than other brands and accounted for a large share of its revenue growth. Unilever also achieved cost savings through eco-efficiencies (like reducing waste and energy use) and enjoyed a reputational boost, becoming a preferred employer for talent interested in purposeful work. This example shows that a committed, well-governed approach to CSR can both drive financial success and positive societal impact, reinforcing the idea that business and sustainability goals can align.

On a smaller, local scale, **Moldcell** – one of Moldova’s leading telecommunications companies – provides a positive example of how CSR and transparency can be integrated into corporate strategy in an emerging economy. Moldcell was among the first companies in Moldova to join the UN Global Compact (in 2006), committing to its Ten Principles in human rights, labor, environment, and anti-corruption (Stoian, 2024). The company established a Corporate Responsibility department and launched programs focusing on digital education, healthcare, culture, and environmental protection. For instance, it helped equip schools with internet labs (bridging the digital divide), ran SMS donation campaigns for health causes, sponsored cultural and youth development events, and adopted eco-friendly practices like electronic billing to reduce paper usage. Crucially, Moldcell paired its CSR initiatives with **transparency**: it voluntarily published annual CSR reports detailing its community investments, employee welfare efforts, customer satisfaction metrics, and even challenges faced. This level of open reporting was unprecedented in Moldova at the time and helped build public trust in the company. Internally, Moldcell also promoted ethics by adopting a comprehensive Code of Ethics (aligned with its international parent company’s policies) and training employees on issues like anti-bribery and customer data privacy. The results were beneficial – Moldcell’s brand became associated with reliability and community care (not just good network coverage), and its stance pressured competitors in the telecom sector to step up their own CSR efforts (Stoian, 2024). Moldcell’s experience demonstrates that even in a developing market, a company can differentiate itself and achieve long-term goodwill by voluntarily embracing CSR and ethical, transparent practices, rather than treating social responsibility as an afterthought.

In summary, CSR broadens a company’s perspective beyond short-term profits to consider long-term sustainability and stakeholder value. When authentically adopted, CSR can enhance a company’s reputation, mitigate risks (for example, by ensuring compliance and preventing scandals), and even open new opportunities (such as new

markets or products that address social needs). As global challenges like climate change, inequality, and social justice gain prominence, businesses are increasingly expected to be part of the solution. CSR is one of the main avenues through which corporate power is channeled toward positive ends, aligning business strategies with the broader goals of society.

9.4. Non-Financial Reporting and International Standards (GRI, ESG, etc.)

As the importance of transparency, ethics, and CSR has grown, so too have the frameworks and standards designed to measure and report on corporate performance in these areas. **Non-financial reporting** refers to the disclosure of information about a company's environmental, social, and governance (ESG) performance – essentially, reporting on how the company manages its responsibilities toward society and the environment, rather than just its financial results. Investors, regulators, and the public are increasingly interested in non-financial metrics because they provide insight into a company's long-term sustainability and ethical impact. This section outlines key international standards and initiatives that guide companies in this domain, including sustainability reporting frameworks and ESG benchmarks.

The **Global Reporting Initiative (GRI)** is one of the most widely adopted frameworks for sustainability reporting worldwide. The GRI Standards provide a structured set of indicators and guidelines that companies can use to report their impacts on issues such as climate change, labor practices, human rights, governance, and community development. By using GRI, companies ensure they disclose information in a way that is transparent, credible, and comparable across organizations. For example, under GRI standards a company might report its greenhouse gas emissions, energy usage, water consumption, workforce demographics, health and safety incidents, community investment spending, and anti-corruption measures, among other data. The GRI framework encourages reporting not just positive outcomes but also challenges and shortcomings, to give stakeholders a balanced view. As of the 2010s and 2020s, thousands of companies worldwide (including many Fortune 500 firms) produce annual **sustainability reports** or **CSR reports** referencing the GRI Standards. This widespread adoption has created a *de facto* global language for non-financial performance. The benefit of using GRI or similar standards is that stakeholders – from socially conscious investors to consumers and NGOs – can better assess and compare companies' real impacts on society and the environment, much as financial statements allow comparison of financial health.

Another closely related concept is **ESG criteria** – a set of Environmental, Social, and Governance factors that investors and rating agencies use to evaluate companies. ESG has become a mainstream term in finance: large institutional investors (like pension funds, asset managers, and sovereign wealth funds) are increasingly integrating ESG

metrics into their decision-making, under the rationale that companies managing ESG risks and opportunities will be more resilient and successful in the long run. ESG metrics can include things like carbon footprint, board diversity, labor relations, supply chain ethics, executive compensation tied to sustainability goals, and transparency in accounting. Specialized rating agencies (such as MSCI, Sustainalytics, and others) compile ESG scores or ratings for companies, and these ratings can influence which companies are included in ESG-focused investment funds or indexes. In response, many companies now produce **ESG reports** or integrate ESG information into their annual reports to demonstrate accountability on these fronts. Non-financial reporting frameworks have evolved alongside this trend: for example, the **Sustainability Accounting Standards Board (SASB)** developed industry-specific standards for disclosing financially material sustainability information, and the **Task Force on Climate-related Financial Disclosures (TCFD)** issued guidelines for reporting climate-related risks and opportunities. More recently, in 2021 the IFRS Foundation established the **International Sustainability Standards Board (ISSB)** to create unified global standards for sustainability disclosure, reflecting the push to standardize ESG reporting similar to financial reporting. The overarching goal of all these initiatives is to make non-financial performance transparent and standardized, so that stakeholders can hold companies accountable and make informed decisions (e.g., investors deciding where to invest, or consumers deciding which brands to support, based on sustainability performance).

In addition to reporting standards, there are broader international frameworks that guide corporate responsibility and ethics on the global stage. We've already mentioned some: the **OECD Guidelines for Multinational Enterprises** (most recently updated in 2023) provide comprehensive recommendations for responsible business conduct, covering disclosure, human rights, labor rights, environment, anti-corruption, consumer interests, and more (OECD, 2023). These guidelines, while voluntary, are endorsed by governments of dozens of countries and create expectations for multinational companies operating across borders. The **United Nations Global Compact** is another major initiative: companies that sign on to the UN Global Compact commit to its Ten Principles and must report on their progress annually (UN Global Compact, n.d.). This serves as both a commitment mechanism and a reporting mechanism, fostering transparency about steps taken to uphold human rights, fair labor, environmental protection, and anti-corruption. We also have standards like **ISO 26000 (Guidance on Social Responsibility)**, which, although not a certifiable standard, provides a detailed blueprint for organizations on how to operate in a socially responsible way (ISO, 2010). ISO 26000 covers seven core subjects (organizational governance, human rights, labor practices, environment, fair operating practices, consumer issues, and community involvement) and emphasizes the importance of stakeholder engagement and transparency in each. Some companies choose to align

their internal CSR policies with ISO 26000 guidelines to signal that they follow international best practices. Additionally, the UN **Sustainable Development Goals (SDGs)**, while primarily aimed at governments, have galvanized many companies to frame their CSR efforts in terms of contributions to these global goals. It's now common to see companies publish how their various initiatives map to specific SDGs (for instance, a pharmaceutical company might highlight contributions to *SDG 3: Good Health and Well-Being*, or a renewable energy project mapping to *SDG 7: Affordable and Clean Energy*). The SDGs thus serve as a unifying vision that companies can use to communicate the broader impact of their activities in internationally understood terms.

These international frameworks all share a common thread: they create a shared language and set of expectations for corporate behavior across countries. Adhering to such standards signals that a company is serious about transparency, ethics, and social responsibility at a global level. For example, a Moldovan company that aligns with GRI reporting, UN Global Compact principles, or OECD guidelines sends a message to foreign investors or partners that it adheres to the same high standards as a company in the EU or US. In fact, as countries strengthen laws on corporate responsibility, some aspects of these frameworks are transitioning from voluntary to mandatory. The European Union has been at the forefront of this: beyond its reporting directives (NFRD and the new CSRD), the EU is moving toward **mandatory human rights and environmental due diligence** for large companies. A proposed EU directive (expected to be enacted mid-2020s) would require companies to identify and address human rights and environmental risks throughout their supply chains, essentially operationalizing principles from the UN Guiding Principles and OECD guidelines. This means that even companies in non-EU countries (like Moldova) that wish to export to or partner with EU businesses will likely need to adopt similar diligence and transparency practices to meet these emerging requirements.

A significant development in non-financial reporting is the European Union's evolving legislation. The **EU Non-Financial Reporting Directive (NFRD)**, in force since 2018, required large public-interest companies (with over 500 employees) in EU member states to report on environmental protection, social responsibility and treatment of employees, respect for human rights, anti-corruption and bribery, and diversity on company boards. While this directive improved transparency, its scope was relatively limited. In 2022, the EU adopted the **Corporate Sustainability Reporting Directive (CSRD)**, which greatly expands the scope and depth of sustainability reporting. The CSRD will require many more companies (including medium-sized and non-listed companies meeting certain thresholds) to report on sustainability issues, will mandate use of **European Sustainability Reporting Standards (ESRS)** that specify exactly what and how to report, and will require external assurance (audit) of the sustainability information, similar to financial audits. The CSRD also has an

extraterritorial effect: non-EU companies with substantial operations in the EU will have to provide sustainability reports under the new rules. This marks a shift from voluntary to mandatory disclosure of ESG information on a large scale, recognizing that transparency on sustainability is necessary for Europe's broader goals (like achieving carbon neutrality and protecting human rights). Companies worldwide are watching these developments, as they may become a model for other jurisdictions or effectively set a global benchmark due to the size of the EU market.

In conclusion, non-financial reporting and international CSR standards have become integral to modern corporate governance. They complement traditional financial reporting by highlighting how a company's activities affect stakeholders and the environment. For masters-level students of international corporate governance law, understanding these frameworks is crucial. They reflect how soft law (like voluntary guidelines) and hard law (like binding directives) interact in shaping corporate behavior. Moreover, they illustrate a key point: transparency and accountability now extend beyond finances to all aspects of corporate impact. A company's reputation and license to operate in the 21st century depend not just on delivering profits, but on *how* those profits are earned – responsibly and sustainably, as evidenced by clear reporting and adherence to accepted standards.

Transparency, business ethics, and corporate social responsibility are now rightly seen as essential ingredients of effective corporate governance and sustainable business success. They are deeply interrelated: transparency shines a light on corporate activities, enabling accountability; an ethical culture guides decision-makers to act with integrity, which in turn supports honest disclosure and genuine CSR commitments; and CSR broadens a company's perspective to consider all stakeholders, which inherently demands ethical conduct and transparent engagement. Together, these elements ensure that a company not only meets its financial objectives but does so in a manner that is accountable, fair, and sustainable.

The theoretical foundations discussed in this chapter show that while profit remains a fundamental business goal, it can – and must – be pursued within a framework of social values and stakeholder respect. In practice, companies that neglect transparency, ethics, or CSR principles risk severe repercussions: loss of stakeholder trust, legal sanctions, and even financial collapse, as evidenced by cautionary tales like Enron's demise or Moldova's banking scandal. Conversely, organizations that embrace transparency, uphold ethics, and invest in CSR tend to enjoy enhanced reputations, loyal stakeholders, and greater resilience. They are better equipped to navigate the challenges of the modern business environment – be it regulatory changes, public scrutiny, or global crises – because they have built a reservoir of goodwill and robust governance structures. In essence, good ethics is good business; over time, integrity and

openness contribute to more stable and enduring success than short-sighted, unethical strategies ever could.

For countries like Moldova (and other transitioning or emerging economies), integrating these principles into corporate life is particularly pivotal. As a country keen on attracting investment and integrating with European markets, improving corporate governance standards is not just a box-ticking exercise but a development imperative. The case studies we reviewed (such as Moldcell's proactive CSR strategy and the post-scandal banking reforms) offer a glimpse of progress: they demonstrate that even in challenging environments, leaders can make a difference by instituting responsible practices, and that doing so yields tangible benefits (e.g., customer trust, investor confidence, market stability). Moldovan law and institutions are gradually aligning with international norms, but true change will come when companies internalize these values not only because they are forced to by regulations, but because they recognize the intrinsic value in them. Educational initiatives (such as this course at ASEM) and public recognition of ethical, transparent businesses can help nurture a new generation of managers who prioritize these aspects.

On the international stage, frameworks like the OECD Guidelines, the UN Global Compact, the GRI/ESG reporting standards, and ISO 26000 provide valuable roadmaps. They reflect a global consensus that corporate power must be matched by corporate responsibility. As globalization and digital connectivity expose companies to greater scrutiny, transparency is increasingly non-negotiable – hidden practices eventually come to light, whether in the court of public opinion or in courts of law. The rise of ESG investing and conscious consumerism further tilts the scales in favor of companies that are accountable and purpose-driven. In the near future, it is plausible that businesses will be judged as much by their social and environmental impact as by their financial returns.

It's worth emphasizing that transparency, ethics, and CSR are not one-time achievements but continuous journeys. They require ongoing commitment, regular reassessment, and agility to respond to new ethical dilemmas (such as data privacy in the digital age or the ethics of artificial intelligence). Corporate governance must evolve with these challenges, embedding a culture of "doing the right thing" at every level of the organization. There is a saying that "trust is earned in drops and lost in buckets" – through transparent and ethical conduct, companies earn trust bit by bit; through CSR they demonstrate they deserve that trust by contributing positively to society. But losing that trust through deceit or irresponsibility can happen swiftly and can be catastrophic.

Ultimately, companies that succeed in harmonizing profit with principles are those most likely to endure and flourish. They will be the employers of choice, the partners of choice, and the investments of choice in the years ahead. The lessons from theory,

frameworks, and real cases all point to a clear message: **integrity, openness, and responsibility are not just moral choices; they are strategic choices.** In the long run, they separate the truly great companies from the merely good, and the sustainable enterprises from those destined to fail. As future business leaders and policymakers, understanding and incorporating these values into decision-making will be key to building not only successful organizations, but also a more transparent, ethical, and equitable world of business.

Self-Assessment Quiz:

1. What is meant by corporate transparency in governance, and why is it considered crucial for accountability and investor confidence?
2. Identify and briefly describe the three primary components of effective corporate transparency. How do these components help stakeholders trust a company's disclosures?
3. How do business ethics differ from legal compliance? Provide an example of an ethical decision that goes beyond what the law requires.
4. Why is leadership "tone at the top" important in fostering an ethical corporate culture? What are some steps boards and executives can take to institutionalize ethics within an organization?
5. Define Corporate Social Responsibility in your own words. What are the four levels of responsibility outlined in Carroll's Pyramid of CSR, and how do they build upon each other?
6. Explain the Triple Bottom Line concept ("People, Planet, Profit"). How does this concept broaden the way we evaluate business success compared to traditional financial metrics?
7. Name two international frameworks or standards for corporate social responsibility or sustainability reporting (e.g., GRI, UN Global Compact, ISO 26000, SDGs). For each, briefly describe its purpose or what it requires companies to do.
8. What does the term "ESG" stand for, and why are companies increasingly reporting on ESG criteria? How do frameworks like the Global Reporting Initiative (GRI) or EU directives (NFRD/CSRD) influence what companies disclose publicly?
9. Give an example of a company or scandal where a lack of transparency or poor ethics led to serious consequences (such as financial losses or legal penalties). What governance failures contributed to this outcome?
10. Give an example of a company that benefitted from strong CSR or ethical practices. What did this company do, and what positive outcomes resulted from its commitment to responsibility?

Sources:

- Balmforth, R. (2015, August 10). Billion dollar bank scam shakes faith in little Moldova's pro-EU leaders. *Reuters*. <https://www.reuters.com>
- CEE Legal Matters. (2023). *Corporate governance in Moldova – Comparative Legal Guide 2023*. CEE Legal Matters. <https://ceelegalmatters.com>
- European Commission. (2011). *A renewed EU strategy 2011–14 for corporate social responsibility (COM(2011) 681 final)*. Brussels: European Commission. <https://eur-lex.europa.eu>
- Francis, J. R., Huang, S., Khurana, I. K., & Pereira, R. (2009). Does corporate transparency contribute to efficient resource allocation? *Journal of Accounting Research*, 47(4), 943–989. <https://doi.org/10.1111/j.1475-679X.2009.00340.x>
- Ghedrovici, O., & Ostapenko, N. (2016). Business ethics in post-Soviet economies: The case of Moldova. *Advances in Management & Applied Economics*, 6(3), 85–106.
- Global Reporting Initiative (GRI). (2021). *GRI Standards*. Retrieved from <https://www.globalreporting.org>
- Hromadske Television. (2019, August 5). “Theft of the century”: Report reveals how 2014 bank scheme robbed Moldova of billions. *Hromadske*. <https://en.hromadske.ua>
- International Organization for Standardization. (2010). *ISO 26000:2010 – Guidance on social responsibility*. Geneva: ISO.
- Kenton, W. (2025, May 11). Triple bottom line (TBL). *Investopedia*. <https://www.investopedia.com>
- OECD. (2023). *OECD Guidelines for Multinational Enterprises on Responsible Business Conduct*. Paris: OECD Publishing. <https://www.oecd.org/corporate>
- Orlitzky, M., Schmidt, F. L., & Rynes, S. L. (2003). Corporate social and financial performance: A meta-analysis. *Organization Studies*, 24(3), 403–441. <https://doi.org/10.1177/0170840603024003910>
- Peregrine, M., & Elson, C. (2021, April 5). Twenty years later: The lasting lessons of Enron. *Harvard Law School Forum on Corporate Governance*. <https://corpgov.law.harvard.edu>
- Schnackenberg, A. K., & Tomlinson, E. C. (2016). Organizational transparency: New perspectives on managing trust in organization–stakeholder relationships. *Journal of Management*, 42(7), 1784–1810. <https://doi.org/10.1177/0149206314525202>
- Stoian, E. (2024). Corporate social responsibility initiatives in the Republic of Moldova: Moldcell SA. *Информация та социалъм / Information and Society*, October 2024, 84–90.

- Twin, A. (2024, June 27). What is business ethics? *Investopedia*. <https://www.investopedia.com>
- United Nations Global Compact. (n.d.). *The Ten Principles of the UN Global Compact*. Retrieved 2025, from <https://www.unglobalcompact.org/what-is-gc/mission/principles>
- United Nations. (2015). *Transforming our world: The 2030 agenda for sustainable development*. New York: United Nations. <https://sdgs.un.org>
- European Commission. (2022). *Corporate Sustainability Reporting Directive (CSRD)*. Brussels: European Commission. https://finance.ec.europa.eu/publications/corporate-sustainability-reporting_en

CHAPTER 10: RECENT TRENDS AND REFORMS IN CORPORATE GOVERNANCE

Corporate governance is a continually evolving field, shaped by global economic shifts, regulatory changes, and growing stakeholder expectations. In recent years, the corporate world has witnessed significant governance reforms aimed at enhancing transparency, accountability, and sustainability in how companies are directed and controlled. These changes have been spurred by financial crises, corporate scandals, technological advances, and a heightened focus on Environmental, Social, and Governance (ESG) factors in business. International bodies such as the OECD, G20, and EU have updated key governance principles and directives, reflecting a broader move from a purely shareholder-centric model toward a more stakeholder-inclusive approach. Likewise, individual countries – including emerging economies like the Republic of Moldova – have undertaken governance reforms to align with global best practices and strengthen their institutional frameworks. This chapter explores the recent international trends in corporate governance, delves into the specific reforms implemented in Moldova as it modernizes its governance regime, and examines the unique governance challenges in state-owned enterprises (SOEs) and the financial sector. Through case studies and comparative insights, we will illustrate how effective governance is pivotal for corporate integrity, investor confidence, and economic stability.

Learning Objectives:

By the end of this chapter, students should be able to:

- **Identify key international trends** in corporate governance over the past decade, including the integration of ESG considerations, enhancements in board practices, and strengthened shareholder rights.
- **Explain recent reforms** in the Republic of Moldova's corporate governance framework and how they align with European Union standards and OECD principles.
- **Discuss the role of corporate governance in state-owned enterprises (SOEs)**, why good governance is critical in the public sector, and what specific measures are being taken to improve SOE governance (with examples from Moldova).
- **Describe the distinctive corporate governance issues in the financial sector**, especially banking, and summarize global guidelines (such as Basel Committee principles) and national reforms aimed at ensuring financial institutions are well-governed.

- **Analyze case studies** of governance successes and failures – for instance, how governance lapses contributed to Moldova’s 2014 banking crisis and how reforms addressed those issues, or how governance improvements in an SOE like Termoelectrica can lead to better performance.
- **Evaluate the impact of global initiatives** (OECD guidelines, EU directives, etc.) on national corporate governance practices and debate the ongoing challenges (e.g. balancing stakeholder vs. shareholder interests, and ensuring compliance beyond a “box-ticking” approach).
- **Apply the concepts** by answering self-assessment questions to reinforce understanding of how recent trends and reforms shape modern corporate governance at both international and national levels.

10.1. Recent International Trends in Corporate Governance

In the past decade, corporate governance practices worldwide have evolved significantly, influenced by financial crises, technological change, and increasing stakeholder expectations. **International policy reforms** have been central to this evolution. Notably, the G20/OECD *Principles of Corporate Governance* were revised in 2023 – the first update in nearly a decade – to emphasize sustainability and resilience. The latest OECD principles include a new chapter on “sustainability and resilience,” providing guidance for boards on managing climate and other ESG risks and calling for transparent sustainability reporting. This marks a shift from traditional shareholder-centric governance toward a more stakeholder-inclusive approach. Many jurisdictions now require or encourage companies to disclose non-financial information on environmental and social impacts. For example, in the EU, the new *Corporate Sustainability Reporting Directive (CSRD)* extends mandatory sustainability disclosure to a far larger number of companies starting with the 2024 financial year. This reflects a global push for greater corporate transparency on social and environmental performance. At the same time, stewardship codes for institutional investors – pioneered in the UK and Japan – have proliferated across markets, promoting active engagement and long-term stewardship by shareholders. These developments underscore a consensus that sustainable value creation and prudent risk management are integral to good corporate governance.

Board structure and diversity is another clear international trend. Regulators and investors worldwide have sought to strengthen board independence, expertise, and diversity. Many countries have tightened requirements for independent directors on boards of listed companies to improve oversight and protect minority investors. It is now common for corporate governance codes to call for anywhere from one-third to a majority of board members to be independent in publicly traded firms. Alongside independence, there is growing emphasis on board diversity – particularly gender

diversity. The share of women on corporate boards, while rising, remains below 30% on average globally. Since 2019, numerous jurisdictions have introduced quotas or targets for female board representation or mandated companies to disclose their diversity policies. The European Union's recent *Directive on Gender Balance on Corporate Boards* (adopted in 2022) will require many EU-listed companies to have at least 40% of non-executive director positions held by the underrepresented sex (typically women) by 2026. This law also mandates transparent, merit-based appointment processes and penalties for non-compliance. Such measures reflect a broader recognition that diverse boards – in terms of gender, skills, and backgrounds – enhance decision-making and corporate credibility. Beyond gender, attention is increasing on other dimensions of diversity (e.g. ethnicity, international experience, age) and on regular board refreshment to prevent stagnation.

Shareholder rights and engagement have been bolstered through reforms in many markets. The EU's Shareholder Rights Directive II (SRD II) and parallel reforms elsewhere expanded shareholders' say on executive pay, related-party transactions, and other key issues. There is a general trend toward enabling more effective shareholder participation in governance. For example, cross-border voting has been simplified in the EU, and many countries now explicitly allow virtual or hybrid shareholder meetings – a practice accelerated by the COVID-19 pandemic. As of the end of 2022, approximately 75% of jurisdictions surveyed allowed and regulated fully virtual shareholder meetings, and over 80% permitted hybrid meetings, with legal safeguards to ensure equal shareholder participation. These digital meeting formats have made it easier for shareholders (especially foreign or small investors) to attend annual general meetings and voice their opinions. In tandem, the rise of activist investors and proxy advisory firms internationally has put pressure on boards to be more responsive. In markets like the US and UK, we have seen an uptick in shareholder resolutions on ESG topics – for instance, proposals asking companies to adopt climate-transition plans or improve workforce diversity. Such developments indicate that shareholders are increasingly using their governance powers to press for broader corporate accountability and long-term value, not just short-term financial returns.

Executive remuneration and accountability remain focal points of governance reform. Many countries have introduced “say on pay” votes, giving shareholders a regular vote (binding or advisory) on executive compensation to influence pay practices. There is a push to align executive pay with long-term performance and risk outcomes, rather than short-term stock price movements. Alongside pay reforms, internal control and risk oversight have been significantly strengthened, especially in the financial sector after the 2008–2009 global financial crisis. Regulators now expect boards to take responsibility for risk management – often by establishing dedicated board Risk Committees – and to ensure the company has robust internal audit and

compliance functions. For instance, banking regulations influenced by the Basel Committee and national laws require that banks' boards define a risk appetite, oversee senior management, and that compensation structures do not incentivize excessive risk-taking. Recent high-profile corporate failures – whether due to accounting fraud, unethical sales practices, or cybersecurity breaches – have also spurred boards worldwide to enhance oversight of financial reporting and emerging risks. Audit committees are expected to be more vigilant and composed of independent experts, and boards are increasingly attuned to areas like cyber risk, data privacy, and fraud prevention. The overall trend is toward viewing effective internal controls and risk management not as mere compliance formalities, but as central pillars of good governance that protect the company's reputation and stakeholders.

Corporate governance and technology is an emerging area influencing how companies are run. On one hand, technology serves as an enabler of better governance: digital tools such as board portals, data analytics, and even artificial intelligence can improve board efficiency, decision-making, and information flow. For example, many companies now use secure digital platforms to disseminate board materials, allowing directors to access up-to-date information and collaborate remotely. Regulators encourage using such digital means for timely disclosures and shareholder communications (as seen in electronic filing systems and online investor meetings). On the other hand, technology introduces new risk areas that boards must oversee. Cybersecurity, data protection, and the ethical use of AI systems have become critical topics on board agendas. Leading governance codes now explicitly call on boards to ensure proper management of technology risks and to acquire sufficient expertise in this domain. In some jurisdictions, companies are required to disclose significant cyber risks or breaches to the market, and there is movement toward having at least some directors with technology or cybersecurity expertise. The COVID-19 pandemic underscored the importance of digital resilience: companies had to pivot to remote operations virtually overnight, testing the agility of their governance structures. Boards that were able to navigate this crisis – by holding virtual meetings, supporting management in major strategic shifts, and safeguarding employee welfare – exemplified the need for crisis-ready governance frameworks in an increasingly digital world.

Despite differences in national governance models (for instance, unitary boards in Anglo-American markets vs. two-tier boards in countries like Germany), there has been a convergence around core principles such as transparency, accountability, fairness, and responsibility. International bodies like the OECD, World Bank, and Basel Committee disseminate best practices and benchmarking tools that influence national regulations. The OECD's Corporate Governance *Factbook* compiles data across nearly 50 jurisdictions, showing the common trends and variations in governance practices. Many emerging economies have voluntarily adopted corporate governance codes

aligned with the OECD Principles to signal investor-friendliness. However, implementation and enforcement of good governance remain challenging in practice. Active debates continue on several fronts. One debate is the purpose of the corporation – **shareholder primacy vs. stakeholder governance**. In 2019, for example, the U.S. Business Roundtable (a group of prominent CEOs) issued a statement redefining a corporation’s purpose to serve not only shareholders but also employees, customers, and communities. Supporters argue that considering stakeholder interests leads to more sustainable long-term success, while critics worry it could dilute accountability to owners. This discourse raises questions about how governance structures and laws can balance profit goals with social responsibilities. Another debate is the effectiveness of “comply or explain” governance codes (which provide flexibility for companies to deviate if they explain why) versus strict legal mandates. Some experts argue that while flexibility allows tailoring to context, it can also enable superficial compliance – where companies formally meet code provisions but without substantive change (“box ticking”). There is also discussion about the role of regulatory oversight versus market forces in improving governance: for instance, should diversity or sustainability be mandated by law, or will investor pressure naturally drive these changes? In summary, recent international trends depict a dynamic landscape. Corporate governance is **expanding in scope** – embracing sustainability, stakeholder engagement, and technological challenges – while also **deepening in rigor** – with more independent oversight and stronger shareholder rights. All these reforms share an overarching goal: to strengthen trust in corporations after past scandals and crises, and to ensure that governance systems contribute to long-term corporate resilience, ethical conduct, and value creation on a global scale.

10.2. Corporate Governance Reforms in the Republic of Moldova

The Republic of Moldova, as an emerging economy and an EU candidate country (since 2022), has been actively reforming its corporate governance framework to align with international and European standards. Moldova historically faced weaknesses in corporate governance – characterized by concentrated ownership (including significant state ownership in key industries), underdeveloped capital markets, and several corporate scandals – which underscored the need for robust reforms. In recent years, the government and regulators have introduced a series of measures to modernize governance practices in both the private sector and state-owned sector, with the twin aims of improving the business climate and fulfilling commitments under Moldova’s EU Association Agreement.

A major driver of Moldova’s reforms is the goal of harmonizing with the EU *acquis communautaire* on company law and corporate governance. In 2023–2024, Moldova undertook significant legal changes in this regard. Notably, Moldova’s *Corporate*

Governance Code was revised and a new version took effect in March 2024, replacing the earlier 2015 code. The revised code was designed to incorporate key shareholder rights provisions from EU directives, encourage long-term shareholder engagement, and improve corporate transparency. For example, the changes align with the EU Shareholder Rights Directives by strengthening the rights of minority shareholders and clarifying board duties toward shareholders. There is now clearer guidance on facilitating shareholder participation (including using digital tools for communication) and on handling conflicts of interest and related-party transactions in line with EU norms. Progress has also been made in digitalizing corporate processes: as of 2023, Moldova enabled the use of qualified electronic signatures for filing business documents and fully digitized its company registry archives. These steps not only improve efficiency but also bring Moldova closer to EU best practices (reflecting the EU directive on digital tools in company law). Another area of EU alignment is in financial reporting and audit standards. In November 2023, Moldova adopted a package of laws updating financial reporting and statutory audit requirements, aiming to comply with EU directives on company financial disclosure and auditor oversight. This included mandating International Financial Reporting Standards (IFRS) for public-interest entities and strengthening the independence of auditors – moves intended to enhance the accuracy and reliability of corporate financial statements. While further alignment work is still needed in complex areas like cross-border mergers, takeovers, and insolvency, the reform trajectory shows Moldova’s commitment to meet European corporate governance benchmarks.

Moldova introduced its first comprehensive Corporate Governance Code in 2015, spearheaded by the National Commission for Financial Markets (NCFM). This 2015 Code was largely based on OECD Principles and regional best practices, and it applied on a “comply or explain” basis to improve governance among listed companies and other public-interest entities. Under the original code, companies such as listed firms, banks, certain large companies, and some state enterprises were expected to observe principles regarding shareholders’ rights, equitable treatment of shareholders, the role of stakeholders, disclosure and transparency, and responsibilities of the board. Key provisions of the 2015 Code included: requiring at least one-third of board members to be independent directors for public-interest companies; establishing board committees (audit committees, remuneration committees, risk committees, etc.) for important oversight functions; and fostering an ethical, non-corrupt corporate culture. Companies had to publish annual reports on their compliance with the code’s provisions, which created transparency and gently pressured companies to improve their practices over time.

By the early 2020s, Moldovan authorities recognized that stronger measures were needed to close governance gaps and respond to EU recommendations. Thus, in 2023–

2024, the country moved to make certain governance requirements more stringent and binding. According to a recent policy change, adopting a governance code is now *mandatory* (rather than just comply-or-explain) for all entities of public interest – including large state-owned enterprises – and is recommended for other companies. In 2023, the government approved a **Model Corporate Governance Code for State Enterprises**, effectively extending tailored good governance practices into the public sector realm (this aspect is discussed more in Section 10.3). The updated code and related regulations emphasize several aspects:

- **Clear separation of roles** between the board of directors and executive management, reinforcing that boards set strategy and oversight while executives handle day-to-day operations. Directors’ fiduciary duties (duty of care and duty of loyalty) are now explicitly defined in line with international norms, meaning directors must act prudently, in good faith, and in the best interests of the company and its shareholders.
- **Strengthened independence criteria** for board members in public-interest entities. The requirement that at least one-third of directors be independent is maintained, and regulators encourage including independent experts even on boards of state-owned companies (where historically boards were often populated solely by government representatives). This aims to ensure objective judgment and reduce insider dominance on boards.
- **Board committees**: The establishment of specialized board committees is reinforced. Audit Committees are now obligatory for all public-interest entities (including state enterprises) to enhance financial oversight and internal control. Other committees – such as risk management, nomination, or remuneration committees – are recommended as needed to address key governance areas. These committees should be chaired by or include independent directors and follow clear charters.
- **Transparency and reporting**: Enhanced disclosure requirements mandate that companies publish annual **corporate governance statements** describing their governance structures and compliance with the code’s provisions. Public-interest companies must report on each principle of the code, covering areas like how they protect shareholder rights, whether they have effective internal control and audit systems, how they manage stakeholder relationships, etc. This comprehensive reporting is intended to shine light on governance practices and compel companies to either comply or publicly explain any deviations.

It is important to note that while Moldova’s regulatory framework has improved on paper, implementation presents challenges. The European Commission’s 2024 progress report on Moldova acknowledged that a new corporate governance code and related laws have been adopted, “**though implementation lags behind**”. Ensuring that

companies – especially those with entrenched practices or state influence – genuinely follow these rules (rather than treating them as a box-ticking exercise) will require sustained effort. This includes training for board members and executives, stronger enforcement by regulators, and a cultural shift toward valuing good governance. Building the capacity of institutions like the NCFM and the Public Property Agency to monitor and enforce compliance will be key in the coming years. The next few years (leading up to Moldova’s hoped-for EU accession talks) are thus critical for translating these formal reforms into practical improvements in how Moldovan companies are governed on a day-to-day basis.

Outside of regulatory mandates, there have been some positive moves within Moldova’s private sector to improve governance, particularly among companies seeking investment. Moldova’s capital market remains very small – only a handful of companies are listed on the local stock exchange – which limits the market pressure for governance improvements. However, companies that venture abroad for capital have voluntarily upgraded their governance to meet investor expectations. A case in point is *Purcari Wineries*, a prominent Moldovan-origin wine producer. Purcari listed its shares on the Bucharest Stock Exchange in neighboring Romania in 2018, becoming the first Moldovan company to go public on an EU market. In preparation for its initial public offering (IPO), Purcari adopted rigorous corporate governance measures to attract investors. It appointed independent directors to its board, established board committees (including an Audit Committee and a combined Nomination/Remuneration/Corporate Governance Committee), and adhered to the Romanian Corporate Governance Code requirements. These steps signaled to foreign investors that Purcari was committed to high governance standards, and indeed the IPO was successful. The Purcari example demonstrated that Moldovan companies *can* compete for global capital by voluntarily meeting international governance benchmarks. It set a benchmark for other firms – showing that good governance is not just a regulatory obligation but also a smart business strategy to gain investor confidence and access financing.

10.3. The Role of Governance in State-Owned Enterprises

State-owned enterprises (SOEs) play a significant role in Moldova’s economy and present unique corporate governance challenges. Effective governance of SOEs is crucial not only for the enterprises’ own performance but also for protecting the public interest, given that these entities manage state assets and often provide essential services (energy, transportation, etc.). Historically, Moldova’s SOE sector suffered from weak oversight, political interference, and inefficiencies. As of early 2023, Moldova had over 170 fully state-owned enterprises and dozens of partially state-owned joint-stock companies, active in sectors such as energy, transport,

telecommunications, and agriculture. Many of these enterprises were long plagued by problems familiar in public sectors worldwide: boards staffed by political appointees rather than independent experts, lack of clear commercial objectives, insufficient transparency, and at times corruption or mismanagement. Poor governance in SOEs can lead to significant fiscal risks (since the state often must cover losses or debts), reduced quality of public services, and the crowding out of private investment.

Recognizing these risks, Moldova has made reforming SOE governance a major focus in recent years. With support from international partners (the World Bank, OECD, European Bank for Reconstruction and Development, and others), the government embarked on overhauling the legal framework for SOEs. A milestone was the amendment of the *Law on State and Municipal Enterprises* in April 2023, which introduced modern governance practices for SOEs. These amendments and related government decisions established several key changes:

- **Mandatory governance codes for SOEs**

Each state-owned enterprise is now required to adopt a corporate governance code based on the new model code approved by the government (as noted above). This essentially extends the principles of the national Governance Code into the public sector, creating a standardized benchmark for how SOEs should be governed. This includes stipulations on board responsibilities, shareholder (state owner) rights, disclosure, and controls, analogous to those for private companies. An IMF assessment in 2022 had pointed out that Moldova previously lacked an SOE-specific governance code and would greatly benefit from strengthening public corporate governance – the 2023 reform directly addresses this gap.

- **Empowering the state as an active owner**

The state (through the Public Property Agency, or PPA) is mandated to exercise its ownership role more professionally. The law now explicitly gives the PPA authority to conduct regular evaluations of SOE managers' performance and to hold SOE boards accountable for results. This is a shift toward the OECD's recommended model for state ownership, where the state acts as an informed and responsible owner (rather than intervening politically). In practice, this means setting clear objectives for each SOE, monitoring their financial and operational performance, and intervening (e.g., replacing board members or managers) if they underperform or violate governance standards.

- **Independent boards and depoliticization**

Crucially, the legal changes allow and encourage the appointment of **independent board members** on SOE boards – individuals who are not affiliated with government

bodies or political parties. Previously, SOE boards were often composed entirely of ministry officials or politically connected persons, which blurred lines between ownership and management and introduced conflicts of interest. Now, including independent, professionally qualified directors is meant to bring objective oversight and expertise. For example, an SOE in the energy sector might now have technical or financial experts on its board, rather than only civil servants. This is a significant cultural shift aimed at depoliticizing SOE governance and mirroring private-sector board practices. The OECD's *Guidelines on Corporate Governance of State-Owned Enterprises* (which were updated in 2024) emphasize the importance of professionalizing SOE boards and insulating them from undue political influence. Moldova's reforms are timely in aligning with these international guidelines.

- **Transparent board appointments and evaluations**

In 2023, Moldova introduced a **Regulation on the selection and remuneration of SOE board members**. This regulation establishes transparent, merit-based procedures for recruiting directors to SOE boards. Key features include public competitions for board vacancies, the use of nominating committees to vet candidates, fit-and-proper criteria (ensuring candidates have relevant qualifications and no conflicts of interest), and fixed term limits. The regulation also sets performance-based remuneration for board members, replacing token or politically driven appointments with a system that can attract qualified professionals (including from the private sector or academia). Alongside appointment, new rules were issued to regularly evaluate board members' performance, so that ineffective directors can be replaced. These steps aim to curb nepotism and patronage, ensuring that boards are composed of capable individuals committed to the enterprise's success.

- **Audit committees and financial oversight**

Another innovation is requiring that SOEs which qualify as "public interest entities" (large state-owned JSCs, for example) establish Audit Committees as part of their governance structure. This mirrors private-sector best practice for financial oversight and is now obligatory for major SOEs. An Audit Committee, typically composed of non-executive and preferably independent board members with financial expertise, is responsible for overseeing financial reporting, internal controls, and the audit process. By instituting such committees, Moldova intends to enhance the integrity of financial management in SOEs and prevent abuses such as off-the-books liabilities or misuse of funds, which have been issues in the past.

In addition to these structural reforms, Moldova has also been working on **strategic restructuring and transparency** in the SOE sector. The Public Property Agency in

2022–2023 undertook a comprehensive inventory and **screening of SOEs** – identifying about 238 enterprises and classifying them by whether they should be privatized, restructured, liquidated, or retained in public ownership. This effort is part of a broader *State Ownership Strategy* to rationalize the sector. While progress in executing these decisions has been gradual, it marks an important step in focusing state resources on strategically important firms and preparing others for possible privatization under improved governance conditions.

Moldova’s SOE governance reforms have been guided by international frameworks like the OECD SOE Guidelines mentioned above. The update of those guidelines in 2024, for instance, stresses sustainability, competitive neutrality, and the need for **professionalized boards** in SOEs. Moldova has received technical assistance from development partners to implement these principles. For example, the Soros Foundation Moldova and local think tank Expert-Grup have supported the Ministry of Economy and Ministry of Energy in drafting sector-specific governance codes and regulations for SOEs. In the **energy sector**, which is critical and largely state-controlled, external experts have been working with the government since 2023 to develop a tailored governance code for major state-owned energy companies. This code is expected to introduce standardized rules on board composition, clarify roles and responsibilities, and set performance indicators for management in enterprises like *Moldelectrica* (electricity transmission) and *Termoelectrica* (electricity and heat producer). Such sector-specific initiatives recognize that certain industries (like energy) have additional governance considerations – e.g., the influence of foreign stakeholders or regulators (Moldovagaz, the gas company, involves a partnership with Gazprom), and the importance of reliable public service delivery. By institutionalizing good governance tools across the public enterprise sector, Moldova aims to improve SOE efficiency, financial viability, and accountability to citizens.

Case Study: Governance Reform in Moldovan Energy (Termoelectrica)

– *Termoelectrica* is Moldova’s state-owned electricity and heat generation company, and for years it struggled with heavy losses, debt, and outdated infrastructure. In the mid-2010s, *Termoelectrica* was burdened by inefficiency and required ongoing state subsidies to stay afloat. Under a World Bank-funded project focused on restructuring the energy sector, *Termoelectrica* was required to implement a series of governance improvements. These included establishing a more independent board of directors (bringing in at least one independent member and reducing the number of seats automatically held by government officials), creating an audit committee to oversee finances, and adopting IFRS accounting to increase financial transparency. Over the course of this reform program, *Termoelectrica* began publishing clearer financial reports and the board started to make decisions based on commercial criteria rather than political dictates. The results were notable: financial

discipline improved, operational losses were reduced, and service reliability (electric and heat supply to the capital) increased. While challenges remain – for example, political pressures to keep consumer tariffs artificially low can still strain the company – Termoelectrica’s experience illustrates that even long-entrenched SOEs can benefit from modern governance practices. By clearly delineating authority (empowering professional managers while having the board set and monitor targets) and by enhancing transparency, the government and lenders could better understand the company’s needs and hold it accountable for performance. This case reinforces the lesson that good governance is essential for turning around public utilities and ensuring they serve the public effectively without becoming a drain on state finances.

In summary, the role of governance in SOEs is to ensure these enterprises operate efficiently, transparently, and in alignment with the broader public interest. Moldova’s recent reforms – introducing independent boards, merit-based appointments, audit committees, and adherence to codes – represent significant steps toward that goal. These efforts are still ongoing, and the success of SOE governance reforms will depend on persistent implementation. Challenges such as political will (to allow SOE boards to make independent decisions), building a pipeline of qualified independent directors, and resisting the temptation to use SOEs for short-term political aims will test Moldova’s commitment. Nevertheless, if sustained, these reforms can lead to more financially sound SOEs, reduced fiscal risks, better public services, and greater investor confidence in Moldova’s economy. Importantly, a well-governed SOE sector also moves Moldova closer to OECD and EU standards, supporting the country’s international integration and development objectives.

10.4. Corporate Governance in the Financial Sector

The financial sector – particularly banking – has been at the forefront of corporate governance reforms both internationally and in Moldova. Financial institutions hold the public’s trust and are critical to economic stability, so regulators worldwide impose stricter governance requirements on them than on perhaps any other sector. Banks, in particular, are often “systemically important,” and their failures can have far-reaching consequences, which is why bank governance has received intense regulatory scrutiny since the global financial crisis.

Internationally, the 2008–2009 financial crisis exposed grievous failures of governance in major banks: excessive risk-taking went unchecked by boards, complex financial products were not understood by directors, compensation schemes encouraged short-term bets, and in some cases outright fraud or cover-ups occurred. In response, regulators and standard-setters introduced robust new norms specifically for financial institution governance. The Basel Committee on Banking Supervision issued

revised *Corporate Governance Principles for Banks* (most recently updated in 2015) which set out 13 principles covering board responsibilities, risk governance, internal controls, executive compensation, and transparency. Key expectations from these principles include: bank boards must have a sufficient number of independent directors and members with financial expertise; boards should establish dedicated risk committees and define the bank's risk appetite in a formal statement; senior management must be subject to effective oversight and act in accordance with the board-approved risk appetite and policies; and remuneration policies for executives and traders should be aligned with long-term prudent outcomes (for example, by deferring bonuses and making them contingent on sustained performance). Many jurisdictions have incorporated these global principles into their banking laws or supervisory guidelines. In the European Union, for instance, the *Capital Requirements Directive IV/V* includes detailed governance requirements for banks – such as requiring banks to have risk committees at board level, limiting the number of board positions any one individual can hold (to ensure sufficient time commitment), conducting regular “fit and proper” assessments of board members, and capping bankers' bonuses relative to salary to curb excessive risk incentives.

Another international trend has been enhancing the **fit-and-proper assessment** of bank owners and managers. In many countries, bank regulators now rigorously vet significant shareholders, board nominees, and top executives of banks for integrity, competence, and financial soundness. The aim is to prevent unqualified, conflicted, or unethical individuals from controlling financial institutions. This came after experiences where dubious shareholders misused banks for related-party lending or fraud. Along with governance structures, **transparency** in banks has improved by regulation: banks are typically required to disclose detailed information on their risk exposures, capital adequacy ratios, governance arrangements, and remuneration policies. International Financial Institutions (like the IMF and World Bank) as well monitor countries' banking governance as part of financial sector assessments, recognizing that weak governance in banks can quickly escalate into systemic crises.

Moldova's banking sector provides a stark illustration of why strong corporate governance is vital. The country experienced a major banking crisis in 2014–2015, often referred to as the “*Billion Dollar Bank Scandal*.” In that episode, three Moldovan banks – Banca de Economii, Unibank, and Banca Socială – were used to issue over \$1 billion in fraudulent loans (a huge sum equivalent to roughly 12% of Moldova's GDP) to shell companies ultimately controlled by insiders. The loans were never repaid, and the banks collapsed, leading to a taxpayer-funded bailout. This scandal revealed shocking governance failures: concentrated ownership by opaque investors, boards filled with politically connected individuals who failed to exercise oversight, blatant conflicts of interest, nonexistent internal controls, and complicity of bank executives in the fraud.

The fallout from this crisis was severe – it caused public outrage, rocked the economy, and brought intense pressure from international partners for reform.

In response, starting in 2015, Moldovan authorities – particularly the National Bank of Moldova (NBM) – undertook sweeping changes to banking regulation and supervision to restore trust and prevent a repeat. A new *Law on Banking Activity* was enacted in 2017, aligning Moldova’s banking framework with EU directives and Basel principles. This law and subsequent NBM regulations imposed rigorous fit-and-proper criteria for bank shareholders and managers, stricter requirements on transparency of bank ownership, and higher corporate governance standards across the sector. Some of the key reforms and outcomes were:

The NBM carried out a comprehensive review of bank shareholders (with support from development partners). Shareholdings in banks that were found to be non-transparent or held by nominees for hidden beneficiaries were frozen or unwound. Throughout 2015–2018, the central bank used its authority to block proposed acquisitions that did not meet credibility tests and to force existing unfit owners to divest. This broke the grip of local oligarchic interests that had previously controlled several banks behind the scenes. As a result, by 2018–2019, the ownership of the major banks had been “cleaned up” and indeed transformed: foreign strategic investors from reputable European banking groups acquired controlling stakes in the top Moldovan banks. For example, Hungary’s OTP Bank and Romania’s Banca Transilvania – both well-regarded regional banks – purchased two of the largest Moldovan banks. This influx of fit owners not only stabilized the sector financially but also “imported” better governance, as these foreign banks brought in new management, internal processes, and a culture of compliance consistent with EU banking norms.

Under NBM regulations, all banks in Moldova were required to strengthen their board structures. Banks must now have a minimum of one-third independent directors on their boards (similar to the general corporate governance code, but here it is enforced by law). Additionally, bank boards must establish key committees: Audit Committees, Risk Committees, and Remuneration (Compensation) Committees are obligatory. Each of these committees has a defined mandate (e.g., the Risk Committee oversees the bank’s risk management strategy and risk appetite, the Audit Committee oversees internal and external audits and financial reporting). The members of these committees are mainly non-executive directors and often include the independent directors, to ensure objective oversight. These structures were either completely new or much improved compared to pre-2014, when some banks had rubber-stamp boards with little independent oversight.

Moldovan banks dramatically overhauled their internal control frameworks post-2015. They are now required to *maintain effective internal audit departments* that

report to the board's Audit Committee, as well as independent risk management and compliance functions. Many banks *hired chief risk officers* and chief compliance officers and gave them greater authority. Banks must implement stringent controls to prevent and detect related-party lending (which was abused in the scandal) and to combat money laundering. The NBM introduced a Corporate Governance Code specifically for banks; banks like MAIB (Moldova Agroindbank) began publishing detailed annual governance statements by 2020–2021, disclosing their governance structure and practices to the public. This *enhanced transparency* allows the market and regulators to hold banks accountable.

A critical piece of the reform was making sure that the people running banks are qualified and honest. The NBM instituted strict vetting for bank administrators: anyone proposed as a board member or senior manager of a bank must pass a fit-and-proper test by the central bank, examining their experience, integrity, and financial soundness. During the immediate post-crisis period, the NBM even barred or removed individuals who had been associated with the defrauded banks from ever holding banking positions again. It also set **limits on tenures** and required rotation in some cases to bring fresh perspectives. These measures were aimed at refreshing bank leadership and ensuring a clean break from past malpractices.

Alongside formal rules, the NBM *adopted a more intrusive and proactive supervision approach*. It began conducting regular on-site inspections with a focus on governance – for example, reviewing board meeting minutes to see if directors were truly questioning management, checking how banks approve large loans, and ensuring that internal audit findings were addressed. When governance deficiencies are identified, the NBM can issue orders for corrective action or even impose sanctions. This intense scrutiny has sent a clear message to bank boards and executives that they will be held accountable. Banks responded by significantly improving compliance and documentation, knowing that regulators were watching. Furthermore, programs were launched to educate and support bank board members – for instance, some **Board Training/Advisory programs** were set up with international experts coaching Moldovan bank directors on best practices. Over time, this helped cultivate a more professional governance culture within banks.

A vivid case illustrating the impact of governance reform is the aftermath of the 2014 banking fraud in Moldova. As mentioned, three banks (Banca de Economii, Unibank, and Banca Socială) had issued over \$1 billion in fraudulent loans to entities secretly controlled by insiders, leading to the banks' collapse. Governance lapses – such as politically connected board members failing to question suspicious loans, executives colluding in the scheme, and the absence of effective internal audits – enabled this disaster. When the scandal came to light, it triggered public outrage and strong demands from Moldova's international

partners (IMF, EU, World Bank) to clean up the banking system. The authorities took unprecedented steps: the NBM seized control of the failing banks and worked with the government on a resolution plan. Ultimately, the government had to issue bonds (equal to about 12% of GDP) to cover depositors' losses – effectively transferring the cost to taxpayers, a consequence of governance failure. However, this crisis also became the catalyst for sweeping reforms described above. The NBM decisively revamped banking governance rules to prevent a repeat. It banned individuals involved in the fraud from any future ownership or management roles in banks. It required all banks to report large exposures and related-party loans in real time to the NBM for monitoring. Over the next few years, as noted, two major banks (MAIB and Moldindconbank) that had previously murky ownership were compelled to find transparent, fit owners – leading to their acquisition by European banking groups. By 2020, the banking system was regarded as far more transparent and well-governed than in 2014. This case demonstrates both the catastrophic cost of governance failures and the crucial importance of rigorous reforms. It took a crisis to prompt change, but Moldova's banking governance today is largely built on the hard lessons learned from that episode.

Thanks to these changes, Moldova's banking sector stability indicators have markedly improved in recent years. Capital adequacy ratios and liquidity are comfortably above regulatory minimums, and non-performing loans (bad loans) have trended downward, indicating healthier loan portfolios. Foreign investors view Moldovan banks more positively now, given the presence of reputable international owners and stricter oversight. Public trust, which was severely shaken, has been gradually recovering as evidenced by slowly rising deposit levels and use of banking services. However, challenges persist: financial intermediation (the level of lending to the economy) remains relatively low, partly because banks became very cautious post-crisis and Moldova's economy is still developing. Overcoming this will require banks to lend more to businesses, which ties back to governance – well-governed banks are better at managing risks and can extend credit more confidently.

Beyond banking, **corporate governance in other financial institutions** in Moldova has also come under reform. The National Commission for Financial Markets (NCFM), which regulates sectors like insurance and capital markets, updated governance regulations for insurers, requiring them to have actuaries, risk managers, and in some cases risk committees to protect policyholders. For the tiny capital market, any listed companies must follow the general Corporate Governance Code and publish annual governance reports. While the stock market is currently small, efforts (often with EBRD assistance) are underway to develop it – including improving the governance of market institutions like the central securities depository and the stock exchange, to ensure integrity and investor confidence.

In conclusion, the financial sector exemplifies how robust corporate governance is a cornerstone of stability and trust. Moldova's experience, particularly the reforms triggered by the 2014 bank scandal, highlights the dramatic difference that governance improvements can make: from a crisis characterized by corruption and collapse to a much sturdier, more transparent banking system operating closer to international standards. That said, maintaining vigilance is key – as new risks emerge (for instance, fintech innovations, cryptocurrencies, or external economic shocks), bank boards and regulators will need to continuously adapt governance frameworks. The Moldovan journey underscores that improving corporate governance in finance is an ongoing process, but one that is indispensable for financial stability, investor protection, and sustainable economic growth.

Self-Assessment Quiz:

1. What are some of the most significant international trends in corporate governance in the past decade? Describe at least three trends (such as those related to ESG, board practices, shareholder rights, etc.) and explain why they have gained prominence.
2. How have international organizations and regulations (for example, the OECD Principles of Corporate Governance or EU directives) influenced national corporate governance reforms? Provide an example of a recent change in corporate governance that was driven by international standards.
3. Outline the key steps Moldova has taken since 2022 to reform its corporate governance framework. What changes were made to the Corporate Governance Code in 2023-2024, and how do these align with EU requirements?
4. Why is good corporate governance particularly important for state-owned enterprises? Identify at least two common governance problems in SOEs and explain how Moldova's 2023 reforms aim to address them (e.g., board composition, appointment process).
5. Based on the Termoelectrica case, what governance measures were implemented in a Moldovan state-owned energy company and what were the observed benefits? Discuss how independent boards, audit committees, or transparency contributed to performance improvements in that case.
6. What are some key corporate governance principles for banks recommended by the Basel Committee and incorporated into EU banking regulations? How do these principles (e.g., risk committees, fit-and-proper tests) help prevent the kinds of failures seen in past financial crises?
7. Summarize the main governance failures that led to Moldova's 2014 banking crisis. After the crisis, what were the major governance reforms implemented in the banking sector, and how have they improved the stability and transparency of banks?

8. How have recent trends made it easier for shareholders to engage with and influence corporate governance? Mention technological changes (like virtual meetings) and regulatory changes (like “say on pay” or shareholder votes on certain matters) that empower shareholders.
9. Explain the rationale behind initiatives to increase board diversity (for example, gender quotas in the EU). What are the arguments that diverse boards improve governance? Are there any challenges or criticisms associated with imposing diversity requirements?
10. Discuss the difference between a “comply or explain” approach to corporate governance and a strict legal compliance approach. What are the advantages and drawbacks of each? In your view, how can regulators encourage companies to move beyond a box-ticking mentality to genuinely improve governance practices?

Sources:

- Atlantic Council. (2023, October 3). Mixed messaging from Moldova on energy sector reforms. *UkraineAlert Blog*. <https://www.atlanticcouncil.org>
- Blume, D., & Isaksson, M. (2024, February 3). The 2023 OECD Corporate Governance Factbook. *Harvard Law School Forum on Corporate Governance*. <https://corpgov.law.harvard.edu>
- CEE Legal Matters. (2023). Comparative guide to corporate governance – Moldova. In *Corporate Governance 2023*. <https://ceelegalmatters.com>
- European Commission. (2023). *Republic of Moldova: EU Candidate Status Report*. Brussels: European Commission.
- European Commission. (2024). *Republic of Moldova: Analytical Report 2024*. Brussels: European Commission.
- Expert-Grup. (2022). *Institutionalizing good governance tools for SOEs: Governance code and board nomination regulation*. Chişinău: Expert-Grup.
- Government of Moldova. (2023). *Law on State and Municipal Enterprises* (amended April 2023). Chişinău: Monitorul Oficial al Republicii Moldova.
- Government of Moldova. (2023). *Regulation on selection and remuneration of SOE board members*. Chişinău: Government Decision Register.
- Ignat, A., Stratan, A., & Lucasenco, E. (2017). Development of cooperatives in the Republic of Moldova. In *Agrarian Economy and Rural Development – Realities and Perspectives for Romania* (Vol. 8, pp. 229–235). Bucharest: Romanian Academy.
- International Monetary Fund (IMF). (2022). *Republic of Moldova: Selected issues* (IMF Country Report No. 22/61). Washington, D.C.: IMF.
- National Bank of Moldova. (2017). *Law on Banking Activity No. 202/2017*. Chişinău: NBM.

- National Bank of Moldova. (2020). *Annual Report 2019*. Chişinău: NBM. <https://bnm.md>
- National Commission for Financial Markets (NCFM). (2015). *Corporate Governance Code*. Chişinău: NCFM.
- OECD. (2023). *Corporate Governance Factbook 2023*. Paris: OECD Publishing. <https://www.oecd.org/corporate/corporate-governance-factbook.htm>
- OECD. (2023, September 11). G20/OECD Principles of Corporate Governance 2023 [Press release]. Paris: OECD Publishing. <https://www.oecd.org>
- Pinsent Masons. (2023, October 20). Sustainability among new focus in revised OECD corporate governance principles. *Out-Law News*. <https://www.pinsentmasons.com/out-law>
- Purcari Wineries PLC. (2018). *Annual report and financial statements 2017*. Bucharest/Chişinău: Purcari Wineries PLC. <https://purcari.wine>
- Soros Foundation Moldova. (2023, October 20). Support to Ministry of Energy for improving corporate governance of enterprises [Press release]. Chişinău: Soros Foundation Moldova. <https://soros.md>
- U.S. Department of State. (2020). *Investment climate statement: Moldova 2020*. Washington, D.C.: Bureau of Economic and Business Affairs. <https://www.state.gov/reports/2020-investment-climate-statements/moldova>
- World Bank. (2023, May 31). Moldova to improve delivery of agricultural services to farmers with World Bank support [Press release No. 2023/AGRI]. Washington, D.C.: World Bank. <https://www.worldbank.org>

Bun de tipar 11.12.2025
Coli editoriale 15,85.Coli de autor 15,65. Coli de tipar 28,0.
Comanda nr. 72.

Serviciul Editorial-Poligrafic
al Academiei de Studii Economice din Moldova
Chişinău, MD-2005, str.Bănulescu-Bodoni 59.
Tel.: 022-402-910
www.ase.md