

# Corporate Governance

## Definition

The concept of corporate governance is defined in a number of different ways. As a rule, however, it is understood to mean the system of company management and oversight.<sup>1</sup> Governance is consequently to be understood as an integral organism in which there is an interplay of different regulations and market forces.<sup>2</sup> This combination shapes the regulation of corporate governance.

## Distinction between external and internal governance

*External governance:* external governance is closely linked to company financing through the capital markets. Alongside capital market regulations (for example, capital-market-law rules on disclosure, rendering of accounts, oversight of central decision-making bodies) which in turn influence the saleability of shares (exit), a rich set of instruments for reacting and applying pressure is at the disposal of market actors.<sup>3</sup> The regulations on external governance are already largely harmonised at European level.

*Internal governance:* internal governance refers to the possibility of influencing decisions within a company. In contrast to external governance the rules on internal governance are harmonised on only a few points (for example, codetermination).

## Aims of internal governance

Whose interests do managements have to consider in the first instance in their decisions and actions? There are three main approaches to this:<sup>4</sup>

- a) *Shareholder value approach:* according to this the actions of the management are aimed solely at the interests of the shareholders. The only thing that counts is maximising their profits, for example, through dividends, (share) price gains or proceeds from sales.
- b) *Mixed shareholder–stakeholder approach:* according to this the actions of the management do not have to be oriented solely towards the interests of the shareholders but may also take into account other interest groups which are likewise closely and permanently linked to the company (stakeholders).
- c) *Enlightened shareholder value approach:* here again shareholders' interests take precedence. However, ethical, charitable or environmental concerns also come into play, disregard of which could at least in the long term lead to losses for the shareholders.

It depends on the national legal background how these approaches are observed and implemented. Anglo-Saxon law is traditionally shaped by the shareholder value approach. Today, however, an 'enlightened shareholder' approach is probably the norm.<sup>5</sup> German (continental European) law, in contrast, works on the principle that employees' interests must be taken into account in company decision-making, or at least to a certain extent. There is a similar understanding in France and Italy. In British law there is some dispute concerning whether the board may at least consider the interests of other stakeholders.

Source: Stefan Grundmann, *Europäisches Gesellschaftsrecht* (Heidelberg: C.F. Müller, 2004).

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<sup>1</sup> Cf. COM(2003)284 final, p. 12.

<sup>2</sup> Grundmann, para. 438.

<sup>3</sup> Cf. Grundmann, para. 440.

<sup>4</sup> Grundmann, para. 457ff.

<sup>5</sup> Grundmann, para. 458ff (with further references).