



the Autonomous Management School of
Ghent University and Katholieke Universiteit Leuven

Vlerick Leuven Gent Working Paper Series 2004/22

**THE INTERFACE BETWEEN CORPORATE GOVERNANCE
AND CORPORATE SOCIAL RESPONSIBILITY
AND ITS RELEVANCE FOR THE FINANCIAL AND INSURANCE SECTOR**

LUTGART VAN DEN BERGHE

Lutgart.VanDenBerghe@vlerick.be

CELINE LOUCHE

Celine.Louche@vlerick.be

**THE INTERFACE BETWEEN CORPORATE GOVERNANCE
AND CORPORATE SOCIAL RESPONSIBILITY
AND ITS RELEVANCE FOR THE FINANCIAL AND INSURANCE SECTOR**

LUTGART VAN DEN BERGHE

Vlerick Leuven Gent Management School

CELINE LOUCHE

Vlerick Leuven Gent Management School

Contact:

Céline Louche

Vlerick Leuven Gent Management School

Tel: +32 09 210 98 16

Fax: +32 09 210 97 00

Email: Celine.Louche@vlerick.be

ABSTRACT

Based on the argument that Corporate Social Responsibility is not just a fashion but rather the future from another angle, this paper explores the link between corporate governance and corporate social responsibility in insurance. Although insurance industries have been less exposed to criticisms than other sectors, like any other business, they are subject to increasing societal scrutiny. After a reconsideration of the corporate governance paradigms and mechanisms, the paper analyses the relevance of corporate social responsibility and corporate governance for the insurance sector. It explores its positive and negative externalities and its role as institutional investor. The paper also provides policy recommendations for mainstreaming corporate social responsibility within the sector.

INTRODUCTION

Corporate Social Responsibility: yet more hype without a sustainable future, or the future from another angle?

Time and time again, with the regularity of a clock, businessmen and management professors find themselves assailed by new business fashions, pretending to hold the absolute and definitive key to strategy and thus to the future of the company. Kenneth Clark pointed to the danger of this when he stated that “Confident articles on the future seem to me, intellectually, the most disreputable of all forms of public utterance”¹. It would be understandable were certain readers of this article to reject the concept of Corporate Social Responsibility (CSR) as being just another business fashion, a new religion or a new ideology, which in practice has nothing to offer; understandable, but wrong, at least in the opinion of this article’s authors².

The present contribution represents a reconnoitring of the future of business conduct and governance. To avoid provoking the above criticism of Kenneth Clark, however, we would just say that, in such an exercise, posing the right questions (and particularly continuing to pose them) is more important than giving answers, which will necessarily change anyway over the years. Indeed, anyone attempting to promote his or her piece of the truth as the entire truth destroys its value.

Becoming involved in CSR can be seen as a passionate expression of faith. While disclaiming a passionate involvement, we aim to analyse the contextual factors that could lead to CSR simply being a sensible strategic option in the chaotic world we live in, or at least in a number of industries closely connected with the knowledge society. Before doing so, we have to point to the link between CSR and corporate governance.

The interface between 'Corporate Social Responsibility' and 'Corporate Governance'

The concept of CSR is closely allied to that of governance. Both CSR and corporate governance have to do with the direction of companies and with the translation of that into corporate strategy. What has been written on the latter subject³ is overwhelming and increasingly underlines to what extent change ought to be a part of our thinking and how

¹ Quoted in John D. Barrow, *Impossibility, The Limits of Science and the Science of Limits*, OUP, 1998, 232 pp.

² For more detail see, Van den Berghe, L. & Verbeke, L. *Duurzaam Ondernemen ... of het heruitvinden van de toekomst en het doorbreken van fundamentalismes*, in 'De durf om te ondernemen : nieuwe aspecten van ondernemerschap en groeimanagement' Hans Crijns en Hubert Ooghe (eds.), Lannoo, juni 2001, ISBN 90 209 4183 6, pp. 224-235

much more rapidly change occurs. Success seemingly holds little relevance for the future and it can sometimes be a few years or just a few months before the difference between winning and losing becomes apparent. Whereas strategy could previously be approached as 'strategic planning', comparable to equipping a steamship for the voyage between Southampton and New York, whereby fuel consumption and the precise time of departure and arrival (barring confrontations with icebergs *en route*) were known, it is now more like navigating a sailing-ship on a river after a rainstorm, with many rocks barring the way and many other boats and craft darting about and preventing easy passage. In such a raplex environment (with rapid and complex changes), at least equally essential as a precise idea of one's destination and how to reach it, is the quality of the crew.

Our growing impotence to 'plan strategically' also has to do with increasing discontinuity and the paradoxical phenomena about which Charles Handy⁴ and others have written so well. One thing which appears paradoxical is the phenomenon of the 'and' world instead of the 'or' world: the necessity to opt steadily less for 'either the one thing or the other' and to reconcile what, at first sight, appear to be opposing ideas and objectives. As will become apparent below, CSR is an excellent example of this.

Corporate strategy, too, has to be fleshed out in a world in which the concepts of dualism are coming to be steadily less meaningful. The antagonism between capital and labour or between private interest and common good is obsolete, though this is not to say that there is a resulting harmony, but rather that there is a resulting, consciously experienced, disharmony. The key lies in tension and in conscious searching. CSR begins where dualist thought ends.

Approach and hypothesis of this contribution

Faced with the increasing pressure for corporate social responsibility and a broader role of business in society, it is no longer sufficient for a 'responsible firm' to live by the law and focus on financial profit to create value for shareholders. This is also true for the financial and insurance sector. However, traditional corporate governance as well as traditional management tools and accounting principles do not allow corporate social responsibility to be

³ For a description and a scientific criticism of the various schools of strategy and for an introduction to the many illusory pronouncements in this respect, see Mintzberg, H. "Strategievorming : Tien scholen.", transl. Th. J. Tromp, Scriptum (Schiedam), 1994 153 p

⁴ C. Handy, *Trust and the virtual organization – How do you manage people whom you do not see?*, Harvard Business Review, May/June 1995, pp. 40-50; C. Handy, *The Hungry Spirit: Beyond Capitalism – A Quest for Purpose in the Modern World*, Hutchinson, 1997, 288pp.

managed efficiently and effectively. This is the central thesis we want to discuss in this article.

In a next section, we will examine the increased focus on the role of business in society and its effects on corporate governance. We will approach the redefinition of the role and the content of corporate governance in three steps. First, we will highlight the need for a new paradigm underlying traditional corporate governance thinking. In a second step, we will redefine the corporate governance mechanisms. And in a third and final step, we will elaborate on the monitoring of corporate governance and corporate social responsibility. Section 3 will address the relevance of Corporate Social Responsibility (CSR) and Corporate Governance (CG) for the financial and insurance sector. We will develop its potential for specific negative and positive externalities as well as its role as institutional investor. Based on these sectoral specificities, we will present some suggestions for mainstreaming CSR and CG into their policies. We conclude with a short summary and some ideas for further research and reflection.

INCREASED FOCUS ON THE ROLE OF BUSINESS IN SOCIETY AND ITS EFFECTS ON CORPORATE GOVERNANCE

Business conduct under growing societal scrutiny

Manifestations of change

Anyone who watches television, who reads newspapers or listens to the radio has been extensively informed of the tough battle of the anti-globalists against globalisation in general and global businesses more specifically. If we unload this anti-globalisation movement of its spectacular street fights and sometimes outrageous manifestations, we can observe that some of the basic messages go to the heart of CSR. A growing number of organisations, referred to as 'civil society' are thoroughly questioning the business conduct of increasingly powerful global players. They claim that a business firm should have a 'responsible' attitude and behaviour, wherever they operate. Respect for human rights, no pollution, no involvement with corruption are top priorities in their world-wide scrutiny of business firms. CSR presumes a conscious search for a balance, beyond short-term efficiency, whatever its nature. The challenge is to achieve long-term, sustainable success, based on a balanced respect for the interest of all parties involved in the company. In a certain sense, this is the business model that in corporate governance circles is known as the 'Rhineland' or 'stakeholder' model.

Albeit from a quite different nature, the corporate scandals like Enron or WorldCom in the United States, Ahold in the Netherlands, Vivendi in France or Parmalat in Italy, also resulted in a growing criticism against business managers and directors. Here too, the media played an important role in creating world-wide awareness for the problems these failures brought about for all stakeholders involved.

Whereas the anti-globalisation movement mainly focused on a firm's behaviour in less developed countries, the corporate scandals forced the world-wide attention on firms not living up to standards of business conduct and corporate control. Undoubtedly, the recent American and European corporate scandals contain aspects of shortcomings of corporate governance. However, it is striking to see that some of these companies, like Enron, at first sight were good adherents of the basic recommendations on corporate governance. Yet, it went wrong!

A more thorough analysis of these corporate failures, which goes beyond the search for the 'guilty', clearly shows numerous failures of 'business monitoring'⁵: market failures, internal monitors that failed, shareholder monitoring failed and also management failures.

Underlying forces: the changing paradigms

Although the anti-globalisation agenda and the diagnosis of the recent corporate failures may -at first sight- be of a totally different nature, their underlying forces are surprisingly comparable.

Opening-up the black box: the new invisible hand

The increasing emphasis on corporate accountability has probably be driven primarily by non-market forces:

"When the market fails to achieve an optimal state, society will, to some extent at least, recognize the gap and non-market institutions will arise attempting to bridge it" (Arrow, 1962, p. 22).

These non-market forces are so powerful that some describe them as the new 'invisible hand' (Huysse, 1999) that reigns the business world and definitely opened-up the black box of board and management trade-offs and decision-making. The media and the Internet helped numerous types of NGOs, trade unions, institutional investors and governments to hold the

⁵ For more detail, see Van den Berghe & Baelden, 2003

business world increasingly responsible for their direct and indirect impact on society. These market and non-market forces operate in a very complementary way. Polonsky (1995) considers the media as a 'bridging stakeholder' because of its ability to influence other stakeholders who can -in turn- directly influence corporate behaviour.

The past years witnessed an increasing influence of powerful NGOs, which in some countries may have far more members than the democratically elected government. In a globalising world, NGOs become more and more the conscience of the world and have been influencing the public opinion significantly. Moreover, they are perceived as the "true credible source on issues related to the environment and social justice" (Vogl, 2003). A World Economic Forum inquiry (2003) has shown that NGOs have a far higher credibility than the business world in these issues. There is a growing ability and sophistication of activist groups to target corporations that are perceived as socially irresponsible.

In an 'information age', the impact of these various pressure groups is growing perceptibly, thanks to, among other things, the Internet, which permits information to be disseminated in a modern, cheap and rapid way. The damage that their action can inflict, certainly on the value of a listed share, can be enormous. Also the media played an important role in facilitating and stimulating this evolution. Examples of the growing power of the media can be found in CSR as well as in governance failures. Shell is an interesting case in this respect: with the Brent Spar-case the debates between Greenpeace and Shell received massive attention leading to a change in the public opinion; with the recent restating of its oil reserves, the media echos the shareholders' concerns. This resulting in far-reaching effects on its management and governance: several executives stepping down while at the same time forcing a rethinking of Shell's corporate governance structure.

Stimulated and influenced by this new invisible hand, market parties also start to consider CSR and good corporate governance as the prerequisite for sustainable growth and welfare within a globalising business environment. Critical customers, knowledge workers and shareholder activists increasingly scrutinise corporate behaviour and attitude. If customers are aligning their purchases with social criteria, they have the power to influence a firm's CSR stance. There is also pressure from the investor community for firms to engage in CSR practices.

This 'opening-up of the black box' is only one aspect of the fact that we live in an increasingly transparent society. Listed companies are obliged to disclose detailed financial results and urged to publish a social and environmental report. Moreover, they are faced with an increasing demand for more information on the individual remuneration of executives.

Even the results of unlisted companies must be made public. Society at large is searching for more disclosure on numerous other aspects, e.g. it becomes fashionable to publish lists of the private wealth of the richest families and Internet chat rooms disseminate the latest news (correct or incorrect). It is obvious that there is an increasing amount of scope for malicious news about companies, but whether this malice has an impact depends on how those companies are perceived. The citizen, the consumer and the employee are finding their tongues, are better informed (or believe they are) and demand better management at all levels: less of the 'more' and more of the 'better'. Personal judgment is coming less and less to determine what is correct and what is not; it is rather the media and organizations with access to it (such as the many action groups) that determines what the vast majority of people think about issues in general and companies in particular. Multinationals have learned that the censure of a court of law in another country has less effect than a negative pronouncement on the part of a reputable and respected action group. They asked themselves to be 'audited' by that same action group, and establishing a good case is the following step on the way. In this way, non-governmental organizations are increasingly becoming a source of law. Law is essentially territorial (its basis being the nation state) and hierarchic (the one norm stands above the other). The entire Internet business is essentially neither territorial nor hierarchic. This fundamental mismatch between the knowledge economy and the way in which law is currently made and administered is a major factor in the crisis facing the justice system.

Ignoring business externalities no longer a possibility?

In order to understand the potential impact of these new business paradigms, it is interesting to look at the question of business externalities (Van den Berghe and Carchon, 2002). Externalities are the side-effects of corporate activities on society. They can be either positive (economies) or negative (diseconomies).

In a completely liberal economy, without any government interference or regulation, the optimal firm behaviour is to ignore these externalities, because it is not considered a firm's duty to take these external factors into consideration. Given that some of these externalities can be important, the welfare economists developed the thesis that it is the role of the government to create stimuli to foster positive externalities (e.g. through subsidies) or discourage negative externalities (by installing a levy or a tax) or by simply forbidding these types of activities. As long as firms remain within a 'closed' regulatory system, the

combination of these two approaches gives rise to an optimal welfare. But the anti-globalisation movement criticised the ability of national and even supra-national organisations in monitoring the global behaviour of business firms and their effects on society at large. The lack of common standards on CSR and corporate governance is one of their main concerns. Given the huge societal impact of the new invisible hand, forward-looking business firms prefer to take their societal responsibility into their own hands. In so doing they also hope to make further regulation unnecessary.

However the different national and corporate attitudes towards corporate responsibility make the degree of integration of business externalities quite different around the globe. In a competitive environment, business firms will need to balance the costs involved in coping with externalities while keeping their long-term economic profit in mind. In order for a business firm to manage this difficult balance, one needs to develop a better view on stakeholder expectations. At the other hand stakeholders do need a better understanding of the limits to the societal role of a business firm. Bridging the expectation gap must therefore receive more prominent attention. Numerous pressures to make the business world responsible lead to creating extreme and unrealistic expectations and defines corporate social responsibility in too broad a perspective:

"... society's plea to provide innovative solutions to deep-seated problems of human misery'; ...'the calls for corporate involvement in redressing broader problems of society'; ...'should a firm devote its resources to combat such problems as malnutrition, infant mortality, illiteracy, etc.?" (Margolis & Walsh, 2001, p. 2, 4 & 7).

We would therefore like to point to the critique put forward by Zadek (2001): he urges society to be careful with what it can expect from business: "In fact, we do not and probably cannot know enough about the system to understand in this sense the relationship between the activities of one organisation and the whole system. There is little point in blaming pigs for not being able to fly". He adds that "a business's contribution to sustainable development therefore needs to be understood in terms of its viable options and what it makes of them". Indeed, one could wonder whether taking care of better housing, better schools, and a cleaner environment is a duty of companies. Some authors see a more explicit role of the government in this respect: "It might be better to look at the things that the private sector does not deliver, and then get governments fill the gap [...] Companies are not here to build a fairer society. That is the job of government" (The Economist, 2002).

Faced with the combined forces of the new invisible hand and the alerted market parties, the business world can no longer ignore its increased societal accountability. In this respect traditional corporate governance and management paradigms need a thorough reconsideration.

The need for a new corporate governance paradigm

Although corporate governance received quite some attention in “specialized” circles during the nineties, it remained a rather vague and unknown topic for the majority of (the business) society. The recent wave of corporate scandals in the United States (Enron, Worldcom, Tyco, etc.) and in Europe (Parmalat, Ahold, Vivendi, Lernout & Hauspie, etc.) increased the interest in corporate governance dramatically. All of a sudden, discussions about corporate governance, boards of directors, CEOs, auditors, etc. have become daily business, even in the mass media.

Corporate governance has been defined by Sir Adrian Cadbury as the direction and control of the company. For our analysis we need a broader look and define the underlying philosophy and methodology. In philosophic terms, it has to do with transparency, with accountability (in the sense that our errors can be laid to our score) and with honesty; these are the universal realities of governance. In methodological terms, it has to do with the necessity of achieving greater certainty in the correctness of decisions being taken and to achieving that via a number of measures (structures, processes, checks and balances, correct monitoring, etc.). Proper governance will thus probably lead to the situation where, in a board of directors, various strands of interest (family shareholders, institutional investors, management and the common good) may and ought to be brought forward in discussion, but where ultimately resolutions have to be taken (by all) in the interest of the company, an interest which all members of that board are required to serve.

The idea of governance rapidly leads to questions that go beyond methodology and efficiency: what the purpose of business is, what the interest of the company is that has to be served, where the balance has to be sought between return and, for example, social responsibility.

In this sense, corporate governance (and principally a well-composed and properly operating board of directors with real independence in the interest of the company) is a methodology for sustainability and a guard against the blinkered vision that can send a company down the wrong path. Furthermore, corporate governance and CSR are two concepts that draw vigour from the same source: transparency, accountability and honesty.

Mainstream corporate governance thinking is under attack

The traditional neo-classical view of the firm still dominates governance thinking (see Van den Berghe, 2003). Due to the focus on shareholders and financial performance, the impact of corporate activity on society, has largely been ignored in traditional corporate governance.

Even today, mainstream governance literature and regulations ignore the more modern theories of the firm. Meanwhile economic and management literature as well as business practice and society at large have criticised the traditional view on the role of the firm. Corporate governance can no longer ignore these new concepts and need redefine a number of its underlying paradigms need to be redefined:

Redefining the role of the firm and its effect on corporate governance

Traditional governance thinking is founded on the boundaries of the firm as developed by the transaction-cost theories. In legal as well as economic theories of corporate governance the concept of ownership of the firm plays a crucial role. Hence the focus on capital and shareholders (owners of the firm) as the reference base for all corporate governance mechanisms.

Alternative theories such as resource-based view, knowledge-based view, networkers and the communitarians view (for more detailed information see Van den Berghe, 2003) have challenged these 'boundaries' of the firm from several perspectives. Network theories stressed the importance of firm-networking and cooperation. The knowledge-based view of the firm stressed the knowledge-creating capabilities, which cannot be owned in the classical sense of the word: 'What determines the boundary of the firm is not the legal ownership of some assets, but how well a firm can facilitate such interactions' (Nonaka et al., 2000); hence the huge importance of intangible assets, like intellectual and social capital, reputation, etc. Based on these assumptions, corporate governance needs to go beyond the legal boundaries of 'the' company and integrate group relations, joint ventures and all relevant sources of capital into the reference base for developing good direction and control mechanisms. This does not mean that these new theories ignore the primary role shareholders can play, but that corporate governance should integrate the interaction with the broader set of stakeholders.

From the traditional principal-agent theory to the management of complex principal-agent relationships

The neo-classical model is still based on the shareholder as the only 'principal', all other stakeholders being considered as 'agents'. This paradigm goes back to the hypothesis that there is only one scarce factor of production, being capital while labour is abundant and environment is a 'free' good. Implicitly it is assumed that it is not the role of the firm to take externalities into consideration when making business judgements. Moreover these premises suppose that the shareholder is the 'owner' of a firm's assets. Indeed capital and assets can be owned. But this becomes far more complicated with intangible assets, knowledge workers, partnerships and trust. The more the latter become fundamental ingredients of the value of a modern firm, the less this paradigm becomes relevant.

Based on this neo-classical theory, one of the main challenges for corporate governance is to govern the potentially conflicting relationship between the principal (owner) and the agent (manager)⁶, between the creation of shareholder value and the corporate strategy developed by managers. From the perspective of CSR, this basic challenge should be enlarged to include all potential conflicts of interest within a firm and this not only from a shareholders' perspective, but from the broader stakeholder perspective. More attention is therefore necessary for the interaction and relationships between different classes of 'agents' and 'principals', involved in a corporation and the governance problems stemming from their diverging objectives.

The big challenge for corporate governance theories is to include these complex sets of relationships and their potential conflicts of interest and develop governance mechanisms to manage them effectively and efficiently. There will be a greater need for a transparent view on the interests the firm should foster. This choice will be impacted by micro-factors (who has the force to control? one or all shareholders? or does talent make capital dance⁷?) as well as macro-factors (main premises of the macro governance environment, e.g. primacy of market

⁶ In general terms, the agency conflict relates to the possibility that the execution of the authority delegated from the principal to the agent is not in accordance with the agency contract defined as the "contract under which a person (the principal) engages another person (the agent) to perform some service on his behalf which involves delegating some decision making authority to the agent". In corporate governance terms the principal is defined as the shareholder(s) while the manager is seen as the 'agent'. Jensen, M. and W. Meckling, 1976, "Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure", *Journal of Financial Economics*, 305-360; Jensen, M., 1986, "Agency costs of free cash flow, corporate finance and takeovers", *American Economic Review*, 323-329.

⁷ Ridderstale, Jonas and Nordström, Kjell, 2000, 2000, « Funky Business - Talent makes capital dance », *Ft.com*, Pearson Education Limited.

forces versus legal straight jacket). The art of corporate governance is to strike a balance between the interests of each of the aforementioned parties i.e. to minimise the conflicts of interest and to arrange that the interests of the firm (whatever they may be) are fostered. Therefore one of the duties of corporate governance is to organise for monitoring and disciplinary mechanisms, so that this balance of interests is well respected. This can be organised on the base of laws, by-laws, regulations, self-regulation and of course also market forces.

From short-term shareholder value to sustainable value creation

Based on neo-classical and transaction cost theory, the highest priority in corporate governance is given to the functioning of capital markets and the respect of shareholder interests. Shareholders have a prominent place as the principal of the firm, who expects from its agent, the manager, to maximise profitability and shareholder value (Macho-Stadler et al., 2001; Eisenhardt, 1989; Jensen & Meckling, 1976). Given these priorities, maximising shareholder value becomes the final goal of the firm as well as the final duty of the board and the management (Easterbrook & Fischel, 1991). Also capital markets and investment circles often focus on short-term financial performance indicators.

However academics as well as business managers are starting to reconsider the pure shareholder thinking as the primary goal of a for-profit corporation (George, 2001). Adept of the neo-classical theory of the firm have devoted quite some attention to these critiques and tried to come up with adapted versions. For example Atkinson et al. (1997) provide an analytical framework to integrate the societal objectives in the traditional shareholder model. For these modern neo-classicals, the whole challenge is to prove that corporate social performance leads to better corporate financial performance. Demonstrating that the financial bottom-line benefits from being a responsible firm, creates awareness -within the shareholder wealth-maximization paradigm- for humanitarian concerns⁸.

Other interesting developments of performance management instruments are the balanced scorecard (Kaplan & Norton, 1997), the EFQM model (European Foundation for Quality Management, 1999) and the Employee-Customer-Profit chain (Heskett et al., 1997). These instruments are aware that creating long-term shareholder value requires more than the

⁸ For an overview of the literature that studied the link between corporate social performance and corporate financial performance see Margolis & Walsh, 2001.

pursuit of financial objectives. There is need for widening the management of financial objectives to include non-financial objectives as well.

No convergence to the dominant firm logic?

The reliance of corporate governance on the more 'traditional' theories of the firm can probably be explained by the 'dominant firm logic' paradigm. The concept of the 'dominant firm logic' refers to those governance structures that are used as the reference base for developing (national) laws, regulations and self-regulatory recommendations (Van den Berghe et al., 2002). Since most of the corporate governance laws and recommendations are mainly developed for listed companies, the 'capital market' model is the main reference framework for corporate governance. Global capital markets are headed by Anglo-American countries. In these countries the "Berle & Means" model of the publicly listed company with a (very) dispersed shareholding (Berle and Means, 1932) is the dominant firm logic (Van den Berghe et al., 2002). Following Berle and Means' analysis, governance literature presumed dispersed ownership and the separation of ownership and control to be universal (Becht and Mayer, 2001). It therefore became the dominant firm logic not only in research, but also in laws, regulations and self-regulatory recommendations (Van den Berghe et al., 2002; Bebchuk and Roe, 1999; Roe, 1994 & 1991; Black 1990).

Given the reliance on capital markets, the neoclassical economic theory has been an important reference framework to develop corporate governance thinking. The separation of ownership and management, so typical for the dominant firm type, induced further reliance on the concepts developed by transaction-cost economics and contractarian theories.

The prevailing global dominant firm logic is only relevant for certain types of firms. The less the Berle and Means' firm typology is relevant for a country because of a wider range of firm types, the less useful the dominant firm logic becomes. This is the case in numerous Continental European as well as Asian countries and certainly holds for less developed markets. Continental European countries have quite diverging business models, so that their dominant firm logic leads to different national corporate governance laws and recommendations. In fact, the dominant firm logic explains why the so-called single European market does not exist when it comes to corporate governance, company law and capital market regulations (Van den Berghe et al., 2002). Defining an optimal governance system is necessary in order to give the firm a better chance for success and to foster the creation of shareholder value and the economic wealth for all stakeholders. Optimal corporate governance can be developed along a double track: while the basic corporate governance

principles are universal, their translation and implementation in practice needs to be differentiated according to the type of firm (and its relevant governance challenges and problems⁹) (Figure 1).

Insert Figure 1 About Here

Towards responsible corporate governance

To embody the idea of the responsible firm, we developed a hierarchical governance framework. This enlarged corporate governance framework is based on the redefinition of the theory and role of the firm, as well as on the enlargement of the principal-agent theory to include multiple principals and agents (stakeholder-inclusiveness). Such a framework should allow a firm to reflect upon the potential issues modern corporate governance should take into consideration.

In its simplest form, corporate governance focuses on the operation and composition of the Board of Directors (*level 1* in Figure 2). This is the central perspective of most of the codes and recommendations on corporate governance.

Insert Figure 2 About Here

Taken in a broader context, corporate governance is viewed from the angle of the so-called *corporate governance tripod* (*level 2*), whereby particular attention is paid to the relationship between shareholders, directors and management. Given the focus on the traditional role of the firm, this angle receives most attention, both in the legal disciplines and in practice. The tripod is also the focus for a large part of economic research: indeed a great deal of this research concentrates on how the motives of management (the agent) can be aligned with the interests of shareholders (the principal). In this monitoring process, the financial markets and external directors are assigned a major monitoring role.

⁹ For a more detailed analysis of the synchronization between firm typology and relevant corporate governance challenges at the one hand and corporate governance rules and recommendations at the other hand, see Van den Berghe et.al. (2002).

From a modern management perspective, a more holistic approach at the corporate or firm level is required (*level 3*). Companies are increasingly structured in national and international groups. Moreover, global competition within the network economy is giving rise to the embedding of companies in a cluster of networks with both suppliers and clients. Managing such networks therefore becomes a much more complex matter than managing just a single, specific company with a single principal – the shareholder – and a single agent – the management. In the new knowledge society, firms rely more and more on networks and other long term relationships. Consequently greater attention is being given to employees and other stakeholders.

From a socio-economic and chiefly political angle, a company is increasingly being forced to act as a corporate citizen (*level 4*). Consequently, the mission of corporate governance has broadened to take into consideration all stakeholders and it has become the task of corporate governance to ensure that attention is given to a balanced weighing of all stakeholder interests. In such an approach, no further distinction is made between levels 3 and 4 and one speaks simply of the *stakeholder model*. This model pays a great deal of attention to the *sustainable or responsible* enterprise.

Lastly, at *level 5*, the corporate governance debate focuses on the question of the primary reason for a company's existence. The fundamental question is whether a company's *raison d'être* is to create shareholder value or to create prosperity for all stakeholders involved. This perspective is central to the discussion of corporate social responsibility and the responsible firm. But also the debate on convergence of corporate governance models essentially boils down to this fundamental question.

The enlarged reference framework for corporate governance is not sufficient to develop a modern corporate governance toolbox. It is not only a question of reflecting upon the parties and interests involved. A broader societal role for the firm should also be translated in the recommendations and principles that guide good corporate governance. Figure 3 gives an overview of the dimensions corporate governance should cover.

Insert Figure 3 About Here

Financial corporate governance focuses on the structures and processes necessary for the pursuit of shareholder value. Important elements in this discussion are shareholder rights, protection of minority shareholders as well as transparency and disclosure issues. This is by

far the most important focus of the investment community in general and shareholder service firms more specifically.

In order to reach the goal of financial corporate governance, attention traditionally focused on *conformance issues*. The main emphasis of the many codes and recommendations has been on the development of a set of rules and principles that corporations should respect. Living up to the formal standards or benchmarks became the reference point to judge the quality of corporate governance. Many of these recommendations can easily lead to a kind of *box ticking* exercise with some *superficial* or *cosmetic* adaptations. The focus on compliance can therefore be at the detriment of sufficient attention for governance reality. Interesting examples where such box ticking often applies is in disclosing the composition of the board, the minimal number of independent directors, the establishment of board committees etc. The great challenge, however, is to change the fundamentals related to the correct governance attitude and behaviour of (business) leaders and directors. Only then will substance reign over form. Numerous are the corporate governance codes, recommendations, and governance rating systems that were developed from this perspective. The emphasis on conformance resulted in many recommendations to organise better control and supervision over management, like establishing board committees, such as the audit committee, the search for truly independent directors, management oversight etc. However the failure of numerous firms that followed these recommendations, at least formally, has created much support for an enlarged governance approach.

First of all, the disproportionate emphasis on conformance distracted attention from the complimentary issues of *performance*. We may not forget that corporate governance is not an aim in itself, but a mechanism of structures and processes to allow companies to realise their ambitions and goals and to create welfare and economic well-being. The pursuit of shareholder value is certainly hampered if the emphasis in processes and board structures is univocally oriented towards control and supervision. Attention must be given to the establishment of the necessary structures and processes to realise a firm's strategic ambitions. Entrepreneurship and stewardship are instrumental ingredients to foster business prosperity.

Secondly, directors have traditionally been (very) sensitive to the demands of their shareholders. However, in the modern business environment, firms more and more have to cope with other critical stakeholders. The challenge for corporate governance in general, and board members more specifically, is to include the duty of balancing the interests of all stakeholders. In an information and knowledge society a firm's reputation, its intellectual capital, and finally its license to operate, become largely dependent on this complex balance

of interests. Therefore, the content of corporate governance has to be extended to *responsible corporate governance*¹⁰. The essential difference between financial corporate governance and responsible corporate governance lies in the definition of the goal of the firm in general and of corporate governance more specifically. In both cases corporate governance is about structures and processes to allow the firm to realise its strategic goals. Financial corporate governance defines the firm as the instrument of the shareholders and considers that the role of the firm and its directors' duties are simply shareholder value maximisation. Responsible corporate governance defines the firm as a long-term partnership of shareholders and other stakeholders. Therefore corporate governance should aim at optimising the (long-term) return to shareholders whilst satisfying the *legitimate* expectations of stakeholders. In fact, this supposes that shareholders become *shared value holders*. Understanding the issue of responsible corporate governance now lies at the heart of good corporate governance. It is essential in establishing a corporate brand, so that frustrating this broader scope of corporate governance could prove to be commercial suicide.

Responsible corporate governance transcends the attention for the interests of employees. It is about balancing the legitimate interests of all stakeholders involved. Moreover the emphasis on ethics and sustainable growth is fundamental.

It should be clear that a 'responsible' firm is far more than a nice to have *add-on* like charity, philanthropy, etc. Corporate social responsibility is more than public relations or reputation management. The societal responsibilities of a firm must be *fully integrated* in corporate governance and management practice and theory. The modern view on the role of the firm in society should be translated into the firm's products, the production process, the treatment of stakeholders (including the environment), the system of governance and accountability, and the codes of conduct (Wilson, 2000). It forms an intrinsic part of modern business opportunities, threats and risks. This is so central to the success of the firm that corporate social responsibility cannot be completely delegated. It must become the final responsibility of senior management and the board of directors. Hence, a broader scope of firm performance is necessary.

¹⁰ For a more in-depth analysis of these principles we refer to Van den Berghe L.A.A. Carchon S. Levrau A. Van der Elst C. 2002. Corporate Governance in a Globalising World : Convergence or Divergence? A European Perspective. 223 p. Kluwer Academic Publishers. '

Redefining the corporate governance mechanisms

Given the increased expectations towards business in society and taking into consideration the increasing mistrust due to corporate failures, fiddling with a couple of formal requirements with respect to corporate governance is not the answer. If we want to rebuild trust in the corporate world, numerous corporate governance mechanisms will need to be redefined. We will present some fundamental principles, which are complimentary conditions to obtain effective monitoring and control.

Managing conflicts of interest to avoid that private benefits prevail over the corporate interest

From the analysis of the corporate scandals, we learned that numerous types of conflicts of interest were at the heart of the corporate breakdown. Many of the parties involved seemed to have pursued their private interests, while ignoring the long-term interest of the company. In the case of Enron, all monitoring bodies received direct or indirect funding from the top management of the company (see Figure 4). Consequently monitors were restrained from effectively challenging the people at the helm of these companies. They were not willing to bite the hand that fed them. They all became richer, while long-term shareholders, including the employees of the company, lost their money. This case clearly shows that the Enron-employees suffered the most from this failure: given the huge investments of pension money into the firm, the employees not only lost their shareholder capital, they also lost their pension savings as well as their jobs.

Insert Figure 4 About Here

Enron, World Com, Parmalat and other scandals show that the impact of business failures goes far beyond the loss of shareholder value. The societal values destroyed by these companies are immense. In fact, the actual corporate scandals highlight the need for another kind of corporate monitoring, also in terms of negative externalities. No wonder many of the recent reform initiatives focus on the elimination of certain conflicts of interest by strengthening the role of (independent) internal and external monitors.

Redefining the role of the board: making the correct trade-offs

Since the board of directors is the first instrument for monitoring the firm, the board should be aware of its enlarged duties. Sound governance will ensure that, via a well-constituted board of directors, all the relevant responsibilities will be addressed and that a balance will be struck in dialogue with the management. Tensions do not have to be avoided in this. The key lies in a conscious handling of the many tensions: short versus long term, self-interest versus the common good, left versus right, capitalism versus the social economy, efficiency versus taking it easy, the team versus the individual, less management versus better management; in short, away from the 'or' world to the 'and' world. The same message is translated in the concept of the 'Triple Bottom Line'. This rhetorical device, coined by Elkington, has created a safe linguistic haven for business, government and civil society, allowing previously antagonistic players to share a common vision of the longer term, rather than simply fight over an unsatisfactory 'current reality' (Wheeler et.al. 2003).

Suggestions of this enlarged role of boards can be found in the academic literature. Pfeffer and Salancik (1978) viewed the board as a key link to the external environment and identified three key roles: serving as co-optive mechanism to access resources vital to the organisation, serving as boundary spanners and enhancing organisational legitimacy. Hung (1998) goes a step further in enlarging the board's role: among the six basic board roles figure duties like 'linking the organisation to the external environment' and 'coordinating the interests of shareholders, stakeholders and the public'.

In mainstream business, a stakeholder approach has yet fully to supersede the shareholder primacy model of corporate governance, though a narrower, but still responsive relationship model, is now commonplace. The evidence is now mounting that what is said to one stakeholder group, i.e. the investors, need no longer be in conflict with what is said to employees, customers, supply chain partners and local communities. This may soon help to eliminate a potent historical source of double-speak by corporate board members and

executive officers as well as the limitless potential for cognitive dissonance caused by the disconnect between the rhetoric of corporate leaders and stakeholders' actual experience (Wheeler et.al.; 2003).

The broader scope of the role of the firm is leading in some countries to a reformulation of the legal duties of directors. The new company law in the UK as well as the duties included in the Turnbull report (holistic risk management) or the new French law on CSR reporting by the board of directors are illustrative in this respect. In the US corporate constituency laws passed recently in at least 29 states now explicitly permit corporate directors to base their decisions on non-shareholder interests. These statutes suggest a fundamental –but highly controversial- shift in the definition of the role of the corporation¹¹.

In continental European countries, that traditionally devoted more attention to the societal impact of corporations, like the Netherlands or Germany, an opposite movement seems to take place: giving a louder voice to shareholders' interest.

More effective monitoring through independent/objective directors

Avoiding conflicts of interest as much as possible is a first important step, but is, surely, not enough to rebuild trust in the capital markets. Trying to guarantee that monitors can perform their role from an unbiased, “independent” point of view, is one thing. Motivating them to make all the necessary efforts to complete their task is something else. What we need, is effective control, done by vigilant monitors who are willing to challenge the company and its top executives. The right structures can help to regain confidence, but eventually, only the right people with the right attitude will make the difference.

The presence of a sufficient amount of independent directors in the board and in its sub-committees, can be a facilitating factor to create the right culture inside the boardroom, but is, nevertheless, no sufficient guarantee that directors will have the right attitude. In fact, one should make a distinction between “*formal independence*”, which can be interpreted as an absence of possible conflicts of interest and “*independence of mind*”, which comes down to an attitude of independent thinking. What we really need to ensure effective control, is “independence of mind”.

Given the complex nature of “independence of mind”, it is advisable that more attention and research is devoted to the necessary conditions, the underlying indicators and

¹¹ Wharton Impact, Winter 1993, p.4.

drivers, and possible routes to judge and evaluate the degree of independent behaviour. If such a reference framework could be developed it could become an interesting instrument for pre-nomination discussions and post-nomination evaluations and feedback. Meanwhile, it is generally accepted that “formal independence” is the best possible guarantee, as monitors faced with conflicts of interest will have a tougher stand to display an independent judgement; hence the greater attention given to formal criteria in order to define a minimum degree of independence in the board room. However, we should keep in mind that it is not a sufficient condition for “independence of mind”. Moreover, “formal independence” is in theory not even a necessary condition to display a true “independence of mind”. Ideally, a really self-critical person is able to identify and transcend his own dependencies to make an objective decision in the interest of the company and its stakeholders. Of course, real *objectivity* is very difficult to achieve. We all live in a personal context and have our own views. But this should not restrain us from pursuing objective decision making in the corporate world.

The efforts of the High Level Group of Company Law Experts (2002) and the Sarbanes-Oxley Act to strengthen “formal independence” and to increase the presence of that type of directors in the board of directors and its committees are extremely valuable. Notwithstanding, the attention in the future should be on the “soft factors” – like culture, attitude, ethics, etc. – factors that influence objective decision-making by the board of directors.

Empowering the board to go beyond the pursuit of short term shareholder value

Minimizing conflicts of interest, motivating directors to perform a challenging monitoring role and increasing the degree of independence of the board are already three important steps in the right direction. But of course, we also have to give corporate monitors the necessary powers to perform an effective job.

All new governance recommendations and codes attach great importance to the empowerment of the board in order to perform its role as the crucial internal monitor. From a legislative perspective especially the audit committee is increasingly positioned as the conductor of the corporate control process. Given this enhanced pressure on audit committees to prevent future scandals one could even question to what extent audit committees will be able to live up to these expectations (Spira, 2002).

But in today’s business environment it will mainly be the shareholder that has to be convinced of the need to empower the board to focus the attention on long-term value

creation. Although many family shareholders have been quite sensitive to societal needs, the movement of corporate social responsibility will probably be led by the larger international groups, which are mostly listed on international stock exchanges. The overwhelming focus of corporate governance on listed companies (cf. dominant firm logic), their high visibility and international position places their shareholders in the spotlight for fostering ‘responsible firms’. Therefore the institutional shareholders could well become an important driving force.

Although shareholder activism does get quite some attention in corporate governance circles, it mainly relates to financial corporate governance and fostering shareholder value. Active monitoring by institutional investors to create the *responsible* firm is still underdeveloped. But their sheer size will put institutional investors in the spotlight to behave as *responsible institutions*. As trustees of the money of their members (pension funds) or customers (insurance companies, mutual funds), they themselves will come under increased scrutiny of the new invisible hand of the media and the NGOs. Combining their shareholder activism with the concept of the ‘responsible firm’ leaves us with the possibility that institutional investors could well become the most important force in rethinking the corporate governance paradigms.

One possible route to stimulate the multiplier-effect of shareholder activism could be to make institutional investors *accountable for the role of business in society*. Even without the hard scientific proof that corporate social responsibility is leading to shareholder value optimisation, the sheer belief of institutional investors that this is inevitable in actual society would prove to be a kind of a self-fulfilling prophecy. This is not unrealistic, as has been proven with the famous effect of institutional investors’ belief in the positive correlation between corporate governance and financial performance: even without highly convincing scientific proof, institutional investors do believe in such a positive correlation, as has been highlighted by concepts such as the McKinsey premium, or the CalPERS’ effect (Van den Berghe et al., 2002). Especially *socially responsible investment funds* could lead the way, as highlighted by Margolis and Walsh (2001):

“... while scholars continue to debate whether corporate social performance enhances corporate financial performance, companies continue to invest in social initiatives.”

No effective monitoring without information

Empowerment of the board and of external directors goes hand in hand with measures to guarantee a better quality of information. Regulatory reforms attach great importance to

external transparency (see chapter regulation), but do give less attention to internal transparency towards directors. In this respect, the adequacy and reliability of the information process is a critical point, especially because of the information asymmetry between insiders/executives and outsiders/non-executives, and sometimes even between the representatives of the reference shareholder and the other directors. One cannot expect a director to perform an effective monitoring role without the right and timely information. Concrete suggestions on how to do this are difficult to make (“one size does not fit all”), but every board of directors and every board member should strive for the right information and evaluate its quality periodically. Does every board member know where he can obtain additional information? What procedure has to be followed to ask independent external advice? Are there sufficient (informal) contacts with the management team?

Responsible governance is not only a duty of business firms

Considering the global trend to impose tougher corporate governance principles on the business world, it is surprising to observe that the same focus on governance principles is (almost) lacking in many other organisations. The list of organisations, that need further attention from a governance perspective, is unfortunately very long. It is striking to observe that institutional investors, supra-national organisations or non-governmental organisations, whose impact is expanding quickly, do not face or even do not practice hard governance rules. The same holds for state-owned enterprises and other governmental organisations. Potential agency conflicts and control bias can exist because most of these organisations are not subject to market disciplinary measures, nor are most of them subject to tough rules of control, accountability and disclosure.

Institutional investors are crucial drivers behind the recent changes in corporate governance thinking. However, they themselves are not immune to conflicts of interest and control bias problems. To remedy these potential problems, corporate governance rules for institutional investors should be developed or/and institutional investors will need to monitor their own corporate governance programs. The same holds for the numerous rule-setting bodies or the semi-public institutions that perform a supervisory or monitoring function. Besides responsible *corporate* governance more attention should therefore be paid to *societal* governance (Van den Berghe et al., 2002).

RELEVANCE OF CSR AND CG FOR THE FINANCIAL AND INSURANCE SECTOR

The insurance and financial services companies: firms as any other enterprise?

The financial and insurance sector is –as any other business sector- subject to tougher societal scrutiny. The insurance and financial services sector has certainly not been on the forefront of great attacks from the anti-globalisation movement. Its rather low profile in environmental risks is probably one of the major explanations. In the recent corporate collapses, financial services firms were not among the ‘leading’ examples either. If we however go back in time, important sectoral corporate scandals occurred in the 80’ies and 90’ies. Just think of BCCI, Maxwell (pension fund) or Barings. These were certainly at the origin of a first wave of stricter corporate governance rules in the UK (like the Cadbury Code in the mid 90’ies). The more recent corporate collapses also had quite substantial indirect effects on the financial services sector. Some illustrative examples in this respect were the conflicts of interest of investment banks and financial analysts, or the loss of pension savings in the Enron case. Moreover, the insurance sector, which was heavily invested in stocks after the bull market of the nineties, was greatly hurt by the stock exchange debacle, that followed these corporate collapses.

If we analyse the relevance of the general antecedents of the increased role of business in society, we come to some interesting observations. Given its specific core business, its regulatory environment and its important potential for positive and negative externalities, this sector shows some very specific characteristics that make it an interesting test case for applying the analysis of CSR and corporate governance, as discussed in the previous part. Such a sectoral approach has explicitly been suggested by the European MultiStakeholderForum as a route towards a better understanding and mainstreaming of CSR:

“A close collaboration between firms in specific sectors can enable the awareness for CSR and facilitate the transfer of knowledge between firms. There is indeed a great need for building case studies as learning tools, thus creating awareness and developing the skills of future managers and other stakeholders; hence, the suggestion to look at stimulating sector networks”.

Sectoral relevance given its potential for specific positive externalities

Given the huge potential for positive externalities, embedded in the insurance and financial services sector, it is clear that these firms perform a far greater role in society than their pure micro-economic market role. From a CSR-perspective this supposes that governments and civil society should foster the development of these sectors in order to optimise societal value. It is still open for discussion whether these positive elements are sufficiently taken into consideration or whether the potential for negative externalities has overwhelmed the public perception.

Management of pure risks: how financial institutions and insurers can help to solve societal problems

From a conceptual perspective, we have proven the positive externalities created by the insurance and financial services industry¹². In fact, by applying the law of large numbers, insurance companies transform individual insecurity into transferable risk and by doing so, they create a higher level of assurance and stimulate economic risk taking. Moreover, insurance is built on a solidarity mechanism between fortunate and unfortunate insured customers. In order to make insurance ‘affordable’ to persons and organisations with higher risks, governments can even allow insurers to build-in elements of obligatory systems of solidarity.

One of the ways CSR could translate into better performance at corporate as well as at societal level, is through a more efficient and more effective risk management. The potential for positive externalities can clearly be documented by referring to some recent examples.

Strict liability, especially for pollution, makes financial institutions and insurances directly or indirectly responsible for the projects they are insuring or financing. For example in 1980, the Comprehensive Environmental Response Compensation and Liability Act (CERCLA) in the U.S. backed up the Environmental Protection Agency’s (EPA) efforts to clean up contaminated sites. This Act – also known as Superfund – made owners of contaminated sites liable for the cleanups. Although the Act exempted lenders from ownership status, due to the complexity of the issues involved, some banks were forced to enter into the court procedure and some recorded financial losses (Environmental Protection Agency, 2001).

A second example is the Directive on Civil Liability for Damage Caused by Waste issued in 1989 by the European Commission. According to this document the liability for damage caused by waste could be assigned to both a producer of the waste and a person “who had actual control of the waste, if he is not able within a reasonable period to identify the producer” (extracted from Schmidheiny & Zorraquin, 1996). The bankers’ community found the wording “actual control” potentially dangerous, since the interpretation of the phrase could lead to lender’s liability in certain instances.

Another example is the Fleet Factors case in 1990. The Fleet Factors Corporation case was among the first in a series of legal proceedings in the U.S. that eviscerated the banks’ exemption from Superfund liability. The liability issue has been an important element that started to question the role of financial institutions within sustainable development. Although it is a rather negative approach, financial institutions were forced to consider environmental aspects in their business.

The liability issue is certainly an imperative consideration to be taken up by financial institutions and insurers. They have an important role of assessing risks, estimating ways to manage these risks and calculate the return of possible risk management routes. The insurance industry can help to remediate environmental damage and provide a mechanism to internalise environmental and social externalities by putting a price on environmental and social risks.

Because it is desirable to prevent damage rather than remediate it, insurers need to send clear market signals to accurately price risks and reward socially and environmentally well-managed companies. Since reducing risk is in everybody’s advantage and interest, it would be beneficial to the corporation as well as to society at large if CSR would result in risk reduction. This was shown in the European MSF by the case of Federchimica: after adopting their Responsible Care Programme the number of accidents dropped significantly. This has a direct effect on the cost of insurance cover and hence, can be considered as a positive financial driver for CSR. On the other hand, if the business world is unable to answer the societal needs, new liability legislation could be further forced upon them. To what extent this creates new captive markets for insurance cover will depend on the insurability of the risks involved.

Since liability has been clearly strengthened through legislation as well as through civil society, this also raises new challenges for corporate risk managers. If they want to gain

¹² Van den Berghe, L. (1981)

access to bank finance or insurance at reasonable cost, they will need to improve their overall social and environmental performance.

Another relevant CSR-issue for the insurance industry is climate change. Recent apparent instability in the weather and a succession of natural catastrophes have made it more difficult for insurers to calculate risks. The insurance industry already took some initiatives such as the development of financial tools to help business off-load some of its environmental risks, and the drafting by insurers of a U.N. charter on sustainable development. Leading insurers such as Munich Re and Swiss Re are taking the idea of global warming very seriously.

Management of business risks: how financial institutions and insurers can help to evaluate the governance and risk profile of the business firms

From a corporate governance perspective, the recent corporate collapses resulted in tougher regulations. Especially the Sarbanes-Oxley Act (aiming at companies listed in the US) directly and indirectly increased the focus on risk management for all companies worldwide. Directors, members of the audit committees as well as external auditors have to pay attention to the management of corporate risks, not just the financial ones. Directors are responsible for insuring that an effective system of risk management is installed. This results in the fact that the core business of insurers and financial service providers becomes all of a sudden one of the focal points of attention of boards and top management.

A positive side-effect of the instrumental role insurance and financial services firms are playing, could well be that they get more responsibility in judging the governance and risk profile of business firms. Regulations like Sarbanes-Oxley and the Basle II put indeed quite some additional responsibilities on the shoulders of insurers and bankers. The increased obligations on risk management and on monitoring of corporate governance, installed by Sarbanes-Oxley, will necessitate that insurers take a closer look at these elements before accepting to take over some of the business risk.

Illustrative in this respect is the amuck run by AIG, who had insured the directors' liability of the failing Ahold executives. AIG blamed Ahold for their incorrect corporate governance. Recently they finally reached an agreement that laid down some far tougher rules on the firm. Ahold put in place a series of measures that aim at reinforcing accountability, controls and corporate governance. They have replaced the decentralized system of internal control with a one-company system with central reporting lines. The Internal Audit

department now not only reports to the Chief Executive Officer, but also to the Audit Committee of the Supervisory Board. The accounting and business control functions have become more centralized while the division of responsibilities at Corporate level is now better reflected through the establishment of separate Business Controlling and Accounting and Reporting departments. Ahold initiated a company-wide financial integrity program, and is now convening a shareholders' meeting devoted solely to corporate governance. It is also one of the first companies in the Netherlands to implement the recommendation of the Dutch Tabaksblat Committee on corporate governance. Shareholders have been given more rights and the cumulative preferred financing shares have been restructured. All these proposals aim at improving transparency and a far-reaching increase in the power of Ahold's shareholders. Indeed, they are considered by third-party experts to be at the forefront of corporate governance initiatives in The Netherlands.

Management of economic and system risks: the large-scale impact of financial intermediation

By intermediating between surplus and deficit sectors, financial service providers create economic value while facilitating corporate and private financing as well as saving and investment. The less capital markets are developed, the more important this intermediation function becomes. In this respect these firms can play a very important role in less-developed countries to start-off economic development.

In buying insurance or investment products trust in the service provider is of enormous importance. In life insurance and pensions, customers should have the trust that the company they pay yearly premiums to, will still be around after 30 or 40 years and be able to pay them back all of their saving money. In trusting one's money, savings or investments to financial service providers, a customer must have the necessary guarantees of solvency and liquidity at all times. Trust in the financial system is therefore of utmost importance for the stability of the economy; hence the serious interference of governments to regulate these activities.

Special attention for the potential of negative externalities

Unfortunately for the insurance and financial service providers, their sectoral specificities not only hold the potential for positive externalities. On the contrary, also important negative externalities can occur. These have probably gained far more public attention (recently) than their positive side-effects.

The danger of false expectations and miss-selling

Sometimes, customers of insurance and financial service providers suffer from ill-advised products, overselling or even miss-selling. This has not only given rise to numerous customer complaints, but also to outright scandals. In some cases it is clear that hard selling techniques and unfair distribution practices are at the heart of the problem. In other cases it is more the complex nature of modern financial services that gives rise to the potential for miss-selling. The more developed capital markets become, the more financial products proliferate in all formats and shapes. These sophisticated products can pose complex challenges for advisors as well as for customers to choose the correct product that best fits the customers' specific needs. Moreover, the pricing of these products can become rather intransparent. This certainly holds for a great deal of investment products. That the potential for miss-selling is considerable has recently been shown in many countries:

- ✓ Great negative publicity was given to the pension and mortgage miss-selling in the UK.
- ✓ Another example of negative externalities was experienced by Dexia, a Belgian-French financial conglomerate. They suffered a huge reputation loss as well as numerous court cases in relation to the stock-lease products, developed by the investment company they bought from the Dutch insurer Aegon.
- ✓ In the US, numerous financial services providers have been condemned by the SEC for incorrect cost and investment allocations in their mutual funds in the US.

That the number of these complaints and court cases has drastically increased the last couple of years is probably not due, in the first place, to an enormous deterioration of the ethical stance of insurance and financial services firm. A far more important driver is to be found in the effects of the new invisible hand. The Internet lowered the barrier for product comparisons, while consumer groups and frustrated customers have made large-scale use of the media to echo their complaints publicly.

The silent revolution in shifting the risk burden back to the customer

Numerous examples of actual and future shifting of the risk burden, back to the customer, can be observed in the insurance world. This silent evolution could well become a boomerang if not well addressed and managed in a responsible way.

The more open the competition becomes and the more individualism reigns, the less viable is it to build large-scale solidarity into insurance products. In such environment, risk tarification becomes more and more individualised. For the good risks, this is a great evolution, but for the higher end of the risk spectrum insurance cover becomes far more expensive if not outright unaffordable. This has been overwhelmingly clear in the tough competitive battle in markets like auto-insurance. In some countries, insurers have been blamed for reckless tarification on the back of the more problematic risk groups. This in itself is a proof of the externalities and their devastating potential effects on this type of business.

From a CSR-perspective, a future time-bomb is ticking under the pension system. With the growing longevity, the funding of pensions is increasingly under attack. Governments, business firms as well as insurers and pension funds try to switch gradually from a defined-benefits to a defined-contribution system. The enormous impact of this shift is however not sufficiently explained and the potential risks involved, for the future generations of pensioners, is certainly not clear at all. In an era of increased accountability and scrutiny of the business world by civil society, it is in the interest of the service providers to invest more time and effort in improving the understanding of the great consequences of this shift. Another important step could be to offer sufficient transparency and choices, certainly for those that can not or do not want to carry this risk burden themselves.

From dominant firm logic to fair value accounting: is there still a future for long-term risk spreading?

The focus on the dominant firm logic has driven the accounting principles into the direction of fair value accounting. In a listed company with dispersed shareholders the market is finally the best monitor. However market monitoring supposes very detailed disclosure, in order to make external monitoring feasible. Moreover in a stock market where the engine is made up of sharetraders and daytraders disclosure of fair market value is of tremendous importance. Although these recipes mainly hold for that dominant firm logic, as in any other field of corporate governance, all other types of firms are greatly affected too. In the EU the IAS accounting regime will hold for all listed companies that have to publish consolidated annual accounts, including banks and insurance companies.

Without going into the detailed effects of this new accounting regime, it is necessary from the perspective of externalities to point to the negative effects this fair value accounting could have for the core business of insurance. Given the inversion of the exploitation cycle,

the need for risk spreading from a time as well as from a customer perspective, insurers need to build substantial technical provisions. Such long-term stability buffers are essential for smoothly performing their core function. Indeed, insurance is embedded in uncertainties as to the timing, frequency and amounts of claims to be paid. This is in fundamental contrast with the short-term focus of fair value accounting. Although solutions can be found in the capital market to shift the burden away from insurers, it remains to be seen whether this shift is not endangering the mere existence of the insurance transfer function.

Specific CSR- and corporate governance relevance, given the role as institutional investor

Although to a different degree, all insurance companies, pension funds, investment funds, credit institutions, etc. perform a role as ‘institutional investor. In respect to corporate governance as well as to CSR, the institutional investors can perform an important role.

The potential role in shareholder engagement

Many countries are supervising the investment behaviour of institutional investors in as far as it influences their solvency. Some go one step further, by making them accountable for effectively voting in shareholders’ meetings. If accountable for voting behaviour, this mainly focuses on disciplinary mechanisms to improve shareholder return. However, institutional investors themselves are under increased scrutiny from society in two directions: they are increasingly questioned about their own corporate governance while pressure is also mounting to enlarge their accountability for checking also the CSR-policies of firms. Indeed, insurance companies and pension funds are stewards of their customers or members’ money, and as such, they have a (very) powerful position. Their own corporate governance and CSR is increasingly being questioned:

“...are these interventionist owners of shares, who may simply be stewards of pension fund investments, empowered to act in disregard of employee considerations?”

...highly visible yet frequently anonymous, with notable exceptions, creators of mergers and acquisitions, financial engineers, asset strippers, institutions, whom I’ve already argued often, are but the stewards of pension fund investments masquerading as owners” (Denis Cassidy, Henley Conference on Corporate Governance, 2001).

As the recent literature points out the interest of institutional investors in CSR is increasing (Hummels, 2003; Coles, D. and D. Green 2002; Bayon. 2001; Gribben, C. and A.

Faruk, 2004). But also inter-governmental organisations such as the European Commission or the U.N. and governmental organisations are exerting pressures on financial institutions and insurance to engage in CSR through their powerful position as investors.

According to Clarck and Hebb (2003) institutional investors changed behaviour in the 1990s to began to aggregate shareholders' interest and to use their concentrated power, and the resulting reductions in transaction costs, to actively engage with board of directors in order to lengthen investment horizons and raise firm-level standards of behaviour across a range of issues such as accountability, transparency and, social and environmental standards. Shareholders have rights to align directors' interests with those of shareholders and hold them to account for the management and performance of the company (Forum for the Future, 2002).

Institutional investors adopt different engagement strategies which range from passive to active. The first strategy, negative screening, is based on exclusionary criteria through which investors make use of their exit voice (see Hirschman, 1970). Basically investors may decide to divest from a company or a whole sector if this one does not meet their criteria. The other strategies are positive screening, engagement, and proxy voting. Hummels, Willeboordse et al (2004) define engagement as "influencing corporate policy by virtue of the position as investor and the associated rights". Shareholder activism is the strongest form of engagement where shareholders exercise their power through general protest voting at AGM or the support of SRI/CG related shareholder resolutions¹³. Engagement differs from voting, as voting is often required by Law and in that sense not necessarily an active stance. These strategies, especially the last two, are more active and involve the voice option (see Hirschman, 1970). Rather than simply divesting from companies engaged in activities they consider to be contrary to their values, investors are choosing to actively invest and use their positions as shareholders to affect corporate behaviour. These strategies are not exclusive, and investors can apply combined strategies.

For a long time, the most active institutional shareholders have been found in the US, especially driven by large public pension funds like CalPERS and TIAA-CREF. More recently, the British insurers and pension funds started to develop their shareholder activism much more in concert with each other. Especially sectoral organisations, like the Association of British Insurers (ABI) and their colleagues from the pension side, the National Association of Pension Funds (NAPF) played a prominent role in this respect. Now that they also joined

forces with the Investment Management Association (ima) and the Investment Trusts (its) to form the 'Institutional Shareholders' Committee', they are really becoming a powerful monitor of business firms in the UK.

Socially Responsible Investments: a marginal market or an important CSR-driver?

According to Insight Investment, institutional investors and fund managers have a responsibility towards stimulating CSR. They argue that Socially Responsible Investment (SRI) in particular might considerably influence the ethical stance of a company. As SRI receives growing attention, more companies are actively taking measures to make sure they are not excluded from SRI-indexes such as the FTSE4Good and the Dow Jones Sustainability Index. Therefore, SRI and investor relations' officers (who are both explaining companies' strategies to investors and echoing investors' expectations within their companies) are considered as possible drivers of a CSR-approach for companies. However it can take some years before investor relation officers will be able to perform their potential role as CSR-catalysts.

Although seen by many as one of the drivers behind CSR, it cannot be overlooked that SRI has still an extremely limited market share. Defining SRI funds from both a positive and negative screening perspective, the relevant SRI-fund market is less than 1 % of the total retail market across Europe and between 2-3 % of the institutional market (figures for 2003). However, if the SRI definition simply comprises exclusions – for instance from an industry perspective – and engagement practices, the ratio of SRI funds reach a considerable size in certain countries (in particular in the UK and the Netherlands).

Notwithstanding its relatively small portion of total investments, socially responsible investing continues to grow and becoming more mainstream and influential. Total investments using at least one social investment strategy have grown from \$40 billion in 1984 to \$639 billion in 1995, to \$2.34 trillion in 2001, according to the report by the Social Investment Forum (SIF). Social investments now account for about 12 percent of the estimated \$19.9 trillion under professional management in the U.S., according to the SIF report¹⁴. According to the SIF 2001 report, the growth rate of assets found in socially screened portfolios was over one and a half times that of all professionally managed investment assets

¹³ Eurosif (2003). Socially Responsible Investment among European Institutional Investors: 2003 report.

¹⁴ SIF (2001). 2001 Report on Socially Responsible Investing - Trend in the United States, Social Investment Forum US.

in the US. Note that the 2001 figures, although still going up, reveal a slow down of the curves. It may be interesting in the near future to check whether this tendency is continuing or whether it is an accident. If it continues, one may wonder whether or not ethical investment has reached some kind of maximum threshold. A study carried out by the Siri Group shows a similar growth in Europe. The total assets that are socially screened have increased from 11.1 billion Euro at the end of 1999 to 14.4 billion Euro at the end 2001 (SIRI Group, 2002). According to the SiRi 2002 report four countries – United Kingdom, France, Sweden and Belgium –account for more than 68% of the funds available in Europe, and three countries – UK, Sweden, Netherlands – hold 58% of the total European ethical retail asset.

SRI: a need for evidence

According to Harry Hummels¹⁵, institutional investors will not consider SRI unless there is evidence that there is a positive link between social, environmental and ethical issues (SEE) and long term shareholder value.

Fiduciary duties are the most important duties of institutional investors. They are required to carry out investment decision in the sole interest of their beneficiaries. Since no Law in Europe clearly and explicitly defines the relationship between fiduciary duty and social, environmental and ethical issues (SEE), institutional investors do not feel the necessity to integrate SEE in their investment policy. There are different views on this issue from both academics and practitioners. Generally the traditional view considers SRI/CG as having a negative effect on the profitability and therefore may infringe upon their duties. Academic research, analysing the portfolio performance of SRI funds, shows diverse results (see Louche, 2004). The dominant claim is that ethical investment provides higher financial returns than regular funds (Luther, Mataka, & Corner, 1992; Mallin, Saadouni, & Briston, 1995; Snyder et al., 1993; Social Investment Forum, 1998; Bauer, 2002). A number of studies show inconclusive results either because of a lack of significant statistical difference between the returns of ethically screened and unscreened universes (Diltz, 1995; Sauer, 1997) or because of sector and style biases (Louche, 2001; Pava & Krausz, 1996). Very few studies conclude that ethical funds under-perform (Mueller, 1991).

As long as the positive impact of SEE on portfolio performance is not shown, institutional investors will remain reticent to SRI. A positive relationship is a prerequisite for

¹⁵ Interview with Harry Hummels, 25 May 2003

SRI to become a logical development. However very slowly institutional investors are recognising that social and environmental standards are appropriate concerns in order to ensure long-term returns and therefore fulfil rather than detract from their fiduciary duty.

Linking SRI and CG

Recently corporate governance (CG) is becoming an important issue among institutional investors. The Parmalat and Enron scandals proved to the world that stakeholders can suffer together from abuse by company management, as well as by some influential shareholders. Moreover research showed that good corporate governance is positively linked to financial returns. Initially the scientific research was directed mainly towards the relationship between one or more corporate governance characteristics and the share price, valuation and earnings of the company. Positive relationships were found¹⁶. Other more comprehensive studies, such as Gompers, P. A., J. L. Ishii, et al. (2003), showed also positive results. Therefore and contrary to SRI, CG does not face the question of fiduciary duties as described in the previous paragraph.

Although the Dutch Foundation for Corporate Governance Research for Pension Funds (SCGOP) recognises only an indirect link between SRI and CG¹⁷, there are at least two clear links between the two. First of all, SRI and CSR advocate and encourage stakeholder dialogue. Shareholders are one of the stakeholders of the company and corporate governance enables the dialogue between the company and its shareholders through the right to information, shareholder's representation at company board level, right to submit resolution at AGMs, and the voting rights.

And secondly good corporate governance, both in its informational and shareholders' rights aspects, enables SRI. As argued Clark and Hebb (2003), institutional investors have a role to play in the monitoring of firm management behaviour as they "engage directly with the firm through corporate governance over longer time periods" and "began making linkages between the underlying fundamentals of the firm, its day-to-day decision-making process and long-term shareholder wealth". He also expects a greater awareness of the impact of corporate governance on long-term value after the scandals such as Enron and WorldCom.

¹⁶ Bauer, R. and N. Gunster (2003 (May)). Goed bestuur loont voor beleggers. ESB also available at www.abp.nl.

¹⁷ SCGOP (2004). Manual Corporate Governance, SCGOP.

Moreover through their rights, institutional investors can enable SRI and CSR. Indeed what we see developing lately is the broadening of shareholders concerns which increasingly include issues related to social and environmental concerns. Their argument is that a greater regard for long term impacts of the firms and increased CSR reduce risks, adds share value and in the long term serves owners' interests. Although SRI and CG have a different end, they can be seen as complementary. As said Clark and Hebb (2002), there is an intersection of interest between the two.

Moreover, good corporate governance is central to Engagement and Voting. Although institutional investors may not use the traditional techniques of SRI, negative and positive screening, they may embrace corporate engagement and voting as a sound mechanisms to raise firm-level standards and long-term performance. Through engagement they will improve transparency and disclosure of companies.

SOME SUGGESTIONS FOR DEVELOPING A POLICY TO MAINSTREAM CSR AND CG IN THE FINANCIAL AND INSURANCE SECTOR

Greater emphasis on the management of negative externalities

Compliance with customer needs

Given the complexities involved with financial planning and risk management, an average customer is certainly not able to come up with a clear view on what his or her actual needs are and/or his or her future interests will be. With a more critical customer base and a more demanding society the insurance and financial services sector can no longer allow itself to stick to a push-marketing and cross-selling attitude. The service providers need to invest more time and effort into a better understanding of the specific needs of the customer. In the context of the new invisible hand, too much focus on short-term profit at the cost of long-term sustainability can easily lead to a kind of a boomerang-effect. Building a corporate culture that rewards integrity will probably be a far better instrument than any strict regulation.

Educative efforts towards (potential) customers

Customers as well as employees and distribution representatives need a far better understanding of the complex characteristics of modern insurance and financial services products. Risk identification, risk transfer and solidarity, investment options and cost elements all deserve far more attention. But the most difficult challenge will be to make the transfer from mere product information over financial education to good financial advice. Interesting in this respect is the recent initiative of the OECD, financed by Prudential to bench mark best

practices in financial education (presented at the OECD Forum in Paris on 12 & 13 May 2004).

Making more optimal use of the potential for positive externalities

The focus of CSR and corporate governance on risk management carries huge potential for the insurance and financial services sector. This opens-up new opportunities for the development of tailored business solutions. At the same time, trade federations and other sectoral organisations should more pro-actively build on the potential for improving the sector's reputation.

From a governance as well as from a CSR-perspective, insurers, pension funds and other institutional investors will increasingly be placed before their responsibilities as 'external' monitors of good corporate behaviour. The Combined Code on Corporate Governance has explicitly given the institutional investors the duty to perform a tough monitoring of the firms they invest in. After the Dutch Tabaksblat code did the same, there is now a Dutch initiative to install a special corporate governance commission to develop specific recommendations for the accountability of institutional investors. Faced with the potential for conflicts of interest, some of these service providers will turn to specialist shareholder services for outsourcing this important duty. However with or without outsourcing, they will finally be held responsible for making full use of their potential for positive externalities also on this level.

In a recent speech at the London seminar of the International Insurance Society, the British Financial Services Authority explicitly stated their reliance on corporate governance mechanisms of insurers as a corner stone for its regulatory approach.

CONCLUSION

From a societal perspective, the duties and responsibilities placed on the enterprise, have increased drastically the last couple of years. The more the business world becomes a prominent economic force, the more society expects firms to operate in a responsible way. In essence a responsible firm takes into consideration all direct and indirect external effects of its operation. By doing so, the business world "confirms" that the pure market theory as developed by neo-classicals and contractarians is incomplete in as far as they are ignoring externalities:

“Even if people believe that maximizing shareholder value enhances human welfare, the belief does not make it so; ...there is a difference between pragmatism and religion.” (Margolis & Walsh, 2001).

Positive externalities or external economies are integrated in concepts like corporate citizenship and philanthropy. The critique put forward by the anti-globalist movement focuses on the negative externalities or external diseconomies. Their claims on the firm go far beyond the borders of the pure local market. In fact, the attention for the potential negative effects of globalization is a global and large-scale expansion of the fragmented opposition against environmental and social malpractices of the business world.

After acknowledging that business conduct is facing increasing societal scrutiny, in the first part of the paper, we looked at the effects of corporate social responsibility on corporate governance. We first point at several paradigms that need to change in order to integrate new concepts such as CSR. A number of shifts need to be made: from the traditional notion of boundaries founded on the boundaries of the firm as developed by the transaction cost theories to network theory in order to include a broader range of stakeholders; from the traditional principal-agent theory to the management of complex principal agent relationships; from short term shareholder value to sustainable value creation; and to revise the dominant firm logic to move towards an optimal corporate governance system. Based on these paradigm shifts, we developed a hierarchical governance framework in order to embody the idea of responsible firm. This enlarged corporate governance framework is based on the redefinition of the theory and role of the firm, as well as on the enlargement of the principal-agent theory to include multiple principals and agents (stakeholder-inclusiveness). Such a framework should allow a firm to reflect upon the potential issues modern corporate governance should take into consideration. We then redefine some of the corporate governance mechanisms, which is necessary if we want to build trust in the corporate world. The mechanisms covered include managing conflicts of interest, role of the board, empowering the board, effective monitoring through independent and objective directors, and power and information. The section ends by looking at the monitoring of corporate governance and corporate social responsibility. We discuss the issue of voluntarism vs regulation, the role of the government and of civil society. We conclude by arguing that information and communication with stakeholders is an important element of CSR but also of CG.

In the second part of the paper, we focus on the relevance of CSR and CG for the financial and insurance sector. As any other sector of activity, financial institutions and insurances are subject to tougher societal scrutiny. Although the social and environmental

impacts of the sector are limited, it is not excluded from societal pressures. Its specific core business, its environment and its important potential for positive and negative externalities makes it an interesting sector for applying the analysis of CSR and corporate governance. Two main aspects come out of the analysis. Financial institutions and especially insurances can play an important role as valuer in assessing risks and estimating returns and as institutional investors. Transparency and CSR can become additional valued properties for the financial institutions and insurance. This is in line with World Business Council for Sustainable Development (WBCSD) who argues that the pursuit of sustainable development makes the organisations “[...]more resilient to shocks, nimble in a fast-changing world, [...], and more at ease with regulators” (Holliday Jr. et al, 2002). The increasing level of CSR with regards to investment strategy goes hand in hand with risk management and integration of CSR in organisation structure (Moskowitz, 1972). The investment policy must evolve hand in hand with the risk management and supports the evolution of SRI and environmental social and ethical considerations.

SRI as strategy to invest is maybe a too far reaching approach. However we believe that an engagement strategy may be a valuable strategy to enable CSR. They would have a direct contact with companies, including communication with senior management and board members about performance, corporate governance and other matters affecting shareholders’ interests, including CSR. Insurance, as institutional investors, should use their voting rights. For this purpose it would be useful to write a policy document on the exercising of proxy votes as well as communicate to the clients the voting activities in order improve transparency.

As this paper shows, corporate governance and corporate social responsibility are highly relevant for the financial and insurance sector. A number of issues, that have been raised, need to be further researched. First of all, financial services firms and insurance companies have to develop a better understanding of their numerous positive and negative externalities. However, assessment is only the first step in a comprehensive management of these externalities. Given the increasing attention for risk management and its relevance to both corporate governance and CSR, special attention must be given to build on the societal role the financial sector can play in this respect. In order to play its role of valuers, the financial and insurance sector need better tools to assess social and environmental risks. Moreover, corporate governance and socially responsible investment are two powerful means for corporate social responsibility. Notwithstanding some integrative initiatives they remain two separate concepts. SRI-rating organisations recently tend to consider corporate

governance more seriously and start to integrate some of these elements in their screening assessment. On the other end, corporate governance ratings only slowly start to integrate CSR-related indicators into their evaluation instruments. It would be of interest for both managers and academics to further investigate the link between CG and SRI. It is only when there will be scientific certainty of a positive relationship that institutional investor may adopt a SRI investment strategy.

REFERENCES

- Atkinson, A.A.;Waterhouse, J.H. & Wells, R.B. (Spring 1997). "A stakeholder approach to strategic performance measurement", Sloan Management Review; Cambridge, Vol. 38 (3), p. 25-37.
- Bauer, R. and N. Gunster (2003 (May)). "Goed bestuur loont voor beleggers". ESB also available at www.abp.nl.
- Bauer, R., K. Koedijk, et al. (2002). "International evidence on ethical mutual fund performance and investment style."
- Bayon, R. (2001). "Pension Fund Giant Takes SRI Flyer." Environmental Finance September 30.
- Bebchuk, L. & Roe, M. (1999). "A Theory of Path Dependence in Corporate Ownership & Governance", Stanford Law Review, vol. 52, no. 1, p. 127-170.
- Becht, M. & Mayer, C. (2001). "Introduction", p. 1-45, in Barca, F. & Becht, M. (eds.) (2001). "The Control of Corporate Europe", Oxford University Press.
- Berle, A. & Means, G. (1932). "The Modern Corporation & Private Property", McMillan, New York.
- Black, B.S. (1990). "Does corporate governance matter? A crude test using Russian data", University of Pennsylvania Law Review, vol.149, p. 2131-2150
- Carroll, A. B. and A. K. Buchholtz (2000). "Business and Society: Ethics and Stakeholder Management", South-Western.
- Clark, G. L. and T. Hebb (2003). "Understanding Pension Fund Corporate Engagement in a Global Arena." Working Paper, School of Geography and the Environment, University of Oxford
- Coles, D. and D. Green (2002)." Do UK Pension Funds Invest Responsibly? A survey of current practice on Socially Responsible Investment", Justpensions.
- Diltz, J. D. (1995). "Does Social Screening Affect Portfolio Performance?" Journal

of Investing Spring: 64.

Easterbrook, F.H. & Fischel, D.R. (1991). "The Economic Structure of Corporate Law", Harvard University Press.

Eisenhardt, K.M. (1989). "Agency Theory: An Assessment & Review", *Academy of Management Review*, vol. 14, no. 1, p. 57-74.

Environmental Protection Agency (2001). Superfund, <http://www.epa.gov/superfund>. 2001.

European Commission, (2002), "Corporate Social Responsibility – A business contribution to sustainable development", Office for Official Publications of the European Communities, pp. 30.

European Foundation for Quality Management (EFQM 1999), "Excellence Model", Accessed, 17 January 2001, <http://www.efqm.org/award.htm>

Eurosif (2003). "Socially Responsible Investment among European Institutional Investors: 2003 report".

George, W.W. (November 2001). "Medronic's chairman William George on how mission-driven companies create long-term shareholder value.", *The Academy of Management Executive*, Briarchliff Manor, vol. 15, no. 4, p. 39-47.

Gompers, P. A., J. L. Ishii, et al. (2003). "Corporate Governance and Equity Prices." *The Quarterly Journal of Economics* 118(1): 107-155.

Gribben, C. and A. Faruk (2004). "Will UK pension funds become more responsible? A survey of trustees" (January 2004 Edition), JustPensions.

Handy, C. "The Hungry Spirit: Beyond Capitalism – A Quest for Purpose in the Modern World", Hutchinson, 1997, 288pp

Handy, C. "Trust and the virtual organization – How do you manage people whom you do not see?", *Harvard Business Review*, May/June 1995, pp. 40-50

Hirschman, A. O. (1970). "Exit, voice, and loyalty: responses to decline in firms,

organizations, and states”. Cambridge, Harvard University Press

Holliday Jr., C. O., S. Schmidheiny, et al. (2002). “Walking the Talk: The Business Case for Sustainable Development”. London, UK, WBCSD.

Hummels, H. and D. Timmer (2003). “Money and Morals, The development of Socially Responsible Investing among Dutch pension Funds”. Nyenrode, Universiteit Nyenrode/VBA

Hummels, H., J. Willeboordse, et al. (2004). “Corporate shareholder engagement: Investigating corporate governance and sustainability in the relation between Dutch corporations and their investors”, Universiteit Nyenrode.

Hung,H. (1998). “A typology of the theories of the roles of governing bodies”, Corporate Governance: An International Review, Vol 6 N°2, pp 101-111.

Huyse, L. (1999). De opmars van de calimero’s. Over verantwoordelijkheid in de politiek, Van Halewyck, Leuven

Jensen, M. and W. Meckling, 1976, “Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure”, Journal of Financial Economics, 305-360

Jensen, M., 1986, “Agency costs of free cash flow, corporate finance and takeovers”, American Economic Review, 323-329.

Jensen, M.C. & Meckling, W.F. (1976). "Theory of the firm : Managerial behavior, agency costs & ownership structure", Journal of Financial Economics, vol. 3, p. 305-360.

John D. Barrow, “Impossibility, The Limits of Science and the Science of Limits”, OUP, 1998, 232 pp.

Kaplan, R.S. & Norton, D.P. (1997), "The Balanced Scorecard : Translating Strategy into Action", Harvard Business Review Press, Boston.

Louche, C. (2001). “The corporate environmental performance-financial performance link: Implication for Ethical Investments. Sustainable Banking”. J. M.

H. A. Bouma J.J., klinker L. Sheffield, UK, Greenleaf Publishing Limited: 187-200

Louche, C. (2004). "Ethical Investment: processes and mechanisms of institutionalisation in the Netherlands, 1990-2002". PhD dissertation, Erasmus University Rotterdam. Rotterdam, Optima Grafische Communicatie.

Luther, R. G., J. Matakò, et al. (1992). "The investment performance of UK ethical unit trusts." *Accounting, Auditing and Accountability Journal* 5(4): 57-70.

Macho-Stadler, I. & Pérez-Castrillo, J.D. (2001). "An Introduction to the Economics of Information. Incentives & Contracts", 2nd Edition, Oxford University Press, Oxford.

Mallin, C. A., B. Saadouni, et al. (1995). "The financial performance of ethical investment funds." *Journal of Business Finance & Accounting* 22(4): 483-496.

Margolis, J. D. and J. P. Walsh (2001). "Misery Loves Companies: Whither Social Initiatives by Business?", Aspen Institute's Initiative for Social Innovation through Business, The Harvard Business School, University of Michigan Business School.

Mintzberg, H. "Strategievorming : Tien scholen.", transl. Th. J. Tromp, *Scriptum* (Schiedam), 1994 153 p

Moskowitz, M. R. (1972). "Choosing socially responsible stocks." *Business and Society Review* 1: 71-75.

Mueller, S. (1991). "The opportunity cost of discipleship: ethical mutual funds and their returns." *Sociological Analysis* 52(1): 111-124.

Nonaka, I., R. Toyama, et al. (2000). "A firm as a knowledge-creating entity: a new perspective on the theory of the firm." *Industrial and Corporate Change*, Volume 9, Number 1, pp. 1-20 9(1): 1-20.

Pava, M. L. and J. Krausz (1996). "The association between corporate social-responsibility and financial performance: the paradox of social cost." *Journal of Business Ethics* 15: 321-357.

Pfeffer, J. and Salancik, G.R. (1978). "The External Control of Organizations: A Resource Dependence Perspective", Harper and Row, New York, NY.

Ridderstale, Jonas and Nordström, Kjell, 2000, 2000, "Funky Business - Talent makes capital dance", Ft.com, Pearson Education Limited.

Roe, M.J. (1991). "A political theory of American corporate finance". Columbia Law Review, 91 (1), 10-67

Roe, M.J. (1994). "Strong managers, weak owners", Princeton University Press, Princeton.

Sauer, D. A. (1997). "The impact of social-responsibility screens on investment performance: evidence from the Domini 400 social index and Domini equity mutual fund." Review of Financial Economics 6(2): 137-149.

SCGOP (2004). Manual Corporate Governance, SCGOP.

Schmidheiny, S. and F. Zorraquin (1996). "Financing Change: The Financial Community, Eco-efficiency, and Sustainable Development". London, UK, MIT Press.

SIF (2001). "2001 Report on Socially Responsible Investing - Trend in the United States". Social Investment Forum US.

SIRI Group (2002). "Green, social and ethical funds in Europe 2002". SiRi Group/Avanzi.

Snyder, J. V. and C. H. Collins (1993). The performance impact of an environmental screen, Winslow Management Company.; Social Investment Forum (1998). Fund Performance, www.socialinvest.org.

Spira, L. (2002). "The Audit Committee: Performing Corporate Governance", Kluwer Academic Publishers, Hingham.

The Economist (2002). Special Report: "Lots of it about - Corporate Social Responsibility". 14/12/2002: 62-63.

[Van den Berghe L.A.A.](#) and [Carchon S.](#) (2003). "Redefining the role and content of corporate governance from the perspective of business in society and corporate social responsibility". In Cornelius, Peter & Kogut, B. (Eds.). Corporate Governance and Capital Flows in a global economy. Oxford University Press. Chapter 23.

[Van den Berghe L.A.A.](#), [Levrau A.](#) and [Van der Elst C.](#) (2002). "Corporate Governance in a Globalising World : Convergence or Divergence? A European Perspective". 223 p. Kluwer Academic Publishers.

Van den Berghe, L. & Verbeke, L.(2001). "Duurzaam Ondernemen ... of het heruitvinden van de toekomst en het doorbreken van fundamentalismes", in 'De durf om te ondernemen : nieuwe aspecten van ondernemerschap en groeimanagement' Hans Crijns en Hubert Ooghe (eds.), Lannoo, juni 2001, ISBN 90 209 4183 6, pp. 224-235

Van den Berghe, L. (1981), "Critical Analysis into the Validity of the National Accounting for the Evaluation of the Services Performed by the Insurance Sector", Etudes et Dossiers n°, Geneva Association, pp113.

Van den Berghe, L. and Baelden, T. (2003), "Rebuilding Trust: A Challenge for Corporate Governance and Audit", in Paape, L. et al. (Eds.), Internal/Operational Auditing: bijdragen aan governance & control, NIVRA, pp. 291-307.

Van den Berghe, L.; Carchon, S.; Levrau, A. & Van der Elst, C. (2002). "Corporate Governance in a Globalising World: Convergence or Divergence? A European Perspective", Kluwer Academic Publishers, Boston.

Vogl, A.J., (2003), "Does it Pay to be Good?", Across the Boards, Jan/Feb 2003, pp. 15-23.

Wheeler, D.; Colbert, B. & Freeman, E. (2003). "Focusing on Value: Reconciling Corporate Social Responsibility, Sustainability and a Stakeholder Approach in a Network World" Journal of General Management, vol. 28, n° 3; spring 2003, pp 1-28

Wilson, I. (2000). "Changing societal expectations: new guidelines for corporate conduct", Keynote Speech, 3rd International Conference on Corporate Governance

& Direction, Henley Management College, October 17, 2000; 17p.

Zadek, S. (2001), "The Civil Corporation: the new economy of corporate citizenship", Earthscan Publications, London, pp. 257.

FIGURE 1

Positioning corporate governance : extending the dominant firm logic

Source: Van den Berghe et al (2002)

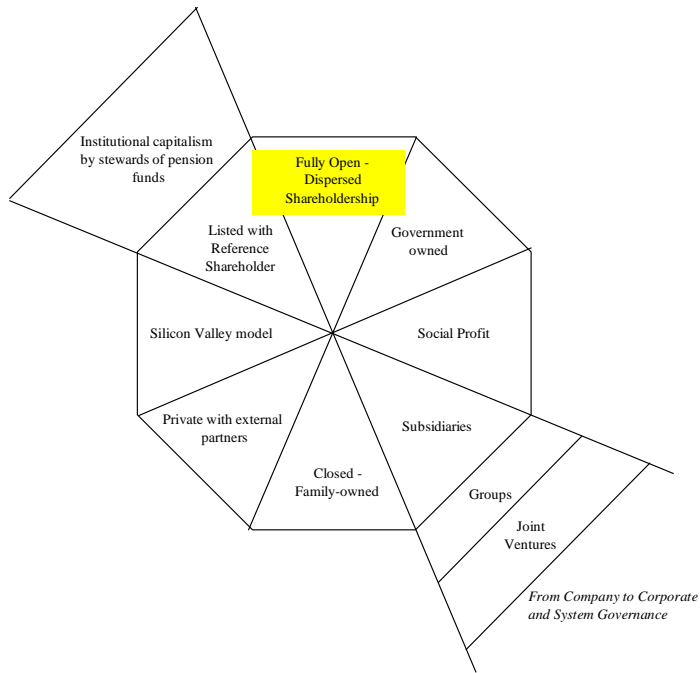


FIGURE 2

Corporate governance framework

Source: Van den Berghe et al. (2002)

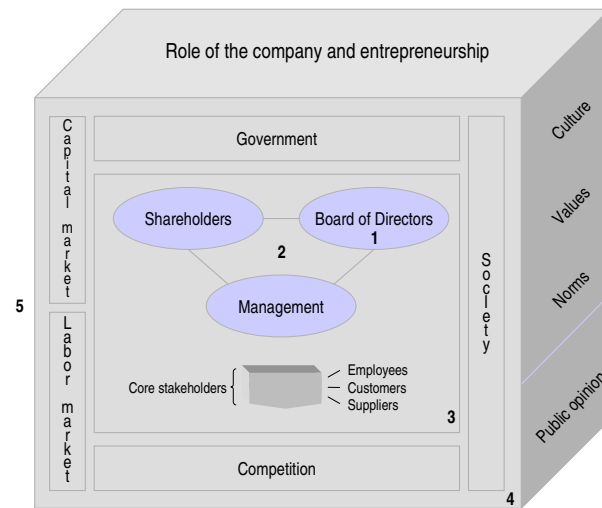


FIGURE 3.

Governance pyramid



FIGURE 4

Identifying conflicts of interest in the Enron Case

Source : Van den Berghe & Baelden (2003)

