

**TRANSPLANTING THE ANGLO AMERICAN CORPORATE
GOVERNANCE MODEL INTO ASIAN COUNTRIES: PROSPECTS
AND PRACTICALITY**

A Context Statement submitted to Middlesex University in partial fulfilment of
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ABSTRACT

The works in this document illustrate the difficulties in implementing measures based on the Anglo American model to improve corporate governance in four Asian countries; Korea, China, Malaysia and Japan. The evidence shows that corporate governance transformations in these countries have brought about conflict between newly adopted governance mechanisms and the existing domestic environment. I argue that attempts to improve corporate governance through adopting models from foreign jurisdictions cause enormous complications, and that their adoption is often prompted by a flawed belief that they will naturally bring about order to corporate governance in the host country.

The works in this document also explore the impact of transplanting Anglo American employment practices (an important constituent of the Anglo American corporate governance model) on employment relations in Asian countries. Employment relationships in these countries, traditionally characterised by norms of life long employment, promotion and remuneration based on seniority and strong ‘familial’ relations between employers and workers, are increasingly being undermined by Anglo American employment practices which promote certain forms of labour flexibility, erode trust between employer and workers and encourage increasing reliance on formal legal rights to protect interests. I conclude that Asian countries need to ensure that laws and practices which are adopted to advance corporate success are appropriate for their domestic environments.

The works in this document contribute to the study of corporate governance in three ways. First, it contributes to an understanding of the problems and practicalities in implementing the Anglo American model across different national systems. Second, it contributes to the growing literature on this subject in Asian countries, a significant area of growth in the world economy. Third, it generates ideas which may be useful in instigating empirical research to investigate further impacts on Asian corporate governance of the adoption of foreign models.

CONTENTS PAGE

Richard Croucher & Lilian Miles, “The Legal Structuring of Women's Collective Voice in the South Korean Workplace” (2009) *Journal of Contemporary Asia*, 39, 2, 231 – 246

Lilian Miles “Transferring the Anglo American System to South Korea: At What Cost and Are there Alternatives?” (2008), *Bond Law Review*, 20, 2, 71 – 91

Lilian Miles, “The Cultural Aspects of Corporate Governance Reform in South Korea”, (2007), *Journal of Business Law*, 51, 8, 851 – 867

Lilian Miles, “The Application of Anglo American corporate practices in societies influenced by Confucian values” (2006), *Business and Society Review*, 111, 3, 305 – 322

Lilian Miles & Zhong Zhang, “Improving corporate governance in state owned enterprises in China: Which way forward?” (2006), *Journal of Corporate Law Studies*, 6, 1, 213 – 248

Lilian Miles & Miao He, “Protecting the rights and interests of minority shareholders in China: Challenges for the future” (2005) *International Company and Commercial law Review*, 16, 7, 275 – 290

Lilian Miles & Simon Goulding, “Corporate Governance in Western (Anglo American) and Islamic Communities: Prospects for Convergence?” (2010), *Journal of Business Law*, 2, 126 – 149

Lilian Miles, “Waking Up after the 1997 Financial Crisis: Corporate Governance in Malaysia” (2005), *Journal of International Banking law and Regulation*, 20, 1, 21 – 32

Lilian Miles “The Significance of Cultural Norms in the Evolution of Korean HRM Practices” *International Journal of Law and Management*, (2008), 50, 1, 33 – 46

Lilian Miles, “Current Changes in Labour Management and Industrial Relations in Japan and their Impact on Its ‘Stakeholder Oriented’ Governance Model”, *Managerial Law*, (2007), 49, 4, 117 – 128

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TRANSPLANTING THE ANGLO AMERICAN CORPORATE GOVERNANCE MODEL INTO ASIAN COUNTRIES: PROSPECTS AND PRACTICALITY

INTRODUCTION

The Anglo American corporate governance model is generally regarded in American management literature as optimal. Its corporate governance structures, shareholder friendly laws and active capital markets with high levels of disclosure are regarded as mechanisms which can putatively enable ‘global’ standards of efficiency, accountability and transparency to be achieved. The reasons for its superiority being asserted have been attributed to US and UK economic imperialism and consequently, the leading role they have played in framing corporate governance best practices.¹ Many countries outside of the US and UK are strongly encouraged by the international financial community to emulate this model as a means of attracting business.²

The literature discussing whether national corporate governance systems will ultimately converge towards the Anglo American model is voluminous.

Convergence theorists argue that convergence is inevitable for various reasons; firstly, that globalisation is reducing the diversity in corporate governance

¹ In the early 1990s, corporate governance debate centred on how the US could improve its economic success through adopting governance mechanisms from other jurisdictions, such as Germany and Japan. By the mid to late 1990s, however, with the US economy prosperous and the ‘globalisation’ debate taking centre stage, the direction of the debate changed to how other countries could emulate its model in order to recreate its successes. See J Hill, “The Persistent Debate about Convergence in Comparative Corporate Governance” (2005) *Sydney Law Review* 27, 743 – 752.

² On pressures on Asian countries to do so, see HJ Chang, “Globalisation, Global Standards and the Future of East Asia” (2005), *Global Economic Review*, 34, 4, 363 – 378, S Soederberg, “The Promotion of Anglo American Corporate Governance in the South: Who Benefits from the New International Standard?” (2003), *Third World Quarterly*, 24, 1, 7 – 27, PK Liew, “Corporate Governance Reforms in Malaysia: the key leading players’ perspectives”, (2007), *Corporate Governance: An International Review*, 15, 5, 724 – 740, J Glen & A Singh, “Corporate Governance, Competition and Finance: Re-thinking Lessons from the Asian Crisis”, (2005), *Eastern Economic Journal*, 31, 2, 219 – 243.

practices across countries by forcing them to align their governance structures with the most desirable model. Secondly, the expansion by increasingly powerful US-based multinationals of their businesses into host countries is causing local companies to shake free from their customs and traditions, to evolve toward the Anglo American model of governance and operation. Last but not least, such esteem is accorded to the Anglo American model by global investors and markets that companies outside of the US and UK have succumbed to pressures to adopt this model.³

Others however, have strongly opposed the convergence theory, arguing that factors such as culture, legal systems, individual social and political histories and institutional ‘path dependence’⁴ are preventing convergence from taking place.⁵ These scholars posit that different national environments influence companies in different ways in the formulation of strategies to compete in the global economy. Moreover, foreign based multinationals seek legitimacy in

³ See for example, H Hansmann & R Kraakman, “The End of History for Corporate Law”, (2001), *Georgetown Law Journal*, 89, 439 – 468, RJ Gilson “Globalising Corporate Governance: Convergence of Form or Function” (2001), *American Journal of Comparative Law*, 49, 2, 329 – 357, J Coffee, “The Future as History: The Prospect for Global Convergence in Corporate Governance and its Implications” (1999), *Northwestern University Law Review*, 93, 3, 641 – 707, C Jordan, “The Conundrum of Corporate Governance”, (2005), *Brooklyn Journal of International Law*, 30, 983 – 1027, A Dignam and M Galanis, “Corporate Governance and the Importance of Macroeconomic Context” (2008) *Oxford Journal of Legal Studies*, 28, 2, 201 – 243.

⁴ ‘Path dependence’ refers to the idea that institutions evolve only very gradually over time, and that only minor deviations from the path are likely.

⁵ See for example, the works of S Jacoby, “Corporate Governance in Comparative Perspective: Prospects for Convergence”, (2000) *Comparative Labor Law and Policy Journal*, 22, 5, 5 – 32, JN Gordon & MJ Roe (eds), *Convergence and Persistence in Corporate Governance*, (2004), (Cambridge University Press, UK), DM Branson “The Very Uncertain Prospects of Global Convergence in Corporate Governance” (2001), *Cornell International Law Journal*, 34, 321 – 362, M Guillen, “Corporate Governance and Globalisation: Is there Convergence across Countries?” (2000) *Advances in International Comparative Management*, 13, 175 – 204, TA Parades, “A Systems Approach to Corporate Governance Reform: Why Importing US Corporate Law isn’t the Answer” (2004) *William and Mary Law Review*, 45, 1055 – 1158, U Braendle & J Noll, “On the Convergence of National Corporate Governance Systems” (2006) *Journal of Interdisciplinary Economics*, 17, 57 – 81.

host countries and themselves adapt strongly to the environments in these countries, thus ‘hybridising’ their practices. In Germany, where considerable emphasis is traditionally given to co-operative relations between stakeholders and worker protection and welfare, the participation of labour in supervisory boards is still a key corporate governance feature. In France, Italy, Switzerland, Austria, and also in Germany, where banks and regional government are also core players in companies, they have not relinquished their role in corporate governance, despite the rapid growth of capital markets in these countries. In Japan and South Korea, where cultural collectivism and Confucian values dominate, companies organise themselves in such a manner as to provide security and stability for each other.⁶ The adoption of foreign governance models may disrupt the equilibrium and the delicate interdependence between original models of governance and other national elements. Countries which do so may experience loss of efficiency, destabilisation and inconsistency.⁷ In other words, a definite evolution toward one model of corporate governance is very questionable.

The works in this synoptic document have subscribed neither to the ‘convergence’ nor the ‘path dependence’ argument. They simply illustrate the difficulties in implementing measures based on the Anglo American model to improve corporate governance in countries with fundamentally different backgrounds. As will be explained below, many emerging Asian economies have fashioned their laws and practices on the Anglo American model in order to attract business and investment. Many also do so in the belief that these laws and practices can improve corporate governance in their companies. But

⁶ M Guillen, (2000), pp. 227 – 229

⁷ See P Hall & D Soskice, (eds.): *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, (2001), (Oxford: OUP) who use the term ‘institutional complementarities’ to describe the interdependent and mutually supporting nature of a collection of institutional arrangements which together, not only enable comparative advantages for firms, but also steer their performance and economic development in a particular direction. Disruption of one institution disturbs the equilibrium and causes loss of efficiency. See also L Bebchuk & M Roe, “A Theory of Path Dependence in Corporate Governance and Ownership” (1999), *Stanford Law Review*, 52, 127 – 170 and R Schmidt & G Spindler, “Path Dependence, Corporate Governance and Complementarity, (2002), *International Finance*, 5, 3, 311 – 333.

corporate governance transformations in these countries have brought about conflict between newly adopted governance mechanisms and existing national elements. Many of the latter are deeply historically derived and embedded; they cannot be easily reconciled with the Anglo American model. I show across the works submitted here how corporate governance developments through adopting models from foreign jurisdictions cause enormous complications. I conclude that it is misguided to argue that the adoption of foreign governance models will naturally bring about order to corporate governance in host countries, without exploring how transplantation interacts with existing local environments.

The works in Part A of this document concentrated on the issues associated with and actual prospects of transplanting the Anglo American corporate governance model into Asian countries. It also investigated the possibility of whether Asian countries can construct corporate governance models more suited to their economic, social, and political conditions. The works in Part B explored the impact of transplanting Anglo American employment practices (an important constituent of the Anglo American corporate governance model) on the employment relationship in Asian countries. The topic has special significance in Asia because employment relationships in many of these countries have frequently been characterised by norms of life long employment, promotion and remuneration based on seniority and strong 'familial' relations between employers and workers. Although 'employment relations' is a discipline in its own right, I investigate it in the context of corporate governance because the subject gives meaning to the way companies are organised and managed. The works in Part B demonstrated that employment relationships in Asian countries are increasingly undermined by policies based on Anglo American practices which promote certain forms of labour flexibility by legalising lays offs and mass redundancies, cause existing levels of trust between employer and workers to decline and encourage increasing reliance on formal legal rights to protect individual and collective interests.

OVERALL CONTRIBUTION OF WORKS

The works in this document contribute to the study of corporate governance in three important ways. First, and most obviously, they make a critical contribution to an understanding of the problems and practicalities in implementing Anglo American corporate governance across different national systems. Second, they contribute to the limited but growing literature on this subject in Asian countries, a significant area of growth in the world economy. This topic has only recently received attention in western corporate governance literature, despite the increasing importance these countries are playing in global trade. I present an overview of corporate governance developments in four Asian countries, demonstrate why difficulties in transplantation have arisen and emphasise the conflict between foreign models and existing environments. I also show the importance of blending employment practices with national institutions in order to find the most appropriate regime for advancing corporate success. Third, the works generate ideas which may be useful in instigating empirical research to investigate further impacts on Asian corporate governance of the adoption of foreign models. They complement a wide range of existing research which investigates how corporate governance can be improved in Asian countries.

THE EVOLUTION OF MY THEORETICAL PERSPECTIVES

The transplantation issue may be approached from three perspectives – ‘culturalist’ ‘institutional’ and ‘political/historical’ perspectives. My approach initially concentrated on the influence of culture on corporate governance models. The ‘culturalist’ perspective argues that cultural values are central elements which shape corporate governance development. Importantly, unless corporate governance mechanisms are compatible with the cultural traits of the host country, such mechanisms will be ineffective in promoting good management and advancing corporate success. Culture is taken to mean the deeply embedded and resilient values, beliefs, goals and ‘ways of life’ which are held in common among the members of a particular society and which are passed along from one generation to the next. The influential Dutch expert, Geert Hofstede, who investigated the relationship between national cultures

and organisational cultures defines ‘culture’ as the ‘collective programming of the mind that distinguishes the members of one human group from those of another’. In other words, ‘culture’ is synonymous with a system of collectively held values.⁸ Indeed, there is a wide body of recent research on the effect of national culture on corporate governance development, and which stresses its importance in cross country research.⁹ I have gradually however, recognised the significance of the ‘institutional’ and ‘political/historical’ perspectives as alternative ways of understanding the difficulties experienced when transplanting foreign governance models.

The ‘institutionalist’ perspective is a strand of discussion which argues that it is institutions, rather than culture, which determine the nature of corporate governance models. The ‘culturalist’ and ‘institutionalist’ approaches may be

⁸ Hofstede attributed five dimensions to a country’s cultural attitudes – power distance, uncertainty avoidance, individualism v collectivism, masculinity v femininity and time orientation. See <<http://www.geert-hofstede.com/>>. Some of his works exploring cultural differences and their impact on work values in the work place include G Hofstede, *Culture's Consequences, Comparing Values, Behaviors, Institutions, and Organizations Across Nations*, (2001), (Thousand Oaks CA: Sage Publications) and G Hofstede & GJ Hofstede, *Cultures and Organizations: Software of the Mind*, (2004), (New York: McGraw-Hill USA).

⁹ For discussions and case studies on the relationship between culture and corporate governance, see A Licht, “The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems” (2001), *Delaware Journal of Corporate Law*, 26, 1,147 – 205, A Licht, C Goldschmidt & S Schwartz, “Culture, Law, and Corporate Governance”, (2005), *International Review of Law and Economics*, 25, 229 – 255, A Licht, “Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform”, (2004), *Berkeley Journal of International Law*, 22, 2, 195 – 239, BS Tabalujan, “Why Indonesian Corporate Governance Failed - Conjectures Concerning Legal Culture” (2002), *Columbia Journal of Asian Law*, 15, 2, 141 – 171, RM Haniffa & TE Cooke, “Culture, Corporate Governance and Disclosure in Malaysian Corporations” (2002), *Abacus*, 38, 3, 317 – 349, JT Li & JR Harrison, “National Culture and the Composition and Leadership Structure of Boards of Directors” (2008), *Corporate Governance: An International Review*, 16, 5, 375 – 385, T Walker & K Pukthuanthong, “Venture Capital in China: A Culture Shock for Western Investors” (2007), *Management Decision*, 45, 4, 708 – 731, R Dimo & Z Maurizio, “The impact of national culture on corporate social performance” (2007), *Corporate Governance: The International Journal of Effective Board Performance*, 7, 4, 476 – 485, W Qu & P Leung, “Cultural Impact on Chinese corporate disclosure? A Corporate Governance Perspective,” (2006), *Managerial Auditing Journal*, 21, 3, 241 – 264.

complementary rather than mutually exclusive, but that is not my subject here. The ‘institutionalist’ approach assumes that the institutional environment in which an organisation operates strongly influences its policies and practices. Institutions guide, regulate, constrain and interact with the behaviour of organisations. There is no universally accepted definition of ‘institutions’ for the purposes of the theory. They have been used in the ‘formal’ sense; for example, in referring to frameworks of laws or legal regulations. They have also been regarded as ‘organisational’; that is, organisations such as employers’ associations and trade unions. Finally, they have been used in an ‘informal’ sense, referring to norms of behaviour, customs and conventions.¹⁰

Institutional theorists argue that organisations choose a particular form of structure or set of practices either because they would receive legitimacy within the national environment, or because there is little reason to undertake disruptive change in existing host-country arrangements. Institutions do not operate individually, but rather are linked together in systems of ‘complementarities’. Institutional configurations differ very markedly across countries. They also evolve, albeit gradually. This gradual change is ‘path dependency’, meaning that only minor changes and excursions from the historical ‘path’ are likely as institutional configurations adapt to the environment. Viewed from the perspective of ‘institutionalist’ theory, the

¹⁰ Seminal works on institutional theory in their various contexts include D North, *Institutions, institutional change, and economic performance*, (1990), (New York: Cambridge University Press), WR Scott, *Institutions and Organizations*, 2nd edition, (2001), (Thousand Oaks, CA: Sage), R Whitley, *Divergent Capitalisms: The Social Structuring and Change of Business Systems*, (2000), (Oxford: OUP), G Morgan, R Whitley & E Moen, *Changing Capitalisms? Internationalisation, Institutional Change and Systems of Economic Organisation*, (2005), (Oxford: OUP), P Hall & D Soskice, (eds). *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, (2001), (Oxford: OUP), W Powell & P DiMaggio (eds.), *The New Institutionalism in Organizational Analysis*, (1991), (Chicago, University of Chicago Press), P DiMaggio & W Powell “The Iron Cage Revisited: Institutional isomorphism and collective rationality in organizational fields,” (1983), *American Sociological Review*, 48, 2, 147 – 160, B Amable, *The Diversity of Modern Capitalism*, (2003), (Oxford: OUP), LG Zucker, “Institutional Theories of Organisation” (1987) *Annual Review of Sociology*, 13, 443 – 464.

reason why many transplantation initiatives have failed in Asian countries is because their governments have adopted governance models which are inconsistent with their domestic institutions.

The 'institutionalist' perspective regards corporate governance as part of, and as structured by, a country's institutional framework. Hence, the unique institutional arrangement which affect corporate governance practices need to be fully understood. So for example, whether shareholding in companies is dispersed or concentrated is influenced by institutional arrangements such as the extent to which the law protects shareholders from expropriation by company directors and controlling shareholders.¹¹ Similarly, the extent to which institutional shareholders such as private pension funds involve themselves in corporate governance depends on the welfare arrangements and pension provision in their countries. Where the latter are generous and widely available, it is likely that private pension funds will play a lesser role in corporate governance because they will have lower resources. Last but not least, the capacities of banks and financial institutions to engage in long-term relationships with companies depend strongly on national capital market structures, such as whether or not there are active capital markets which can generate capital quickly and easily for companies.

In one of my recent works, I adopted an 'institutionalist' perspective on the development of labour management practices (R Croucher & L Miles, "The Legal Structuring of Women's Collective Voice in the South Korean Workplace" (2009) *Journal of Contemporary Asia*, 39, 2, 231 – 246). In this work, the limitations inherent in the Korean legal framework are examined to explain the reduced possibilities for women to address their problems in the

¹¹ Works by F Lopez-de-Silanes, R La Porta, A Shleifer & R Vishny, "Investor Protection and Corporate Governance", (2000), *Journal of Financial Economics*, 58, 1, 3 – 27 and F Lopez-de-Silanes, R La Porta & A Shleifer, "Corporate Ownership Around the World" (1999), *Journal of Finance*, 54, 2, 471 – 517, for example, suggest that companies in countries in which shareholders enjoy strong legal protection from expropriation by the managers and controlling shareholders of companies tend to have widely held shareholding, conversely, where shareholder protection is poor, companies are typically tightly held.

workplace. Despite the government introducing a range of legislation to rectify the situation, this has had limited impact on employers' practices. Although these laws could be positively complemented by other legislation to ensure that women have a collective voice at work, this has not taken place, reducing the possibilities for women to address their own problems directly.

The theoretical strand which I label 'political/historical' argues that the operation and structure of individual companies is strongly influenced by different political systems. Political factors shape the path taken by companies in the development of their corporate governance regimes, including how companies are regulated, the nature of the relationship between the different organs in the company and the kinds of shareholding structures which exist. Roe,¹² a pioneer of this perspective, (focusing only on the US, the larger continental Europe countries and Japan) argues that political forces account for the difference in choice of corporate governance models. The reason for the variety of corporate governance models which exist today is political environments and the correlation between the two is argued to be powerful. Political forces, such as party systems, political institutions, the orientations of individual governments and ideologies determine the extent to which shareholding is dispersed and the way key players within the company interact with each other.¹³ For example, strong social democracies¹⁴ (Germany, France, Italy) are often linked with weak shareholder rights and ownership dispersion because in such societies, directors look beyond profit maximisation for

¹² MJ Roe, *Political Determinants of Corporate Governance*, (2003), (New York: OUP), MJ Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance*, (1994), (Princeton: Princeton University Press).

¹³ For an argument that the differences in political institutions among these countries may account for much of the variations in Asian corporate governance, see X Wu, "Political Institutions and Corporate Governance Reforms in Southeast Asia" in KL Ho, (ed.) *Reforming Corporate Governance In Southeast Asia: Economics, Politics And Regulations*, (2005), (Institute of Southeast Asia Studies (ISEAS) Publications, Singapore), 16 – 37.

¹⁴ In these countries, governments aim to reform capitalism democratically through state regulation and implementation of policies which ameliorate the social injustice and inefficiencies associated with capitalist economies.

shareholders.¹⁵ Such societies expect directors to cooperate with employees rather than focus solely on shareholders. If the latter wished to ensure that their interests are looked after, then the best way to achieve this is to ensure that their shareholding is concentrated. This explains why such economies have developed corporate governance mechanisms to mitigate the problems created by concentrated shareholding. By way of contrast, the US has had one of the world's weakest social democratic influences (as a result of its specific historical evolution), and the company has been able to flourish in a relatively *laissez faire* environment. Large companies were managed by powerful directors with dispersed and distant shareholders. Banks and other financial institutions were not, under the political environment, granted the right to hold significant amounts of equity to control directors – in fact, they were deliberately fragmented for fear that they would gain too much power. Where social democracy is weak, ownership dispersion could proliferate. This also explains the nature of laws enacted to address perceived agency problems in US companies.¹⁶

All three approaches have some utility when investigating the subject of transplantation and I have drawn on each when examining the appropriateness of transplanting the Anglo American corporate governance model in order to enhance corporate governance standards in the following countries: Korea, China, Malaysia and Japan.

¹⁵ M Belloc & U Pagano, "Co Evolution of Politics and Corporate Governance" (2006), available at

<http://papers.ssrn.com/sol3/papers.cfm?abstract_id=729725>

¹⁶ See also P Gourevitch & J Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance*, (2005), (Princeton: Princeton University Press) who similarly introduce a political element to explain or interpret corporate governance. The authors argue that certain political environments encourage policies that promote dispersed shareholding, while others give rise to concentrated shareholding. Further, in G Miller, "Political Structure and Corporate Governance: Some Points of Contrast between the United States and England" (1998), at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=110515>, the author argues that different political systems give rise to different rules on takeovers and derivative actions.

THE ANGLO AMERICAN MODEL: AN OPTIMAL MODEL?

The Anglo American corporate governance model, based on normative ‘free market’ principles, relies on various pre-requisites for its successful operation – entrepreneurship, free allocation of resources, free trade, competition and self regulation with minimal governmental intervention. The focus of corporate governance is on the relationship between the board of directors and shareholders. The company is managed by a board of directors (in agency theory, the agent), nominally appointed by, and responsible to, shareholders (in the same theory, the principal). However, as shareholding in Anglo American jurisdictions is typically dispersed, shareholders are ineffective in controlling the board. Indeed, in their pioneering 1932 work, Berle and Means¹⁷ created the now well-known ‘agency theory’ and warned of the concentration of power brought about by the rise of the large companies and the emergence of a powerful class of professional directors. Where shareholding is widely dispersed, the typical shareholder is unable to influence the management of the company. The result is that those who can, i.e. directors, have the ability to manage it to their own advantage. They may do it in a way to further their own interests, divert the assets of the company to themselves and disregard the interests of minority shareholders. Unless shareholders possess sufficient shareholdings in the company, they are unable to discipline and monitor directors. The resulting agency problems, including the financial costs, are a major concern to American corporate governance scholars.

To mitigate these problems, various mechanisms are adopted under the Anglo American governance model to align the interests of directors with those of shareholders. Firstly, independent directors are considered an important aspect of corporate governance control, as they can act as the eyes and ears of shareholders and bring an element of objectivity to internal company discussions. Secondly, the law typically imposes on directors various duties to the company, penalising them when they fail to carry out this duty.¹⁸ In

¹⁷ *The Modern Corporation and Private Property*, (1932), (New Brunswick: NJ, 1997, originally published in 1932).

¹⁸ Examples of duties include duties to act in the best interests of the company, exercise their powers for a proper purpose, act with reasonable care and skill

addition, the presence of active capital markets continually exposes companies to the prospect of takeovers – providing a strong incentive for directors to manage the company diligently lest they lose their jobs. Further, shareholders are given the power to commence legal actions against the board in the event of breach of duty. The laws which regulate the legal relationship between directors and their companies and between directors and shareholders are highly developed. American corporate culture is also litigious. Where a dispute arises, parties invoke their legal rights and resort to litigation in order to obtain a remedy. Last but not least, the media, industry and the legal and accountancy professions all undertake an active role in setting appropriate standards for directorial conduct.¹⁹

(1) KOREA’S (CONFUCIAN) CULTURAL CONSTRAINTS

A large volume of literature exists which discusses the nature of economic measures adopted by the Korean government to spur national growth since the 1960s, as well as the subsequent devastating effect of the 1997 financial crisis on its economy.²⁰ I singled out the effects of the crisis on the corporate sector for discussion, because I wanted to demonstrate firstly, how business was

and avoid a conflict of interest and duty. For cases in the UK in relation to these duties (which have been codified in statute), see *Re Smith Fawcett* [1942] Ch 304, *Howard Smith v Ampol Petroleum* [1974] AC 821, *Aberdeen Railway v Blaikie Bros* [1854] 1 Macq 461, *Regal Hastings v Gulliver* [1967] 2 AC 134, *IDC v Cooley* [1972] 1 WLR 443, *Re Barings plc (No 5)* [1999] 1 BCLC 433. These are today codified in the Companies Act 2006, ss. 171 – 178.

¹⁹ For a discussion of the essential characteristics of Anglo American corporate governance (also known as ‘outsider’ or ‘market based’ or ‘shareholder’ model), see T Clarke, “Anglo American Corporate Governance” in T. Clarke, *International Corporate Governance: A Comparative Approach*, (2007), (Routledge: Oxford), 129 – 169, and J Solomon, *Corporate Governance and Accountability*, 2nd ed., (2007), (John Wiley & Sons), 179 – 198.

²⁰ See, as a sample, A Amsden, *Asia’s next giant: South Korea and Late Industrialization*, (1989), (New York: OUP), TY Kong, *The Politics of Economic Reform in South Korea: A Fragile Miracle*, (2000), (Routledge: New York), JG Kim, “The Next Stage of Reforms: Korean Corporate Governance in the Post Asian Financial Crisis Era” (2006) *Asian Journal of Comparative Law* 1, 1, 44 – 67, HC Lim & JH Jang, “Neo Liberalism in Post Crisis South Korea: Social Conditions and Outcomes” (2006), *Journal of Contemporary Asia*, 36, 4, 442 – 463, JM Cho & JH Keum, “Job Instability in the Korean Labour Market: Estimating the Effects of the 1997 Financial

organised before the 1997 financial crisis and how this changed post-1997. Secondly, I wished to illustrate the difficulties experienced in improving corporate governance because reform measures clashed with various cultural aspects of Korean society.

REFORMING CORPORATE GOVERNANCE IN KOREA POST 1997

No meaningful discussion of corporate governance in Korea can take place without the reader being familiar with the large conglomerates which were once the backbone of the Korean economy. Indeed, many attribute Korea's remarkable growth after two devastating wars to the dynamics between the government and these conglomerates. Based on a state led development model, the Korean government exercised full and direct control over the country's economy and social institutions. In pursuing high growth, it selected a small number of big businesses to carry out its developmental plans in return for privileges such as low interest credits and monopolistic licenses. These developed into the Korean *chaebols* as we know them today. I describe how these *chaebols* function in my works (L Miles "Transferring the Anglo American System to South Korea: At What Cost and Are there Alternatives?" (2008), *Bond Law Review*, 20, 2, 71 – 91, L Miles, "The Cultural Aspects of Corporate Governance Reform in South Korea", (2007), *Journal of Business Law*, 51, 8, 851 – 867 and L Miles, "The Application of Anglo American corporate practices in societies influenced by Confucian values" (2006), *Business and Society Review*, 111, 3, 305 – 322). I emphasise the point that

Crisis" (2004), *International Labour Review*, 143, 4, 373 – 392, JY Koo & SL Kiser, "Recovery from a Financial Crisis: The Case of South Korea" (2001), *Economic and Financial Review*, 4, 24 – 36, J Crotty & KK Lee, "Economic Performance in Post Crisis Korea: A Critical Perspective on Neo liberal Restructuring" (2001), *Seoul Journal of Economics*, 14, 2, 183 – 242, EH Kim & WC Kim, "Changes in Korean Corporate Governance: A Response to Crisis" (2008), *Journal of Applied Corporate Finance*, 20, 1, 47 – 58, JW Lee & CY Rhee, "Crisis and Recovery: What We have learned from the South Korean Experience" (2007), *Asian Economic Policy Review*, 2, 1, 146 – 164, JS Shin & HJ Chang, "Economic Reform after the Financial Crisis: A Critical Assessment of Institutional Transition and Transition Costs in South Korea" (2005), *Review of International Political Economy*, 12, 3, 409 – 433, HJ Chang & JS Shin, "Evaluating the Post Crisis Corporate Restructuring in Korea" (2002), *Seoul Journal of Economics*, 15, 2, 245 – 276.

chaebols are organised around Confucian principles.²¹ They are typically founded by one individual, who retained control over them and who passed this control to the eldest son upon his retirement or demise. Their social relations normatively resemble a family, where the employer is regarded as a parent who looks after workers and their families. Management within the *chaebols* is autocratic and dictatorial, with the influence of the founder apparent in how they are led. Decision making is often centralised. In-group harmony, identity with the firm logo and loyalty to employers are characteristics typical of workers, who in turn are rewarded and promoted on the basis of their seniority. These Confucian ethics are said to be responsible for Korea's rapid economic growth.²²

After the Korean government started to pursue economic liberalisation policies in the 1980s, it also started to loosen its hold over the *chaebols* and they were allowed to expand freely. They pursued ambitious expansions that often lacked economic justification. Their practice of cross-shareholding, debt guarantees and vertical integration resulted in extensive networks which prevented them from disposing of unprofitable businesses. Yet, instead of addressing these fundamental problems, the government simply extended funds to them in order to prop them up.²³ Their subsequent collapse (after the 1997 Asian financial

²¹ Particularly helpful resources explaining the power of Confucian doctrine in Asia are D Bell, *Beyond Liberal Democracy: Political Thinking for an East Asian Context*, (2006), (Princeton: Princeton University Press) and D Bell, *Confucian Political Ethics (Ethikon Series in Comparative Ethics)*, (2007), (Princeton: Princeton University Press).

²² Many Asian scholars draw a link between Confucian culture and economic growth, see, as a sample, OY Kwon, "A Cultural Analysis of South Korea's economic prospects", (2005), *Global Economic Review*, 34, 2, 213 – 231, TK Park, "Confucian Values and Contemporary Economic Development in Korea" in T Brook & HV Luong (eds.) *Culture and Economy: The Shaping of Capitalism in Eastern Asia*, (1999), (The University of Michigan Press), 125 – 136, KC Lee, "Back to the Basics: New Interpretation of Confucian values in Korea's economic growth" (1995), *Korea Observer*, 16, 2, 97 – 114, AE Kim & GS Park, "Nationalism, Confucianism, work ethic and Industrialisation in South Korea", (2003), *Journal of Contemporary Asia*, 33, 1, 37 – 49.

²³ A valuable discussion of the history of *chaebols* may be found in SJ Chang, *Financial Crisis and Transformation of Korean Business Groups: The Rise and Fall of Chaebols*, (2003), (Cambridge University Press, UK).

crisis) brought about catastrophic consequences for the Korean economy. As a condition for bailing the Korean economy out, the IMF, to which the government appealed for aid, imposed several conditions, one of which was that its companies had to be restructured along the lines of the Anglo American model.²⁴

The literature discussing economic reform in Korea²⁵ describes in detail the measures adopted by the government to overhaul the way *chaebols* were managed after the financial crisis. This was done in several ways, namely improving their corporate governance, welcoming foreign investors to participate in the local economy, promoting labour flexibility and tightening the financial industry. *Chaebols* were renowned for their multi diversification practices, high levels of debt and because of a centralised and familial style of management, poor levels of internal discipline and oversight. On the basis that they were inefficient entities whose hold on the economy needed to be broken, they were forced to downsize, limit the number of potential affiliates and cut down on amount of debt they could guarantee. Heavy fines were imposed on what was perceived to be ‘unfair’ internal transactions. Laws and regulations based on the Anglo American corporate governance model were introduced to increase corporate transparency and accountability and to align directors’ and shareholders’ interests. The law imposed Anglo American style ‘fiduciary duties’ on directors, required companies to recruit independent outside directors, increased the levels of financial reporting and allowed minority shareholders to commence actions against the board. A corporate governance code of best practice was also introduced.²⁶ Finally, controlling shareholders were forced to accept various disclosure obligations to reveal their interests.

²⁴ This is particularly well discussed in HJ Kim, “Living with the IMF: A new approach to corporate governance and regulation of financial institutions in Korea” (1999), *Berkeley Journal of International Law*, 17, 1, 61– 94, although many of the sources in Footnote 20 also discuss this subject.

²⁵ See for example Crotty & Lee, (2001), Shin & Chang, (2005), Kim, (2006) and Lee & Rhee, (2007)

²⁶ The Code may be viewed at

http://www.ecgi.org/codes/documents/code_korea.pdf .

In addition to overhauling the way *chaebols* were managed, the literature also shows how the government welcomed foreign investment, on the basis that it would constitute the key to successful corporate and financial restructuring.²⁷ Indeed, the government viewed their participation as potentially increasing competition, enabling new managerial methods to be imported and destroying the ability of *chaebols* to block economic reform. With the blame for the crisis laid on *chaebols*, continued reliance on a *chaebol-centred* system to ensure economic growth was seriously questioned. To encourage foreign investment, restrictions on foreign ownership of shares and national assets were removed. The percentage of foreign ownership in the Korean economy quickly increased.²⁸ However, this brought with it two significant consequences – first, the acceleration of Anglo American corporate governance, and second, an increase in mergers and acquisitions.²⁹ Finally, the government streamlined the provision of credit to *chaebols* by restructuring the banking system. Through mergers and acquisitions, the number of banks declined dramatically.³⁰ Rules were introduced to require banks to maintain a Bank for International Settlements (BIS) capital adequacy ratio³¹ of 8% as a condition of lending, a standard many banks found impossible to meet.³² Their credit evaluation systems, prudential regulation and criteria for loan classification and risk management criteria were all brought into line with international standards.³³ This had the dramatic effect of emasculating banks, once core players in the governance of Korean companies.

²⁷ See for example, Lim & Jang, (2006), pp. 445, and Shin & Chang, (2005), pp. 420 – 422

²⁸ I Yanagimachi, “Chaebol Reform and Corporate Governance in Korea” *The 21st Century Center of Excellence Program*, (2004) at < coe21-policy.sfc.keio.ac.jp/ja/wp/WP18.pdf > 1 – 22, pp. 13.

²⁹ *ibid.*

³⁰ Lee & Rhee, (2007), pp. 156 – 157

³¹ The BIS capital adequacy ratio is the measure of a bank’s ability to meet the needs of its depositors and other creditors, expressed as a ratio of its capital to its assets.

³² BS Min, “Changing Pattern of Corporate Governance and Financing in the Korean Chaebols” *Economic Papers*, (2007), 26, 3, 211 – 230, pp. 221 – 222. Indeed, the reform of the financial sector brought about evaporation of external funds to the corporate sector. See Shin & Chang, (2005), pp. 415 – 416.

³³ Lee & Rhee, (2007), pp. 157

Many scholars have blamed the measures taken by the government post 1997 as responsible for the significant costs experienced by the country's financial and corporate sectors, as well as society generally.³⁴ I show that due to variances in culture, reform measures adopted from foreign jurisdictions have proven unsuitable in addressing the problems of a flailing corporate governance regime. The dynastic control by families of Korean *chaebols* presented unusual corporate governance problems which required specially tailored solutions; the answer did not lie simply in transplanting laws from other jurisdictions in the hope of reproducing their successes. Thus, simple mimetic adoption of these laws has proved inadequate.

FAILED REFORM MEASURES

I explain in two of my works (L Miles, "The Application of Anglo American corporate practices in societies influenced by Confucian values" (2006), *Business and Society Review*, 111, 3, 305 – 322 and L Miles "Transferring the Anglo American System to South Korea: At What Cost and Are there Alternatives?" (2008), *Bond Law Review*, 20, 2, 71 – 91) how the new corporate governance regime presented challenges which were not readily understandable to a Korean society influenced by Confucian values. I illustrated this by using some examples. Thus, the recruitment of independent directors in Korean companies was problematical, given the nature of their tasks. The need for independent directors to behave without prejudice and in a normatively 'objective' manner was viewed as unacceptable in a culture where conformity was expected. Similarly, *chaebols* experienced difficulty in meeting disclosure obligations under the new regime. Traditionally, there was little need to make disclosures to shareholders in Korean companies for the simple reason that there were few outside shareholders. Companies were owned and managed by controlling shareholders, who were also their founders. Thirdly, the company, traditionally viewed as a support network for workers, disintegrated, in the face of increasing legislation being enacted to legalise lay offs, redundancies and increase reliance on casual and irregular workers. The

³⁴ See for example, Lim & Jang, (2006), Crotty & Lee, (2001), Kim, (2006), Cho & Keum, (2004), Chang & Shin, (2002).

loss of a sense of community and trust in society, increasing inequality between core and casual workers, job insecurity and the low morale which resulted were said to be liable to raise transaction costs and adversely affect the Korean economy in the future.³⁵ Fourthly, the financial crisis brought about significant changes in the role of banks, traditionally key players in the economy. In the previous institutional framework, the state, banks and business groups shared the risks involved in managing the economy. As a result of restructuring and mergers in the financial industry, however, the risk taking role was removed from the state and *chaebols* (in the latter, by banning internal transactions, mutual guarantees and cross shareholding) and given over to financial institutions, despite the fact that their own risk-taking capability was also severely constrained. The primary concern of these institutions was now to meet newly introduced supervision standards, which in general penalised corporate lending. They thus had little incentive to take high risks in lending or resolve problems of bad loans by turning troubled companies around, tending instead, to sell poorly performing firms at a discounted price or liquidating them. All in all, reform measures have brought little but malfunction to the Korean financial industry.³⁶ Finally, Koreans traditionally lived their lives in pursuit of harmony. Confucian societies were not litigious. Disputes were solved through mediation and negotiation, not through the court system. Moreover, as directors were often related to controlling shareholders, few instances arose where legal action was taken against the former for misconduct or breach of duties. Individuals and businesses also dealt with each other only after getting to know each other and establishing trust. Unlike business relationships in the west, businesses in Korea did not typically rely on contract or legal rules to conclude business deals. It was thus unsurprising that there has traditionally been little need for black letter law, attorneys or a sophisticated judicial system. Indeed, despite moves to encourage shareholder intervention in the company by strengthening their legal rights, shareholder involvement has continued to be modest. They have experienced difficulties in tackling poor governance practices not only because the board continued to enjoy the

³⁵ Kwon, (2005), pp. 223 – 227

³⁶ Shin & Chang, (2005), pp. 426

support of controlling shareholders, but because they could not obtain the information they needed, or count on support from other shareholders. Even when they have commenced legal action against they board, they have only obtained relatively modest remedies. Korean judges are traditionally generalists, with no expertise in dealing with company or securities cases.³⁷ In summary, the adoption of corporate governance measures based on foreign models has not proved cost effective and has not brought about the anticipated results.

THE FUTURE

I also highlight (in L Miles “Transferring the Anglo American System to South Korea: At What Cost and Are there Alternatives?” (2008), *Bond Law Review*, 20, 2, 71 – 91), the work of Korean scholars who argue that the Korean government should have modernised the traditional model (building on its strengths and minimising its weaknesses), not break with it.³⁸ The perspectives of the Korean people themselves with regard to the reform measures adopted after the 1997 financial crisis have received little attention in conventional corporate governance literature in the west. This is a gap which I fill. Many Korean scholars argue that the reform process was not carried out in a manner which met the needs of the Korean people. For example, given the historical importance of banks in corporate governance, it might have been more effective to introduce mechanisms to increase their efficiency as management monitors, rather than taking away their ability to do so by radically restructuring them. Secondly, despite their weaknesses, one of the strengths of *chaebols* was their ability to take business risks, due to financial and resource

³⁷ Indeed, even with radical changes to the corporate governance system, it is argued that problems still remain with regard to the extent of power which controlling shareholders wield over the company, weak public and private enforcement of laws, poor levels of shareholder activism and weak capital markets. See JG Kim, (2006), 28 – 34.

³⁸ See for example, Crotty & Lee, (2001), HJ Park, “After dirigisme: Globalisation, Democratisation and the Still faulted State and its social discontent in Korea” (2002), *The Pacific Review*, 15, 1, 63 – 88, MG Kang, “Globalisation of the economy and localization of politics? Restructuring the developmental state via Decentralisation in Korea” *Korea Journal*, 2006, 46, 4, 87 – 114.

support networks between companies. But the prohibition on internal transactions in *chaebols* drastically reduced their ability to support new ventures. Rather than ban internal transactions altogether, would it not have been more pragmatic to increase company transparency or to strengthen the right of minority shareholders to monitor these transactions?³⁹ Thirdly, the desire for foreign capital must be set against potential costs. Foreign investors typically prioritise the maximisation of short term profit. It has been argued that this is at variance with the Korean ethic of prioritising long term growth.⁴⁰ Finally, despite various claims that capital markets can carry out a disciplining function, their effectiveness in doing so has not yet been demonstrated in Korea, not least because a large proportion of the affiliates of *chaebols* remain unlisted. Due to the practice of cross shareholding, it is still possible for owner directors to accumulate control and voting power despite an apparently low level of ownership. This, coupled with poor levels of disclosure, has continued to protect their position and has restricted the ability of the capital markets to exercise a disciplining function.⁴¹

Overall, it is misguided to regard the implementation of the new regime as a cure for corporate governance failure in Korean companies. Perhaps recognising the benefits traditional corporate structures can bring, the government recently eased restrictions on *chaebols* so they may invest more in their affiliates. New regulations were introduced to relax the cross shareholding limit and allow *chaebols* to hold up to 40% in affiliates. Despite criticisms that these measures would pave the way for *chaebols* to dominate the economy once again, the government insisted that the revision would encourage corporate investment in the current climate of economic

³⁹ Chang & Shin (2002), pp. 270

⁴⁰ Shin & Chang, (2005), pp. 429

⁴¹ See BS Min, (2007), in which the author argues that the financial system in Korea has moved from mainly R (relationship)-mode financial contracts towards M (market)-mode contracts since the 1997 financial crisis, due to reforms introducing Anglo-American style corporate governance. However, the effectiveness of this change in improving companies' performances has yet to be demonstrated.

uncertainty.⁴² It is also anticipated that the government will remove restrictions on *chaebols* owning banks, counteracting recent attempts to reform the financial sector.⁴³ Thus, despite the Anglo American corporate governance model being touted as the solution for corporate and economic revival, it has not proved to be an antidote to Korean corporate governance failure, because many of the practices promoted under the model have proved unsuitable in a fundamentally different culture.

(2) CHINA: A FORMALLY COMMUNIST POLITICAL ENVIRONMENT

I investigate the wealth of literature which discusses the development of corporate governance in China⁴⁴ in my works (L Miles & Z Zhang, “Improving corporate governance in state owned enterprises in China: Which way forward?” (2006), *Journal of Corporate Law Studies*, 6, 1, 213 – 248 and L Miles & M He, “Protecting the rights and interests of minority shareholders in China: Challenges for the future” (2005) *International Company and Commercial Law Review*, 16, 7, 275 – 290). Since 1978, various reform measures have been implemented to enable the Chinese economy to progress from a centrally directed economy to one in which elements of ‘free markets’ can play a role. A central theme of the reform programme has been to improve the performance of state owned enterprises (SOEs), which, prior to the adoption of market based reforms, were both unprofitable and inefficient. The government undertook to make SOEs more productive by converting them into companies with separate legal identities (arrangements based on Anglo

⁴² JA Song, “Bill eases limits on power of chaebol”, *The Financial Times*, April 3, 2007, pp. 6

⁴³ JA Song, “S Korean pledge to transform economy” *The Financial Times*, March 24, 2008, pp. 1, JA Song, “S Korea leader vows to hit growth target” *The Financial Times*, March 24, 2008, pp. 4

⁴⁴ For a sample, see YW Wei, “An Overview of Corporate Governance in China” (2003), *Syracuse Journal of International Law and Commerce*, 30, 23 – 48, OK Tam, “Ethical Issues in the Evolution of Corporate Governance in China” (2002), *Journal of Business Ethics*, 37, 3, 303 – 320, S Voß & YW Xia, “Corporate Governance of Listed Companies in China” in C Vidya, *Corporate Governance: Policy Perspectives*, (Amicus Books: The Icfai University Press, Hyderabad, India), 2007, Chapter 8 and G Wei, “Ownership Structure, Corporate Governance and Company Performance in China” (2007), *Asia Pacific Business Review*, 13, 4, 519 – 545.

American corporate practice). It believed that corporatisation would improve SOE productivity and performance, allow them to generate income from other avenues and increase overall wealth. Many SOEs were converted into public companies and listed on China's stock exchanges. In theory at least, they would become independent (of the state), be able to make their own decisions and be responsive to market forces. The number of listed companies expanded rapidly, as did the number of registered investors. Today, over 1600 companies are listed on China's stock exchanges,⁴⁵ virtually all having been converted from SOEs. Within a short space of time, the corporate landscape in China changed remarkably.

Whether or not measures based on the Anglo American model have improved SOE governance and productivity is the subject of contention among scholars of Chinese corporate governance. I show that the adoption of measures based on the Anglo American model has not worked to improve governance because corporate governance reform is incompatible with the country's political environment. Many of the problems experienced relate to state ownership of shares. Under the communist system, the state owns all property on behalf of the people – the Chinese economy continues to be characterised by this feature. Despite ongoing plans to reform the economy along the lines of 'free market' principles, and although other forms of ownership including private ownership have gradually been allowed, the state continues to control the reform process through its ownership of companies.⁴⁶ Thus, despite converting SOEs into listed companies, the state continues to control them. Empirical research shows that the direct and indirect control of companies by the state is very substantial;

⁴⁵ See China Securities Investor Protection Fund Corporation (CSIPF), 24 September 2009, at <http://www.sipf.com.cn/en/chinassecuritiesmarketoverview/organisations/index.shtml>

⁴⁶ The Communist Party and the Chinese Constitution continue to provide that state ownership should be a dominant feature in the economy. On ownership structures in Chinese listed companies, see Wei, (2007), pp. 520 – 526. The author describes the different kinds of shares which exist and gives an account of state ownership in listed companies in different industries.

the state owns up to two thirds of the total issued shares in China.⁴⁷ Various reasons exist for state control, but the desire to maintain employment levels, control sensitive industries and ensure social stability feature highly.⁴⁸ That the state as majority shareholder has several negative connotations for corporate governance, is widely asserted in ‘free market’ literature.⁴⁹

I show how corporate governance problems have arisen because the state, as majority shareholder, has not exercised its right to monitor management. As the state has no physical presence in its companies, it has to act through agents. However, these are typically civil servants recruited from government departments, not capitalists interested in the economic performance of companies. Crucial company-related functions are thus liable to be performed without adequate care. For example, as civil servants do not benefit from appointing competent directors nor bear negative consequences if they appointed unsuitable ones, there is little incentive for them to employ the best individuals for the job. In many cases, directors themselves have associates in

⁴⁷ Shi, (2007), at 862. See also R Tomasic & N Andrews, “Minority Shareholder Protection in China’s Top 100 Listed Companies” (2007), *The Australian Journal of Asian Law*, 9, 1, 88-119 who show the considerable influence the state as majority shareholder over the governance of companies, despite the presence of laws protecting minority shareholders. Further, see G Liu & P Sun, “Ownership and Control of Chinese Public Corporations: A State Dominated Corporate Governance System” in K Keasey et.al. (eds.) *Corporate Governance: Accountability, Enterprise and International Comparisons*, 2005, (Chichester: John Wiley & Sons), Chapter 16.

⁴⁸ D Clarke, “Corporate Governance in China: An Overview” (2003), *China Economic Review*, 14, 4, 494 – 507, pp. 495.

⁴⁹ See for example, A Shleifer & RW Vishny. “Politicians and Firms” (1994), *Quarterly Journal of Economics*, 109, 737 – 783, M Boycko, A Shleifer & RW Vishny, “A Theory of Privatisation” (1996), *Economic Journal*, 106, 309 – 319, A Krueger, “Government Failures in Development” (1990), *Journal of Economic Perspectives*, 4, 3, 9-23, E Chang & S Wong, “Political Control and Performance in China’s listed firms” (2004) *Journal of Comparative Economics*, 32, 4, 617 – 636, C Xu, T Zhu & YM Lin, “Politician control, agency problems and ownership reform: Evidence from China” (2005), *Economics of Transition*, 13, 1, 1 – 24, JQ Qiu, “Corporate Governance in China: From the Protection of Minority Shareholders Perspective” (2005), at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=905170>, L Chen & DW Su, “Does State Control Affect Managerial Incentives? Evidence from China’s Public Listed Firms” (2009), *Journal of Business Economics & Management*, 4, 291 – 311.

the Communist Party as well as in governmental departments, and derive support from them. Despite the law imposing various duties and responsibilities on directors, they have little fear of being dismissed for mismanagement. Embezzlement of corporate property is rife, with directors openly benefiting themselves and their cronies. Secondly, state appointed directors prioritised the achievement of state-set targets rather than maximising profit for the enterprise.⁵⁰ This gives rise to problems for corporate governance. Where civil servants are the same persons as company directors, they are bound by the constraints set by government policies. The objectives of the government (maintaining social stability, ensuring full employment and preserving control over sensitive industries) often come into conflict with the interests of the company as a business enterprise. Thirdly, as authority to direct the company is shared among many different regulatory bodies, institutions and ministries, no one is directly accountable for its failures.⁵¹ In response to these problems, the government set up an asset management agency (SASAC – State-Owned Assets Supervision and Administration Commission) in 2003 to consolidate the functions previously shared by these agencies, such as carrying out ownership functions on behalf of the state, reorganising SOEs, appointing directors and carrying out audit functions. The intention was for the large numbers of SOEs to be restructured to reduce their number, so as to increase competitiveness and efficiency. To date, however, SASAC has only achieved limited success, in large part because acting both as owner and regulator creates conflicts of interest.⁵²

Research emanating from those within the ‘free market’ tradition argues that state ownership weakens corporate governance.⁵³ To improve corporate

⁵⁰ For a discussion of these and other governance problems in Chinese companies, see Chang & Wong, (2004), Xu, Zhu & Lin, (2005), Chen & Su, (2009).

⁵¹ Voß & Xia, (2007), pp. 13 – 14

⁵² CX Shi, “Recent Ownership Reform and Control of Central State-Owned Enterprises in China: Taking One Step at a Time” (2007), *The University of New South Wales Law Journal*, 30, 3, 855 – 866.

⁵³ See the sources in Footnote 49. Additionally, this is also discussed in W Shen & C Lin, “Firm Profitability, State Ownership, and Top Management Turnover at the Listed Firms in China: A Behavioral Perspective”, (2009), *Corporate Governance*, 17, 4, 443 – 456, SO Wu, NH Xu & QB Yuan, “State

governance in Chinese companies, many have called for state ownership of shares to be transferred to private investors. Thus, the state's dual role of controlling shareholder and holder of political power should be separated. In terms of financial performance, the literature suggests that companies with dominant state ownership performed worse compared to those without dominant state ownership. The literature also indicates that changes to company value and financial performance were much greater when ownership was transferred from SOEs to private entities than when ownership was simply transferred from one SOE to another. Improved performance after ownership was transferred to private investors indicates, it is suggested, that private investors were better equipped and had greater incentive than SOEs to monitor and discipline directors.⁵⁴ In responding to these arguments, the government relaxed the prohibition on the trading of state shares in 2005. At the end of 2004, non-tradable shares accounted for 65% of total shares in the Chinese capital market.⁵⁵ Virtually all listed companies in China have today been able to dispose of state owned shares on the markets,⁵⁶ although it is anticipated that restrictions on the extent to which such shares can be traded freely will remain for several more years. It is envisaged that governance problems caused by the non-tradability of shares will diminish quickly. It may well also be the case that state shares will be sold to private investors on the open market, which will lead to a more efficient market for corporate control.

Control, Legal Investor Protection, and Ownership Concentration: Evidence from China", (2009), *Corporate Governance*, 17, 2, 176 – 192, G Wei, "Ownership Structure, Corporate Governance and Company Performance in China" (2007), *Asia Pacific Business Review*, 13, 4, 519 – 545, V Nee, S Oppen & S Wong, "Developmental State and Corporate Governance in China" (2007), *Management and Organisation Review*, 3, 1, 19 – 53, Y Li, YF Sun & Y Liu, "An empirical study of SOEs' market orientation in transitional China", (2006), *Asia Pacific Journal of Management*, 23, 1, 93 – 113

⁵⁴ H Berkman, R Cole & J Fu, "Improving corporate governance where the State is the controlling block holder: Evidence from China", (2007), at < http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1020170 >.

⁵⁵ China Securities Regulatory Commission, *China's Securities and Futures Markets* (2006) at <<http://211.154.210.238/en/jsp/detail.jsp?inford=1153810173100&type=CMS.STD>>

⁵⁶ Shi, (2007), pp. 862 – 863.

Although the Chinese state may, for political reasons, maintain control of its companies, I argue in my works that there are other (albeit limited) ways in which corporate governance can be improved even within this framework. These include strengthening the rights of minority shareholders (the law already enables cumulative voting and the commencement of derivative actions, but it is ambiguous), encouraging institutional shareholder activism (institutional shareholders are still low in numbers because of the non-tradability of state owned shares) and strengthening the monitoring capacity of independent directors through education and training. Within the existing company law framework, laws can also be strictly enforced in order to deter directors from engaging in corrupt activities or embezzlement. Public regulators and the judiciary need to understand the rationale of the reforms and fulfil their law enforcement duties accordingly. Professional directorial associations can also be set up in order to set standards, guide and educate directors so they can discharge their responsibilities efficiently. I point out in my works that to date, inadequate attention has been given to these measures to improve corporate governance.⁵⁷

In summary, I suggest that Chinese corporate governance derives its features from China's political orientation. The state continues to hold a controlling stake in its companies, formally on behalf of the people. Attempting to reform corporate governance in this context by adopting the Anglo American model raises inherent tensions and difficulties. Indeed, it said that "*it is particularly difficult for the Chinese legal system to borrow from Western jurisdictions because the Chinese system, as a result of its history... is concerned more with the balancing of interests than with the vindication of rights.*"⁵⁸ The Chinese system revolves around the supremacy of the state. So long as it refuses to relinquish its shareholding in its companies, the adoption of measures from the Anglo American corporate model (recruitment of business-oriented individuals to manage the company, the establishment of active markets for corporate

⁵⁷ See also Wei, (2007), pp. 540 – 542 and Voß & Xia, (2007), pp. 20 – 25

⁵⁸ D Clarke, "Lost in Translation? Corporate Legal Transplants in China" (2006), 1 – 22, pp. 2, available at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=913784>

control, strengthening the rights of minority shareholders, encouraging shareholder activism, the pursuit of profit etc.) are unlikely to work to improve governance standards. All in all, it may be that the obsession with adopting the Anglo American governance model has not led to sufficient regard being given to whether its specific variant of communist ideology is compatible with this model.

(3) WHERE RELIGION DOMINATES: MALAYSIA

Countries with an Islamic tradition (for example, United Arab Emirates, Malaysia, Brunei, Pakistan, Indonesia and Turkey) are, like all others, subject to pressures to attract investment or be competitive in global markets. Within these countries, Islam wields a significant influence over all aspects of life. Many of these countries have adopted governance templates based on the Anglo American model. But how appropriate are these measures in improving corporate governance within their companies? I explore the compatibility between Islamic and Anglo American values in Malaysia. Malaysia presents an interesting case study, because it is both an Islamic country *and* one regarded as modern and forward looking. It is also home to many multinationals and foreign investors. Thus it constitutes fertile ground in which to study the application of the Islamic faith to a business environment influenced by western values.

ISLAMIC TEACHINGS

I describe in my work (L Miles & S Goulding, “Corporate Governance in Western (Anglo American) and Islamic Communities: Prospects for Convergence?” (2010), *Journal of Business Law*, 2, 126 – 149) the principles upon which Muslims are required to conduct business. I also explain that the extent to which a business framework based on *religion* is compatible with that of the Anglo American model is attracting growing academic interest. Primarily, this is because of increasing trade between Islamic countries and the West, but also because many scholars are arguing that western business principles lack a moral dimension and are advocating a new kind of business conduct (based on Islam) by demonstrating positive associations between religious faith and business transactions. The continuing uneasy relations

between the Middle East and the West have led many Islamic thinkers to debate the likelihood of finding common ground between Islamic and Western values. Indeed, the question of whether or not the Muslim community engages with a world dominated by Western secular values has been propelled to centre stage recently by the rise of Islamic movements determined to resist Western domination and control over Muslim territories. In the light of these developments, it is timely to investigate the compatibility between Islamic values and Anglo American corporate governance.

Islam requires all Islamic organisations to serve God and develop a culture which advances Islamic objectives. Islam does not discourage or prohibit trade, business or the creation of wealth; on the contrary, business is regarded as socially useful and morally justified.⁵⁹ However, it introduces a moral filter to which wealth creation is subject. In other words, individual freedom to pursue economic activity does not operate without a sense of responsibility and Muslims are required to observe certain restraints when carrying out business. Although pursuing material wealth is not wrong, wealth has a corrupting effect, and if pursued without restraint, will distract Muslims from achieving spiritual and material well being.⁶⁰ Thus businesses are required to fulfil a moral duty toward their stakeholders, such as their workers, and to the environment.⁶¹ Muslims are also required to give alms to help the poor and needy in society.⁶² Perhaps most significantly, the Islamic business system emphasises ‘value’ maximisation for the greater good, rather than ‘profit’ maximisation for the

⁵⁹ K Ahmad, “The Challenge of Global Capitalism: An Islamic Perspective” (2003), in J Dunning (ed.), *Making Globalisation Good*, (Oxford Scholarship Online Monographs), 181 – 209, pp. 192, SJ Uddin, “Understanding the Framework of Business in Islam in an era of Globalisation: A Review” (2003), *Business Ethics: An European Review*, (2003), 12, 11, 23 – 32, at pp. 26, 31

⁶⁰ R Wilson, “Islam and Business”, (2006), *Thunderbird International Business Review*, 48, 1, 109 – 123, pp. 114

⁶¹ R Beekun & J Badawi, “Balancing Ethical Responsibility among multiple organisational stakeholders: The Islamic Perspective” (2005), *Journal of Business Ethics*, 60, 131 – 145, pp. 139 and 142 – 143

⁶² MK Lewis, “Islam and Accounting” (2001), *Accounting Forum*, 25, 2, 103 – 127, pp. 118.

satisfaction of a few.⁶³ Businesses which prioritised profit are regarded as wasteful, liable to encourage divisiveness between those who can afford products and services and those who cannot and liable to cause damage to the environment through pollution.⁶⁴ The Islamic position is that if businesses turned away from prioritising material wealth, and if justice became an integral part of business, then a harmonious global atmosphere would result, but which would not detract from promoting competitiveness.⁶⁵ Adherence to the Islamic ethical framework ensures dignity and freedom from all types of bondage.⁶⁶ It also allows individuals to earn their living in a fair and equitable manner without exploiting others, so that ultimately, society benefits. In other words, it has in western terms, more of an emphasis on what economists call ‘welfare’ and ‘public goods’ production.

ISLAMIC PRINCIPLES AND THE ANGLO-AMERICAN MODEL: INHERENT TENSIONS

There are various tensions between Islamic business principles and those inherent in the Anglo American corporate governance model. I deal with this point in detail in my work mentioned above. The Anglo American corporate governance model concerns itself with promoting and prioritising the rights and interests of shareholders. Islam however, requires the consideration of a wider range of stakeholders.⁶⁷ Secondly, the dominant theoretical model of Anglo American corporate governance is based on agency theory, rather than

⁶³ This is the central argument in M Saeed, Z Ahmed, & SM Mukhtar, “International Marketing Ethics from an Islamic Perspective: A Value Maximisation Approach”, (2001), *Journal of Business Ethics*, 32, 127 – 142. See also Z Hasan, “Corporate Governance: Western and Islamic Perspectives” (2009), *International Review of Business Research Papers*, 5, 1, 277 – 293 and T Azid, M Asutay & U Bukri, “Theory of the Firm, Management and Stakeholders: An Islamic Perspective” (2007), *Islamic Economic Studies*, 15, 1, 1 – 30

⁶⁴ G Rice, “Islamic Ethics and the Implications for Business” (1999), *Journal of Business Ethics*, 18, 345 – 358, pp. 347

⁶⁵ Saeed, et al (2001), pp. 130, 137

⁶⁶ Saeed, et al (2001), pp. 140

⁶⁷ MK Lewis, “Accountability and Islam” (Paper presented at the 4th International Conference on Accounting and Finance in Transition – Adelaide, April 10-12, 2006) 1-16, available at <http://www.unisa.edu.au/commerce/docs/Accountability%20and%20Islam.pdf>, pp. 6.

stewardship theory. Directors are regarded not as stewards who are naturally motivated to act in the best interests of the principal, but as self-interested, opportunistic agents who have to be watched over and controlled (see the agency theory discussion above). This view necessitates the creation of laws and other mechanisms to ensure that directors do not abuse their powers. Under strict Islamic principles, however, directors are not viewed in this manner – Muslims are taught to be faithful stewards of assets entrusted to them; indeed, the demonstration of this faithfulness is regarded as an act of worship. Islam thus starts from a different perspective, it does not envisage that directors' powers be curbed; on the contrary, it presupposes that Muslims desire to live by the word of God. Thirdly, it is said that a capitalist economy emphasises the individual and his pursuit of pleasure. Man is free to satisfy his needs in any manner possible, as long as in doing so, he does not infringe the rights of others or contravene the law. The Islamic religion, on the other hand, believes that God is the only source capable of satisfying the needs and desires of man. It does not deny our needs, but sets guidelines as to how these needs and desires can be fulfilled. Islam condemns waste, exploitation and indulgence and prohibits Muslims from engaging in specific activities, which are considered *haram* (forbidden).⁶⁸

Many Middle Eastern scholars regard Islam and western capitalist principles (inherent in the Anglo American corporate governance model) as diametrically opposed.⁶⁹ Capitalism is rejected on the basis that it lacks balance and moderation, excessively emphasises individual rights, materialism and freedom of enterprise which cause suffering and injustice for those who are poor. The

⁶⁸ Islam forbids the taking of alcohol, eating of pork, gambling, hoarding, the charging of interest on financial transactions, extramarital sex and obscenity, all of which are considered *haram*.

⁶⁹ For a helpful comparison between Islam and Capitalism see S Ganjoo, *Economic System in Islam*, (2004) (Anmol Publications Pvt Ltd). The author argues that the Islamic economic system obeys the requirements of moral and ethical doctrines and therefore is fundamentally opposed to European or American capitalist economic principles, which do not heed moral or ethical concepts. See also the writings of Islamists such as Syed Abul Ala Mawdudi, Sayyid Qutub, Hasan Al Banna and Ayatollah Taleqani in C Tripp, *Islam and the Moral Economy: The Challenge of Capitalism*, (2006), (Cambridge University Press), 46 – 76.

west also represents, to many Muslims, a world which is characterised by disintegrating societies in which selfishness and loneliness prevail. Materialism and the quest for wealth dominate the thinking of people who are imprisoned by their desire for money. Their value systems are seen as being based on secular economics, where people aggressively exploit each other and where society is divided into classes which resent one another, as evidenced by the levels of crime, poverty and frustration among the young and unemployed. Finally, such scholars view the west as aggressive, due to their policies of colonialism, economic exploitation and political domination of the world. As a result, they reject western influences on the basis that they corrupt Islamic societies.⁷⁰

MY RESEARCH

In order to investigate whether Islamic business principles are compatible with those under the Anglo American ('free market') model, I conducted several interviews with Muslim directors in various companies in Malaysia. This study was carried out in 2008 (discussed in my work above) and was funded by the British Academy. Despite the large volume of literature on Islamic business principles, little empirical research has been conducted to examine the extent to which they are in practice, compatible with the Anglo American corporate governance model. I attempt to fill this gap.

As a former British colony, Malaysia inherited the English common law system. Company law in Malaysia is based on the Anglo American model, and follows its developments closely. I briefly discussed the corporate governance regime in Malaysia in my other work on Malaysia (L Miles, "Waking Up after the 1997 Financial Crisis: Corporate Governance in Malaysia" (2004), *Journal of International Banking law and Regulation*, 20, 1, 21 – 32). It shows the existence of a sophisticated company law regime and describes the active roles

⁷⁰ See for example, R Wilson, "The Development of Islamic Economics: Theory and Practice" in S Taji Faruoki & BM Nafi (eds.) *Islamic Thought in the Twentieth Century*, IB Tauris, London New York, (2004), 195 – 222 pp. 203 – 205 and J Waardenburg, "Reflections on the West" in S Taji Faruoki & BM Nafi (eds.) *Islamic Thought in the Twentieth Century*, 2004, (IB Tauris, London New York), 260 – 295, pp. 268 – 270.

played by the legal and accountancy professions, the media, institutional shareholders and company regulators in corporate governance.⁷¹

In investigating the compatibility between Islamic business principles and the Anglo American corporate governance model, I pay particular attention to the contribution of Mahathir bin Mohammed (Prime Minister from 1981 to 2003) in blending Islam and modernity. The period under his leadership saw Malaysia change from an agricultural-based economy to an industrialised nation, with its population acquiring extensive knowledge in science and medicine, technology and engineering. Mahathir welcomed foreign investment, reformed the tax structure, reduced trade tariffs and privatised several state-owned enterprises. I show that although he was committed to the ‘Islamisation’ of Malaysia, Mahathir was also critical of Muslims preoccupied with ritualistic Islam and who possessed an introverted or conservative interpretation of religion.⁷² He urged Muslims to engage with worldly affairs, to achieve distinction in secular education and to look beyond religion. He propagated a ‘progressive’ version of Islam (Islam Hadhari), believing that

⁷¹ See also MR Salim, “Legal Transplantation and Local Knowledge: Corporate Governance in Malaysia” (2006) *Australian Journal of Corporate Law*, 20, 1, 55 – 83, PK Liew, “Corporate Governance Reforms in Malaysia: The Key Leading Players’ Perspectives”, (2007) *Corporate Governance: An International Review*, 15, 5, 724 – 740, S Shim, “Governance in the Markets: Malaysian Perspective” (2006), *Journal of Financial Crime*, 13, 3, 300 – 322, P Koh, “Corporate Governance in Malaysia: Regulatory Reform and Its Outcomes” in ET Gonzalez (ed.) *Best Practice in Asian Corporate Governance*, (2007), (Asian Productivity Organisation: Japan), pp. 92 – 128 and LH Loh & R Mat Zin, “Corporate Governance: Theory and Some Insights into the Malaysian Practices” (2007), *Akademika*, 71, 31 – 60

⁷² This interpretation of Islam is attributable to the influence of traditional Islamic scholars trained in the school of conservative hermeneutics. They have dwelt almost exclusively within the world of the book and the law, not the realities of the world. They have interpreted the Qur’an and the legal texts of Islam to speak for them and their interests, rejecting development, modernity and progress. As they have a monopoly over these sacred legal texts, their power and status are very significant. See E Moosa, “We Need New Intellectual Tools for the Age We Live In” in F Noor, *New Voices of Islam* (2002), at http://www.isim.nl/files/paper_noor.pdf, 23 - 28, pp. 26

Islamisation and modernisation can go hand in hand.⁷³ His message that Islam can be modern, liberal and progressive was aimed not only to challenge the mindset of the Muslim community, but also to encourage the collaboration between the Muslim and non-Muslim population.⁷⁴

Far from rejecting the Anglo American model on the basis that its values were incompatible with that of Islam, all the participants in my study welcomed the model and the ‘free market’ system as frameworks in which business can flourish. All recognised the importance of profit and wealth creation for society and the economy and none perceived a conflict between Islam and capitalist principles. They did however, emphasise the importance of moral values, a sense of accountability and a caring spirit taught by Islam, which they perceived as an antidote to the negative repercussions of the ‘free market’ system. They also stressed the need for Islam to be forward thinking and to be able to change with the times in order to accommodate the needs of modern society, clearly embracing the approach advocated by Mahathir.

A caveat is however, required. The research I conducted in Malaysia was

⁷³ Malaysia adopts Islam Hadhari (comprehensive Islam), which emphasises the importance of progress—with an Islamic perspective—in the economic, social, and political fields. It underscores the need for balanced development, both physical and spiritual. See M Bashir “Islam Hadhari: Concept and Prospect” (2005), at <http://www.islamonline.net/english/Contemporary/2005/03/Article01.shtml>), Datuk Seri Abdullah Ahmad Badawi, “Islam Hadhari in A Multi-Racial Society” (2005), at <http://www.asiasociety.org/countries-history/religions-philosophies/islam-hadhari-a-multi-racial-society> and I Gatsiounis, “Islam Hadhari in Malaysia” (2006) at kms1.isn.ethz.ch/serviceengine/Files/ISN/.../en/07_IslamHadhari.pdf

⁷⁴ C Tripp, (2006), at 116-117, I Ahmad, “Islam, Commerce, and Business Ethics”, in Capaldi (ed.) *Business and Religion: A Clash of Civilizations*, (2005), (Salem, MA: Scrivener), pp. 200 – 215. For an argument that there is no inherent contradiction between the ‘free market’ economy and Islam, and that the reason why many Muslim countries are undemocratic is attributable to reasons other than religion, see D Smock, “Islam and Democracy”, (2002) Special Report No. 93, United States Institute of Peace, available at <http://www.usip.org/files/resources/sr93.pdf>. For a Turkish perspective that democracy and ‘free market’ principles are compatible with Islam, see M Acar, “Towards a Synthesis of Islam and the Market Economy? The Justice and Development Party’s Economic Reforms in Turkey” (2009), *Economic Affairs*, 29, 2, 16 – 21.

highly selective and I targeted only high profile, and internationally known, companies. It thus only presented a snap shot of ideas and views of company directors in Malaysia. They may not necessarily represent the experience of the wider community of directors. There may also have been ‘social desirability’ effects in the responses of those interviewed. For a more rounded picture to be presented, research should target smaller, local and less well known companies in order to elicit the views of their Muslim management. The latter may present a different view of the compatibility of western and Islamic business models.

More generally, I point out in my work that the relationship between Islam and the west continues to be a troubled one. One cannot ignore the rise of Islamic movements (e.g. Al Qaeda, Egyptian Islamic Jihad, Hamas, Armed Islamic Group, Hizbul Mujahideen) determined to resist western domination and control over Muslim territories. Their demands to uphold Sha’ria law and to destroy those regarded as ‘enemies of Islam’ has provoked aggression against Islam and its followers. ‘Wahhabism’, a version of Islam which insists on a literal interpretation of the Qu’ran, constitutes an influential force in their lives. Wahhabis regard their version of Islam as the only path of true Islam and oppose any interpretation which aligns Islam with western standards, notably with regards to gender equality and democracy. They also regard individuals who did not practice their version of Islam as heathens and enemies. Many in the west (who are not necessarily aware of the different versions of Islam) openly accuse Islam and the Islamic community of being a threat to security and democracy, although Islamic movements justify their actions on the basis that they are simply resisting western arrogance. Islamic movements have opposed the occupation of Palestine, Iraq and Afghanistan and the adverse publicity Islam receives in the west. The ongoing antagonistic relationship between the west and these Islamists has continued over the decades to stall attempts to initiate dialogue to build peaceful relations across cultural and

religious diversity.⁷⁵

PART B

THE IMPACT OF TRANSPLANTING ANGLO AMERICAN EMPLOYMENT PRACTICES ON THE EMPLOYMENT RELATIONSHIP

Finally, I demonstrate in my works (L Miles “The Significance of Cultural Norms in the Evolution of Korean HRM Practices” *International Journal of Law and Management*, 2008, 50, 1, 33 – 46 and L Miles, “Current Changes in Labour Management and Industrial Relations in Japan and Their Impact on its ‘Stakeholder Oriented’ Governance Model”, *Managerial Law*, 2007, 49, 4, 117-128) how the employment relationship⁷⁶ in Asian companies is being

⁷⁵ See for example M Moaddel & S Karabenick, “Religious Fundamentalism among Young Muslims in Egypt and Saudi Arabia” (2008), *Social Forces*, 86, 4, 1675 – 1710, L Vidino, “Homegrown Jihadist Terrorism in the United States: A New and Occasional Phenomenon?”, (2009), *Studies in Conflict and Terrorism*, 32, 1, 1 – 17, K O’Toole, “Islam and the West: the clash of values”, (2008), *Global Change, Peace & Security*, 20,1, 25 – 40, S Dossa, “Lethal Muslims: White-trashing Islam and the Arabs” (2008), *Journal of Muslim Minority Affairs*, 28, 2, 225 – 236, B Tibi, “The Totalitarianism of Jihadist Islamism and its Challenge to Europe and to Islam”, (2007), *Totalitarian Movements and Political Religions*, 8, 1, 35 – 54, J Haynes, “Al Qaeda: Ideology and Action” (2005), *Critical Review of International Social and Political Philosophy*, 8, 2, 177 – 191, G Picco, “The Challenges of Strategic Terrorism” (2005), *Terrorism and Political Violence*, 17, 1-2, 11 – 16.

⁷⁶ The industrial relations authority, Paul Edwards, defines ‘employment relationship’ as the (contractual) relationship between employer and employee, which organises human resources in the light of their productive aims. It sets the price for a set number of hours of work, determines how much work is done in that time, sets the tasks, ascertains who defines the tasks and what penalty is imposed if the obligations were not met. Traditionally, the employment relationship was characterised by full time work, under a contract of employment for indefinite duration with a single employer. Recently however, new patterns of employment have emerged, signifying a move away from full time employment. The term ‘employment relations’ (sometimes used synonymously with ‘industrial relations’), on the other hand, focuses on all forms of economic activity where an employee works under the authority of an employer and receives a wage in return. It is concerned with maintaining the employment relationship in order to secure productivity, motivate employees and ensure healthy employee morale. See P Edwards, (ed.) “The Employment Relationship and the Field of Industrial Relations” in *Industrial Relations: Theory and Practice*, 2nd edition, (2003), (Wiley-Blackwell), pp. 1 – 36.

undermined by practices which, being based on the Anglo American governance model, promote the adoption of flexible working practices,⁷⁷ encourage increasing reliance on legal rights to protect individual and collective interests and increase levels of mistrust between employers and worker. The effects of policies derived from the Anglo American model on employment practices, and more fundamentally, on the cultural and traditional values of Asian societies is a topic worthy of consideration because they inform us as to whether adopting employment practices from foreign jurisdictions to improve company efficiency is, for Asian countries, necessarily the most efficient and equitable way forward. I investigate the practicability and consequences of implementing Anglo American employment practices in Japanese and Korean companies, two societies heavily influenced by Confucian values.

⁷⁷ Several forms of flexible working practices exist, including part time, temporary/casual, fixed term, home based, shift working and annual hours contracts. The labour economist John Atkinson argues that companies look for three kinds of flexibility – functional flexibility, numerical flexibility and financial flexibility. For a discussion of these, see J Atkinson, “Manpower strategies for flexible organisations”, (1984), *Personnel Management*, 28 – 31, J Atkinson, “Flexibility: Planning for the Uncertain Future” (1985), *Manpower Policy and Practice*, 26 – 29, J Atkinson, “Flexibility or Fragmentation? The UK Labour Market in the 80s” (1987) *Labour and Society*, 12, 1, 87 – 105, J Atkinson & N Meager, *Changing Work Patterns: How Companies Achieve Flexibility to meet New Needs*, (1986), National Economic Development Office, London. For research on the impact of flexible working practices on employer and workers, the literature is voluminous, see as a sample, C Brewster, L Mayne, & O Tregaskis, “Flexible Working in Europe” (1997), *Journal of World Business*, 32, 2, 133 – 151, O Tregaskis, C Brewster, L Mayne & A Hegewisch, “Flexible working in Europe: the evidence and the implications” (1998), *European Journal of Work and Organisational Psychology*, 7, 1, 47 - 64, M Valverde, O Tregaskis & C Brewster, “Labour Flexibility and Firm Performance” (2000), *International Advances in Economic Research*, 6, 4, 649 – 661, AL Kalleberg, “Flexible Firms and Labor Market Segmentation” (2003), *Work and Occupations*, 30, 2, 154 – 175, AL Kalleberg, “Non standard employment relations: Part time, temporary, and contract work” (2000), *Annual Review of Sociology*, 26, 341 – 365, AL Kalleberg, “Organising Flexibility: The Flexible Firm in a new Century” (2001), *British Journal of Industrial Relations*, 39, 4, 479 – 504.

CONFUCIAN CULTURE AND ECONOMIC GROWTH

In the years of economic success of Asian countries (many of which shared Confucian traits), in particular during the 1980s, the possibility that culture constituted an explanation for their prosperity attracted much academic interest.⁷⁸ Strong leadership, collectivism, an emphasis on consensus and cooperation, national consciousness and a thirst for education all enabled economic growth to occur. ‘Collectivism’ in this context stressed the importance of cooperation and unity and encouraged loyalty and conformity to authority. A community spirit helped promote the interest of the whole company. The importance placed on education and self improvement led to the development of scientific and technological expertise, a high quality labour force and high productivity. Lastly, an emphasis on group harmony enabled workers to reach agreement on the importance of achieving future growth. Thus, countries such as Japan and Korea were able to develop rapidly since the

⁷⁸ I have discussed this point in relation to Korea (Footnote 22). The literature on this is vast, see additionally, F Fukuyama, “Culture and economic development: cultural concerns”, 3130 – 3134, at www.sais-jhu.edu/faculty/fukuyama/articles/isb505010.pdf, HJ Lee, “Development, Crisis and Asian values”, (2003), *East Asian Review*, 15, 2, 27 – 42, WM Tu, “A Confucian perspective on the rise of Industrial East Asia”, in S Krieger & R Trauzettel, (eds), *Confucianism and the Modernisation of China*, (1994), (V. Hase & Koehler Verlag), 29 – 41, HC Tai, *Confucianism and Economic Development: An Oriental Alternative*, (1989), (The Washington Institute Press: Washington), G Hofstede & M Bond, “The Confucius connection: From cultural roots to economic growth”, (1988), *Organisational Dynamics*, 16, 4, 5 – 21, J Johnson & T Lenartowicz, “Culture, freedom and economic growth: Do cultural values explain economic growth?” (1998), *Journal of World Business*, 33, 4, 332 – 356, RH Franke, G Hofstede & MH Bond, “National Culture and Economic Growth” in MJ Gannon & KL Newman (eds.) *The Blackwell Handbook of Cross Cultural Management*, (2002), (Blackwell: Oxford), 1 – 15, LJ Cho, “Culture, institutions and economic development in East Asia”, in LJ Cho & YH Kim, (eds), *Korea’s Political Economy: An Institutional Perspective*, (1994), (Westview Press: Boulder, CO), 3 – 41, A Chan, “Confucianism and economic development in East Asia”, (1996), *Journal of Contemporary Asia*, 26, 1, 28 – 45.

1960s, because of the favourable effects of their Confucian culture.⁷⁹

JAPANESE AND KOREAN LABOUR MANAGEMENT PRACTICES

In my works, I underline the importance of Confucian values in the employment relationship in Japanese and Korean companies. Companies in both countries were traditionally constructed as families. In Whitley's terms, there were high levels of employer-worker interdependence. Workers integrated themselves into their companies through working hard and demonstrating loyalty to their employers. In return, employers rewarded them by looking after their welfare, and by investing heavily in educating and training them. Workers usually stayed with their companies until retirement age. Directors were appointed from the pool of senior, long-serving workers within the company. As a result, management and workers have shared views and interests.⁸⁰ Japanese and Korean companies traditionally also operated a wage and promotion system based on seniority. Last but not least, companies were very much regarded as providers of social security. In times of distress, they would attempt to keep workers within the business rather than make them redundant, by cutting back on dividends, reducing overtime opportunities and offering voluntary retirement. Trust, long-term commitment and co-operation were central elements in the relationship between the company and its workers. Certainly, the success of the Japanese economy in the 30 years before the financial crisis was attributed by many to the strong relations between

⁷⁹ OY Kwon, "Korean economic developments and prospects", (1997), *Asian Pacific Economic Literature*, 11, 2, 15 – 39, KC Lee, "Back to the basics: New interpretation of Confucian values in Korea's economic growth", (1995), *Korea Observer*, 16, 2, 97 – 114, KCJ Lam, "Confucian business ethics and the economy", (2003), *Journal of Business Ethics*, 43, 1-2, 153 – 162, M Morishima, *Why has Japan 'succeeded' ? Western Technology and Japanese Ethos*, (1982), (Cambridge: Cambridge University Press), A Sen, "Culture and Development" World Bank Tokyo Meeting, (2000), at http://info.worldbank.org/etools/docs/voddocs/354/688/sen_tokyo.pdf.

⁸⁰ T Araki, "Corporate governance reforms, labour law developments and the future of Japan's practice dependent stakeholder model", (2005), *Japan Labour Review*, 2, 1, 26 – 57, pp. 27.

companies and their workers.⁸¹

JAPANESE AND KOREAN COMPANIES ABANDON TRADITIONAL LABOUR MANAGEMENT

After the Asian financial crisis, many traditional company practices had to be abandoned, because they could not cope with the pressures and demands set by liberalisation and globalisation. In my works mentioned above, I show how traditional employment practices have changed to illustrate how they have been undermined by practices from foreign jurisdictions. Fierce global competition demanded a more efficient utilisation of resources, and calls to formulate a new labour management system based on Anglo American principles, which would provide flexibility and enable companies to compete, were quickly heeded. I then posit, in view of the significant costs which followed, whether there were alternative paths Japanese and Korean companies could have taken. I discuss how these companies, which previously employed almost identical employment practices, have had to discard these. Traditional practices such as life long employment and promotion based on seniority were replaced by reliance on casual labour and performance based pay and promotion systems. Companies removed excess personnel by flattening their organisational hierarchy. Many companies introduced a mandatory retirement age, forcing senior workers to retire. Laws were amended to legalise lay offs and remove employment protection. The use of outsourcing increased. Courts were forced to recognise that economic efficiency necessitated the institution of policies which made it easier for companies to dismiss their workers, and so interpreted

statutes allowing dismissals in favour of employers.⁸² Further, in order to optimise the use of resources, many companies started to experiment with

⁸¹ See for example, Y Kurihara, “The changing corporate governance in Japan: adapting to globalization”, (2005), *Global Business & Economics Review*, 6, 1, 82 – 91, at 83 and Y Kuwahara, “New Developments in HRM in Japan”, *Asia Pacific Journal of Human Resources*, (1993), 31, 2, 3 – 11.

⁸² On the South Korean position, see JT Choi, “Transformation of Korean HRM based on Confucian values”, (2004), *Seoul Journal of Business*, 10, 1, 1 – 26, C Rowley & JS Bae, “Globalisation and Transformation of HRM in

Anglo American style performance appraisal systems to evaluate the productivity of workers as the basis for promotion. Lastly, companies began to recruit specialists to meet specific company strategies, rather than employ generalists who could perform different kinds of roles and who could provide internal flexibility.⁸³ In short, they started to use ‘calculative’ human resource management practices as Gooderham describes them.⁸⁴ All in all, confidence in traditional values was shaken.

South Korea” (2002), *International Journal of Human Resource Management*, 13, 1, 522 – 549, C Rowley & JS Bae, “HRM in South Korea after the Asian financial crisis: Emerging patterns from the labyrinth”, (2004), *International Studies of Management and Organization*, 31, 1, 52 – 82, I Park, “The Labour Market, Skill Formation and Training in the Post Developmental State: The example of South Korea” (2007), *Journal of Education and Work*, 20, 5, 417 – 435. On the Japanese position, see J Benson & P Debroux, “Flexible Labour Markets and Individualised Employment: The Beginnings of a new Japanese HRM system?” (2003), *Asia Pacific Business Review*, 9, 4, 55 – 75, M Yamashita, “Japanese Labour Management Relations in an Era of Diversification of Employment Types: Diversifying Workers and the Role of Labour Unions” (2005), *Japan Labour Review*, 2, 1, 105 – 117, T Araki, (2005), M Rebeck, *The Japanese Employment System: Adapting to a New Economic Environment*, (2005), (OUP, Oxford).

⁸³ On the South Korean position, see ES Lee & SS Kim, “Best practices and performance based HR system in Korea”, (2007), *Seoul Journal of Business*, 12, 1, 3 – 17, EM Chang, “Individual Pay for Performance and Commitment HR practices in South Korea” (2006), *Journal of World Business*, 41, 4, 368 – 381, JS Bae & C Rowley, “Changes and Continuities in South Korean HRM” (2003), *Asia Pacific Business Review*, 9, 4, 76 – 105. On the Japanese position, see H Shibata, “Wage and Performance Appraisal Systems in Flux: A Japan-US Comparison” (2002), *Industrial Relations*, 41, 629 – 652, Y Ogoshi, “Current Japanese Employment Practices and Industrial Relations: The Transformation of Permanent Employment and Seniority-Based Wage System” (2006), *Asian Business and Management*, 5, 4, 469 – 485, M Pudelko, “The Seniority Principle in Japanese Companies: A Relic of the Past?” (2006), *Asia Pacific Journal of Human Resources*, 44, 3, 276 – 294.

⁸⁴ See for example, P Gooderham, O Nordhaug & K Ringdal, “Institutional and Rational Determinants of Organisational Practices: HRM in European Firms” (1999), *Administrative Science Quarterly*, 44, 3, 507 – 531, P Gooderham, O Nordhaug & K Ringdal, “National embeddedness and calculative human resource management in US subsidiaries in Europe and Australia” (2006), *Human Relations*, 59, 11, 1491 – 1513 and P Gooderham, E Parry & K Ringdal, “The Impact of Bundles of Strategic HRM Practices on the

The power of trade unions in both Japan and Korea also weakened dramatically. In Japan, the proportion of workers joining unions dropped from 55.8% in 1949 to less than 20% in 2005.⁸⁵ In Korea, the evidence currently shows a unionisation rate of just 10.8%.⁸⁶ With the gradual decline in trade union influence, workers began to turn to the law to protect their interests. In Japan, the number of individual labour disputes has increased sharply in the last ten years.⁸⁷ With the gradual erosion of the relationships between companies and workers, laws⁸⁸ were introduced to set minimum work standards, prohibit discriminative practices and provide quick and effective dispute resolution mechanisms in the event of dispute.⁸⁹ In Korea, laws governing the resolution of individual labour disputes and the guarantee of certain rights in the work place⁹⁰ have also increasingly been utilised by

Performance of European Firms”, (2008), *International Journal of Human Resource Management*, 19, 11, 2041 – 2056

⁸⁵ Country Trading Profiles, Japan, 2010, at <<http://www.emporikitrade.com/uk/countries-trading-profiles/japan/labour-market>>, see also K Nakamura, “Decline or Revival: Japanese Labour Unions” (2007), *Japan Labour Review*, 4, 1, 7 – 22, pp. 7, R Mabuchi, “How Labour Unions are perceived by Members and Union Disassociation in Japan” (2007), *Japan Labour Review*, 14, 1, 91 – 111, M Yamashita, “Japanese labour management relations in an era of diversification of employment types: Diversifying workers and the role of labour unions”, (2005), *Japan Labour Review*, 2, 1, 105 – 117, pp.107

⁸⁶ Country Trading Profiles, South Korea, 2010, at <<http://www.emporikitrade.com/uk/countries-trading-profiles/south-korea/labour-market>>

⁸⁷ See K Sugeno, “Judicial Reform and the Reform of the Labour Dispute Resolution System” (2006), *Japan Labour Review*, 3, 1, 4 – 12, pp. 7 – 8

⁸⁸ Examples include the Labour Standards Law 2003, Law Concerning Stabilisation of Employment of Older Persons 2004, Law Securing Equal Opportunity and Treatment between Men and Women in Employment 2006, Law for Securing the Proper Operation of Worker Dispatching Undertakings and Improved Working Conditions for Dispatched Workers 2006, Minimum Wage Law 2002 and Labour Tribunal Law 2004. These Acts may be viewed at the website for Japan Institute of Labour and Policy Training at <<http://www.jil.go.jp/english/laborinfo/library/Laws.htm>> .

⁸⁹ See K Sugeno, “The Birth of the Labour Tribunal System in Japan: A Synthesis of Labour Law Reform and Judicial Reform” *Comparative Labour Law and Policy Journal*, (2005), 25, 4, 519 – 534.

⁹⁰ Labour Standards Act 1997, Minimum Wage Act 1986, Equal Employment Act 1987, Occupational Safety and Health Act 1990, Act Relating to Protection etc. for Dispatched Workers 2007, Act Concerning Protection etc. of Fixed Term and Part Time Workers 2007. These Acts may be viewed at the

workers in order to protect their interests, as shown by the escalating numbers of individual labour disputes in recent years.⁹¹

THE FUTURE OF JAPANESE AND KOREAN EMPLOYMENT RELATIONS

I investigate whether recent shifts in employment practices indicate a marginal or central development in Japanese and Korean employment relations. In Japan, some scholars argue that it is inaccurate to say that there is a definite evolution toward the Anglo American model and that whilst Japanese companies are adopting its employment practices, they have been able to adapt and modify their traditional model of governance.⁹² Others say that changes are only “*occurring within the framework of the stakeholder model...not likely...[that it will] completely convert into the shareholder value model, at least for the time being*”.⁹³ Still others propose that employers could opt for a middle way, in order that traditional elements of Japanese labour practices may be retained—that is, through worker share schemes. It is argued that allowing workers to share in the capital of the company would enable the continuation of stable cooperation between management and workers, the very foundation of traditional Japanese management.⁹⁴ Thus whilst employment practices in Japan

website of the Ministry of Labour at
<<http://www.molab.go.kr/english/main.jsp>>

⁹¹ Figures can be obtained from the National Labour Relations Commission website in Korea, at <<http://www.nlrc.go.kr/en/current.html>>. See also SY Kim, “The Legal Regulation of Wrongful Dismissal in Korea” (2004), *Comparative Labour Law and Policy Journal*, 25, 4, 535 – 560, pp. 557 – 558

⁹² C Milhaupt, “A Lost Decade for Japanese Corporate Governance Reform: What’s Changed, What Hasn’t, and Why”, (2003), at <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=442960>, J Morris, J Hassard & L McCann, “New Organisational Forms, HRM and Structural Convergence? A study of Japanese Organizations”, (2006), *Organization Studies*, 27, 10, 1485 – 1511, at 1500-1504, J Benson & P Debroux, “Flexible labour markets and Individualised Employment: The beginnings of a new Japanese HRM system?”, (2003), *Asia Pacific Business Review*, 9, 4, 55 – 75, at 70 – 73, G Jackson, “Stakeholders under pressure: corporate governance and labour management in Germany and Japan”, (2005), *Corporate Governance*, 13, 3, 419 – 428

⁹³ Araki, (2005), pp. 53.

⁹⁴ P Debroux, “Internal Corporate Governance Discipline and the HRM system in large Japanese Companies” (2004), *Asia Pacific Business Review*, 10, 3/4, 346 – 359

are changing, it is difficult to identify precisely to what extent, as there is evidence that its core practices are continuing.⁹⁵

The same arguments are made with regard to Korean employment practices. Confucian traits such as patriarchy, collectivism, an emphasis on solidarity and cooperation are no longer regarded as compatible with the modern 'free market' system. The importation of new practices has been criticised as causing damage to society.⁹⁶ Should companies continue to shed traditional practices because they are seemingly at odds with globalisation? Defenders of the Confucian tradition have resisted the spread of western influences and values into Korea, arguing that Confucian values are needed to counteract individualism and materialism which have seeped into Korean companies. The emphasis on individualism and materialism in the west are seen as having caused the Korean economy to disintegrate and become devoid of morals, where families and communities are breaking down and where the gap between the rich and poor is widening. Poorer classes are alienated, material wealth is exalted and success is achieved by exploiting labour and the environment. Confucian values, with their emphasis on solidarity, harmony and support on the other hand, can act as a rehabilitative remedy for modern society.⁹⁷

I suggest that following a foreign model may be self-defeating as it destroys national elements which are crucial for future growth. Scholars point to research which shows that companies which keep traditional employment practices have been able to maximise the advantages of Confucian values. For example, some have retained the seniority principle, by applying performance related remuneration and promotion only to managers or workers with higher qualifications. Others have awarded remuneration not on the basis of

⁹⁵ Morris, Hassard & McCann, (2006), pp. 1504

⁹⁶ Two helpful articles discussing the social costs of reform are AE Kim, "The Social Perils of the Korean Financial Crisis" (2004), *Journal of Contemporary Asia*, 34, 2, 221 – 237 and Lim & Jang, (2006).

⁹⁷ See SH Lee, "Asian values and the future of the Confucian culture", (2000), *East Asian Review*, 12, 1, 45 – 61 and Choi (2004), pp. 21 – 25. For a discussion of the durability of Confucian values, see G Rozman, "Can Confucianism survive in an age of Universalism and Globalisation?" (2002), *Pacific Affairs*, 75, 1, 11 – 37.

individual achievement, but on the basis of group merit. Still others have achieved flexibility by utilising job rotation, offering reduced over time hours, encouraging workers to take temporary leave and making use of temporary retirement schemes instead of dismissing workers outright. The employment of such practices combines the benefits of Confucian culture with those of western practices to produce a system which contains characteristics that reflect traits from both.⁹⁸ Thus, it may be over simplistic⁹⁹ to assume that Korean systems are abandoning traditional employment practices in favour of western ones, rather, it may be that, in the long term, a hybrid model will emerge.

CONCLUSION

The works presented in this document contribute to an understanding of the problems and practicalities involved in implementing the Anglo American corporate governance model in Asian countries. They have drawn on three perspectives (‘culturalist’; ‘institutionalist’; ‘historical-political’) to explain why problems have arisen when foreign corporate governance models are adopted to improve company performance in Asian countries. Initially, I drew only upon the ‘culturalist’ perspective. I soon recognised however, that there were other perspectives which could be used to explain the same subject. I have thus reflected on how ‘institutional’ and ‘political’ theories can be used in this regard. With regard to the first, I realised the need for corporate governance models to be legitimised by existing institutions in the host country before they can facilitate change in corporate behaviour. This does not take place quickly. With regard to the second, I began to understand how

⁹⁸ Choi, (2004), at 21 – 25 and Rowley & Bae, (2002), pp. 546. See also I Park (2007), which argues that despite rapid change, deeply held cultural views about the nature of work retain significance in charting the future role of the state with respect to regulating the labour market.

⁹⁹ Indeed, Rowley & Bae (2004) suggest that Korean HRM remains even more of a labyrinth after the Asian crisis as changes in its HRM have been piecemeal, ad hoc, and by no means universal, resulting in a patchwork of practices—for example, the weakening of lifetime employment, but combined with a continuing expectation of very high employee commitment, or the spread of performance criteria in appraisal, rewards, and promotion systems but within a culture where collectivism, seniority, and age remain important aspects in everyday life and society in general.

governance models imported from jurisdictions with different political orientations are unlikely to bring about the anticipated results in the host country. Whichever perspective is adopted, I have shown that the expectation that the adoption of foreign corporate governance models will naturally bring about an 'ordering' effect in Asian countries has not materialised. It is only possible to determine the optimal regime for companies through first understanding how individual cultures, institutions and political environments have influenced the way they have developed. I conclude that the challenge for Asian countries is not to implement all or several of the aspects of the Anglo American corporate governance model, but to be selective and shape them as appropriate to their individual environments if their effectiveness as a tool of economic development is to be realised.

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