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The History of Corporate Governance

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Abstract

"Corporate governance" first came into vogue in the 1970s in the United States. Within 25 years corporate governance had become the subject of debate worldwide by academics, regulators, executives and investors. This paper traces developments occurring between the mid-1970s and the end of the 1990s, by which point "corporate governance" was wellentrenched as academic and regulatory shorthand. The paper concludes by surveying briefly recent developments and by maintaining that analysis of the inter-relationship between directors, executives and shareholders of publicly traded companies is likely to be conducted through the conceptual prism of corporate governance for the foreseeable future.

Keywords: corporate governance, board of directors, shareholder activism, agency costs

JEL Classifications: G30, G38, K22, N21

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There is no definitive historical treatment of corporate governance and there may never be one, given the vastness of the subject. Corporate governance has been with us since the use of the corporate form created the possibility of conflict between investors and managers (Wells, 2010: 1251). The history of corporate governance correspondingly extends back at least to the formation of the East India Company, the Hudson's Bay Company, the Levant Company and the other major chartered companies launched in the 16th and 17th centuries. Addressing all relevant aspects of this history in a systematic way would be a daunting challenge. *A History of Corporate Governance Around the World* (Morck, 2005) illustrates the point. Despite being 687 pages in length, the volume only deals with 11 countries and only addresses one corporate governance issue in detail, this being share ownership patterns.

This chapter, rather than surveying the history of corporate governance in a general way, focuses on the process through which debates about managerial accountability, board structure and shareholder rights became channelled through the term "corporate governance". In so doing, it describes how a phrase that only came into vogue in the 1970s in a single country – the United States -- became within 25 years the subject of debate worldwide by academics, regulators, executives and investors. The chapter traces developments occurring between the mid-1970s and the end of the 1990s, by which point "corporate governance" was well-entrenched as academic and regulatory shorthand. The analysis is necessarily American in orientation, given that corporate governance only acquired a strong international dimension in the 1990s. The chapter concludes by bringing matters up to date and by commenting briefly on corporate governance's future.

Corporate Governance Comes on the Agenda

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In the decades immediately following World War II, the U.S. experienced a prolonged economic boom and its leading corporations grew rapidly. Amidst the widespread corporate prosperity, the internal governance of companies was not a high priority (Cheffins, 2009: 6) and the phrase "corporate governance" was not in use (Greenough and Clapman, 1980: 917). With the "managed corporations" that were in the U.S. economic vanguard during this era "managers led, and directors and shareholders followed (Pound 1995: 91)." Boards, absent an outright corporate crisis, were expected to be collegial and supportive of management, a reasonable pre-supposition given that top executives strongly influenced the selection of directors (Seligman, 1987: 330-32). As for stockholders, the retail investors who dominated share registers were "known for their indifference to everything about the companies they own except dividends and the approximate price of the stock (Livingston, 1958: 81)."

The federal Securities and Exchange Commission (S.E.C.) brought corporate governance on to the official reform agenda in the mid-1970s. By 1976, the year the term "corporate governance" first appeared in the Federal Register (Ocasio and Joseph, 2005: 167), the official journal of the federal government, the S.E.C. was beginning to treat managerial accountability issues as being part of its regulatory remit. In 1974 the S.E.C. brought proceedings against three outside directors of Penn Central, a railway which had diversified into pipelines, hotels, industrial parks and commercial real estate, alleging that they had misrepresented the company's financial condition under federal securities law by failing to discover a wide range of misconduct perpetrated by Penn Central executives (Schwartz, 1976: 399-401). Penn Central had gone bankrupt in 1970 with many criticizing its board for its passivity (Seligman, 1982: 536-37).

The discovery in the mid-1970s of widespread illicit payments by U.S. corporations to foreign officials drew the S.E.C further into the corporate governance realm. Few, if any, of the outside directors of the numerous companies involved knew that the firms they were ostensibly directing were paying bribes, due in part to falsification of corporate records of which senior executives were quite often aware (Seligman, 1982: 537). The widespread corporate bribery represented, according to a 1976 S.E.C. report, “frustration of our system of corporate accountability” (Seligman, 1982: 542), and the federal agency resolved numerous cases with settlements where the companies involved undertook to make board-level changes, such as the appointment of additional outside directors and the creation of an audit committee (Sommer, 1977: 130-31). Also, in 1976 the S.E.C. prevailed upon the New York Stock Exchange to amend its listing requirements to require each listed company to maintain an audit committee composed of independent directors and the N.Y.S.E. complied.

The chairman of the New York Stock Exchange said in 1977 the greatest challenge facing U.S. business and private enterprise generally might be “The prospect of pervasive government supervision and control over corporate governance and management (Chicago Tribune, 1977).” Indeed, the S.E.C. held that year six weeks’ worth of hearings into “shareholder participation in the corporate electoral process and corporate governance generally”, receiving in the process information from over 300 corporations, individuals, public interest groups and law firms (Securities and Exchange Commission, 1980: A-1-A-2). Ultimately, though, the S.E.C. refrained from orchestrating major changes, with key reforms being restricted to requiring publicly traded firms to disclose information on the independence of their directors and the use of audit, nomination and compensation committees (Seligman, 1982: 534, 550).

Harold Williams, who was appointed S.E.C. chairman in 1977 by Democratic President Jimmy Carter, made liberal references in speeches to corporate governance and maintained that an “ideal” board would have only one managerial appointee (the chief executive officer) and would establish an audit committee, a nomination committee and a compensation committee. He was reluctant, however, to force his views on the corporate world and instead advocated voluntary reform by corporations (Kripke, 1981: 178; Seligman, 1982: 548-50). Similarly, when in 1980 S.E.C. staff issued a report on the S.E.C.’s 1977 corporate governance hearings (Securities and Exchange Commission, 1980), the report generally refrained from recommending regulatory measures concerning board structure or related governance issues. Corporate governance-oriented law reform was, however, on the agenda elsewhere.

In 1978, Senator Howard Metzenbaum, chairman of the Judiciary Committee’s Subcommittee on Citizens and Shareholder Rights and Remedies, appointed a “blue-ribbon” advisory committee on corporate governance composed of representatives of industry, consumers, shareholders and labor. The advisory committee agreed that improvements in corporate governance were vital to the future of the economic system but failed to achieve a compromise on suitable legislation (Metzenbaum, 1981). Nevertheless, Caspar Weinberger, who served in the Nixon, Ford and Reagan administrations, argued in 1979 that corporate governance had moved from a “fuzzy notion” to a candidate for a major Congressional battle (Chicago Tribune, 1979). Metzenbaum indeed introduced to Congress in 1980 the Protection of Shareholders’ Rights Act of 1980, a bill that prescribed minimum federal standards of corporate law for large public companies and contained provisions mandating an independent director majority on boards, requiring the establishment of audit and nomination committees composed solely of independent directors and giving shareholders the right to nominate candidates for election to the board of directors (Metzenbaum, 1981: 932-33).

Debates in the U.S. about corporate governance were not restricted to the corridors of power in Washington D.C. Ralph Nader, Mark Green and Joel Seligman's *Taming the Giant Corporation*, a 1976 book that likely provided the earliest available theorization of the term "corporate governance" (Ocasio and Joseph, 2005: 167), spelled out a legal image of corporate governance with shareholders electing directors who were authorized to manage the corporation, who in turn would delegate as appropriate to executives serving as corporate officers. Nader, Green and Seligman argued the legal model bore little relation to the practical reality of a dysfunctional "corporate autocracy" oriented around executives where "checks upon management have all but disappeared" resulting in "irrational decisions, hurried decisions, decisions based upon inadequate factual analysis or executive self-favoritism (Nader, Green and Seligman, 1976: 77)." They maintained that corporate governance should be reformed through the enactment of federal laws returning the board to its historical role as internal auditor of the corporation responsible for constraining management from violations of law and breaches of trust (Nader, Green and Seligman, 1976: 119). Their prescription for change resembled that offered by Melvin Eisenberg in an influential 1976 book on corporate law where he advocated without specifically invoking the cause of corporate governance replacing the received legal model of the board with a "monitoring" model where a majority of directors would be independent of management and the primary task of boards would be to foster managerial accountability (Eisenberg, 1976: 164-65, 174-77).

An American Bar Association corporate law sub-committee, animated by "current concerns in areas of public policy and emerging trends of corporate governance", issued in 1976 a *Corporate Director's Guidebook* that recommended that there be substantial outside director representation on boards and that executive directors be excluded from audit, compensation and nominating committees boards established (Subcommittee on the

Functions and Responsibilities of Directors, 1976: 11; Small, 2011: 133). The following year the American Assembly, a Columbia University think tank, issued a report characterized by the *New York Times* as "the first draft of a new constitution for corporations" (New York Times, 1977) that provided the departure point for a 1978 symposium on "Corporate Governance in America". In 1978, the Business Roundtable, a group established in 1974 to represent the views of 180 chief executive officers of major corporations, issued a statement on "The Role and Composition of Directors of the Large Publicly Owned Corporation" that discussed the place of the board in "the corporate governance triad of shareowners/directors/operating management" and acknowledged that boards of public companies should typically be composed of a majority of non-management directors and should establish audit, compensation and nomination committees outside directors dominated (Business Roundtable: 1978: 2089, 2108).

The American Law Institute (ALI), a private organization composed of practicing lawyers, academics and judges that produces scholarly work to clarify and modernize the law, committed itself in principle in 1978 to undertake a project on corporate governance (Seligman, 1987: 342-43; Small, 2011: 135) and followed up by organizing in 1980 a conference co-sponsored with the American Bar Association and the New York Stock Exchange that senior corporate executives, academics, lawyers and government officials attended. There was at the conference a consensus in favor of the ALI's efforts, with business community support arising in part from a belief the ALI could provide, at least in comparison to legislative proposals Congress might come to consider, a restrained response to the events of the 1970s. As one chief executive said, "We're in a period of transition and instability in corporate governance. We might as well have it happen in the way that will remake the corporation in a way we'd like (New York Times, 1980)." A political earthquake would soon mean the business community would be less conciliatory to the ALI project.

Corporate Governance Reform: A 1980s Counter-Reaction

In 1980, William Greenough, trustee of a major pension fund and a director of the New York Stock Exchange, said he believed "the battle over governance is as fundamental as anything that has happened on the corporate scene in decades (Greenough, 1980: 74)." A political shift to the right, exemplified by Ronald Reagan's election to the presidency that year, would rapidly change the parameters of debate and effectively ended the 1970s movement for corporate governance reform. The Protection of Shareholders' Rights Act of 1980 stalled in Congress, and, as Senator Metzenbaum acknowledged in 1981, with Congress having become more conservative, it was unlikely to pass legislation of a similar sort for the foreseeable future (Los Angeles Times, 1981). Likewise, the S.E.C. seemed unlikely to pursue corporate governance reform with great vigour with John Shad, Reagan's choice as chairman, saying in 1981 that his predecessor Harold Williams "was identified very much with corporate governance, and I hope to be identified with capital formation (Wall Street Journal, 1981)." In the early 1980s debates about corporate governance reform correspondingly focused largely on the ALI's corporate governance project (Weiss, 1984: 1). The de-regulatory impulse was in evidence here as well.

The ALI's corporate governance "reporters" – academic members of the ALI drafting on its behalf -- released their first public output, Tentative Draft No. 1, in 1982. The corporate world reacted with horror. While the New York Stock Exchange had co-sponsored the 1980 national conference that set the stage for the ALI project, its board of directors declared its unanimous opposition to Tentative Draft No. 1 being placed on the agenda at the ALI's next annual meeting for ALI members to endorse (Andrews, 1982: 35). The Business Roundtable likewise urged its members to oppose ALI adoption of the Draft and issued a paper strongly criticizing the document (Seligman, 1987: 345).

One explanation for the strong counter-reaction was that, with the threat of federal corporate governance reform having abruptly abated, various business leaders felt they could abandon backing restrained ALI-led change and oppose regulatory reform outright (Seligman, 1987: 345, 359-60). Corporate executives, however, were also alarmed at the content of Tentative Draft No. 1 and feared that ALI policy missteps could be implemented as formal legal doctrine by the courts and by legislators (Bainbridge, 1993: 1049). In particular, concerns were expressed that Tentative Draft No. 1's treatment of directors' duties and litigation procedure would expand markedly the liability risk directors faced (Seligman, 1987: 363-64, 377-78). Also, critics from the business community said that Tentative Draft No. 1, which proposed mandatory rules requiring boards to have a majority of independent directors, to establish audit and nomination committees and to refrain from doing more on the managerial front than overseeing senior executives, failed to make due allowance for beneficial governance innovations already occurring voluntarily in U.S. public companies and for wide variations that could appropriately exist regarding the functioning of boards (Mofsky and Rubin, 1983: 174-76).

ALI critics from the business community had vocal academic allies who were analyzing corporate law from a new, market-oriented "law and economics" perspective (Macey, 1993: 1213). While the reporters on the ALI corporate governance project avoided spelling out explicitly their own normative model of corporate governance (West, 1984: 638-41), Adolf Berle and Gardiner Means' classic *The Modern Corporation and Private Property* (1932) was, consistent with mainstream academic thought in the corporate law area, the intellectual departure point (Mofsky and Rubin, 1983: 180). Berle and Means' contention that ownership had typically separated from managerial control in large U.S. public companies dominated the research agenda of American corporate law scholars for 50 years following its publication, with the inference typically being drawn that without robust

regulation shareholders would be short-changed by powerful executives (Cheffins, 2004: 40-44).

The corporate law academics who initially embraced economic analysis rejected the Berle and Means' inspired pro-regulation orthodoxy that underpinned the ALI corporate governance project at its inception. As Jonathan Macey, a leading law and economics scholar, said, "the law and economics movement was replacing the traditional view that shareholders were helpless pawns ruthlessly exploited by management (Macey, 1993: 1225)." Agency cost theory was highly influential in this context, with economically-inclined corporate law professors (e.g. Fischel, 1982: 1261-64) taking their cue from papers by Jensen and Meckling (1976) and Fama (1980) that offered intellectually elegant accounts of various market-oriented limitations on the exercise of managerial discretion. Law and economics scholars correspondingly criticized the initial ALI corporate governance proposals on the basis the ALI reporters had ignored the pressures market forces exert on those running public companies to establish governance structures that shareholders value (Easterbrook, 1984: 542, 555-57). Law and economics scholars also chastised the ALI for proposing board reform without taking into account empirical evidence on point and for failing to make the case in an explicit or convincing way that fostering litigation would improve on the decisions made by corporate executives or serve shareholders' interests generally (Wolfson, 1984: 632-33, 636-37).

Senior figures at the ALI were initially being taken aback by the firestorm Tentative Draft No. 1 elicited (Manning, 1993: 1325) but the ALI ultimately sought to mollify critics of its corporate governance project. The ALI replaced the chief reporter responsible (Elson and Shakman, 1994: 1763) and added Ronald Gilson, a prominent law-and-economics scholar, as a reporter (Bainbridge, 1994: 1048), while the ALI corporate governance

reporters recast the proposed mandatory guidance on board structure as mere recommendations (Karmel, 1984: 548-49). What E. Norman Veasey, Chief Justice of the Delaware Supreme Court from 1992 to 2004, characterized as a "very responsible process of dialogue and negotiation ensued" (Veasey, 1993: 1267), with management's views being channelled into the deliberative process by CORPRO, a panel of lawyers with close professional connections to the business community (Elson and Shakman, 1994: 1764-68).

Ultimately, the version of the ALI's *Principles of Corporate Governance: Analysis and Recommendations* approved in 1992 and published in 1994 was modified to the point where the contents closely resembled the existing law, meaning even formerly vociferous critics had relatively few complaints (Macey, 1993: 1224, 1232). By this time, however, the deliberations of the ALI had largely receded from wider view, with one law professor observing in 1989 that in relation to problems of corporate governance the "current debate over the ALI project offers no solution because it has bogged down over trivia (Dent, 1989: 902)." Other factors, however, were sustaining and accelerating corporate governance's rise to prominence.

Institutional Shareholders "Find" Corporate Governance

The law and economics scholars of the early 1980s who critiqued the Berle and Means-inspired pro-regulatory orthodoxy maintained that the widely acknowledged tendency of shareholders to eschew active involvement in corporate governance posed few dangers for investors because the market for corporate control combined with other market mechanisms to align substantially the interests of managers and shareholders (Fischel, 1982: 1264, 1267-68, 1276-80; Easterbrook, 1984). This stance was understandable, given the context. The 1980s, sometimes referred to as "the Deal Decade", was exemplified by bidders relying on aggressive, innovative financial and legal techniques to engineer takeover bids offering

generous premiums to shareholders of target companies to secure voting control. Also, as the decade got under way it was widely acknowledged that shareholders were poorly positioned to play a pivotal role in overseeing potentially wayward executives (Kripke, 1981: 177, 193; Hessen, 1983: 288). Even a "shareholder democracy" advocate such as law professor Donald Schwartz conceded in a 1983 paper that "most sophisticated observers" assumed "that shareholder participation is not capable of working well because of its impracticability and because of the rational indifference of shareholders to participation in corporate affairs (1983: 55, 65)."

Shareholders, or more accurately institutional shareholders, would in fact become during the 1980s increasingly logical contenders to play a major corporate governance role. Enhanced voting power was one reason -- the proportion of shares in U.S. public companies institutional investors owned rose from 16% in 1965 to 47% in 1987 and again to 57% in 1994 (Useem, 1996: 25-26). The growth in stakes held by institutional investors also meant it was becoming more common for them to have shareholdings in particular companies that were large enough to preclude them from relying readily on the traditional "Wall Street Rule" and selling out when a company was poorly run (Black, 1990: 572-73; Useem, 1996: 6, 30). Institutional investors correspondingly began to develop a corporate governance agenda during the Deal Decade, with the market for corporate control being the initial setting (Wilcox, 1997: 46-47).

1980s executives, faced with the prospect of unwelcome takeover bids, often reacted defensively (Kahan and Rock, 2002: 74-75). In various instances, companies made "greenmail" payments to buy out putative bidders who had obtained a sizeable "toehold" stake. Companies also commonly introduced management entrenchment devices such as the poison pill to deter hostile takeover offers from being launched. A shareholder-oriented

counter-reaction ensued. In 1984, Jesse Unruh, state treasurer of California was outraged when Texaco, in which the California Public Employees Retirement System (Calpers) held a 1% stake, paid the Bass brothers, a potentially hostile suitor, a 12% premium over the market price, for the Basses' 10% Texaco stake without offering the same opportunity to Calpers or other shareholders (Rosenberg, 1999: 99; Fox, 2009: 271-72). More generally, institutional investors often disposed of sizeable blocks of shares in takeovers and they wanted to protect the option to sell their stock in response to a premium-priced bid (Wall Street Journal, 1989).

Stifling the managerial counter-reaction to takeovers proved to be an uphill struggle. Only rarely were anti-takeover schemes that required a shareholder vote for adoption rejected outright (Black, 1990: 571). More generally, an economic downturn combined with a debt market chill to bring the merger wave of the 1980s to a halt and the deployment of takeover defences, backed by anti-takeover statutes in many states, meant hostile bids were particularly hard hit (Kahan and Rock, 2002: 879-80). When shareholders used litigation to attack the adoption of defensive tactics in the courts, the judiciary generally upheld steps taken if outside directors exercising independent judgment endorsed what was done. This judicial stance helped to entrench the outside director as a key corporate governance player (Gordon, 2007: 1522-25).

Though shareholder efforts on the takeover front ultimately foundered, a shareholder-oriented corporate governance infrastructure nevertheless emerged. In 1985 Unruh and Calpers launched the Council of Institutional Investors (CII), an association of public pension funds, to act as a lobbying group for shareholder rights (Fox, 2009: 272). They did so with the encouragement of Robert A.G. Monks, who had just kicked off within the Department of Labor a controversial policy initiative that would ultimately result in pension fund trustees being under a legal onus to vote shares held (Rosenberg, 1999: 91-93, 99-100, 112-14).

Monks, who fancied himself as "an entrepreneur of the idea of corporate governance", left the Department of Labor in 1985 and established Institutional Shareholder Services as a voting services company that would provide disinterested advice to institutional investors lacking the expertise to vote their shares in an informed manner (Rosenberg, 1999: 118-25). One fund manager had correctly anticipated the career change, telling Monks, "Guys like you, you go into government and start a forest fire and then you come and try to sell us all fire extinguishers (Rosenberg, 1999: 117)."

As the 1990s dawned, institutional investors broadened their corporate governance agenda in various ways. One change was the development and publication of policy statements for use as benchmarks to evaluate directors and boards (Wilcox, 1997: 49). Calpers and other major public pension funds also began urging boards to remove underperforming chief executives, and between 1991 and 1993 boards of prominent companies such as Westinghouse, American Express, IBM, Kodak and General Motors complied (Pound, 1993: 1006, 1059).

During the early 1990s institutional investors additionally began to pressure companies to overhaul existing executive pay arrangements to replace a traditional bias towards "pay-for-size" in favor of pay-for-performance (Dobbin and Zorn, 2005: 189). The message got through, as a dramatic increase in equity-based compensation – most prominently the awarding of stock options – would increase markedly CEO pay-to-performance sensitivity (Gordon, 2007: 1530-31). Moreover, Calpers and other public pension funds, with the backing of various academics, lobbied for the relaxation of rules that reputedly created obstacles to shareholder intervention in corporate affairs (Zalecki, 1993: 840-41). In 1992, following three years' worth of debate, the S.E.C. amended its regulations governing the solicitation of proxies to ensure institutional shareholders discussing privately

particular investee companies would not have to comply with requirements imposed on parties seeking change through the proxy process, such as a potentially onerous obligation to file relevant documentation with the S.E.C. to obtain advance clearance (Wilcox, 1997: 47).

The *Economist* said in a 1993 article entitled "Shareholders Call the Plays", "These are heady days for America's corporate governance enthusiasts (Economist, 1993)." The potential for a rebalanced relationship between shareholders and executives, however, ultimately went unfulfilled in large measure. Public pension funds, which were by some distance the most vocal advocates of corporate governance intervention, constituted only a minority of institutional investors. Other U.S. institutional shareholders – most prominently mutual funds and private pension funds -- shied away from taking a "hands on" corporate governance role (Coffee, 1991: 1292-93; Useem, 1996: 54-61).

Overall, during the 1990s institutional shareholders typically spent only trivial amounts on their governance efforts, rarely acted in tandem when they interacted with companies, routinely disclaimed having the ability to resolve beneficially company-specific policy debates and did not seek representation on corporate boards (Black, 1998). Institutional shareholder activism was correspondingly restricted to participating episodically in behind-the-scenes discussions with executives, demanding periodically shareholder votes on contentious corporate governance practices and voting against policies management supported when a shareholder advisory service recommended doing so (Kahan and Rock, 2007: 1042-45, 1056-57). Regardless, the rise of institutional shareholders in the 1980s and early 1990s sharpened the focus on basic questions concerning the allocation of power within corporations and caused a shift in the vocabulary of corporate governance debate towards shareholders and shareholder returns (Ocasio and Joseph, 2005: 170-71).

And Economists Too

A 2001 *Review of Financial Economics* survey of 25 years' worth of corporate governance literature observed the "sheer volume of papers that have been written on the subject makes the prospect of surveying corporate governance a daunting task (Denis, 2001: 191)." Nevertheless, economists were somewhat late joining the corporate governance bandwagon. A 1981 review of the published proceedings of the American Assembly's 1978 symposium on "Corporate Governance in America" observed "the focus of the book is so alien to the concerns of the academic economist that one's first reaction is to dismiss this book as another example of the mushiness we so often attribute to our colleagues in management (Carroll, 1981: 1168)." In a 1988 corporate governance literature review that provided an annotated bibliography of 110 publications on point, not one was a paper from a major economics or finance journal (Cochran and Wartick, 1988: 36-63).

The fact that economists were relative latecomers to analysis of corporate governance seems odd given that Jensen and Meckling's 1976 paper on agency cost theory is the most widely cited in corporate governance research and Fama's 1980 paper on agency problems is also among the most frequently cited papers in the field (Durisin and Puzone, 2009: 270-72, 281-82). However, these papers did not mention "corporate governance" explicitly and distinguished economist Oliver Williamson remarked in a 1984 article that up to that point in time there had been a "failure to address the economics of corporate governance in microanalytic terms (Williamson, 1984: 1197)." Changing perceptions of the efficacy of the publicly traded company as an organizational form would soon help, however, to marry up economists and corporate governance.

A key theme in the pioneering work on agency costs was to explain how the widely held company thrived in spite of the apparent handicap of a separation of ownership and control, with emphasis being placed on how successfully boards, the market for managerial

talent and the market for corporate control addressed the potential divergence of interest between managers and shareholders (Jensen, 1983: 328-29, 331; Easterbrook, 1984: 543-46). The implicit message, then, was that there was no corporate governance problem to solve, which was why early law and economics scholars drew on agency theory scholarship to critique the ALI's reform efforts. Jensen's 1992 presidential address to the American Finance Association signalled that perceptions were shifting markedly among economists. Jensen said "(s)ubstantial data support the proposition that the internal control systems of publicly held corporations have generally failed to cause managers to maximize efficiency and value" and observed that "(c)onflicts between managers and the firm's financial claimants were brought to center stage by the market for corporate control in the last two decades" while bemoaning "the shutdown of the capital markets as an effective mechanism for motivating change, renewal, and exit (Jensen, 1993: 850, 852, 871)." Jensen correspondingly argued "For those with a normative bent, making the internal control systems of corporations work is the major challenge facing economists and management scholars in the 1990s (Jensen, 1993: 873)."

Growing awareness in the economics fraternity that there was something amiss with publicly traded companies that merited analysis did not guarantee that economists would adopt corporate governance nomenclature as they pursued their research. When the phrase first achieved prominence, it connoted a political structure to be governed and political characterizations of the firm were incongruent with mainstream economic theory (Ocasio and Joseph, 2005: 174). By the late 1980s, however, "governance" was becoming part of economists' lexicon, a trend reflected by Jensen and Jerold Warner using the term multiple times in a *Journal of Financial Economics* paper that served as the introduction for published proceedings from a 1987 conference entitled "The Distribution of Power among Corporate Managers and Directors" (Jensen and Warner, 1988). By the early 1990s corporate

governance was even being characterized as a "rapidly evolving social science (Wall Street Journal, 1993)."

The growing shareholder orientation of corporate governance helps to explain the transition. With institutional investor concerns about takeover defences, board structure and executive pay being cast in corporate governance terms, beginning in the mid-1980s the phrase "corporate governance" became increasingly associated with the preservation and promotion of shareholder value (Ocasio and Joseph, 2005: 174). This resonated with the concerns of economists, who ultimately tended to equate corporate governance with mechanisms designed to ensure suppliers of finance received a satisfactory risk-adjusted return on their investments (Shleifer and Vishny, 1997: 737-38). With the term "corporate governance" additionally offering the advantage of linguistic accessibility, its prominence within economic discourse was duly assured (Ocasio and Joseph, 2005: 174).

Corporate Governance Goes International

During the 1970s and 1980s analysis of corporate governance focused pretty much exclusively on U.S. corporations (Denis and McConnell, 2003: 1). By the early 1990s, the situation was changing and by 2003 there had been "an explosion of research on corporate governance around the world (Denis and McConnell, 2003: 2)." The reorientation of corporate governance analysis along international lines began in the U.S. but quickly gained momentum elsewhere.

Following World War II it was implicitly assumed in the U.S. that the managerial corporation, characterized by executive dominance in a context of dispersed share ownership, was the pinnacle in the evolution of organizational forms (Gilson and Roe, 1993: 873). The dominance of the managerial model, seemingly exemplified by U.S. global corporate success, meant corporate governance arrangements in other countries that differed were largely

ignored. As Ronald Gilson and Mark Roe put it, "Neither laggards nor dead-ends made compelling objects of study (Gilson and Roe, 1993: 873)."

Matters changed as the 1990s began. With faith in the U.S. economy taking a hit amidst recessionary conditions, the competitive threat posed by German and Japanese companies alarmed many and generated a substantial literature exploring the causes of, and proposed solutions to, the ostensible economic decline of the U.S. Corporate governance featured prominently in the discussion, as there was a growing sense that competition existed between governance systems as well as products, with the U.S. often coming out second best (Gilson and Roe, 1993: 873). A key theme was that U.S. corporate executives, compelled by takeovers and related financial market pressures to focus on the next quarter's earnings at the expense of performance over the long haul, were handicapped by "time horizon" problems that did not arise in Germany and Japan due to their having corporate governance regimes focused on long-term relational investment (Porter, 1992; Blair, 1995: 6-7). Boards of U.S. public companies also stood accused of having become counterproductively complacent and detached due to the unusual stability and prosperity America enjoyed following World War II (Johnson, 1990).

Corporate governance would soon come on to the agenda elsewhere. Britain led the way. Corporate governance generally attracted little attention in the U.K. prior to the 1990s, with the term "corporate governance" only being mentioned once in the *Times* newspaper up to 1985 (Times, 1978) and with the *Economist* refraining from using the phrase until 1990 (Economist, 1990). The pattern began to change when the accountancy profession, the London Stock Exchange and the Financial Reporting Council, which regulates accounting standards in the U.K., established in 1991 the Committee on the Financial Aspects of Corporate Governance.

As the Committee's chairman, Sir Adrian Cadbury, acknowledged in his forward to the Committee's 1992 report, the Committee's launch did not catch the headlines but its proceedings would become the focus of unanticipated attention (Committee on the Financial Aspects of Corporate Governance, 1992: 9). One reason was that, soon after the Cadbury Committee was established, a number of prominent British public companies collapsed in circumstances which suggested that a lack of accountability on the part of top executives had contributed to the problems which had arisen. Also, Britain was in the midst of a recession that fostered concern about the country's relative decline in terms of competitiveness, with managerial shortcomings left unaddressed by inattentive boards reputedly causing Britain's economic standing to suffer (Cheffins, 1997: 72).

A *Financial Times* columnist observed in 1999 that "The 1990s have been the decade of corporate governance (Financial Times, 1999)." The momentum was sustained in the U.K. with a 1995 report on executive pay by a blue-ribbon committee chaired by Sir Richard Greenbury (Greenbury, 1995) and a 1998 report by a committee chaired by Sir Ronald Hampel that reviewed the work done by the Cadbury and Greenbury committees (Committee on Corporate Governance, 1998). The 1992 Cadbury Report also achieved notoriety internationally. The Cadbury Committee encapsulated its recommendations in a Code of Best Practice and arranged for enforcement by persuading the London Stock Exchange to add the Code as an appendix the London Stock Exchange's listing rules, with listed companies becoming obliged either to comply with the provisions of the Code or explain why they had failed to do so (Cheffins, 1997: 76-77). The Cadbury Code would soon serve as a model for the development of corporate governance codes in various countries around the world (Cheffins, 2000: 12-13). As the Hampel Report said, Cadbury had "struck a chord in many overseas countries; it has provided a yardstick against which standards of corporate

governance in other markets are being measured (Committee on Corporate Governance, 1998: para. 1.5)."

Interest in the Cadbury Code coincided with a change in tone in debates concerning comparative corporate governance. While the topic first came to prominence when the U.S. was suffering a crisis of confidence, by the mid-1990s the U.S. economy had rebounded smartly. With the U.S. reputedly reaping the dividends of a "golden age of entrepreneurial management (Economist, 1995: 2)," Japan being in the midst of a prolonged and pronounced recession following a frenzied boom in the 1980s and Germany struggling to cope with costly post-unification economic adjustments, the U.S. corporate governance model was suddenly being hailed as the one to follow (Becht, Bolton and Röell 2003: 42).

At the same time the U.S. approach to corporate governance was finding favor the corporate governance "movement" that had begun in the U.S. and had become established in the U.K. put down roots in continental Europe and Japan (Financial Times, 1993). Corporate governance controversies occurring in the mid-1990s at companies such as German shipbuilder Bremer Vulkan, German metals and mining group Metallgesellschaft, the Spanish bank Banesto, French conglomerates Navigation Mixte and Suez and the Italian conglomerate Ferruzzi prompted calls for reform (Berglöf, 1997: 93). Liberalization of capital markets also helped to put corporate governance on the agenda. European firms that were seeking capital to restructure in response to challenges posed by growing cross-border competition turned increasingly to equity markets as a source of funding, meaning they were under an onus to be responsive to the concerns of shareholders (Financial Times, 1996). Institutional investors aiming to diversify their holdings beyond their domestic markets were among the most receptive when European companies tapped equity markets, but there was a *quid pro quo*. American public pension funds, having already emerged as the most vocal

shareholder proponents of better corporate governance in the U.S., took their campaign to Europe and Japan in the mid-1990s, seeking allies from pension funds based elsewhere in so doing (Kissane, 1997).

The process would soon repeat itself elsewhere. Weaknesses in corporate governance arising from family control of major publicly traded companies were cited as a cause of the Asian stock market crash of 1997, prompting calls for legal reforms designed to protect minority shareholders (Asian Wall Street Journal, 2000). Asia's tycoons also found themselves under pressure to adopt a more shareholder-friendly "western" style of business as their reliance on Anglo-American equity capital grew (Economist, 2000). A 1998 report by an Organisation for Economic Co-operation and Development (OECD) advisory group that provided the departure point for the OECD's issuance of corporate governance principles in 1999 confirmed that companies that strengthened their corporate governance arrangements should be advantageously positioned when it came to attracting capital to finance growth (Business Sector Advisory Group on Corporate Governance, 1998: 7, 14). A widely publicized 2000 report by management consultancy McKinsey & Co. did likewise, as it indicated institutional investors would pay a premium of nearly 30% for shares in well-governed companies operating in countries believed to have weak shareholder rights (Financial Times, 2000).

Epilogue

As the 20th century drew to a close, corporate governance had clearly "arrived". In the space of 25 years, a term that U.S. regulators and academic lawyers were just beginning to deploy had become, to quote the 1998 report by the OECD's corporate governance advisory group, a topic "of great international interest and concern" (Business Sector Advisory Group on Corporate Governance, 1998: 7, 14). The tenor of debate admittedly

would soon change markedly. As the 2000s began, the U.S. was riding high. Its corporate governance system seemed to be functioning well and there were various predictions of global convergence along American lines (Cheffins, 2009: 9). Calpers was in the vanguard, using its platform as the most important institutional investor activist in the U.S. to promote better corporate governance by issuing a set of global proxy voting principles (Hawley and Williams, 2005: 1998).

Perceptions changed promptly and dramatically as the 2000s got underway. A sharp stock market decline precipitated by the demise of a "dot.com"-driven bull market in shares and scandals that rocked major U.S. public companies such as Enron and WorldCom discredited the U.S. model of corporate governance domestically and made it much more difficult to sell abroad (Los Angeles Times, 2002). Regardless, corporate governance was well-entrenched as an intellectual construct, both in the United States and elsewhere. A "corporate governance complex", composed of a dense array of public institutions, private firms and academic centers, had emerged that were dedicated to the pursuit of "better" corporate governance (Stevens and Rudnick, 2010). Accordingly, during the financial crisis of 2008 and in its immediate aftermath "corporate governance" would be the term that academics, policymakers, investors and corporate executives around the world would typically deploy when analyzing issues of managerial accountability, board structure and shareholder involvement in publicly traded companies.

Will corporate governance's analytical grip prove to be durable going forward? In 2010, a corporate social responsibility consultant proclaimed corporate governance was "dead. Gone. Pfffft (Richardson, 2010)." This bold claim raises a valid point, which is that it is unclear whether there are major new corporate governance frontiers that remain to be explored. Instead, corporate governance's "core" themes have been well-defined for some

time. As we have seen, board structure has been debated in the corporate governance context since the 1970s. Likewise, since the 1990s shareholder activism has been high on the corporate governance agenda, as has executive pay (Murphy, 2002: 856-57), and corporate governance has had a strong international dimension.

While it may be the case that from an analytical perspective the basic terrain of corporate governance is now well known, a declaration of death is premature. The possibility of conflict between investors and managers has been with us for centuries and will continue to be a matter for concern so long as business activity is conducted through the corporate form. Corporate governance now provides a tested and familiar nomenclature for addressing the issues involved, and a substitute analytical paradigm has yet to emerge. Moreover, corporate governance is unlikely to become moribund from a policy or intellectual perspective. Future economic shocks and corporate scandals will no doubt raise afresh concerns about managerial and corporate accountability. Empirical analysis should also provide fresh insights concerning familiar research questions. For the foreseeable future, then, debates concerning the inter-relationship between directors, executives and shareholders of publicly traded companies seem destined to be conducted through the conceptual prism of corporate governance.

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