The USA as a good comparator for UK in corporate governance

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Abstract

Purpose – This paper aims to explore the reasons why the USA makes a good comparator for the UK when it comes to corporate governance.

Design/methodology/approach – The paper is largely theoretical.

Findings – The paper finds that the USA has become a laboratory for ideas in corporate governance and the UK can learn a lot in areas such as takeovers and shareholders' rights.

Originality/value – The paper explains the reasons why the UK and the USA have dominated research literature in corporate governance. The findings and arguments raised throughout the paper are very original.

Keywords Takeovers, USA, Corporate governance, UK, Comparative research, Shareholders' rights

Paper type Conceptual paper

1. Introduction

Corporate governance as a field of study is premised on finding solutions to the harmful consequences resulting from the separation between ownership and control. The interrelationship between shareholders and directors or ownership and control has generally been the coalescing point in defining corporate governance. This paper endorses the definition by the economist and Noble Laureate Milton Friedman printed in 1970 in *The New York Times*, in which he argued that "corporate governance is to conduct the business in accordance with owner or shareholders' desire which generally will be to make as much money as possible, while conforming to the basic rules of the society embodied in law and local customs" (Laona and Gherghina, 2007). It is a definition premised on market value maximisation through the medium of the law. The aim is to find a solution to the separation between ownership and control by setting company objectives in line with the interests of shareholders, giving incentives to make managers serve those interests and balancing regulatory and market discipline.

Historically, the question of who manages the company has been a contentious one, with the board of directors, appointed or elected to oversee the activities of the company, and shareholders, both seeking to impose their judgement over corporate decision-making. This was settled at the turn of the twentieth century by the English Court of Appeal in *Automatic Self-Cleansing Filter Syndicate Co.* v. *Cunningham*[1]. The court affirmed that the powers of management were vested in the board and shareholders in the general meeting could not interfere with their lawful exercise[2].

Studies on the consequences of the separation between ownership and control first gained prominence in the USA. This is because major construction projects in Britain during the eighteenth and nineteenth centuries were carried out by the governmental organisations; thus, there was limited potential for conflict of interest. The USA used public companies to raise funds from the public to finance the development of their railway system (Davis and North, 1971). This led Alfred Marshall, a leading British economist at the time, to remark that "America appeared rather late in the field but she is already a chief leader in it" (Marshall, 1919). In 1932, American scholars Berle and Means spearheaded academic studies

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on the separation of ownership and control in public companies. The authors highlighted how the growth in the number of people with an ownership interest in public companies reduced their incentive to exercise any real influence over the company in which they have invested[3]. This is because shareholders were divorced from the corporate "technostructure" which left companies in the hands of skilled managers who could seek to serve their own interests.

Although Berle and Means brought attention to the consequences of the separation of ownership and control at the turn of the twentieth century, British economist Adam Smith had already raised the issue in 1776, although it was never developed until the 1930s (Smith, 1776). The British economist saw a lack of incentive on the part of directors to look after investors' money with as much care as the owners themselves would. Adam Smith made his observations at a period when the public company was still at an embryonic stage of development and not helped by the climate of increasing corporate ownership upon which Berle and Means made their observations in the 1930s. Thus, minimising the consequences of separation of ownership and control by making management serve the interests of the shareholders has been a contentious issue since the advent of the public company.

According to the World Bank, global investors prefer jurisdictions with strong legal systems and adequate corporate governance frameworks, because the system offers more protection to their investment than a system without such measures[4]. It is not surprising therefore, that the UK, which requires all listed companies to comply with the Code on Corporate governance, is a hub for global investment. This is because investors want to put their money in companies that are well governed to stand any chance of having a return on their investment. This is supported by Charles Oman, who argues that good corporate governance improves the performance of companies because it mitigates the conflict of interest between management and shareholders (Oman, 2001). As a result, this creates conditions for operational efficiency and long-term productivity.

2. Defining corporate governance

The term "governance" was first explored by Plato in approximately 380 BC in his influential work "The Republic"[5]. Although Plato's work was purely about justice and philosophy, its reference to leadership, management, organisation and supervision made it influential for governments. The term became influential in subsequent work on the role of government in society. But it was until 1776 that Plato's ideas were used by Adam Smith in relation to companies. Adam Smith looked at how companies were governed and remarked on the potential conflict of interest that can emerge when the owners are not in control of their money. Plato's ideas remained influential for companies and governments well into the twentieth century. Classical works by economics and management theorists such as Berle and Means, Dodd (1932) and Coase (1937) picked up from Plato's ideas and sought to distinguish the way governance is used in the company to that in the government. They saw governance in companies as based on control and incentive, whereas governmental theorists viewed governance as based on rules and punishment (Kooiman, 1993).

The separation between governance in companies and that of government helped to pave the way for company-specific governance ideas. The term "corporate governance", according to Becht *et al.* (2002), was already used in finance literature by the beginning of the twentieth century. It was not until the mid-60s, that the term "corporate governance" emerged within legal and economics scholarship. For example, it was used by Eells (1960), in reference to "the structure and functioning of the corporate polity". The term came at a period when economies of countries such as Germany and Japan were starting to grow rapidly, and thus, research on legal systems and their role in promoting successful companies was flourishing (Alchian, 1969). The term added emphasis to Berle and Means' 1932 work by confining all aspect of governance related to companies under the umbrella of corporate governance. In the 70s and 80s, the term began to be commonly used in legal and economics literature, and corporate governance failures in the 90s gave it the publicity it deserved.

However, defining corporate governance has often been a challenging and a much-debated issue. This is because corporate governance is interpreted differently in a number of disciplines. For economists such as Shleifer and Vishny (1997), the role of corporate governance is to minimise conflict of interests between various participants, especially management and shareholders. They believe that the absence of conflict would lead to more equity financing and a more efficiently managed organisation. The economists provide a more modern approach because they recognise the role of both free markets and state intervention. They view corporate governance as "institutions that influence how business organisations allocate resources and returns" and "the organizations and rules that affect expectations about the exercise of control of resources in firms" (Salacuse, 2004). This definition underpins both the formal rules and informal principles of corporate governance. This was the same approach taken by Monks and Minow (1995) when they defined corporate governance as a "relationship among various participants in determining the direction and performance of corporations". This contemporary view of corporate governance is in line with views of classical economists such as Adam Smith and Berle and Means, who were seeking new ways of imposing accountability in the agency relationship between shareholders and directors.

Legal researchers view the role of corporate governance as being there to facilitate the control and direction of the company. However, the legal definitions tend to focus narrowly on internal practices, thus neglecting the external factors that underpin the stakeholder theorem. It should be remembered that at the time of the Cadbury Report, corporate governance implosions such as Enron and WorldCom, which influenced law makers and academics to advocate for tighter governance rules, were yet to be realised.

In contrast to the legal and economic definitions, management studies view the role of corporate governance as being there to create conditions that would foster greater performance and efficiency within companies. Management scholars believe that corporate governance is primarily concerned with promoting good behaviours within companies, in terms of greater performance, efficiency, growth and treatment of shareholders and other stakeholders (Gray *et al.*, 1996). Thus, the managerial view of corporate governance is more intertwined with the internal functionality of the company with little regard to forces in the external business environment such as legal principles capable of shaping corporate behaviour.

The "absence of any real consensus" (Keasey *et al.*, 1997) on the definition of corporate governance is indicative of its complexity. By uniting management, legal and economic scholarship, I have been able to select a definition that reflects the practices of modern companies and fosters the success of all corporate participants. Milton Friedman's threefold definition of corporate governance takes into consideration company value maximisation which is the goal of economists, the availability of managerial incentives to make them serve shareholders' interests and imposing control and direction on management through rules and regulation.

3. The USA as a good comparator for the UK

There are a number of reasons for selecting the USA as a comparator for the UK. The first reason is the similarity in market composition. The UK has a high presence of institutional investors in its listed companies and a number of individual shareholders (Investment Management Association, 2011). These investors are widely dispersed and have limited involvement in corporate decision-making. The UK has a significant securities market as a result, which facilitates the buying and selling of companies securities (Black and Coffee, 1997).

In contrast, there are countries that have a few majority shareholders in their listed companies who tend to exercise control over the companies. These kinds of systems are found in countries such as Japan and Germany and are referred to as "insider" systems (Nestor and Thompson, 1999). The close control limits the potential for conflict of interest but impedes the role of market-based disciplinary mechanisms such as the market for corporate control. Their concentrated ownership structure differentiates them from the system found in the UK.

The market composition in the UK, however, is also similar to that in the USA. The US market is also dominated by institutional investors followed by a small number of individual shareholders (Clifford, 2009). These investors are widely dispersed, leaving the control in the hands of directors (Franks *et al.*, 2007). Thus, the potential for conflict of interest is equally significant in the USA. However, the separation between ownership and control allows the market for corporate control to pose a significant influence in the market. This system is referred to as the "Anglo-American system".

Comparing takeover regulation on a system that facilitates proxy contests and takeover bids is important because the system would have measures in place to limit conflicts of interest. Thus, seeking to learn from an insider country, which has less potential for takeover activity, is likely to yield fewer lessons for the UK as compared to an Anglo-American country. However, any ideas on how to improve corporate governance that can be obtained from countries such as Germany and Japan are used where necessary.

Despite the rejection of the insider countries for comparative purposes, there are other countries that have dispersed ownership and market compositions similar to those in the USA, although slightly more concentrated (Luo, 2007). These countries include Australia, New Zealand and Canada. Although these common law countries, which fall within the Anglo-American category, have similar market structures, the USA is higher in terms of regulatory development and new ideas. Thus, the USA offers a better comparator ahead of other Anglo-American countries.

The second reason for selecting the USA as a comparator is its growing influence around the world. Britain's status as a colonial power helped it to spread the English common law system around the world. Countries such as Australia, Canada, New Zealand, South Africa and Hong Kong all developed their corporate laws along British lines. However, Jordan (1998) and Cheffins (1999a) argued that the influence has waned in the past 50 years. One reason being the adoption of European Union (EU) company law directives which have isolated the UK from non-European countries which used to look at them for guidance. In addition, the significant role being played by associations such as the Organisation for Economic Co-operation and Development (OECD) and the Commonwealth in developing model rules and standards has also reduced the significance of UK rules on other countries.

Despite the role of the OECD and Commonwealth in developing corporate laws, UK corporate laws have long been influential in Commonwealth countries. For instance, in Canada, a corporate governance study by the Toronto Stock Exchange acknowledged the value it had derived from the work done by the Cadbury Committee and subsequent disclosure requirements were developed along UK lines (Cheffins, 1999b). The Australian Stock Exchange (1994) similarly adopted corporate governance guidelines along UK lines. The Irish Stock Exchange implemented the 1999 recommendations from the Hampel Report

(Mahony, 1999). The South Africa King Committee borrowed heavily from the Cadbury Report, resulting in their Code of Corporate Practices and Conduct (Du Plessis, 1997). The Confederation of Indian Industry also followed the approach by the Cadbury Committee in formulating its own corporate governance code. Even insider systems in Continental Europe have exported British corporate governance ideals with countries such as France, Belgium and Italy, reviewing Cadbury's recommendations before drafting their corporate governance rules (Sargent, 1997).

The recent inclusion of enlightened shareholder value in the Companies Act 2006 could be a pull factor for legal reformers around the world to once again become more observant of UK corporate laws[6]. However, enlightened shareholder value is neither novel nor path-breaking. As the law in Continental European countries conforms to this pattern, then the enlightened shareholder value development is likely to have few observers. However, the approach in Continental Europe largely ignores the interests of many stakeholders, such as the community and environment. Reporting on such matters is largely carried out on a haphazard basis. Thus, making such reporting mandatory may push Continental European countries to take note of UK's experience.

Despite the development of enlightened shareholder value, many legal reformers around the world have shifted their attention from the UK to the USA, as a provider of model rules and standards for governing their corporations. First and foremost, this is due to America's economic dominance. The USA is widely regarded as the most powerful country in the world economically[7]. As a result, the USA is expected to lead the effort to improve corporate regulation and supervision around the world. This means that national reformers must be observant of the decisions and of choices of the USA, given their influence on economic outcomes. This helped the USA become the laboratory within which corporate standards and rules are created and exported into other countries. It led Hansmann and Kraakman (2001) to proclaim that all countries should aim to converge towards the US corporate governance model.

Based on the abovementioned, the UK's declining influence on corporate law reform around the world is compounded by the USA's status as a global economic and political leader. This is of great influence to countries around the world that are keen to learn from the policies of the pace-setter to improve their own economies. As a result, this makes the USA an important comparator for the UK when examining powers afforded to shareholders and how they use these powers to minimise conflicts of interest at the onset of a takeover.

Despite the wide influence of the USA on corporate governance development around the world, they need to work in concert with other countries in formulating standard rules. As aforementioned, the phenomenon of publicly quoted companies is as widespread in the UK and the USA, whereas in Continental Europe, most large companies are privately held. This means that investors in both the UK and the USA have good reasons to be fearful of agency costs and seek to improve managerial accountability. For both countries, agency costs are exacerbated by the fact that managers and companies constantly cross over to either country (Ndubizu, 2002). This makes it critically important that both countries have strong corporate rules to deter conflicts of interests. It also means that both countries must take lessons from each other on how to align managerial interests with those of shareholders.

Thirdly, the EU can make valuable contributions to such legal developments. Whereas it is easier for the USA to influence individual countries like the UK, it is equally difficult for them to influence the EU. This is because EU member states are still finding appropriate balance of power and have broad differences over social, political, historical, language and other factors. There is also no central government in the EU, unlike the federal government in the USA. This makes it difficult to implement regulatory developments in the USA because they may not fit all nations. Thus, the EU can take lessons from the USA but cannot implement them directly, given the broad differences in the two unions. Although there are potentially many lessons both the EU and the USA can learn from each other, the implementation of those lessons in the EU seems to be more difficult than in the USA.

However, both the USA and the EU continue to reform their laws for the benefit of member states while fully observant of reforms in Asia and Africa. Organisations such as the G8, consisting of the eight most powerful economies, often meet to break deals on how to improve financial regulation and spur economic development, among other agendas. These developments are of great influence to the UK and are often taken on board by the EU in a bid to create efficiency and deter malpractices.

Although the UK can learn a great deal from the USA, given their leadership and influence around the world, it would be fruitless to look for lessons from the EU. Being a member state, EU directives apply in the UK. Thus, most of the EU developments are either incorporated into UK law or already subject to debate. The UK has long been of influence to the EU in the area of corporate governance. For example, developments such as the separation of chief executive officer and chairman roles and the involvement of independent nonexecutive directors on the board were formulated by the Cadbury Committee and taken on board by the EU[8]. Although developments in EU are welcome, the USA remains the pace-setter, thus making it a more worthwhile teacher. On that background, if the UK seeks to improve its corporate laws, it ultimately has to look at the standard setter, which is the USA.

Even though the USA is seen as a laboratory for the development of corporate rules, the influence of the Commonwealth has not waned. The Commonwealth has been influential in the development of corporate rules, and recently developed a code for Commonwealth countries to follow when drafting their corporate governance rules.[9] Countries such as Hong Kong and South Africa have been worthy observers of these guidelines and many countries around the world continue to refer to them when making reforms. Despite their appeal to many countries, the UK was at the forefront their development, and most of the guidelines are already enshrined in the principles of corporate governance in the UK.

Thus, it is not worthwhile to examine what the UK can learn from the Commonwealth; rather, focusing on an individual country's approach to corporate governance is likely to yield more questions over corporate governance in the UK. As aforementioned, countries such as Australia, New Zealand and Canada have similar market structures as in the UK, but the high number of family-held companies has made them a hybrid of the Anglo-American system. These English-speaking countries are at par with the UK in terms of corporate governance development, being members of the Commonwealth. Australia represents even a more immediate case for comparison, as their court decisions are cited in the UK, whereas the USA, New Zealand and Canadian case law is not cited in the UK but only looked at for guidance.

However, as the law is always enacted to combat an ongoing injustice, legal reformers must aim to be proactive and focus on the future offences. This is difficult to achieve by seeking to learn from the Commonwealth countries because the UK directly competes with them, whereas the USA is superior and represents the futuristic ideas. Despite the cultural and legal similarities, Australia is not higher than the UK in progressive ideas; thus, it is not worthwhile to conduct a comparison with it. The USA is ideal for comparison because Delaware is the trend setter for almost everything in corporate law. However, developments in Commonwealth countries such as Australia should not be ignored.

4. Takeovers and corporate governance

For UK companies, it is essential to learn from US approaches to takeover regulation to benefit and compete with their companies. The reason behind the focus on takeover regulation stems from the recent surge in mergers and acquisitions and the crossover of managers from the USA. This makes it critically important that both countries implement adequate rules to govern mergers and acquisitions. Coffee (2007) argued that foreign firms continue to list on US markets because of their higher regulatory standards. He also argued that firms which cross-list on the US Stock Exchange gain significant valuation premiums (Coffee, 2007).

In the UK, the City Code on Takeovers and Mergers (Takeover Code) is written and administered by the Panel on Takeovers and Mergers (the Takeover Panel). Personnel on secondment from the professional community staff the Takeover Panel. One of its major attributes is its real-time resolution to takeover issues and flexibility, which is a result of not following court procedural routes. Although the Takeover Panel offers an out-of-court solution to takeover problems, it is important to explore the merits of a courtroom-based system to identify any lessons that can be learned from such an approach.

Such a courtroom-based system can be found in the USA, with takeover decisions being handled by Delaware courts. The ex post nature of court decisions has been argued to render the decision-making process as inflexible and long. Whether this is indeed the case in the USA can only be unearthed through research. Nevertheless, the USA is likely to yield a lot of questions regarding the UK takeover decision-making process. The lessons learned from the mode of decision-making would be critical in identifying ways of improving the UK takeover system.

The Takeover Panel, however, relies on the Companies Act and Code on Corporate Governance to function effectively. The Companies Act contains director's duties and the conduct of the general meeting, whereas the Code contains a number of principles that must be met within organisations. Together, they provide resolutions during takeovers and other areas of corporate management that have the potential for conflict of interest and agency costs.

The agency costs that ought to be minimised are costs of using specialised agents or managers to run the companies. The agency costs were used to warn shareholders that they must give managers incentives to minimise the harmful consequences emanating from the separation of ownership and control within public companies (Jensen and Meckling, 1976). The consequences of separation between ownership and control are the focal point of corporate governance research literature.

The quest to find solutions to the agency costs arising from the separation between ownership and control is vitally important for the stability of the UK economy and welfare of her citizens. The significant role played by public companies has been recognised since the passing of the Joint Stock Companies Act over a century ago (Committee on Joint Stock Companies, 1844). The growing importance of public companies has meant that reducing the potential for conflict of interest is of paramount importance to the country. This is because conflict or interests can affect the company's potential to provide goods and services. On a radical note, conflict of interest can result in corporate failure, which would impact on the welfare of the citizens and the national economy. Major corporate failures in recent years include the mismanagement of financial risk at Enron in the USA. The management at Enron pursued risky business ventures, while concealing the financial health of the company, which inevitably led to company's collapse in 2002 (Coffee, 2003). Similarly, the collapse of Lehman Brothers in 2008 was blamed on the mismanagement of risk and fraudulent accounting practices (Mahani, 2009). These corporate failures negatively impacted on the economy of the concerned countries and welfare of citizens.

The potential for conflict of interest when a company is controlled by skilled mangers is rooted in the nature of a public company. The distinct feature of a public company is its inherent ability to offer shares or stock for sale to the general public. A share is an interest in the property of a company which is often rewarded through dividends. By inviting investors to buy an interest in the company, often large public companies end with hundreds of shareholders. Thus, the founding promoters of the company also find themselves in the pool of shareholders who hold an interest in the company and are unable to exercise direct control.

Conflict of interests may arise during takeovers where directors seek to frustrate a takeover bid due to fear of being ousted from their positions. The threat of a hostile takeover, one which the board do not consent to, is a disciplinary mechanism available to dispersed shareholders. This disciplinary mechanism is referred to as the market for corporate control. The role of the market for corporate control is explored at great length in Chapter 2. The mechanism seeks to reduce the harmful consequences of the separation between ownership and control by making managers seek to improve the company's share value in a bid to deter potential buyers, who may be seeking to buy an under-performing company and make it more profitable. Thus, the market for corporate control theoretically serves the objective of corporate governance.

As takeover rules in the UK deter the frustration of takeover bids by directors, comparing the UK system to a system that does not deter the frustration of takeovers is likely to yield a lot of lessons. The level of protection afforded to shareholders at the onset of a takeover and how this protection limits conflicts of interests is the main question that seeks to be answered by examining a system that allows the frustration of takeover bids. This question will yield a number of lessons that can be learned on how to limit conflict of interest and areas of future reform. The USA does not empower shareholders during takeovers; rather, it leaves most of the decision-making in the hands of directors.

Another area of inquiry is the mode of regulation and how this influences the goal of deterring agency costs and limiting conflict of interest in companies. In UK, the Takeover Code was developed by city professionals and it follows a self-regulatory or "soft law" approach. The rules were designed to protect the interests of shareholders. They did not emerge from an accumulation of common law precedents which are reliant on cases being decided in courts and the incentive of parties to litigate. Common law precedence can also influence the substance of the rules, because decisions are based on the jurisprudence developed by the courts, and if the majority of cases are brought by managers, subsequent jurisprudence is likely to reflect that pattern and buttress the needs of managers. Thus, systems that developed out of common law jurisprudence are likely to provide a good comparator for the takeover system in the UK. The USA has a takeover system that developed out of common law jurisprudence.

However, given the soft law mode of takeover regulation in the UK, the rights afforded to shareholders become critically important. This is because it is these rights, often enshrined in company laws, that offer some degree of shareholder involvement in company decision-making. The question of who corporate governance rights should be designed for has been a much-contested one in the takeover literature. Two organs, the board of directors or the shareholders, are wrestling for the power to determine the outcome of a takeover bid.

Those who defend board frustration rights argue that the board has the skills and expertise to examine the merits of a takeover bid and thus will reject hostile bidders that seek to strip the company of its assets or increase debt levels in the company

(Burrough, 1990). Leveraged buyouts offer support to this argument because they involve high levels of debt, which is placed on the acquired company to repay in a selected period (Gottschalg *et al.*, 2008). This mechanism harms the liquidity of the company and its long-term survival is left in an uncertain state. Those who defend board empowerment during takeovers ultimately believe that the board will try to get the best possible price from the bidders, given their skills and experiences. This is because shareholders generally do not have the technical knowledge to evaluate complex business plans; therefore, they consider the bidder with the highest value for their shares. However, these arguments undermine the conflict of interest argument that underpins shareholder empowerment.

Those who support shareholder empowerment at the onset of a takeover bid base their arguments on the potential conflict of interest that emerge during takeovers. They believe that shareholders must be protected from harmful or self-interested actions by directors. The passivity thesis, for example, by Easterbrook and Fischel (1981) defends the empowerment of shareholders during takeovers on the basis that those who own the shares in the company should have the final decision on whether to accept the bid. While managers recognise that a takeover can improve the target company's performance by reconfiguring assets and exploiting synergies, it indirectly spurs managers to try to fend off such a positive move. This is because the bidders may seek to bring in new managers who they believe will improve the value of the company. The mere prospect of managers losing their positions has an indirect benefit on the company because it will keep managers on their toes, eager to improve financial results and share value to fend off would-be acquirers or to stand a good chance of holding onto their position once the company has been acquired. While the disciplinary nature of the market for corporate control has the potential to limit conflict of interest, its strength will depend on the availability of shareholders' rights either in company law or takeover rules, giving them involvement rights during takeovers.

The decision whether to allow the board of directors to frustrate takeover bids will determine the nature of a takeover system. As the UK does not permit the frustration of takeover bids, comparing the UK system to a system that allows the board of directors to frustrate takeover bids is likely to yield lessons for both systems on how to protect shareholders from conflict of interest during takeovers. Given the aforementioned importance of corporate governance to governments and investors, it is important that a system limits the potential for corporate abuse at the onset of a takeover bid.

5. Shareholders' rights

According to Professor Hu (1997), throughout the twentieth century, increasing shareholders wealth was the sole objective of public companies. There was a general consensus that corporations were economic institutions with an inherited role to serve society but with a sole aim of maximising shareholder value. This prompted the emergence of shareholder value theory to offer much-needed support to other corporate constituents (Williams, 2000). Shareholder value advocated that only after serving shareholders' interests may a company consider the interests of other stakeholders.

Professor Bainbridge (2003) divided the shareholder value theory into different segments. Firstly, the corporate objective should be wealth maximisation for the benefit of shareholders, and secondly, shareholders have the ultimate control over the corporation. Thus, where there is conflict between shareholder value and other stakeholder theories, directors must return to their overarching goal of protecting shareholders' wealth. However, by recognising shareholders as the main constituency, the two theories helped to cement shareholders as the most important participant in the company and the worthy beneficiary of corporate rules and regulation.

Those in support of shareholder value relied on the argument that shareholders are the residual owners because they benefit if fortunes increase and lose out if fortunes do not materialise (Macey, 1999). However, stakeholder theorists such as Professor Margaret Blair counterargued that shareholders are not the only residual risk bearers; even a shareholder with majority shareholding will not solely bear the risks, as the welfare of other participants would be adversely affected by managerial decision-making as well, at least ex post (Blair, 1995). For instance, employees who have invested in firm-specific human capital and suppliers who make firm-specific investments may suffer losses if a company is liquidated due to poor managerial decision-making. As shareholders can do the "Wall Street walk" (Anat and Pfleiderer, 2005) by selling shares, poor corporate performance leaves stakeholders such as employees and supplies with no resort, bound by contract law and no possibility of withdrawing their capital.

Shareholder value received unlikely support in Professor Easterbrook and Fischel's nexus of contract theory. They saw the corporation as a nexus of contracts with many residual claimants contributing to the nexus. This metaphor posits that the organisation is a collection of complex, private, expressed or implied contract-based relations carried out by a range of people in the company (Easterbrook and Fischel, 1989). It offers support to the argument that balancing the interests of all participants can make the decision-making process difficult and lengthy. In addition, concentrating on one goal allows courts to review management conduct with some rationality. Thus, the nexus of contract argument offered support to stakeholder involvement in corporate objectives but also highlighted other dangers attached to such an outcome.

Due to the limitations of shareholder value, the inclusion of enlightened shareholder value theory under the Companies Act 2006 was a momentous development for stakeholder theorists, as it legalised the rights of stakeholders to be considered in the decision-making process. The rise of enlightened shareholder value was due to the demise of shareholder value, which crumbled as environmental and community issues became tangled up with corporate image. However, enlightened shareholder value does not replace the fact that management must first consider shareholders' interests before turning to those of other stakeholders. This is because shareholders' interests are directly linked to the success of a company, namely, to increase shareholder wealth or increase share price. Thus, shareholders in the UK remain the focal point of corporate governance protection, although management must take into consideration other constituents when devising corporate objectives.

In the USA, however, debates over corporate objectives were ongoing before Berle and Means' intervention. The foundation of which can be traced to the 1919 case of *Dodge* v. *Ford Motor Corp*,[10] where it was affirmed that a business is run primarily to make profit.[11] However, the court did not reject stakeholders' interests as part of the corporate objective. The shift to enlightened shareholder value is evidenced by participant statutes that have been enacted in more than 40 US states (Keay, 2011). They have been accompanied by a surge in literature advocating for stakeholder theory. For example, Professor Tung (2008) noted that contracts drafted by creditors more often than not restrict the implementation of shareholder value. Professors Baird and Henderson (2008) recently pointed out that shareholder value is being challenged by the increased financial innovation in the commercial world. In the area of takeovers, cases such as *Paramount Communications Inc* v. *Times Inc* show that directors have no duty to maximise shareholder value, *Paramount Communications Inc* v. *Time Inc* (1989), 571 A. 2d 1140 at 1150 (Del, 1989).

In other jurisdictions, for example Canada, the Canadian Supreme Court recently laid down two important decisions that called for shareholders to consider a wide range of participants when making company objectives rather than primarily focusing on shareholders, *Peoples' Department Stores* v. *Wise* (2004) SCC 68; (2004) 244 DLR (4th) 564; *BCE Inc* v. *1976 Debentureholders* (2008) SCC 69. A recent empirical study of Australian directors showed that they viewed their responsibilities as those pertaining to stakeholders as a body not shareholders alone (Jones *et al.*, 2007). Thus, other Anglo-American countries recognise the importance of including stakeholders in corporate objectives but still regard shareholders as the main constituent that company law seeks to protect.

As a result of enlightened shareholder value provisions, the UK now cuts across practices in Continental Europe where employees are permitted on boards of companies and those in Anglo-American countries. Whether this offers them an economic advantage remains to be seen. For future research, it would be interesting, however, to see whether the UK, by advocating for stakeholder rights, places it in a more favourable corporate governance position above its Anglo-American competitors such as the USA and Australia.

6. Approach to carrying out a comparison

Some researchers have argued that it is not realistic to conclude that the entirety of law (statutory law, case law, legal practice and legal culture) in one country can ever become identical to another (Bebchuk and Roe, 1999). For example, the European Directives on Company Law provides for minimum harmonisation but leaves many gaps and may be applied differently, resulting in many differences among member states (Enriques, 2006). Thus, an overhaul of UK takeover law to move along US lines is not supported by research literature, rather they should cherry-pick rules and practices that could improve corporate governance and takeover regulation in the UK.

To identify what is needed to be learned from US takeover laws and corporate governance, a 1998 Millstein Report on the common principles of corporate governance is used. It looked at what is necessary by way of governance to attract capital and align shareholders' interests with management. The Millstein Report stressed that government intervention is likely to be most effective in attracting capital. However, this can only be achieved by focusing on four essential areas.

Firstly, the protection of shareholders' rights, including the rights of minority and foreign shareholders. The aim is to create fairness and foster the development of stock markets by attracting a range of investors. Secondly, it stressed the timely disclosure of adequate, clear and comparable information on financial performance, corporate governance and corporate ownership. Increased transparency should help investors make informed decisions and judge the performance of the company and its management. Thirdly, the report stressed the need to clarify governance roles and responsibilities and support voluntary efforts to ensure the alignment of managerial and shareholder interests. This is aimed at promoting accountability while the board is responsible for conducting the monitoring. Finally, it stressed the need to ensure that laws and regulation are being complied with. It saw enforcement as a disciplinary mechanism which is likely to promote responsible behaviour. This report was influential in the development of the OECD corporate governance code and subsequent law reforms in the EU.

7. Conclusion

The paper has explored corporate governance and explained why the UK can learn from the USA on takeover regulation and shareholders' rights. In these two similar market economies, the high presence of public companies has made the division between ownership and control a more pertinent issue. This similarity in market structure has been the uniting factor for these two countries and as managers cross-over into either country every year, putting in place an adequate system of regulating managerial conduct has forced these countries to take lessons from each other. Shareholder empowerment and takeovers are two areas in which most of the academic discussions on corporate governance has been largely focused. As shown, takeovers bring agency costs, which shareholders seek to minimise though legal and economic safeguards. Similarly, shareholder primacy under UK takeover law has put the interests of stakeholders under threat. What is surprising, however, given the similarity in market structure, both countries treat shareholders and regulate takeovers differently. In UK, shareholders are the decision-makers during takeovers, whereas the US business judgement rule leaves the decision-making power in the hands of directors. Similarly, shareholders in the UK have more involvement rights as compared to those in the USA.

What has been suggested, however, is for the UK to cherry-pick some of the rules in the USA that can improve corporate governance. The USA is seen as a laboratory for new ideas in corporate law; thus, countries around the world are beginning to model their regulatory ideas around those of the USA. Still, the enlightened shareholder value approach taken to protect the interests of company stakeholders is a legal development the USA can aim to learn from. It remains to be seen whether these two countries will ever have similar corporate laws, but recent trends show that they are moving in the same direction.

Notes

1. [1906] 2 Ch 34.
2. Per Cozens-Hardy LJ at 44. It was endorsed by the House of Lords in *Quin & Axtens* v. *Salomon* [1909] AC 442 and has since received general acceptance.
3. Their observation was evidenced by the trends on increasing company ownership in American. For example, the *American Telegraph* had a meagre 10,000 shareholders in 1901 but by 1931, they had over 645,000 shareholders on their register.
4. The World Bank, Doing Business Report 2011, at 35.
5. In Plato's writings, see, e. g., "The Republic" (390 BC) and "The Laws" (347 BC), are debates concerning the best possible form of government, where he completes his sketch on the form and the institutions (constitution) of the state.
6. Section 172 (1) Companies Act 2006.
7. World Economic Outlook Database: International Monetary Fund (April 2012, accessed 18/02/2012).
8. Guidance on the 8th EU Company Law Directive – Article 41, Europe, September 2010.
9. Commonwealth Association for Corporate Governance (CACG) Guidelines Principles for Corporate Governance (1999).
10. 170 NW 668.
11. 170 NW 684.

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