

# **Corporate Governance exercised through the delicate balance between Shareholder's rights and Board roles in Europe**

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## **Abstract**

Corporate governance is fundamental to well-run organisations. Accordingly, it is associated with the positive performance of corporations and international best practices. It is the blueprint that helps shareholders scope their activities and engagement within a company, including the role and structures of the Board of Directors (BoD). It is against this backdrop that the BoD is the nexus between executive leadership and corporate governance, a hallmark of an effective functioning corporation and the affirming of an integrative approach. Thus, good corporate governance is arguably an important tool in curbing corporate malfeasance and limiting scandals in corporations. Conversely, poor corporate governance is observed when there are lapses in this relationship between shareholder's rights and board roles. Invariably, this leads to corporate lapses and scandals.

Europe has made strides in corporate governance, through its developing legislative framework. Pursuantly, corporate governance theories exercised in Europe posit ownership and management as key variables to achieving well-run organizations. Thus, central to corporate governance is the principle of separation of ownership and management. In tandem with this view, good corporate governance is achieved through the delicate balance of the rights of shareholders as owners of the company and the roles of directors who have the duty to run the affairs of the company, as enshrined in the Statute governing Company law. The empirical basis for this paper has included collecting data mostly from primary and secondary sources, including literature review on books, articles, caselaws and relevant Statutes. The paper contributes to theory, practice, and policy formulation but specifically, to the importance of shareholders' rights and board roles in corporate governance in Europe. Similarly, policy-makers could find these insights useful to inform evidence-based practices and policymaking

**Key words: Corporate governance, separation of ownership and control, shareholder's rights, board roles,**

## Introduction

Empirical evidence show that the European Union is arguably one of the most successful legal order in Community laws. Community law often seen as an effective way to enhance and strengthen good domestic corporate governance, which is at the heart of the principle of “separation of ownership and control.”<sup>1</sup> Slaughter and Burke-White posits that EU’s single market and legal system may be the best way to go for the application of International law:

“...to the extent that the European way of law uses International Law to transform and buttress domestic political institutions, it is a model for how international law can function, and in our view, will and must function to address twenty-first-century challenges.”<sup>2</sup>

Against this background, it can be argued that international law still has a place in a globalised world, as its name denotes. Thus, the EU has gone a long way in developing the corporate governance framework that is essential in the, “harmonization of corporate governance in Europe.”<sup>3</sup> Corporate governance has made progress in the EU to “adapt to company practices and regulatory developments.”<sup>4</sup> OECD states that: “Corporate governance is one key element in improving economic efficiency and growth as well as enhancing investor confidence.”<sup>5</sup> Good corporate governance is achieved through the delicate balance of the rights of shareholders as owners of the company and the roles of directors who have the duty to run the affairs of the company, as enshrined in the Statute governing Company law.

## Shareholder Rights, Powers and Engagement in Europe

The principle of “separation of ownership and control”<sup>6</sup> has been instrumental in clearly determining the roles between shareholders, who are the owners of the company, and directors who are often the managers of the company. Shareholders primarily exercise their ownership right through appointing of directors and monitoring the conduct of the directors,<sup>7</sup> as provided by the Company law. Further, other identified shareholder rights, as per the Shareholder Rights Directive in EU Commission, include procedural rights involving asking

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<sup>1</sup> Brenda Hannigan, *Company Law* (4<sup>th</sup> edn, OUP 2016) 142.

<sup>2</sup> AM Slaughter and W Burke-White, ‘*The Future of International Law is Domestic (or, The European Way of Law)*’ 2006. 47 *Harvard International Law journal* 327.

<sup>3</sup>International Finance Corporation (IFC) “A Guide to Corporate Governance Practices in the European Union” (2015)  
<[http://www.ifc.org/wps/wcm/connect/c44d6d0047b7597bb7d9f7299ede9589/CG\\_Practices\\_in\\_EU\\_Guide.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/c44d6d0047b7597bb7d9f7299ede9589/CG_Practices_in_EU_Guide.pdf?MOD=AJPERES)>.

<sup>4</sup> Ibid.

<sup>5</sup> The Organisation for Economic Co-operation and Development OECD Principles of Corporate Governance (2004), p 11

<sup>6</sup> Hannigan (n1)

<sup>7</sup> G Proctor & L Miles, *Corporate Governance* (Cavendish Publishing Limited 2003) 47.

questions, tabling resolutions, voting in absentia, and participating in general meetings.<sup>8</sup> The shareholders execute their powers in respect of the principle of “separation of ownership,”<sup>9</sup> as per the Articles determining roles.

## **Board Roles and Powers**

It is common cause that, an effective and well-functioning board enhance company performance. The Board of Directors in the European Union have a “fiduciary duty”<sup>10</sup> and responsibility to carry out the strategic affairs of the company, among others but not limited to the” director’s judgement,”<sup>11</sup> “duty of care,”<sup>12</sup> “duty of loyalty,”<sup>13</sup> owed primarily to the company. Thus, powers of the board are primarily the “control of the company.”<sup>14</sup> Simply put, they have management powers. Whereas in the UK, board members have what is termed as the “universal power,”<sup>15</sup> entrusted to control and manage the company. Executive directors are involved in day-to-day management of the company, non-executive directors not involved in day-to-day running of the company.

The duty of “financial and nonfinancial reporting”<sup>16</sup> remains one of the important roles for the board as expounded in the Guide to Corporate Governance Practices in the European Union. Appropriate checks and balances ensure good governance and harmonizes power dynamics between key stakeholders in a company. Examples can be drawn from; all EU listed companies which have adopted the International Accounting Standards.<sup>17</sup> The Enron case,<sup>18</sup> famously known for its poor governance and unethical conduct, demonstrated how important it is for directors to do their oversight role by asking the right questions and importantly acting on the information obtained.

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<sup>8</sup> International Finance Corporation (IFC) “A Guide to Corporate Governance Practices in the European Union” (2015)  
<[http://www.ifc.org/wps/wcm/connect/c44d6d0047b7597bb7d9f7299ede9589/CG\\_Practices\\_in\\_EU\\_Guide.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/c44d6d0047b7597bb7d9f7299ede9589/CG_Practices_in_EU_Guide.pdf?MOD=AJPERES)>.

<sup>9</sup> Brenda Hannigan, *Company Law* (4<sup>th</sup> edn, OUP 2016) 142.

<sup>10</sup> Ibid.

<sup>11</sup> Klaus J. Hopt and Patrick C. Leyens, Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy, 1 ECFR 135 (2004)

<sup>12</sup> Klaus J. Hopt and Patrick C. Leyens, Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy, 1 ECFR 135 (2004)

<sup>13</sup> Ibid.

<sup>14</sup> Hannigan (n 2).

<sup>15</sup> Ibid.

<sup>16</sup> International Finance Corporation (IFC) “A Guide to Corporate Governance Practices in the European Union” (2015)  
<[http://www.ifc.org/wps/wcm/connect/c44d6d0047b7597bb7d9f7299ede9589/CG\\_Practices\\_in\\_EU\\_Guide.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/c44d6d0047b7597bb7d9f7299ede9589/CG_Practices_in_EU_Guide.pdf?MOD=AJPERES)>.

<sup>17</sup> International Accounting Standards

<sup>18</sup> Enron case is a well-documented scandal on poor ethical leadership and failure in corporate governance

## Board Structure in the EU

European Union has adopted three (3) categories of board structure, namely, unitary board,<sup>19</sup> two-tier board<sup>20</sup> and Nordic board<sup>21</sup> structure. Unitary board<sup>22</sup> structure generally includes executives and Non-executive directors. A board must appoint subcommittees, which will deal with specialised areas of governance, which may include, audit committee, remuneration committee, human resources, etc.

Europe 2020 and the EU Action Plan 2012 are some of the corporate governance reforms intending to enhance corporate governance in Europe. Bodies like The European Confederation of Directors' Associations are very critical for boards in EU. Although the European Commission of 2003<sup>23</sup> modernised the board of directors to adapt to the changing economic environments, however, the issues of interference by shareholders seem to still hover in the background. The Commission seems to advocate for the respect and acknowledgement of the complex relationship between community laws and sovereignty of the member states, thus, "the coexistence of different board models deeply rooted in national legal systems, stating that it would not pursue board-structure harmonization."<sup>24</sup> The complex role between EU laws and national laws was expounded in the case of *CO Sociedad de Gestion y Participacion SA v De Nederlandsche Bank NV*<sup>25</sup> as it was held, "...Member States may be regarded as being authorised by Directive 92/49 art15a(7) to subject the approval by the competent national authorities of proposed acquisitions to requirements that were less restrictive than those laid down by Directive 92/49, provided that the criteria listed in art.15b(1) were met."<sup>26</sup>

## Common elements in EU member states

Disclosing company information frequently is a common feature in EU countries which is seen as a hallmark for transparency and accountability,<sup>27</sup> this has a good effect of boosting investor

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<sup>19</sup>International Finance Corporation (IFC) "A Guide to Corporate Governance Practices in the European Union" (2015)  
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<sup>20</sup> Ibid.

<sup>21</sup> Ibid.

<sup>22</sup> Hannigan (n3).

<sup>23</sup> European Commission. 2003a. *EU Corporate Governance Action Plan*. Brussels: European Commission.

<sup>24</sup> International Finance Corporation (IFC) "A Guide to Corporate Governance Practices in the European Union" (2015)  
<[http://www.ifc.org/wps/wcm/connect/c44d6d0047b7597bb7d9f7299ede9589/CG\\_Practices\\_in\\_EU\\_Guide.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/c44d6d0047b7597bb7d9f7299ede9589/CG_Practices_in_EU_Guide.pdf?MOD=AJPERES)> accessed 19 September 2018.

<sup>25</sup> *CO Sociedad de Gestion y Participacion SA v De Nederlandsche Bank NV*

<sup>26</sup> *CO Sociedad de Gestion y Participacion SA v De Nederlandsche Bank NV (C-18/14)*

<sup>27</sup> Hannigan (n 4).

confidence and stakeholder relationship. Investors are often known for valuing trust which is often based on transparency. Declaration of conflict of interest by directors is also very prevalent in EU member states. Diversity in boards is one of the hallmark achievements, it was adopted that at least 40% of women should form part of the Board in EU countries. Director evaluation and board development are one of the common features within EU member states.

### **Differences in member EU states**

Diversity of board structures is one of the distinct differences observed in corporate governance of the EU. Germany, for instance, adopted a two-tier board structure.<sup>28</sup> In the German Corporate Governance Code,<sup>29</sup> there is a role of a supervisory board included, in contrast to the unitary board structure wherein there is no supervisory board. Some critics argue the lack of clarity in the concept of supervisory board that “while the clear responsibility of the management board is the running of the business, the role of the supervisory board is not clear”.<sup>30</sup> Board size and composition also varies.

### **Strengths and Weaknesses of different forms in achieving transparency and accountability**

The harmonization of corporate governance in EU has sought to strengthen the EU as a single market, thus making for easy trading amongst EU members. The highly industrialised and globalised EU can benefit to corporate governance practices that are unified. Flexibility of choosing any of the board structures or the combination of the two is seen as one of the strengths of the EU corporate governance. Some of the key strengths may include, better access to financing within member states, a lower cost of capital,<sup>31</sup> improved operational performance,<sup>32</sup> increased company valuation<sup>33</sup> and improved share performance,<sup>34</sup> improved company reputation.<sup>35</sup> Effective shareholder monitoring powers can boost investor confidence because owners won't allow directors to behave badly.

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<sup>28</sup> German Corporate Governance Code paras. 5.4.2 and 5.3.2.

<sup>29</sup> Klaus J. Hopt and Patrick C. Leyens, Board Models in Europe - Recent Developments of Internal Corporate Governance Structures in Germany, the United Kingdom, France, and Italy, 1 ECFR 135 (2004).

<sup>30</sup> Ibid.

<sup>31</sup> International Finance Corporation (IFC) “A Guide to Corporate Governance Practices in the European Union” (2015)

[http://www.ifc.org/wps/wcm/connect/c44d6d0047b7597bb7d9f7299ede9589/CG\\_Practices\\_in\\_EU\\_Guide.pdf?MOD=AJPERES](http://www.ifc.org/wps/wcm/connect/c44d6d0047b7597bb7d9f7299ede9589/CG_Practices_in_EU_Guide.pdf?MOD=AJPERES).

<sup>32</sup> Ibid.

<sup>33</sup> Ibid.

<sup>34</sup> Ibid.

<sup>35</sup> Ibid.

In conclusion, whilst it is commendable that the EU has a unified corporate governance, however one of the weaknesses could be that it discourages innovative ways various member states can develop best practices suitable to their own countries. This may potentially undermine the capacity for European companies to innovate and continue to develop best corporate governance practices that serve their business model and help them define “high road” strategies.<sup>36</sup> Too much power on shareholders and thus, leading to interference is seen as one of its weakness. This may lead to ineffective boards due to shareholder interference.

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<sup>36</sup> Ibid