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Corporate accountability in a globalizing environment empirical evidence

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Corporate accountability in a globalizing environment

empirical evidence

John Kong Shan Ho

2009

University of Dundee

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THESIS

2009

PhD. Thesis Title:

***“Corporate Accountability in a
Globalizing Environment:
Empirical Evidence”***

By:

**John Kong Shan, Ho.
University of Dundee
(Matric. No: 030010138)**

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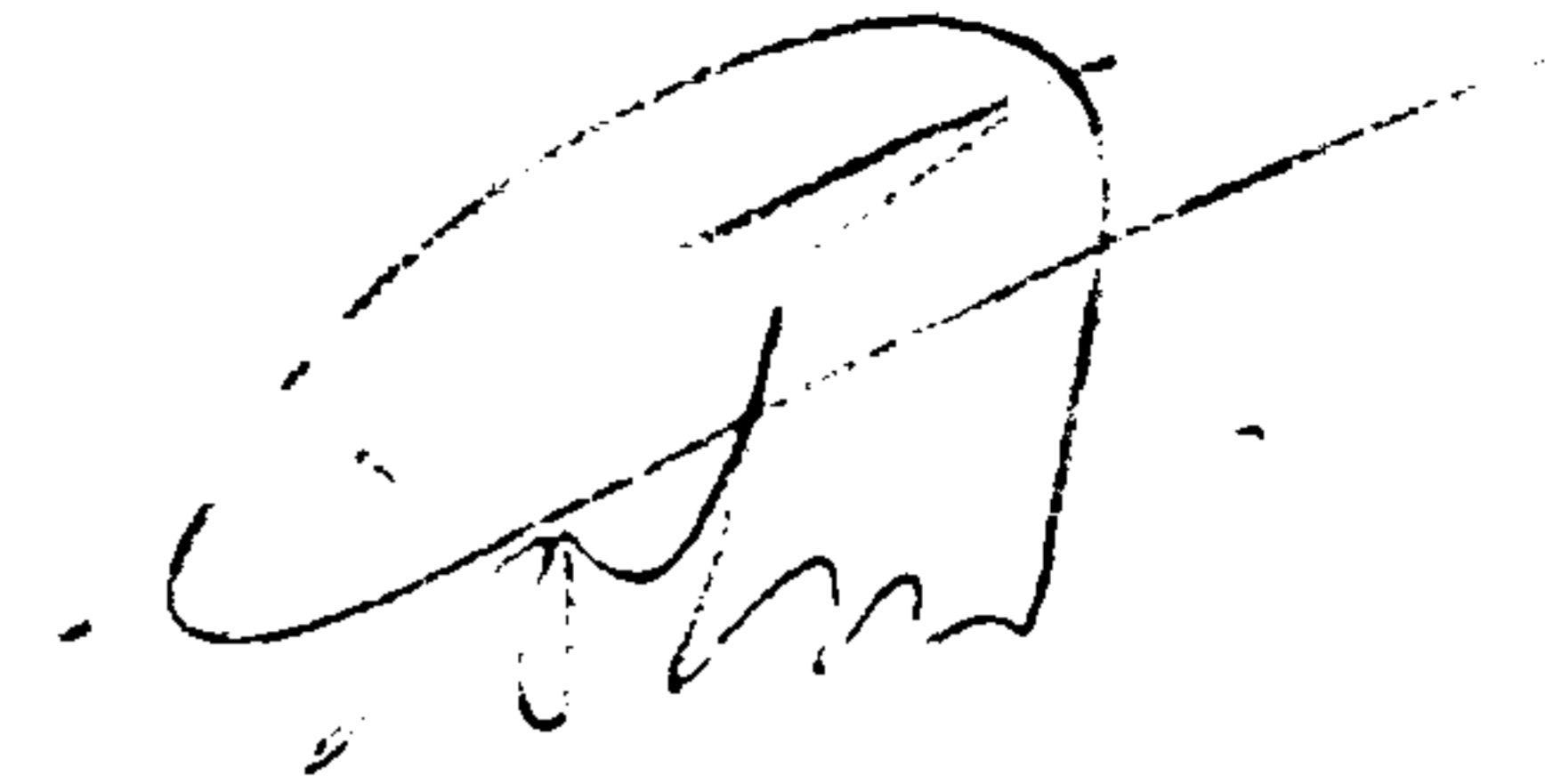
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Declarations

I, **John Kong Shan Ho**, declare that I am the author of this thesis. Unless otherwise stated, all references cited have been consulted by me. The work of which the thesis is a record has been done by me, and that it has not been previously accepted for a higher degree.



**John Kong Shan Ho,
September 2009**

I, **Prof. Alice Belcher**, supervisor of the above student, declare that the student is the author of this thesis. I am satisfied that the conditions of the relevant Ordinance and Regulations have been fulfilled.

**Prof. Alice Belcher,
September 2009**

Summary of Contents

For many years, there have been vigorous arguments between supporters of the shareholder and stakeholder models as to which system is more effective in enhancing corporate values and disciplining managements. What view one takes of course very much depends on political viewpoint and national background. For example, economists or lawyers in the US or UK may argue that the Anglo-American shareholder model is more appropriate. This is because there is at least a criterion (i.e. share price) by which you could measure and compare corporate performance. Supporters of the stakeholder model may argue that the concept of stakeholder is anti-capitalism and that it is too broad and abstract, providing no clear boundary as to who may or may not fall into that category. Yet in contrast, their Japanese or German (and other Continental European) counterparts may argue that the Anglo-American approach of primarily focusing on share value and wealth maximization is too narrow and an over-simplistic view of the role played by corporations. Supporters of the stakeholder theory would argue that it is necessary to take into consideration interests beyond those of shareholders. This is because businesses ought to demonstrate certain responsibilities towards the society in which they operate.

This thesis neither supports nor challenges the validity of either the shareholder or stakeholder approach. Instead it attempts to search for a “middle approach”. The aim is to bring the concept of both values together to form a corporate governance model based on convergence and co-existence.

The main proposal of this thesis is as follows. Living in the twenty-first century, we must understand that our world is neither being Americanized nor

Europeanized or Orientalised. We are instead being globalized. National identities in terms of corporations will become less and less important as multinational corporations extend their activities throughout the globe. With the advance in technology and increase in cross-border business transactions amongst countries, it is no longer justified to argue that “one business model fits all”. As academics and practitioners we must therefore explore ways in which we could bring the best out of different models so that they can be converged to form a more coherent approach towards the balancing of different conflicting interests.

Chapter 1: Introduction

In capitalist societies such as the UK, corporations are perhaps the major organized form of economic entities. The enterprises that we encounter on a daily basis, whether as employers/employees, suppliers of food, utilities and consumer goods are likely to have adopted the corporate form as the basis of their economic association. Developed western societies are fundamentally dependent on business activity. Very often the great goal of economic growth relentlessly pursued by virtually all governments means no more than an increase in the level of business activity in the form of making, buying and selling goods and services. It is therefore clear that economic activity in the sense described is something that needs to be encouraged. The concern for economists and lawyers must be to see how the law can help in that process.

Given the fact that the corporate economy forms the bedrock of the capitalist system, it is therefore the overall performance of corporations which determine the competitiveness of an economy. Over the last 15 to 20 years, we often hear the term “corporate governance” being mentioned in the public domain. But what does the term entail and what is the most effective manner for governing corporations? Different commentators will give a different meaning of the term, in general, “corporate governance” is concerned with the institutions that influence how business corporations allocate resources and returns¹. To be more specific, a system of “corporate governance” determines who makes investment decisions in corporations, what types of investment they make, and how returns from investments are distributed. The central focus of this research is the relationship between systems of corporate governance and the financial performance of corporate enterprises themselves.

¹O’Sullivan, “Contests for Corporate Control: Corporate Governance and Economic Performance in the United States and Germany”
Oxford University Press 2000, at p. 1

In general, power within the company is divided between the management, personified by the board of directors, and the capital providing investors, the shareholders. The existence of the company as a separate legal personality has become the linchpin of the modern times on the separation of ownership and control of corporations. Since the turn of the twenty-first century, a number of corporate collapses and scandals on both sides of the Atlantic have caused concern amongst academics and practitioners. Regulators have been keen to prescribe better measures to strengthen how businesses are governed so as to make them more accountable to the public.

While everyone agrees on the importance of strong corporate governance, yet the controversy remains as to how it can be strengthened. Over the last few decades, corporate governance has largely been dominated by two schools of thought. On the one hand, there is the shareholder model approach which is largely influenced by the *economic theories of the firm*. This argues that directors are agents of the shareholders, and that their ultimate objective is wealth maximization in the interest of shareholders. In contrast, the stakeholder theory argues that a corporation should take into account other interests beyond shareholders such as employees, customers and the environment. Both models attempt to assert superiority over another and seek to argue that its governance approach tends to bring the most optimal performance for companies.

However, the major problem with many of these literatures and the practical corporate world in general, is the relative polarization of two extreme values. There has been little attempt made to converge the two models. Instead of asserting the superiority of either model, the focus of this research thesis is on how companies manage their relationship with stakeholders. Three case studies shall be presented here. The objective of this research is to explore whether it is possible for businesses to strike a balance between satisfying the financial interest of

shareholders and yet cater for the needs of other non-shareholding stakeholders. This thesis attempts to argue for a model (or approach) that takes the middle ground. It shall illustrate via selected case studies that the traditional demarcation between those two extremes does not exist any longer.

This chapter shall begin by first examining the legal and economic background leading to the development of the current corporate governance framework. Later on in the chapter, some of the concepts and theories of both the economic theory of the firm and stakeholder theory will be briefly discussed. Their relevance to the current research will be examined. Towards the end of this chapter it will formulate the research question and hypothesis. It will also further elaborate on the objective and contribution which this research is attempting to achieve.

1). Emergence of the Corporate Form

The first Companies Act was passed as far back as 1844, and the United Kingdom was the pioneer in the development of this legal framework. But when the Act was enacted at the time, it was not actually concerned with the creation of ‘companies’. The joint stock companies were already well-established and had been known for over a century². This particular Companies Act provided for the registration of the “deed of settlement” of such companies, which was the principal constitutional document. In return for registration, they were conferred corporate status, recognised by the law as “entities” in their own right.

By the mid nineteenth century, due to the expansion of the British Empire, joint stock companies such as the likes of Hudson’s Bay Company and the British East India Company became too important to be ignored. These organizations consisted of hundreds of members.

²Sealy, “Cases and Materials in Company Law”.
Butterworths 1996, 6th edition, at p. 1.

They were set up by the equity draftsmen where large-scale ventures were organized on the basis of joint stock pooled by participants. They were run by directors and managers for the benefit of all members. The 1844 Act was therefore the first step in giving them legal recognition³.

By 1855, a further piece of legislation was passed allowing shareholders who invested in a company to limit their liability. A year later in 1856 the Joint Stock Companies Act established the framework for the modern-style company that we are more familiar with today. This was incorporated by the process of registration and enjoyed limited liability. Likewise, the old deed of settlement also gave way to the memorandum and articles of association. The UK Parliament consolidated all the statutory provisions into one major Act, the Companies Act 1985. As a result, the Act became a “jumbo” legislation with some 747 sections and 25 schedules, making it the biggest piece of legislation in the United Kingdom.

Prior to October 2004, there were basically four types of companies that are recognized by law in the UK⁴. They are: (i). **Companies limited by shares**; (ii). **Companies limited by guarantee**; (iii). **Private and public companies**; (iv). **Unlimited companies**. However, the Companies (Audit, Investigations and Community Enterprise) Act 2004, which received Royal Assent on October 29, 2004 introduces a new corporate vehicle, the “community interest company” (CIC). A CIC is intended to be an incorporated company limited by shares or guarantee whose profits and assets are to be used for the benefit of the community. A CIC is established under the Companies Act 1985. It benefits from the flexibility and certainty of the

³Ibid, p. 2.

⁴Hannigan, “Company Law”.
Butterworths 2003, 13-23.

corporate form with additional features to ensure that it is working for the benefit of the community⁵.

The vast majority of companies today are companies limited by shares and they are either public or private. According to statistics held by the UK Companies House, as of the end of August 2007, there were over 2.6 million companies on the register. Over 99% of them were private and only less than 1% were public⁶. The distinction between a public and private company speaks for itself. A public company must state in its memorandum of association that it is a public company and must be formally registered as such. They are subject to a minimum capital requirements and a greater degree of regulation by the law. They are able to offer shares by advertisement and via the stock exchange to the public for investment. A private company on the other hand, is any company that is not a public company. The Companies Act makes a number of concessions for private companies that cannot be enjoyed by public companies⁷. It is also these two types of companies that this thesis will be focusing on.

a). Sources, reform and purpose of company law

As of mid 2005, company law in the UK is governed by the Companies Act 1985⁸. However, there are other legal provisions which are important as well. The Insolvency Act 1986 contains important provisions governing bankruptcy. Furthermore, there are large statutory instruments containing important provisions and there is also the importance of case law. Many principles of company law were actually developed through cases such as the role of directors and fiduciary

⁵A number of businesses similar to the new CICs are already active in areas such as childcare, social housing, leisure and community transport.

⁶<http://www.companieshouse.gov.uk/about/busRegArchive/statsAug07.pdf>

⁷See s. 282 and s.379A of the Companies Act 1985 as examples.

⁸The new Companies Act 2006 received Royal Assent in November 2006 and is scheduled to come into effect in October 2009.

duty. The law of negligence in tort is important and as we shall see later, contract is a very significant part of corporate arrangement.

Apart from those mentioned above, there are other extra legal or non-legal sources of regulations. First of all, there is the so called "Yellow Book" which contains the stock exchange listing rules. This is provided by the Stock Exchange rules now regulated by the Financial Services Authority and the failure to comply would result in de-listing. There is now the Combined Code, although it does not carry the same force as enacted regulation, yet public companies almost always comply with it. Companies failing to comply would either have to provide justification or risk negative publicity.

European Union influence is also becoming more important in the UK company law. Overridingly, the European Union wants a level playing field in the market. Art. 549(g) of the Treaty of the European Union empowers the Commission to adopt measures to ensure that there is the appropriate law in the member state in relation to the governing of companies. There is also a board equivalence of company law in the EU. The purpose of this is to prevent unfair competition, where a member state may impose a corporate code which is more relaxing and easy to comply with, thus attracting more investments.

The EU has issued directives addressing certain aspects of company law, largely aiming at public companies. But not all directives issued have been implemented in the UK. The fifth directive for example is aimed at corporate governance which includes workers' participation. The main influence of this is from Germany, which contains strict workers' participation and this directive was not implemented by the UK until the Labour government came into power after 1997. The other European action which has not yet been implemented is the European Company statute. The idea is to set up in place a company law code allowing the establishment of a

European company registered in the EU. However, this proved to be far too ambitious. It seems the current approach is to have a European Company Statute with a considerable say by the member state.

Major reform in the law has also occurred recently. In the past, the only reform was from Brussels. But now the most significant reform has come from the Department of Trade and Industry (DTI). The overall reform was proposed in 1997 in a consultation document and the White Paper was eventually published in July 2002⁹. The document focuses on all areas of reform in company law to improve competitiveness of the economy. At the time of writing this thesis, the new company legislation has been scheduled to come into force in October 2007.

The purpose of company law is to provide a vehicle for low-risk investment for investors. On the other hand, company should also try to achieve some balance between investors and outsiders dealing with the company. This is the issue which this thesis attempts to explore.

2). The Classical View of a Company

Ever since the first Companies Act was introduced in the late 19th century, UK Companies legislation has laid out the legal foundation. A company is owned by its shareholders and that it is the fiduciary duty of company directors to operate the company in the interests of its members. This has long been the dominant view in Anglo-American corporate governance. It argues that shareholders bear the financial risks for the establishment of the enterprise and for this reason they remain the ultimate owners of the business. This is often referred to as the *Principal-Agent (Finance) Model*¹⁰, where the shareholders are the principals and the directors and managers as

⁹Modernizing Company Law – Cm 5553, Department of Trade and Industry.

<http://www.dti.gov.uk>

¹⁰Hart, O.D., “Corporate Governance: Some Theory and Implications”.
Economic Journal 1995, 105, 678-89.

agents, are therefore accountable to them. This view rests on the idea that markets for ownership and management provide the most effective restraints on management. They will ultimately commit corporate resources to value-maximizing ends.

Those in support of the above view assume that a corporate venture is a contract by itself¹¹. The terms present in the articles of incorporation for example, at the time of establishment is real agreement¹². Corporate governance arrangements are contractual in the sense that they are fully priced in transactions among the interested parties. They are tested for desirable properties and firms that pick the wrong terms will fail in competition with other firms competing for capital¹³. As we shall see later, under the nexus of contract theory, even everything to do with the relation between the firm and employees, suppliers and contractors is contractual. It therefore resists any external intervention by the government. In short, it is a business model based on the free market model.

Throughout the 20th century, this model has found a great deal of support in the English-speaking world, particularly in the US and UK. In the 1930s, commentator Berle in his article, “For Whom Corporate Managers Are Trustees: A Note”¹⁴, reiterated the importance of shareholder value and that this view ought never to be abandoned:

“...Now I submit that you can not abandon emphasis on the view that business corporations exist for the sole purpose of making profits for their stockholders until such time as you are prepared to offer a clear and reasonably enforceable scheme of responsibilities to someone else...”.

¹¹Easterbrook & Fischel, “The Corporate Contract”.
Columbia Law Review 1989, Vol. 89, 1416-1448

¹²See s. 14 of the UK Companies Act 1985.

¹³*Supra*. n. 11, at 1430.

¹⁴[1932] 45 *Harvard Law Review*, 1365 at 1367.

The late Professor Milton Friedman, who has long been a champion of the free-market economic model, even went as far as arguing that the notions of company social responsibility beyond a duty of shareholders are subversive:

“...(social responsibility) is a fundamentally subversive doctrine...few trends could so thoroughly undermine the very foundations of our free society as the acceptance by corporate officials of a social responsibility other than to make as much for their stockholders as possible”¹⁵.

Thus, under the principal-agent or the shareholder value model, profit-maximization and wealth creation by firms for the interest of the company and shareholders became the ultimate objective for managers. This model assumes that in a society where there is a highly developed capital/equity market, the principal/agent problem can be solved via the market for corporate control. To put it in another way, where there is a principal/agent structure the market should be as free as possible. This is because in a free market, it is up to the shareholders (as principal) to discipline the management via the market. Shareholders can bring in new management to better the company in the manner the shareholders want it to be. Supporters of this model would argue that the imposition of any additional obligations on the corporate board such as taking into consideration of employees as “stakeholders” would undermine this concept.

A number of scholars have in fact defended and extended this classical view of a company and resist any attempt to include stakeholders from consideration by the company. Those who argue in favour of the principal-agent or the shareholder model state that stakeholder theory is parasitic. It is an ill-defined notion that encourages arrogant and unresponsive managements, and resistance to takeover bids beneficial to shareholders¹⁶. Stakeholder theory is

¹⁵[1962] *Capitalism and Freedom*. University of Chicago Press.

¹⁶Sternberg, E., “The Defects of Stakeholder Theory”.
Corporate Governance: An International Review 1997, 5, 1, 3-10.

therefore to be firmly resisted because it undermines private property, the duties that agents owe to principals and wealth.

Maximizing shareholder value accomplishes both accountability and efficiency. It ensures that managers are focused on a single clear objective, leading to the most efficient outcomes – profit.

3). Economic Theories of the Firm

The traditional Anglo-American corporate concept is based on the economic theories of the firm that looks at corporations from a purely economic perspective. I shall discuss this in greater depth later in chapter 2. Yet I shall now briefly explore their origins and underlying rationale.

These theories originate from the work of Coase¹⁷, and they look at the nature of the firm from the economic standpoint. This theory was later further elaborated by commentators such as Alchian and Demsetz¹⁸ and Fama¹⁹. The principles expressed in Coase’s article on the nature of the firm apply to any production unit however organized, which includes the modern company. According to this theory, the main reason why it is profitable to establish a company (or firm) is that it will eliminate the costs involved in negotiating and concluding a separate contract for each exchange transaction that takes place on a market. The firm is therefore viewed as a “team-oriented production” where productivity can be increased by pooling the necessary resources together to create outputs.

¹⁷Coase, R.H., “The Nature of the Firm”.
Economica 1937, 4, 386.

¹⁸Alchian & Demsetz, “Production, Information, Costs and Economic Organization”.
American Economic Review 1972, 62, 777-783.

¹⁹Fama, “Agency Problems and the Theory of the Firm”.
Journal of Political Economy 1988, 88, 288-307.

Jensen and Meckling went one step further by defining the firm as a web of relationship connected by a “nexus of contracts”²⁰. They argue that the company is merely a “legal fiction” which serves as a nexus for contracting relationships. This is also characterized by the existence of divisible residual claims on the assets and cash flows of the firm.

Fama (1988) in his article points out that under the nexus of contracts and theory of the firm perspective, ownership of the firm is an irrelevant concept²¹. He argues that in order to understand the modern company, it is better to separate the manager, i.e. the agents, from the risk bearer (principal/shareholder). This is because under the theory, shareholders only hold the residual claim and have the right to sell his/her central contractual residual status. In practice, it is the agent who is vested with the absolute power in running the day-to-day affairs of the company. Fama argues that it is anomalous to see the shareholders as corporate owners and unpragmatic to claim that directors’ main role should be driven by the need to maximize profit for shareholders. To put it simply, a corporation is viewed as factor providers, whose interests in the corporation are defined and regulated by contractual negotiations with the corporation.

In fact this theory is consistent with the current legal position in the English-speaking common law jurisdictions, as was decided by the English Court of Appeal. It held that the directors are the agent of the company and not the agent of the general meeting of shareholders. Once the board is elected at a day-to-day level by shareholders at general meeting, it can act on its own discretion²². For example, when an individual investor acquires some shares of a large public corporation, from a corporate law perspective, he/she does become the “owner” of that company. However, at a practical level it would be inconceivable to assume that the

²⁰Jensen & Meckling, “Theory of the Firm: Managerial Behaviour, Agency Costs, and Capital Structure”. *Journal of Financial Economics* 1976, 3, 305.

²¹Fama, supra n 19.

²²*Automatic Self-Cleansing Filter Syndicate Co Ltd v. Cuninghame* [1906] 2 Ch 34.

management or the board of that company is accountable to that particular investor in the day-to-day decisions it makes with regards to the company.

4). Attributes of the classical view and its flaws

The classical view and the economic theories of the firm as mentioned above have had significant influence on the corporate governance structure of the 20th century in the English-speaking world. Those in favour have argued that they seem very ideal. If an investor or shareholder makes an investment in a business then of course he or she would expect to make a reasonable level of return from that investment²³. Therefore, there is nothing wrong with managers and directors focusing on ways to maximize those returns for the individual investors.

However, the practical world is usually not as simple or idealistic as we assume it to be. The principal-agent or the shareholder model assumes the existence of a pure free market where the level of information available to investors or potential investors is always ubiquitous. Guided by self-interest, each individual would utilize information rationally to maximize their personal wealth. The shareholder model assumes that there is genuine competition on the basis of price where individuals can freely select and make their decisions. It assumes the absence of barriers of entry for new participants to enter the market.

Yet in practice, we live in a world where many economists would recognise “market failure”. This is when the market mechanism fails to allocate resources in the most efficient way and it can be manifested in a number of ways, including the growth of monopolistic firms. This can limit the making the flow of information and narrow the selection of choice. Markets also fail when externalities such as water and air pollution are not costed, so that firms make private profit at the cost of social welfare.

²³Sternberg, supra n 16, p 5.

The argument that the principal/agent problem or conflict is best resolved by the market is itself flawed. This is because from a legal point of view, the problem could equally well be solved through contractual agreements ensuring that the relevant parties are acting *intra vires*. Furthermore, if it is assumed that the markets for ownership and management provide the most effective restraints on management, then why do corporate law vests voting rights on shareholders to determine fundamental corporate changes or policies at the first place? As we shall discuss later in greater details, the purpose of company law is to provide a vehicle for low-risk investment for investors. This is because the law recognizes that the bargaining power between the parties can be unequal. The law is therefore needed in order to achieve some balance between investors and outsiders who deal with the company.

A major problem with the Anglo-American shareholder model is short-termism. It is often argued that overemphasis on share value or “market for corporate control”, not only punishes weak and inefficient companies. It also penalizes companies with long-term growth potential. Pike and Ooi (1989) conducted a study on 100 large UK firms and it found that 69% thought that short-term profit was more important than long-term profit or growth potential. The study found that the firms’ main purpose remains the maximization of shareholder wealth.

Many reasons – economic, social, political and historical – have been argued to explain the decline in the industrial competitiveness of US and Britain in the 20 to 30 years. One reason that is frequently advanced to explain UK’s loss of international competitiveness, is the low level of its industrial investment compared with that of international competitors like Japan and Germany²⁴. The dominant reason for this low level of UK investment is, due to managerial

²⁴Cox & Kriegbaum, *Innovation and Industrial Strength: A Study in the UK, West Germany, the United States and Japan*. *Policy Studies Institute* 1989, London

short-termism²⁵. The Anglo-American approach of shareholder value and wealth maximization over and above all other interests has been criticized by many commentators as “marketing myopia”. This means a short-sighted approach to marketing by ignoring the need for other interests such as customer orientation. It argues that short-termism imposed on managers lead to reduced long term expenditures such as R & D. This can lead to an overall negative impact on the general economy.

Furthermore, financial accounting practices in the US and UK within the corporation also give rise to unnecessarily high rate of return requirements or, alternatively, unrealistically short pay-back periods²⁶. This is often due to an executive labour market which rewards and appoints on the basis of short-term performance. As a result, the role of scientists and engineers in US or UK boards tend to be meagre in comparison to the greater power played by accountants. This often undermines corporate performance due to a lack of proper representation.

Perhaps the principal problem to the Anglo-American corporate governance approach is the abusive use of corporate executive power. At law, it is the shareholders who possess the rights to appoint or remove directors and executives on the board. Yet given the dispersed ownership of share in practice, it is unlikely that an individual who holds a small and insignificant amount of share would have any say in determining the appointment and removal of any member on the board. Therefore, this vests excessive power in the hands of senior management, allowing some to abuse this in order to make personal gains. Many corporate scandals such as Maxwell in the UK that occurred more than a decade ago and more recently Enron and WorldCom in the United States are all consequences of this problem. In all of these

²⁵Marsh, “Short-termism on trial”

Institutional Fund Managers Association 1990, London

²⁶Sykes, “Proposals for Internationally Competitive Corporate Governance in Britain and America”.
Corporate Governance: An International Review 1994, Vol. 2, No. 4, 187-195.

cases, the senior executives had vested interests in the shares of the company. As a result, they committed fraud by using sophisticated accounting techniques to prop up the share prices. This eventually led to the collapse of some of the biggest companies on both sides of the Atlantic.

Short-termism is also frequently blamed on the incentive schemes of the fund managers of institutional investors in the US and UK. Fund managers are rewarded for investing in companies producing profit in the short term. Therefore, market seems to value short-term profit and managers respond by emphasising set profit.

Furthermore, it is argued that the stock market often fails to reflect the true or long-term value of the company because the market constantly experience boom and bust. Therefore, share prices are affected by factors that maybe totally unrelated to the underlying fundamentals of the company.

Similarly, the analysis of the company based on the economic theory of the firm as mentioned earlier also provides a relatively narrow view . This approach tends to focus on the analysis of legal rules in a descriptive manner. However, it does not provide a coherent solution as to how we can strengthen corporate governance in the modern company context. A law and economic scholars may argue that the proper way to make management more accountable is to provide more information. This, they argue improve the quality of the signal embodied in the share price. This is because in the market model, shareholders are active by buying and selling shares. However, this is merely extending the status quo of what the company already is. It fails to provide any alternative as to how the scope of accountability can be broadened. Furthermore, even if we do assume that by providing more information to shareholders would strengthen shareholder activism and thus make management more accountable to the principal/owner, there is often a cost associated with that. We cannot expect an individual investor/shareholder to bear

the burden of those extra costs, particularly when the amount of share he/she owns may only represent a tiny proportion of its investment or what the company is actually worth.

In fact, according to a more recent study conducted by Blair and Stout, the modern public corporation is made up of different constituencies (shareholders, employees, creditors etc.)²⁷. They pooled their resources together in forming a “team” known as the company. The board of directors should accurately be referred as the “mediating hierarchy”. Its role is to mediate disputes that cannot be resolved at lower levels between different team members or constituencies. This model suggests that the public corporation is to be viewed as a nexus of firm-specific investment made by many and varied individuals. They voluntarily give up control over those resources to an authority (in this case the board), in hopes of sharing in the fruits that can flow from team production. Thus they argue that, as the ultimate decision-making body within the firm, the board is therefore not subject to the direct control or supervision by any constituency, including the shareholders. This reinforces the notion that although it is shareholders who elect directors and remove them under certain circumstances²⁸, yet they cannot tell them what to do. In fact according to US corporate law, even if shareholders successfully pass a unanimous resolution directing the board to pursue some course of action, the board does not necessarily have to comply²⁹.

It is therefore submitted that corporate directors are not “agents” in a strictly legal sense. This is because according to agency law, the principal controls the agent, yet as suggested above, that element of control by shareholders over directors is virtually non-existence both legally and practically. Instead Blair and Stout argues that directors are indeed a unique form of fiduciary

²⁷Blair, M. & Stout, L., “A Team Production Theory of Corporate Law”.
Virginia Law Review 1999, Vol. 85, No. 2, 247-328.

²⁸See s. 303 of the UK Companies Act 1985.

²⁹*Auer v. Dressel*, 118 N.E.2d 590, 593 (N.Y. 1954).

who are allowed discretion to consider and make trade-offs between the conflicting interests of different constituencies³⁰. The theory of the firm thus dispels the proposition that shareholders own the corporation and that they are the main beneficiaries of the directors' fiduciary duties. To put it more bluntly, the prevailing academic view in the English-speaking world that corporate law adheres to a shareholder primacy norm turns out to be an illusion.

Therefore, what we need is a system where the accountability of the company can be broadened. This is not only beneficial to the incumbent "owners" of the company, but it will also widen the accountability and responsibility of the company. This allows company to be more adaptable to the contemporary economic world and this is what the next section will be based on.

5). The emergence of stakeholder theory

As far back as the 1930s, there have been calls by certain commentators that corporate managers should take into consideration the interest and well being of constituencies other than shareholders³¹. Professor Dodd in writing his article was actually providing a counter-argument towards another commentator, Berle, who in the same year of the *Harvard Law Review*, rallied for the importance of shareholder interest³². Although Dodd never mentioned the phrase "stakeholders" in his article, yet he did argue that:

"...public opinion, which ultimately makes law, has made and is today making substantial strides in the direction of a view of the business corporation as an economic institution which has a social service as well as profit-making function..."³³

³⁰Blair & Stout, supra n. 27 at 291.

³¹Dodd, "For Whom Are Corporate Managers Trustees?" *Harvard Law Review* 1932, Vol. 45, No. 7, 1145-1163.

³²Berle, supra n. 14 at 1367.

³³Dodd, supra n. 31 at 1148.

Dodd in particular looked at the economic depression of the 1930s. The socio-economic condition was forcing corporations and as well as both the legislative and judicial branches of the government in the United States to take a more “inclusive” approach in considering the interest of employees, customers and the wider community as a whole. Dodd further argued that the sole function of directors and managers is not only to obtain the maximum amount of profits for shareholders. He proposed that offering high wages and economic security for workers can indeed increase the profits of shareholders because they increase the consumption of the things which businesses produce.

However, the stakeholder movement did not really gain much attention until the late 1970s, where there has been a significant shift from the traditional shareholder model of the firm. It focuses on whether the notion of overemphasis on shareholder value ignores the claims of other stakeholders that ought to be represented in the company. In particular, it questions whether the traditional legal scope of directors’ duties in the English-speaking world should be widened to include the interests of “all stakeholders” and not just those of shareholders.

The origin of the stakeholder debate was the perception that during the late 1970s and early 1980s, the US and UK economies were losing grounds to Germany and Japan. In many sectors, German and Japanese companies were outperforming their Anglo-American counterparts.

In contrast, Japanese and German companies were more successful because they took a more long-term approach towards capital investment. They also maintained a better employer/employee relationship by rewarding long term commitments as opposed to the Anglo-American approach of “flexible labour” policy through the use of hire and fire³⁴.

³⁴Gamble, A. & Kelly, G., “Shareholder Value and the Stakeholder Debate in the UK”. *Corporate Governance: An International Review* 2001, Vol. 9, No. 2, 110-117.

German and Japanese industries adhere to the “bank-based” systems where they maintain a relatively good relationship with banks, often through shareholding by the latter. This means, unlike its US and UK counterparts, they are more inclined to take on projects with long-term implications. This is because the cost of financing these projects tend to be lower than it is in the US or UK.

Unlike the US and UK boards, those in Germany consist of employee representatives where the interests and needs of the workers are often reflected to the management. This benefits the overall performance of the company in the long term. Also, German boards have more engineers and fewer accountants. This perhaps also explains why German industries have constantly outperformed that of the UK in terms of productivity in the last three decades.

6). What does stakeholder theory entail?

One of first scholars who extensively developed the stakeholder theory was R. Edward Freeman in his landmark book, *Strategic Management: A Stakeholder Approach*³⁵. Since then, the concept of “stakeholders” has become embedded in management literatures and managers’ thinking. However, as popular as the term has become, there is no agreement on what Freeman calls “The Principle of who or What really Counts”. In other words, there is no general consensus as to who or what are the stakeholders of the firm and to whom or what do managers ought to pay attention to? I shall discuss this in greater detail later in chapter 2.

Corporate governance theory in the US or UK as I previously stated, is traditionally focused on shareholder value as the dominant corporate objective. However, in Continental Europe for example, business and economic policies tend to focus on the improvement of overall

³⁵Freeman, R., “Strategic Management: A Stakeholder Approach”.
Pitman Publishing Inc. 1984

living and working conditions as a social goal to which all major institutions, including corporations, should aspire³⁶. The stakeholder model is often seen as a challenge to the traditional principal-agent or shareholder model embraced by the US and UK. The theory is a broad concept and there are numerous ways as to how it should be defined, depending on what literature one reads. According to Freeman, “stakeholder” is any group or individual who can affect or is affected by the achievement of the firm’s objectives. Thus a stakeholder view would entail the firm to take into account all those groups and individuals that can affect or are affected by the accomplishment of organizational purpose³⁷. Other commentators argue that the central theme of the stakeholder approach is that, a company should be defined more widely than the maximization of shareholder wealth alone³⁸. It argues that there should be some recognition of the interests of other groups that have a long-term relationship with the company. Such groups include suppliers (business partners), customers, and in particular, employees. However, even here, there are debates as to the distinction between “internal” and “external” stakeholders and this shall be further elaborated later in chapter 2.

According to stakeholder theory, each of these groups plays important role in the success of the business enterprise in today’s environment. Each of them has a “stake” in the modern corporation. The emergence of this theory over the last two decades is largely driven by changes which have occurred in the external environment of business such as globalization. In particular, there have been shifts in traditional relationships with groups such as suppliers, customers, employees, shareholders and even government and special interest groups like Non-governmental organizations (NGOs). Therefore, a new management approach is necessary.

³⁶COM(2001) 366 *Corporate Responsibility*.

³⁷*Supra*, n. 35 at 25

³⁸Keasey, K., Thompson, S., Wright, M, “Corporate Governance-Economic, Management, And Financial Issues”. *Oxford University Press* 1997, p. 8.

Furthermore, due to increased foreign competition, businesses have been forced to make changes in order to survive in modern times. During the 1980s and 1990s, US and UK businesses faced vigorous competition from their German and Japanese counterparts. The emergence of these foreign competitions made the necessity to abandon “traditional” managerial view of the firm urgent. This is because when foreign competitors figure out how to satisfy customers with high quality products at less expensive price, then any competitive advantage which domestic firms have would be at peril³⁹.

It is often argued that in both Japan and Germany, corporate goals and objectives are defined more widely than shareholder profits. For example, in Germany companies are under a social obligation to employees and the local community. In both countries, the company is viewed as an enduring and continuous social organization. Suppliers and major customers may be linked to the company via cross-shareholding and cross-directorates. In both systems, banks play a much influential role in financing investment and in its corporate governance.

Furthermore, in both Germany and Japan the interests of labour receive particular attention in corporate decision-making. Mandated employee representation on boards or through works councils also occurs in several European countries such as France, Holland, Belgium and Spain. The German model for example, involves workers’ participation in work councils under a two-tier board structure. For firms employing 20,000 or more, there is a requirement under the Public Companies Act of at least 50% representation by employees on the supervising board of directors (*Aufsichtsrat*)⁴⁰. This body is also responsible for the nomination of members on the managerial board. Similarly, Japanese workers employed in large industrial sectors, enjoy lifetime employment.

³⁹*Supra*, n. 35, at 17-18.

⁴⁰Belcher, A., & Naruisch, T., “The Evolution of Business Knowledge in the Context of Unitary and Two-tier Board Structures”. *Journal of Business Law*, July 2005, 443-472.

As we can see, the German and Japanese systems display many differences which strongly differ from the Anglo-American model. In Germany or Japan, corporate decisions are conventionally made with the interests of employees being taken into consideration. In contrast, for the latter model, decisions are often made on the basis of cost-cutting at the expense of employees to boost shareholder wealth. This also means that hostile takeovers in the Germany and Japan are more rare than it is in the US or UK.

7). The Objective & Research Question of this thesis

For many years, there have been vigorous arguments between supporters of the shareholder and stakeholder models as to which system is more effective in enhancing corporate values and disciplining managements. What view one takes of course very much depends on political viewpoint and national background as shall be discussed in latter chapter in greater details. For example, economists or lawyers in the US or UK may argue that the Anglo-American shareholder model is more appropriate. This is because there is at least a criterion (i.e. share price) by which you could measure and compare corporate performance. Supporters of the shareholder model may argue that the concept of stakeholder is anti-capitalism and that it is too broad and abstract, providing no clear boundary as to who may or may not fall into that category. Yet in contrast, their Japanese or German (and other Continental European) counterparts may argue that the Anglo-American approach of primarily focusing on share value and wealth maximization is too narrow and an over-simplistic view of the role played by corporations. Supporters of the stakeholder theory would argue that it is necessary to take into consideration interests beyond those of shareholders. This is because businesses ought to demonstrate certain responsibilities towards the society in which they operate.

This thesis neither supports nor challenges the validity of either the shareholder or stakeholder approach. Instead it attempts to re-examine corporate accountability in a modern and globalizing world and look at the factors which corporations take into consideration in their decision-making process in the 21st century. The aim is to illustrate with selected case-studies as to how corporations response to a rapidly changing environment by adhering to different measures and strategies to balance the needs of different stakeholders or “corporate constituents” in order to maintain their competitiveness in the practical world.

The main proposal of this thesis is as follows. Living in the twenty-first century, we must understand that our world is neither being Americanized nor Europeanized or Orientalised. We are instead being globalized. National identities in terms of corporations will become less and less important as multinational corporations extend their activities throughout the globe. With the advance in technology and increase in cross-border business transactions amongst countries, it is no longer justified to argue that “one business model fits all”. As academics and practitioners we must therefore explore ways in which we could bring the best out of different models so that they can be harmonized to form a more coherent approach towards the balancing of different conflicting interests.

Since the collapse of Enron, regulators on both sides of the Atlantic have imposed new measures to strengthen corporate governance. The US Congress enacted the Sarbanes Oxley Act which came into force in July 2002. The effects of the new legislation extend beyond the United States because it has a long arm jurisdiction and catches directors and auditors of any company listed in the US even if this is only a secondary listing of European regulated companies. This has led to some concerns amongst corporate Europe with regards to the repercussions this may have on their activities.

In their turn, many European states have produced a number of corporate governance codes to monitor public companies. The United Kingdom being at the forefront, published the Combined Code in 2003 which consolidated the recommendations of all the reports of the 1990s. Although the Code is voluntary by nature, yet the UK operates a “comply or explain” system. Companies are now obliged to put all aspects of corporate governance in their annual report to shareholders explaining exactly why they have not followed particular aspects of the code. This system has also been followed by a number of other EU states such as Germany and France who have also produced their version of the corporate governance code following the UK example.

Moreover, at EU level, a number of directives over the years have also forced a change in the corporate governance landscape of a number of countries, particularly the United Kingdom. The Collective Redundancies Directive and the Acquired Rights Directive on Transfers of Undertakings now establish the obligation of employers to inform and consult employees’ representatives in these particular situations.

The foundations of the European Social Policy are to be found in the Single European Act of the 1986, the Maastricht Treaty 1992 and the Treaty of Amsterdam in 1997. The Treaty on European Union signed at Maastricht, Holland in February 1992 was the last major policy document indicating the planned direction of the Social Policy. The Treaty was signed by 11 of the then 12 member states. The United Kingdom under the last Conservative government derogated from the Treaty of Maastricht, refusing to continue implementing the Social Policy. However, following a landslide victory by the Labour party in 1997, it has abandoned the stance. The Collective Redundancies Directive and the Acquired Rights Directive on Transfers of Undertakings also require the establishment and consultation of the European Works Council for all undertakings with a Community dimension with at least 150 employees in at least 2 member

states. However, the UK was found in violation of the directives by the ECJ since it never had a system for the setting of work councils⁴¹. It was forced to create ad hoc works councils of representatives elected only to deal with these particular matters. This marks a new dimension to corporate governance development in the traditional UK shareholder model.

On the other hand, the corporate governance mechanism in Continental Europe has also been transformed due to an increase in foreign investment, particularly from Anglo-American institutional investors. They are demanding the same level of rights and information as they might on their own stock exchanges. The introduction of voluntary codes of corporate governance such as the *Vienot* in France and the *Peters* in Holland are also new element to the Continent where countries have traditionally relied on enforced rules and legislations in governing corporate activities.

Moreover, the US and UK economies have fared significantly better than many of its Continental and Japanese counterparts since the mid 1990s. This has led to calls amongst Continental practitioners and academics arguing that it may be necessary for Continental Europe to expand market control mechanisms to facilitate the maximization of firm value, like that seen in the US or UK⁴².

On the other hand, the UK has proposed changes in its law regarding duties to stakeholders. After thorough consultations by the **Company Law Review Steering Group** (CLRSG), it eventually adopted the “inclusive approach” in its company law review. The newly drafted Companies Act 2006 shall contain a statement of directors’ duties. In line with the concept behind the inclusive approach, the key objective of directors is “to promote the success

⁴¹Commission v. United Kingdom [1994] ECR 2435.

⁴²Cuervo, A., “Corporate Governance Mechanisms: a plea for less code of good governance and more market control”.

Corporate Governance: An International Review 2002, Vol. 10, No. 2, 84-93.

of the company for the benefit of its members”. They must uphold the current legal view that the shareholders’ interests override all other parties within the corporate nexus. However, the statement does go on to list other relevant factors that the directors must take into account. These include the need to foster business relationships with employees, business partners and customers. Directors also need to take into consideration of their operations on the communities and the environment. One objective of the proposed company law reform is to bring together shareholder and stakeholder interests. I shall discuss this issue in greater depth later on in chapter 6.

Also in Japan, after being battered by an entire decade of lacklustre economic performance, the traditional system is under pressure to change. There has been a greater level of foreign direct investment and institutional shareholder activity, particularly from the United States. This has led to the introduction of non-executive directors and the emergence of shareholder governance.

As can be seen from above, our world has become more and more globalized. The distinction between each corporate governance model is becoming more blurred by the day. As a result, the research question that I sought to resolve in this thesis is:

“How is it possible for a company to attain healthy financial performance and yet at the same time be accountable to various corporate stakeholders in its operation and decision-making process in a globalizing environment?”

As mentioned above, “stakeholder” is a very wide concept and it will not be possible for me to study every potential group of claimants that may be affected by corporate activities. I have therefore decided to focus on four specific groups namely – (i). Workers and, (ii). Customers/Consumers; (iii).Environment/Local Communities and, (iv).Shareholders/Investors.

Before I continue further, I must reiterate that the term “stakeholder” is not limited to include only the four abovementioned constituencies. The reason why these four particular groups are being targeted for my study is due to their direct implications on the survival and well-being of a corporation. Workers or labourers are the ones who actually provide the goods and services supplied by the firm. In the last 20 years, scholars have from time to time discussed the importance of human resources management to the success of a business. Their welfare often dictates the quality of the goods or services supplied by the firm which directly affects its reputation. Furthermore, workers and trade unions have always been treated as a special interest group by politicians and governments in the western world. Numerous legislations have been passed in the last three decades that are either directly or indirectly concerned with workers. It is therefore an important constituency that ought to be given special attention.

The other constituency that is being studied is customer. I believe the reason for this simply speaks for itself because no business can survive without customers. They are therefore the ones who actually pay for the wages of the employees and executives. Secondly, like employees, there are also many legislations that have been passed to protect their interests. In the west, we often hear governments blocking proposed mergers or forcing monopolies to sell and break up their companies. These are all measures that are designed to protect the well-being of the consumers in the long-run.

Given the concern that has been raised about issues such as environmental protection in recent years, this is one stakeholder group that cannot be ignored with. This is because the general public have become more aware as to how companies are contributing to a better quality of life and those who neglect the issue often risks bad publicity.

Finally, I shall also be looking at how the selected companies manage their relationships with shareholders and investors. This is a thesis about balancing the interests between shareholders and non-shareholding constituencies. Given that all of the case-study is publicly-listed companies, it would not be complete if the interest of shareholders is ignored.

Furthermore, I shall attempt to justify and elaborate for the choice of stakeholders to be studied in this thesis in greater details in the later chapter. In conducting my research, I realised that by simply interviewing the representatives and gathering documentary evidence from the companies could create an element of bias to my study. Therefore, in an attempt to resolve this problem, I shall conduct interviews with other stakeholder groups in order to get a diverse opinion as to the meaning of corporate stakeholder engagement. Due to time and resource restrains, it would not be practicable for me to conduct interviews with every single stakeholder group. Therefore, I have narrowed down such groups to NGOs (Non-governmental organizations) and government representatives.

The case study approach shall be applied for conducting this research and it is important to stress at this stage that this is intended to be a qualitative study. I shall be focusing on three case-studies selected from three separate jurisdictions: Hong Kong; United Kingdom and the Netherlands. The particular research method is adopted due to the nature of the study. Case study analysis enables a researcher to achieve high levels of conceptual validity and measure variables which may be difficult to do so under statistical studies. One of the key concepts of this research is the term “stakeholder”, which can have a different meaning to different people depending on who they are. Therefore, by conducting a case study and interviewing the representatives from different companies would allow the interviewees to speak for themselves and elaborate on how they define the term “stakeholder”. In chapter 3, entitled “research

approach”, I intend to discuss my research question and hypothesis further. It will also justify for the research approach which I have selected for this thesis.

8). Contents of thesis

In the following chapter, I shall begin by examining the features and shortcomings of the economic theories of firm. This is because they have influenced the corporate governance and framework of the 20th century in the English-speaking world. Following that, I will turn to some of the more up-to-date literatures that argue for a more inclusive approach in corporate-decision making. By the end of the second chapter, I shall be able to pinpoint the contribution that I sought to make for my research and how that helps to fill in the gaps of previous literatures.

Then the focus of the third chapter shall be on the research approach for my thesis

Chapters 4 to 6 shall be the main body of my thesis. These chapters shall be treated as a separate case study from my selected jurisdictions. I shall be focusing on certain special group of claimants as mentioned above by using a case study analysis approach to look at whether the interests between shareholders and stakeholders can be converged. The responses of external stakeholder groups such as NGOs and government representatives would also be reported within the case study chapters. Finally, chapter 7 shall be the conclusion of the thesis.

Chapter 2: Conceptual & Theoretical Review of Corporate Governance

In the previous chapter, I have discussed some of the historical developments of company law and briefly looked at the sources of company law and its purpose. In this chapter, I shall elaborate on this matter further. I will review on literatures that have contributed in shaping the current corporate legal framework and how they have influenced the management of modern corporations.

As mentioned in some of the discussions in the previous chapter, the key issue which corporate governance is concerned with is accountability. Both the shareholder and the stakeholder model focus on disciplining management and how to make them more accountable. Yet the two theories have very contrasting views as to the nature and function of corporations. The shareholder model being largely influenced by the economic theories of the firm views corporations from a purely economic perspective. It argues that directors are the agents of their shareholder principals and that the key objective of the directors is to maximise shareholders' wealth. On the other hand, stakeholder theory looks at corporate accountability from a wider perspective. It argues that corporations should also take into consideration interests of other stakeholders ranging from employees through to the community at large who also contribute to the well-being of the company.

The purpose of this research is not to assert superiority of one model over another. The aim and objective as mentioned in the previous chapter is to search for a "middle approach" in which the concept of both values can be brought together to form a corporate governance model based on convergence and co-existence. However, in order to do this, it is important to understand the fundamental values and historical developments of both models. This is because

they have influenced the current corporate governance practices which we are witnessing in the real world.

Therefore, the objective of this chapter is to examine more closely the characteristics of both the economic theories of the firm and the stakeholder theory. As a result, this is a relatively long chapter due to the breadth of literatures that needs to be covered.

The chapter will begin by first looking at the legal foundation as to how corporation is defined. It will then compare and contrast different corporate governance models and their origin. Later on, it shall review in depth many of the major literatures that have been developed in the twentieth century dominantly in the English-speaking world. In particular, I shall be concentrating on those theories that have shaped the current corporate legal framework that have been influenced by the legal definition of corporation. Towards the end of this chapter, attention will be shifted towards more up-to-date literatures that call for changes of the current framework and ways in which they have influenced modern corporations.

1). Corporate Personality

As mentioned earlier in chapter one, the first Companies Act was passed during the mid-nineteenth century and the UK was the pioneer in its development. Throughout the twentieth century, the corporate economy has been the bedrock of the western capitalist societies. Individuals have taken advantages of the corporate form and pooled their resources to pursue in commercial activities. Incorporation of business organizations provides a relatively low-risk investment for investors. Once incorporation takes place, the business becomes a “separate legal person” and this enables individuals to conduct business affairs on the basis of “limited liability”, a distinctive feature of company law. In ordinary speech, we usually use the word “person” to

refer to an individual human being i.e. a man, woman or child. But in law, the word has a more technical meaning – it is capable of enjoying rights and subject to duties which are not the same as those enjoyed or borne by its members. It is in this sense that we speak of a corporation as a “person” and recognise its separate personality.

The fundamental principle of corporate personality was laid down in the famous nineteenth century English case of *Salomon v. A Salomon & Co Ltd*⁴³. Salomon was a renowned boot and shoemaker in London. He and his legal adviser decided to form a company. Forming a company in those days required seven members and Salomon established the company with his wife and five children. The process which they adopted was that the business is valued, the company is formed and the company buys the business, and shares were issued. The business was valued at 38,000 pounds and the company paid through the issue of shares. Salomon himself took 20,000 shares and the rest of the members took 1 share each. Salomon was also issued 10,000 pounds worth of debentures. The business eventually collapsed and in trying to rescue the company, Salomon mortgaged his debentures to a third party, who put 5000 pounds into it. By holding the debenture, this actually gave Salomon priority over the company’s assets above that of unsecured creditors. The company eventually went into liquidation and the liquidator tried to set aside the debenture by claiming it was a fraud.

At first instance, the ruling judge not only invalidated the debentures, but also made Salomon liable for the debts. It held that the company was simply Salomon’s agent and that at all material time, he was carrying on his business through this agent. The Court of Appeal affirmed the judgement but took a different line. It took a purposive approach to statutory interpretation and held that the statute was never intended to allow one trader to bring in six dummies to comply with the provision of the Act and thereby obtain limited liability. The Court

⁴³[1897] AC 22.

of Appeal held that the company was a trustee for Salomon. When the case got to the House of Lords, it was unanimously reversed. Their Lordships held that you either have a company or you don't and there is no "half-way house". Once it is registered, it is considered as an entirely separate legal entity. It makes no difference to the rule that one member owns all or substantive part of the shares.

The decision made by the House of Lords has since become the most important legal principle in corporate law of the English-speaking common law jurisdictions. There has been no sign suggesting that this rule would be changed or amended in the near future.

The consequence of the Salomon decision not only affirms the company as a separate legal entity, but it has also shaped the corporate law development that has taken place in the English-speaking world for the last one hundred or so years. By being a separate legal person, the company therefore has both rights and duties. It can enter into contracts with creditors and suppliers, it can hire employees or managers to oversee its day-to-day affairs. It also has the right to sue and be sued.

As a result, this has caused many corporate law and economic scholars throughout the twentieth century to conduct studies of what the "company" actually constitutes. Many of these studies have looked at the corporation from both the economic and legal perspectives. In particular, they have all attempted to explore the actual purpose of forming a company and its role. It is these literatures that I shall now turn my attention towards in the next section.

1). Debates on corporate governance

The question of how corporations should be governed to enhance corporate and economic performance has been widely discussed in both the academic and practical world. Contemporary

debates about corporate governance stem, in part, from the recognition by economists of the centrality of corporate enterprises for allocating resources in the economy. To address the issue of resource allocation, economists strive to find answers to questions such as, “how should these resource allocation decisions be made? Who should make these decisions? How can those who are responsible for making these decisions be induced to make the right decisions? How are they to know what and how much information to acquire before making the decisions? How can the separate decisions of the millions of actors-decision makers- in the economy be controlled?”⁴⁴ As mentioned earlier, corporate governance is concerned with the institutions that influence how business corporations allocate resources and returns. Specifically, a system of corporate governance shapes who makes investment decisions in corporations, what types of investments they make, and how returns from investments are distributed⁴⁵. There are two schools of thought when it comes to corporate governance debate, the shareholder theory and stakeholder theory. I shall now discuss their contrasting views in greater details.

2). The shareholder theory of corporate governance

The Anglo-American debates on corporate governance that have taken place over the last two to three decades have been largely confined to shareholder theory as the dominant perspective. Advocates of the shareholder view contend that shareholders are the “principals” in whose interests the corporation should be run even though they rely on others for the actual running of the corporation⁴⁶. When corporations are run to maximize shareholder value, it is argued, the

⁴⁴O’Sullivan, “Contests for Corporate Control: Corporate Governance and Economic Performance in the United States and Germany”.
Oxford University Press 2000

⁴⁵Ibid., p. 1

⁴⁶Ibid., p. 43

performance of the economic system as a whole, not just the interests of shareholders, can be enhanced. In making this claim, advocates of shareholder theory portray residuals as rewards for critical economic functions that shareholders perform. In other words, shareholder returns are regarded as incentives for risk-bearing and waiting⁴⁷.

The underlying rationale of shareholders dominant is on the basis that they are the residual risk-bearers in the corporate enterprise and this notion is widely accepted not only in financial economics but among many mainstream economists. It is argued that shareholders are the only economic actors who make investments in the corporation without any contractual guarantee of a specific return. Therefore, shareholders thus bear the risk of the corporation's making a profit or loss and have an interest in allocating corporate resources to their best alternative uses to make the residual as large as possible. Since all other stakeholders in the corporation will receive the returns for which they have contracted, "the maximization of shareholder value" will result in superior economic performance not only for the particular corporation but also for the economy as a whole⁴⁸.

As a class, it is argued that shareholders are better equipped to bear risk than managers and workers, because they are not tied to the firms in which they hold shares. This is because shareholders can diversify their investment portfolios to take advantage of the risk-minimization possibilities of grouping or consolidating different types of risk. This is supported by scholars such as Fama and Jensen:

"...the least restricted residual claims in common use are the common stocks of large corporations. Stockholders are not required to have any other role in the organization; their residual claims are alienable without restriction; and, because of these provisions, the residual claims allow unrestricted risk sharing among stockholders"⁴⁹.

⁴⁷Ibid

⁴⁸Ibid

⁴⁹Fama & Jensen, "Separation of Ownership and Control"
Journal of Law and Economics 1983, 26: 301-25, at 303.

However, the risk allocation advantage comes at a cost in terms of incentives within the corporation. This is because separation and specialization of decision management and residual risk bearing leads to agency problems between decision agents and residual claimants. This is the problem of the separation of ownership and control that has long troubled the shareholder theory⁵⁰. The governance problem of the modern corporation, as financial economists conceptualize it, is that those who bear the residual risk i.e. the shareholders or principals have no assurance that the corporate managers or agents who make decisions that affect shareholder wealth will act in shareholder interests. The costs that result from the exercise of managers' discretion to act other than in the best interests of their principals, as well as the expenses of monitoring and disciplining them to prevent the exercise of that discretion, are referred to as "agency costs"⁵¹.

Due to the abovementioned problem, throughout the twentieth century, academics and scholars have searched for ways to reduce agency costs in order to maximize the return of the principals (shareholders) from both a legal and economic perspective. This has led to the development of the economic theories of the firm (corporation). These are the literatures which I shall now turn my focus towards.

a). Economic theories of the Corporation

In general, economic theories of the corporation perceive corporate constituents as factor providers. Their interests in the corporation are defined and regulated by contractual negotiations with the corporation.

⁵⁰Ibid., at 312

⁵¹Supra n. 44, at 44

b). Coase's Theory of the Firm

One of the first scholars to explore the concept of the corporation from an economic perspective was Ronald Coase. In 1937, Coase published a seminal work entitled, *The Nature of the Firm*⁵², which represented a major theoretical reference point at the time. The idea expressed by Coase on the nature of the company (firm) can be applied to any production unit, including the modern corporation.

In his study, Coase looked at the comparative cost analysis of organizing production through the market and the firm. The objective of his study was to provide the cost explanations for organizing production through the endorsement of the firm, even though the market may perform such function. Coase argued that:

“In view of the fact that while economists treat the price mechanism as a co-ordinating instrument, they also admit the co-ordinating function of the entrepreneur, it is surely important to enquire why co-ordination is the work of the price mechanism in one case and of the entrepreneur in another”.⁵³

In pursuing his objective, Coase examined the economic rationale for using the firm to organize production by assuming that, besides the market, production could also be organized through the firm. According to his theory, one main reason why it is more efficient or profitable to set up a firm is that there is a cost of using the price mechanism. He identified that there would always be extra costs in negotiating and concluding a separate contract for each exchange transaction that takes place on a market. But according to Coase, cost savings can be made by simply co-ordinating the business under one umbrella-the corporation. This is because the existence of a firm reduces the number of contracts that needs to be entered into. In Coase's

⁵²Coase, “The Nature of the Firm”.
Economica 1937, 4, 386.

⁵³Ibid. at 387.

view, a firm is a system of relationships which come into existence when direction of resources is dependent on an entrepreneur⁵⁴.

However, one flaw of Coase's analysis is that he never made any distinction between the entrepreneur-manager and the entrepreneur-capitalist. He simply focused on the cost advantages which a firm could achieve by being able to minimize production costs through co-ordinated and enduring contracts with factors of production (land, labour, capital and entrepreneur).

Furthermore, Coase did not tackle the issue about corporate management and governance. He did not illustrate how best to address issues such as managerial shirking, opportunism and unrestrained managerial discretion. Nor did he propose methods to ensure a transparent and accountable management. These are issues that concern modern corporate governance and they were all causes of major corporate collapses that we witnessed over the last twenty years.

c). Alchian & Demsetz's Team Production Theory

Following Coase, Armen Alchian and Harold Demsetz conducted a series of studies in the late 1960s and early 1970s, from an economic perspective. They provided a theoretical framework for controlling managerial shirking, an area which was neglected by Coase. In 1972, Alchian and Demsetz published an article in the *American Economic Review* that sought to explore the matter⁵⁵.

Unlike Coase, who focused on the saving of transaction costs, Alchian and Demsetz presented a theory of the firm based on the need to align productivity with reward, which they referred as "metering". They argued that long-term contracts between employer and employee

⁵⁴Ibid. at 400.

⁵⁵Alchian & Demsetz, "Production, Information, Costs and Economic Organization". *American Economic Review* 1972, 62, 777-783.

are not the essence of the organization that we call a firm. According to them, the firm does not own all its inputs. It has no power, no authority, and no disciplinary action any different in the slightest degree from ordinary market contracting between any two people⁵⁶. Thus their focus is on the centralized contractual agent and accordingly, a firm is a team production:

“Team Production, to repeat, is production in which (1) several types of resources are used and (2) the product is not a sum of separable outputs of each cooperating resource. An additional factor creates a team organization problem-(3) not all resources used in team production belong to one person”⁵⁷.

According to them, productivity does not create its reward (metering) at zero cost. They further claimed that it was important to monitor productive activities of input providers to avoid shirking. They claimed that if there is net increase in productivity available by team production, net of the metering cost associated with disciplining the team, then team production would be relied upon rather than a series of bilateral exchange of separable individual inputs.

Under Alchian and Demsetz “classical firm” theory, one way of reducing shirking is to employ someone that specializes as a monitor to check the input performance of team members. However, they do recognize that there is a risk that the monitor himself/herself may resort to shirking. They therefore propose that the monitor should be given title to the net earnings of the team, net of payments to other inputs. They argued that if owners of cooperating inputs agree with the monitor that he/she is to receive any residual product above prescribed amounts, then the monitor should have an added incentive not to shirk:

“Specialization in monitoring plus reliance on a residual claimant status will reduce shirking...”⁵⁸.

Therefore, two necessary conditions exist for the emergence of the firm under Alchian and Demsetz: (1). It is possible to increase productivity through team-oriented production, a

⁵⁶Ibid. at 777-778.

⁵⁷Ibid. at 779.

⁵⁸Ibid. at 782.

production technique for which it is costly to directly measure the marginal outputs of the co-operating inputs. This makes it more difficult to restrict shirking through simple market exchange between cooperating inputs. (2). It is economical to estimate marginal productivity by observing or specifying input behaviour.⁵⁹ They further argued that these two conditions would lead to the contractual organization of inputs, referred as the “classical capitalist firm” with (a) joint input production, (b) several input owners, (c) one party who is common to all the contracts of the joint inputs, (d) who has rights to renegotiate any input’s contract independently of contracts with other input owners, (e) who holds the residual claim, and (f) who has the right to sell his central contractual residual status.⁶⁰

In their article, Alchian and Demsetz also looked at the theory proposed by Coase. They agreed with Coase’s theory that the higher is the cost of transacting across markets the greater is the comparative advantage of organizing resources within the firm. However, they argued that Coase’s analysis would suggest open-ended contracts. According to Alchian and Demsetz, Coase did not address the issue of the residual claimant status and nor did it make a distinction between employee and sub-contractor status.⁶¹ They claimed that employees are generally not employed on the basis of long-term contractual arrangements, but on a series of short-term or indefinite length contracts. Alchian and Demsetz believed that the key contribution of their work explains why the person to whom the control monitor is responsible receives the residual and the implications this has concerning the corporation, partnerships and profit sharing.

In analyzing the structure and decision-making of the corporation, Alchian and Demsetz sought to explain the rationale for hiring managers and agents to oversee the organization. They point out that it is impracticable for every stock owner participated in each decision-making

⁵⁹Ibid. at 783.

⁶⁰Ibid. at 783.

⁶¹Ibid. at 784.

process in a corporation because of the large bureaucratic costs that may incur. Furthermore, many shareholders would shirk the task of becoming well informed on the issue to be decided because the losses associated with unexpectedly bad decisions will be borne in large part by the other shareholders. They therefore argued that more effective control of corporate affairs is achieved by transferring decision-making authority to a smaller group, whose main role is to negotiate with and manage the other inputs of the team⁶².

But in delegating their authorities what shareholders would retain, is the power to review (or remove) the membership of the management group and over major decisions that affect the structure of the corporation or its dissolution. In fact this view is consistent with modern corporate law. For example in the UK, section 303 of the Companies Act confers power on the general meeting of shareholders to remove any director from the board by an ordinary resolution. Section 9 of the same legislation authorizes the general meeting of shareholders to alter the articles of incorporation by a special resolution. Furthermore, Alchian and Demsetz stated that the right to sale of shares without approval of any other shareholders is paramount⁶³. Any shareholder may remove her wealth from control by those with whom she has differences of opinion. Unrestricted salability, they argued, provides a more acceptable escape to each shareholder from continued policies which he/she disagrees. Accordingly, the monitoring of managerial shirking also relies on market competition from new groups of would be managers as well as competition from incumbent members who seek to displace existing management. Alchian and Demsetz's theory therefore suggests shareholder primacy and the assumption of market for corporate control.

⁶²Ibid. at 788.

⁶³Ibid. at 788.

However, there are limitations with Alchian and Demsetz's theory. First of all, their work is narrowly focused on the employer-employee relationship. Secondly, their analysis seems to be restricted to a scenario in which management and ownership of the corporation are both vested in one group. But in a large public corporation, share-ownership is very much dispersed. Therefore, their theory does not actually address the problems of corporate governance faced by modern corporations.

d). Jensen & Meckling's Nexus of Contracts Theory

Following Alchian and Demsetz's analysis of the firm as a team production, in 1976, Jensen and Meckling defined the firm in terms as "a nexus of contracts" in their work⁶⁴. Jensen and Meckling elaborated on the problem of shirking and monitoring proposed by Alchian and Demsetz. They looked at agency costs in their study and defined it as the sum of: (1) the monitoring expenditures by the principal, (2) the bonding expenditures by the agent, and (3) the residual loss⁶⁵. They argued that since the relationship between shareholders and managers of a corporation fit the definition of a pure agency relationship it should be no surprise to discover that the issues associated with the separation of ownership and control in the modern diffuse ownership corporation are intimately associated with the general problem of agency⁶⁶.

According to Jensen and Meckling, the firm or corporation is simply a form of "legal fiction. It serves as a nexus for contracting relationships which is also characterized by the

⁶⁴Jensen & Meckling, "Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure".
Journal of Financial Economics 1976, 3, 305-360.

⁶⁵Ibid. at 308.

⁶⁶Ibid. at 309.

existence of divisible residual claims on the assets and cash flows of the organization. These can generally be sold without permission of the other contracting individuals”⁶⁷.

They further noted that viewing the firm as a nexus of contracting relationships among individuals also makes it clear that “personalization of the firm implied by asking questions such as what should be the objective function of the firm, or does it have a social responsibility is seriously misleading”⁶⁸. According to them, the firm is not an individual. The “legal fiction” simply serves as a tool for a complex process in which conflicting objectives of individuals are brought into equilibrium within a framework of contractual relations. Therefore, the behaviour of the firm is like the behaviour of the market. It is an error to see the firm as if it was a person with motivations and intentions.

One may argue that there is indeed some basis in viewing the corporation as web of contractual relationships from both a practical and legal point of view. Section 14 of the UK Companies Act 1985 provides the legal effect of the memorandum and articles of incorporation. The provision defines them as contractual documents between the company and the members and viewed as if under seal by deed. Shareholders could no doubt sue the company and any argument that the company is not bound by the contract would not sustain. There is also reciprocity under the provision between the contractual obligations of members and the company. For example in the case of *Rayfield v. Hands*⁶⁹, there was a clause in the articles that in the event of members wishing to leave, they should first offer shares to the directors who would be bound to take them at an agreed price. But the directors declined and the members successfully enforced the clause against the directors without suing through the company. The court held that the article is binding on the members. In a more recent case, Lord Hoffmann in

⁶⁷Ibid. at 311.

⁶⁸Ibid. at 311.

⁶⁹[1958] 2 All ER 194.

delivering his judgement in the House of Lords also recognised a company, as an association of persons, exists to perform an economic purpose. By subscribing shares, shareholders automatically become privy to the terms of the corporation documents:

“A company is an association of persons for an economic purpose... The terms of the association are contained in the articles of association and sometimes in a collateral agreement between the shareholders”⁷⁰.

The “nexus of contracts” theory of the corporation has acquired much attention in the academic world. It has instigated a number of scholars in the last 20 years to further explore and analyse the significance of this theory.

Following Jensen and Meckling, Eugene Fama, in his article claimed that in order to understand the workings of the large modern corporation, it is necessary to separate security ownership and control of the corporation. He argued that the corporation should be viewed within the “set of contracts” perspective⁷¹.

According to Fama, when trying to understand the nexus of contract theory, one must first set aside the general presumption that a corporation has owners in any meaningful sense. The corporation is simply the set of contracts covering the way inputs are joined to create outputs and the way receipts from outputs are shared among inputs:

“In the nexus of contracts perspective, ownership of the firm is an irrelevant concept. Dispelling the tenacious notion that a firm is owned by its security holders is important because it is a first step toward understanding that control over a firm’s decisions is not necessarily the province of security holders”⁷².

Secondly, according to Fama, it is also necessary to set aside the role usually attributed to the entrepreneur. This is because by retaining the concept of the entrepreneur, “one is prevented from developing a perspective on management and risk bearing as separate factors of production,

⁷⁰*O’Neil v. Phillips* [1999] 2 All ER 961 at 966.

⁷¹Fama, “Agency Problems and the Theory of the Firm”.
Journal of Political Economy 1988, 88, 288-307.

⁷²*Ibid.* at 290.

each faced with a market for its services that provides alternative opportunities and, in the case of management, motivation toward performance”⁷³.

Fama argued that the function of management is to oversee the contracts among factors and to ensure the viability of the firm. The role of the owners or security holders is to provide indirect assistance to the managerial labour market by valuing the firm’s management⁷⁴. A potential investor would only purchase shares with confidence if the price paid reflects the risks he/she is taking. The value of that investment is priced in the future to allow the investor to reap rewards of her risk bearing. In other words, it is the force of the market that disciplines the management. This is because it is the managerial labour market that determines each manager’s outside opportunity wage in accordance to its performance⁷⁵.

Under Fama’s analysis therefore, the board of directors of a corporation should be viewed as a “market-induced institution”, which is the “ultimate internal monitor of the set of contracts called a firm, whose most important role is to scrutinize the highest decision makers within the firm”⁷⁶. Furthermore, the board also provides a relatively low-cost mechanism for replacing or reordering top managers. According to Fama, under a competitive environment it is the lower-cost sets of monitoring mechanisms that are likely to survive.

Fama’s theory is highly reliant on the assumption of market for corporate control. The dispersion of share-ownership in large public corporation is a tool in which managers are disciplined through managerial labour markets, both within and outside of the firm. Coupled

⁷³Ibid. at 291.

⁷⁴Ibid. at 292.

⁷⁵Ibid. at 293.

⁷⁶Ibid. at 294.

with assistance from internal and external monitoring devices that stimulate the efficiency of the corporate form and that the market for outside takeovers also provide discipline of last resort⁷⁷.

In 1989, commentators Easterbrook and Fischel published an article, entitled, *The Corporate Contract*⁷⁸. According to Easterbrook and Fischel, the corporation:

“...is a complex set of explicit and implicit contracts, and corporate law enables the participants to select the optimal arrangement for the many different sets of risks and opportunities that are available in a large economy”⁷⁹.

Accordingly, the corporate structure is a set of contracts through which managers and certain participants exercise a great deal of discretion that is reviewed by interactions with other self-interested actors.

Easterbrook and Fischel also explored the agency problem and argued that there is a possibility of managers abusing their discretionary power to make self-gains at the owners' expense. However, they claimed that the “dynamics of the market drive them (managers) to act as if they had investors' interests at heart. It is almost as if there was an invisible hand”⁸⁰.

Their argument is based heavily on the assumption that the market is the controlling device in persuading potential investors in entering into the “corporate contract”. It is often a choice that individuals make voluntarily when deciding to enter into such contract. It therefore argues that corporate law or the status of corporation as entity plays little or no part in this process⁸¹.

The corporate venture, as Easterbrook and Fischel argued, has many real contracts. For example, the terms present in the articles of incorporation at the time the firm is established or issues stock are real agreements. Likewise, everything to do with the relation between the firm

⁷⁷Ibid. at 295.

⁷⁸[1989] Columbia Law Review, Vol. 89, 1416-1448.

⁷⁹Ibid. at 1418.

⁸⁰Ibid. at 1419.

⁸¹Ibid. at 1426.

and the suppliers of labour, goods and services is also contractual⁸². Furthermore, they argued that the rules and procedures that govern how rules change are also real contracts. This argument emphasises the corporation as a “nexus of contract”. This is also consistent with corporate law in the United Kingdom as we have just mentioned above.

According to the “corporate contract” theory proposed by Easterbrook and Fischel, the corporation’s choice of governance mechanisms does not harm anybody who voluntarily participates in the venture. This is because investors, employees and others can participate or go elsewhere:

“In general, all the terms in corporate governance are contractual in the sense that they are fully priced in transactions among the interested parties. They are thereafter tested for desirable properties; the firms that pick the wrong terms will fail in competition with other firms competing for capital. It is unimportant that terms may not be negotiated; the pricing and testing mechanisms are all that matters, as long as there are no effects on third parties...”⁸³.

Easterbrook and Fischel pointed out that the value of stocks of a public corporation traded in the equity market is established by professional investors. These include investment bankers, managers of mutual funds and pension trusts, and others. They handle huge sums that they are willing to use them to purchase undervalued stocks. They investigate the firm’s profits and prospectus and bid or sell accordingly. Those who do this poorly will find the funds at their disposal falling, yet those who do it well will accumulate additional sums⁸⁴. Therefore, if the terms of corporate provisions and the details of corporate structure have any effect on investors’ wealth or investment, this should be reflected in the profits of the firm and the eventual price of the stock. In their article, Easterbrook and Fischel strongly advocate that it is not the role of the law to intervene in the sphere of corporate contract. They argue that investors and other

⁸²Ibid. at 1429.

⁸³Ibid. at 1430.

⁸⁴Ibid. at 1431.

participants agreed on the stake (money) they wanted to invest. They therefore agreed unanimously to whatever rule that maximizes the total value of the firm. Thus the rules of corporate governance are opened for all to see⁸⁵. Accordingly, participation in corporations is “uniquely amenable to contracting because even the ignorant have an army of helpers”⁸⁶.

However, what if the contractual terms selected by the firm are incomplete?

Easterbrook and Fischel argue that this might justify the prescription of a mandatory term by law. However, according to them, this too is a contractual way of looking at the corporation⁸⁷.

They recognized that the technique courts use to fill the gaps in explicit contracts inevitably arise because it is impossible to cover every contingency:

“The gap-filling rule will call on courts to duplicate the terms the parties would have selected, in their joint interest, if they had contracted explicitly. It promotes clear thought to understand that the silence or ambiguity in corporate documents itself is a problem of contract, one the parties could solve if they wished and if the costs of negotiating were worthwhile in light of the stakes”⁸⁸.

According to Easterbrook and Fischel acknowledge that mistakes maybe made by individuals when entering into corporate contracts. However, corporate governance mechanisms that have survived in many firms for extended periods are examples of corporate contracts that have been generally accepted by participants. They emphasised that the durability of a practice both enables people to gauge its effects and enables competition among firms to weed out the practices that do not assist investors. It is therefore argued that mandatory terms prescribed by law inevitably halt the process of shaking out inefficient ways of organizing:

⁸⁵Ibid. at 1434-35.

⁸⁶Ibid. at 1435.

⁸⁷Ibid. at 1433.

⁸⁸Ibid. at 1433.

“Unless there is a strong reason to believe that regulation has a comparative advantage over competition in markets in evaluating the effects of corporate contracts, there is no basis for displacing actual arrangements as mistakes or exploitation”⁸⁹.

Easterbrook and Fischel’s corporate contract theory therefore heavily campaigns for corporation-as-contract in lieu of corporate law. They argued that the best way to solve the agency problem of monitoring is simply to draft better contracts amongst participants. This allows for the market to decide which corporation has better contractual terms through the mechanism of pricing. Corporate law should only be a set of contractual terms available off-the-rack so that participants in corporate ventures can save the cost of contracting⁹⁰. The law is only there to complete open-ended contracts and should not be used to impose a term that defeats actual bargains or reduces the venturers’ joint wealth:

“The role of corporate law here, as elsewhere, is to adopt a background term that prevails unless varied by contract. And the background term should be the one that is either picked by contract expressly when people get around to it or is the operational assumption of successful firms”⁹¹.

e). Flaws of the economic theories of the corporation

The economic theories of the corporation have gained much attention and endorsement over the last 30 years. They have largely influenced the manner in how corporations are governed and managed, yet there are many fundamental problems with these theories. In this section, I shall attempt to explore them in greater details.

Almost all of the economic theories of the firm assume that a principal/agent relationship exists and that they all propose the use of contractual arrangement to resolve modern corporate problems. Coase looked at how transaction cost could be reduced through the establishment of a firm and thus reducing the number of contracts being entered into. Alchian and Demsetz focused

⁸⁹Ibid. at 1442.

⁹⁰Ibid. at 1444.

⁹¹Ibid. at 1446.

their work on the centralized contractual agent in a team productive process to resolve the problem of shirking. The nexus of contract theory proposed by Jensen and Meckling argued that the corporation is simply a web of contractual relationship characterized by the existence of divisible residual claims on the assets and cash flows of the organization.

However, they all seem to have neglected the importance of corporate law in their analysis. The purpose of corporate law is to provide for a vehicle enabling low risk investment for investors. In trying to achieve that aim, the law has always tried to strike some balance between investors and outsiders who deal with the company. It is often said that the purpose of law is to do justice, although courts in the UK are very reluctant to imply terms into contracts, yet they generally do so when the necessity arises. In fact, many major corporate principles in the common law jurisdictions such as the relationship between shareholders and directors were developed through cases. Secondly, by providing for the creation of separate legal personality, limited liability and transferable shares, company law enables the raising of capital from the public for the financing of corporate ventures. These are issues that cannot be adequately dealt with through the mere use of contracts. This is because individuals would always find it easier to “contract” against a fixed background rule of construction – company law.

The nexus of contract theory claims that the corporation is simply a “legal fiction” and that the firm is just made up of a web of contractual relationship between parties. However, it is self-contradictory to conceptualize the corporation both as a legal fiction and nexus of contracts if the essence of the latter theory is to provide a framework for defining intra-corporate rights and responsibilities that are incompatible with those which derive from perceiving the corporation as a fiction. In other words, why do we need contracts at the first place to define the boundaries between different constituencies for such a “fictitious creature”? Secondly, one

major flaw with the theory is that it fails to make a distinction between corporate contracts that affect “insiders” as against those which affect “outsiders”. For example as mentioned earlier, the articles and memorandum of incorporation are viewed as contractual documents between the company and the members. It is the procedural rights provided under these documents that shareholders and members often resort to in aligning the behaviour of managers and directors. However in contrast, contracts made between the corporation and other constituencies (outsiders) such as creditors, suppliers and even employees are the result of hard bargaining between the respective parties. They are subject to different rules or different sphere of the law and even these contracts are subject to judicial scrutiny, where courts from time to time would intervene to imply terms into them in order to achieve justice (particularly in the UK in the context of employment contracts).

Another assumption of many of these economic theories is the existence of market for corporate control. However, we live in a world where things are often not as ideal as we expect it to be. In practice, there is no such thing as a pure free market. Instead, what we have in the real world is market failure and information asymmetry. Corporate contract proponents argued that the value of stocks of a public corporation traded in the equity market is established by professional investors⁹². They handle huge sums that they are willing to use to purchase undervalued stocks. They investigate the firm’s profits and prospectus and bid or sell accordingly. Those who do this poorly will find the funds at their disposal losing, yet those who do it well will accumulate additional sums. But what happens when these so called professional investors were ignorant, negligent or even worse, colluded with large public companies in inflating the value of the shares? In fact, this is exactly what happened in the collapse of Enron where big names on Wall Street including Citigroup and Merrill Lynch at one point or other

⁹²Easterbrook and Fischel, *supra* n. 78.

helped Enron to make the fraud possible. There were even credit rating agencies claiming that they had no idea as to how Enron made its money⁹³.

Furthermore, the economic theories assume that the relationship between shareholders and directors are one of principal and agent. However, as I shall examine later, this analogy is itself flawed. The more accurate analogy is that, directors are “fiduciaries” of the company and they owe responsibilities to shareholders only as a general body. Even here, different common law jurisdictions hold different views as to what constitutes as directors’ fiduciary duties. This means in practice, the control over directors by shareholders in large public corporation is remarkably limited. The level of control shareholders have over the board of directors very much depends on the dispersion of share-ownership and more importantly, the eagerness of the shareholders to control. In practice, many investors have a portfolio of investment where they hold a variety of financial assets ranging from stocks to bonds. This means it would not make economic sense to devote so much time and resources in monitoring a single organization, although this may be changing due to the emergence of more active institutional investors. Very often the only influence shareholders can use is simply “exiting” the company by disposing the shares in the equity market.

Likewise, the assumption of the nexus of contracts theory that the board is independent of management, the management or the board has no influence on the market for corporate control and that the shareholders have uninhibited rights to transfer their shares are all illusions. The Chief Executive Officer (CEO), who chairs the board, often wields considerable influence over board decisions and in the United States, many public companies have implemented Shareholder Right Plans which impose excessive transaction costs on those who buy shares beyond a

⁹³http://news.bbc.co.uk/1/hi/english/static/in_depth/business/2002/enron/36.stm

specified quantity, ranging between 10 and 15% of the shares, unless the board consents to such transfer.

Economic theories of the corporation simply provide an analysis as to the economic rationale of organizing production through the establishment of a team or corporation. However, they fail to look at the differences in the relations between a corporation, its management and shareholders on one hand, and a corporation, its management, employees, creditors or other constituencies on the other hand. In the following section, I shall attempt to explore these relationships with the theory of the firm and corporate law from another perspective.

The economic theories of the firm and their associated ideologies were created and constructed based on company law theory and classical economics developed in the 19th and the beginning of the 20th century. Under such a paradigm, “corporate assets” are usually perceived as physical assets which are often more imperative than human resources. Power and authority is based on the exclusive possession of financial capital and raw materials, even labour is often regarded as a commodity that can be easily disposed of. Such traditional ideologies might have been acceptable in earlier times, however, our society and environments have changed significantly in the 21st century.

The term “corporate assets” entails something much broader in today’s knowledge economy such as corporate reputation and customer satisfaction. These attributes are more difficult to quantify than physical assets. The effective utilization of human resources has replaced the importance of physical assets. Capital allocation by large corporations in order to maintain competitiveness and the phrase “team production” must be given a more enlightened meaning in the new millennium.

Moreover, we need to recognize that corporate governance regime stems from different historical, cultural and political background. It is therefore necessary to explore a modern corporate governance model that embraces different values and concepts, which is the basis of this thesis. This is what I intend to look at in further details in the latter sections.

3). The emergence of stakeholder theory

In the previous sections, I have examined the economic theories of the firm, looked at how they have influenced the shareholder theory of corporate governance and how they view corporate governance from a more narrow perspective based on corporate legal theory that were developed in the 19th and 20th century. However, as our world enters the 21st century, transformations have taken place and as a result of globalization, many economies and corporations have been forced to change their approaches and management style.

In the previous chapter, I have briefly mentioned some of the origins of the stakeholder theory and for the following section, I shall discuss and explore the theory in greater details and how they have influenced management approach in the modern business world.

a). The stakeholder perspective

Notwithstanding the fundamental problems with the theoretical framework that financial economists bring to the analysis of corporate governance as mentioned above, shareholder theory remains dominant in the governance debates, particularly in the English-speaking world⁹⁴.

However, as shareholders have flexed their muscles to demand greater control over the allocation of corporate resources, there have been various attempts to develop an intellectual response in the form of a stakeholder theory of governance. The stakeholder perspective is more often

⁹⁴Supra n. 44, at 52

expounded as a political position than as an economic theory of governance. Indeed, many of its proponents rely on sweeping and unsubstantiated assumptions about the foundations of economic success⁹⁵. For example, in their recent edited volume of essays on “stakeholder capitalism”, commentators Gavin Kelly, Dominic Kelly and Andrew Gamble, identify the key challenge for proponents of stakeholder governance as reconciling in practice the competing claims of economic efficiency and social justice:

“...individuals well endowed with economic and social capabilities will be more productive; companies which draw on the experience of all of their stakeholders will be more efficient; while social cohesion within a nation is increasingly seen as a requirement for international competitiveness”⁹⁶.

Other commentators such as Margaret Blair emphasize the need for an analysis of corporate governance which is based on “a broader range of assumptions about how wealth is created, captured, and distributed in a business enterprise”⁹⁷. Blair does not challenge the claim of shareholder perspective that shareholders are principals. She accepts that shareholders have residual claimant status because she believes that they invest in the productive assets of the enterprise and bear some of the risk of its success⁹⁸. However, she argues that the physical assets in which shareholders allegedly invest are not the only assets that create value in the corporation. Individuals invest in their own human capital and to some extent their skills are specific to the firm for which they work. As a result, they bear some of the risk associated with the enterprise. Since employees with firm-specific skills have a stake that is at risk in the company, Blair argues that they should be accorded residual claimant status alongside shareholders⁹⁹. In other words, in allocating corporate returns, the system of corporate governance should recognize the central

⁹⁵Ibid

⁹⁶Kelly et al., “Stakeholder Capitalism”
Basingstoke: Macmillan 1997, at 244.

⁹⁷Blair, “Ownership and Control: Rethinking Corporate Governance for the twentieth first century”
Washington, DC: Brookings Institution 1995, at 15.

⁹⁸Ibid, at 22

⁹⁹Ibid, at 238

importance of individuals' investments in human assets to the success of the enterprise and the prosperity of the economy.

However, ideal as stakeholder theory may sound, it nevertheless has many fundamental problems. The key question is: who or what constitutes as stakeholder(s)? Certain groups such as employees or customers may be clear cut, yet beyond that, it is still very unclear as to the scope of stakeholders that need to be considered. For example, does practicing stakeholder theory mean that businesses ought to be accountable to all "potential claimants" who may be affected by their activities? How should these stakeholder groups be prioritized? Many scholars have tried to provide solutions to these questions and in the next section, I shall turn the focus to the historical development of stakeholder theory and explore how various commentators have attempted to resolve these issues.

b). History of "Stakeholder"

The actual term "stakeholder" first appeared in the management literature in an internal memorandum at the Stanford Research Institute in the 1960s.¹⁰⁰ Originally, the term was supposed to generalize the notion of shareholder as the only group to whom management need be responsive. Therefore, the concept was originally defined as "those groups without whose support the organization would cease to exist"¹⁰¹. The list of stakeholders originally included shareholders, employees, customers, suppliers, lenders and society. The Stanford Research Institute (SRI) argued that unless executives understood the needs and concerns of these

¹⁰⁰Stanford Research Institute (now SRI International, Inc.) 1963.

¹⁰¹Freeman, R.E., "Strategic Management: A Stakeholder Approach". Pitman Publishing Inc. 1984, at 31

stakeholder groups, they could not formulate corporate objectives which would receive the necessary support for the continued survival of the firm¹⁰².

The work at SRI eventually diverged into a number of directions such as the corporate planning literature, systems theory literature, corporate social responsibility literature and organization theory literature. According to Freeman, the major concerns of each main area of research are not mutually exclusive. Many of these literatures are concerned with formulating plans and systems of plans for business level entities, with understanding the role of the corporation in social systems, with the social responsibility of business and the need for integrative theories to explain the behaviour of a large population of organizations and their environments are of great importance to managers and organizational researchers¹⁰³.

In using the term “stakeholder”, managers and theorists will come to see these groups as having a “stake”. A group that is identified as “stakeholder” would then in theory give rise to “legitimacy”, in the sense that managers would have to take into consideration of their interests because this group has the ability to affect direction of the firm¹⁰⁴. However, when the term “legitimacy” is used, the question then becomes whether all stakeholders have an equally legitimate claim on the resources of the corporation? To put simply, the term “stakeholder” should refer to those groups that make a difference to the organization. For the purpose of this thesis, I shall define the term stakeholder as “any group or individual who can affect or is affected by the achievement of the organization’s objectives”. However, it is important to stress at this stage that this is just a basic term and does not provide any guidance as to who is or who is not a stakeholder of an organization. This is because as we shall see later, stakeholder theory literatures have diverged in a number of directions and it is to these literatures which I shall turn

¹⁰²Ibid., at 32

¹⁰³Ibid., at 43-44

¹⁰⁴Ibid., at 45

focus to in the next section. However, before doing that, it is important at this stage that we contrast the theory of the firm with the stakeholder theory. The neoclassical theory of the firm which was examined in previous sections attempts to explain the economic principles governing production, investment, and pricing decisions of established firms operating in competitive markets¹⁰⁵. In contrast, the stakeholder theory is intended both to explain and to guide the structure and operation of the established corporation. It views the corporation as an organizational entity through which numerous and diverse participants accomplish multiple, and not always entirely congruent purposes. Stakeholder theory has been presented and used in a number of ways that involve different methodologies, evidence and criteria of appraisal. There are 3 types of uses which are critical to its analysis: *Descriptive*; *Instrumental*; *Normative*. It is to these which I shall now turn to.

c). “Descriptive” stakeholder theory

This theory is used to describe, and at times to explain, specific corporate characteristics and behaviours. The underlying rationale behind this theory is based on descriptive evidence that many managers believe themselves, or are believed by others, to be practising stakeholder management¹⁰⁶. For example, a survey conducted by Raymond Baumhart in the mid 1960s revealed that 80% of upper-level managers regarded it as unethical management behaviour to focus solely in the interest of shareholders and not in the interest of employees and customers¹⁰⁷.

¹⁰⁵Cyert & March, “A behavioural theory of the firm”.
Englewood Cliffs, NJ: Prentice Hall 1963

¹⁰⁶Donaldson & Preston, “The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications”.
Academy of Management Review 1995, 20, 1, 65-91.

¹⁰⁷Baumhart, “An honest profit: What businessmen say about ethics in business?”
New York: Holt, Rinehart and Winston 1968.

Other surveys conducted asking similar questions regarding the stakeholder sensitivity of managers have also returned similar results¹⁰⁸

This theory is based on the fact that although managers may not make explicit reference to “stakeholder theory”, yet they apparently adhere in practice to one of the central tenets of the theory, that their role is to satisfy a wider set of stakeholders and not just shareholders¹⁰⁹.

Another rationale favouring the descriptive stakeholder theory is due to the change in mood of our society including legal opinion and statutory law. In the United States for example, court decisions and new legislation have weakened the so called “business-judgement rule”, which vests management with exclusive authority over the conduct of a company’s affairs only on the condition that the financial welfare of shareholders is single-mindedly pursued¹¹⁰. About 30 states in the US have now adopted statutes that extend the range of permissible concern by boards of directors to a host of non-shareowner constituencies, such as employees, customers and local communities¹¹¹. Likewise, the new UK Companies Act which is scheduled to come into force by late 2009 also contain provisions where directors can take into consideration of other interests beyond that of shareholders for the well-being of the company¹¹².

Commentators have noted that this trend toward “stakeholder law” is not solely a US or UK phenomenon, but also exist in many other jurisdictions. For example in Germany, the co-determination laws require employee representation on second-tier boards of directors. Similarly in Japan, both law and custom presume that corporations exist within a tightly connected and

¹⁰⁸Brenner & Molander, 1977; Posner & Schmidt, 1984

¹⁰⁹Supra, n. 101

¹¹⁰Chirelstein, “Corporate law reform. In Mckie (Ed.),
“Social responsibility and the business predicament”: 41-78,
The Brooking Institution 1974

¹¹¹Orts, “Beyond shareholders: Interpreting corporate constituency statutes”.
The George Washington Law Review, 61(1): 14-135.

¹¹²The Companies Act 2006 is scheduled to come into force in October 2009.

interrelated set of stakeholders, including suppliers, customers, lending institutions and friendly corporations¹¹³.

These legal developments epitomize the earlier statement that stakeholders are defined by their “legitimate” interest in the corporation. However, neither the legal developments nor the management survey results are sufficient *per se* to constitute the basis for the stakeholder theory of management. This is because the danger of using purely *descriptive* data or theory could lead to the problem of hasty generalization. Societal trend and mood can change over time and if new studies show that managers for some reason were abandoning stakeholder orientations, or if the legal support for broad stakeholder interests were to weaken, then the theory becomes invalid. Hence the descriptive support for stakeholder theory maybe of limited significance and important issues regarding stakeholder theory is to be found elsewhere.

d). “Instrumental” stakeholder theory

As mentioned above, the descriptive approach of stakeholder theory seems inadequate therefore, it is important to explore a connection between stakeholder strategies and organizational performance. This theory establishes a framework for examining the connections between the practice of stakeholder management and the achievement of various corporate performance goals. The main focus here has been the proposition that corporations practicing stakeholder management will be relatively successful in conventional performance terms¹¹⁴.

However, the large numbers of literature dealing with the connections do not translate easily into a stakeholder theory context. Whatever value the social or financial performance studies may have on their own merits, most of them do not include reliable indicators of the

¹¹³Supra, n. 94

¹¹⁴Supra, n. 101 at 66-67

stakeholder management side of the relationship. A study conducted by Preston and Sapienza¹¹⁵, there is some evidence that benefits to one stakeholder group need not come entirely at the expense of another. Likewise, Kotter and Heskett's case studies of a small number of high-performance companies indicated that the managers of those companies tend to emphasize the interests of all major stakeholder groups in their decision-making¹¹⁶. However, there is still no compelling empirical evidence that the optimal strategy for maximizing a firm's conventional financial and market performance is stakeholder management.

Earlier in this chapter we have looked at literatures on established concepts of principal-agent relations and the firm as a nexus of contracts. As mentioned above, agency theorists argue that corporations are structured to minimize the costs of getting some participants (the agents) to do what other participants (the principal) desire. Firm-as-contract theorists argue that participants agree to cooperate with each other within organizations rather than simply deal with each other through the market, to minimize the costs of search, coordination, insecurity etc.

One of the most ambitious attempts to integrate stakeholder concept and agency theory is by Hill and Jones¹¹⁷. They enlarged the standard principal-agent paradigm of financial economics, which emphasizes the relationship between shareholders and managers, to create a "stakeholder-agency theory". According to this concept, managers can be seen as agents of all other stakeholders. They noted that stakeholders differ among themselves with respect to (a) the importance of their stake in the firm and (b) their power vis-a vis the managers¹¹⁸. They also noted that there is considerable friction within the stakeholder-agent negotiation process-some of

¹¹⁵Preston & Sapienza, "Stakeholder management and corporate performance".
Journal of Behavioral Economics 1990, 19, 361-375.

¹¹⁶Kotter & Heskett, "Corporate culture and performance".
New York: Free Press 1992.

¹¹⁷Hill & Jones, "Stakeholder-agency theory".
Journal of Management Studies 1992, 29, 131-154.

¹¹⁸*Ibid.*, at 141

it because of some participants' ability to gain better bargain. They therefore argue that it is wrong to assume that stakeholder-agent relationships are in equilibrium at any particular time¹¹⁹.

Similarly, the firm-as-contract analysis of Freeman and Evan also recommended integrating the stakeholder concept with the Coasian view of the firm-as-contract to conceptualize the firm as a set of multilateral contracts over time. Thus according to Freeman and Evan, managers administer contracts among employees, owners, suppliers, customers, and the community. Each of these groups can invest in asset specific transactions which affect the other groups, therefore, methods of conflict resolution, or safeguards must be found¹²⁰. They emphasized that all parties have an equal right to bargain and, therefore, that a minimal condition for the acceptance of such multi-partite agreements by each party is a notion of "fair contract", which ensure that the interests of all parties are taken into consideration¹²¹.

According to both agency theory and firm-as-contract theory of stakeholder interpretations, success in satisfying multiple stakeholder interests rather than in meeting conventional economic and financial criteria would constitute the ultimate test of corporate performance¹²².

Both analysts, Hill & Jones and Freeman & Evan, placed strong emphasis on the process of multiple-stakeholder coordination than on the specific agreements/bargains. They both stressed the importance of mutual and voluntary acceptability of bargains by all contracting stakeholders as the necessary criterion for efficient contracts. Likewise, both ignored the roles of potential stakeholders not conspicuously involved in explicit or implicit contracts with the firm. However, they differed slightly in one respect. Hill and Jones saw the network of relationships

¹¹⁹Ibid., at 145

¹²⁰Freeman & Evan, "Corporate governance: A stakeholder interpretation".
The Journal of Behavioral Economics 1990, 19(4), 337-359.

¹²¹Ibid., at 352

¹²²Ibid

as consisting of separate implicit contracts between each stakeholder group and management. Yet Freeman and Evan viewed the firm as a series of multilateral contracts among all stakeholders¹²³.

However, the *instrumental* justification of the stakeholder model has many weaknesses. Although they rely initially on the conceptual apparatus of instrumental theories, yet they ultimately rely upon non-instrumental or normative arguments. According to the authors, the ultimate success of stakeholder-agency theory would require a fundamental shift in managerial objectives away from shareholders and toward the interests of all stakeholders. Such a shift would undoubtedly involve normative, rather than purely instrumental considerations¹²⁴.

Therefore, stakeholder theory cannot be fully justified by instrumental considerations. Although many who use the stakeholder concept often cite its consistency with the pursuit of conventional corporate performance objectives, few of them would abandon the concept if it turned out to be only as equally efficacious as other conceptions. As a result, it is important that we turn to explore the *normative* justification of stakeholder theory.

e). "Normative" stakeholder theory

The normative justification of stakeholder theory involves connection with more fundamental and better-accepted philosophical concepts. It argues that stakeholders are identified by their interest in the affairs of the corporation and that the interests of all stakeholders have intrinsic value¹²⁵. More formal normative justifications of stakeholder theory are based either on broad theories of philosophical ethics, such as utilitarianism, or on narrower middle-level theories derived from the principle that a social-contract exists between corporations and society.

¹²³Supra n. 120, at 354

¹²⁴Ibid

¹²⁵Ibid

According to Donaldson and Preston, stakeholder theory can be normatively based on the evolving theory of property¹²⁶. This argument is based on the notion that if the focus on traditional property rights justifies the dominance of shareholders' interests, then the fact that property rights are the critical base for conventional shareholder-dominance views makes it all the more significant that the current trend of thinking with respect to the philosophy of property runs in the opposite direction¹²⁷.

However, which uses of property should be restricted and which persons should count as stakeholders remain unspecified. Merely bringing non-owner stakeholders into the concept of property does not provide by itself justification for stakeholder arguments and managerial responsibilities toward specific groups such as employees and customers. Yet the important point here is that the concept of private property clearly should not ascribe unlimited rights to owners and does not support the popular claim that the responsibility of managers is to act solely as agents for shareholders¹²⁸.

Many analysts of property rights reject the notion that any single theory of distributive justice is universally applicable. Becker argues for a more pluralistic theory of property rights allowing more than one fundamental principle to play a role¹²⁹. If a pluralistic theory of property rights is accepted, then the connection between the theory of property and the stakeholder theory becomes explicit. For example, the "stake" of long term employees who have worked to build and maintain a successful business operation is essentially based on effort. The stake of people living in the surrounding community may be based on their need for clean air or the maintenance of their civic infrastructure. Customer stakes are based on the satisfactions and protections

¹²⁶Supra n. 106, at 83

¹²⁷Ibid., at 83

¹²⁸Ibid., at 84

¹²⁹Becker, "Property Rights".
London: Routledge & Kegan Paul 1978.

implicitly promised in the market offer and so on. All that is needed is to show that such characteristics give various groups a moral interest, commonly referred to as a “stake” in the affairs of the corporation. Therefore, the “normative” principles underlying the contemporary pluralistic theory of property rights also provide the foundation for the stakeholder theory as well¹³⁰.

f). Major differences between broad and narrow view and implications on managers

The abovementioned analysis illustrates the distinction between different stakeholder theory justifications. What implications this has on management would require further discussion and it is the responsibility of managers to select activities and direct resources to obtain benefits for *legitimate* stakeholders. The question is, who are the legitimate stakeholders? Some views on this answer are too narrow and others are too broad.

According to Freeman, “a stakeholder is any group or individual who can affect or is affected by the achievement of the organization’s objectives”¹³¹. This is certainly one of the broadest definitions in the literature. In contrast, narrow views of stakeholder are based on the practical reality of limited resources, limited time and attention, and limited patience of managers for dealing with external constraints. Narrow views of stakeholders attempt to define relevant groups in terms of their direct relevance to the firm’s core economic interests. As mentioned above, those favouring a narrow definition of stakeholders as searching for a “normative core” of legitimacy so that managers can be advised to focus on the claims of a few legitimate stakeholders. The broad view of stakeholders, in contrast, is based on the empirical reality that companies can indeed be vitally affected by, or they can vitally affect, almost

¹³⁰Supra n. 106, at 85

¹³¹Supra n. 101, at 46

anyone¹³². As mentioned above, the firm as contract theory holds that legitimate stakeholders are identified by the existence of a contract, either expressed or implied between them and the firm. Direct input contributors are included, but environmental interests such as communities are also believed to have at least some “loose quasi contracts” with their business constituents¹³³.

In contrast, excessive breadth in the identification of stakeholders has arisen from a tendency to adopt definitions such as “anything influencing or influenced by the firm” which was endorsed by Freeman. This definition opens the stakeholder set to actors that form part of the firm’s environment and that indeed may have some impact on its activities but have no specific stake in the firm itself¹³⁴. The ultimate managerial implication of the stakeholder theory is that managers should acknowledge the validity of diverse stakeholder interests and should attempt to respond to them within a mutually supportive framework since that is a moral requirement for the legitimacy of the management function. Although groups can be identified reliably as stakeholders based on their possession of power, legitimacy or urgency in relationship to the firm, it is nevertheless the management who determine which stakeholders are salient and therefore will receive greater attention.

According to Mitchell et al, stakeholders possess some combination of three critical attributes: power, legitimacy, and urgency. Therefore, the salience of a particular stakeholder to the firm’s management is low if only one attribute is present, moderate if two attributes are present, and high if all three attributes are present¹³⁵. If the stakeholder is particularly clever at coalition building, political action or social construction of reality, that stakeholder can move

¹³²Mitchell et al., “Toward a theory of Stakeholder Identification and Salience: Defining the Principle of Who and What really counts”.

Academy of Management Review 1997, Vol. 22, 4, 853-886, at 857

¹³³Supra n. 106, at 85

¹³⁴Ibid., at 86

¹³⁵Supra n. 132, at 879

into what is called “definitive stakeholder” category, characterised by high salience to managers¹³⁶. Thus managers should never forget that stakeholders change in salience, requiring different degrees and types of attention depending on their attributed possession of power, legitimacy or urgency, and that levels of these attributes can vary from issue to issue and from time to time.

In recent years, many stakeholder scholars have attempted to search for “Who or What Really Counts” in a firm’s stakeholder environment and the bases for legitimacy in stakeholder-management relationships. However, there are fears amongst some that a shift from the traditional shareholder orientation to a stakeholder orientation will make it more difficult to detect and discipline self-serving behaviour by managers, who may attempt to increase their powers and influence by claiming to be serving some broad set of stakeholder interests¹³⁷. Yet some commentators believe that over time, the law is capable of achieving arrangements that encourage a broader, stakeholder conception of management while at the same time restraining the moral hazard of self-serving managers¹³⁸.

The above analysis suggests that stakeholder theory must account for power, urgency and as well as legitimacy, no matter how distasteful or unsettling the results. Managers must know about entities in their environment that hold power and have the intent to impose their will upon the firm. In other words, power and urgency must be attended to if managers are to serve the legal and moral interests of legitimate stakeholders. As a result, the emergence of a hybrid model of stakeholder theory has emerged in recent years which I shall discuss in greater details in the following section.

¹³⁶Ibid., at 879

¹³⁷Orts, “Beyond shareholders: Interpreting corporate constituency statutes”.
The George Washington Law Review, 61(1): 14-135.

¹³⁸Supra n. 106, at 87

g). The Convergent Stakeholder Theory

As mentioned above, there have been many controversial debates as to “Who and What counts as stakeholders?” and its “legitimacy”, therefore, proposal for a hybrid stakeholder theory has emerged in recent years by combining both social science and ethics. According to Jones and Wicks, there is no reason that instrumental stakeholder theory cannot be a class of theories rather than a single theory. This is because by definition, instrumental theory involves *if/then* statements. Therefore, nothing about the existence of if A, then B precludes the existence if C, the D or if E, then F¹³⁹. Thus the emergence of other versions of instrumental stakeholder theory is not only possible but probable.

Secondly, it is clear that stakeholder theorists consider normative issues to be of great importance. For example, Donaldson and Preston who we looked at earlier explicitly endorse such view and provide for a property-based normative foundation for stakeholder concerns. Furthermore, based on the shared values discussion above, most stakeholder theorists should agree that any instrumental stakeholder theory with its roots in the stakeholder concept must have morally acceptable ends and means, where applying instrumental theory to just any ends should not be appropriate¹⁴⁰.

Instrumental stakeholder theorists can explicitly embrace the addition of normative soundness to their theorizing without abandoning any of the criteria of good theory in the organization sciences; in fact, they may even enhance the credibility of their contributions. In their analysis, Jones and Wicks argue that the term “convergent stakeholder theory” applies to a class of theories which would possess certain characteristics. Firstly, the firm is publicly held and operates in a competitive market economy where important corporate decisions are made by

¹³⁹Jones & Wicks, “Convergent Stakeholder Theory”.
Academy of Management Review 1999, Vol. 24, No. 2, 206-221.

¹⁴⁰*Ibid.*, at 213

professional managers and the behavioural contingency is adopted. The theory does not depend on any specific behavioural assumptions and assumes that human behaviour is both varied and variable, and that human behaviour is malleable which often depends on context and circumstances. It is a theory of relationships, which is broader than merely contracts or transactions, and it is simultaneously normative and instrumental, offering both normative standards of behaviour and arguments where adherence to those standards will lead to outcomes that are both normatively and practically acceptable¹⁴¹.

Furthermore, according to Jones and Wicks, normative foundation is explicitly and undoubtedly moral and has to be explicitly defended in moral terms. Instrumental means are not either applied to immoral behavioural standards or used to pursue immoral ends. The instrumental means-ends chain is persuasively argued and demonstrates the practicality of the behaviour called for in the normative core. Convergent stakeholder theory is managerial in focus, which instructs managers with respect to the way in which relationships with corporate stakeholders should be structured¹⁴².

Other commentators such as Weaver and Trevino examined possible relationships between the normative and empirical branches of business ethics, offer three distinct possibilities namely, parallelism, symbiosis, and integration¹⁴³. Parallel development implies that normative and empirical approaches to stakeholder theory share little but an interest in the same kinds of business behaviour. Symbiosis means that the two modes of inquiry take insights from each other but remain essentially distinct in their theoretical principles, methodologies and meta-

¹⁴¹Ibid., at 215

¹⁴²Ibid, at 215

¹⁴³Weaver & Trevino, "Normative and empirical business ethics".
Business Ethics Quarterly 1994, 4: 129-144.

theoretical assumptions¹⁴⁴. Integration implies that the two theories can be seen as elements of a single theory and involves a conscious commingling of the cores of the two disciplines¹⁴⁵.

According to Weaver and Trevino, if integration means that the same methods must be employed in the defence of the normative core and the supporting instrumental theory, full integration of normative and empirical theories is highly improbable¹⁴⁶. Convergent stakeholder theory therefore, is clearly congruent with the following representative statement describing symbiosis:

“Deliberate attention to descriptive, empirical theory can prevent normative researchers from proposing programs of moral improvement which ...in practice are unfeasible or even likely to undermine moral behaviour. Attention to normative theory, in turn, aids empiricists in being self-conscious about the purpose, character, and results of their work...”¹⁴⁷.

Convergent stakeholder theory meets the following criteria for theoretical reciprocity. That is, there is an intentional interdependence of normative and empirical theories and the framework’s success in providing either an empirical description or normative evaluation of some phenomenon depends on its normative or empirical adequacy¹⁴⁸. Therefore, convergent stakeholder theory is both normatively sound and practically viable where each version must have a well-defended normative core and supporting instrumental arguments to demonstrate its practicability.

¹⁴⁴Ibid., at 133

¹⁴⁵Ibid., at 136

¹⁴⁶Ibid., at 137

¹⁴⁷Ibid., at 133

¹⁴⁸Ibid., at 136

f). Challenges of the stakeholder theory

After reviewing the different types of stakeholder theory, one issue of central concern for academics and business practitioners is, whether organizations pursue the satisfaction of stakeholder interests for economic reasons or simply because doing so has intrinsic merit.

As mentioned earlier, stakeholder theory has burgeoned in recent years. Ever since Freeman's work on the topic since the mid 1980s, a dozen of books and more than 100 articles primarily concerned with the stakeholder concept had appeared. Since then interest in stakeholder theory has quickened, not only in the academic, but also in the practical business world. For example, references to stakeholders are commonplace in the media, particularly with the current British government's association of the term "Third Way". As contributions to the stakeholder concept have grown, they have also become diffuse as discussed above. Integration of separate methodological strands of stakeholder theory to achieve a convergent stakeholder theory as mentioned above, has been identified by some commentators as "the most interesting problem in stakeholder theory today"¹⁴⁹.

In general, the integrating exercise is premature. Not enough work has been done on the organization/stakeholder relation itself in order to combine the different strands of stakeholder theory into a single meaningful framework. This is due to lack of work that distinguishes different types of stakeholders¹⁵⁰. In particular, most works on stakeholder theory limit their discussion to legitimate stakeholders, using different definitions of legitimacy, without exploring what distinguishes legitimate from illegitimate ones¹⁵¹. Furthermore, it is implicitly assumed

¹⁴⁹Donaldson, "Making stakeholder theory whole".

Academy of Management Review 1999, Vol. 24, 2, 237-241.

¹⁵⁰Harrison & Freeman, "Stakeholders, social responsibility, and performance: empirical evidence and theoretical perspectives".

Academy of Management Journal 1999, Vol. 42, 5, 479-487.

¹⁵¹Friedman & Miles, "Developing Stakeholder Theory".

Journal of Management Studies 2002, Vol. 39, No. 1

that the boundary is obvious, clear-cut and stable, thereby precluding exploration of the boundary and consideration of how certain stakeholders may cross it.

As mentioned above, Mitchell et al., was one of the first to develop the idea that stakeholders become important to managers to the extent that those managers perceive them as possessing *power*, *legitimacy* and *urgency*. They note that each factor is a variable rather than a steady state, and they briefly discuss dynamism in stakeholder-manager relations. Their focus is on defining who or what are the stakeholders of the firm, rather than the dynamics of the organization/stakeholder relation. However, they do not explore why some stakeholders will be perceived as having more of the three factors than others, how managers' perceptions of stakeholder may change, and differences in the way managers behave in relation to stakeholders perceived as possessing widely different degrees of these attributes¹⁵².

Furthermore, many integration attempts discussed was for the normative to dominate the instrumental. For example, Jones and Wicks normative stakeholder theory as discussed above, involves specifying the moral obligations stakeholder theory places on managers. One strain of normative justification of stakeholder theory involves creating alternative narrative accounts of moral behaviour in a stakeholder context. Yet trying to develop a convergent stakeholder theory based on normative cores at this stage lays stakeholder theory open to criticism of naivety¹⁵³. Although such criticism maybe countered if descriptive stakeholder theory was formulated in a manner that allowed a better understanding of the pragmatic forces operating in the corporate world as they apply to particular organization/stakeholder relations.

More importantly, stakeholder theory has been hampered by almost exclusive analysis of stakeholders from the perspective of the organization. For example, Freeman in the mid 1980s

¹⁵²Ibid

¹⁵³Gioia, "Practicability, paradigms, and problems in stakeholder theorizing"
Academy of Management Review 1999, Vol. 24, No. 2, 228-232.

justified consideration of stakeholders for their contribution to the strategic management of firms. Similarly, according to Jones and Wicks, one of the essential premises of stakeholder theory is that it focuses on managerial decision-making. In general, stakeholder theory has been approached from the point of view of business ethics, corporate governance and/or corporate social performance. This puts the organization at the centre of the analysis and discourages consideration of stakeholders in their own right as well as discouraging balanced viewing of the organization/stakeholder relation. Some commentators have argued that many previous literatures on stakeholder theory have led to a lack of appreciation of the range of organization/stakeholder relations that can occur. In particular, extremely negative and highly conflicting relations between organizations and stakeholders have been ignored or under analysed. The extent to which organization with stakeholders' relationship can change over time, together with analysis of how and why such changes occur, has also been neglected¹⁵⁴.

Many large corporations now operate in a global environment and they are therefore more sensitive to issues such as politics and environment. The growing influence of Non-governmental organizations (NGOs) or civil society organizations (CSOs) means that many corporations have begun to forge collaboration and partnership with these organizations. For example, the emergence of a set of ideas and culture around the concept of sustainable development during the mid-1990s following the Rio Conference has encouraged a degree of co-operation, which has pushed corporations and environmental groups such as Greenpeace relationships towards quadrant¹⁵⁵.

Therefore, in recent years, many commentators have urged to explore multi-stakeholder relationship in a broader manner due to geopolitical development which has taken place. In

¹⁵⁴Supra, n. 134

¹⁵⁵Ibid

particular, due to globalization, as mentioned above, corporations face many challenges as they operate in different parts of the world where culture may vary. As a result, it has been argued that we need to take into consideration of globalization and the impact it has brought to corporate governance and stakeholder management. It is to these literatures which I shall turn my focus towards in the following section.

4). Globalization and stakeholder theory

Economic globalization is one of the most powerful forces to have shaped the postwar world. In particular, international trade in goods and services has become increasingly important over the past fifty years or so, and international financial flows over the past thirty years¹⁵⁶. During the past decade, the term “globalization” has become a term which an increasing number of politicians, business people and scholars view and make sense of a changing world. The notion of globalization provides a shared vocabulary to express the sense of “connectedness” between various parts of the world¹⁵⁷. The two major drivers of economic globalization are reduced costs to transportation and communication in the private sector and reduced policy barriers to trade and investment on the part of the public sector. Globalization is not just supplanting traditional lines of social conflict and cooperation, but it is also redrawing them. Interest groups such as employers, multinational corporations, trade unionists, environmentalists, and the likes have found that the capacity to achieve their goals is affected, in one way or another, by the forces of globalization¹⁵⁸. Therefore, many of them seek to make sense of this reality and understand its implications for their interests and values because their activities are now influenced by factors

¹⁵⁶Nye & Donahue, “Governance In A Globalizing World”.
Brookings Institution Press Washington DC 2000

¹⁵⁷Held & Koenig-Archibugi, “Taming Globalization: Frontiers of Governance”.
Polity Press 2003, p. 1

¹⁵⁸Ibid., at p. 2

beyond their own scope of control. As mentioned earlier, since many multinational corporations operate in various parts of the world, they are required to take into consideration of local factors and have greater understandings of different cultures. Moreover, due to greater media and public scrutiny, they are under tremendous pressure to take into account more stakeholders such as NGOs in their decision-making.

Globalization provides opportunities as well as challenges for many corporations and societies. In recent years, globalization, despite its many benefits, also has its backlashes. Critics of globalization argue that its benefits are distributed highly unequally. Large parts of the developing world such as Sub-Sahara Africa are left behind, income disparities among the world's people, as distinguished from countries, either have not improved significantly during the past three decades or actually may have become worse, depending on how they are measured¹⁵⁹. Although there are many explanations for such disparities, yet some have accused multinational corporations of corporate greed and aggravating the matter. In attempting to abate such resistance and adversity, many corporations have voluntarily taken up the initiative to join forces with multi-stakeholder groups such as NGOs and CSOs (Civil Society Organizations) in order to “legitimize” their activities by taking into wider consideration of stakeholders who may be affected by their corporate activities. I shall now explore them in greater details.

a). The rise of corporate social responsibility (CSR)

In the past, governance at the international level was entirely a statist affair. International alliances, regimes, law and organizations, or trans-national networks of national bureaucracies, states both monopolized the conduct of governance and were the primary objects of their joint decisions and actions. However, in recent years, real world players have come to recognize the

¹⁵⁹Ibid., p. 96

involvement of civil society organizations (CSOs) in several areas related to global rule making where many other players from corporations to governments regard CSOs' participation as legitimate¹⁶⁰.

CSOs play increasingly important roles in generating, deepening and implementing transnational norms in areas such as human rights, the environment and anti-corruption. In particular, CSOs have become a major force to induce greater social responsibility in the global corporate sector, by creating transparency in the overseas behaviour of corporations and their suppliers and creating links to consumers back home¹⁶¹.

The rights enjoyed by multinational corporations have increased many folds over the past two decades, as a result of multilateral trade agreements, bilateral investment pacts and domestic liberalization. Yet along with such rights, have also come demands, led by civil society that corporations accept commensurate obligations. As governments have been creating the space for multinational corporations to operate globally, other social actors have therefore attempted to infuse that space with greater corporate social responsibility¹⁶².

Many CSOs and NGOs have joined issue with the global corporate sector for several reasons. First, certain individual corporations have made themselves targets by conducting "unethical" activities in the past. For example, Shell in Nigeria, Nike in Indonesia, and Nestle in relation to its breast milk substitute products. Even where corporations may be breaking no laws, they have been targeted by activist groups for violating the corporations' own self-proclaimed standards or broader community norms in such areas as human rights, labour practices and

¹⁶⁰Ibid., p. 105

¹⁶¹Blackett, "Global Governance, Legal Pluralism and the Decentred State: A Labour Law Critique of Codes of Corporate Conduct".

Indiana Journal of Global Legal Studies 2001, 8, 401-407

¹⁶²Supra n. 156, at 107

environmental sustainability¹⁶³. Secondly, the growing imbalance between corporate rights and obligations itself has become a major driving CSO campaigns, particularly where it touches on life and death issues such as HIV/AIDS treatment and related public health crises in the developing world. In many of these instances, civil societies have successfully framed price reductions as a corporate obligation.

In the face of global governance gaps and governance failures, civil society and increasingly other actors as well, including states, seek to engage the corporate world's global platform to advance broader social objectives. For example, Kofi Annan's Global Compact is based entirely on this rationale¹⁶⁴.

It is argued that improving corporations' social and environmental performance has direct benefits for their employees and the communities in which they operate. But equally important is the potential for generating positive social spill-over effects. In the developing world, adoption of good practices by major corporations may exert an upward pull on the performance of local enterprises in the same sector¹⁶⁵. Likewise, in the industrialized countries, the gradual diffusion of good practices by major corporations social and environmental performance abroad could lessen the fear that a global race to the bottom will undermine their own policy frameworks for achieving social inclusion and economic security at home¹⁶⁶.

As a result of pressure from civil society, companies and business associations began to accept, on a voluntary basis and at a modest pace, new corporate social responsibilities in their

¹⁶³Ibid., p. 107

¹⁶⁴Ibid., pp. 107-108

¹⁶⁵Garcia-Johnson, "Exporting Environmentalism: US Multinational Chemical Corporations in Brazil and Mexico" Cambridge, Massachusetts: MIT Press 2000

¹⁶⁶Supra n. 157, at 108

own corporate domains. The decision by corporations to engage is driven by a variety of factors, mainly by the sensitivity of their corporate brands to consumer attitudes¹⁶⁷.

Due to the expansion of civil society and its engagement with the corporate sector, a global public domain is emerging. Some areas of global public policy today are largely driven by voluntary initiatives and would barely exist were it not for non-state actors. In addition to the traditional machinery of interstate governance, the likes of essentially private certificate institutions are becoming significant components of global rule making. Globalization has brought challenges and opportunities to our world. Likewise, economic activities of multinational corporations have brought both costs and benefits to societies, depending on what view one holds. What we can say is that a fundamental recalibration is going on of the public-private sector balance, and it is occurring at the global level no less than the domestic. Haltingly and erratically, something akin to an embedded liberalism compromise is being pulled and pushed into the global arena, and the corporate connection is a key element in that process¹⁶⁸.

As globalization becomes more and more prevalent, one other problem also emerges – the clash between different cultures and heritages. This is particularly the case as multinational corporations extend their activities beyond their own shores. In doing that, these corporations may often bring their own national and organizational culture to other countries which may be completely different to host countries. In particular, a corporate culture of an organization is usually a reflection of the national origin of that particular organization. As mentioned earlier, different corporate culture may hold different view towards corporate governance and traditionally, this is where the clash lies. Therefore, in the next section, I shall explore this in greater details.

¹⁶⁷Ibid., p. 108

¹⁶⁸Ibid., p. 118

5). The governance dilemma – Shareholder vs. Stakeholder

The traditional view held by classical economists and scholars is that stakeholder theory is incompatible with business¹⁶⁹. One major opponent of stakeholder theory is commentator, Elaine Sternberg. In her article, *The Defects of Stakeholder Theory*, Sternberg argues that balancing stakeholder benefits is itself an unworkable objective. This is because stakeholders are all those who can affect or are affected by the organization, thus the number of people whose benefits need to be taken into account is infinite. In order for a balance to be struck, their numbers must be limited, yet stakeholder theory offers no guidance as to how the appropriate individuals or groups should be selected¹⁷⁰.

Furthermore, according to Sternberg, stakeholder theory is incompatible with corporate governance because it requires business managers to balance stakeholder interests where managers may be required to violate the prior obligations to owners (or shareholders) that they undertook in accepting their jobs. Sternberg calls this the “inciting betrayal of trust”, which is ironically used to promote a better conduct¹⁷¹. Most important of all, Sternberg believes that stakeholder theory undermines private property, agency theory and wealth.

The view expressed above by Sternberg echoes those of the traditional economic theories of the corporation as mentioned earlier. Since then, many scholars and commentators have developed many theories that sought to argue against such traditional view.

Commentator Gerald Vinten, in his article, has provided a counter-argument towards Sternberg’s view¹⁷². According to Vinten, factors such as customer satisfaction and staff morale

¹⁶⁹See Chapter 1 on the remark by Milton Friedman.

¹⁷⁰Sternberg, “The Defects of Stakeholder Theory”.

Corporate Governance: An International Review 1997, Vol. 5, No. 1, 3-10.

¹⁷¹Ibid. at 5.

¹⁷²Vinten, “Shareholder versus Stakeholder-is there a governance dilemma?”

Corporate Governance: An International Review 2001, Vol, 9, No. 1, 36-47.

have long been added to traditional financial measures in order to promote long term economic value for many corporations. In other words, the business world has moved far beyond Sternberg's world¹⁷³.

Vinten then reviewed literature written in 1932 by Berle in the *Harvard Law Review*, "For Whom Corporate Managers are trustees", and argued that Berle erred in assuming that stakeholder theory relies entirely on regulation and enforcement, rather than being a willing and desired activity of companies. According to Vinten, the law contains only the minimum compliance standards, and many corporations in practice have exceeded that. Therefore, a stakeholding corporation in Vinten's view:

"...is one that recognizes not only its direct legal and statutory responsibilities to its shareholders, creditors, bankers, external auditors, customers, employees, central or local government, and all those who facilitate the running of its business, but also recognizes its need for a licence to operate and responsibilities to those indirectly affected by its activities and decisions, past, present and future, and including the natural world, with a measured balance achieved"¹⁷⁴.

In support of his argument, Vinten then provided some examples where corporations have taken in account of stakeholder interest such as the stakeholder cooperatives in Mondragon in the Basque area of Spain, where a balance can be achieved.

Likewise, certain soft law and government publications in the UK have also urged corporations to take in account of wider responsibilities. The Greenbury Report for example, has an introductory section entitled Public and shareholder concerns. Its predecessor, the Cadbury Report, when discussing the role of directors' reports under paragraph 2.7 also urges directors to take into account of not just shareholders but also a wider audience such as employees' interests, which boards have a statutory duty to take into account.

¹⁷³Ibid, at 38.

¹⁷⁴Ibid. at 39.

Also, the Company Law Review Steering Group which commenced its work in 1998/99 has emphasised how accounting and disclosure arrangements can benefit the community as a whole. In its final Annex I of “Issues to be Addressed by Second Phase Working Groups”, it provides that companies with effective stakeholder relations have a better chance of success in the long term. It stipulates that when a company tells a full story to its shareholders they understand it better and this can mean a cheaper cost of capital in the long run. At the other extreme, companies which choose to ignore their stakeholders can find themselves the target of consumer pressure and boycotts and the activity of whistleblowers¹⁷⁵.

The second point about stakeholder theory which commentators like Sternberg have argued is that stakeholder theory is incompatible with corporate governance because it contradicts with the notion that corporations should be accountable to their owners (shareholders). Stakeholder theory provides no common purpose and no effective standard against which corporate agents can be judged.

However, in response to that, Vinten argues the fact that there are competing stakeholders is no different from decisions boards have to make on a regular basis as to how best to utilize their corporate resources in light of competing interests. Other commentators like Hill and Jones have even illustrated in their work that the traditional principal/agent relationship of agency theory is in fact a subset of the more general stakeholder/agent relationship¹⁷⁶.

One area which has become highly common in recent years in corporate management is linking executive remuneration with performance, to avoid the self-serving behaviour of directors. Although this may be a movement led by shareholders and institutional investors in order to protect their own wealth, yet there is also a wider feeling that such behaviour is against

¹⁷⁵Ibid. at 40.

¹⁷⁶Hill & Jones, “Stakeholder-Agency Theory”.
Journal of Management Studies 1992, Vol. 29, No. 2, 131-154.

the public interest and unethical. Likewise, in some jurisdictions such as Hong Kong, when granting planning permission, one condition is that the developer is required to take into account of community benefit. In one case, a property developer's plan to develop a mega-tower comprising of hotel and office in the central business district of the territory has been rejected over 10 times by the local Town Planning Board in the last two decades on grounds that the development would spoil the view of many tenants and worsen congestion on the nearby surroundings¹⁷⁷. Similarly in the UK, it is now a requirement to include social housing in housing developments, where direct state involvement in providing housing will gradually die out. These are all examples where corporations are required to take in account of competing stakeholder interests.

In recent years, there have also been developments in both the US and Europe where institutes and organizations have called for the inclusion of stakeholder interest in business decision making. For example in the UK, the Royal Society of Arts produced an influential report in 1995 providing evidence of companies which have gained competitive advantage through a stakeholder approach. Based on extensive consultation and research, the report recommends that companies move towards partnership, teamwork, and shared values and goals. They should focus less exclusively on shareholders and on financial measures of success to include all their stakeholder relationships. The Tomorrow Company Report wants companies to relate to stakeholders because this is the way to maximize profits in the long run. The report also includes agendas for action for directors, managers, the investment community, and learners and educators. The New Labour government in the UK has endorsed the RSA report and its emphasis on stakeholding in the belief that companies should recognise that there are other stakeholders in the future of the company than just shareholders.

¹⁷⁷ http://www.thestandard.com.hk/thestandard/news_detail_frame.cfm?articleid=49434&intcatid=1

In concluding his remarks, Vinten argues that the traditional view proposed by Sternberg is anachronistic and culturally bound. Stakeholder theory is increasingly universally present in influential economies such as Germany and Japan. Even in the so called traditional Anglo-American economies such as the US, 75% of those working in corporations now recognize the meaning of the term stakeholder. Likewise in the UK, the introduction of the idea of stakeholder pensions has also brought public attention into the forefront with the mooted possibility of novel types of corporate governance being appropriate to such schemes¹⁷⁸.

c). The impact of cross-border business activities

Over the years, due to globalization and cross-border mergers and acquisitions, many commentators have begun to look at how different business approaches in the world are starting to converge with each other.

A recent study by Peter Burbidge discusses the development of corporate governance in Europe and how it is being influenced by Anglo-American approaches based on shareholder value and Continental approaches based on the interests of stakeholders such as employees, focusing on how these two approaches are coming together¹⁷⁹.

The purpose of the study is to compare the system in the United States, based on SEC regulation and the legislation introduced in response to the Enron Scandal, with that of the European systems, mainly based on corporate governance codes such as the Combined Code in the UK. It also looks at the significance of a landmark case and discusses the impact it has on

¹⁷⁸*Supra*, n. 172, at 44.

¹⁷⁹Burbidge, "Creating High Performance Boardrooms and Workplaces – European Corporate Governance in the twenty-first century".
European Law Review 2003, Vol. 28, No. 5, 642-663.

workers' consultation of corporate decisions and how that is changing the landscape in the UK¹⁸⁰.

The article begins by comparing the difference in governance style between companies in common law countries such as the US and the UK, as against that of continental jurisdictions. Accordingly, in the US and the UK, as mentioned earlier, directors' duties are owed to the company and thus ultimately to the owners (shareholders) as a general body. Corporate governance is therefore usually linked with the regulation of stock exchanges because it is very much concerned with the protection of shareholder investors from corporate management abuses. In contrast, continental countries tend to adopt a wider definition of "companies" where corporate interests go beyond the mere interests of shareholders and embrace other stakeholders such as employees¹⁸¹.

In many continental countries, notably Germany, employees are conferred with certain rights in the management of their enterprise. Through statutes in employment law employees are allowed access to information, consultation on major corporate decisions and even participation as directors on the board. In contrast, jurisdictions that conventionally embrace a shareholder model such as the UK, there has been no practice of such worker participation in the management of companies. However, due to EU membership and under the influence of a series of EC directives imposing workers' consultation rights, the UK (as well as Ireland) is being forced to move towards the continental model. The newly drafted UK Companies Act which is expected to come into force by April 2008 will also contain provisions where directors can take into consideration of interests beyond that of shareholders, in order to "promote the success of the business". Yet at the same time, continental companies who have become more dependent on

¹⁸⁰*CGT Commerce & Distribution v. Marks & Spencer SA* (Unreported, April 9, 2001) (Trib Gde Inst-Paris), France.

¹⁸¹*Supra* n. 179, at 642-643.

stock exchange investment and institutional investors have been heavily influenced by Anglo-American theories of corporate governance and the emphasis on shareholders' interests. The author seems to be suggesting that Europe is moving towards a corporate governance regime which combines the codes of best practice on one hand, and a regulatory framework entailing financial regulations, company law and employment law on the other¹⁸².

According to Burbidge, the Enron (and later WorldCom) scandal illustrates the downside of the Anglo-American shareholder-centric governance model, which often tends to lead to conflicts of interest. The directors were at a position where they could exercise unfettered discretion, making a fortune in share options by artificially inflating the share price at the expense of the company. Furthermore, the overemphasis of shareholder value under traditional Anglo-American approach is also seen as too narrow. This is because shareholders were happy to see their shares go up in value and are not concerned with policing the conduct of the directors at general meetings¹⁸³.

The United States' response towards the series of corporate scandals was the introduction of more regulation on top of the already existing Securities and Exchange Act 1934. The enactment of the Sarbanes-Oxley Act in July 2002 aroused major concern due to its worldwide repercussions, since it applies to directors and auditors of any company listed in the United States, even if this is only a secondary listing by overseas companies. This indeed has led to some conflicts between the EU and the US, with some EU based companies considering delisting from the New York Stock Exchange.

In contrast to the regulation-based approach of the US, jurisdictions in Europe have tended to lean towards the implementation of voluntary codes with the United Kingdom at the

¹⁸²Ibid. at 643.

¹⁸³Ibid. at 644.

forefront. Partly as a response to the Enron scandal and the Sarbanes-Oxley Act in the US, the UK consolidated all its previous codes and introduced the Combined Code in July 2003 with the emphasis on the role of non-executive directors¹⁸⁴.

The role of non-executive directors is seen as rather important in the UK because unlike other continental jurisdictions such as Germany, the UK does not have a supervisory board (*Aufsichtsrat*). Therefore, the supervision of executive directors has to be dealt with "internally" by NEDs (Non-executive directors) who are supposedly independent. However, one problem with unitary board structure of the UK is that directors, regardless of whether they are executives or non-executives are in general governed by the same rules and liabilities to the company. In other jurisdictions where there is a two-tier board system such as Germany, the issue is not that clear either because the supervisory board and management board members are jointly and severally liable to the company. In practice, breaches of duty are difficult to define and the supervisory board often lacks sufficient expertise, information, personnel and opportunity to monitor management.

Perhaps one conventional approach of the UK governance regime which is now being challenged is the participation of employees in corporate decision-making. As mentioned earlier, under the Anglo-American shareholder-model approach, directors' duties are owed to the company and the shareholders as a general body. Yet under the influence of EC legislations, the UK has been forced to make necessary changes in order to cater for a wider group of claimants.

Originally, the UK has opted out of the Maastricht Treaty's social chapter and the European Works Council directive under the last Conservative government. The directive required companies with a total of 1000 employees with at least 150 in at least 2 member states to set up a work council. However, the reality was that British multinationals with operation in

¹⁸⁴Ibid. at 648.

other parts of the continent were affected by the directive. Therefore, when the Labour government came into power in 1997, they simply made the logical step of incorporating it¹⁸⁵.

Despite this, British companies have constantly faced problems when operating in other EU jurisdictions with regards to the consultation of employees in making major corporate decisions such as closure and redundancy. This is because for UK listed companies, there could potentially be a conflict between the duty to inform the employees and the contemporaneous requirement to inform the stock market on any matter that may affect the company's share values. This problem was illustrated with regards to the Marks & Spencer's case¹⁸⁶. In March 2001, the M&S group central management announced on the London Stock Exchange that they were to close all their shops on the continent in order to concentrate on their home market. This was the sort of measure which requires consultation with works councils, giving them the opportunity to make comments before the decision. Furthermore, under the directive, the employer should have approach the works council with a draft social plan setting out the reasons for the redundancies, and to minimize the effects of the measure on the workers.

However, no draft plan was ever put forward by the management of M&S and the French works council was only informed informally of the decision just before the announcement on the stock exchange. As a result, the works councils representing the French branches of M&S obtained a court injunction, and the French court ruled that the decision taken in London by the board of the group was invalid unless and until a social plan had been presented and discussed with the work councils. A social plan was thus subsequently negotiated and nearly all French workers managed to preserve their jobs through the successful acquisition of the shops by other local department stores.

¹⁸⁵Ibid. at 658.

¹⁸⁶*Supra*, n. 176.

The M&S case illustrates a very important point about cross-border business activities and the impact of globalization. M&S despite being a UK company is not relieved of its obligation to abide by national law relating to works councils, where it has subsidiaries or operations in other continental countries like France. Secondly, there is also the question of the conflict with the UK Listing Rules, which require the immediate disclosure of price sensitive information to the market so as to prevent what would otherwise be a false market price for the shares¹⁸⁷. However, this could have been avoided by M&S if they informed the employee representatives in confidence about the proposal before they are announced. In both the UK and France, the employee misusing the information might have been guilty of insider dealing anyway¹⁸⁸.

In his article, Burbidge sought to portray the convergence of the UK corporate governance with the more social model that exists on the continent. In his conclusion, Burbidge acknowledges the existence of conflict between shareholders' and employees' interests. On the one hand, shareholders are looking to maximize their investment return and this could mean cost cutting with the workforce as a primary target. Yet at the other end, employees are concerned with higher wages and job security so their demands on management may run counter to shareholders. Company law in the UK, is historically designed to cater for the former.

However, Burbidge does mention that with the increase in employees' share-ownership scheme, that distinction begins to dissipate because employees start to see things from the management perspective and this has an impact on the work councils because the focus of the board and general meeting of shareholders of the company is changed¹⁸⁹.

¹⁸⁷Ibid. at 661.

¹⁸⁸Annex B to the Department of Trade and Industry's discussion document contains the views of the Financial Services Authority that their rules do not create an obstacle to such (worker) consultation.

¹⁸⁹Burbidge, above at 662.

Regardless of whether someone is a shareholder or employee, he/she would all be interested in the transparency of the company and to be provided with information and consultation on matters that concern him/her. More recently, in a number of boardroom revolts, both the public (including shareholders) and employees were concerned about the levels of executive pay¹⁹⁰. This means there is the basis for convergence between Anglo-American corporate governance regime for informing and consulting shareholders primarily on the one hand and the continental social or inclusive model for consulting and involving workers on the other in corporate decision-making.

Another commentator from Ireland, Irene Lynch Fannon went even further in her article. Fannon claims that the traditional distinction between the Anglo-American and Continental models of corporate governance does not exist in reality due to globalization and geopolitical development that have taken place in recent years¹⁹¹.

In her study, Fannon looked at development in her native Ireland and the United Kingdom (both common law jurisdictions), and she argued that it is incorrect to speak of an Anglo-American model of governance. Being members of the European Union, both the UK and Ireland have fully subscribed to the social policy¹⁹². The two common law jurisdictions, despite possessing features of the American model such as dispersal of share-ownership in their listed companies, also possess features of the European social model. This provides an opportunity for what Fannon calls “cross-fertilisation”. In short, the conventional classification

¹⁹⁰GlaxoSmithKline & Granada are two examples.

¹⁹¹Fannon, “Employees as Corporate Stakeholders: Theory and Reality in a Transatlantic Context”.
Journal of Corporate Law Studies 2004, Vol. 4, Pt. 1, 155-186.

¹⁹²*Ibid.* at 171.

distinguishing Germany or Japan with the Anglo-American model does not realize the change in corporate governance landscape operating in the global economy¹⁹³.

In jurisdictions such as Germany, France and the Benelux, employee participation pre-existed under their own legal structures even before the introduction of European social policy. The development of the social policy largely reflects influence of these approaches where countries such as Germany and France have been at the forefront of such developments.

According to an estimate, over 1000 companies operating in Europe are covered by these EU provisions, including many UK companies and at least 250 US multinationals. In March 2002, the new Information and Consultation Directive was passed to establish a general framework setting out minimum requirements for the rights to information and consultation of employees in undertakings or establishments within the Community¹⁹⁴. This directive stipulates information and consultation structures where there are at least 50 employees in an undertaking, or at least 20 in an establishment or unit of business “regardless of whether the company is unionised”. Also, amendments have been made to the Acquired Rights Directive, providing for new changes in particular relating to the election of worker representatives where there is no union¹⁹⁵. Employees must be informed at least 30 days before the transfer of the date of transfer, the reasons for transfer, the legal implications of the transfer and the economic and social implications of transfer for employees and measures envisaged in relation to employees. There are also extensive information and consultation obligations with regards to the transfer of obligations under the contract of employment from the transferor to the transferee in a business transfer.

¹⁹³Ibid. at 172.

¹⁹⁴Directive 2002/14 EC OJ L080/29.

¹⁹⁵Directive 75/129 EC [1975] OJ L48/29 and Directive 98/59 EC [1998] OJ L225/16.

Fannon argues that all of the abovementioned developments illustrate the “Europeanization” of the Anglo-American model which exists in the British Isles. British and Irish companies are therefore clearly closer to the Continental corporate governance structures when it comes to recognizing employees as stakeholders¹⁹⁶.

Fannon also compared and contrasted the difference in values in corporate governance between US and Europe. In the US, governance and management is still largely influenced by the economic theories of the firm, where the general consensus is that employer-employee contract is a bargain that ought not to be interfered with by the state. The rationale is that the parties exercising their bargaining skills will reach the most optimal terms of this contract¹⁹⁷. In contrast, the European social model accepts that bargaining power is not necessarily always equal and that state regulation is needed to protect individual workers, to ensure that workers participate in management of companies and to ensure that women and other ethnic groups are not discriminated in the workplace.

Traditionally, the United States has been a greater believer and champion of the free-market principles than Europe and this is largely due to the diffusion of share ownership. The importance of Wall Street, the major New York Investment banks and the New York Stock Exchange to industrial investment in the twentieth century arose from the way it structured the separation of stock ownership from strategic control. It mainly focused on how the principals (shareholders) can better monitor the agents in order to maximize wealth for the interest of shareholders. This has particularly been the case in the last 20 to 25 years due to the political and economic philosophies introduced under the Reagan administration. This also had its influence in the United Kingdom post 1979 under the Thatcher government. The central theme

¹⁹⁶*Supra*, n. 191, at 172.

¹⁹⁷Bainbridge, “In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green”.
Washington and Lee Law Review 1993, Vol. 50, 1423.

of the 1980s and 1990s was the emphasis on small government, individualism/entrepreneurialism and the rolling back of state. As a result, the market mechanism became superior and wealth maximization was the key in accomplishing what is known as the “shareholder democracy”. Moreover, during the US boom of the 1990s, there has been a significant increase in the level of share options for employees coupled with a dramatic rise in share values on Wall Street and the City. The merger and acquisition activities that took place in the late 1990s on both sides of the Atlantic such as Britain’s Vodafone hostile takeover of Germany’s Mannesmann also led to the belief that the market was the most efficient manner for corporate control as it forces management to restructure its organizations in order to maximize investors’ returns.

However, the Enron and WorldCom scandals in the US and the collapse of Parmalat in Europe have exposed the problem of corporate abuses by executives. It shows how overemphasis on short-term share value return can lead to the neglect of sound corporate governance. Furthermore, adherence to shareholder value does not necessarily mean that shareholder wealth must be maximized in the short term to such an extent that other aspects such as voice, participation and other benefits by stakeholders such as employees be sacrificed. In light of modern corporate developments, it is submitted that a way forward in the new millennium is to strike a balance between the shareholder and stakeholder models.

6). The current problems of corporate governance

Throughout this chapter, I have reviewed many of the major literatures that I consider to be highly relevant to the study of my thesis. In the early part of the chapter, I looked at how the economic theories of the firm influenced the legal and economic philosophies of the English-speaking world in the twentieth century, and how they view corporate contract as an alternative

to corporate law for controlling management and allocation of corporate resources. In the latter part, I have examined literatures on stakeholder theory and globalization that seek to adopt a more inclusive approach in corporate governance that involves other constituencies beyond shareholders. At the end, I also looked at literatures that argue for a stakeholder approach in corporate management.

However, the major problem with many of these literatures and the practical corporate world in general as mentioned earlier, is the relative polarization of two extreme values. Each of them attempts to assert superiority over another and yet this is unhelpful for both the academic and practical world.

The shareholder model approach, being largely influenced by the economic theories of the firm assumes there is a unique culture in the world. It fails to recognize that a particular system of corporate governance is indeed a reflection of the cultural value of that particular society. Furthermore, as mentioned earlier, corporate resources are often measured in tangible forms such as land, capital and labour, and what matters most is who has the right to control and allocate those resources. However, in the modern world, a corporation is in fact a "team" that is made up of different members which is not confined to just shareholders. They include other groups such as employees and customers who all contribute to the success of the corporation at different degree.

On the other hand, a pure stakeholder model approach is not ideal because at a practical level. This is because as examined earlier, there are fundamental problems with stakeholder theory, in particular, there are still controversial debates as to "who or what" counts as stakeholders and to what extent managers should be accountable to these claimants. Furthermore, we need to acknowledge that most corporations are originally set up by private

individuals or entrepreneurs in order to pursue some personal goals and achievements. Private enterprises are not welfare states, they need to have a sound financial well being in order to survive. Their success has been the bedrock of the western capitalist system for over 150 years. so they cannot operate purely on the basis of social responsibility.

Many of the literatures mentioned in this chapter have sought to argue for the convergence of different corporate governance models. However, their argument is based on national or cultural lines between Anglo-American model on one hand and Continental model on the other. However, as mentioned earlier in this chapter, in the modern world, globalization has heavily influenced in many economies. Today, multinational corporations operate in various parts of the world, who face different level of challenges from cultural difference to pressure from interest groups such as NGOs or CSOs.

Therefore, what this thesis is trying to contribute is a model that takes the broader approach and to show that the traditional demarcation between those two extremes does not exist any longer. Instead of adopting a single business philosophy, businesses should understand that our society is becoming more and more volatile. Something which may work today or in the past does not necessarily mean it would work tomorrow. Likewise, a stakeholder group who may have the greatest stakes in the company at a particular time may not be as equally important at other times. Therefore, it should be left to businesses (directors and managers) themselves to determine which constituent group(s) deserve greater consideration depending upon the circumstances such as the state of the business, socio-economic condition, legal environment and more importantly, the business objective at that particular time.

Furthermore, not many literatures in the past have actually proved (or disproved) whether at a practical level shareholder and stakeholder models can converge and co-exist at harmony. It

is the objective of this thesis therefore, to use a case-study analysis to illustrate whether the two traditional extreme views can in fact co-exist in harmony and how companies manage to balance the conflicting interests of multiple stakeholders. In the next chapter, I shall focus on discussing my research question and hypothesis. I will also justify for the research approach which I have chosen for the research.

Chapter 3: Research Approach

Earlier in chapter one, I have already mentioned that the case study research approach shall be applied for this thesis. Therefore, the aim of this chapter is to further elaborate on the research approach which I have chosen. I shall begin by identifying the research question for the thesis, then the focus will be shifted to discussing some of the characteristics of my research approach. Later on in the chapter, I shall concentrate on justifying the particular research approach.

Research Question:

“How is it possible for a company to attain healthy financial performance and yet at the same time be accountable to various corporate stakeholders in its operation and decision-making process in a globalizing environment?”

Since the purpose of this thesis is to examine corporate accountability in the globalizing environment, it is therefore important to look at the financial performance of the selected case-studies to answer the research question. The main reason for doing so is because in order for a corporation to be sustainable in the long term, it needs to have a healthy financial performance and without one, no company is able to survive or satisfy the interests of any of its stakeholders or constituents. It is important to reiterate at this stage that the objective of this thesis is not to suggest that financial performance of a company must be sacrificed in order to cater for the interests of other stakeholders. Instead, it attempts to explore how companies balance different conflicting interests and yet at the same time manage to have a sustainable and healthy financial performance.

Many large corporations in the world have their own “financial performance goals”. Typical businesses are guided by specific objectives for profitability, cash flow, stock market

performance, and other indicators of the organization's financial soundness¹⁹⁸. Businesses may set goals of increasing profits or operating revenues of a specific amount. Investors and analysts pay particular attention to the degree to which businesses achieve these goals. Likewise top executive compensation and increasingly, lower-level employee salaries and bonuses are often directly tied to a firm's financial performance¹⁹⁹.

At macro-level, shareholders, financial analysts, suppliers, employees and other stakeholders want to know how well the business is performing. For this type of assessment broad measures, many general indicators are used such as the cash flow type analysis of EVA (Economic Value Added) method, ROCE (Return On Capital Employed), net profit and other related financial measures²⁰⁰. Analysts and institutional shareholders typically focus their performance evaluation on three periods: (i). The past 5-10 years with particular reference to the most recent period, the aim is to identify significant trends that may provide a guide to future performance; (ii). The present, the aim of which is to focus and identify the company's strengths, weaknesses, opportunities and threats in order to provide another perspective on the company's growth prospects; (iii). The future and that is based on (i) and (ii) above but also entails scenario analysis and a consideration of general factors that could affect the company's future performance. Therefore, in illustrating my case studies in chapters 4, 5 and 6, I shall focus on these measures of the companies to analyze whether they have attained healthy/sustainable financial performance.

¹⁹⁸Hodge et al., "Organization Theory: A Strategic Approach".
Prentice Hall Inc., 5th edition, 1996, at p. 62.

¹⁹⁹Ibid

²⁰⁰Keown et al., "Financial Management: Principles and Applications".
Pearson Education International, 10th edition, 2005, at pp. 445-449.

1). The Case Study Research Approach

Before getting into details as to what case study entails, I should first define what a “case” actually is. Different people may have different views on this but in general, a case is a unit of human activity embedded in the real world which can only be studied or understood in context. It exists in the here and now that merges in with its context so that precise boundaries are difficult to draw²⁰¹.

A case therefore, can be an individual, a group, a class, or an office. It can be an institution such as a school or it can be a large-scale community such as a town. There can be a single case or multiple cases. It all depends on what the researcher wants to find out²⁰².

A “case study” is one which investigates the chosen unit of analysis to answer specific research questions by seeking a range of different kinds of evidence, which is there in the case setting and which has to be abstracted or collated to get the best possible answers to the research question(s)²⁰³. In other words, case studies allow a researcher to achieve high levels of conceptual validity, or to identify and measure the indicators that best represent the theoretical concepts the researcher intends to measure²⁰⁴. No one kind or source of evidence is likely to be sufficiently valid on its own. The use of multiple sources of evidence is a key characteristic of case study research. The case study is one of the many ways which social science research can be conducted. Alternative ways include surveys, histories and experiments, just to name a few. Which research approach is more suitable, depends on three major conditions²⁰⁵: (i).the type of

²⁰¹Gillham, “Case Study Research Methods”.

Continuum 2000 edition, p. 1

²⁰²George & Bennett, “Case Studies and Theory Development in the Social Sciences”.

MIT Press 2004, Chapter 1, p. 3-36.

²⁰³Supra, n 201

²⁰⁴Supra, n 201 at 19

²⁰⁵Yin., “Case Study Research Design & Methods”.

Applied Social Research Methods Series, 2003, Vol. 5, 3rd edition, p.1.

research question; (ii).the control an investigator has over actual behavioural events: and (iii).the focus on contemporary as opposed to historical phenomena.

Case studies are the preferred approach when “how” or “why” questions are being posed, when the researcher has relatively little control over events, and when the focus is on a contemporary phenomenon within some real-life context²⁰⁶. For example, many of the variables that interest social scientists such as democracy and political culture are difficult to measure. This often requires a detailed consideration of contextual factors which is extremely difficult to do in statistical studies but is common in case studies²⁰⁷. Whereas statistical studies run the risk of “conceptual stretching” by lumping together dissimilar cases to get a larger sample, case studies allow for conceptual refinements with a higher level of validity over a smaller number of cases.

One of the most powerful advantages which case studies possesses, is the heuristic identification of new variables and hypotheses through the study of deviant or outlier cases and in the course of field work such as archival research and interviews with participants, area experts or historians²⁰⁸. For example, if a case study researcher asks one question of individuals or documents but get an entirely different answer then case studies can help to develop new theories that can be tested through previously unexamined evidence. Although statistical methods can identify deviant cases that may lead to new hypotheses, yet in and of themselves these methods lack any clear means of actually identifying new hypotheses. Unless statistical researchers do their own archival work, interviews, or face-to-face surveys with open-ended

²⁰⁶Ibid., at p. 1

²⁰⁷Supra, n 202 at 19

²⁰⁸Ibid at 20

questions in order to measure the values of the variables in their model, they have no unproblematic inductive means of identifying left-out variables²⁰⁹.

Case studies are much stronger at identifying the scope conditions of theories. They assess arguments about “causal necessity” or “sufficiency” in particular cases than they are at estimating the generalized causal effects or causal weight of variables across a range of cases²¹⁰. Thus, as a research methodology, the case study is used in many situations to contribute to our knowledge of individual, group, organizational, social, political, and related phenomena. It has been a common research approach in psychology, sociology, political science, social work, business and community planning. It can also be found in other disciplines such as economics for example, where the structure of a given industry or the economy of a city may be investigated by using this method. In almost all of these situations, the need for conducting case studies stems from the desire to understand complex social phenomena²¹¹. The case study approach enables researchers to maintain the meaningful characteristics of real life events, such as organizational or managerial processes, neighbourhood change, the maturation of industries and etc.

a). Different types of case studies

Different critics may give different opinions as to how many different kinds of case studies methods there are. It is not the intention of this section to analyse various forms of case study method, yet nevertheless it is worth mentioning at this stage the distinction between them as this may become important later on in the thesis.

²⁰⁹Ibid at 21

²¹⁰Ibid at 25

²¹¹Bryman, “Social Research Methods”.
Oxford University Press, 2004, 2nd edition, p. 50.

In general, there are three different types of cases. The first one is the *critical case*, where the researcher has a clearly specified hypothesis, and a case is chosen on the grounds that it will allow a better understanding of the circumstances in which the hypothesis will or will not hold. The second type is the *unique or extreme case*, where a case is often selected due to the personal belief of the researcher based on the life experienced by the researcher. The third type is called the *revelatory case*, where the basis for such case exists when an investigator has an opportunity to observe and analyse a phenomenon previously inaccessible to scientific investigation²¹².

However, it is to be noted that most case studies take place on the basis of the so called *exemplifying case*, where cases are often chosen not because they are extreme or unusual in some way but because they tend to provide an appropriate context for certain research questions to be answered. In other words, they allow the researcher to examine different social processes which I mentioned earlier.

b). Alternative research approaches in social sciences

As mentioned earlier, the case study is only one of the many methods of conducting social science research. The key question is, when and why should you want to do a case study on particular topic? For example, should you consider other methods such as survey or history? Each strategy has its own advantages and disadvantages and to get the most out of using the case study strategy, one needs to appreciate these differences.

In order to determine when to use each research strategy, three conditions need to be considered²¹³: (i). the type of research question posed; (b). the extent of control a researcher has

²¹²Ibid., p. 51

²¹³Gillham, "Case Study Research Methods".

over actual behavioural events; and (c). the degree of focus on contemporary as opposed to historical events.

The first condition covers research question(s). If a research question focuses mainly on “what” questions, then the investigation tends to be categorized as “exploratory”, where the goal is to develop pertinent hypotheses and propositions for further inquiry. As an exploratory study any of the research strategies mentioned (case study, history, survey) can be applied. But if the research question posed concerns quantity i.e. “how many” or “how much”, then a survey is more of an appropriate method.

In contrast, “how” and “why” questions are more “explanatory” and likely to lead to the use of case studies, histories or experiments as the preferred methods. This is because such questions deal with operational links needing to be traced over time, rather than mere frequencies or incidence.

With regards to the second and third conditions abovementioned (control over behavioural events and degree of focus on contemporary versus historical events), histories are the preferred method when there is virtually no control or access. For example, historical method is more ideal in dealing with the dead past where it requires researchers to focus on archives as the main sources of evidence. On the other hand, the case study method is preferred in examining contemporary events where the relevant behaviours cannot be manipulated. The case study relies on many of the same techniques as history, but it adds two other sources of evidence. That is the direct observation of the events being studied and interviews of the persons

involved in the events. In situations like these, the strength of the case study strategy is its ability to deal with a full variety of evidence such as documents, interviews, and observations²¹⁴.

c). Reliability & Validity of case study research

As a distinctive form of empirical inquiry, some researchers disdain the case study strategy. Case studies have often been viewed as a less desirable research method than others such as experiments or surveys. The greatest concern has been over the lack of discipline of case study research. For example, the researcher has been sloppy, has not followed systematic procedure, or has allowed equivocal evidence or biased views to influence the findings and conclusions.

Moreover, people have often confused case study teaching with case study research. In teaching, case study materials may be deliberately altered to demonstrate a particular point more effectively. Yet in research, any such step would be forbidden²¹⁵. Every case study researcher needs to work hard to report all evidence fairly.

Analysts have often criticized case studies for having a “degrees of freedom problem”. This is a statistical term for the broader issue of under-determination, or the potential inability to discriminate between competing explanations on the basis of the evidence²¹⁶. In statistical methods, the term “degrees of freedom” refers to the number of observations minus the number of estimated parameters or characteristics of the populations being studied. In a statistical study, degrees of freedom are crucial because they determine power of a particular research design or the probability of detecting whether a specified level of explained variance is statistically significant at a specified significance level. In other words, as the sample size increases or the number of variables decreases, either of which would increase the degrees of freedom. Lower

²¹⁴Ibid at p. 8

²¹⁵Ibid at p. 11

²¹⁶Supra n 202, at 28

and lower levels of explained variance are necessary to conclude with some confidence that the relationship being studied is unlikely to have been brought about by chance²¹⁷. It is this definition that leads to the conclusion that case studies suffer from an inherent degrees of freedom. In a strictly literal sense, any study of a case using one or more variables might seem to have zero or even negative degrees of freedom and be hopelessly indeterminate apart from simple tests of necessity or sufficiency.

However, the above criticism is a fundamentally mistaken interpretation of the purpose of case study research because qualitative variable has many different attributes that might be measured. Statistical researchers tend to aggregate variables together into single indices to get fewer independent variables and more degrees of freedom, but case study researchers do the reverse. That is, case study researchers treat variables qualitatively, in many of their relevant dimensions²¹⁸.

Another major concern about case studies is that, they provide little basis for scientific generalization. For example how can one generalize from a single case? Perhaps this problem can be solved using multiple case studies, but the short answer is that case studies are generalizable to theoretical propositions and not to populations or universes²¹⁹. Case Study researchers do not aspire to select cases that are directly representative of diverse populations. They usually do not and should not make claims that their findings are applicable to such populations except in contingent ways²²⁰.

Statistical methods require a large sample of cases that is representative of and allows inferences about a larger population of cases from which the sample is drawn. Statistical

²¹⁷Ibid at 28

²¹⁸Ibid at 28-29

²¹⁹*Supra* n 207, at 10

²²⁰McKeown, "Case Studies and the Statistical World View", *International Organization*, Vol. 53, No. 1 (Winter 1999), 161-190.

researchers devote much effort to try and make the sample as representative as possible. While useful and necessary in statistical studies, these practices are inappropriate and sometimes counterproductive if extended to case study methods²²¹.

Case studies may uncover or refine a theory about a particular causal mechanism such as collective action dynamics, that is applicable to vast populations of cases, but usually the effects of such mechanisms differ from one case or context to another. Case study researchers generally sacrifice the parsimony and broad applicability of their theories to develop cumulatively contingent generalizations that apply to well-defined types or subtypes of cases with a high degree of explanatory richness²²². That is, case study researchers are more interested in finding the conditions under which specified outcomes occur, and the mechanisms through which they occur, rather than uncovering the frequency with which those conditions and their outcomes arise²²³.

So far, I have discussed some of the characteristics of the case study research method, their advantages and disadvantages, and what a researcher needs to be aware of in conducting a case study research. In the rest of this chapter, I shall be explaining the nature of my research and focusing on the case studies which I have selected. The attempt is to justify the research approach and the cases which I have selected. I also seek to avoid some of the drawbacks of case study research which I have mentioned earlier.

2). The Research Interview

This research is mainly conducted by interviews with representative of the selected companies and other stakeholder groups which shall be discussed later. One may ask what is the purpose of

²²¹*Supra* n 202, at 29

²²²*Ibid* at 29

²²³*Ibid* at 29

interview in research? The answer lies in what the researcher wants to find out and the nature of the research which is being conducted. The interview method conducted in this research is largely semi-structured. Semi-structured interview is the most important way of conducting a research interview because of its flexibility balanced by structure, and the quality of data so obtained²²⁴. This type of interview implies that the same or similar questions are asked of all those involved and the kind/form of questions go through a process of development to ensure the topic focus. It ensures equivalent coverage interviewees are prompted by supplementary questions if they haven't dealt spontaneously with one of the sub-areas of interest and approximately equivalent time is allowed in each case²²⁵.

The major features of the semi-structured interview are that the questions are open, that is the direction or character of the answer is open and probes are used according to whether the interviewer judges there is more to be disclosed at a particular point in the interview. This type of research technique is ideal for the current research thesis because the nature of the research topic is fairly broad. The key to this research is the term "stakeholder" and "stakeholder engagement". Different people may hold a different view as to who constitute as stakeholders of a company. Therefore, a semi-structured interview is better suited as it allows the interviewees more flexibility to elaborate their views on this topic. The major advantages of this research technique are that, it provides a balance between structure and openness, and the analysis is facilitated by the level of structure.

However, there are also disadvantages and limitations with this type of research. Face-to-face interviews can be very time-consuming. Secondly, the more practical issue is, how valid and reliable are interview data and analysis? When a researcher analyses the interview data (be

²²⁴Gillham, "Research Interviewing The range of techniques".
Open University Press 2005. 70

²²⁵Ibid., at 70

it words or phrases), he/she is inevitably making some kind of judgement or interpretive construction of what the interviewee says. Even if it is done with system, rigour and reflection, and with careful attention to representative selection from the interview transcript, specifying the evidence for the inferences, it does not change the fact that a subjective interpretation is being conducted²²⁶.

Often in an interview, the interviewee is constructing themselves in what they say but so also is the interviewer. In other words, “inter-subjectivity” is at the heart of all social relations, whether in a research context or anywhere else. This is not to say that data gathered in an interview is totally bias or one-sided but it is important to consider the role of this dimension. The validity of an account of a research interview does not lie so much in whether it gives a true picture of the person but whether or not it is a balanced account of the interview that took place, and the importance and the implication for assessing the validity of interview data is that interviews need to be part of a multi-method approach, like case studies which was discussed in greater details earlier.

In order to gather data for this thesis, semi-structured interviews were conducted with representatives from these companies and primary data were gathered from documents provided by the companies. Each of the interviews was conducted with a senior representative of the company who hold key positions and vested with the responsibilities of communication with key stakeholders ranging from shareholders to government or environmental groups. They were selected due to the nature of their responsibilities. Interviews with these representatives were conducted by first sending questions to the interviewees before the actual interview, and then later actually conducting a face-to-face interview with them by asking them how they manage their relationship with key stakeholders and yet maintain a healthy financial performance

²²⁶Ibid., at 6

(questions of these interviews are contained in the appendix section). Each of the interview lasted between one and one and half hour, they were tape recorded, transcribed and reported thoroughly throughout the case-study chapters. Interviews with other stakeholder groups were also conducted in similar ways and the details are also covered later on in this chapter and the thesis.

3). Justification of Research Approach

As mentioned earlier, I have selected to conduct the research through case-study analysis and interviews. It is important to stress at this stage that this research is intended to be a qualitative study. I shall be focusing on three case-studies selected from three separate jurisdictions and the three jurisdictions are Hong Kong, United Kingdom and the Netherlands. These jurisdictions are selected due to their legal and economic origin.

The UK and Hong Kong are common law jurisdictions and the Netherlands is a civil law jurisdiction. Evidence has shown that a system of corporate governance is often influenced by the legal system of that jurisdiction. According to a study conducted by La Porta et al, legal systems matter for corporate governance and that firms have to adapt to the limitations of the legal system that they operate in²²⁷. The study by La Porta et al illustrates that in general, common law countries have a package of laws most protective of shareholders. The German-civil-law countries are not particularly protective of shareholders because they usually block shares before shareholder meetings and never allow voting by mail. French-civil-law countries afford the worst legal protections to shareholders²²⁸.

²²⁷La Porta et al., "Law & Finance"
Journal of Political Economy 1998, Vol. 6, No. 6, 1113-1155.

²²⁸*Ibid.*, at 1126-1134

Likewise, different legal system also has different attitudes towards the protection of creditors. In their studies, La Porta et al also found that common law countries offer creditors stronger legal protection against managers. They guarantee that secured creditors are paid first and they frequently preclude managers from unilaterally seeking court protection from creditors, and they have the highest incidence of removing managers in reorganization proceedings²²⁹. The French-civil-law countries offer creditors the weakest protections and countries in the German-civil-law family are strongly pro-creditor²³⁰. In terms of ownership concentration, this is determined by the quality of legal protection of shareholders. The study by La Porta et al supports the idea that heavily concentrated corporate ownership results from weak protection of investors in a corporate governance system. The evidence indicates that weak laws actually make a difference and may have costs. One cost of heavily concentrated ownership in large firms is that their core investors are not diversified. The other cost is that these firms probably face difficulty raising equity finance, since minority investors fear expropriation by managers and concentrated owners²³¹. In general, evidence suggests that countries whose legal rules originate in the common law tradition tend to protect investors considerably more than the countries whose laws originate in the civil-law, and especially the French-civil-law tradition. The German-civil-law and the Scandinavian countries take an intermediate stance toward investor protections. There is no clear evidence that different countries favour different types of investors. The evidence rather points to a relatively stronger stance favouring all investors in common law countries²³².

²²⁹Ibid., at 1138

²³⁰Ibid

²³¹Ibid., at 1151

²³²Ibid., at 1151

Therefore, the selection of companies from the UK, Netherlands and Hong Kong is justified based on the above analysis between corporate governance and legal system. The United Kingdom is studied because it is a common law system, with a corporate governance model that is more shareholder-oriented. That is, management is generally more focused on profit-maximization and shareholder returns. Therefore, exploring a case-study based in the United Kingdom allows us to see whether or not the company follows that traditional approach in their management and what sort of effect it is having on the overall performance of the company.

A company from the Netherlands is chosen due to the uniqueness of its legal origin and economic model. Firstly, the Netherlands is a civil law country, and the Dutch economy is traditionally based on the cooperation between employers, employees and the government. This has led to the creation of a corporate governance model where decisions are often made through consensus between relevant parties. Therefore, the purpose of studying a company based in the Netherlands is to see how its legal, economic and cultural values affect its corporate management approach and its effects.

However, by only selecting companies based in Europe, it may lead to the research being too “Eurocentric”. Therefore, in order to balance that, a case-study from a non-European jurisdiction has been chosen. After due consideration, Hong Kong has been selected due to its legal and economic origin. Although it is politically a part of the PRC (People’s Republic of China), yet its legal and economic model are more in adherence with the likes of the UK due to its colonial past. Therefore, it has a common law system where its corporate governance approach is heavily influenced by Anglo-American values in which companies are also

traditionally focused on profit and shareholder returns. Examining a case-study company based in Hong Kong therefore would make the research more appropriate.

The three case-study companies which I have selected for this thesis are all publicly-listed companies in their own respected jurisdictions. My research is conducted by interviewing a senior representative of each company and asking them the approach which they adopt in operating their businesses and whether or not it is possible for them to strike a balance between achieving healthy financial performance and shareholder return and at the same time consider the interests of other stakeholders. Apart from conducting interviews, I shall also be using the documentary evidence which I have gathered from the companies, academic literatures supporting the theories and other sources to supplement the findings, including journal articles written about the companies and views gathered from third parties through interviews.

However, the contrast between the three selected cases is that, they are of different sectors. The main reason in doing so is because the findings of the research is not intended to be a generalisation as to how companies in identical sector operate and make decisions in various jurisdictions. As already mentioned in chapter one, this research is not intended to be a statistical or comparative study and if companies from the same sector were selected, then the proposition or hypothesis of the research would have to be altered to whether or not is it possible in this particular sector for a company to balance the joint welfare of multiple stakeholders. Yet as the research question and hypothesis illustrate, the purpose of this research is to look at the approach adopted by different businesses in separate jurisdictions and whether or not these approaches enable them to strike a balance between healthy financial performance and the interest of other non-shareholding stakeholders. This is also consistent with the research objective and purpose of case studies as mentioned earlier, that is case studies are generalizable to theoretical propositions

and not to populations or universes. Therefore, in conducting a case study, the aim is to expand and generalize theories and not to enumerate frequencies.

As mentioned earlier, case study research enables a researcher to achieve high levels of conceptual validity and measure variables which may be difficult to do so under statistical studies. It can also identify new variables and hypothesis through the study of deviant or outlier cases and in the course of field work such as observations and interviews. This is precisely the aim and objective of this research. As mentioned earlier, one of the key concepts of this research is the term “stakeholder”, which can have a different meaning to different people depending on who they are. Therefore, by conducting a case study and interviewing the representatives from different companies would allow the interviewees to speak for themselves and elaborate on how they define the term “stakeholder”. These three companies are from different sector and engage in a number of different business activities. Therefore, a stakeholder group which may be regarded as important for one company may not necessarily have the same priority for another. By conducting semi-structured interviews and open-ended questions, interviewees would be able to elaborate on their responses as to why they see certain stakeholder groups as more important. Such variables are difficult to measure using statistical methods because this would entail a detailed consideration of contextual factors which is extremely difficult to do in statistical studies but is common in case studies. Therefore, given the nature of the research question and hypothesis, case study analysis is more ideal for this research because it is much stronger at identifying the scope conditions of theories and assessing arguments about causal necessity or sufficiency in particular cases than they are at estimating the generalized causal effects or causal weight of variables across a range of cases²³³.

²³³Supra n 202, at 25

Furthermore, the particular research question is designed to focus on the study of the relevant companies for a particular time which is confined to the companies being studied. Case studies method is more suitable because it allows the research to be more focus on particular events and activities which took place within the companies. This is because in real life, corporate strategy changes depending upon the circumstances in which a company operates. Thus, the pecking order of different stakeholder groups changes as well. In conducting a case study research and semi-structured interview, the company (or its representative) can have the opportunity to elaborate why the company adopted a particular strategy at a particular time or why a particular stakeholder group enjoy higher priority at a particular time. This is difficult to conduct using statistical methods because it cannot be easily explained or measured by numbers such as one or zero.

Each of the case study company is to be treated as a separate chapter and the rationale for doing so is to make the research more manageable so that a more in depth study of the companies can be conducted as to how they manage their relationship with various stakeholder groups. Each of the chapter will begin by briefly introducing the economic and socio-legal system of the society where each of the company is based. The reason for doing so is because as mentioned earlier, evidence has shown that “the law matters” in corporate governance and firms have to adapt to the features or limitations of the legal systems they operate in. Therefore, by discussing the economic and socio-legal tradition of the jurisdiction where the selected company is based can provide a basic idea of how companies operate and make decisions. This enables us to see whether companies are capable of being accountable to various stakeholders regardless of the legal and economic system they are based in, which is the key objective of this research.

Furthermore, it provides an overview and explains why I have selected a company from that particular jurisdiction as a case study.

The case study chapters would also briefly examine the historical developments of these companies and the reason for this is because corporate culture is often related to its historical root. This has direct impact as to how or why a particular company adopts certain strategy in relation to its key stakeholders. This approach is similar to “process-tracing”, which is a method well-suited to testing theories in a world marked by multiple interaction effects, where it is difficult to explain outcomes in terms of two or three independent variables. This is often used in case-study analysis because process-tracing converts a historical narrative into an analytical causal explanation couched in explicit theoretical forms and this is the purpose of case-study research²³⁴.

In conducting my research, I realised that by simply interviewing the representatives and gathering documentary evidence from the companies could create an element of bias to my study. Therefore, in an attempt to resolve this problem, I have managed to conduct interviews with other stakeholder groups in order to get a diverse opinion as to the meaning of corporate stakeholder engagement. Due to time and resource restrains, it was not practicable for me to conduct interviews with every single stakeholder group. Therefore, I have narrowed down such groups to NGOs (Non-governmental organizations) and government representatives. I have conducted an interview with an NGO group in Hong Kong which has extensive research on stakeholder engagement and corporate social responsibility on Hong Kong-based companies in general. I have conducted interview with the provincial government of the Netherlands via emails and they have been very helpful in providing me with responses and assistance with regards to my research. I have also interviewed NGO groups or business consultancies in the

²³⁴Supra n 202, at chapter 10, 205-232

United Kingdom that specialise in the research of stakeholder engagement in order to get a wider view on this issue. In the next section, I shall justify the stakeholder groups interviewed, and the findings of these interviews are to be reported in the chapters

As mentioned earlier, Case studies are the preferred approach when “how” or “why” questions are being posed, when the researcher has relatively little control over events, and when the focus is on a contemporary phenomenon within some real-life context. Therefore, the case study method is more appropriate for the current research.

With regards to my research question, the key to this thesis is the term “stakeholder”. It is a very broad concept and different companies may have a different view of who their stakeholders are. Secondly, the aim of this research is to look at how companies balance the conflicting interests between shareholders and non-shareholder constituencies in practice, so the ideal way of investigation is to interview representatives from these respected companies and ask them how they are doing it and the purposes. The approach which I shall be using is the *critical case* method, where it has a clearly specified hypothesis, and a case(s) is chosen on the grounds that it will allow a better understanding of the circumstances in which the hypothesis will or will not hold. Therefore, discussions with senior representatives would involve matters concerning the difficulties or barriers they face when implementing their chosen governance style.

Furthermore, case study analysis has been a common research approach in many social science disciplines such as business/economics and political science. In almost all of these situations, the need for conducting case studies stems from the desire to understand complex social phenomena. As abovementioned, the case study approach enables researchers to maintain the meaningful characteristics of real life events, such as organizational or managerial processes. This further stresses the application of the case study research approach for this thesis.

4). Justification of stakeholder groups interviewed

As mentioned earlier, the research approach of the thesis is case-study based, where the findings are based on the interviews with the representatives of each of the selected case-study companies and documents obtained from them. However, the shortcoming of this approach is the potential of being biased in favour of the companies studied. Therefore, in order to resolve such a risk, I shall obtain the views from other stakeholder groups and find out what they think corporate stakeholder engagement should entail and then compare them with what the corporations actually think about the issue. Therefore, these stakeholder groups have been specifically selected due to their significance. They are NGO/Consultancy group and governmental body. Although ideally, it would have been more appropriate to interview the stakeholder groups of the company for which I am researching (i.e. workers, customers, shareholders and the community at large), yet as mentioned earlier, due to time and resource constraints, it would not be practicable to do so. Furthermore, there are also other legal and technical problems which inhibit me from doing so. As a result, I have selected to interview those stakeholder groups which have extensive research on corporate stakeholder engagement and CSR and try to find out what they believe genuine stakeholder engagement should consist of.

a). NGO/Consultancy group

According to a recent article published by academics from Tilburg University, Netherlands²³⁵, a company's stakeholders are divided between internal and external. Internal stakeholders are basically those constituencies who have direct dealings with the company. They include employees, shareholders, clients, business partners and suppliers. External stakeholders in contrast, are in general made up of neighbours, government agencies, and all kinds of NGOs.

²³⁵Maessen, Seters & Rijckevorsel, "Circles of Stakeholders".
Institute for Globalization and Sustainable Development, Tilburg University, Netherlands.

Traditionally, NGOs are found in the “outer circles” of the stakeholder classification. However, in recent years, there has been a trend by companies bringing them “inward”, whereby partnership is developed between the corporate sector and NGOs. As mentioned earlier in chapter 2, pressure-groups such as NGOs or CSOs play increasingly important roles in generating, deepening and implementing trans-national norms in areas such as human rights, the environment and anti-corruption.

In particular, CSOs have become a major force to induce greater social responsibility in the global corporate sector, by creating transparency in the overseas behaviour of corporations and their suppliers and creating links to consumers back home²³⁶.

The rights enjoyed by multinational corporations have increased many folds over the past two decades, as a result of multilateral trade agreements, bilateral investment pacts and domestic liberalization. Yet along with such rights, have also come demands, led by civil society that corporations accept commensurate obligations. As governments have been creating the space for multinational corporations to operate globally, other social actors have therefore attempted to infuse that space with greater corporate social responsibility²³⁷.

Many CSOs and NGOs have joined issue with the global corporate sector for several reasons. First, certain individual corporations have made themselves targets by conducting “unethical” activities in the past. For example, Shell in Nigeria, Nike in Indonesia, and Nestle in relation to its breast milk substitute products. Even where corporations may be breaking no laws, they have been targeted by activist groups for violating the corporations’ own self-proclaimed standards or broader community norms in such areas as human rights, labour practices and

²³⁶Blackett, “Global Governance, Legal Pluralism and the Decentred State: A Labour Law Critique of Codes of Corporate Conduct”.

Indiana Journal of Global Legal Studies 2001, 8, 401-407

²³⁷Supra n. 156, at 107

environmental sustainability²³⁸. Secondly, the growing imbalance between corporate rights and obligations itself has become a major factor driving CSO campaigns, particularly where it touches on life and death issues such as HIV/AIDS treatment and related public health crises in the developing world. In many of these instances, civil societies have successfully framed price reductions as a corporate obligation.

In the face of global governance gaps and governance failures, civil society and increasingly other actors as well, including states, seek to engage the corporate world's global platform to advance broader social objectives. For example, Kofi Annan's Global Compact is based entirely on this rationale²³⁹.

As a result of pressure from civil society and NGOs, companies and business associations began to accept, on a voluntary basis and at a modest pace, new corporate social responsibilities in their own corporate domains. The decision by corporations to engage is driven by a variety of factors, mainly by the sensitivity of their corporate brands to consumer attitudes²⁴⁰.

As mentioned earlier in chapter 2, since globalization has now become a trend, one other problem also emerges – the clash between different cultures and heritages. This is particularly the case as multinational corporations extend their activities beyond their own shores. In doing that, these corporations may often bring their own national and organizational culture to other countries which may be completely different to host countries. In particular, a corporate culture of an organization is usually a reflection of the national origin of that particular organization. As mentioned earlier, different corporate culture may hold different view towards corporate governance and traditionally, this is where the clash lies.

²³⁸Ibid., p. 107

²³⁹Ibid., pp. 107-108

²⁴⁰Ibid., p. 108

Therefore, many corporations see relationships with NGOs as an emerging strategy to deal with the complexities of a globalising context for their enterprises²⁴¹. This is largely due to the economic and political necessity for engaging NGOs. NGOs are perceived as being trustworthy in the same way that companies are being perceived as being untrustworthy. For example, 76% of Europeans trust what Amnesty says, compared to 35% who trust Coca-Cola Corporation, 27% who trust any political party and 26% who trust McDonalds²⁴².

Recall that in chapter 2, we explored “who and what really counts as stakeholders”, and I mentioned that this would depend on the combination of three critical attributes: power, legitimacy, and urgency. Therefore, the salience of a particular stakeholder to the firm’s management is low if only one attribute is present, moderate if two attributes are present, and high if all three attributes are present²⁴³. If the stakeholder is particularly clever at coalition building, political action or social construction of reality, that stakeholder can move into what is called “definitive stakeholder” category, characterised by high salience to managers²⁴⁴. Thus managers should never forget that stakeholders change in salience, requiring different degrees and types of attention depending on their attributed possession of power, legitimacy or urgency, and that levels of these attributes can vary from issue to issue and from time to time.

Therefore, based on the above analysis, many NGOs have managed to gain some or all of the three attributes as important “stakeholder” from the perspective of many corporations who cannot be ignored. Yet at the same time, NGOs themselves have also learned a lesson or two to improve their position and tactics. Coalitions with employees, customers or shareholders, for instance, maybe looked for deliberately and have proven to be an effective strategy on several

²⁴¹Ibid. at p. 1.

²⁴²Hertz, “Corporations on the Front Line”.

Corporate Governance: An International Review, 2004, Vol. 12, No. 2, pp. 202-209.

²⁴³Supra n. 132, at 879

²⁴⁴Ibid., at 879

occasions for changing corporate behaviour. Furthermore, it is recognised by some in the corporate sector that NGOs can also be an interesting source of knowledge and information. NGOs may be of help to gain legitimacy in the open and unsettled situations corporations find themselves in due to globalization. NGOs may realize that legislation, which is in general bound to nation states, may not be the most effective manner to deal with international issues. But also at the government level, there is a growing awareness that new instruments are needed in addition to regulations and financial incentives in order to solve huge social problems of our times. This therefore provides an interesting perspective for collaboration and so for moving NGOs to the more inner circles of the company's stakeholders²⁴⁵.

As it can be seen from the analysis above, NGOs in general are gaining importance as stakeholders from the corporate perspective. However, at the same time, it must be noted that they could also be biased and there are questions about who they can claim to represent. The purpose for conducting an interview with such a body is to gain an alternative perspective. Interviewing representatives from an NGO or other similar body is therefore justified in order to gain a wider view of what corporate stakeholder engagement and CSR should entail.

b). Governmental body/representative

The underlying rationale for interviewing a government representative as a stakeholder group simply speaks for itself. Every company is bound by legislation and regulations enacted by central or local government regardless of where they operate. Furthermore, the government also represents the interest of the people and society which it governs (at least in theory). Therefore, the view of the government as to what constitutes corporate stakeholder engagement or CSR is becoming very important.

²⁴⁵Supra n. 223, at p. 13.

In many developed economies today, we often hear the term “Public Private Partnership” (PPP), where large corporations often collaborate with central and local government to conduct projects that seek to benefit the communities. Such a trend has changed the role of government as stakeholder. Conventionally, government is regarded as external stakeholder, however, with the rise in the level of PPP, government has become the partner of many businesses, where its role as stakeholder has become more “internalized”.

Moreover, many governments throughout the world have become more proactive in promoting CSR and stakeholder engagement. For example, the current Labour government in the UK was elected on the agenda of stakeholder capitalism. Also at EU level, the European Commission published a Green Paper in July 2001 on promoting a European framework for CSR²⁴⁶, defining what corporate social responsibility is and how European companies should behave towards their major stakeholders. Therefore, based on the above analysis, conducting an interview with a government representative is justified in order to gain a view of what corporate stakeholder engagement or CSR should entail.

For the remainder of this chapter I shall elaborate on the nature and characteristics of the three particular stakeholder groups which I shall be interviewing for the thesis in order to further justify in selecting them to provide alternative views for my study.

²⁴⁶Promoting a European Framework for Corporate Social Responsibility Green Paper
Employment & Social Affairs, European Commission, July 2001.

4a). Hong Kong NGO's viewpoint on Stakeholder engagement & CSR

In order to understand how NGOs in Hong Kong define corporate stakeholder engagement and CSR, I shall conduct an interview with an organization called **Community Business**²⁴⁷. It is a non-profitable organization that specialises in the research of Corporate Social Responsibility and stakeholder engagement in Hong Kong.

The underlying rationale for selecting this particular organization for my research is because it is one of the leading CSR organizations in the territory. In particular, it works with many large Hong Kong based corporations to develop and implement strategy and policy as well as promote community investment and diversity initiatives. Furthermore, it also launched the **Hong Kong CSR Charter** in September 2005, which was signed up to by many large corporations in Hong Kong, including the Mass Transit Corporation (MTR), which is the case-study company that is being studied for this thesis. Therefore, this makes Community Business an ideal NGO to be interviewed since it can comment on the CSR practices of the company that is being studied in the thesis.

4b). Dutch Local Government viewpoint on Stakeholder engagement & CSR

In order to understand how another major stakeholder group, the government, defines corporate stakeholder engagement and CSR I shall conduct an interview with a local government representative via email. The interviewee is a senior project leader of the *Afdeling Economische Zaken*, which is an economic departmental body of the Limburg regional government, Netherlands. The reason why I have selected to interview this particular body is because one of the selected case-study companies, DSM NV, is based in the Limburg region. The company was originally founded in this part of the Netherlands as a state mining corporation over a century

²⁴⁷<http://www.communitybusiness.org.hk>

ago. Although it has now been privatized and no longer conducts mining, the company still collaborates with the local government in many projects in the surrounding areas. Moreover, the company contributes significantly to the local economy. Therefore, interviewing the local government of Limburg is appropriate since it can comment on the CSR practices of the company that is being studied in the thesis.

4c). UK NGO/CSR consultancy viewpoint on Stakeholder engagement & CSR

In order to understand how an NGO/CSR consultancy in the United Kingdom defines corporate stakeholder engagement and CSR I shall conduct an interview with a representative from an organization called **SustainAbility**²⁴⁸, based in the United Kingdom. This organization is an NGO/CSR consultancy with its headquarter in London. The reason why I have selected to interview this particular body is because it is a strategy consultancy and independent think tank specialising in the business risks and market opportunities of corporate responsibility and sustainable development. The organization was founded in the mid 1980s on the principles that profitable business must be socially and environmentally responsible, but further that social and environmental innovation is key to the new market opportunities of the future. It combines strategic counsel and consultancy services to a wide range of corporate clients, and also undertakes pro-bono work with other NGOs and civil society organizations. It believes the markets and solutions of the future will evolve from a fusion of both corporate and civil society agendas. Its research aims to bring new insight to defining trends, most recently with regard to the role of 21st century NGOs and the part governments have to play in driving change. Therefore, interviewing a representative of SustainAbility is appropriate since it can comment

²⁴⁸<http://www.sustainability.com>

and give insights on the CSR practices of UK and European large corporations that are related to this thesis.

5). Summary of Chapter

Throughout this chapter, I have explained and justified for the research approach selected for this thesis and some of the organizations or people whom I shall be gathering opinions from. It is important to reiterate here that the particular research approach selected for this study is not the only way of conducting this kind of research. The research approach is selected due to its suitability given the context and nature of the research question and hypothesis as mentioned earlier.

For the remaining part of the thesis, I shall shift my focus to analysing the particular case studies which I have selected. Towards the end, an overall conclusion will be provided which seeks to answer the research question and whether or not the hypothesis holds. It is to this which I shall now turn to beginning from the next chapter.

Chapter 4: Hong Kong Case Study

The aim of this chapter is to provide analysis for my case study of the company in HKSAR (Hong Kong Special Administrative Region), hereto referred to as Hong Kong. In the previous chapters, I have reviewed many concepts and theories of corporate governance and justified my research approach. The major focus of my next three chapters is to examine the relationship between my case study corporations and their stakeholders in greater depth.

I shall begin the chapter by giving an overview of the socio-legal and economic background of Hong Kong explaining why I have selected Hong Kong as a case study and what it would contribute to my research. The rationale for doing so has been explained in the previous chapter, where evidence suggests that the law matters in corporate governance. By examining the socio-legal system of the jurisdiction where the company is based provides a basic idea as to how corporations are managed since corporations often have to adapt to the features of the legal systems they operate in and see whether the company is capable of adopting the “middle approach” despite the system in where it is based. Later in the chapter, I shall illustrate how the company which I have selected manages its relationships with different stakeholder groups based on responses from the corporate representative whom I have interviewed. I shall supplement these findings with documentary evidence gathered from the company, academic literatures supporting the theories and any other sources (newspaper report etc) which comment on the company. At the end of the chapter, I intend to illustrate whether or not the company in question has managed to balance the interest and satisfy the needs of different stakeholders.

Hong Kong: Law, Economics & Politics

Ever since being ceded by the British in the mid 19th century after the Sino-British Opium War, the territory was conceived as a free port as it was originally acquired to be a centre of commerce to serve the interest of the British Empire in the Far East. A free port could not exist without a free market. Therefore, the essential characteristics of Hong Kong became firmly established. It was allowed to become a particularly free, laissez-faire market-oriented economy with the English common law system as its legal foundation. Due to such a historical background, the territory today is probably one of the most “westernised” societies in the Asia-Pacific rim in terms of both culture and system. According to one western commentator, the Hong Kong government is “more firmly committed to nineteenth-century policies of allowing free play to market forces than is the case anywhere else in the world”.²⁴⁹ In fact, according to the latest ranking conducted by the United States Heritage Foundation, a conservative think-tank, Hong Kong is the world’s freest economy and it has held this position for 11 consecutive years.²⁵⁰

By the early 1980s, the Chinese government expressed to Britain its determination to resume sovereignty over Hong Kong. Finally in December 1984, the two sides ratified and signed the Sino-British Joint Declaration under which Hong Kong was to return to Chinese sovereignty on July 1 1997 as a Special Administrative Region. Under this arrangement, Hong Kong is to be administered by its mini constitution, the Basic Law, which was enacted and adopted by the Chinese National People’s Congress in April 1990.

The regime of the Basic Law arises out of the transfer of sovereignty over Hong Kong to China after more than 150 years of British administration, where China recognises that the territory is a society distinctive from the rest of China, in its economy, political institutions and

²⁴⁹Miners, “The Government and Politics of Hong Kong”.
Oxford University Press 1995, 5th edition, 47.

²⁵⁰ <http://www.heritage.org/research/features/index/countries.cfm>

values, legal system and global view. It is driven in large measure by the need to preserve its distinctiveness, while at the same time accommodating the sovereignty of the People's Republic of China.

Under the Basic Law, the Hong Kong Special Administrative Region (HKSAR) is to exercise a high degree of autonomy under the principle of "one country, two systems"²⁵¹. Accordingly, a socialist system and policies will not be practised in Hong Kong. Instead capitalism shall prevail for 50 years. The rights and freedoms of the residents are laid down. Executive, legislative and judicial bodies are established. The underlying legal system remains the common law, and the bulk of the law to be applied is either laws carried over from the previous regime or enactments of the HKSAR legislature, subject to the supremacy of the Basic Law itself. Its financial, monetary and trade systems are to remain separate from those in mainland China. Hong Kong will continue to operate its currency separately from the Chinese currency. Chinese sovereignty is only preserved by reserving the HKSAR's foreign and defence affairs to the Central Authorities of the People's Republic of China.

As can be seen from above, despite the fact that Hong Kong is not a "sovereign state" by international definition, yet due to its unique historical and political background, it is recognised as having its own "international legal personality" which enjoys a significant international capacity and status²⁵². In fact the two sovereign powers, Britain and China, had begun to establish an independent international regime for Hong Kong even before the enactment of the Basic Law. The territory, with the consent of Britain and China, became an independent member

²⁵¹Article 2 of the HK Basic Law.

²⁵²Mushkat, *One Country, Two International Legal Personalities: The Case of Hong Kong*. Hong Kong University Press 1997.

of the GATT in 1986.²⁵³ In 1994, Hong Kong became a founder member of the World Trade Organization (WTO), although China itself failed to secure that membership at the time.

Secondly, to continue the practice of foreign investment, the Hong Kong government on its own, even though under British authorization and the consent of China, entered into a series of international treaties on the encouragement and protection of investment with some of its major trading partners, like Australia, US, Sweden and Japan before the transfer of sovereignty in 1997. These treaties remain binding today despite the return of the territory to China.

The court hierarchy of the territory is similar to that of the United Kingdom with the Court of Final Appeal (equivalent to the House of Lords or Privy Council) having the power of final adjudication²⁵⁴. Many of the laws functioning in Hong Kong today were enacted before 1997, where the legislative procedures and the principles are almost identical to those of the United Kingdom.

Hong Kong today is the world's 10th largest trading economy and is often referred to by commentators as one of the leading international financial centres along with New York, London and Tokyo. It is one of the world's four largest gold markets, the world's 7th largest foreign exchange market, the world's 12th largest banking centre, and Asia's 2nd largest stock market in terms of market capitalisation as at the end of 2005. Since 2004, Hong Kong has been Asia's largest fund raising centre for two consecutive years²⁵⁵.

By any standard, Hong Kong's economy has more resemblance to that of the Anglo-American economic model than the rest of mainland China or other parts of the Asia-Pacific rim due to many of the historical, political and legal issues which I have just identified and this

²⁵³Under art. XXVI of its constituent instrument whereby a customs territory having autonomy over its external commercial relations and other GATT matters may become a member.

²⁵⁴Supra n. 252, 297-300.

²⁵⁵<http://www.hkex.com.hk/index.htm>

makes Hong Kong an ideal case study for this thesis. Being a free-market economy that has largely been influenced by Anglo-American economic values, its business model ought to be categorised as a “conventional” shareholder approach similar to that of the US or UK. This also enables comparisons to be drawn with case studies from the UK and Continental Europe.

The Corporate Legal Framework

Corporate entities operating in Hong Kong are governed by the Companies Ordinance. Prior to 1997, there was the Companies Ordinance 1984 which is based on the fundamental principles of the UK Companies Act 1948. Since then, the legislation has been amended twice as a measure to strengthen the territory’s competitiveness. Yet despite such amendments, the basic legal principles remain very similar to that of the UK Companies legislation.

The Amendment Ordinance to a very large extent reflects the desire of the Hong Kong Company Law Reform Committee to relax certain corporate formalities for private companies. However, equal importance was given to considerations of ensuring that companies would continue to conduct their business in accordance with international standards of corporate governance and that Hong Kong would continue to be perceived as a credible jurisdiction by practitioners and the international business community.

Publicly listed companies in Hong Kong are governed by the regulatory framework and rules of the Hong Kong Exchanges and Clearing Limited (HKEx). It operates and maintains a stock market of the territory and is the primary regulator of Stock Exchange Participants with respect to trading matters and of companies listed on the Main Board and Growth Enterprise Market (equivalent to the NASDAQ in the US) of the Stock Exchange. The responsibilities of

the HKEx include safeguarding the integrity of these markets and maintaining the strategic importance of Hong Kong as a major international financial centre.

In early 2005, the Hong Kong Government released a Consultation Paper²⁵⁶ outlining the legislative amendments required to give statutory backing to parts of the Listing Rules. This follows a decision in 2004 to shift some of the responsibility for enforcing the Listing Rules from the Stock Exchange to the Securities and Futures Commission (SFC), thereby allowing for a wider array of sanctions to be applied (such as fines and director disqualification) than was previously possible and more effective enforcement. The sections of the Listing Rules to be given legislative backing include rules on disclosure, notifiable transactions and connected transactions. The SFC has begun to enforce these sections since early 2006, while Hong Kong Exchanges and Clearing continues to enforce the remainder of the Listing Rules. The SFC also released a Consultation Paper in early 2005 on the specific wording of its proposed amendments to the Securities and Futures (Stock Market Listing) Rules.

Apart from the Listing Rules mentioned above, on November 19, 2004, the Stock Exchange of Hong Kong also published a final report on its new "Code on Corporate Governance Practices"²⁵⁷ (initially released in late January 2004 for public comment). The new Code is in part a response to the UK Combined Code published in July 2003 and it is seen as a big improvement on Hong Kong's original Code of Best Practice, which was contained in a terse document dating back to 1993 (though some critics still believe it falls short of international standards in several areas). Similar to the UK, it adopts a "comply or explain" format and has been published in conjunction with a new set of rules requiring issuers to include a "corporate governance report" in their annual reports.

²⁵⁶ http://www.acga-asia.org/public/files/FSTB_Stat_Backing_Consultation_Jan05.pdf

²⁵⁷ http://www.acga-asia.org/public/files/HK_New_CGCode_Conclusions_%20Nov04.pdf

Labour Relations and Regulation

Hong Kong's labour law is largely based on the classical UK labour law model, which demonstrates a reliance on voluntary collective bargaining, non-legal enforceability of collective agreements, voluntary conciliation and arbitration and trade union immunity against liabilities for direct action²⁵⁸.

In October 2002, Chiu of the Southeast Asia Research Centre, City University of Hong Kong, published an extensive Working Paper regarding labour relations and regulation in Hong Kong²⁵⁹ and it generally paints a grim picture of employment relations of the territory.

According to Chiu, labour legislation in Hong Kong consists of ordinances and regulations. They relate to employees' rights and benefits, employment and labour relations, safety and health, discrimination and compensation. The key legislation regulating employment rights is the Employment Ordinance enacted in 1968 and there are 41 international labour conventions of the International Labour organization (ILO) which apply in Hong Kong. The Labour Tribunal has jurisdiction to adjudicate on disputes arising out of a contract of employment. There is no legal representation required, though tribunal officers can help claimants and magistrates have the power to investigate and require parties to submit relevant documents. Claimants in unsettled cases may appeal on a point of law to the Court of First Instance and all the way up to the Court of Final Appeal.

Legislative changes can be initiated by the Government, members of Legislative Council, and the Law Reform Commission, which is an advisory body appointed by the Chief Executive

²⁵⁸Database of Labour Law in Hong Kong, Southeast Asia Research Centre, City University of Hong Kong.
<http://www.cityu.edu.hk/searc/labourlaw/db.htm>

²⁵⁹Chiu, "Labour Relations and Regulation in Hong Kong: Theory and Practice" Working Paper Series No. 37, October 2002. City University of Hong Kong, SEARC.

of the day. However, with regards to the legislative procedure of the territory, the Legislative Council can only introduce Bills which do not relate to public expenditure, to the political structure or to the operation of the Government, thus limiting its power in changing the laws²⁶⁰.

According to Chiu, this makes it difficult for members of the Legislative Council to introduce a Bill in favour of Labour. It is also difficult for them to amend a Bill with a view to improving labour welfare should the Government bring forth a labour related Bill. This is because doing so requires a majority vote of each of the two groups of legislators: (i). those representing functional constituencies and (ii). those returned by direct election or by the Election Committee. Pro-labour legislators are minorities in both groups:

“The pseudo-democratic political representation, the limited number of labour representatives in the legislature, the limitations on introduction of Bills initiated by legislators together with the restrictive voting rules of the Legislative Council all put workers at a disadvantage as far as their legal rights and protections are concerned”²⁶¹.

Basic protection for employees includes payment of wages, restrictions on wage deductions, and the granting of statutory holidays. Under the Trade Union Ordinance of the territory, both employees and employers enjoy the right to form trade unions with other employees or employers. However, employers are free to decide whether or not to negotiate with trade unions, regardless of the nature of the unions concerned. Union membership is an employee right under the Employment Ordinance and an employee cannot be dismissed or discriminated for being a member of a trade union.

²⁶⁰Ibid. at 5.

²⁶¹Among the 60 members of the Legislative Council, 30 are returned by direct elections, 30 are elected by functional constituencies representing different sectors, of which 3 are labour constituencies. Yet there are 4 representatives in the legislature who are elected by members of chambers of commerce and industry federations to act on behalf of employers' interests.

However, unlike many western jurisdictions such as Continental Europe, trade unions do not have a legal role or function in terms of collective employment provisions. The role of unions in negotiating terms of employment and in representing workers in case of dispute depends entirely on the willingness and goodwill of the employers. Therefore, Hong Kong has no collective bargaining legislation. Although a statute was introduced by the legislature before 1997 under British administration, yet it was soon repealed after the change of sovereignty largely due to lobbying by employers' associations and their support in the legislative council. As of 2004, collective agreements only covered about 5% of the overall workforce and they are of a voluntary nature.

Also, unlike most developed economies in the west, Hong Kong has no minimum wage legislation, except that a minimum wage is imposed on foreign domestic helpers.²⁶² This also means that there is no maximum work hour legislation either and nor is there any legislation restricting overtime, except for children and young persons in industrial undertakings. Since there is no maximum work hour legislation and due to the economic downturn which the territory suffered between 1997 and 2003, working hours have increased over the past five years. HKSAR government statistics gathered in the Census 2001 show that the number of workers who work more than 55 hours per week has increased from 501,300 in 1997 to 729,000 in the first quarter of 2002.

Chiu concludes that Hong Kong only has basic provisions to protect Labour's interests. The absence of a collective bargaining law and legislation for minimum wage and maximum work hours reflects the fact that employers remain unchallenged in these respects. This can be accounted for by a number of factors²⁶³.

²⁶²HK\$ 3,670 per month in 2002.

²⁶³Supra n. 259, 36.

Firstly, Hong Kong has long been a great preacher of free market principles and most research institutes around the world have attributed the territory's economic success to the adherence of such fundamental values²⁶⁴. Therefore, Hong Kong is heavily influenced by classical economic theories (the late Milton Friedman often cites the territory as a role model), which believes that employment, like most other matters ought to be dealt with by the terms of contract freely entered into by relevant parties. Apart from that, there has long been under-representation of pro-Labour members in the legislature and government inertia is also partly to be blamed due to anticipation of opposition from business interest groups. Furthermore, unfavourable economic conditions created by the Asian Financial crisis since 1997 have in fact given employers greater bargaining power as the unemployment rate has significantly risen.

The above analysis of the legal, socio and economic backgrounds of Hong Kong reiterate the fact that the territory is a conventional free-market economy based on the shareholder model approach. However, as the territory continues to make the transition to a knowledge-based economy and yearns to consolidate itself as the region's major financial centre, there have been calls amongst academics, practitioners and even certain members of the business community that apart from bringing economic growth and prosperity to the public, it is also equally important to improve the overall living environment and quality of life of the people. In response to such demands, certain local businesses have begun to take greater consideration of other stakeholder groups beyond that of shareholders. The aim of this chapter is to look at how this is being conducted at a practical level via a selected case study company of the territory and what results it has brought.

²⁶⁴Hong Kong has been ranked as the world's freest economy by the Heritage Foundation for 11 consecutive years.

Hong Kong Case-Study: The MTR Corporation

The case study company which I have selected for Hong Kong is the MTR Corporation Limited (MTR). The period that will be studied mainly covers for the years between 1999 and 2004.

The company is the largest railway operator of Hong Kong, which is the equivalent of the London Underground or the New York Subway.

The railway operator was originally established as the Mass Transit Railway Corporation in 1975 as a Government owned statutory Corporation. In the year 2000, the Hong Kong government decided to privatise the business through the issue of shares on the stock market. as a result it became known as the MTR Corp. Limited on 30 June 2000, a publicly listed company on the Hong Kong Stock Exchange. Apart from being listed on the Exchange of Hong Kong, its shares are also traded in the USA through American Depositary Receipt (ADR) Level 1 Programme sponsored by JP Morgan Chase Bank. MTR shares are also quoted on the London Stock Exchange Automated Quotation (SEAQ) International System. At year-end 2004, the Corporation had over 5 billion shares outstanding, with the Government of Hong Kong still holding over 4 billion shares making it the largest shareholder (76.40%), with the remaining as freely floated on the market (23.60%)²⁶⁵. The company is also included in the Dow Jones Sustainability Index²⁶⁶ and the FTSE4Good Global Index²⁶⁷.

In February 2004, the Hong Kong SAR (*Special Administrative Region*) Government announced the invitation to the Company and the Kowloon-Canton Railway Corporation, to commence discussions on the possible merger between the two entities. The MTR and KCR submitted a joint merger report to the Government on the possible merger between the two in

²⁶⁵<http://www.mtr.com.hk/eng/investors/shi.htm>

²⁶⁶<http://www.sustainability-index.com>

²⁶⁷<http://www.ftse.com/ftse4good/>

September 2004. In early 2006, the MTR, KCR and the government of Hong Kong signed a memorandum of understanding agreeing to merge the two railway corporations whereby MTR would be given a 50 year right to operate the KCR. This proposal was eventually approved by the Legislative Council of Hong Kong in mid 2007. The two rail operators have successfully merged on Oct. 9th, 2007 after voting by shareholders of the MTR at a special meeting. The merged operator shall change its name to the Hong Kong Railway Corporation in early 2008.

Today MTR has a daily patronage of over 2.4 million passengers, it is one of the most intensively utilised mass transit railway systems in the world, transporting 1 in 3 of Hong Kong's population every day.

The Hong Kong MTR is also a member of CoMET, which is a programme of international railway benchmarking. It is made up of a consortium of eleven of the world's largest metropolitan railways (metros). The group is managed by the member metros who have the ultimate control over all its activities. A president for the group is elected annually by members and a programme is set out for accomplishing the established objectives. The Railway Technology Strategy Centre (RTSC), at Imperial College London, acts as the administrator, facilitates the process and provides the research resources²⁶⁸. The Hong Kong MTR has been confirmed by a benchmarking study conducted by CoMET as one of the world's finest railways for reliability, customer service and cost-efficiency. As of the end of 2003, the MTR operated 116.7 km of railway in Hong Kong, comprising of 6 railway lines with some 50 stations.

²⁶⁸For further information on CoMET please visit its website:
<http://www.comet-metros.org/>

Research Method

After selecting the MTR Corp. Limited as my case study for Hong Kong, I have managed to establish contact with a representative of the company and conducted an interview with him. The person whom I interviewed is Dr. Glenn Frommer, the sustainability development manager of the company. Dr. Frommer oversees the sustainable development aspects and produces a sustainability report for the company annually.

Apart from interviewing a senior representative from the MTR, I have also conducted an interview with Shalini Mahtani, a representative from Community Business²⁶⁹, a Hong Kong based NGO which conducts extensive research on corporate stakeholder engagement in the territory. The reason for interviewing other stakeholders has already been explained in the previous chapter and I do not intend to repeat it here again.

For the purpose of this thesis, I shall be looking at the approach which MTR endorses in treating its various stakeholders. Recall that in chapter 1, it was mentioned that the major stakeholders that I shall be focusing are workers, customers, the local environment and institutional investors/shareholders.

My analysis shall be based on the responses of the interviews which I conducted and I shall also be relying on the documents of the company such as annual or sustainability reports up to the year 2004. Other external sources such as journal articles or anything said about the company in the public domain. This method will also be applied for the other two case studies which I shall look at in order to maintain consistency and to make comparison.

1). Workers as stakeholders

In this section, I shall begin by looking at how the MTR Corp. manages its relationships with its employees/workers and the findings are gathered by conducting an interview with the relevant

²⁶⁹<http://www.communitybusiness.org.hk>

representative of the company as mentioned earlier and by analysing the documents provided by the company and gathered from other external sources.

According to the Sustainability Report published by the company for the year 2003, the company puts considerable effort in enhancing its staff productivity. Since 2000, MTRC total workforce has steadily fallen from well over 7,000 to approximately 6,500 by the year 2003. The gradual reduction in staff numbers is mainly due to the completion of one of its main railway line, the Tseung Kwan O Line.

According to its 2003 Sustainability Report, the Company practices a philosophy and culture, enabling it to attract, retain and develop people of high calibre at all levels, by offering well-structured remuneration, training and career paths and a stimulating, caring working environment with open staff communication for employees, consultants and contractors. I shall look at how the Company makes the endeavour in achieving these objectives in greater details later on.

In business and economics, one of the key components companies endorse in assessing employees' morale is staff-turnover rate. This is a measurement of the rate at which employees are leaving an organization. The general assumption is that if an organization has a high staff-turnover ratio, then it is usually due to low morale, perhaps due to ineffective management or leadership. In September 2004, the Corporate Environmental Governance Programme at the University of Hong Kong²⁷⁰, together with Community Business Hong Kong²⁷¹, published a Work-Life Balance Survey Results of Hong Kong. The report finds that employees in Hong Kong has one of the longest working hours in the world and low employees' morale overall. With regards to the findings on staff-turnover, more than 28% of the respondents surveyed have

²⁷⁰www.hku.hk/cegp

²⁷¹Supra, n. 269

claimed that they would be considering leaving their jobs in the next 12 months. By any standard, this is much higher than the norms one would expect and this could also cause major problems in many sectors and would be a large cost to businesses affected. In certain sectors such as real estate, as much as 35% of the respondents surveyed were considering leaving their jobs, and even in the Government sector the ratio is over 16%.

By such standard, the Hong Kong MTR performs significantly better than the Hong Kong average. According to its 2003 Sustainability Report, the voluntary turnover rate for the Company for 2002 was a mere 1.1%. The figure increased slightly to 2.9% for 2003, yet this is still very low in comparison to other Hong Kong companies where the average voluntary turnover rate has been 7.8% in 2002 and 7.9% in 2003²⁷². The MTR attributes such an achievement to organizational restructuring and streamlining, balanced by staff redeployment and the steady development of a multi-skilled workforce. I shall now look at a few mini case-studies as to how this is done.

Knowledge Management System

Knowledge Management is a new discipline introduced by the MTR, enabling individuals, teams and the entire organization to collectively and systematically create, share and apply knowledge to better achieve its business objectives. The corporate wide KM (Knowledge Management) was launched in 2003 and KM policy was developed and applied to the whole company. In Operations and Project, it has been promoted mainly through the so called Knowledge Library (KL) and Virtual Team (VT).

²⁷²Institute of Human Resources Management, Manpower Statistics.

The Knowledge Library is a repository capturing knowledge created in MTR's business processes. The Library serves as the platform for managing company knowledge, the content of which is structured in a way to optimise day-to-day sharing and re-use.

With regards to the Virtual Team, staffs working on a project communicate through a virtual electronic workspace where documents created during the course of the project are automatically captured and stored. Such practice reduces the chance of loss of documents and speeds up their transfer and retrieval. Furthermore, this also facilitates the distilling of useful knowledge from the project workspace to the Knowledge Library.

The Knowledge Management System developed by the MTR has helped improve the productivity and competitiveness of the MTR in the long run. In its 2003 Sustainability Report, a number of benefits have already been recognised in the early stages of Knowledge Management implementation in Operations and Project. Such benefits include: (i). Improved access to existing ideas leading to significant cost reductions; (ii). Transferred best practices faster, leveraging knowledge and improving quality; (iii). Increased organizational responsiveness and adaptability; (iv). Increased the efficient use or reuse of critical knowledge assets; and (v). Enhanced functional effectiveness.

The MTR Knowledge Management System is indeed similar with the so called "Knowledge-based" view of the firm. This suggests that a firm's competitive advantage is related to its "knowledge assets" which include employees and other internal stakeholders. The origins of the knowledge-based approach can be found in Penrose's book which was published in the late 1950s and early 1960s²⁷³. In the 1980s and 1990s, a more general resource-based

²⁷³Penrose, "The Theory of the Growth of the Firm", Basil Blackwell, Oxford, 1959.

approach theory was also published by Wernerfelt²⁷⁴ and Barney²⁷⁵. According to the resource-based view, the firm is seen as a bundle of resources and comparative advantage is explained by the possession of a bundle with particularly valuable attributes. Resources are regarded as particularly valuable if they are rare and hard to imitate. Therefore, according to Foss²⁷⁶, most interest has centred on internally accumulated resources, such as routines and capabilities, rather than those that can be purchased on factor markets. Such centring on knowledge and skills as key resources focuses the resource-based view of the firm down into the more specific knowledge-based approach. In short, the knowledge-based view can be summarised as follows:

“The Knowledge-based view of the firm views a firm as a knowledge-creating entity, and argues that knowledge and the capability to create and utilize such knowledge are the most important source of a firm’s sustainable competitive advantage. Knowledge and skills give a firm a competitive advantage because it is through this set of knowledge and skills that a firm is able to innovate new products/processes/services, or improve existing ones more efficiently and/or effectively. The *raison d’être* of a firm is to continuously create knowledge”²⁷⁷.

In their article, Nonaka *et al.* conceptualise the firm as a “knowledge creation function” and suggest that the so called “knowledge conversion rate” of a firm is associated with factors such as organizational form, incentive system, corporate culture and organizational routines.

MTR Code of Conduct

In the year 2002, the company published its Code of Conduct setting out the policies and practices that the company has developed to conduct itself responsibly with its internal and external stakeholders. As far as employees are concerned, the Code explains the company’s

²⁷⁴Wernerfelt, “A resource-based view of the firm”, *Strategic Management*, 1984, No. 5, 171-180.

²⁷⁵Barney, “Firm Resources and Sustained Competitive Advantage”, *Journal of Management*, 1991, No. 17, 99-120.

²⁷⁶Foss & Foss, “The Knowledge-Based Approach and Organizational Economics”, *Competence, Governance, and Entrepreneurship*, Oxford University Press 2000, p. 65.

²⁷⁷Nonaka, Toyama & Nagata, “A Firm as a Knowledge-creating Entity: A New Perspective on the Theory of the Firm”, *Industrial and Corporate Change* 2000, 1-20 at 1.

business philosophy and values governing staff conduct in achieving business goals. According to its Sustainability report 2003, the aim of the Code is to “sustain a high level of integrity in all aspects of the Corporation’s operations”. This is again related to its philosophy of managing its organization according to the knowledge-based view where the interests of key stakeholders are taken into consideration.

MTR makes every effort in embedding the Code in its daily operation. It has carried out extensive training and a communication campaign to ensure all levels of staff understand the content of the Code and the philosophy of an ethical working culture. Accordingly, all staff was issued a personal copy of the Code of Conduct. Each manager was also issued a Corporate Guidebook for Managers with particular examples for better illustration and communication with staff. In 2003, the Code was reviewed again in response to developments in corporate governance standards, including the standards set out under the Sarbanes-Oxley Act of 2002.

The Code of Conduct focuses on the following areas: (i).Ethics in management (bribery, illegal gifts, entertainment and commissions); (ii).Conflict of interests (relationship with suppliers, contractors, consultants and interfacing parties); (iii). Responsibilities to shareholders and the financial community; (iv).Relationship with customers; (v). Relationship with employees; (vi).Health and safety; (vii).Responsibilities to the community; and (viii).Monitoring of compliance & the means of enforcement. Further guidance on sexual orientation, disability of discrimination and family status have also been added to the Code in 2004 and communicated to all staff. This is also included in the Sustainability Report 2004.

The abovementioned example of the MTR Code of Conduct is an illustration of how rules can affect the overall performance of an organization. According to a July 2005 article

published in the *Journal of Business Law* by Professor Alice Belcher and Till Naruisch²⁷⁸, rules affecting an organization can be distinguished into rules set from outside (law and self-regulation), rules boards set for themselves and rules boards set for the running of their organizations.

These rules grant powers and impose responsibilities and also state the consequences of success, in terms of incentives, or failure, in terms of liability. According to Belcher and Naruisch, the resource-based view (RBV) as mentioned earlier has been developed in the strategic management literature and it is in relation to strategic/management powers that it is most obviously applicable to corporate boards. Corporate governance codes on the other hand, focus on the board's powers and responsibilities in the area of monitoring and control²⁷⁹.

Therefore, if the RBV approach simply encourages a particular style of rules in the strategic or management domain and corporate governance rules are applicable only in the area of monitoring and control, the recommendations of the governance and RBV literatures could be taken in isolation. However, the line between monitoring and control is often not as clear cut. According to Belcher and Naruisch, how best to monitor and control depends on the business assets and activities that need to be monitored and controlled. This view is also supported by the Sustainability Manager of the MTR, Dr. Glenn Frommer, with whom the interview was conducted:

“...On the one hand there is the value of capital which the company has in order to maximise financial returns, yet on the other hand you need to distinguish that with the values which you are creating and investing within the business...”.

According to Dr. Frommer, stakeholder engagement is more concerned with the latter values and these include communication and consultation which we shall now look at in greater details.

²⁷⁸Belcher & Naruisch, “The Evolution of Business Knowledge in the Context of Unitary and Two-tier Board Structures”. *Journal of Business Law*, July 2005, 443-472.

²⁷⁹Ibid., at 448.

Staff Communication & Consultation

The Hong Kong MTR put strong emphasis in communicating and consulting its staffs on major operation and decision-makings. Ever since 1980, it has established a comprehensive staff consultation mechanism that has proved to be successful in resolving issues of common concern between management and staff as well as reinforcing mutual trust.

By tradition, most corporations in Hong Kong follow a shareholder approach in their decision-making process similar to that of the US and UK. The opinions of employees are rarely taken into account. However, in contrast, the Hong Kong MTR has established a two-tier mechanism which comprises the Joint Consultative Committees (JCCs) at the foundation level and the Staff Consultative Council (SCC) at the corporate level to discuss issues relating to the interests and welfare of employees. The SCC is for discussing matters of corporate wide interest while JCCs are departmental consultative bodies. According to its Sustainability Report 2003, about 460 members of staff are elected by their colleagues to serve on 23 JCCs across the company.

Apart from the staff consultation mechanism as mentioned, there are also two staff unions, the Staff General Association and the Staff Union. The company maintains regular dialogue and cordial relations with the unions.

One method in which the company gathers staff's attitude and opinions is by conducting Staff Attitude Survey (SAS). In the year 2001, the company conducted its fourth SAS and the survey provided essential input in formulating the company's future policies and plans. Staff identified a number of areas where MTR was strong including company image, pay and benefits, training, safety and working conditions, downward communication and employee involvement. Staff surveyed also raised concerns on job security, staff morale and work stress.

An action plan for the corporate issues identified in the 2001 SAS was eventually devised and communicated to staff in 2002. According to its Sustainability Report 2003, the company's efforts to address corporate issues continued and included enhancing communication between management and staff, reviewing organizational effectiveness and encouraging multi-skilling. For example, a training programme entitled "A New Horizon for Leaders" was launched to enhance communication and leadership skills of 1,100 junior managers and senior supervisors.

In order to monitor trends of employee attitudes and measure the progress of the follow-up actions, the company conducted another SAS at the end of 2003. A random sampling approach was adopted to make the survey more cost effective. Accordingly, 97% of the 2,000 randomly selected staff that were invited participated in the 2003 survey. To ensure confidentiality and impartiality, an independent survey company assisted in the project and performed the data analysis.

According to the Company's Sustainability Report 2004, MTR argues that due to its strategy to nurture and train a highly-skilled, motivated and professional workforce, it has been able to deliver a world-class service. Such a strategy involves best practice in remuneration, training and training facilities and maintaining open and fair communication channels with staff. Its achievement can be illustrated through the marked trend in increased productivity levels across all company divisions and its low voluntary turnover rates (1.3% compared with the 10.9% Hong Kong corporate average in 2004).

The Hong Kong MTR has adopted four core values in its undertaking of human-resource practices in Hong Kong and other geographical areas in which it operates: (i).Equal Opportunities; (ii).Human Rights; (iii).Rewards & Benefits and, (iv).Health & Safety. The company's hiring and remuneration practices exceed those stipulated by the law of Hong Kong.

As mentioned earlier, staff regularly participate in surveys and are informed of any changes or decisions relevant to their careers through a system of timely newsletters, web alerts and department management briefings. Moreover, employees have the opportunity to consult openly with senior management through its system for consultation and dialogue. This can be compared with the European Union requirement to consult workers that is currently being implemented across Europe.

The company also has in place other mechanisms to encourage dialogue and to identify issues well before crisis stage including informal staff meetings with the CEO and senior management, encouraging the culture of enterprising spirit among work groups and providing training to enhance communication skills at supervisory and management levels. For example, when SARS (Severe Acute Respiratory Syndrome) struck Hong Kong in the year 2003, willingness to travel by rail fell dramatically and MTR launched a series of cost reduction measures. Among these was the “One Day No Pay Leave Per Month Programme”, implemented upon consultation with staff from July to December 2003. Due to staff commitment and hard work, MTR patronage and other commercial activities recovered sooner than expected. In showing its appreciation, the company provided all staff with a special payment to fully compensate the reduction in salaries.

One aspect of its operation about which the company has constantly consulted its staffs is regarding the development and subsequent impact of the possible rail company’s merger with the KCR (Hong Kong’s other major rail operator owned by the government). The usual corporate practice in Hong Kong is that employees almost never get consulted about proposed mergers with rival operations. However, the MTR has set up a dedicated task force with the agenda to

monitor events, initiate dialogue on a timely basis with department heads and the SCC and to maintain continual communication with all staff on the progress of the merger.

Furthermore, the company has also extended its learning culture to its contractual partners for better efficiency in rail project delivery through on-site training, information sharing seminars and co-organised tertiary institution construction management courses. In its Sustainability Report 2004, the company reports that partner productivity, environmental compliance and on-site safety practices have measurably improved since the introduction of the partner training scheme. For example, the completion in 2003 of the Tseung Kwan O (TKO) rail line with construction costs reduced by 48% and a minimal contractual disputes, demonstrates the results of this scheme in practice.

The MTR has also extended its corporate practices beyond Hong Kong in its expansion elsewhere in the world. In its Mainland China operation for example, there are training programmes for suppliers, contractors, designers and operators. From on-site environmental workshops to long-term technical and management training programmes conducted in Hong Kong, the company has embedded a Corporate Social Responsibility (CSR) culture and transferring the technologies and skills to implement and sustain what it calls “long-term good corporate citizenship”. The company is also conducting similar best practice training programmes for rail operators in other emerging economies where the concept of CSR is still relatively novel such as Delhi, Bangkok and Singapore.

One staff training programme which the MTR is proud of is the Work Improvement Teams (WIT) programme, which marks its 15th anniversary in the year 2004. The programme is designed to help staff work smarter, increase productivity and encourage innovation and teamwork in the workplace. WIT currently embraces almost 40% of staff and since 2002 has

been extended to external project contractors. Many of WIT proposals have been adopted across the company and exemplify sustainability in practice. These include a systemised computer disposal programme to benefit charities, the introduction of numerous pro-environment operational and maintenance efficiency systems, and time and resource saving administration procedures. According to its Sustainability Report 2004, total savings from WIT projects in 2004 were HK\$ 13.5 million (approx. £ 1 million).

Employees' Interest & Corporate Governance

MTR's commitment to its staff and widening of its employees' participation in decision-making process is very much related to the governance and management structure that foster such practices. We shall now briefly examine its corporate governance practices and analyse how they actually help to promote better employees' welfare.

According to its Sustainability Report 2003, the company is committed to the "highest standards of corporate governance in the interests of shareholders and devotes considerable effort to identifying and formalising best practices". The company has complied with the Code of Best Practice as set out in Appendix 14 of the Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited, except that non-executive Directors of the company are not appointed for a specific term but are subject to retirement by rotation and re-election at the company's annual general meetings in accordance with Articles 87 and 88 of the MTR Articles of Association²⁸⁰.

Apart from being listed on the Stock Exchange of Hong Kong, MTR shares are also listed in the USA through American Depository Receipt (ADR) and are also quoted on the London

²⁸⁰This is a practice adopted by the MTR since its days as a state-owned corporation in order to maintain independence and conflict of interest.

Exchange International System. As a result, the company is required to comply with listing regulations in other markets as well. For example, by being listed in the USA, MTR is a Securities and Exchange Commission reporting company so it is therefore bound by the Sarbanes-Oxley Act which came into force in July 2002. The Act was introduced in response to the Enron and WorldCom scandals and seeks to enhance the transparency and accountability of companies in the areas of corporate governance and financial reporting. The legislation is often referred as “long-arm jurisdiction” because it applies to all companies listed in the United States even if it is a secondary listing. In response to this, the Hong Kong MTR has been reviewing its internal systems and practices and implementing new requirements under this legislation in line with applicable compliance dates.

One unique feature of the MTR which distinguishes from many listed or large companies in Hong Kong is its management structure. Due to Anglo-American influence, the majority of the companies in Hong Kong have a single tier board or management. In the US or UK for example, most large corporations have a unitary board structure where the CEO play a dominant role. The MTR is probably one of the few (if not the only) large publicly-listed company in Hong Kong where the senior management is made up of a two-tier management structure, the Board and the Executive Directorate. The Board is the highest level of authority and is supported by the Executive Directorate.

a). Role of the Board

The overall management of the company’s business is vested in the Board of Directors. Yet pursuant to the company’s articles of association and the Protocol adopted by the Board of Directors, the Board has delegated the day-today management of the company’s business to the

Executive Directorate, and focuses its attention on matters affecting the company's overall strategic policies, finances and shareholders. They include financial statements, dividend policy, significant changes in accounting policy the annual operating budget, major financing arrangements, major investments, risk management strategy, treasury policies and fare structures.

Similar to Boards in the United Kingdom, the Board at MTR has also established three main committees, namely the nominations committee, audit committee and the remuneration committee. In order to comply with the UK Combined Code, each of these committees has defined written terms of reference with at least half of its members as non-executive directors to ensure independence and objectivity so that MTR continues to achieve the high standards expected of a major listed company²⁸¹.

In April 2003, the Board of Directors announced its intention to split the roles of the Chairman and Chief Executive Officer (CEO) in order to comply with the UK Combined Code, given the fact the company is also quoted on the London Exchange International System. In addition, the majority of the Board members are non-executive directors who bring a wide range of business and financial experience to the Board.

b). Executive Directorate and Executive Committee

As mentioned earlier, MTR is probably one of the few large publicly-listed companies in Hong Kong where the senior management is made up of a two-tier management structure, the Board and the Executive Directorate. The Board of Directors is the highest level of authority and it has delegated its day-to-day management of the Company's business to the Executive Directorate.

There are seven members of the Executive Directorate and, together with the General Manager of Marketing and Station Business, they form an Executive Committee. Accordingly.

²⁸¹Further information on the Board committees is available in the MTR Corporation Annual Report 2003, p. 45-47.

the Executive Directorate and General Manager regularly present to the Board reports on the performance of the principal activities of MTR. It is the duty of the Executive Directorate to review the progress on sustainability achievements at least twice per year. The Executive Directorate in turn has established a number of executive committees to assist in the management and control of MTR's various core businesses and functions. The key executive committees currently set up are:

- Operations Executive Management Committee;
- Property Executive Management Committee;
- Project Control Group;
- Safety Committee;
- Railways Extensions Steering Group;
- Financial Planning Committee;
- Operations Performance Meeting;
- Information Technology Executive Management Committee;
- Tender Board;
- Executive Tender Panels;
- Commercial Letting Committee;
- Investment Committee;
- Business Development Executive Committee

Membership, authorities and duties of these committees are documented in their terms of reference.

The above analysis illustrates that the management structure of the Hong Kong MTR is very similar to the two-tier board structure that is prevalent in Continental Europe such as

Germany and Holland. Although, the company may not formally refer itself as having a two-tier board structure, yet from its hierarchical structure, a similar comparison can be made. This is also perhaps the reason why the Company has been able to take greater consideration of other stakeholders' interests such as employees. In giving its interview responses, Dr. Glenn Frommer refers such company practice as "Enterprising Spirit" for workers:

"...the interface between senior management and lower management is the key to sustainability of the company..."

This also concurs with a recent article written by Belcher and Naruisch²⁸², whether in a unitary board structure (the UK for example) or a two-tier board structure (Germany or Holland), the way in which board members interact is imperative. This is because the tacit knowledge that could be created in the boardroom is the knowledge of how to work together as a team²⁸³. The knowledge that could evolve in a boardroom can sometimes be knowledge of how and when to switch between working styles, and it is such tacit knowledge which is likely to produce competitive advantage²⁸⁴. Therefore corporate governance structures that make clear how different roles result in different responsibilities and liabilities might facilitate fruitful interaction because teams work when there is a well-coordinated sense of individual roles.

In short, the Hong Kong MTR case study illustrates that when a management structure of a company has clear roles and responsibilities for each executive directorate and committee, it fosters a culture that encourages interaction and communication between employees and management. This creates a competitive advantage for the company and this can be reflected on the performance of its employees and as well as for the company.

²⁸²Supra, n. 278.

²⁸³Ibid. at 471.

²⁸⁴Ibid. at 472.

Risk Management & Employees' Interest

In claiming itself as a responsible corporation, the Hong Kong MTR through its corporate governance structures has implemented risk management strategies, by “seeking to identify and manage risks which may materially affect its business and by implication, the interests of shareholders, customers and staff and the Hong Kong Environment”. According to its Sustainability Report 2003, the company argues that by likening risk management to sustainability, MTR gains greater insights into the creation of long-term shareholder value as well.

According to Dr. Glenn Frommer, the company has already launched its risk-based approach to safety management. In 2002/03, the company has adopted a three-year program to develop further its approach to risk management, strengthen its reporting systems and related internal controls and provide enhanced comfort to its stakeholders over the quality of information provided. In achieving such an objective, it has engaged PricewaterhouseCoopers to assist and support this programme.

The MTR has a four-stage approach for managing business risk and they are: (i).

Identification; (ii). Prioritization; (iii). Action and, (iv). Monitor & Report.

(i). Identification

By identifying the three elements of sustainability (economic, social responsibility and environment), a long list of possible risks to the business is compiled.

(ii). Prioritization

Each of the identified risk is assessed in terms of severity defined by consequence and frequency of occurrence. Risks with a high consequence – likelihood score are identified as priority business risks and taken forward to the next stage for senior management attention.

(iii). Action

Risks are identified and prioritized by the Executive Directorate and subsequently approved by the Board. Actions are then allocated to relevant divisions.

(iv). Monitor & Report

Implementation and effectiveness of the actions are monitored on an ongoing basis using key performance indicators wherever possible. Senior management is informed of risk and action status through regular reporting and key results are presented in MTR's Annual Report and Corporate Sustainability Report.

The Hong Kong MTR realizes that it is the city's major rail operator, therefore the health and safety of both staffs and passengers are vital to its well-being and this is also reiterated by its Sustainability Development Manager, Dr. Glenn Frommer:

“...we have some 7000 staffs, transporting 2 to 3 million people daily, we therefore need to reduce accident numbers to a minimum and the risk-base approach management contributes significantly to our overall sustainability values...”.

The MTR risk management strategy is similar to the risk-based approach or “internal control” which was introduced in the United Kingdom by the Turnbull Guidance in 1999 and now included in the Combined Code. According to Belcher (2002)²⁸⁵, the internal control provision introduced by Turnbull explicitly goes beyond the purely or directly financial aspects which is widely understood by the accounting profession. The Turnbull Guidance itself

²⁸⁵Belcher, “Corporate Killing as a Corporate Governance Issue”.
Corporate Governance: An International Review, Vol. 10, No. 1, January 2002

emphasises the wide scope and this is provided under Code Provision C.2.1 of the Combined Code:

“The board should, at least annually, conduct a review of the effectiveness of the group’s system of internal controls and should report to shareholders that they have done so. The review should cover all material controls, including financial, operational and compliance controls and risk management systems”.

In her article, Belcher²⁸⁶ argues that the Turnbull guidance involves the identification and prioritising of risks and embedding the risk management approach in the culture and processes of the business. This comment is almost identical to the aim and objective of the risk management strategy implemented by the MTR, which is to increase the values it creates for shareholders and enhances the overall sustainability of the company to other stakeholders such as employees. Such strategy should be associated with the opening of a new level of corporate governance debate that will focus on corporate behaviour rather than corporate policy. The company’s monitor and report approaches to its risk management strategy reinforce this idea and notion²⁸⁷.

Moreover, the company’s effort in training and enhancing the values of its employees at workplace has also won public recognition. For three consecutive years between 2002 and 2005, the Hong Kong MTR has been honoured with the Good People Management Awards by the Hong Kong Labour department for its contribution in fulfilling the job satisfaction of its employees and promoting an overall harmonious industrial relationship in Hong Kong²⁸⁸.

2). Customers as Stakeholders

²⁸⁶Ibid, at p. 42

²⁸⁷It is to be noted that the recommendation stipulated under the Turnbull Guidance has only recently been incorporated by companies across the UK. Its benefits and effects on stakeholders are still yet to be seen.

²⁸⁸Please refer to the Hong Kong Labour Department website for further details regarding the criteria of the award.
<http://www.labour.gov.hk/eng/home/index.htm>

In the previous section, I have looked at how the Hong Kong MTR manages its relationship with its employees and the impact that they have had on the company. In this section, the focus shall shift to how the company manages the relationship with another stakeholder group, customers, and see what effect this has on the business.

Being the city's major rail operator, the customers of MTR are mainly passengers who travel on the railway on a daily basis. According to its Sustainability Report 2004, the MTR is one of the most intensively utilised mass transit railway systems in the world. In 2004, its daily patronage averaged 2.4 million passengers per weekday, transporting 1 in 3 Hong Kong's population everyday, and demonstrating a substantial increase over the 2.3 million recorded for the year 2003. The rail network operates six railway lines, comprising 88 km of rail lines connected by 50 stations.

The vision of the MTR is to make Hong Kong to a "fast track world class city". In defining such vision, Dr. Glenn Frommer, its Sustainability Development Manager, gave the following response:

"...Hong Kong is one of the most densely populated city in the world...but we here at MTR think that with the right approach, it can grow from its current densely populated urban environment to become a world class city...safe, clean, vibrant and stimulating...".

However, the company realizes that this requires the government, business and society to work together with full transparency and accountability. In trying to achieve such goal and vision, the operator sought to provide what it calls "equitable access to affordable, safe, useful, highly energy efficient and reliable transportation". It plays a significant role in reducing the environmental impacts of moving over two million people every day. We shall look at this later in greater detail.

a). The Rail + Property Business Model

The business model which the Hong Kong MTR endorses is the so called “rail + property business model”, which is unique to Hong Kong. This is also included in the company’s mission statement:

“To develop and manage a world class railway together with property and other related business, to enhance the quality of life in Hong Kong”²⁸⁹.

The MTR attributes its success to this model and believes that it is the key in helping the operator to provide excellent rail service to the public and a major policy in achieving its vision.

According to the law of Hong Kong, MTR Corporation has the negotiated right to develop and own property on lands above its stations. The company claims that such a business model provides the means for sustained profitability while investing in and building future rail lines for passengers, which also helps to reduce the level of congestion on the roads of Hong Kong. The company’s portfolio of investment properties includes mainly shopping centres and commercial properties, with a land bank for future development of 2.5 million square metres.

The success of this business model also depends on other private property developers. Typically, MTR enters into partnerships with reputable developers who bear all development costs, including land premium and construction costs, and therefore all development risks. MTR would take the lead in development planning and supervising construction and eventually shares part of the profits upon completion and sale.

Through the development of properties linked to the MTR network of stations, the Corporation has played an important role in the successful creation of new living and working communities in Hong Kong. Not only has the rail and property model optimised the use of airspace at railway stations, but it has also enhanced the quality of life for people by

²⁸⁹MTR Corporation Sustainability Report 2003, p. 12.

integrating the railway together with other daily services such as shops, travelling between homes and offices and recreation space. One of the most attractive elements of this model as far as passengers and residents are concerned, is their location. Being one of the most densely populated city in the world, one of the biggest (if not the biggest) urban problem which Hong Kong faces is traffic congestion. Therefore, people enjoy working, living and shopping in properties located directly above or adjacent to railway stations, as they offer travel convenience, added value and efficiency. Since these properties are fully integrated with the stations below, people can travel to and fro without being exposed to unfavourable weather and transport conditions as their places of work, home or leisure are situated directly above major transport hubs. This business model brings benefits in at least two ways. Firstly, it allows the rail operator to earn income from property related businesses which can be used to subsidise its rail business or any future expansion of rail lines. Secondly, it also brings comfort to its passengers or people living and working in these properties as it helps to facilitate their daily travel.

The rail + property business model is now well recognised throughout the world and is being introduced in many countries by the Hong Kong MTR where the Corporation provides rail related consultancy businesses in many cities around the world such as Shanghai and Shenzhen in Mainland China. However, Dr. Glenn Frommer of the MTR argues that such a business model is not necessarily ideal for rail operators in other metropolitan areas. Such a business model would only work if the majority population of that city (like Hong Kong) prefer to live within the convenience of the urban areas nearby railway stations. For example, such a model may not work in Europe or North America where people prefer to live in the tranquillity of the countryside or suburbs and would rather enjoy driving as a mean of commuting.

Neither would such a business model work in a city where land and property prices are already very high. According to Dr. Glenn Frommer, this model works for Hong Kong because:

“...prices (property) in Hong Kong started on a low-base during the late 1970s and early 1980s...”..

Property prices in Hong Kong started to soar in the early 1990s and this allowed the MTR to reap a large return from the model because much of the land was originally acquired and claimed during the era when prices were still relatively low.

However, this business model is not without its criticism. Firstly, there are concerns amongst certain sectors of the society about whether MTR ought to be playing the role of land supplier as its activity may distort property prices in the market. Furthermore, many of its partners are large reputable developers, who already hold significant land banks themselves and there are concerns as to whether that would actually further push up the property prices of Hong Kong, where prices are already one of the highest (if not the highest) in the world.

Yet in defence of this model, Dr. Glenn Frommer argues the benefits which it has brought to MTR and as well as the Hong Kong public. This is because transport network is about developing resource capital and in the case of MTR that would be land:

“...by giving us property and development rights...allows more investment to fit the development of railway. It provides initial capital injection for future development and expansion...and as the value of property increases, it helps to pay off railway capital cost”.

This is also evident by the comfort and convenience which it has brought to its passengers.

b). Octopus Smartcard System

In trying to achieve its vision by making Hong Kong a “fast track world class city”, MTR realizes that it must make travelling on its trains as fast and convenient as possible for its

passengers as this helps to reduce crowdedness and congestion during rush hours. The result was the eventual launch of the Octopus Smartcard System.

As far back as 1992, the MTR Corporation Limited took the lead in reviewing its fully automatic fare collection technology and looked at devising a future development strategy for the next decade. After extensive research, contact-less smartcard technology was subsequently recognised as the most appropriate platform for future systems. In 1994, the MTR together with four other major public transport operators of Hong Kong established a joint venture, Creative Star Limited (which was renamed Octopus Cards Limited in 2002) to oversee the contact-less smartcard system's development and implementation.

The Octopus Smartcard System was eventually launched in 1997, allowing commuters to travel on six different public transport systems using one single card, bringing the benefit of eliminating the inconvenience of finding exact change for individual journeys, thus saving time for both passengers and staffs. Today, Octopus Card can be used in almost all Hong Kong's transportation systems and also retail outlets, wet markets, self-service businesses, leisure facilities, schools, parking and access control.

Today the Octopus Cards Limited is a private company owned partly by the MTR with other major transport operators in Hong Kong and the company's mission and core values are very similar to the ones promoted by the MTR:

Mission

“To make life easier for customers by applying innovative ideas through secure and robust technology”.

Core Values

“Create a trusting and encouraging environment for customers, staff and shareholders whereby we can communicate, collaborate, share and support each other as equal partners.

Continuously innovate, seeking better ways to conduct business and creating new opportunities.

Striving to delight customers whenever they encounter Octopus”.

Since its launch in September 1997, 12 million Octopus cards are in circulation. As of May 2005, 8.7 million transactions are processed everyday, amounting to almost HK\$60 million (£4.5 million), smartcards are used by more than 95% of the Hong Kong population. Today, over 300 service providers accept Octopus and new uses are regularly being added. In the past few years, Octopus has gone from strength to strength with its superior operations and continuous innovations, earning it a global reputation and setting an exemplary model for overseas counterparts. It is now the world’s leading and most extensive smartcard system with the highest penetration, the highest transaction volume and the widest scope of applications.

Furthermore, the Octopus System has also won international acknowledgement and according to the MTR Sustainability Report 2003, MTR and Octopus together secured a series of contracts with Thales to create an Automatic Fare Collection (AFC) system in the Netherlands. The two companies will work with the East-West Consortium to provide a software system as well as expertise in the operation of a new public transport e-ticketing system. The new system is the first in the world to be implemented on a national scale and will offer integrated travel covering all modes of public transport including train, bus tram, metro and ferry. The first phase for the Rotterdam area was planned for September 2004. The Chief Executive Officer (CEO) of Octopus Cards Limited, Eric Tai, claims that, “Octopus’ success is important to Hong Kong and we will continue to build our service, making life easier and simpler for our customers, here and around the world”.

Likewise, MTR's Sustainability Development Manager, Dr. Glenn Frommer also shares the same view:

“...the smartcard (Octopus) is not just a product of the MTR...its perhaps the most innovative technology this city (Hong Kong) has ever created and the whole society is enjoying the fruits of it...”.

The Octopus Smartcard System illustrates the importance and success which R&D (Research & Development) brings to an organization, in terms of customer satisfaction. Many researches have been conducted in the past as to the benefits which R&D brings to a company. For example, a research conducted by Griffin and Page²⁹⁰ shows that business practitioners use about four measures from a total of two different dimensions, most frequently customer acceptance and financial performance as paramount. This was later confirmed by another research conducted by Hultink and Robben²⁹¹, who found that companies regard four factors as being equally important for measuring the short-term and long-term success of a new product. They include customer satisfaction, customer acceptance, meeting quality guidelines, and product performance level. In particular, customer satisfaction/acceptance was found to be the most important measure for both the short and long terms²⁹².

Based on the above findings, it can be said that the MTR has been relatively successful in developing and launching its product because the smartcard system is very widely accepted by customers since it is now used by more than 95% of the Hong Kong population. By investing in R&D, the MTR has brought satisfaction and convenience to its customers (or passengers), facilitating travelling and shopping, and at the same time it has also brought the company businesses worldwide and financial success for its joint-venture company.

²⁹⁰Griffin & Page, “An Interim Report on Measuring Product Development Success and Failure”.
Journal of Product Innovation Management, 1993, Vol. 10, No. 4, 291-308.

²⁹¹Hultink & Robben, “Measuring New Product Success: The Difference that Time Perspective Makes”.
Journal of Product Innovation Management, 1995, Vol. 12, No. 5, 392-405.

²⁹²Ibid, at 400.

c). Services Quality & Safety

The MTR realises the importance of providing safe and comfortable travel for its passengers. The advantage of the metro system like MTR, is that it is unaffected by road traffic or weather conditions. MTR trains run 19 hours a day, 7 days a week, from 6 am to 1 am. During rush hours passengers only need to wait 2 to 3 minutes on major lines, this makes stations and trains less crowded and helps to shorten the travelling time of passengers.

The company has designed a Customer Service Pledge with demanding quantitative targets and conducts passenger surveys regularly in order to find out their needs. In 2003/04, it conducted more than 30,000 individual questionnaires and they have shown that the three most important factors for passengers are train headway (time between trains), safety and reliability. According to its Sustainability Report 2003, the company achieved all 12 of its Customer Service Pledges over the course of 2001, 2002, 2003 and 2004. For example, in 2004, it set a Customer service pledge target of 99% train punctuality for its major rail lines and airport express line, and the actual performance were 99.7% and 99.9% respectively.

Although the abovementioned targets were set by the MTR themselves based on the practical reality of the Hong Kong transport environment, yet on an international basis, the company's targets are consistent (if not better) than the benchmark set by the CoMET Group for performance and sustainability, which is a programme of international railway benchmarking consisting of twelve of the world's largest metropolitan railways²⁹³. In 2003, the MTR was ranked 3rd in 11 of the 25 CoMET key performance indicators. The company's safety standards also continue to improve against its own internal targets. In 2003, there were 7 fatalities amongst its passengers caused by suicides, trespass on tracks, passengers' own medical conditions and accident in escalator. However, in 2004, the number of passenger fatalities fell to 3, who

²⁹³ <http://www.comet-metros.org/>

committed suicide on the network. No accidents resulting in fatalities among passengers, staff or contractors occurred. In order to reduce fatality rate further, the company has installed screen doors on its platforms and this is expected to reduce suicide attempts and track trespassing.

The company has introduced a health and safety code of conduct, consisting of 10 safety objectives, a customer safety campaign, on-site training programmes and contractual compliance procedures. These are devised and managed through a hierarchy of committees that start with the Executive Directorate policy committee which I have just mentioned earlier. They are subsequently imposed through a seven-step cyclic management process to implement, monitor and audit procedures with a view to improvement on a continuous basis.

3). Community/Environment as Stakeholder

In the previous sections, I have examined how the MTR manages its relationship with its employees and customers. For this section, I shall turn the focus on MTR corporate policies with regards to the environment and what actions the company take (or has taken) in managing its relationship with local communities.

a). Environmental Management System

The Hong Kong MTR realises that the operation of its business is highly environmentally sensitive as it is one of the city's major public transport provider. Recall that the company's vision is to make Hong Kong into a "fast track world class city", the company believes that it has a responsibility to make a significant contribution towards reducing traffic congestion, noise and air emissions in a densely populated city like Hong Kong.

Environmental responsibility is a top priority for the MTR which starts at the highest level and cascades down throughout the company where staff are made to understand their own responsibilities to assist the company in achieving its environmental targets.

Back in 1997, the company initiated the development of a corporate-wide Environmental Management System (EMS) in order to ensure that all environmental impacts were controlled and monitored. In 2002, the company further developed its EMS to meet the requirements of the international ISO14001 environmental management system standard. In March 2003, the MTR was able to receive the ISO14001 certification for “provision of railway project management, operation, maintenance and relevant administrative services”, and has maintained this certificate during the course of 2003²⁹⁴. The company’s ISO14001-certified EMS is distinctive in the sense that environmental risks are identified and prioritised by its risk management system which I have mentioned earlier, through what is referred to as a “bottom-up approach” through a series of workshops involving more than 200 staff from across Project and Operation Divisions. Furthermore, the system is based on a set of challenging, quantitative targets, which are designed to improve performance. They are supported by detailed action plans defining responsibilities and timescales.

Apart from Hong Kong, the MTR has also introduced its EMS (Environmental Management System) initiative in its overseas operations in emerging markets where the concept is relatively new. Since 2002, MTR has established a joint venture company, Shanghai Hong Kong Metro Construction Management Co. Ltd. (SHKMCM) to undertake project management of railway construction projects in Shanghai, Mainland China. As an attempt to bring best practices to the project, an Environmental Impact Assessment Report (EIAR) was undertaken by the lead engineering consultant and the Environmental Research Institute during the design

²⁹⁴Stated scope of ISO14001 Certificate.

stage. The EIAR was submitted to both the Chinese National and Shanghai Environmental Protection Bureaus for assessment and approval. During construction, regular environmental inspections will be carried out to ensure the works are executed in a manner which meets the requirements of the local regulations and the EIA. The success of this initiative is important not just for the MTR in achieving its environmental target, but it is also a sign of contribution by the company to less-developed societies by leveraging its expertise in systems, procedures and accountability in managing environmental impacts, helping the economy to achieve sustainability in its development.

b). Legal Compliance

The MTR complies strictly with the legal requirements of Hong Kong when it comes to environmental protection. It is committed to take actions beyond the “bare minimum” by cooperating with the relevant governmental department.

For example, the company has agreed with the Environmental Protection Department of Hong Kong on an annual program of monitoring noise levels at 25 locations along its railway lines to ensure compliance. According to its Sustainability Report 2003, the company received 51 complaints from local residents regarding its noise level, and each warning and complaint was investigated through ad-hoc monitoring with appropriate corrective actions taken if noise levels proved higher than limits imposed by the Hong Kong Noise Control Ordinance. In its Sustainability Report 2004, the company reports an improvement in its noise level performance over the previous year. During 2004, no noise abatement prosecutions were brought against the company and the internal self-monitoring results achieved 97% within the criteria set out under the Noise Control Ordinance. The company’s Sustainability Manager argues that this is a very high compliance target because it is impossible for train operator to attain 100% criteria

fulfilment of the Ordinance due to the nature of its business: "...unless you are telling me no train should run in the city...".

In a similar project with the Environmental Protection Department, the MTR has also instituted self-monitoring of wastewater discharge at 153 designated discharge points. This enables corrective actions to be taken in a timely fashion to achieve compliance with the water discharge licences issued by the Environmental Protection Department. In 2004, the company managed to achieve a 97% rate of discharge limits at its designated discharge points and in a further move towards improvement, the company also initiated a program that substantially reduces water consumption through the introduction of automatic taps at selected maintenance stations.

c). Energy Conservation and Efficiency

With average daily passengers of 2.4 million, the MTR is one of the greatest energy users of the city. Electricity is one of the company's most significant direct operating costs. As a result, the company has pursued cheaper and more efficient ways of operating. During the year 2003/04, the company developed Hong Kong's first hybrid solar and wind power turbine to run the streetlights at one of the company's largest train depots. Electricity generated during the day is stored in a retired locomotive lead-acid battery powerful enough to operate the streetlights of the depot for several years. This project allowed the company to eliminate the need for additional cable installation, and the company saves 3,504 kWh/year and more than 2,000 kg of carbon dioxide in greenhouse gas emissions annually. Although this is a small project, yet it is nevertheless an innovative step in the pursuit of renewable resources into their operations,

enabling the company to save operational costs and yet at the same time contribute towards environmental protection.

d). Community Engagement

In Hong Kong, there are a few areas where the government would require companies to take into the interest of local communities. For example, the government has a Town Planning Board made up of experts from relevant fields which is responsible for granting planning or development permission. One condition is that the developer is required to take account of community benefits such as traffic and pollution level. However, according to Community Business, an NGO based in Hong Kong, in general large companies rarely take account of community interests in their decision-making process. This is because most companies follow the traditional shareholder model approach where the ultimate goal of the business is profit maximization and increasing shareholders' value²⁹⁵.

As the population of Hong Kong continues to increase, there shall be more railway projects and extensions in the next few years, however, some of these extensions are not without controversies. In 2002, the KCR (another major rail operator of Hong Kong) had one of its rail extension project rejected due to its location. The extension would cross over the Mai Po Marshland, in the outskirts of Hong Kong, which is a conservatory zone providing natural habitat for migratory birds from northern China during the winter months. The project was heavily criticised by various green groups and was eventually rejected by the Environmental Protection Department of Hong Kong on the ground that it would damage the ecological cycle of the surroundings. Dr. Glenn Frommer of the the MTR argues that the reason why KCR had its project rejected is due to communication failure:

²⁹⁵<http://www.communitybusiness.org.hk>

“...the KCR neglected many of its stakeholders over the consultation process...”.

In learning from that experience, the MTR takes a more inclusive approach in its planning process. Since 2003, the MTR has been engaged in two major projects in Hong Kong, the Tung Chung Cable Car Project, and the West Island & South Island Line Projects and we shall now look at how various stakeholders and communities are (were) being involved:²⁹⁶

(i). Tung Chung Cable Car Project:

This project is one that is in keeping with the theme of sustainable tourism which is currently being promoted by the HKTA (Hong Kong Tourism Association). The project comprised construction of a cable car system between Tung Chung and Ngong Ping, one of Hong Kong’s most popular tourist spots. MTR has focused on public involvement right from the start. The company engaged in consultations with key green groups Green Power, Friends of the Earth, the WWF (Worldwide Fund for Nature) and relevant Government Departments.

All parties were provided with working papers and the draft EIA and their comments were taken on board throughout the Study. MTR argues that the key objective of consulting these groups is to ensure smooth running of the project by avoiding conflicts. One successful example which benefited from this consultation is the diversion of a stream course. At the Ngong Ping terminal site a stream course runs through the site boundary and was initially considered to be a highlight of the Theme Village. Observations over a long period of time indicated that the water course was stressed through the effects of pollution primarily from domestic sources and would pose a health and safety risk to the public. As a consequence of

²⁹⁶The Tung Chung Cable Car Project was fully completed in mid 2006 and is currently in operation.

MTR's briefing, the Green groups raised their concerns to Government that MTR was not following the correct procedures. In response MTR applied directly to the Environmental Protection Department and obtained an Environmental Permit for this diversion.

MTR also provided the findings from these consultations to the Sustainability Advisory Board (SAB) which is run by Hong Kong University. The SAB comprised of 16 government departments, the Po Lin Monastery (a key tourist spot of the local area) and green groups and was responsible for producing annual sustainability reports for the Tung Chung Cable car project. The SAB also focused on longer-term development and sustainability of the Ngong Ping tourism industry.

(ii). West Island & South Island Line Projects

The proposed Western and Southern Island lines consist of 11 planned stations and 16.2 rail km. serving nine regional districts. The public consultation exercise was conducted in conjunction with the Feasibility study. Views from the public have been considered and where appropriate, incorporated into the scheme being developed.

The Key parties consulted during the Feasibility Study included the District councils where the railway will be serving, Legislative Council Transport Panel, professional bodies such as the Hong Kong Institute of Planners and other statutory bodies such as the Advisory Council on the Environment (ACE) and the Town Planning Board.

MTR argues that most of the parties consulted expressed their support for the project. Many of them gave their views on railway alignment, station locations, interchange arrangement, inter-modal co-ordination, fares and funding. Some also expressed concerns on the possible impacts of the railway during construction and operation phases. As a result of the continuing

public involvement, the majority of the new railway lines are underground with most stations constructed as rock caverns to minimize the environmental impacts during construction.

The public consultation exercise will continue after submission of the Project Proposal²⁹⁷. MTR will report back to the consulted parties and stakeholders on the latest proposed scheme of the project.

The company firmly believes that this exercise has provided a “better railway project”, will enable an earlier public endorsement of the proposal and will pave the way for early implementation of the project, which the company believes is the “most important demand” of the residents of Western and Southern Districts. The company has also pledged that when the projects are underway, a sustainability advisory committee, based on the SAB model used for the Tung Chung Cable Car Project, will be established to keep the community involved and active in the development of these lines.

e). Factors influencing environmental/community engagement

The abovementioned examples and cases illustrate the MTR believes that environmental and community engagement ought to be given a high priority in its decision-making process and operation, and there are many factors why this may be the case.

According to Fineman and Clarke²⁹⁸, there are four broad interest-sets that can influence an industry’s response towards environmental protection²⁹⁹. The first is represented by bodies whose manifest mission is to care for the planet. These include national or local green pressure groups and high profile individual champions in society. Together, they pressurize companies to

²⁹⁷The proposal was submitted in 2006.

²⁹⁸Fineman & Clarke, “Green Stakeholders: Industry Interpretations and Response”.
Journal of Management Studies 1994, Vol. 33, No. 6, 715-730.

²⁹⁹Ibid, at pp. 716-717.

act responsibly towards the environment ranging from methods of conservative persuasion to direct confrontation. The second area is regulatory. A regulator can apply environmental law to protect society from the environmental harm that may be created if industries were unregulated. Typically, regulators seek industry's compliance with legislative requirements through either coercive or negotiative means.

The third factor comes from those who have an indirect interest in industry's environmental performance. They may not sponsor environmental protection as an end in itself, but are happy to enjoy the rewards of greener services, process or products if they serve their own needs or profits. In this group we may find shareholders/institutional investors, banks, who may gain from the economic attractiveness of a green industry, customers who prefer to buy "green" and even suppliers whose environmental reputation could be enhanced by dealing with that particular organization.

Lastly, there are the "internal stakeholders". These include corporate officers in industry whose role includes environmental work, such as CEO, environmental managers, public relations managers, production and marketing, and legal personnel.

In the case of MTR, all of the factors mentioned above have played their roles in influencing the company's policy and practice towards environmental protection. Firstly, there are the green pressure groups who constantly lobby the company and the government with regards to the environmental impact which MTR's projects can bring. Even MTR itself acknowledges that by including such groups in its consultation process and Sustainability Advisory Board would avoid the mistake committed by another rail operator, KCR, which I mentioned earlier, where the project was rejected due to environmental concern. Furthermore.

involvement by green groups can also enable an earlier public endorsement of the proposal and will pave the way for early implementation of the project.

Secondly, there is the regulator i.e. the Hong Kong Government. There are environmental legislations which the MTR needs to comply with in its operation such as the Noise Control Ordinance and Waste Disposal Ordinance which were mentioned earlier. The company cooperates with the Environmental Protection Department in a number of joint projects to minimize the environmental impact which its operation may bring. Thirdly, there are the customers or passengers of the MTR i.e. the general public. As the overall living standard and education level of Hong Kong have significantly increased, people are more conscious of their health and quality of life. They prefer to travel on transportations that are safe, comfortable and at the same time environmentally friendly.

Lastly, the “internal stakeholders” of the company also play an important role on this issue. For example, the interviewee of this case study, Dr. Glenn Frommer, who is the Sustainability Development Manager of the company, responsible for promoting the company’s sustainable development policies, CSR (Corporate Social Responsibility) and stakeholder engagement. Internally, the company has also developed a culture of considering wider stakeholder interests in its operation, which Dr. Glenn Frommer put it:

“...MTR does what it does because it’s the right thing to do...transparency also requires the company to report on these issues...”.

During 2004/05, Chan and Welford of the Corporate Environmental Governance Programme, University of Hong Kong, conducted a research on the awareness of Hong Kong listed companies of current trends of corporate environmental management³⁰⁰. A total of 219

³⁰⁰Chan & Welford, “Assessing Corporate Environmental Risk in China: An Evaluation of Reporting Activities of Hong Kong Listed Enterprises”.
Corporate Social Responsibility and Environmental Management 2005, Vol. 12, No. 2, 88-104.

companies listed in Hong Kong were studied, all of them with businesses based in either Hong Kong or Mainland China. The findings of the study illustrate that in general, Hong Kong listed companies have failed to provide sufficient information for investors (or potential investors) to assess their positions with respect to environmental management and this increases their significant risks of possible accusations of poor environmental performance³⁰¹.

Further, the research shows that the Hong Kong MTR is the only company studied that published an annual sustainability report with reference to the Global Reporting Initiative (GRI)³⁰². The report argues that one fundamental reason for the lack of environmental disclosure is that environmental reporting was incompatible with the traditional financial accounting system, which is mainly based on costs in monetary terms, and that environmental data is not wholly compatible with financial accounting.

However, the study by Chan and Welford urges Hong Kong market regulators and the government to improve corporate environmental disclosure in the long term as this would eventually benefit both companies and Hong Kong, as the region's major financial centre:

“...environmental performers and underperformers will eventually be rewarded and punished respectively by China's (as well as Hong Kong) civil society. Ultimately, environmental practices will benefit those companies that are most proactive. The most successful enterprises in China are going to be at the cutting edge of environmental responsibility and transparency. Like it or not, over time, across the whole of China, as the move towards more open and free markets is developed the central government will also have to take action. The risks of not doing so are so serious that action needs to be taken at the highest possible levels. When this happens, companies that are currently environmentally negligent are going to face some serious risks”³⁰³.

Companies perceived as environmentally negligent have witnessed accusations of mismanagement and recklessness and, in turn, the marketability of their products or services has diminished. A considerable group of investors has started to consider sound environmental

³⁰¹Ibid, at 88 & 102.

³⁰²Ibid, at 98.

³⁰³Ibid, at 102.

management as a vital part of good corporate governance, which contradicts the narrow objective of profit maximization at the expenses of the communities and environments.

By having a sound environmental management system as abovementioned, the Hong Kong MTR has benefited in two ways. Firstly, it has established itself as an environmentally responsible company by “doing things which it thinks is right”. Secondly, it may also give the company an extra competitive edge in the long term attracting investment from a growing number of institutional investors who reward companies based on sustainability and social responsibility.

4). Financial Performance & Shareholders' Interest

In the previous sections, I have explored how the MTR manage its relationship with three main groups of stakeholders – (i).workers; (ii).customers, and (iii).community/environment.

However, it must be noted that the MTR is a publicly listed company of the Hong Kong Stock Exchange with a large number of retail and institutional investors. Therefore, the interests of shareholders are just as important as the other three stakeholder groups mentioned above. This is because a company must be able to bring in capital investments if it is to survive. Investors would only be willing to commit their stakes into a company if the company has a sound economic performance and a healthy of financial return. In this section, I shall focus on the overall economic performance of the MTR and how it responses to the needs of its shareholders.

a). Corporate Economic Structure

The MTR operates under a unique hybrid business model, providing the need for public transport infrastructure, yet at the same time operating as a commercial organization. Apart from

generating its income from normal fare collections, the company also derives its revenue streams from the financial opportunity of development rights to those properties attached to the rail infrastructure. This is also referred as the “rail + property” business model, which was mentioned earlier in greater details. As such, the model has enabled the company to operate as a profitable business where proceeds earned from property development can be used to subsidise development or extension of its railway.

The MTR became a publicly listed company on the Hong Kong Stock Exchange in October 2000 and was subsequently included in the local Hang Seng Index, which represents Hong Kong’s 33 blue chip companies. Today, the company is a member of the Morgan Stanley Composite Index (MSCI) and FTSE All-World Hong Kong Indices as the Dow Jones Sustainability Index, FTSE4Good and the Ethibel Stock Indices. As of 31 December 2004, the company’s market capitalization was approximately HK\$66,000 million (approx. US\$8,000 million) and the company is ranked No. 15 in the Hong Kong Stock Exchange. As of the end of 2004, 76% of the company’s shares are held by the Government of Hong Kong and the remaining 24% are privately held. Amongst the 24%, there are more than 380,000 retail investors and a few major institutional investors which we shall look at later in greater details.

The MTR operates under prudent financial principles and is committed to high financial transparency. The company won a “Silver Award” for its 2002 Annual Report in the General Category in the “2003 Best Annual Reports Competition” organised by the Hong Kong Management Association. This marked the 15th consecutive year since 1988 that MTR received such recognition. The report also won the Bronze Award in the “Overall Annual Report Category” amongst transport companies at the International Academy Awards of Annual Reports

Awards” in New York organized by the International Academy of Communications Arts & Sciences³⁰⁴.

Figure 1 on the next page shows a summary of the MTR financial and operational statistics for the years between 1999 and 2004³⁰⁵. The focus of this thesis shall be on the statistics between 2000 and 2004 since the company became listed in the year 2000. The statistics illustrate that the company’s turnover has risen from HK\$ 7,577 million in the year 2000 to HK\$ 8,351 million in the year 2004. At the same time, profit has also risen from HK\$ 4,069 million to HK\$ 4,496 million. Its earnings per share have remained constant lying between HK\$ 0.7 and HK\$ 0.84.

	2004	2003	2002	2001	2000	1999
Financial						
Profit & loss account (in HK\$ million)						
Turnover	8,351	7,594	7,686	7,592	7,577	7,252
Operating profit before depreciation	9,114	9,116	7,769	7,301	7,290	5,523
Depreciation	2,512	2,402	2,470	2,178	2,091	2,039
Interest & Finance charges	1,450	1,539	1,125	874	1,143	1,104
Profit	4,496	4,450	3,579	4,278	4,069	2,116
Dividend proposed & declared	2,259	2,215	2,161	2,118	500	0
Earnings per share (in HK\$)	0.84	0.85	0.70	0.85	0.81	0.42
Balance Sheet (in HK\$ million)						
Total assets	106,674	102,366	101,119	98,126	92,565	87,250
Loans	20,378	32,025	33,508	31,385	27,203	23,177
Deferred income	4,638	5,061	6,226	8,411	10,403	13,776
Shareholders' funds	63,499	57,292	53,574	53,893	50,355	45,115
Financial ratios (in percentage)						
Operating margin	54.40	49.30	52.20	53.40	51.70	48.20
Non-fare revenue as a percentage of turnover	29.00	27.70	25.60	24.60	24.60	22.20
Gross debt-to-equity ratio	47.80	55.90	62.50	58.20	54.00	51.40
Gross debt-to-equity ratio (excl. revaluation reserves)	56.20	63.30	71.10	66.40	62.20	58.50
Interest cover in times	6.10	5.60	4.50	3.80	3.80	3.70

Fig. 1

³⁰⁴Source: MTR Corporation Sustainability Report 2003, p. 58.

³⁰⁵Source: MTR Annual Report 2004, p. 54-55.

The company's balance sheet has also performed well between 2000 and 2004. There has been a constant increase in the value of its total assets and shareholders' fund during those periods. Financially, the company has performed well since its Initial Public Offering (IPO) in 2000, despite the fact that the Hong Kong economy itself was in a severe recession and the equity market in a bear market situation, between 2000 and 2003.

Since listing in 2000 and until the latest financial year (2004), the company's share price has outperformed the local Hang Seng Index and returned to shareholders an average of 9.8%. Meanwhile, it consistently pays dividends and in 2004 announced a full-year dividend of HK\$ 0.42 (just above US\$ 0.05) per share, more or less on par with previous years:³⁰⁶

Summary of MTR's Total Shareholder Return (2000-2003):

	MTR Corp Total Shareholder Return	Hang Seng Index
Total Shareholder return (from IPO 2000 to 31 Dec 2003)	HK\$ 2.23 per share	- 2,464.699 HSI Points
Total Shareholder return (from IPO 2000 to 31 Dec 2003) in %	23.8%	-15.23%
Total Shareholder return (from IPO 2000 to 31 Dec 2003) Annual Equivalent	6.8%	-5.0%

Fig. 2a

Summary of MTR's Total Shareholder Return (2000-2004):

³⁰⁶Sources: MTR Sustainability Report 2003, p. 57.
MTR Sustainability Report 2004, p.35.

	MTR Corp Total Shareholder Return	Hang Seng Index
Total Shareholder return as a %	48.7%	-2.35%
Total Shareholder return annual equivalent	9.8%	-0.6%

Fig. 2b

Figures 2a and 2b above illustrate the company's shareholders' return since its IPO for the years 2000 to 2003 and 2000 to 2004. During the peak of the economic recession and bear market between 2000 and 2003, the local Hang Seng Index lost over 2,400 points and a total shareholder return of -15% and -5% respectively. Even when the market started to recover in 2004, the local index still had a total shareholder return of -2.35% and -0.6%.

However, in contrast, during the peak of the recession (2000 to 2003), the MTR still had a shareholder return of 23.8% and 6.8% respectively. When the market recovered in 2004, the total shareholder return of the company was an astonishing 48.7%, giving it an average shareholder return of 9.8% between the year 2000 and 2004.

The above figures show that shares of the MTR have outperformed the local market since its IPO. This stresses the point that the organization operates under prudent financial principles that generate reasonable level of return for its shareholders despite the bear market suffered by the overall economy, and this is a performance which the company itself is very proud of:

“...outperforming by 10% of the Hang Seng since IPO is very substantial...showing full shareholder value...”

(Dr. Glenn Frommer of the Hong Kong MTR).

In recognising the company's commitment to economic sustainability the MTR's Sustainability Report 2003 and 2004 have won the ACCA Hong Kong Best Sustainability Report award for two consecutive years. The aims of the ACCA Hong Kong Awards for Sustainability

Reporting are to encourage and recognise those organizations which report and disclose environmental, social or full sustainability information³⁰⁷. This further proves how committed the company is in promoting sustainability, which provide values for its other stakeholders (employees, customers and the community) and yet at the same time pursue a business model which nurtures long-term economic and financial viability for itself and its shareholders.

b). Impact of Institutional Investors

The company also maintain a good relationship with its main institutional investors. One of the MTR major institutional investor is Calpers (California Public Employees' Retirement System), which is the largest American public pension fund, with over US\$ 100 billion in assets worldwide. The beneficiaries of the Calpers Trust Fund are one million plus public servants of California and their families, and the 13 member Board of the Trust has the duty to assure Calpers members that their retirement benefits are safe.

The fact that Calpers have invested their funds in the MTRC is a vote of confidence for the company. This is because Calpers are highly selective of its investment and that a company must meet certain requirements in order to win the trust fund support. Accordingly, when Calpers invest in a company that is outside the United States, that company must meet the fund's "Global Principles of Corporate Governance", which entail:³⁰⁸ (i).**Accountability**; (ii).**Transparency**; (iii).**Equity/Fairness**; (iv)**Voting Methods (Proper Voting)**; (v).**Adherence to local Codes of Best Practices**; and (vi).**Long-term Vision**.

³⁰⁷For further details on this award please refer to the ACCA Hong Kong website:
<http://www.accaglobal.com/sustainability/awards/hkera/>

³⁰⁸<http://www.calpers.gov.ca>

More recently, Calpers have also been actively involved in Socially Responsible Investment (SRI), focusing on companies' social and environmental performance as a measure in enhancing shareholder value.

The fact that Calpers is a major institutional investor of the MTRC is also beneficial to the company itself because it disciplines management to perform better, enhancing both corporate transparency and sustainability, as Dr. Glenn Frommer put it:

“...they (Calpers) help by bringing in new management concepts to a company making changes...so their values are our values too...this benefits ordinary shareholders as well in the long term...”.

4). Views from stakeholder group

In the previous sections, I have looked at how the company itself defines corporate stakeholder engagement and how it is being practiced on a daily basis. Yet they are only views expressed by the company and in order to avoid bias, I have managed to gather an alternative view from another stakeholder group as to how they define corporate stakeholder engagement and whether or not they differ from the company. I managed to conduct an interview with an organization called **Community Business**, which is a non-profitable organization that specialises in the research of Corporate Social Responsibility and stakeholder engagement in Hong Kong.

The underlying rationale for selecting this particular organization for my research is because it is one of the leading CSR organizations in the territory. In particular, it works with many large Hong Kong based corporations to develop and implement strategy and policy as well as promote community investment and diversity initiatives. Furthermore, it also launched the **Hong Kong CSR Charter** in September 2005, which was signed up by many large corporations in Hong Kong, including the Mass Transit Corporation (MTR), which is the case-study company

that is being studied here. Therefore, this makes Community Business an ideal NGO to be interviewed since it can comment on the CSR practices of the company that is being studied.

The person whom I interviewed was Shalini Mahtani, who is the founder and CEO of Community Business Hong Kong. The first question which I asked her was how she and her organization define corporate stakeholder engagement and good CSR practice. According to her, good stakeholder engagement is about “open and transparent” process and dialogue with the primary stakeholders of the company. This would of course depend on company to company as to who their stakeholders are:

“...A good CSR practice would take into account the view of the stakeholders and the process of looking what good CSR should be such as work-life balance. Stakeholder engagement is not a cocoon which is developed by a few members of senior management...”.

According to Ms. Mahtani, on a scale of 1 to 10 (1 being the lowest and 10 being the highest), companies in Hong Kong generally score pretty low on stakeholder engagement in their decision-making processes, approximately a 2 or 3 out of 10. This is because Hong Kong companies do not see and benefit in stakeholder dialogue. Companies in Hong Kong do not have any external pressure in engaging stakeholder dialogue with the community, customers or even investors. More importantly, some companies just see CSR as mere “philanthropic giving”.

As mentioned earlier, Community Business has collaborated with many large corporations in Hong Kong to promote CSR and stakeholder engagement, and the Hong Kong MTR is one of them. Shalini Mahtani believes that companies like the MTR are leading in terms of CSR and stakeholder engagement. According to Ms. Mahtani, the Hong Kong MTR is probably the only company in Hong Kong to produce an annual sustainability report and has been voted as one of the best in the world:

“...They are open about their reports, the good and the bad. They report to their stakeholders about what they do in their sustainability report. Secondly, they are big in their leadership. I have a leadership team on CSR from senior members of various companies and the head of this leadership team is the MD (managing director) of the MTR. I have worked with many members of the MTR and their social and environmental values are fundamental to their group. Finally, it is about their engagement. The best example is the building of the Ngong Ping Cable Car and the number of people they have engaged in their decision-making process (per Shalini Mahtani)...”.

However, one of the concerns which the public have is that even if a company claims that it is highly committed to CSR and stakeholder engagement, the community in general may feel uncertain as to whether the company is genuine or just merely doing it as a marketing or publicity gimmick. This is because as mentioned earlier, in many developed societies such as Western Europe, only about a third of the people who surveyed trust large corporations or multinationals³⁰⁹. Community Business Hong Kong acknowledges that there is such concern, yet it believes that a distinction can be made between genuine practices and merely publicity stunts. According to Ms. Mahtani, if a company is just interested in their publicity it would not need to go that far:

“...they would just simply go and sponsor or pump money in an environmental program for example. You see that all the time here in Hong Kong or all over the world...”.

Ms. Mahtani believes that companies like the MTR do not do that. It is about the way how they conduct their operation and engaging stakeholders in the process and the MTR does that well in comparison to other large companies in Hong Kong.

Furthermore, as I mentioned earlier, many companies are realizing that collaborating with NGOs or non-profitable organizations can benefit themselves because this would enable them to gain wider legitimacy and acknowledgement amongst the general public with their activities. In response to such trend, Community Business Hong Kong launched the **Hong Kong Corporate**

³⁰⁹Supra n. 225

Social Responsibility Charter in September 2005 in collaboration with many businesses in Hong Kong. The Charter was not actually developed by Community Business but by the Community Business Leadership Team (CBLT), which is made up of many senior executives of large companies, chaired by the MD (managing director) of the Hong Kong MTR. According to Ms. Mahtani, the objective of the charter is to make a commitment to CSR and that those signatory companies also want to show they are leading in CSR. The charter is to be used as a “tool and guidance” which can be recommended to other businesses.

Summary of Chapter

In the previous sections, I have looked at how the Hong Kong MTR manages its relationship with its major stakeholders, ranging from employees to shareholders. Moreover, I have also gathered views from stakeholder groups such as Community Business on the issue of CSR and how the MTR perform in this aspect.

After analysing/comparing the views expressed by both the MTR and Community Business, it can be seen that the key in promoting good corporate governance is by maintaining transparency and treating each of its stakeholder constituent with respect and equity, as Dr. Glenn Frommer put it: “...treat people with respect it works”. The company believes in the benefit of sustainable development and argues that long-term sustainability means to “survive and thrive”. This view is also consistent with what the NGO group believe in.

In order to promote such objective, the MTR has joined the ASrIA (The Association for Sustainable and Responsible Investment in Asia)³¹⁰. This is a non-profitable, membership association dedicated to promoting corporate responsibility and sustainable investment practice in the Asia Pacific region. ASrIA's members include investment institutions managing over

³¹⁰<http://www.asria.org>

US\$4 trillion in assets. The association's goal is to build market capacity for SRI, providing insightful, up to date and accessible information on the development of SRI in Asia and globally. Furthermore, as abovementioned, the company is also a founding signatory of the **Hong Kong Corporate Social Responsibility Charter** which was launched on 26 September 2005.

The analysis of the HK MTR illustrates many of the benefits which the company's policy has brought to both the community and the financial advantage for the company. In maintaining dialogue and involving other non-shareholding constituents in its decision-making and operational processes, the company has earned the respect of its stakeholders such as employees, customers and the community as a whole. In March 2005, the South China Morning Post, a leading English newspaper in Hong Kong conducted a poll about public perception of large companies. Thirty-three of the biggest publicly listed companies were evaluated according to their standards of corporate governance, contribution to the community, their use of environmentally friendly practices, how well they treated their staff and respect for public opinion and MTR came top of the list.

At the same time, the company has also managed to bring a high-level of profitability for itself and achieved a good level of investment return for its shareholders, despite an overall economic downturn which Hong Kong experienced between 1998 and 2003, as mentioned earlier. The approach adopted by the MTR shows that a balance can be struck between shareholder and non-shareholder interests.

Recall that in the previous chapters, the research question which I have designated for this research is:

“How is it possible for a company to attain healthy financial performance and yet at the same time consider the interests of non-shareholder constituencies in its operation and decision-making?”

From my analysis of the management approach taken by the MTR and external views gathered from other sources, it seems that it is possible for the shareholder and stakeholder model and interests to co-exist in harmony and that in the new millennium, the borderline between shareholder and stakeholder is often fairly thin since their interests can often overlap with each other.

Therefore, as far as the Hong Kong MTR is concerned, the answer to the research question should be positive. That is, the modern corporation is made up of a web of relationship between various constituencies and that good corporate performance should be determined by how well the management balances the different interests of multiple stakeholders.

Chapter 5: Netherlands Case Study

In the previous chapter, I have looked at how the selected case study company in Hong Kong manages its relationship with major stakeholders. For this chapter, I shall shift the focus from Asia-Pacific to Continental Europe. The company which I have selected for this chapter is based in the Netherlands. Over the last decade, the Dutch economy has often been in the headlines and praised for the economic achievement it has made, leading many academics and economists to study features of the so called “Dutch economic-model”.

In this chapter, I shall be looking at how the selected Dutch company manages its relationship with its major stakeholders, and like the previous chapter, I shall begin this chapter by briefly introducing the Dutch economy and its socio-legal system. The rationale for doing so is similar to what I have done for the Hong Kong case study in the previous chapter because the law matters in corporate governance and it also provides an overview and explains why I have selected a Dutch-based company as a case study. I shall then turn to my selected case study company and explore how its relationships with stakeholders are being managed.

The Dutch Economy: Polder Model

The Netherlands became a driving force in global trade and banking during the 17th and 18th centuries. Despite developing a large, European-style safety net over the years, it has maintained its economic openness to the rest of the world, a legacy which originated from its colonial era.

However, during the late 1970s and early 1980s, the economic performance of the Netherlands was so weak that it was often referred to as the ‘Dutch disease’. GDP growth had stagnated and in terms of per capita income, the Dutch had fallen well behind other OECD member countries.

In the election of 1981, a coalition government of Christian Democrats and Conservative Liberals came to power, and realized that something drastically needed to be done in order to turn the nation's economy around. The government knew that in order to take the economy back on its track, it would require the cooperation of both employees and employers and this eventually led to the signing of the Wassenaar Accord.

The Wassenaar Accord was an agreement that was entered into at the end of 1982 between employers, employees and the government. An important part of the agreement was the consent made by the labour unions to lower demands for higher wages as long as high unemployment prevailed³¹¹. In return, the business community agreed to keep executive pay at reasonable levels and not to lay off more workers unless absolutely necessary. The government on the other hand, agreed to continue to provide a safety net for the unemployed, and at the same time control public spending in order to reduce the budget deficit and taxes on businesses.

More than 20 years have passed since the signing of the Accord, and today, the Netherlands is being recognised as a star economy in the European Union. During the late 1990s and early 2000, real GDP increased between 3.5 to 4 percent, with an average inflation rate between 2 and 2.5 percent. The unemployment rate remained low and steady at approximately 3 percent.

The Netherlands contrasts impressively with its larger neighbours such as Germany and France in terms of how well it marshalled its labour market resources in the 1990s. For example, Germany rarely attained even 2 percent annual real GDP growth that decade, and German unemployment consistently flirted with a two-digit percentage. On the other hand, the Netherlands stimulated significant job creation during the first half of the decade, and multiplier

³¹¹Schreuder, "The Polder Model in Dutch Economic and Environmental Planning".
Bulletin of Science, Technology & Society, Vol. 21, No. 4, Aug. 2001, 237-245.

effects from the incomes generated helped enhance the country's subsequent near-boom. The Netherlands' experience is being referred by many as the 'Dutch miracle', a sharp contrast to the 'malaise' which afflicted the economy in the early 1980s.

Despite being a small country with a small population of just 16 million, the Netherlands today has a large and powerful economy. It is the world's 8th largest exporting country, the 6th largest source of investment, and its gross domestic product (GDP) value is the 15th highest in the world, with a GDP per capita of US\$ 27,000³¹².

Many academics and economists attribute the Dutch economic success of the last 20 years to its economic system which is widely regarded as a model based on consensus. Stability is maintained by close and regular contact in the Socio-Economic Council between trade unions, employers and the government. Thus the Dutch economic model is often referred to as the "Polder Model". This requires cooperation between capital, labour, and the state, a model based on consensus building and democratic self-rule³¹³.

The success of the Dutch economy is in fact attributed to its national culture of consensus and cooperation between different parties, a phenomenon unique to the Netherlands. By coordinating its actions with other parties in the society the government can sell its policies more effectively. This is because important social and economic policy shifts in the Netherlands can only be successful in the long run if they are supported by all stakeholders who are affected by the policy change and feel that they are responsible for it³¹⁴.

The above analysis of the Dutch economic model illustrates how a culture of a society can influence its social and economic policy. In the next section, I shall briefly explore some of

³¹²Year 2002 statistic.

³¹³The polder model is rooted in the past but is used as a concept to describe the revival of a corporatist tradition that has been part of Dutch society since the 17th century.

³¹⁴Van der Hoek, "Does the Dutch Model really exist?" *International Advances in Economic Research*, No. 6, 387-403.

the fundamental principles of the Dutch corporate legal framework. I will examine what sort of influence its national culture has in the way how company manage themselves and their relationships with other stakeholders.

Dutch Corporate Legal Framework

The Dutch corporate law has gradually changed during the last two to three decades. Some significant amendments have been made since 2004, in particular since the introduction of the new corporate governance code that came into force on January 1, 2004.

It is not the intention of this thesis to deal at length with the corporate legal framework of the Netherlands. However, the researcher believes that it is important to point out some of the key elements and fundamental principles of Dutch corporate law since this enables comparison to be made with the legal fundamental principles of the common law system where the other two case studies are based.

Types of corporations

Like corporate law of most other jurisdictions, corporations in the Netherlands are conferred with legal personality. Individuals who intend to establish a corporation can either opt for a public limited company, *naamloze vennootschap* (NV), or a private limited company, *besloten vennootschap* (BV). Most statutory rules applying to NVs and BVs are identical. The main differences are, firstly, a BV has to have a minimum capital of at least 18,000 euro, as opposed to 50,000 euro for an NV. Secondly, only a BV is subject to a mandatory share transfer restriction regime to ensure its closed character. Only NVs may issue bearer shares to the public and be listed at a stock exchange³¹⁵.

³¹⁵Meinema, M., "Mandatory and Non-Mandatory Rules in Dutch Corporate Law".

The legislative provisions governing companies in the Netherlands are largely contained in Book 2 of the Dutch Civil Code (*Burgerlijk Wetboek*). Publicly listed companies (NVs) are also subject to the Act on the Supervision of the Securities Trade 1995 (*Wet Toezicht Effectenverkeer*). The 1995 Act contains obligations on filing a prospectus and on disclosing information. The Minister of Finance has also delegated authority to supervise the compliance with the WTE 1995 to the Securities Board of the Netherlands (*Stichting Toezicht Effectenverkeer*). The Securities Board is the body responsible for the supervision of the Disclosure of Major Holdings in Listed Companies Act 1996 (*Wet Melding Zeggenschap 1996*). Both the 1995 and 1996 Acts are based upon European Community Directives. Furthermore, the Securities Board carries out the assessment of licence applications for institutions seeking admission to the Euronext Amsterdam Stock Exchange, as well as the possible withdrawal of a licence. It has the right to impose penalties and administrative fines in case of infringement of the Acts. Companies listed on the Amsterdam Exchange have to comply with its Listing and Issuing Rules. This is supervised by the Euronext NV, which makes decisions upon advice of the Listing and Issuing Rules Advisory Committee. It may remove or suspend a listing.

Principles of Corporate Law

Although the Netherlands is a civil law jurisdiction and company law is codified, yet it is often the case law which gives substance to the statutory provisions. One special feature of Dutch Company law is the importance of the investigation procedure. The Enterprise Chamber or the Supreme Court may order an investigation into the affairs of a company if it believes there are well-grounded reasons to doubt the soundness of the company's policies. Such a request may be

made by shareholders representing at least 10% of the issued share capital, by a trade union whose members are employed by the company or by the advocate-general at the Amsterdam Court of Appeal. Employees' interests are highly regarded within Dutch corporate arrangements and this is also reflected in its company legislation.

Although a large part of its corporate law is considered to be mandatory, yet the court does recognize the freedom of the individual to contract. There is no general statutory provision on shareholder agreements, but like the articles of association, shareholder agreements must not be contrary to mandatory law, public policy and morality. Shareholder agreements have indeed become more popular in private companies as a useful tool for completing the structure and organization.

Corporations as "institutions" and the two-tier board structure

Under Dutch law, a company is not merely perceived as a shareholder's instrument, but an institution where numerous interests come together. They include shareholders, creditors and employees. Such features can be deduced from various statutory provisions. This is particularly the case for the so called "large companies".

In the Netherlands, both private and publicly listed companies can qualify as large companies. This part of the legislation has now been amended. Since October 1, 2004, Book 2 of the Dutch Civil Code requires an NV or BV to file a statement with the competent Chamber of Commerce Trade Register as a large company, if a company has an issued capital of at least €16 million, employs at least a hundred workers by itself or with its subsidiaries and it must have

established a works council (*ondernemingsraad*) pursuant to the Works Council Act (*Wet op de Ondernemingsraden*)³¹⁶.

Unlike the United Kingdom or other economies with an Anglo-American influence where virtually all companies, regardless of size have a single board structure, organizations that qualify as large companies in the Netherlands are obliged to have a two-tier board structure, the management board and the supervisory board. Before October 1, 2004, the members of a Board of Supervisory Directors (*raad van commissarissen*) of a company with a large company regime were co-opted by the Board itself. Since October 2004, this co-option has been replaced by a system in which the General meeting of Shareholders appoint the members of the supervisory board. The supervisory board has the power to appoint and remove executive directors, to adopt annual accounts and its consent is required for certain decisions of the executive board (*raad van bestuur*).

The new process for appointing supervisory board members will require the board to prepare a profile that sets out the size and composition of the supervisory board and the expertise required of its members. The profile will then be submitted to, and discussed with the general meeting of shareholders. When a vacancy occurs, the supervisory board will be required to inform the general meeting of shareholders and the works council of the requirement to fill the vacancy and present the profile that will apply to the vacancy to be filled³¹⁷. Accordingly, the works council and the general meeting of shareholders will be entitled to recommend persons to fill the vacancy. The works council will have an enhanced recommendation right applying to 1/3

³¹⁶Before October 1 2004, the threshold amount of issued capital was 13 million euro.

³¹⁷Van Sint Truiden, "Legislative Comment Netherlands: Company Law – Large Company Regime". *International Company and Commercial Law Review* 2005, Vol. 16, No. 1, 3-5.

of the total number of the supervisory board members. Therefore, the supervisory board must nominate a person recommended by the works council, except under certain circumstances³¹⁸.

The amendments made to the corporate legislation have significantly strengthened the power of the general meeting of shareholders and this is an attempt by the Dutch authority to increase corporate transparency and shareholder activism in order to strengthen the competitiveness of Corporate Netherlands. One new development is that the general meeting of shareholders will have the power, on a vote of non-confidence in the supervisory board as a whole, to dismiss the board in its entirety and with immediate effect. Before October 2004, it was the supervisory board who adopted the annual accounts in companies that were fully subject to the large company regime. Since then, however, the annual accounts are to be adopted by the general meeting of shareholders. Other amendments regarding shareholders' right which have been made include, inter alia, the recommendation and approval of remuneration of both the management and supervisory board members by the general meeting of shareholders.

As mentioned earlier, Dutch corporations are perceived as institutions representing wider interests beyond merely shareholders. This rather inclusive approach towards decision-making is in fact very much embedded in the Dutch culture of consensus and cooperation as mentioned earlier. It is also explicitly reflected in its legislative provisions.

One non-shareholding constituency which has been highly regarded is employees. Even before the introduction of the European Works Council by the European Union, the Netherlands has had legislation recognizing the interests and rights of the Works Council. This is enshrined by the Dutch Works Council Act 1995, which all large companies (NV or BV) are obliged to have. Apart from having an influence on the appointment of supervisory board members as

³¹⁸Either the supervisory board has an expectation that the recommended person will be unsuited for carrying out its duties, or the appointment of the nominated person will result in the board not being properly constituted.

mentioned above, the works council also has the right to give advice to the organization on a catalogue of important decisions which may affect the situation of the employees in events such as merger or take-over decisions, the closing down or transfer of a business or a collective mass dismissal³¹⁹. Article 26 of the Act then stipulates that if the advice is not asked or followed, the works council may challenge the decision at the Enterprise Chamber of the Supreme Court on the grounds that the company could not reasonably have come to this decision, considering all the interests. The Enterprise Chamber is particularly keen on ensuring that the works council is able to give its advice at a time when it may have a real influence on the outcome of the decision. Furthermore, under Article 27 of the Act, the works council has to give its approval to all matters relating to the working conditions in the enterprise. If the approval is denied, the company needs to ask the magistrate court for permission to implement the proposed measure³²⁰.

The Dutch Corporate Governance Code

No analysis of the Dutch corporate legal framework can be complete without mentioning the newly revised Corporate Governance Code that came into force on January 1, 2004. The Code was published in draft form in June 2002, and was subjected to a rigorous public consultation process that resulted in over 257 formal responses from interested parties. It was then refined and improved in view of the responses and was finally unveiled in December 2003.

The former Dutch corporate governance code was based on the 40 recommendations of the Peters Committee in 1997. However, they were considered to have no teeth because companies could apply the guidelines on a voluntary basis and did not have to publish an annual

³¹⁹Art. 25 of the Works Council Act.

³²⁰Workers influence is also derived from the fact that trade unions are authorized to instigate an investigation procedure.

corporate governance statement³²¹. At EU level, the Commission announced an Action Plan to modernise company law and enhance corporate governance within the Union in May 2003. Instead of adhering to one ideal governance structure, the Commission adopted a rather flexible approach to encourage Member States to develop their own national codes.

The development and preparation of this new revised Code was also a response to the corporate scandals that have taken place both internationally and domestically over the past few years³²². The Code is an attempt to restore public trust in the honesty, integrity and transparency of Dutch listed companies. The Code came into force in January 2004, and this is also partly in response to the UK Combined Code which was published in July 2003.

The Dutch Code applies to all companies with a registered office in the Netherlands whose shares or depository receipts for shares are officially listed on a government-recognised stock exchange either in the Netherlands or elsewhere in the world. The Committee has adopted this approach to prevent the scenario where companies could avoid the Code by moving their listing to a different stock exchange³²³.

Many of the principles under the Dutch Code are fairly similar to the UK Combined Code. Like the UK version, companies may choose to depart from the Code under certain circumstances. When the Code was published in draft form, this concept was defined in terms of “comply or explain”, copied from the UK version. However, the Committee eventually decided that it was more appropriate in the local context to use the phrase “apply or explain”. The UK Combined Code focuses extensively on the independence of non-executive directors, likewise,

³²¹Verhoeff, “Corporate Governance In the Netherlands: A Review of the Dutch Corporate Governance Code”.

International Company and Commercial Law Review 2004, Vol. 15, No. 6, 173-179.

³²²The Dutch Grocery Group, Ahold, was involved in €970million accounting loss.

³²³Supra, n. 302, at 174.

the Dutch version also emphasises the importance of maintaining the independence of supervisory board members. It limits the maximum number of supervisory board members to five. The intention is to break through the so called “old boy” network that exists in many Dutch listed companies. Likewise, it also provides that a former management board member cannot be appointed as the chairman of the supervisory board, so as to maintain the independence of the supervisory board.

The Code has only been in effect for a relatively brief period, therefore, it is yet to be seen whether it actually improves the overall corporate governance standard of Dutch companies. Although criticisms have been made of the Code, yet it is not the intention of this thesis to go into details of the critical analysis of the Code. The Code will nevertheless open a new chapter on corporate culture in the Netherlands³²⁴.

As can be seen from the above analysis of the socio-economic structure and corporate legal framework, the Dutch society has many distinctive and unique features as compared with other economies such as the United Kingdom. For the remaining part of this chapter, I shall be analyzing the selected case study company for the Netherlands to see if the overall society has any influence on its corporate governance and if globalization has had any impact on the corporate culture.

Netherlands Case Study: DSM

The company which I have selected for this part of my case study is called **Royal DSM NV**, here referred as DSM, with its corporate headquarters in a small city called Heerlen in the Limburg region, approximately two and a half hours from Amsterdam, the Dutch financial capital. Like

³²⁴The full text of the Code may be found on the Committee’s website:
<http://www.commissiecorporategovernance.nl>

the other two case studies of this thesis, the findings of this chapter shall be based on an interview conducted with a senior representative of the company and documents obtained from the company or other external sources. Just like the other two case studies, the period being studied for this company is between 1999 and 2004, in order to maintain consistency. In this case, I managed to conduct an interview with Mr. Dries Ausems, who is the Director of Investor Relations at DSM, and is responsible for communicating with investors (shareholders) and other stakeholder issues which we shall look at later in greater detail. Furthermore, I have also conducted an interview with a local government representative of the Limburg region to find out how they define stakeholder engagement. The reason for doing so has been explained in chapter 3 and I do not intend to repeat it here again. The findings of this interview will also be reported later on in this chapter.

1). History & Development of the company

DSM was originally founded in 1902 as 'De Nederlandse Staatsmijnen' (Dutch State Mines), based on coal mining operations by the Dutch government. In those days, coal mining was foreign owned, with partly French and German capital. However, due to political reasons, the Dutch government wanted to stay neutral, and yet coal was a very strategic energy source at that time. Therefore, one observation of the government was that it should be in Dutch hands. But the government was not able to attract Dutch private capital to invest in coal mines because most investments were concentrated in the Amsterdam and Rotterdam region, and Limburg was economically deprived and too far away. At the same time, the government realised that private coal mines had very poor social and safety standards. As a result, the government decided to

create a state-owned company which would solve the neutrality problem and also be a model of operation to lift the standard of work.

From the outset, DSM was not to be run as a bureaucratic part of the government but as a company in its own right. There was arms-length supervision by the state, with a clear social goal and charter. And this was the DSM “genes” and even more than a hundred years later today, the culture of DSM is to provide work at a high quality standard working environment for all employees. We shall look at this in greater detail later.

In the 1930s, the company began to diversify into chemicals and produced ammonia and fertilisers which in those days were fairly novel. In the 1950s, there was diversification towards petrochemicals since it became clear that coal per se was no longer stable as a source of revenue. By the end of the 1950s, the whole economy of coal mining deteriorated due to cheap imports and the business was contracted. By 1965, a decision was made to cease coal mining and the number of employees drastically reduced from 70,000 to around 45,000. As a result, the company further diversified into petrochemicals making plastics and other performance materials and enhancing the quality of the products. Today, more than a quarter of the company’s business is focused on producing high quality plastic products.

At the same time, the company also began expansion beyond the Limburg region by making acquisitions elsewhere and becoming a more international company. In the 1980s, the company made in-roads into life sciences. In 1989, the Dutch government decided to privatise DSM through the sale of shares on the stock exchange. In 2000, petrochemicals made up 1/3 of the company’s business but have since dropped to about 20%. The company aims to accelerate in the production of specialty products such as high quality plastic and life science products and that is to be achieved by divesting from petrochemicals with the proceeds being re-invested into

the specialty sector of DSM as well as strong investment in organic growth. In 2002, DSM sold its petrochemical operation to SABIC (Saudi Arabia Basic Industries) and in 2003, DSM invested in the acquisition of what is now called DSM nutritional products (formerly owned by Roche). In February 2005 NeoResins, the coating resins business of Avecia was purchased. It is now known as DSM NeoResins, this acquisition forms part of DSM Coating Resins, a business group in the performance materials cluster.

DSM shares are listed at Euronext since the company's IPO (initial public offering) in 1989 and its shares are currently being traded in the Netherlands via Euronext Amsterdam and in the United States through a Citibank/ADR program. The company today is one of the Netherlands' five largest multinationals, with an annual sales of around 8 billion Euro and employing approximately 24,000 people worldwide³²⁵.

2) Company's Core Values

DSM claims itself as a 'stakeholder company' and the company defines this as, "...serving the interests of a coalition of parties in the context of a longer-term horizon"³²⁶. The core values of DSM are based on the so called "Triple P" principle, namely **People, Planet and Profit**. The aim of this principle is to pursue valuable growth for all the company's stakeholders. The three key criteria of its principle are³²⁷:

(i). *Valuable partnerships*; (ii). *Respect for People*; (iii). *Good Corporate Citizenship*.

For the remaining part of this chapter, I shall be exploring how the company adheres to its core values in engaging with its various stakeholders. I shall begin by looking at how it manages its relationship with employees.

³²⁵The other four largest multinationals are: Philips, Shell, Akzo Nobel and Unilever.

³²⁶DSM Sustainability Report 2004, http://www.dsm.com/en_US/html/sustainability/stakeholder_engagement.htm

³²⁷Triple P Report 2004 Royal DSM NV – People, Planet, Profit, p. 6.

3). Workers as Stakeholders

As mentioned earlier, DSM is one of Netherlands' largest multinationals employing some 24.000 employees worldwide. The company understands that as a scientific-based corporation, it is very important to retain and manage employees of the highest quality. However, this has never been easy for the company and this is largely due to the nature of its business and locality. According to Mr. Dries Ausems, first of all, it is very difficult to get younger generations to work in the chemical industries in today's world because many of them prefer to work in the service and hi-tech sectors. Furthermore, Limburg region itself is not attractive enough:

“...young and talented want to work in Amsterdam because it is the Dutch centre of business...”.

Therefore, the company is very active in promoting itself in the local communities and schools. It tries to show youngsters what it means to work for DSM, what the company does and how it does it.

a). People Matter(s) Program

In the year 2003, DSM launched the “People Matter(s) Program”, which provides the framework for its human resources strategy for the period up to 2006. The aim of this strategy was to safeguard its position as an attractive employer, to create possibilities for personal development and to develop new management styles and skills.

In 2004, in order to find out the effectiveness of its project, the company conducted an internal survey with regards to employees' perceptions of the company policy on personal development. The survey found that almost 60% gave a positive reply to the question of whether the company provides opportunities for personal development and growth³²⁸.

³²⁸Ibid, at 26.

In order to strengthen the skills of its staff further, the company has set up an internal training institute, the DSM Business Academy, providing a series of programs designed to teach management and leadership skills to professionals, managers and executives in 2004. The company also plans to tailor its programs for specific disciplines such as R&D and Marketing & Sales to the new management and leadership approach. It would also introduce a new course on leadership with respect to safety, which we shall look at later in greater detail. The key to all these projects is to develop and retain the best staff:

“...once they (staff) develop its skills, they rotate within the company and move onto another post where they will learn new things and get to learn more about managerial responsibility...” (Mr. Dries Ausems).

Also at the end of 2004, the company set up its first “Talent Development Centre”, with the objective of further professionalizing its Management Development system and promotion of outstanding talent to executive level.

b). Working Climate Analysis

In June 2004, DSM conducted a worldwide working climate analysis in order to gain a clearer impression of the motivation and commitment of its employees. The company conducted a global survey covering a representative sample of 4,000 employees from around the world, covering 56 sites. The company received a high response rate of 75%, illustrating the importance of the subject matter. Amongst the returned surveys, 71% of the respondents felt the courses they followed were good preparation for their work. Most respondents also felt the training was a useful means of increasing professional knowledge and creating opportunities to find a new job.

The working climate analysis also covered the company's appraisal system. The majority of employees surveyed understand how performance is assessed and regard the appraisal as fair. However, DSM admits that its programs are not perfect and that there is room for improvement and this is also supported by the findings of its survey³²⁹.

The findings of the survey illustrate how important staff training is to an organization. Krueger & Rouse³³⁰, in a 1998 article examined the impact of a workplace education program on variables such as earnings, staff turnover, performance awards and job attendance. The study shows that employee training tends to bring positive outcomes for companies. Employees who participate in training are less likely to leave the company than those who did not participate in training. Furthermore, evidence suggests that training programs can encourage employees to bid for more jobs and improves their likelihood of receiving job changes and reduces overall absenteeism³³¹.

Likewise the findings by DSM of its own internal survey also seem to illustrate more positives towards the training programs amongst staff. By improving its staff's quality and enhancing their prospects, this should enable DSM to gain an extra competitive edge over its rivals in the long term.

c). Diversity and Flexibility

Corporate diversity and female participation have long been the recurring topics of debate amongst Dutch trade and industry. According to the Dutch Statistical Office, although the percentage of female managers had risen from 14% in 1995 to 25% in 2002, yet the number

³²⁹Full details and results of the survey are to be found in the company's Triple P Report 2004, pp. 24-26.

³³⁰Krueger & Rouse, "The Effect of Workplace Education on Earnings, Turnover, and Job Performance". *Journal of Labour Economics* 1998, Vol. 16, No. 1, 61-94.

³³¹*Ibid.*, at pp. 76-88.

remains very low when compared with the total number of women who are active on the job market. Despite the fact that women account for 45% of the Dutch working population, only 2% of the directors of the 100 largest companies in the Netherlands are female, and this is attributed to the so called 'glass ceiling effect', preventing women from rising to the top.

In response to such a shortfall, DSM launched the diversity and flexibility project, as an attempt to make careers at DSM more attractive for women. The company believes that diversity produces a more creative and more innovative company that takes better decisions. Networks for female managers and male part-time managers have been formed and a coaching program for female managers has also been established. The program is aimed at striking the right balance between male and female competences. It has focused mainly on the recruitment and retention of female staff. The target of the company is to double the percentage of the number of women in the 1500 most senior jobs in DSM and the number of jobs with a flexible structure among the 1500 most senior positions in the company compared with the year of 2002. According to the company's Triple P Report 2004, it still has not reached that target yet but it will continue to pursue its objective of increasing the proportion of women in executive position.

This diversity program implemented by DSM is also supported by a number of researches which suggest that more diversity in board membership could improve overall performance. A study conducted by Fondas and Sassalos³³² found that US women directors brought more varied experiences and backgrounds to the board, as well as higher expectations regarding their responsibilities as board members, thus improving corporate governance. Also in

³³²Fondas & Sassalos, "A different voice in the boardroom: how presence of women directors affects board influence over management". *Global Focus* 2000, Vol. 12, No. 2, 13-22.

a similar study conducted in the UK of the FTSE 100 companies, female directors were to be found in the bigger, more profitable firms, and particularly those with the largest turnovers³³³.

d). Workers' Safety

DSM understands that the nature of its business can be potentially hazardous for its employees, therefore it takes safety at work very seriously. According to Mr. Dries Ausems, workers' safety is "priority No. 1" at DSM. According to its company's health and safety policy, every monthly report of Business Group managers must begin with a paragraph on the SHE (Safety Health Environment) performance. This entails making chemicals more sustainable and more socially responsible. In all of the company's presentations to investors, there is mention of the "Triple P" policy:

"...even though investors themselves may not be interested in it...For the long term sustainability of the company this is essential. It may not convince investors and fund managers today, but the company needs licence to operate...". (Mr. Dries Ausems).

The company argues that society must accept that you are there and they will only accept it if you do it in the "most safe and clean way". According to Mr. Dries Ausems:

"...For your employees, you also need to ensure that when they come in for work in the morning, they will go home safe in the evening. This is basic responsibility as an employer. This has always been the core value of DSM ever since birth of the company...".

In its Triple P Report 2004, the company claims that it devotes a lot of energy to improving effective and strict compliance with legislation and internal safety, health and environment requirements. In 2004, there were 41 employees of DSM involved in accidents that led to their absence from work for one or more day and this is an improvement of about 4%

³³³Singh, Vinnicombe & Johnson, "Women Directors on Top UK Boards".
Corporate Governance: An International Review 2001, Vol. 9, No. 3, 206-216.

compared with 2003. The company has a target to reduce the annual number of Lost Workday Cases by 20%, however, the company confessed that further reduction of this number is difficult because every accident is associated with “human behaviour”.

In order to avoid future incidents or accidents, the company has developed a culture of “Learning From Incidents”. All incidents and “near misses” are investigated in order to learn from them and to prevent their repetition. Reports of accidents and incidents are registered in the company’s internal central accident reporting system ARIA. These reports are also analyzed with a view to achieving structural improvements in safety at DSM. The aim of this is not only to address the obvious or immediate shortcomings, but also to identify “latent problems” that could materialise at a later stage and to prevent incidents from recurring again. The company has also recently incorporated this new approach in the new SHE (Safety Health Environment) Leadership Training.

Apart from promoting workplace safety at its home base in the Netherlands and Europe, DSM is also strongly introducing it in less-developed countries where safety standards tend to be lower. An example of this is the ZhangJiaKou Gist Brocades Pharmaceutical Company in China, which is a joint venture where DSM and ZhangJiaKou Pharmaceutical Company are equal partners. The Chinese site today has the best safety record of any DSM site in China and an audit conducted in September 2004 found that the site complied with DSM standards for safety³³⁴. The company believes this is a tremendous achievement because as with most joint ventures in China, it is very difficult to change cultural attitudes to safety. The Triple P concept of DSM is proving very successful in bringing a cultural change in its overseas operation such as China and the local authority in ZhangJiaKou regards the site as a role model for other companies.

³³⁴Data on other sites in China are not available.

DSM also pays attention to the health of its employees. In 2004, DSM reported 20 cases of occupational disease worldwide. This is 25% less than the number in 2003. These health complaints range from allergies to chemicals and back complaints and psychological complaints. In response to this, during November 2004, DSM's occupational health and safety department organized a health week at its head office with the theme "Keep fit, stay healthy at work". There were workshops on healthy nutrition, exercise, work and stress.

The above procedures and programs adopted by DSM reiterate how highly the company regards the importance of its employees' interests. This is consistent with one of the company's core values, which is "Respect for people". The company believes that it is only as strong as the people who work for it. For a company like DSM, success is a question of human endeavour. Therefore, employability, commitment to employees, analysis (or safety) of working environments, competitive salaries and diversity are the cornerstones of the company's values and policies. The company believes this is what makes it competitive.

e). Corporate governance & Employees' Interests

In the previous chapter on the Hong Kong case study, we looked at how good corporate governance is related to the issues of recognising the importance of employees' interests. This is the same with regards to DSM, which is also supported by academic literature which I have mentioned in the previous chapter³³⁵.

In 2004, DSM NV changed its corporate structure from that of a company operating under the "Large Company Regime" in the Netherlands to that of an ordinary company. The group believes that due to its expansion of activities in other parts of the world, it was no longer

³³⁵Belcher & Naruisch, "The Evolution of Business Knowledge in the Context of Unitary and Two-tier Board Structures". *Journal of Business Law*, July 2005, 443-472.

required and appropriate to operate under the Large Company Regime. Under the new structure, DSM has formed a new sub-holding company with the name DSM Nederland BV. All DSM's operational activities in the Netherlands were transferred to this new sub-holding company, with a more appropriate consultation structure. However, the group still maintains a two-tier board structure, a supervisory board and a management board. According to regulations, the managing board is charged with managing the company, it is responsible for setting and achieving the company's objectives, strategy and policies, as well as the ensuring delivery of results. The managing board is accountable for these matters to the supervisory board and the general meeting of shareholders. By law, the responsibility for managing the company is vested in the managing board as a "collective". According to Mr. Dries Ausems, at DSM and most other large Dutch companies:

"...the managing board is a full-fledge executive that manages the company. They are running the business..."

The managing board is also responsible for compliance with all relevant laws and regulations and managing the risks related to the company's activities. At DSM, the managing board reports on these issues and discusses the internal risk managing and control systems with the supervisory board and the Audit committee of the supervisory board.

In contrast, the supervisory board is responsible for "supervising" the managing board. At DSM, the supervisory board consists of "independent captains" of industry with a lot of experience who give supervision to the management board. The supervisory board at DSM convenes six times a year, with sub-committees of audit and remuneration. According to Mr. Dries Ausems, the supervisory board is "not a hands-on management". They give "guidance at a high level" and the actual running of the business is the task of the managing board. However, if there are differences between the managing board and supervisory board, the latter prevails:

“...if there is a conflict between the two boards, the supervisory board wins. The supervisory board appoints and selects members of the management board and with the new corporate governance structure...the supervisory will nominate a candidate to the management board and shareholders’ meeting would have to approve...” (Mr. Dries Ausems).

At DSM, the roles of the CEO (Chief Executive Officer) and the Chairman are split. The CEO heads the management board and the Chairman heads the supervisory board. According to Mr. Dries Ausems, in other large Dutch companies, former CEO would end up in the supervisory board but DSM does not do that, mainly to maintain the “independence of the supervisory board”.

However, unlike many Continental and Dutch companies, employees’ interest is not represented in either the managing or supervisory board of DSM anymore. Mr. Dries Ausems explains the reason for this is because it was thought that the supervisory board should not be a lobbyist for one particular constituency:

“...the board (supervisory) should be looking after the corporate interest as a whole and not any particular group. This enables the board to maintain its independence and not specific champion for any particular group or unit within the company...”.

But that does not mean employees’ interest is ignored by management. DSM continues to have a well-established structure within the company where employee representatives have to be consulted on major strategic steps and informed about results and development. For example, DSM’s relationship with trade unions has been structured in the company’s human resource policy for many decades. Dialogue with trade unions has also been developed in other countries where DSM operates. The company recognizes its employees’ right to organize themselves in order to protect their own interests. Trade union representatives in the company are facilitated to discuss employee related issues with their members. DSM’s top management regularly informs trade unions about major changes in business activities and strategy well in advance. One

example which DSM gives is the consultation with employee representatives on its Copernicus project in the Netherlands. The project started in 2003, with an intention to reduce the complexity of the operations at the site, and increase standardization in the business processes so as to reduce costs. The project is expected to generate savings of €50 million a year. The new DSM Manufacturing Centre will be established and some service units will disappear, costing about 300 jobs at its Limburg operation. This project is not without objections. The company reported that on 12th March 2004, the Dutch trade unions organized a demonstration by the staff of DSM Limburg to protest against the plans for the Copernicus project. Employees joined colleagues from their own departments on the march and this was enough to prove employees' grave concern in retaining employment at DSM in Limburg. In responses to such concerns, the company drew up its social plans in consultation with internal consultative bodies and the trade unions, which it has always done for layoffs and redundancies. Special plans were drawn up to help as many redundant workers as possible to find alternative work and a mobility centre was also established to help employees find jobs elsewhere.

The company also tries to manage the restructuring and reorganization processes in a way that is fair and transparent. It acknowledges that the loss of jobs would be painful for employees, yet the company had to take these measures in order to remain competitive in light of changing economic conditions, exchange rate and cost developments, changes in market and technology and the progressive globalization of the company³³⁶.

The above example of the actions taken by DSM reiterates how highly the company regards communication with worker representatives, a core value which it has adhered to over the decades. This is consistent with the Dutch socio-economic system based on consensus and cooperation, a central tenet of the Polder model which was mentioned earlier. Furthermore, it

³³⁶Triple P Report 2004 Royal DSM NV, at p. 22-23.

also shows a real example of how the nature of the Continental European economies are changing due to increased competition. In order to survive in this business world a company needs to make the necessary restructuring and changes. The key to doing this is by striking the right balance and consulting various interest groups in the process in order to minimize conflicts to the lowest level which DSM has done.

4). Customers as Stakeholders

In the previous section, I have looked at how DSM manages its relationships with its employees and the impact on its overall performance. I shall now shift the focus towards another stakeholder group, customers, and see how the relationship is managed.

DSM's core business is in life science products, performance materials and industrial chemicals. The group develops, produces and markets innovative products and services and supplies them to the world. These products are used in a wide range of end-use markets and applications, such as human and animal nutrition, cosmetics, pharmaceuticals, the automotive industry, electronics market and so on.

Given the fact that DSM has a wide variety of products, the company does not just serve one or two customers. According to Mr. Dries Ausems, DSM operates on a "business-to-business" basis and does not sell to end consumers directly. In essence DSM's customers are more like its business partners:

"...DSM's customers are businesses themselves and are able to defend themselves..."

However, DSM maintains a very close relationship with the research and development teams of its customers. One example which DSM gives is their joint research project with Mercedes Benz:

“...we (DSM) have worked with the development team of Mercedes Benz to provide materials of engine part to Mercedes and it has now managed to establish a long-term relationship with Mercedes...”.

The company does not actually advertise itself on the market, but it sponsors the Dutch Olympic team. Sport has been the main theme of DSM’s general sponsorship policy. This is also in line with the company being active in life sciences and the performance materials sector. By sponsoring the national Olympic team, the company has won recognition of several of its remarkable innovations for athletes during Athens 2004. One success story is the Pepto-Pro energy drink developed by the company, which allows athletes to recover far more quickly:

“...we supplied the Pepto-Pro energy drink to the Dutch team and since Athens 2004, the drink has been marketed worldwide as a success...”
(Mr. Dries Ausems).

The above examples again illustrate the importance of research and development (R&D) to the success of a company and how DSM is reaping returns from its innovation, and this has been supported by a number of researches and studies over the last few decades. A study conducted by Branch³³⁷, strongly supports the hypothesis that R&D activity tends to increase both profits and growth and this is particularly the case for the so called high research industries such as chemicals and electrical equipments. A similar study conducted by Grabowski and Mueller³³⁸ found that firms in research intensive industries such as chemicals and pharmaceuticals earn after-tax returns on R&D capital of between 15 and 20%, significantly above the rate of return realized on other investment activities. In another study by Hirschey³³⁹,

³³⁷Branch, “Research and development Activity and Profitability: A Distributed Lag Analysis”.
Journal of Political Economy 1974, Vol. 82, No. 5, 999-1011.

³³⁸Grabowski & Mueller, “Industrial research and development, intangible capital stocks, and firm profit Rates”. *Bell Journal of Economics* 1978, Vol. 9, 328-343.

³³⁹Hirschey, “Intangible Capital Aspects of Advertising and R&D Expenditures”.
Journal of Industrial Economics 1982, Vol. 30, No. 4, 375-390.

it was found that on average, advertising and R&D expenditures have positive and significant market value effects with an average R&D depreciation rate of approximately 25%.

5). Environment as Stakeholders

In the previous sections, I have looked at how DSM manages its relationships with stakeholder groups such as employees and customers. For this section, the focus will shift towards the overall environment and explore what (if any) action the company takes in maintaining a clean environment.

DSM produces chemicals so it understands that the nature of its business is highly environmentally sensitive. However, the company believes that the growth of the world population and the need for greater prosperity does not automatically mean more pollution or the depletion of essential raw materials. In its Triple P Report 2004, DSM argues that the most important contribution it can make to sustainable development and a better environment is innovation. According to Mr. Dries Ausems, the company has a “clear goal” with regards to its environmental impact such as reducing Carbon dioxide emission:

“...this entails making chemicals more sustainable and more socially responsible...”.

The company has set a number of environmental targets which I shall now turn to in greater details.

a). Environmental Targets 2006

In 2001, the company set its environmental targets for 2006 based on the technological possibilities and economic forecasts at the time. The main objective of these targets was to

reduce emissions to water and air, land-filling of waste and water consumption measured by unit of product, must all be significantly lower than in 2000.

According to its Triple P Report, by the year 2003, six of the fourteen environmental targets for 2006 had been met and by 2004, this has risen to nine (as shown in Figure 3 below)³⁴⁰. The company has pledged that by 2006 it will set new targets for coming years and in the process, it will not only use criteria such as historic emissions and the use of energy and materials, but would also benchmark itself by comparing performance with that of similar companies. The group's long-term goal is to be among the "top 25%" of companies engaged in similar activities in terms of environment.

Fig 3. Summaries of DSM Environmental Targets 2006:

Reduction of emissions to air:	Target 2006	Status in 2004 (Reduced by):
Sulphur dioxide:	30%	>30%
Nitrous oxide:	10%	>10%
Dinitrogen oxide:	10%	>10%
Volatile Organic Compounds:	50%	20%
Priority Substances:	60%	15%

³⁴⁰For further details of its environmental targets, refer to pp. 33-36 of DSM's Triple P Report 2004.

Reduction of emissions to Water:	Target 2006	Status in 2004
Chemical Oxygen Demand:	50%	45%
Nitrogen:	40%	>40%
Phosphorus:	25%	14%
Organic halogen Compounds:	90%	>90%
Priority Substances:	90%	>90%

Reduction of: Target 2006 Status in 2004

Ground & mains water consumption:	10%	1%
Energy Consumption outside Netherlands:	5%	>5%
Landfilling of non-hazardous waste:	20%	>20%
Landfilling of hazardous waste:	100%	100%

b). Energy Use

According to its Triple P Report 2004, DSM companies and units worldwide used a total of 66 PetaJoules (PJ) in the form of primary energy for electricity and heat, the same volume as in 2003, even though production volumes increased in 2004. The total expenditure on energy, based on a price for crude oil of US\$ 35 per barrel, was approximately US\$ 370 million, amounting to about 5% of the group's sales.

All of DSM's business groups currently have programs in place to improve overall energy efficiency. Globally, DSM had set itself the goal of improving energy efficiency by 5%

in 2006 compared with 2000. The company reports that this target was actually already exceeded in 2004 and this was largely achieved by upgrading existing plants and the introduction of new technologies.

c). Clean-up of environmentally damaged site

As mentioned earlier, DSM was originally founded as a coal-mining company in the early 20th century. Although the company now no longer operates as such, yet its mining activities in the past have left some marks on the land and soils where it once operated. As a result, the company has committed to voluntarily clean up some of these sites.

One example which the company has cited is the Chemelot site in Geleen, Netherlands. Since the 1980s, as part of its Environmental Action Plan, DSM started cleaning up ten sites and surveyed the soil quality throughout the 800 hectare site. The soil remediation process has cost the company more than €30 million and the after care of the various locations is still currently underway.

In response to the above survey, DSM drew up an action plan for soil pollution caused prior to 1987 and the plan was approved by the authorities in 2000 as a result of agreement. The survey has revealed that there were no unacceptable human or ecological risks and the main aim of the remediation measures were to prevent dispersion of substances in the environment. The action plan is intended to cover the period until 2023 and DSM has agreed with the authorities that the plan will be reviewed every four years to take account of changes in the quality of the groundwater, new methods for soil remediation and to adjust the plan to new policy developments. The company estimates that the total costs of drawing up and implementing the plan would exceed €65 million.

The abovementioned action plan does not extend to soil pollution or degradation that was caused after 1987 since DSM has pledged to clean up those immediately. For example, during 1996, the company was confronted with a major leakage at one of its site in the Netherlands. The complete remediation of the affected area was projected to take until 2011, costing about €18 million.

d). Environmental Protection in developing markets

Apart from committing to environmental protection at its home-base in Europe, DSM has also been actively promoting environmental efficiency in developing economies which it operates, where the concept is rather nascent.

The best example is the DSM Nanjing Chemical Company in China, which is a joint venture in which DSM has held a stake of 60% since 2002. The Nanjing site produces a chemical known as caprolactam and the most significant environmental effects are emissions of sulphur dioxide and nitrogen oxide and dust, mainly as a result of the use of coal to supply energy.

In 2003/04, the Nanjing site began to measure a number of environmental statistics more accurately. The site is also installing filters designed to dramatically reduce dust emissions. DSM Nanjing Chemical Company is currently developing and implementing plans for improvement.

e). Overall Environmental Reputation

As mentioned earlier, DSM is strongly dedicated to its so called “Triple P Policy” and one of the P in this component is the ‘Planet’. Due to its commitment towards environmental protection.

DSM was ranked the No. 1 chemical company in Europe in 2003. In addition to that, in September 2004 it qualified as the global best performing chemical company in the Global Dow Jones Sustainability Index for 2004/05³⁴¹. Furthermore, the company was included in the FTSE4Good Europe and the FTSE4Good Global Index in September 2004.

The company has also been highly supportive of the Dutch government “**White Biotech Agenda**”, which was prepared in 2004 during the Dutch Presidency of the European Union. The aim of the agenda was to outline the importance of industrial biotechnology for the Dutch and European society as well as its economy, and to propose concrete recommendations to boost the further development within the Netherlands and the European Union.

The above analysis reiterates strongly how DSM is committed towards environmental protection. Many investors have started to consider sound environmental management as a vital part of good corporate governance. Therefore, having a sound environmental management policy like DSM may give the company an extra competitive edge in the long term attracting investment from a growing number of institutional investors who reward companies based on sustainability and social responsibility.

6). Local Communities as Stakeholders

In the last section, I have looked at how DSM makes the endeavour in maintaining a clean environment in its operations. For this section, I shall turn to how it manages its relationships with members of the local communities where it operates.

DSM operates in 50 different countries with well over 250 sites, and as mentioned earlier, one of the company’s core values is good corporate citizenship, where it strives to be a good

³⁴¹<http://www.sustainability-indexes.com>

member of the communities in which it operates and encourages employees to adopt a civic-minded and socially responsible attitude.

a). Bond with its home-base

DSM originally began life as Dutch State Mines in the Limburg region. Although over a century has passed and the company no longer operates mines, the province of Limburg still means a lot to DSM.

The company is no longer as commercially active as it used to be in the Limburg region, but it still regularly holds meetings with the provincial authority to discuss how to improve the overall economy of the region. As mentioned earlier, due to the company's Copernicus project at the Chemelot site in Geleen, as many as 300 jobs at the Limburg site could be lost and there have been concerns amongst employees and members of the communities as to the long-term implications this may have on the Limburg region. In response to such concerns, in 2004, DSM entered into a Covenant with local authorities and other organizations on measures to attract new companies and promote employment at the Chemelot site. Furthermore, DSM is also working in association with the University of Maastricht to provide training and skills in technology, science and business which are intended to benefit the community in the long term.

Mr. Dries Ausems argues that DSM convinces the local communities by being "as transparent as possible" and the company has an extensive website where "almost everything" is reported to the public. Mr. Ausems points out that sometimes even the company's lawyers are concerned about the level of the company's transparency and he gives an example of an incident which happened in 2003:

"...For example, 2 years ago there was an accident at the company's site here and 3 people were killed. Immediately, DSM was very open and told the world what went

wrong. But the lawyers became very concern, yet DSM thought that it was necessary to be as transparent as possible about the incident even if the company were to get convicted...”.

DSM’s approach towards the local communities where it operates is also consistent with the recommendations made by the European Union’s Green Paper on Corporate Social Responsibility entitled, “Promoting a European Framework for Corporate Social Responsibility”, which was published in July 2001³⁴². According to Section 2.2.1 of the Green Paper, corporate social responsibility is about the integration of companies in their local setting. “whether this be in Europe or worldwide”. Companies contribute to local communities by providing jobs, wages and benefits, and tax revenues. On the other hand, companies also depend on the health, stability and prosperity of the communities in which they operate. The report goes on to say that the reputation of a company at its location, its image as an employer and producer, but also as an actor in the local sense, influences its competitiveness.

b). Involvement in developing economies

DSM has operations in a number of developing economies and likewise, it encourages its employees in these sites to integrate with members of the local communities as much as possible and the company provides many examples of such approach.

For example, in 2004, a team of DSM employees in Argentina developed a solar-powered cooker for use in the Andes. The use of solar energy combats further deforestation and erosion, and people have more time for growing and tending to agricultural crops. This program has not only benefited the local communities, but has also provided innovative idea for the company, where work has now started on the development of an oven for baking bread powered by solar energy.

³⁴²<http://europa.eu.int>

In other parts of the world such as India and China, DSM has also participated in a number of social programs. In the Punjab region of India, local DSM employees have noticed that the road from Chandigarh to Amritsar is busy and dangerous. DSM improved the situation by installing street lighting and traffic lights. The company is also contributing to the welfare of the region by improving road safety. In China, in recognition of the importance of environmental sustainability, DSM employees in Jiangsu province planted 100 trees and currently provide support for the local “Hope School” which helps children from poor families.

Apart from the above programs, the company also provided assistance to victims of the tsunami in Southeast Asia that hit the region in December 2004. When DSM celebrated its centennial in 2002, the company did not give out any super-dividend to shareholders or bonuses to employees. Instead, it used the money and skills to launch the dream-making project to make the world around DSM better. As part of this project, DSM has managed to develop a new water purification unit for victims and refugee camps:

“...immediately after the tsunami disaster, DSM warehouse was handing out these units in Southeast Asia...” (Mr. Dries Ausems).

DSM’s actions and programs in developing countries not only provide poverty relief for the communities and their people, but can also boost its competitiveness and business in these regions in the long term. In a paper presented at an international conference for marketing in 2004/05³⁴³, Krishnan and Balachandran of the Indian Institute of Management, Ahmedabad, argue that the increase in competition among the multinational companies to gain first mover advantage in various developing countries has made the establishing of goodwill relationships

³⁴³Krishnan & Balachandran, “Corporate Social Responsibility as a determinant of market success: An exploratory analysis with special reference to MNCs in emerging markets”. Marketing Strategies for Firms in Emerging Markets, IIM K- NASMEI International Conference 2005.

with both the state and the civil society vital³⁴⁴. This is because in developing countries government are more inclined to give preference to companies which take care of the interests of all the stakeholders. Also emerging markets have been identified as a source of immense talent with the rising levels of education. In order to draw from this vast talent labour pool, companies need to gain a foothold in these markets by establishing sound business practices addressing social and cultural concerns of the people. The paper cites the case of Coca-Cola in India as an example, where its plant at Kerala was alleged to have exploited the groundwater resources leading to drying up of wells and natural water resources in the area. The Coca-Cola Company had to deal with protests from the local community and environmental conservation groups, who picketed the factory gates for a long period of time causing large scale media attention. The incident eventually led to the local government issuing an order stopping operations of the plant to safeguard the interests of the local community, and there were also nationwide protests aimed against multinational companies in general demanding those irresponsible ones to leave the country. Krishnan and Balachandran warn that multinational companies neglecting the interests of the public in developing markets where they operate do so at their own peril.³⁴⁵

“...many MNCs also take the markets for granted and exploit the laxity in the norms of operations to their advantage. The lack of concern for the local community, the consumers and the environment by these corporations has created large scale public debate and action. It is important in this context to understand that the sustainable business growth is associated with care for the community and markets the corporations operate in. The negative publicity caused by the actions of MNCs has led to suspicion about their operations in the general public in these markets...”.

7). Investor Relations

Profitability is just as important to DSM, hence its Triple P principle (People, Planet, Profit).

The company believes that People, Planet and Profit are “mutually reinforcing” and contribute to

³⁴⁴Ibid, at p. 2.

³⁴⁵Ibid, at p. 16.

long term success. In this section, I shall be focusing on DSM's financial performance and look at how it manages its relationship with shareholders and investors.

a). Corporate/Share Structure

As mentioned earlier, it was in 1989 that the Dutch government decided to privatise DSM through an IPO (initial public offering) on the stock exchange. Today DSM is one of the Netherlands top five multinational companies, being listed in the Netherlands via Euronext Amsterdam and the United States through a Citibank/ADR program. Apart from that, the company is also included in both the Dow Jones Sustainability Index and the FTSE4Good. As of 2004, the DSM group worldwide has net sales of 7.7 billion Euro and a net profit of 262 million Euro.

Under the Dutch Major Holdings Disclosure Act, shareholdings of 5% or more in any Dutch listed company must be disclosed to that company. Accordingly, a number of institutional investors holding 5 to 10 % in Royal DSM have been disclosed and they include big names such as ABN Amro Holding NV and ING Investment Management BV. Apart from Dutch based institutional investors, DSM shares are also owned by a growing group of international investors, a result of cross-border transactions and globalization. These include investors from the UK, North America and other parts of Europe:³⁴⁶

³⁴⁶Source: DSM Investor Relations Report 2004,
http://www.dsm.com/en_US/html/invest/shareholder_base.htm

Geographic spread of DSM Shares 1999-2004
(excl. cumulative preference shares A)
Fig. 4

In%	2004	2003	2002	2001	2000	1999
Netherlands	26	28	25	29	33	29
North America	14	19	30	27	24	38
Belgium/Luxembourg	22	19	15	15	14	12
United Kingdom	19	21	17	16	12	10
Germany	5	3	4	4	5	5
Switzerland	5	6	5	7	7	3
Other Countries	9	4	4	2	5	3
Total	100	100	100	100	100	100

The above table (Fig. 4) illustrates the geographic spread of DSM shareholdings between 1999 and 2004. The table shows that shares held by domestic investors (Netherlands) have remained relatively constant, between 20% and 30%. However, there have been gradual increases in shareholding by overseas investors for both types of shares, particularly from countries such as the United Kingdom, Belgium/Luxembourg and other countries. This trend reiterates the trend of cross-border transactions and globalization.

The wide geographic spread of DSM's shareholding is also due to its multiple listings in various stock exchanges. According to Mr. Dries Aulsems, DSM decided to list on the Swiss stock exchange in 1990 for tactical reasons:

“...when the company was brought to the stock exchange in 1989, the idea was that you should have multiple listing because it was thought to be good for image so that people will see you are an international company...”.

However, Mr. Ausems claims that this is no longer the case. The company is no longer listed on the Swiss stock exchange due to the lack of trading there. Also, most investors from worldwide can now easily buy DSM shares on Euronext Amsterdam.

The only exception is the ADR program in the United States. In the US, there is a restriction on a number of pension funds where they can only invest in US-listed equities. Therefore, an ADR arrangement was made with Citibank where Citibank will sell ADR to US investors and the bank promises that the equivalent amount of shares will be deposited in the treasury of the bank. For every 4 ADRs, there will be one DSM share. According to Mr. Dries Ausems, this creates a legal transaction between the US investors and Citibank. The advantage of such arrangement is that DSM can avoid US regulations.

b). Financial Performance

Investors are most concerned about the company's financial performance and whether or not they are making a reasonable level of return on its shareholdings. By that standard DSM has done reasonably well over the past years³⁴⁷.

The chart (Fig. 5) on the next page illustrates information about the DSM share for the years between 2000 and 2004. For the purpose of this thesis, I shall be focusing on the statistics between 2000 and 2004, since this is the same period measured for the other two case studies.

The chart shows that between 2000 and 2004, DSM share prices measured at year-end on Euronext Amsterdam have risen from 37.31 to 47.62 Euro. Its final dividend has also remained constant, lying between 1.17 and 1.24 Euro for the same period. Moreover, its pay-out to shareholders as percentage of net profit has also risen from 32% in 2000 to 70% in 2004. These

³⁴⁷Source: DSM Investor Relations Report 2004.

statistics show that DSM has performed well in satisfying the interest of its shareholders in relative to the market.

DSM's Share prices & Dividends in € (2000-2004)³⁴⁸ Fig. 5:

per ordinary share in €	2004	2003	2002	2001	2000
net profit from ordinary activities	3.52	2.23	3.38	3.62	5.7
net profit	2.51	1.24	12.08	14.5	5.8
Cash flow	7.98	5.76	16.67	19.92	11.03
shareholders' equity	47.71	47.73	49.64	40.49	28.06
Dividend	1.75	1.75	1.75	1.75	1.75
interim dividend	0.58	0.58	0.58	0.58	0.51
Final dividend	1.17	1.17	1.17	1.17	1.24
payout as % of net profit on					
ordinary activities after taxation	84%	79%	54%	51%	32%
payout as % of net profit	70%	142%	15%	13%	32%
dividend yield	4.30%	4.50%	3.90%	4.50%	5.10%
Share prices on Euronext Amsterdam					
Highest price	47.7	45	51.25	45.15	40.1
lowest price	35.75	31.29	37.9	28.8	30
at year-end	47.62	39.03	43.38	41.01	37.31
(x 1,000)					
no. of ordinary shares outstanding	95,978	95,768	96,589	96,146	95,990
Average daily trading volumes on Euronext Amsterdam					
Average	507	563	517	1,086	857
Lowest	13	65	70	47	161
Highest	3,247	3,270	1,932	5,338	6,668

In its Annual Report 2004, DSM reports that it has posted a considerably better operating profit and net profit from ordinary activities than in 2003. In 2004, it made an operating profit of 489 million Euro, 66% higher than in 2003, and the net profit from ordinary activities was 359 million Euro, an increase of 54% from the previous year³⁴⁹.

The chart below (Fig. 6) is a summary of DSM's income statement for the years between 2000 and 2004. Again for the purpose of this thesis, I shall only be focusing on the figures between 2000 and 2004.

³⁴⁸Source: Presentation to Investors, Annual Results 2004, 1.

³⁴⁹Source: DSM Annual Report 2004, p. 93.

Between the year 2000 and 2004, DSM performed well on the stock market. In 2001 and 2002, it was the best performing stock in the AEX index on Euronext Amsterdam in terms of shareholder return. In 2004, it was the third best performing

DSM's Statement of Income in € (2000-2004) Fig. 6:

in € million	2004	2003	2002	2001	2000
Net sales	7,752	6,050	6,665	7,970	8,090
change compared with previous year (%)	28	-9	-16	-1	28
operating profit plus depreciation & amortization	1,013	723	892	1,042	1,254
operating profit plus amortization of goodwill	512	319	477	550	
operating profit	489	294	450	521	751
Balance of financial income & expense	-51	-31	-14	-97	-57
Tax on profit from ordinary activities	-98	-49	-84	-69	-171
profit or loss of non-consolidated companies	8	5	-3	14	48
profit from ordinary activities after taxation	348	219	349	369	571
minority interests	11	14	-1	1	-1
Net profit from ordinary activities	359	233	348	370	570
Net result from exceptional items	-97	-94	840	1,045	10
Net profit	262	139	1,188	1,415	580
dividend op. cumulative exceptional items	-22	-22	-22	-22	-22
net profit available to holders of ordinary shares	240	117	1,166	1,393	558
workforce at 31 December (x 1000)	24	26	18	22	22
wages & salaries (in € million)	1,487	1,215	1,217	1,251	1,191
percentage ratios (in%):					
EBIT/net sales	6.3	4.9	6.8	6.5	9.3
EBIT/average capital employed (ROI)	8.3	5.9	8.7	9.2	16.4
Net profit available to holders of ordinary shares	5.7	2.5	26.8	42.3	22.5
EBITDA/balance of financial income & expense	19.9	23.3	63.7	10.7	22
dividend (in € million)	190	188	199	199	199

stock on the AEX with a total shareholder return of 27%. This is despite an overall bear market during the same period.

According to its Investor Relations Report 2004, DSM has started to recover in 2004 from the setback suffered between 2001 and 2003. Despite being a difficult business year due to high oil prices and the further weakening of the US dollar, the company achieved an autonomous volume growth of 8% in 2004 and this was due to its restructuring and improvement projects, including the shedding of employees. The company claims that it will continue its programmes of structurally improving its profitability in 2005 and beyond.

In 2000, DSM introduced its strategy entitled, Vision 2005: Focus and Value. This is aimed at accelerating its transformation into a multi-specialty chemical player. The objective was to achieve "...global leadership positions in activities offering a relatively high added value, relatively stable growth and more stable profits". The strategy includes both divestments and acquisitions. In 2002, DSM sold its petrochemical activities to SABIC (Saudi Arabia Basic Industries) for a total amount of €3 billion. In return, it acquired Roche Vitamins & Fine Chemicals division of Switzerland in 2003 for a value of €1.8 billion and in early 2005, it also completed the acquisition of NeoResins for a value of 515 million Euro. DSM claims that these activities fit with its Vision 2005 strategy of being a specialised player in the chemical industry.

c). Relationship with investors/shareholders

Like many listed companies with diverse shareholding, DSM admits that it too faces pressure from various institutional investors or shareholders when operating its business. According to Mr. Dries Ausems, the usual pressure is that they want more returns for their investment and more stability. However, DSM has always tried to maintain a good relationship with investors through proper dialogue instead of confrontation.

One example of pressure from institutional investors which Mr. Ausems gives is that when DSM sold its petrochemical unit to SABIC (Saudi Arabia Basic Industries). DSM received 3 billion Euro from this sale and at that time, institutional investors demanded share buyback and super dividend from DSM. But DSM resisted that pressure. It told the investors that it will transform the company and use the money to re-invest in the company:

“...we informed the shareholders that they will get their dividend and will not be hurt by the transformation. We kept our promise and continued to distribute dividend to the shareholders. Even when the company was shrunk in 2003, the shareholders still received a high dividend...and we used the money to re-invest in the company. We told them (shareholders) there will be a new DSM with a modernised composition and not a miniature DSM...”.
(Mr. Dries Ausems).

Over the last decade there has been a concentration of share-ownership in a handful of institutional investors. For example in the United States, institutional investors hold approximately 52% of all listed domestic corporations and 57% of the outstanding equity of the largest US corporations. Similarly, in the United Kingdom, half of the UK equities in the domestic stock market are owned by fifty financial institutions, the top twenty own about a third of the market and the top ten about a quarter. Some commentators refer such a concentration of share-ownership as “fiduciary capitalism”, where these institutions are legally required to act as a fiduciary for the interests of the beneficiary (actual shareholder)³⁵⁰. Therefore, when shares of a large company are so highly concentrated in a handful of institutions, this inevitably gives them greater bargaining power when negotiating with the management of the company. As the world becomes more and more integrated such trend is likely to become more prevalent. This means companies on both sides of the Atlantic would need to handle this with greater care.

³⁵⁰Hawley & Williams, “The Emergence of Fiduciary Capitalism”.
Corporate Governance: An International Review 1997, Vol. 5, No. 4, 206-213.

Traditionally, Anglo-American investors are more concerned about share price performance and profit maximization and when asked whether the growing number of such investors is having any influence on the management of Continental European corporations like DSM, Mr. Dries Ausems gives this reply:

“...Ever since the 1990s, DSM has had a fairly strong Anglo Saxon investors base. There is nothing new here and DSM has been perceived as a value option and value investing was an Anglo Saxon thing. This is still there... There have been a growing number of European investors as Europe become more integrated. DSM is no longer just a Dutch company and we get investment from throughout Europe... However, there is no fundamental difference between the needs of US/UK and European investors. Today investors ask more in depth questions and what is happening in that part of your business. Investors today regardless of where they are from have more or less converged and they all want value for their investments...”.

This further epitomizes how corporate governance mechanisms are changing in Continental Europe due to increasing influence from US/UK and there are also signs of both systems converging with each other due to cross-border transactions and globalization.

In a study conducted by Cuervo³⁵¹, a comparative analysis was made between corporate governance mechanisms in market-oriented Anglo Saxon and large shareholder-oriented Continental European systems. Although Cuervo points out that neither system is perfect, yet the study claims that in the case of the large-shareholder control system (Continental Europe), there is a need for more market control and less use of codes of good corporate to achieve the ultimate objective of the maximization of the firm's value³⁵². This is because in common law countries such as the US/UK, judges can apply the codes of good governance like the Combined Code directly, allowing it to become enforceable regulation. But in civil law countries i.e.

³⁵¹Cuervo, “Corporate Governance Mechanisms: a plea for less code of good governance and more market control”. *Corporate Governance: An International Review* 2002, Vol. 10, No. 2, 84-93.

³⁵²Ibid, at p. 86.

Continental Europe, judges cannot apply these codes of good governance with the force of regulation, since the law can only be developed in parliament³⁵³.

The case of DSM illustrates how the abovementioned trend is taking place in the Continent. DSM is one of the largest Dutch multinational companies with operations in different parts of the world and the company is adapting to such transformation and abating its “Dutchness”. This means the increase of foreign ownership of its shares is likely to increase even more where this could lead to greater control of its business operations by the market.

8). Views from stakeholder group

In the previous sections, I have looked at how the company itself defines corporate stakeholder engagement and how it is being practiced on a daily basis. Yet they are only views expressed by the company. Like the previous case study on Hong Kong, in order to avoid bias I have managed to gather an alternative view from another stakeholder group as to how they define corporate stakeholder engagement and whether or not they differ from the company. I managed to conduct an interview with a representative from the local government of the Limburg region via email. The interviewee is Alain Nijssen, who is a senior project leader of the *Afdeling Economische Zaken*, which is an economic departmental body of the Limburg regional government, Netherlands. As abovementioned, DSM was originally founded in this part of the Netherlands as a state mining corporation over a century ago and although it has now been privatized and no longer conducts mining anymore, the company still collaborates with the local government in many projects in the surrounding areas. Furthermore, every company is bound by legislations and regulations enacted by central or local government regardless of where they

³⁵³It must be noted that Cuervo wrote his article before Dutch legal reforms and probably before the enactment of the Sarbanes Oxley Act in the US. Therefore, circumstances may differ today.

operate. The government also represents the interest of the people and society which it governs (at least in theory), therefore, the view of the government as to what constitutes corporate stakeholder engagement or CSR is becoming very important.

The first question which I asked Alain Nijssen concerned the uniqueness of the Dutch economic model which is based on the cooperation between government, employers and employees and how does that affect business activities in general. According to Mr. Nijssen, the Dutch model of cooperation results in a solid relationship between the three parties:

“...there is commitment and trust, which results in a conflict avoiding attitude towards each other. Strikes are avoided and negotiations about remuneration and working conditions are conducted with common sense; with respect to each others situation and the overall economic prospects. In short: the Dutch economic model aims at a stable and solid climate for investment and establishment...”.

As it can be seen from the above response, the Dutch model fundamentally encourages dialogue between corporations and various stakeholders. This is often referred as the “Polder model”, which we have already discussed earlier in this chapter.

According to Mr. Nijssen, the Limburg Provincial government views stakeholder engagement and good CSR practice as “embracing the idea of Planet, People, Profit”:

“...that is striving for a durable economy in which we try to find a balance. We have to take our responsibilities for future generations...”.

Moreover, one key objective of the Limburg government is to minimize unemployment and Mr. Nijssen claims that companies that take their responsibilities in that respect (employment) deserve government support. Besides, the government also pay a lot of attention to the role businesses play in education.

Mr. Nijssen argues that a company primarily has a business orientation in order to be competitive in an international market. It means that a company is focused on the business and not the region in order to make sound business decisions. In this respect it is necessary that as a

region the local government does everything that is needed to make the region attractive to invest. (labour, infrastructure, culture, living etcetera). However the government believe that companies also have their responsibilities and commitment to the local area:

“...responsibility to be involved in the region in order to keep the region attractive. They have to be involved in the triple P’s (people, planet, profit), not only within their company but also outside their company...”.

According to Mr. Nijssen, historically DSM has a great involvement in Limburg in employment, education, and culture. But in the past few years this has changed as a result of the fact that DSM has become more and more as a global player. The company is making different business decisions where more and more investments are made elsewhere as a result of cost and market growth. Also they have sold parts of their business to other parties (i.e. their petrochemical division was sold to SABIC) and parts were outsourced. However, despite many of its outward expansion activities, DSM still contributes significantly to the local area, still having a strong role in education and the local community (sports, culture ...) as a result of their historic ties. Furthermore, there are also examples where DSM has pledged to make commitments to the Limburg region:

“...also as results of these historic ties labour unions asked DSM in 2004 (reorganisation Copernicus local in Limburg) if DSM was still willing to invest in the local Chemelot site (900 ac). As a result of that parties (DSM, Province of Limburg, Sittard-Geleen) agreed to invest € 60 million in the Chemelot site in order to improve the business climate and to attract new companies. The projects are listed in the brochure I did send you last time. DSM does invest € 40 million and governmental parties invest € 20 million... As a result of the program and the positive developments in the region (DSM feels welcome in Limburg) they have decided in the vision 2010 to strengthen the position of Limburg as the location where they do their research and development on materials. Also they will develop 2 new business opportunities (Biomaterials and Packaging) in Limburg. If successful these could be huge growth areas...”. (per Mr. Alain Nijssen).

Mr. Nijssen believes that at a practical level, regional government like Limburg can help businesses to adopt and promote the concepts of CSR and sustainable development. The Limburg government calls its “responsible enterprising”, and they are everything they can to help promote this in all disciplines. In particular, they have many local programmes to help companies with the triple P policy.

Summary of Chapter

In this chapter, we have looked at how the selected case study company, DSM, manages its relationships with various stakeholder constituents. The effect this has had on its overall performance has also been examined.

After analysing/comparing the views expressed by both DSM and the local government representative of Limburg, it can be seen that both sides hold similar views in terms of stakeholder engagement and CSR practices. Local government believe that business decisions should be left to be made by businesses. The role of the local government is to provide an environment that creates opportunities for businesses to prosper.

Both DSM and the Limburg provincial government believe that a balance can be struck between profit and social needs. The “Triple P” principle is endorsed by both parties. From its origin as a state-owned mining corporation to its transformation as a publicly-listed worldwide scientific-base chemical and performance material company, DSM has always tried to balance the interests of different stakeholders and this seems to have made it as one of the most successful companies in the Netherlands and Europe. According to a report published by European based **CSR Wire** on September 9 2005, DSM topped the list for the Chemical Industry sector on the Dow Jones Sustainability World Index for the second year in a row, making it the

worldwide sustainability leader in the chemical industry³⁵⁴. According to the report, the company was able to retain its top position because it has integrated sustainability into its decision-making and management processes to a very high level. This integration of sustainability into the company's core activities has resulted in stable high scores for all criteria.

DSM has shown that its Triple P principle (People, Planet, Profit) is attainable by being a “good corporate citizen” and at the same time achieving reasonable level of return for its shareholders. When asked how DSM resolves its tensions between different stakeholder groups, Mr. Dries Ausems gives this reply:

“...In the short term there may be some tensions between different stakeholders. For example, investors may want higher return and employees may want higher wages. However, in the long term, that sort of tension does not arise and that all stakeholders share common interest...”.

Therefore, from the findings of this case study, I can answer the research question in the positive. That is, at a practical level, it is possible for both shareholder and stakeholder values to “co-exist in harmony” in the 21st century and that overall corporate performance can be improved by balancing the joint welfare of multiple stakeholders.

³⁵⁴<http://www.csrwire.com/article.cgi/4383.html>

Chapter 6: United Kingdom Case Study

In the previous two chapters, the focus has been on the analysis of the two case-study companies from Hong Kong and the Netherlands. For this chapter, the focus shall be on the company which I have selected for the United Kingdom.

Recall that in chapter 2, I have already looked at some of the fundamental principles of UK corporate law and how the economic theories of firms have influenced the corporate governance mechanism of the English-speaking world including the United Kingdom. Therefore, instead of repeating them again here, I shall instead explore the UK's system of corporate governance development from a historical perspective.

Before I move on to my case-study analysis, I shall also make a brief analysis of the proposed company law reform which is expected to come into force around 2007 and how that may change (if any) the corporate governance landscape of the United Kingdom. It is again important to explain the reason for doing so because as mentioned in earlier chapters, the law matters in corporate governance and how it has influenced the ways which the selected case-study company is being managed. It also provides an overview and explains why I have selected a UK-based company as a case study. The reason for doing so is to maintain consistency as this was also conducted for the previous two chapters.

1). The UK Political Economy and its relationship with Corporate Governance

As mentioned earlier in chapter 2, since the end of the nineteenth century the British society was heavily dominated by laissez-faire principles. The industrial revolution and the rise of the British Empire gradually created a corporate economy which was given legislative backing by a number of Companies Acts which were passed since 1844. At the end of the nineteenth century,

the doctrine of corporate personality was eventually confirmed by the House of Lords³⁵⁵, conferring limited liability on incorporators thus giving individuals the advantages of establishing their businesses through corporate form. This allowed corporate property to be treated as a private association, which should have the minimum of government regulation and interference.

As a result, there was a lack of political interest in the legal framework for companies. The Conservative party which was in power in the UK for two-thirds of the twentieth century has been a stoic defender of the corporate economy and accepted the integration of corporate property with private individual property, it therefore saw no need for a radical reform programme. The Liberal party, particularly under William Gladstone did show interest in many aspects of corporate organization and produced many new ideas, yet the Liberals were a minority third party force after the 1920s and for most of the time had no influence on government³⁵⁶. Although the Loreburn Committee 1906 resulted in the Companies Act of 1907-08 and the Greene Committee 1926 led to the Companies Act 1928-29, the fundamental principles of corporate law which had developed in the nineteenth century remained relatively intact. The Labour party which came into power after 1945 was expected to push through corporate law reform, but they often gave a relatively low priority. At the time, the Labour party was more concerned with the conception of the public interest through public ownership, legislation on monopolies and mergers and legal support for trade unionism. Although they did commission the Cohen Committee in 1945 and the Jenkins Committee in 1962 on company law, yet they remained committed to the voluntarist tradition in industrial relations, maintaining the ability of

³⁵⁵Salomon v. A Salomon & Co Ltd [1897] AC 22.

³⁵⁶Gamble & Kelly, "Shareholder Value and the Stakeholder Debate in the UK".
Corporate Governance: An International Review 2001, Vol. 9, No. 2, 110-117.

trade unions to bargain freely, treating them as private voluntary associations³⁵⁷. Therefore, unlike many Continental European economies, collective bargaining never obtained any legislative backing in the United Kingdom.

Until the late nineteenth century, shares quoting on the stock market by British industrial and commercial firms were almost unheard of (save a few exceptions). But by the early part of the twentieth century, there came a strong move towards public ownership. Publicly traded firms gradually became a dominant force in the economy. By the middle of the twentieth century they accounted for over 70% of the profits generated by the British corporate sector³⁵⁸.

However, this emergence of publicly-traded companies did not instantly give rise to the so called “Berle-Means” corporation as it did in the United States where there was a strong separation between ownership by shareholders and control by managers and directors of companies. This is because unlike their American counterparts, British entrepreneurs who founded the companies and their heirs retained a relatively high proportion of the shares and played a prominent role in managerial decision making. In the years prior to 1914, family dominance was still very much the prevalent pattern in the public companies of the United Kingdom³⁵⁹. It was not until the latter part of the twentieth century that family control became less pervasive.

Since the 1960s, there has been an emergence of share ownership by the public on publicly traded companies. As a result, there has been growing concern about protecting the interest of shareholders, particularly from corporate executives’ abuses as the separation of ownership and control became more evident. In response to such development, the court had

³⁵⁷Ibid. at 112.

³⁵⁸Law, Economics and the UK’s System of Corporate Governance: Lessons From History”. *Journal of Corporate Law Studies* 2001, Vol. 1, Part 1, 71-89.

³⁵⁹Ibid, at p. 82.

developed a series of case laws to control and regulate the activities of directors. There is no provision of in the Companies Act 1985 with regards to directors' duties. The Act is not a code of directors' duties. This is partly because there was a lack of political interest in the legal framework for companies in general and since the nineteenth century, directors have been viewed as non-professional laymen. The rationale for this was not to discourage investment and entrepreneurialism. In respect of directors' duties of publicly listed companies, there is the Corporate Governance Code, which provides extra control of directors' conduct. Although they are voluntary by nature, yet a PLC would have to comply with them or risk bad publicity.

In some Continental European economies such as Germany, financial institutions have developed strong links with major industrial and commercial enterprises. However, in the United Kingdom (as well as the United States), commercial banks never became closely involved in the governance of industrial and commercial firms. As a result, UK banking institutions never really owned shares of business customers as they did in Germany³⁶⁰. This is because during the late nineteenth and early part of the twentieth century, British banks kept away from taking on responsibility for the operation and development of UK companies. Senior banking personnel were deeply sceptical about maintaining public confidence in the ability to pay cash on demand³⁶¹. As a result of this strong bias in favour of liquidity, banks hesitated in the ownership of shares as an option on grounds of poor marketability and high risk³⁶².

After the Second World War, as the level of public share ownership increased, a separation of ownership and control began to establish in the United Kingdom. In particular, there was a rise in the concentration of share ownership by a handful of financial institutions.

³⁶⁰Yet the number of financial institutions owning shares in UK PLCs has increased rapidly in the last 10 years.

³⁶¹Collins, "Banks and Industrial Finance in Britain 1800-1939".
London, Macmillan 1991, pp. 69-71.

³⁶²Supra, n. 339, at 83.

eventually creating a “market for corporate control”. It is argued that the UK’s system of market for corporate control allows hostile as well as voluntary takeovers to take place. If managers under-perform, the assets under their charge become undervalued, opening the opportunity for a corporate raider to make a bid for the firm by offering existing shareholders substantially more than the existing value of their shares, thus a better guarantor of shareholders’ interest³⁶³.

At the same time, the UK system of market for corporate control was also partly bolstered by the London Stock Exchange, a private body that functioned without direct support from government throughout much of the twentieth century (until fairly recently). The Stock Exchange strengthened investor confidence by scrutinizing offerings of shares before trading commenced. After the Second World War, the Stock Exchange further amended its listing rules to deal with various matters of potential concern to outside investors such as disclosure, preemptive rights, insider trading, and other forms of self-dealing by directors and majority shareholders. The Exchange’s reputation for integrity was gradually growing and this also contributed to the United Kingdom as one of the world’s major financial centres, where companies can sell equity to the public in a sufficiently hospitable environment³⁶⁴.

a). European Union’s Influence

One of the biggest steps which the United Kingdom has taken in international relations in the twentieth century was entering the then European Common Market, now referred as the European Union. Britain was originally sceptical about the Union when it was first formed in the late 1950s, but by the 1960s due to persistent economic decline and loss of influence in

³⁶³Sternberg, “Stakeholder theory exposed”.

Corporate Governance Quarterly 1996, No. 2, 1.

³⁶⁴Supra n. 339, at 86.

world's affairs, it realized that joining the Common Market made both economic and political sense. The UK made two attempts to join in the 1960s, yet it failed on both occasions due to the exercise of a veto by France. It was not until 1973 that the UK became a full member of the European Community.

The main objective of the EU is to promote deeper integration and harmonization of many of the institutional features of the different national economies. However, there have been strong challenges from many member states, including the United Kingdom where governments have not always been supportive of EU policies with regards to social and economic issues.

In 1994, the last Conservative government of the UK opted out of the social chapter and the directive on worker representation. As far as corporate governance was concerned, it has resisted a pan-European company statute and instead put its faith in traditional models of self-regulation through stock exchange regulation and voluntary codes on corporate governance.

The Labour government which came to power in 1997 vowed to take a greater interest in EU affairs and one of the first steps it took was incorporating the social chapter and the worker representation directive. This approach was partly political and at the same time it realized the economic reality since British companies with operations in other member states already had to comply with them. More recently, there have been a number of directives from the European Commission and the possibility of a European Company statute has also been on the agenda³⁶⁵.

b). UK Economy post 1979

When the Conservative Party under Margaret Thatcher came into power, it embarked on a programme of economic reform which was arguably one of the most radical and its legacies are still being felt today in the UK even after two decades under the new Labour government.

³⁶⁵Supra, n. 337 at 113

Ever since the end of the Second World War, Britain's economy has been in persistent decline by comparison to other major industrialized economies such as Germany and USA. By the 1970s, with falling economic output, rising industrial actions and decline in living standard, the UK has often been dubbed as the 'economic sick-man of Europe',³⁶⁶.

The Conservative government under Margaret Thatcher believed that in order to revitalize the nation's economy, it was necessary to remove government intervention in the economy and deregulate markets to improve competitions, a process known as the "rolling back of the state". The two most important economic policies under the Conservatives were the privatization of state-owned assets and labour market reform. During its 18 years in power until 1997, the Conservatives have privatized a number of public utilities such as railways and telecoms and have also introduced legislations weakening the power and influence of trade unions³⁶⁷. The aim of these policies were to affirm the doctrine of the market and to strengthen entrepreneurialism in British industries.

The major winner in the reforms under the Conservative governments has been business corporations. Corporations have been liberated and given greater autonomy by regulatory changes such as the abolition of exchange controls and labour market reforms. Ministers have maintained that corporations will be controlled through the natural operation of the market, guaranteed by the competition policy regime, by natural monopoly regulation, and by self-regulation where necessary.³⁶⁸

As a result, Conservative governments continued to perceive the corporation in the light of a nineteenth century doctrine as a separate legal person, owned by shareholders, to be allowed

³⁶⁶Tomlinson, "Inventing decline: the falling behind of the British economy in the postwar years".
Economic History Review 1996, Vol. 49, No. 4, 731-757.

³⁶⁷Wilks, "Conservative Governments and the Economy, 1979-97".
Political Studies 1997, Vol. XLV, 689-703.

³⁶⁸Ibid at 699

complete freedom to operate and contract in the interests of those shareholders. Company directors, shareholders and business organizations defending corporate autonomy rely on the company law which defines companies as legal persons and director's duties in terms of the shareholders alone³⁶⁹.

As a result, no significant reform of the company law has taken place since 1979 (except for the passing of the Insolvency Act 1986 to protect unsecured creditors). Due to its pro-market attitudes, Conservatives would not have accepted any calls for corporate law reform based on the Continental social market model such as Germany and nor would it have promoted a system of corporate governance recognizing the rights of other stakeholders and wider societal interests. Some argue that the eighteen years of Conservative rule has taken the British corporate system steadily closer to the US model³⁷⁰.

Although there are debates as to whether the economic reforms under the Conservatives have really revived the UK's economic power, yet there seems to be some consensus that the overall economy has performed well enough to justify realistic discussion of the end of relative economic decline³⁷¹. Today, the United Kingdom is the fifth largest economy in the world, the largest recipient of Foreign Direct Investment (FDI) in Europe and London is the second largest global financial centre just behind New York. The structure of the British economy has also changed in many ways. Manufacturing has declined in favour of business services, hi-tech industries have blossomed, Britain now trades more with Continental Europe and the mix of the workforce has changed. Furthermore, the nation as a whole has also become more aware of other social issues such as the environment.

³⁶⁹Parkinson, "Corporate Power and Responsibility: Issues in the Theory of Company Law".
Oxford, Clarendon, 1993.

³⁷⁰Supra n 348, at 701

³⁷¹Ibid. at 702

The Labour governments which came to power in 1997 have largely continued with the policies left behind by the Conservatives. In practice, Labour is also now a party of the market. Terms such as cooperative capitalism and stakeholder capitalism have entered the New Labour discourse³⁷². During its election campaign in 1997, the Labour party had put corporate governance and company law reform high on its agenda and it is to this I shall now turn to in the next section.

2). Stakeholder Capitalism under New Labour

During the election campaign of 1997, one of the pledges New Labour made under Tony Blair was to further strengthen the competitiveness of the UK economy by launching a series of financial regulatory and corporate governance reform.

The Blair government was keen on the idea of what it calls the “enlightened shareholder value” or “stakeholder capitalism”, arguing that the value of shareholders can only be maximised if the interests of other stakeholders are also catered for. Just after one year in power, the Blair government set up the **Company Law Review Steering Group (CLRSG)** in 1998. The main objective of the CLRSG was to devise a framework of company law which “facilitates enterprise and promotes transparency and fair dealing”³⁷³. In its consultation document published in early 1999, it acknowledged that the UK current system of company law operates largely to benefit shareholders. In its first consultation paper, it set out its objectives as being to “provide straightforward, cost effective and fair regulation which balances the interests of business with those of shareholders, creditors and others”.

³⁷²Hutton, “The State We’re In”.

London, Vintage, revised edition, 1996.

³⁷³Company Law Review Steering Group,

Modern Company Law for a Competitive Economy, DTI London, March 1998.

During its preliminary stage, the CLRSG proposed two possible areas of reform, which it termed the “enlightened shareholder value” model and the “pluralist model”. The “enlightened shareholder value” model argues that the shareholder’s interests should prevail. In contrast, the “pluralist” model argues that the directors should balance these potentially conflicting interests, without giving automatic priority to the shareholders³⁷⁴.

The “enlightened shareholder value model” soon became known as the “inclusive approach” and is based on the idea that long-term profit maximization can only occur through the fostering of co-operative relationships with the various non-shareholder constituents. It believes that long-term financial well-being can only be achieved if the parties trust each other. Both the Royal Society of Arts (RSA)³⁷⁵ and the Commission on Public Policy and British Business³⁷⁶ have claimed that one explanation for the poor performance of British companies can be attributed partly to the failure to foster long-term relationships between various parties such as employers and employees. Such relationships of trust between the company and its employees have become imperative in the modern economy due to technological innovations. Employees may be reluctant to gain firm-specific skills if they do not trust the management. Employees that trust their employers will be more willing to acquire those skills and this would eventually have positive effects on profits³⁷⁷.

However, critics of the “inclusive approach” argue that the reform does not go far enough because in cases of conflicts of interest between shareholders and non-shareholder groups, preference is still given to shareholder interests. Alternatively, another recommendation which

³⁷⁴Roach, “The Legal Model of the Company and the Company Law Review”.
Company Lawyer 2005, Vol. 26, No. 4, 98-103.

³⁷⁵RSA Inquiry, *Tomorrow’s Company: The Role of Business in a Changing World*.
RSA, London, 1995.

³⁷⁶Commission on Public Policy and British Business, *Promoting Prosperity: A Business Agenda for Britain*, Vintage, London, 1997.

³⁷⁷Supra n. 355 at 100

was made within the CLRSG was the “pluralist approach”. This approach argues that preference should not automatically be given to shareholders but management should seek to balance these potentially conflicting interests. Those in support of this model believe that giving shareholders automatic priority is not always most efficient because unlike other stakeholders such as employees, shareholders may be reluctant to make the necessary firm-specific investments which may benefit the company in the long term.

After a more thorough consultation, the CLRSG eventually adopted the “inclusive approach” in its company law review. The main concern of the CLRSG was that they could see no practical way of enforcing a “pluralist approach” because if it was adopted, then the directors would have to balance the views of numerous groups within the corporate nexus and such a duty could probably be subjective. It argued that provided the law makes it clear that the inclusive approach should maximise the community of interests between shareholders and wider constituents, then a pluralist approach is largely unnecessary³⁷⁸.

In drafting its statement, the CLRSG also believed that company’s directors ought to have an inclusive approach in mind. As a result, it intended that the new company law should clarify the law on directors’ duties. As mentioned earlier, the current law on this area is to be found in a mass of case law (often confusing) and the occasional statutory measures. They are in turn supplemented by various provisions in the City Code on Takeovers and Mergers, the Listing Rules and the Combined Code. According to a study conducted by the Institute of Directors in 1999, it found that many directors believed that the law required them to maximise short-term shareholder benefit at the expense of long-term profit³⁷⁹. A major step towards reforming this problem was taken in 1999 when the Law Commission formally recommended that directors’

³⁷⁸Company Law Review Steering Group, *Developing the Framework*, para.3.24

³⁷⁹Institute of Directors, “Good Boardroom Practice”.
IOD, London, 1999.

duties be made statutory and offered a proposed statement³⁸⁰. At the time, the Law Commission did not examine the issue as to whom these duties would be owed. But eventually, the statement of directors' duties has been accepted by the government in its White Paper on modernizing Company Law and this is now provided under the proposed Companies Act which is expected to come into force in October 2009. In line with the concept behind the inclusive approach, the key objective of directors is "to promote the success of the company for the benefit of its members". They must uphold the current legal view that the shareholders' interests override all other parties within the corporate nexus. However, the statement does go on to list other relevant factors that the directors must take into account such as the need to foster business relationships with employees, business partners and customers. They also need to take into consideration of their operations on the communities and the environment. One objective of the proposed company law reform is to bring together shareholder and stakeholder interests.

It has been argued that the approach taken by the Steering Group (now the Act) places less emphasis on the modification of directors' duties, but more emphasis on increased disclosure obligations³⁸¹. This is related to the CLRSG's recommendations for a mandatory Operating and Financial Review (OFR). The emphasis on increased disclosure seems to be a response to numerous criticisms about the current reporting system being too narrowed, paying attention only to tangible assets and ignoring issues such as the environment. Under the proposed reform, publicly-listed companies and a small number of very large privately held companies ought to produce an OFR. According to the CLRSG, the objective of the OFR is to provide a "discussion and analysis of the performance of the business and the main factors underlying the results and

³⁸⁰Law Commission Report No. 261,

"Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties".

³⁸¹Birds, "The Reform of United Kingdom Company Law".

De Lacy edition, Cavendish, London, 2002, at p. 160.

financial position are likely to affect performance in the future. This would enable users to assess the strategies adopted by the business and the potential for successfully achieving them”³⁸². In relation to the inclusive approach, the categories which the OFR should include are, the company’s relationships with key stakeholders (employees, customers, and suppliers), corporate governance values and structures, and policies on environmental and community issues.

Critics of the OFR proposal argue that they do not go far enough. Firstly, it will only apply to very large companies and secondly, reporting on the above issues is not actually mandatory. Instead, it is left to the director’s good faith and judgement in the determining whether the issue is “material”. This could lead to piecemeal reporting which undermines the purpose of transparency that the OFR aims for. It is still yet to be seen the impact which the OFR would have after the new company law comes into force.

The approach taken by the CLRSG as mentioned above is in essence a shareholder-centred one and some critics have labelled the proposed reform as merely “shareholder model in disguise”. However, supporters of the reform believe that the inclusive approach adopted by the CLRSG attempts to increase shareholder wealth by building long-term, stable and co-operative relationships with all parties within the corporate nexus. The reform even goes as far as to include the community and the environment for which the directors have to take into account in their decision-makings. This by itself is a fundamental inclusion³⁸³.

From the above analysis, it can be seen that Governments whether of centre-right or centre-left have largely taken a “hands-off approach” towards company law and corporate governance, preferring to allow market forces to determine business activities. Even in the case

³⁸²Company Law Review Steering Group
Developing the Framework, at para.5.79.

³⁸³Supra n. 355, at 103.

of publicly-listed companies, they have largely opted to use the Listing Rules of the stock exchange and other voluntary codes such as the Combined Code to govern their business activities. This has created a company law model based on shareholder interests. Although the Companies Bill has recently been published by the current government yet the steps taken have not been radical departures from the traditional legal model.

For the rest of this chapter, I shall now turn to the case study analysis of my selected company of the United Kingdom. In particular, I shall attempt to explore whether the company is taking an alternative approach with regards to its corporate governance and management style and whether this is having any impact on its overall performance.

The United Kingdom Case Study: WSP

The case-study company which I shall be analyzing for the UK is the **WSP Group plc** here referred as WSP, with its corporate headquarter in London, United Kingdom. The reason for selecting this company as my case study has already been explained earlier in chapter 3, the research approach chapter, and I do not intend to repeat it here again. Like the other two case studies of this thesis, the findings of this chapter shall be based on interview conducted with a senior representative of the company, documents obtained from the company covering the period between 1999 and 2004, and other external sources including journal articles.. In this case, I managed to conduct an interview with Mr. Peter Sharratt, who is the Environmental Director of Sustainability at WSP, and is responsible for promoting the environmental and sustainable development policy and other stakeholder issues of the company which we shall look at later in greater details. Moreover, similar to the two previous case studies, in order to avoid bias, I have also managed to arrange an interview with a representative from an organization called

SustainAbility, which is an independent consultancy/NGO based in the United Kingdom that specializes in corporate stakeholder engagement research. The justification for this is to gather an alternative view as to what stakeholder engagement or CSR entails and compare that with those expressed by the company. The findings of this interview will also be presented in detail later on in this chapter.

1). History & Development of the company

WSP group plc is a global business providing management and consultancy services to the built and natural environment. Its business activities include management and consultancy services to the property, land and construction sectors through subsidiary undertakings across the world. It was established in 1969 and became a publicly listed company on the London Stock Exchange in 1987.

In the early 1970s, it was originally established as a building services consultancy with offices in Surrey, south-western England. The company began to expand in the 1980s by first floating on the Unlisted Stock Market Company in 1987 with just 50 staffs and a turnover of £3.2 million. In 1988, it acquired Cairns & Byles in Northeast UK and the development of the motorway communication division. By the late 1980s, the company continued to expand in the commercial market and the number of staff increased to 160.

During the early 1990s, despite economic recession in the UK, WSP continued its growth through various acquisitions by first acquiring Donald Rudd & Partners and later Parsons Brown. In 1990, the company also moved to a full Stock Exchange listing. In 1991 and 1992, the company opened many offices in large metropolitan areas such as London and Manchester and expanded into other regions of the UK such as Scotland. At the same time, it also started to

diversify its business activities by acquiring AB Consulting plc in 1993, strengthening its structural and civil engineering capability and began to take on the outsourced building services of city councils across the United Kingdom.

By the mid 1990s, the company was expanding into other parts of the world by forming WSP Asia in Hong Kong in 1995. Meanwhile WSP Environmental was also established to cater for growing market needs. In 1997, WSP acquired the Graham Consulting Group and formed development planning and network management businesses. WSP Facilities Management also began to provide aftercare services for clients. The number of staff increased to 1000. In 1998, the group restructured to improve cross selling opportunities and an executive committee was also established to manage the overall running of the group. Meanwhile, the number of staffs increased to 1500 and turnover reached £77 million.

The group's expansion continued in the new millennium through landmark acquisitions. In 1999, it acquired HJT in the UK and WEVS and MBS in South Africa, increasing the number of staff to 2000 and turnover eventually reaching £100 million. In 2000, it further expanded in the Asia-Pacific region by acquiring the Hong Kong based partnership Mitchell, McFarlane, Brentnall & Partners International Ltd (MMBP), increasing WSP Asia to over 200 employees. In the North American region, the acquisition of the Cantor Seinuk Group and Flack + Kurtz Consulting Engineers in the USA, increased the Group to over 3,000 people.

Elsewhere in Europe, it acquired Jacobson & Widmark (J&W) in Sweden increasing the group to over 4,600 people and making WSP group one of the largest consultants in Europe. J&W later changed its name to WSP. In 2002, the group secured two 5 year contracts with Transport for London Street Management to monitor and manage the core road network in the northwest and northeast regions of the UK.

Today, the WSP group has operations throughout the world, with each of them being a separate legal entity in its respective jurisdictions. Through strategic development, the company has grown into one of the largest international consultancy groups. It has some 5,000 staff operating out of 100 offices worldwide and as of 2004, it has a turnover of approximately £300 million. The UK and Scandinavia accounts for about 80% of the group's turnover and it operates in the property, environmental and transport & infrastructure sectors. It provides a full range of service from planning through to studies, design, implementation and maintenance. The group has extensive international experience in the United States, UK, Europe, Africa, the Middle East, and Asia gained through working in over 60 countries and currently has permanent offices in 30 countries. WSP group is a FTSE SmallCap company listed on the London Stock Exchange³⁸⁴.

2) Company's Core Values

WSP's vision and core values are key in defining the culture of the group. The vision of the company is the following:

“To be the outstanding supplier of specialist and integrated services in the built and natural environment”³⁸⁵.

The core values of the group include motivating its staff to give their best and instilling its clients' confidence by delivering solutions of the highest quality. All of the group's activities are centred around the core values of trust, sharing and supporting, pride and passion, sustainability and innovation³⁸⁶. For the remaining parts of this chapter, I shall be looking at how the company endorses such values and what sort of effect is it having on the overall performance of the

³⁸⁴FTSE SmallCap comprises of companies with the smallest capitalisation of the capital and industry segments. It represents approximately 2% of the UK market capitalisation.

³⁸⁵<http://www.wspgroup.com/vision.asp>

³⁸⁶http://www.wspgroup.com/core_values.asp

company. Similarly, like the previous two case studies, I shall also be focusing on how the company manages its relationships with its major stakeholders: employees, customers, the environment/communities and shareholders. I shall now begin the analysis by looking at workers/employees as stakeholder.

3). Workers as Stakeholders

As mentioned earlier, the WSP group employs well over 5,000 people worldwide. It provides special and integrated services in the built and natural environment for its clients. Therefore, it understands that in order to fulfil its corporate vision, it needs to be able to employ and retain the best talents possible.

According to its annual report 2004, the group focuses on high added value appointments and in order to support this, the company has established a new management consultancy division. Furthermore, the company also has a specific target to improve the efficiency of its workforce through improved resource management³⁸⁷.

One of WSP's ambition is to become the employer of choice, attracting the best staff to promote its vision of becoming the outstanding supplier of specialist and integrated services. Therefore, the company conducts many employee surveys to understand the needs and interests of its employees. In its annual report 2004, WSP reports that its employee survey was extended globally and the findings illustrate that employees have an overall satisfaction rate of 71%. In particular, 69% of the staff said that they understood the company's vision and values³⁸⁸. This should enable WSP to gain competitive advantage over its rivals because according to an article

³⁸⁷WSP Annual Report 2004, p.3.

³⁸⁸WSP Annual Report 2004, p.29.

written by Ken Columbia³⁸⁹, organizations that have aligned workforce performance to corporate objectives continue to outperform their competition year after year. These companies have mastered the core components of a performance management system and the techniques required to link output of the system to the goals of the organization.

Furthermore, it has staff appraisals and empowers its senior staffs by giving them financial responsibilities in many projects. According to Mr. Peter Sharratt:

“...the business has a relatively horizontal organizational structure, making senior management and directors more easily accessible to lower-level staffs. The company organizes many social events for its employees to boost overall morale and conducts salary reviews regularly to ensure that employees receive the salary that they deserve...”.

At WSP, training and development of staffs and career progression play an important role in retaining good staff. As mentioned above, annual appraisals for all staff throughout the group provide feedback and assist in drawing up programmes for continuing professional education to strengthen the skills and expertise of its staffs. According to Mr. Peter Sharratt, the key to WSP's success is very much related to the people it has. The company puts considerable amount of resources in training its employees. To further strengthen its commitment towards employees' education, it launched the WSP University in Sweden, the UK and WSP Environmental providing staff with opportunities to develop business, technical, personal and procedural skills. This program is now also being extended to developing countries where WSP has operations:

“...There is the WSP University which provides training and new ideas for its employees. The company in the past has also arranged intensive unit learning team-building course in South Africa, where employees learn about the nature and significance of team-building by observing the wildlife in the jungle. The company also allows its employees to have career flexibility wherever possible so that they do not have to do the same job or work all the time. It seeks for interesting projects which allows its employees to be more innovative in their work, so that they can be more motivated”. (per Mr. Peter Sharratt).

³⁸⁹Columbia, “Connecting employees to goals: All there is?”
The International Journal of Newspaper Technology, June 2005.

a). Knowledge Management

WSP attributes its success to what it refers as Knowledge Management³⁹⁰, bringing together the knowledge, experience and expertise of its staffs. It believes that the size and framework of the global organization brings benefits from economies of scale in terms of sharing knowledge and making information and expertise globally available. The company's knowledge sharing is achieved in many ways. For example, international transfers enable staff to gain overseas experience by providing additional support in offices or on projects where resources or certain skills are lacking. Furthermore, staff with similar skills also team up to exchange knowledge and share experiences, thus encourages the benchmarking of good practices as well as the development of new services.

The Knowledge Management system adopted by WSP is also consistent with the theory of the knowledge-based view of the firm which was developed by academics over the last few decades. According to a paper written by Nonaka et al³⁹¹, the knowledge-based view of the firm conceptualises the firm as a "knowledge creation function" and that the "knowledge conversion rate" of a firm is associated with factors such as organizational form, incentive system, corporate culture and organizational routines. Nonaka et al further argue that knowledge and skills can give a firm a competitive advantage because it is through those set of knowledge and skills that a firm is able to innovate new products and services. In another study conducted by Tsoukas³⁹², it sees the firm as a "distributed knowledge system" and argues that knowledge is not a given or external to the individual but is constructed through discourse and the patterns of

³⁹⁰WSP Annual Report 2004, p.28.

³⁹¹Nonaka, Toyama & Nagata, "A Firm as a Knowledge-creating Entity: A New Perspective on the Theory of the Firm". *Industrial and Corporate Change* 2000, 1-20, at 1.

³⁹²Tsoukas, "The firm as a distributed knowledge system: a constructionist approach". *Strategic Management Journal* 1996, Vol. 17, 11-25.

interrelations between employees. Thus the key to success is to continuously create and share knowledge.

In an empirical study conducted by Swart and Kinnie³⁹³, it also shows that successful knowledge-intensive firms such as law & accounting, management consultancy, engineering and other hi-tech companies gain competitive advantage from the human and social capital which make up their unique trading assets. Human capital includes individual knowledge brought into the organization through its knowledge workers, while social capital refers to knowledge that is embedded within the organizational relationships and routines.

Therefore, the knowledge management culture and organizational structure of WSP illustrate that in the long term, it allows the company to develop competitive advantage over its rivals and should support its corporate vision of becoming the outstanding supplier of specialist and integrated services to the built and natural environment.

According to Mr. Peter Sharratt, the scenario with many UK PLCs(Publicly Listed Companies) is that there is usually 5% of the staffs at the top level which are very important to the business and understand the corporate vision. These are highly motivated and the company will always try to retain them. Below that is the next 15% of the staffs which are also talented and important to the company but they may not share the same vision and culture. But at the bottom of this pyramid is the 40 to 45% of the staffs which simply see their jobs as a normal 9 to 5 and receive their pay-checks at the end of the month. They are not motivated to do well and do not understand the company's vision at all, and these tend to be the first ones to be laid off or get redundant where necessary. Mr Sharratt claims that many of WSP's training and education programs are aimed at tackling this problem:

³⁹³Swart & Kinnie, "Sharing knowledge in knowledge-intensive firms".
Human Resource Management Journal 2003, Vol. 13, No. 2, 60-75.

“...One thing which WSP does in its business is to flatten the abovementioned pyramid as much as possible and try to motivate its staffs by using various techniques as mentioned earlier so that it will be able to retain the best people. This also helps to reduce costs associated with high employee turnover”.

4). Customers/Clients as Stakeholders

As mentioned earlier, WSP’s vision is to be the outstanding supplier of specialist and integrated services in the built and natural environments. When I asked Mr. Peter Sharratt as to what the corporate vision entails, he gave this response:

“...The group is very much market led. In the past, many consultancy services have managed to do significantly well by providing very discreet and specialize services for its clients. However, this is no longer the case...Nowadays clients are looking for a one-stop shop consultancy service that can provide integrated specialize services. In particular, many clients have become more concern about the social and environmental impact of their projects. Therefore, the corporate vision of WSP allows the company to re-invigorate itself and differentiate from its rivals, giving the company an extra competitive edge...”.

Therefore, WSP aims to develop long lasting, sustainable relationships by exceeding expectations, earning respect and developing trust with its clients. WSP understands that due to the nature of its business (consultancy services), clients are very important to its success. Many of the company’s clients in the UK and other parts of the world are government and public authorities and that it is involved in many Public and Private Partnership (PPP) projects and establishing trust with them is always challenging. Mr Peter Sharratt claims that trust with clients is established by “performing well right from the start”. WSP has framework agreements with many clients such as BAA (British Airport Authority) and the Prison Service. It has a key account manager for core business. Senior directors of the company are responsible for establishing and maintaining relationship with clients, which includes communication and dialogue with clients via the telephone or in person.

“...we (WSP) provide clients with effective technology-based solutions that fulfil their needs, with innovation and research being key to providing clients with added value...”
(Mr. Peter Sharratt).

In order to ensure client satisfaction, WSP has established systems and quality assurance procedures throughout the group with the objective of monitoring project delivery to help ensure that projects delivered as intended. They include quality systems that are certified to ISO 9001. It also monitors client satisfaction through other mechanisms such as client satisfaction surveys³⁹⁴.

a). Satisfying clients and end-users

Many of WSP projects have serious social implications such as the redevelopment of schools in many parts of the UK and the Bath regeneration project. Therefore, it is very challenging to convince the locals that such multi-million projects would actually benefit them and the local communities in the long-term. The company recognizes such difficulties and tries its best to engage the locals.

Mr. Peter Sharratt admits that in the past, many companies simply pay lip service to the local communities. Usually, locals are mainly concerned with issues such as how many jobs would be created for the locals. However, this is no longer the case:

“...people are now looking at this issue at a much harder way. It is often a difficult process to convince the locals and the big issue is how much investment the project will bring in and how much influence do locals have...”.

For example, in recognising the interest of the locals, the Bath Western Riverside project which WSP is involved in, has developed an infrastructure capable of ensuring the links with the city centre and in delivering a mixed use development in which homes, shops, businesses.

³⁹⁴WSP Annual Report 2004, p. 25.

community, cultural and leisure facilities and hotels are interleaved to create a vital vibrant community³⁹⁵. In order to win greater support from the local community, WSP has also prepared the environmental statement as part of the outline planning application for the scheme. This includes remediation strategies to deal with contamination. WSP's work shall feed into comprehensive public consultation exercises and presentations. The company claims that local communities and businesses are very much behind this project and have strong and positive aspirations for Bath Western Riverside³⁹⁶. However, according to Mr. Peter Sharratt, regardless of how much the company would like to benefit and engage the locals in many of its public projects, it is the need of the clients (i.e. public authorities etc.) that is of the utmost important:

“...the ultimate loyalty is always to the client and we will always have to comply with what the client wants, even if this may be in conflict with the locals...”.

For a specialised consultancy service like WSP, customer satisfaction is very important in maintaining its competitiveness. There have been many studies that have been conducted which sought to show the relationship between customer satisfaction/orientation and corporate performance. In a more recent study conducted by David Crowther at the London Metropolitan University³⁹⁷, it shows how satisfying the needs of customers can bring long-term shareholder value for a company.

b). Research & Development and Customer Satisfaction

As a specialised consultancy in the built and natural environment, WSP understands that many of its clients are facing ever-increasing pressures of tightening budgets, the constant need for expenditure justification and the burdens of legislation, particularly governing health, safety and environmental performance of buildings and other structures, modern software can offer new and

³⁹⁵Projects & News From WSP Solutions, Summer 2004 Issue, p. 5.

³⁹⁶Ibid

³⁹⁷Crowther, “How Important Is Customer Satisfaction For Long-term Shareholder Value”. London Metropolitan University, July 2005.

effective resolutions to traditional challenges. In recognizing such challenges, experts at WSP have applied the latest technology by providing innovative solutions, tailored to the needs of the customers.

One management tool which WSP is very proud of is the DeDU property management tool which was developed by the company and is now used by local authorities, industries, property and utilities companies throughout Sweden for the efficient management of property maintenance³⁹⁸.

WSP Sweden was approached by Akademiska Hus in Stockholm, an institution that looks after the facilities of educational establishments, including 75% of Sweden's universities. Since the mid 1990s, student numbers have increased by 100,000, leading to considerable growth in the organization's business. Thus Akademiska Hus required a new system for preventative maintenance to cope with the increased workload.

Maintenance engineers at WSP were involved in the evaluation of several systems with Hus, and DeDU was eventually selected because it is simple and easy to use. DeDU is basically a web solution, which can be made accessible to all staffs without having to invest in expensive equipment. Furthermore, staffs using DeDU won't be stuck behind their PCs (Personal Computers) as the system is being introduced to handheld computers so staffs can spend more time out on site. DeDU has proven to be a success, providing a high level of support and service to customers³⁹⁹.

The above example again illustrates how research and development expenditure can help companies to prosper. Over the last few decades, many studies have shown how investment in innovative R&D (research and development) can boost competitiveness of companies. In an

³⁹⁸Projects and News From WSP Solutions
Summer 2004 Issue, p. 7.

³⁹⁹Ibid

article written by Branch⁴⁰⁰, it shows that R&D activity tends to increase both profit and growth. Similarly, in another study conducted by Hirschey⁴⁰¹, it also shows that on average, advertising and R&D expenditures have positive and significant market value effects. This is especially the case for specialised and research-intensive companies like WSP. In a study conducted by Grabowski and Mueller⁴⁰², it indicates that firms in research-intensive industries earn after-tax returns on R&D capital of between 15 and 20%. This is significantly above the rate of return realized on other investment activities. Therefore, investment in R&D can help WSP remain at the forefront of an ever more competitive marketplace and boost its long-term profitability.

5). Environment/Communities as Stakeholders

In the previous sections, I have looked at how WSP manages its relationships with stakeholder groups such as employees and customers. For this section, the focus would be shift towards the overall environment and explore what (if any) action the company takes in contributing to a cleaner environment and better society.

WSP is a consultancy firm that specializes in providing integrated services in the built and natural environment for its clients therefore it understands that the nature of its business is highly environmentally sensitive. According to its Annual Report 2004, there are two principal areas of concern that it identifies through its interactions with society in general and the communities in which it operates. The company seeks to address both the environmental and the social impact of its work and we shall now look at them in greater details.

⁴⁰⁰Branch, "Research and Development Activity and Profitability: A Distributed Lag Analysis". *Journal of Political Economy* 1974, Vol. 82, No. 5, 999-1011.

⁴⁰¹Hirschey, "Intangible Capital Aspects of Advertising and R&D Expenditures". *The Journal of Industrial Economics* 1982, Vol. 30, No. 4, 375-390.

⁴⁰²Grabowski & Mueller, "Industrial research and development, intangible capital stocks, and firm profit rates". *Bell Journal of Economics* 1978, Vol. 9, 328-343.

a). Environmental Performance/Target

Being a service business, WSP considers that its environmental risks as directly associated with the group's own operations are relatively limited in their potential impact.⁴⁰³ It argues that the main environmental impacts are generally restricted to energy and raw materials usage.

Therefore, as an ongoing effort to improve efficiency and reduce waste, WSP has introduced initiatives which include, use of materials from sustainable sources, recycling office waste, use of modern energy efficient offices, energy saving office equipment, and incentives for alternative means of transport other than cars.

Furthermore, WSP's environmental practice has also enabled the company to expand its business in the environmental sector. WSP Environmental was established in the year 2000, since then it has grown significantly in size and by 2004, WSP Environmental recorded a turnover of £36 million employing 572 staffs:

“...when we established WSP Environmental many years ago, it was still at a very infant stage with just a few employees and nobody really knew about it or paid much attention to it. However, in the last few years, the public and indeed many clients have become more aware and concerned about social and environmental implications. As a result the section has grown significantly from just few employees to few hundreds today (Mr. Peter Sharratt).

WSP Environmental specialises in providing environmental solutions to clients at all levels. At national level, it informs government policy and develops energy master plans and carbon emission models for cities. At corporate level, it provides a range of services ranging from sustainability management to environmental auditing. It currently has operations worldwide and has been involved in many projects with environmental impact. For example, one project which the company is very proud of is the building of the Donald Bren School of Environmental Sciences and Management at the University of California, USA. WSP was

⁴⁰³WSP Annual Report 2004, p. 25.

involved in the planning and building of this 85,000 gsf (gross square feet) facility with laboratory, office, teaching and research spaces. The building has been awarded the Platinum LEED certification by the United States Green Building Council for its environmental features⁴⁰⁴.

Today WSP Environmental provides environmental consultancy services across the world from the United Kingdom to South Africa with projects undertaken in over 50 countries in 2004. Apart from developed countries, WSP Environmental is also gradually building itself in other developing and emerging markets where the concern for environmental issues is still relatively low. For example in Saudi Arabia, it has given advises on energy policy as part of a larger project on behalf of the government to develop policy and regulation for environmental protection and in China, it is also helping several new cities to develop energy masterplans. The company believes that its environmental business is well positioned to capitalize on the global marketplace for environmental, social, health and safety consultancy alongside specialised remediation solutions⁴⁰⁵.

The abovementioned example of WSP Environmental illustrates the interrelationship between environmental concern and business success. According to an article written by Stephen Fineman⁴⁰⁶, there are basically four broad interest sets that can influence an industry's response towards environmental protection. The first is pressure from green groups, the second area is government/regulations, the third area comprises those who may not sponsor environmental protection as an end in itself, but are happy to enjoy rewards of greener services if they serve their own interests, and these include the likes of shareholders and customers. Finally,

⁴⁰⁴WSP Annual Report 2004, p. 26.

⁴⁰⁵WSP Annual Report 2004, p. 23.

⁴⁰⁶Fineman, "Green Stakeholders: Industry Interpretations And Response".
Journal of Management Studies 1996, Vol. 33, No. 6, 715-730.

a company's environmental concern can also be influenced by insiders i.e. its own management who may not have a common view of the significance the firm should attach to environmental issues, yet it nevertheless believes that the firm should take into account of the environment in its operation⁴⁰⁷.

In the case of WSP Environmental, it seems that the third and fourth factor explained by Fineman have influenced the business towards raising its environmental concern. As mentioned earlier, WSP established its environmental consultancy in the believe that there would be great potential for the service in the long term and eventually its client base started to grow from around the world due to increasing concern for the environment. Furthermore, its internal stakeholders such as the interviewee of this case study, Mr. Peter Sharratt, who is the company's Environmental Director of Sustainability also has a part to play in it because it is part of his job and duty to promote the environmental and sustainability policies of the business for both self-interest and the overall reputation of the company.

Other studies conducted in the past also suggest that an environmentally responsible strategy can increase corporate value, particularly when those companies are serving the ultimate consumer⁴⁰⁸. It argues that an environmentally responsible firm may be able to decrease its cost of capital while simultaneously increasing its accessibility to funds. This is because lenders and rating agencies may carefully scrutinize a firm's environmental record, responsibility and risk. Moreover, an environmentally responsible corporation is able to market itself and its products to attract a growing segment of the world population as environmental concerns grow.⁴⁰⁹ As a

⁴⁰⁷Ibid. at 716-717.

⁴⁰⁸Curcio & Wolf, "Corporate Environmental Strategy: Impact Upon Firm Value".
Journal of Financial and Strategic Decisions 1996, Vol. 9, No. 2, 21-31.

⁴⁰⁹Ibid. at 23

result, it seems that WSP is reaping the return from its environmental policies and practices as illustrated above.

In his response, Mr. Peter Sharratt believes that there are ways where the company can balance profit and environmental protection such as reducing the environmental impact in its operation and minimize pollution by setting various targets. However, it also acknowledges that there are certain factors which businesses like WSP have no influence:

“...For example there are about 700 million people living in rural China, majority of them are poor. They want to have a better life for themselves and their children. To them, living a better life means moving to large cities such as Beijing and Shanghai and it is not for us living in this part of the world to judge whether or not that is a right decision because they have the rights to realize their own dreams. Inevitably this sort of rural-urban migration will put pressure on cities and have significant social and environmental implications on a global scale....As businesses what we can do is to monitor that development and contribute in whatever we can to reduce the social and environmental impact which economic development may bring and we (WSP) will continue to do that...”.

With regards to the comment above, WSP is therefore is highly committed to the notion of sustainable development and is a signatory member of the BCSD-UK (Business Council For Sustainable Development – United Kingdom)⁴¹⁰, which is an organization that brings together business and professional leaders from a diverse group of companies and organizations within the United Kingdom. It is an action based network, learning from the practical application of sustainable development values and networking that knowledge between member organizations. The mission of BCSD-UK is to be a leading organization in transforming the principles of sustainable development into practical and profitable actions.

⁴¹⁰<http://www.bcsd-nsr.co.uk>

b). Social Contributions

Apart from contributing to environmental protection as mentioned above, WSP also aims to contribute to the social development in countries which it operates. The company achieves this strictly complying with the law and regulations of host countries and promotes human rights and equal opportunities in its employment. According to the group's policy statement, WSP aims to avoid corruption or bribery by conducting its affairs effectively and strives to perform development work in host countries to meet local needs⁴¹¹. The company recognises the importance of respecting local communities and its people because it understands that by neglecting local interests it risks local resentments and it also realises that establishing trust with locals would boost the competitiveness of the company in the long term. This theory is also supported by studies that have been conducted on corporate social responsibility of multinational companies in emerging markets⁴¹².

Furthermore, WSP practices employment diversity and does not discriminate due to gender, age, ethnic background, religion, colour or political opinion. For example, in South Africa, for a number of years, it has implemented Affirmative Action procedures in line with equal opportunities requirements and also actively supports a number of Black Empowerment Enterprises.

The company's policy on employment diversity should benefit its performance in the long term as supported by many studies. In a study conducted by Richard⁴¹³, it shows that diversity added value and was perceived as relative competitive advantage for organizations.

⁴¹¹WSP Annual Report 2004, p. 25.

⁴¹²Krishnan & Balachandran, "Corporate Social Responsibility as a determinant of market success: An exploratory analysis with special reference to MNCs in emerging markets".
Marketing Strategies for Firms in Emerging Markets,
Indian Institute of Management – NASMEI International Conference 2005

⁴¹³Richard, "Racial Diversity, Business Strategy, and Firm Performance: a Resource-Based View".
Academy of Management Journal 2000, Vol. 43, 164-177.

Likewise in a similar study conducted by Erhardt, Werbel and Shrader⁴¹⁴, it also found that relatively higher levels of board diversity would lead to higher organizational performance.

6). Investor/Shareholder Relations

WSP is a publicly-listed company hence profitability is just as equally important for the company because it needs to be accountable to shareholders. The company believes that financial sustainability contributes to long term success. In this section, I shall be focusing on WSP's financial performance and look at how it manages its relationship with shareholders and investors.

a). Corporate/Share Structure

As mentioned earlier, WSP was originally established in early 1970s as a building services consultancy with offices in Surrey, south-western England. The company first floated on the Unlisted Stock Market Company in 1987 with just 50 staffs and a turnover of £3.2 million. It was not until 1990 that the company moved to the full stock Exchange listing.

As of 2005, WSP has some 5,000 staffs operating out of 100 offices worldwide and as of the financial year of 2004 it has a turnover of just above £300 million. The UK and Scandinavia accounts for about 80% of the group's turnover and it operates in the property, environmental and transport & infrastructure sectors. It provides a full range of service from planning through to studies, design, implementation and maintenance. The group has operation in over 60 countries and permanent offices in 30 countries. It is a FTSE SmallCap company listed on the London Stock Exchange.

⁴¹⁴Erhardt, Werbel & Shrader, "Board of Directors Diversity and Firm Performance".
Corporate Governance: An International Review 2003, Vol. 11, No. 2, 102-111.

Like many publicly-listed companies in the UK, many of WSP's shares are held by large group of institutional investors and this has been the trend over the last 20 years, referred as "fiduciary capitalism"⁴¹⁵, where share-ownership is concentrated in the hands of a few institutions the equity on behalf of others. The table below (Fig. 7) is a list of financial institutions that hold substantial interests in the ordinary share capital of WSP:

Substantial Shareholdings

(At 4 March 2005 the directors had been notified of the following substantial interests in the ordinary share capital of WSP) Fig. 7

Name of Institutions	No. of Shares	Percentage
Aviva PLC	6,752,432	11.7%
Henderson Global Investors	5,282,877	8.74%
Standard Life Investments Ltd	2,544,839	4.21%
Legal & General Group PLC	1,829,102	3.03%
Barclays PLC	1,823,807	3.02%

As the level of share-ownership by financial institutions increases, they will inevitably have a lot of influence on the decision-making and operation of the company and this is also argued in a number of researches.⁴¹⁶ Therefore, WSP realises the importance of maintaining a good relationship with institutional investors. When asked about this question, Mr. Peter Sharratt gave this reply:

"...The key to maintaining a good relationship with institutional investors is trust..."

⁴¹⁵Hawley & Williams, "The Emergence of Fiduciary Capitalism"

Corporate Governance: An International Review 1997, Vol. 5, No. 4, 206-213.

⁴¹⁶Holland, "Influence and Intervention by Financial Institutions in their Investee Companies"

Corporate Governance: An International Review 1998, Vol. 6, No. 4, 249-264.

According to Mr. Peter Sharratt, the company manages its major stakeholders (including shareholders) by communicating with them and “establishing a long term relationship based on trust”. For example, with regards to institutional investors, they need time to understand the kind of business WSP is involved in. The company needs to spend time with them to explain what the business entails and how it generates its profit. Once they (investors) understand that they will then start to have faith in the company and share the corporate vision and business approach. Many of the institutional investors such as pension funds are not in for a quick return:

“...They (investors) understand that in order for the business to thrive, they cannot interfere too much on its day-to-day running. Shareholders want to see the business making profit and expect it to have long-term growth potential. The company has achieved growth by making acquisitions worldwide and shareholders have been happy with that and are sharing in our vision and approach...”.

b). Shareholders' Interest & Corporate Governance

In order for the interests of shareholders/investors to be fully protected, it is important for a company to have a good corporate governance structure and this is also the same case with regards to WSP.

WSP is a publicly-listed company on the London Stock Exchange, therefore it must comply with the Listing Rules of the UK Financial Services Authority. Furthermore, it needs to explain how it applies the main and supporting principles of the Combined Code on Corporate Governance and confirm whether or not it complies with the Code's provisions or, where it has not, provide an explanation.

In accordance with the Combined Code, the roles of the Chairman and Chief Executive is split, as agreed by the board, and the Chairman holds regular meetings with the non-executive

directors without the executive directors present⁴¹⁷. To ensure its effectiveness, the Board's composition also brings together a wide range of skills and experience appropriate to the requirements of the business. Board composition and recommendations for the appointment of directors are dealt with by the Nominations Committee and its activities which is also stipulated under the Combined Code. According to its annual report 2004, WSP has complied with all the provisions of the Combined Code on Corporate Governance as laid down in the Listing Rules of the Financial Services Authority⁴¹⁸.

In order to develop mutual understanding of objectives, the executive directors of WSP meet regularly with institutional investors to discuss the performance of the Group, its corporate governance and future strategy. Invitations have also been extended to institutional investors to meet the chairman and other non-executive directors. The company regularly makes corporate and financial presentations to Fund Managers and other institutional investors. At the AGM (Annual General Meeting), separate resolutions are proposed for each substantially different issue to enable investors to receive proper consideration. This illustrates the rising influence of shareholder activism and the influence which institutional investors have as collective bodies over companies, as mentioned earlier⁴¹⁹.

According to Mr. Peter Sharratt, shareholder activism is generally a "good sign". However, there must be check and balance with regards to the power and influence of institutional investors:

"...On the one hand, it is healthy to see shareholders voicing and opposing to issues such as fat cats pay. Yet at the same time there must be checks to avoid institutional investors making unreasonable demands such as unrealistic return on their investments and

⁴¹⁷WSP Annual Report 2004, p. 37

⁴¹⁸WSP Annual Report 2004, p. 39

⁴¹⁹Supra, n. 397, n. 398

constantly interfering in the way how businesses are run. Therefore, communication with investors is very important in establishing that element of trust...”.

As a result of this, the Board of WSP group is responsible for communicating and establishing relationship with institutional investors and they hold regular dialogues with investors.

However, according to Mr. Peter Sharratt, this will inevitably mean that retail investors may be sidelined unless they amass themselves to strengthen their bargaining power.

c). Financial Performance

Investors are most concerned about the company's financial performance and whether or not they are making reasonable level of return on its shareholdings. In this section, I shall be focusing on the overall performance of WSP for the five financial years between 2000 and 2004.

This period is selected because it is the same period measured for the other two case studies.

Consolidated Profit and Loss Accounts

	2004 (£'000)	2003 (£'000)	2002 (£'000)	2001 (£'000)	2000 (£'000)
Group & share of joint ventures and associated undertakings turnover	328,218	298,868	272,024	230,545	137,925
Less: share of turnover of joint ventures and associated undertakings	-19,972	-15,315	-10,574	-5,812	0
Turnover	<u>308,246</u>	<u>283,553</u>	<u>261,450</u>	<u>224,733</u>	<u>137,925</u>
Operating profit on ordinary activities before exceptional items and goodwill	17,813	16,004	14,451	17,502	10,945
Exceptional items	0	-2,250	-6,505	0	0
Amortisation of Goodwill	-5,446	-5,269	-5,128	-3,592	-844
Operating profit	<u>12,367</u>	<u>8,485</u>	<u>2,818</u>	<u>13,910</u>	<u>10,101</u>
Profit on sale of subsidiary undertaking	0	409	0	0	0
Net finance costs	-2,801	-3,313	-2,444	-2,408	-1,352
Profit before tax	<u>9,566</u>	<u>5,581</u>	<u>374</u>	<u>11,502</u>	<u>8,749</u>
Taxation	-4,777	-3,429	-1,988	-4,696	-3,127
Profit/(loss) after tax	<u>4,789</u>	<u>2,152</u>	<u>-1,614</u>	<u>6,806</u>	<u>5,622</u>
Minority interests	-209	-90	-17	0	-21
Dividends	-3,204	-3,010	-2,662	-2,657	-1,560
Retained profit/(loss) for the year	<u>1,376</u>	<u>-948</u>	<u>-4,293</u>	<u>4,149</u>	<u>4,041</u>
Basic earnings/(loss) per share	7.6p	3.6p	(-3.1p)	14.9p	14.8p
Basic EPS before operating exceptional items & profit on sale of subsidiary undertaking	16.6p	15.0p	15.2p	22.7p	17.0p

Fig. 8a

Fig. 8b

Consolidated balance sheets

	2004(£'000)	2003(£'000)	2002(£'000)	2001(£'000)	2000(£'000)
Fixed assets	111,758	113,789	115,815	120,662	42,772
Current assets	106,656	105,105	103,245	98,571	70,652
Total assets	218,414	218,894	219,060	219,233	113,424
Creditors due within one year	-74,263	-127,374	-66,789	-63,824	-63,622
Debtors due after more than one year	0	0	0	7,594	0
Total assets less current liabilities	144,151	91,520	152,271	163,003	49,802
Long term liabilities and provisions	-58,031	-7,071	-66,097	-67,464	-18,086
Net assets	86,120	84,449	86,174	95,539	31,716
Called up share capital	3,023	3,022	2,662	2,657	1,752
Share premium account	76,537	76,510	71,253	70,976	10,190
Shares to be issued	207	253	5,769	7,748	8,761
Profit and loss account	6,033	4,552	6,468	14,158	10,789
Equity shareholders' funds	85,800	84,337	86,152	95,539	31,492
Minority interests - equity	320	112	22	0	224
Total equity	86,120	84,449	86,174	95,539	31,716

Figure 8a and 8b above illustrate a five year review of WSP group's consolidated profit and loss accounts and balance sheets between the years 2000 and 2004⁴²⁰. It shows that during this period the company's turnover has increased from £137.9 million to 308.2 million, a rise of more than 50% in 5 years. Its operating profit has increased from £10.9 million to £17.8 million in the same period, a rise of almost 40%. Although its profit level has fallen between the year 2001 and 2003, yet this was largely due to the economic slowdown in its major markets such as the United States, Asia-Pacific and elsewhere in Continental Europe. Since then, its profitability has risen again significantly from £16 million to £17.8 million.

⁴²⁰WSP Annual Report 2004, p. 76

The company's earnings per share has increased from 17 pence in the year 2000 to over 22 pence in 2001. Although it drastically reduced to around 15 pence in both 2002 and 2003, yet it was largely due to a bear market condition. The situation has improved since then and in 2004, it risen to over 16 pence.

According to WSP's annual report 2004, the group's overall financial performance has started to recover in 2004 from the setback suffered between 2001 and, which saw operating profit increased by 46%, and its earnings per share increasing by 29% from 12 pence to 16 pence between 2003 and 2004. The above results show that despite economic difficulties, WSP was still able to maintain stable profit and earnings for its shareholders and generate healthy return.

7). Views from stakeholder group

In the previous sections, I have looked at how the company itself defines corporate stakeholder engagement and how it is being practiced on a daily basis. Yet they are only views expressed by the company. Like the two previous case studies on Hong Kong and the Netherlands, in order to avoid bias I have managed to gather an alternative view from another stakeholder group as to how they define corporate stakeholder engagement and whether or not they differ from the company. I managed to conduct a personal interview with a representative from an organization called **SustainAbility**, based in the United Kingdom⁴²¹. The interviewee is Seb Beloe, who is a senior researcher of the organization. This organization is an NGO/CSR consultancy with its headquarter in London. The reason why I have selected to interview this particular body and its nature has already been explained in chapter 3 (research approach) therefore I don not intend to repeat it here again. But in general, SustainAbility aims to bring new insight to defining trends, most recently with regard to the role of 21st century NGOs and the part governments have to play

⁴²¹<http://www.sustainability.com>

in driving change. Therefore, interviewing a representative of SustainAbility is appropriate since it can comment and give insights on the CSR practices of UK and European large corporations.

One of the first questions which I asked Seb Beloe was, what makes them different from other NGOs or consultancies in similar field. According to Seb Beloe, unlike other consultancies, SustainAbility does not exist to make money solely:

“...NGOs exist to achieve some public good or public mission. SustainAbility is more an intertwine of the two, we exist to further a particular mission yet also profit making in order to exist. But we make money in order to exist rather than existing to make money. Having it that way around gives us an edge in relationship which we have with companies...”.

SustainAbility was originally founded on the “green issue”. Over the years it has gradually evolved to becoming an independent think-tank and consultancy specialising in corporate responsibility and sustainable development. It believes that sustainability and stakeholder engagement is about helping companies to understand the trend and philosophy of sustainability and environmental issues:

“...We (SustainAbility) introduced the Triple Bottom Line where business processes and strategies are integrating with each other for sustainability and environmental issues...”.

According to Seb Beloe, the UK tends to perform relatively well in terms of stakeholder engagement:

“...We did a benchmark report last year on this, and most of the time the UK companies come on the top quartile. But of course we are looking at a small fraction of UK companies, by in large multinationals. But the bigger UK companies are amongst the best in the world such as BT, BP and Unilever etc...”.

Although SustainAbility believes that there may be certain companies who are promoting CSR or stakeholder engagement merely for the sake of it or just as a publicity stunt, however, it

believes that these are minorities and any company caught doing this may risk even greater loss of reputation in the long term:

“...If it is just a PR gimmick then we can see through it very quickly, especially a particular audience. If it is just PR, then the public would become more sceptical and actually makes it worst for the company...” (per Seb Beloe).

However, there are concerns that an overemphasis on CSR or stakeholder engagement may deter investments and undermine the free-market economy of the UK. Yet in defence, Seb Beloe argues that stakeholder engagement does not contradict with capitalism because business ultimately benefits from strong stakeholder voices and government regulation:

“...There are cases where there is strong government regulation, businesses have benefited from that. For example one of the reasons why the pharmaceutical sector in the USA has done so well is because the FDA has been traditionally a strong regulator and it has provided a very respected and trusted framework in which the industry can operate. If you have a weak regulator, then the industry often have to pick up the responsibility so for example on chemicals, the trust on the industry is very low. Greater stakeholder engagement would benefit businesses in the long term...”.

According to SustainAbility, due to globalization, many large multinationals have operations in many developing societies. In order to ensure that these economies are not exploited, they should aim for “greater transparency and accountability where both companies and government ought to be held accountable for activities in the developing world”. Seb Beloe believes that in the long time, it is possible to strike a balance between the need for profit-maximization and economic development and the promotion of social values at a practical level. This is because many investors are becoming more socially conscious and companies would need to be as well in order to maintain their competitive edge:

“The biggest difficulty is to convince the financial community to look at not just short-term return. The outcome of just focusing on short term return would simply bring sub-optimal results. We are now seeing financial communities such as insurance companies and pension funds looking at more long-term returns of companies. Even ordinary

investors have become more concerned about social and ethical issues. For example a few years ago, when the government launched the baby bond about 3 years ago, there was only one ethical fund option. But now there are about 5. The market is clearly responding to the needs of the public awareness on the issue of CSR and stakeholder engagement...”.

Summary of Chapter

In this chapter, I have looked at how the selected case study company, WSP, manages its relationships with various stakeholder constituents and the effect this has had on its overall performance.

After analysing/comparing the views expressed by both WSP and Seb Beloe of SustainAbility, we can see that both sides hold similar views in terms of stakeholder engagement and CSR practices. That is, both of them believe that the corporate sector ought to foster a culture where stakeholders such as employees, customers and the overall environment ought to be taken into account in decision making. Both WSP and SustainAbility believe that a balance can be struck between profit and social needs. This would eventually benefit the long-term development of the company thus enhancing shareholder wealth.

Since its foundation in 1969, WSP has expanded from a building services consultancy to a publicly-listed company with over 5,000 staffs and 100 offices worldwide, providing specialist and integrated services to the built and natural environment. Throughout this period, it has shown how profitability can be achieved while satisfying the interests of various stakeholders. When asked how WSP resolves its tensions between different stakeholder groups, Mr. Peter Sharratt gives this reply:

“...Due to the nature of business that WSP is in, the company is very rarely in a position where different stakeholders are in conflict. WSP is a consultancy service, therefore it is

only involved in projects where our employees have the expertise and enjoy working on. This makes both employees and clients satisfied, and yet at the same time allows the company to make profit which ultimately benefits the shareholders...”

Furthermore, WSP is also a member of the Business Council For Sustainable Development (BCSD) UK, which is a non-profitable organization made up of companies from a diverse range of businesses. They are represented on the Business Council by their chief executive or another senior member of their management teams. Membership will appeal to companies that are willing and able to show leadership in the pursuit of sustainable development. This involves sharing ideas and experiences; working with other member companies to identify and implement practical business projects; and contributing in-house expertise and resources to support the BCSD-UK programme of projects⁴²². Peter Sharatt, the Environmental Director of WSP group is also a Director of the BCSD Management Committee⁴²³. This shows how committed the company is in contributing to sustainable development.

Therefore, from the findings of this case study, I can answer both my research questions and the hypothesis in the positive. That is, at a practical level, it is possible for a company to attain healthy financial performance and yet at the same time satisfy the interests of other non-shareholding constituents of the company, and that overall corporate performance can be improved by balancing the joint welfare of multiple stakeholders.

⁴²²<http://www.bcsd-nsr.co.uk/members.html>

⁴²³<http://www.bcsd-uk.co.uk/AboutUs/tabid/101/Default.aspx>

Chapter 7: Conclusion

In the previous chapters, I have examined the three selected case-study companies of my research thesis and looked at how they manage their relationships with major stakeholders from employees to shareholders. The thesis has tried to bridge the gap between the economic theories of the firm and stakeholder theory literatures. For this chapter, I intend to draw a conclusion on the findings of my studies and identify some of the problems I have encountered in conducting my research. Towards the end of this chapter, I would also look at whether this research has any future implications.

1). Justification of thesis

As mentioned earlier, the thesis was conducted via the case-study approach as applied to three companies in three different jurisdictions, Hong Kong, the Netherlands and the United Kingdom. As mentioned earlier in chapter 3, the justifications for selecting these three jurisdictions were largely due to their legal, economic and political values and uniqueness. The United Kingdom is studied because its corporate governance model is generally shareholder-oriented where management is generally more focused on profit-maximization and shareholder returns. Therefore, exploring a case-study based in the UK allows us to see whether or not the company follows that traditional approach in their management and what sort of effects it is having on the overall performance of the company.

A company from the Netherlands was chosen because the Dutch economy is traditionally based on the cooperation between employers, employees and the government. This has led to the creation of a corporate governance model where decisions are often made through consensus between relevant parties. Therefore, the purpose of studying a company based in the

Netherlands is to see how its economic and cultural values affect its corporate management approach and its effects. It also provides a contrast with the UK case study. Finally, Hong Kong has been selected because its legal and economic model are more in adherence with the likes of the US or UK due to its colonial past. Therefore, its corporate governance approach is heavily influenced by Anglo-American values where companies are also traditionally focused on profit and shareholder returns. Examining a case-study company based in Hong Kong allows comparison to be made with case-studies based in the UK and the Netherlands.

Moreover, the three companies are involved in different industrial sectors and the main reason in doing so is because the findings of this research is not intended to be a generalisation as to how companies in identical sectors operate and make decisions in various jurisdictions. The objective of this research is to look at the approach adopted by different businesses in separate jurisdictions and whether or not these approaches enable them to strike a balance between profitability and the interest of other non-shareholding stakeholders.

Furthermore, as already mentioned in chapter one and three, this research is not intended to be a statistical study and if companies from the same sector were selected, then the proposition or hypothesis of the research would have to be altered to whether or not is it possible in this particular sector for a company to balance the joint welfare of multiple stakeholders. Yet as the research question and hypothesis illustrate, the purpose of this research is to look at the approach adopted by different businesses in separate jurisdictions and whether or not these approaches enable them to strike a balance between profitability and the interest of other non-shareholding stakeholders. This is also consistent with the research objective and purpose of case studies as mentioned in chapter three, that is case studies are generalizable to theoretical propositions and

not to populations or universes. Therefore, in conducting a case study, the aim is to expand and generalize theories and not to enumerate frequencies.

As mentioned earlier in chapter 1, for many years there have been vigorous arguments between supporters of the shareholder and stakeholder models as to which system is more effective in enhancing corporate governance. For example, economists or lawyers in the US or UK may argue that the Anglo-American shareholder model is more appropriate because there is at least a criterion (i.e. share price) by which you could measure and compare corporate performance. However, on the other hand, supporters of the stakeholder theory would argue that it is necessary to take into consideration interests beyond those of shareholders. It argues that there should be some recognition of the interests of other groups that have a long-term relationship with the company. Such groups include suppliers (business partners), customers, and in particular, employees.

In other words, the major problem with many of these literatures and the practical corporate world in general, is the relative polarization of two extreme values, with each of them attempting to assert superiority over the other and yet this is unhelpful for both the academic and practical world. Thus instead of supporting or challenging the validity of either the shareholder or the stakeholder model, the contribution of this thesis is to search for a middle ground where the concept and theory of both values can be converged.

The justification of conducting this thesis is largely due to the events which have taken place in various parts of the world over the past few years. Since the collapse of Enron, regulators on both sides of the Atlantic have imposed new measures to strengthen corporate governance. In response, many European states have produced a number of corporate

governance codes to monitor public companies, with the United Kingdom at the forefront, ever since the first of its kind, the Cadbury Code was produced in the early 1990s.

Moreover, as mentioned earlier in chapter 1, at EU level a number of directives over the years have also forced a change in the corporate governance landscape of a number of countries, particularly the United Kingdom. The Collective Redundancies Directive, the Acquired Rights Directive on Transfers of Undertakings and the Information and Consultation Regulations now establish the obligation of employers to inform and consult employees' representatives in these particular situations. This signals a new dimension to corporate governance development in the traditional UK shareholder model. The new Companies Act which is proposed to come into force by either late 2007 or early 2008 would also change the corporate landscape of the UK with regards to stakeholder engagement. In line with the concept behind the "inclusive approach", the new Act stipulates that the key objective of directors is "to promote the success of the company for the benefit of its members". Although directors must uphold the current legal view that the shareholders' interests override all other parties within the corporate nexus. However, the statement does go on to list other relevant factors that the directors must take into account such as the need to foster business relationships with employees, business partners and customers. They also need to take into consideration of their operations on the communities and the environment⁴²⁴.

On the other hand, there has been an increase in foreign investment in Continental European companies, particularly from Anglo-American institutional investors who are demanding the same level of rights and information as they might on their own stock exchanges. The introduction of voluntary codes of corporate governance such as the *Vienot* in France and

⁴²⁴Law Commission Report No. 261,

"Company Directors: Regulating Conflicts of Interests and Formulating a Statement of Duties".

the *Peters* in Holland are also a new element to the Continent where countries have traditionally relied on enforced rules and legislations in governing corporate activities.

Furthermore, as many developed economies have reached maturity, there has been an increase in the level of investment in emerging markets by multinational corporations based in the west. Apart from capital and expertise, they may also bring an alternative form of corporate culture and management philosophy which is completely different to that of the recipient country. As their level of investment in these markets increases, there is also concern as to the role played by these corporations both economically and socially and how their activities affect the lives of people in the developing world.

As mentioned earlier in chapters 2 and 3, economic globalization is one of the most powerful forces to have shaped the postwar world. During the past decade, the term “globalization” has become a term which an increasing number of politicians, business people and scholars view and make sense of a changing world. Globalization is not just supplanting traditional lines of social conflict and cooperation, but it is also redrawing them. We have explored how interest groups such as employers, multinational corporations, trade unionists, and NGOs, have found that the capacity to achieve their goals is affected, in one way or another, by the forces of globalization⁴²⁵. Therefore, many of them seek to make sense of this reality and understand its implications for their interests and values because their activities are now influenced by factors beyond their own scope of control. As mentioned earlier, since many multinational corporations operate in various parts of the world, they are required to take into consideration of local factors and have greater understandings of different cultures. Moreover, due to greater media and public scrutiny, they are under tremendous pressure to take into account of more stakeholders such as NGOs in their decision-making.

⁴²⁵Ibid., at p. 2

Globalization provides opportunities as well as challenges for many corporations and societies. Large parts of the developing world such as Sub-Saharan Africa are left behind. Income disparities among the world's people, as distinguished from countries, either have not improved significantly during the past three decades or actually may have become worse, depending on how they are measured⁴²⁶. Although there are many explanations for such disparities, yet some have accused multinational corporations of corporate greed and aggravating the matter. In attempting to abate such resistance and adversity, many corporations have voluntarily taken up the initiative to join forces with multi-stakeholder groups such as NGOs and CSOs in order to "legitimize" their activities by taking into wider consideration of stakeholders who may be affected by their corporate activities. I shall now explore them in greater details.

Therefore, as our world becomes more and more globalized, the distinction between each corporate governance model is becoming more blurred by the day. National identities in terms of corporations will become less important as multinational corporations operate throughout the world. With the increase in cross-border business activities, it is no longer justified to insist that one business model fits all. We must therefore explore ways in which we could bring the best out of different models so that they can be converged to form a more coherent approach towards the balancing of different conflicting interests and this serves as the main research objective of this thesis.

2). Summary & Findings

In conducting this thesis, I have designated one research question and that is.:

"How is it possible for a company to attain healthy financial performance and yet at the same time be accountable to various corporate stakeholders in its operation and decision-making process in a globalizing environment?"

⁴²⁶Ibid., p. 96

From my analysis of the management approach taken by the three selected companies, the MTR in Hong Kong, DSM in the Netherlands and WSP in the United Kingdom, and external views gathered from other sources, it seems that it is possible for a company to attain healthy financial performance and yet at the same time be accountable to various corporate stakeholders in a globalizing environment in the new millennium.

The three jurisdictions studied have very different legal, cultural and socio-economic background. Hong Kong has been a British colony for more than 150 years until 1997 when it was returned to Chinese sovereignty. As mentioned in chapter 4, it is officially a Special Administrative Region of the People's Republic of China which enjoys a high degree of autonomy. The Chinese socialist economic model is not practiced in the city and the Chinese authority has guaranteed that the territory's laissez-faire economic system is to be maintained for 50 years post 1997. Therefore, Hong Kong shares many legal and economic characteristics of the Western World such as the US and UK. This makes it an ideal jurisdiction where a case study research can be conducted. As for the United Kingdom, it has traditionally been one of the most free-market oriented economies in the world where companies have generally been shareholder-oriented and by selecting a case study from the UK allows us to see whether or not the company follows that traditional approach in their management and what sort of effect it is having on the overall performance of the company. With regards to the Netherlands, it practices a unique economic model, known as the "Polder model", which requires the cooperation between three parties, employers, employees and the government. This model has enabled the Dutch economy to achieve a certain degree of economic success over the last 10 years and conducting a case study research of a company based in the Netherlands allows us to see if the

overall society has any influence on its corporate governance and if globalization has had any impact on the corporate culture of the company being studied.

For all three of the companies, the main stakeholder groups that were studied are, employees, customers, the environment/local communities and shareholders. As mentioned previously in earlier chapters, the term “stakeholder” is not limited to include only the four abovementioned constituencies. The reason why these four particular groups are being targeted is due to their direct implications on the survival and well-being of a corporation. Employees are an important stakeholder group because over the last 20 years, scholars have from time to time discussed the importance of human resources management to the success of a business. Their welfare often dictates the quality of the goods or services supplied by the firm which directly affects its reputation. Furthermore, workers and trade unions have always been treated as a special interest group by politicians and governments. Numerous statutes have been passed in the last three decades that are either directly or indirectly concerned with workers. It is therefore an important constituency that ought to be given special attention.

Customers are just as important because no business can survive without customers. They are therefore the ones who actually pay for the wages of the employees and executives. Secondly, like employees, there are also many statutes that have been passed to protect their interests. In the west, we often hear governments blocking proposed mergers or forcing monopolies to sell and break up their companies. These are all measures that are designed to protect the well-being of the consumers in the long-run.

Given the concern that has been raised about issues such as environmental protection in recent years, this is one stakeholder group with growing importance. The general public have

become more aware as to how companies are contributing to a better quality of life and those who neglect the issue often risk bad publicity.

Finally, given that all three of the companies that are being studied are publicly listed on various exchanges, their relationships with shareholders and investors ought to be examined since this is a thesis concerned with balancing the interests of multiple stakeholders.

The Hong Kong case-study (MTR) shows that the modern corporation is made up of a web of relationships between various constituencies and that good corporate performance should be determined by how well the management balances the different interests of multiple stakeholders. The Dutch case-study (DSM) has illustrated that its Triple P principle (People, Planet, Profit) is attainable by being a “good corporate citizen” and at the same time achieving reasonable level of return for its shareholders. Likewise for the UK case-study (WSP), it also demonstrated that at a practical level, it is possible for a company to attain profitability and shareholder return and yet at the same time satisfy the interests of other non-shareholding constituents of the company, and that overall corporate performance can be improved by balancing the joint welfare of multiple stakeholders.

a). Overall Performance in stakeholder engagement

As the research question and hypothesis illustrate, the objective of the thesis is to find out whether it is possible for a business to consider the interests of non-shareholder constituencies and yet at the same time attain healthy financial performance for its shareholders. Given that all three of the selected companies are publicly-listed, they nevertheless face demand from shareholders for greater returns. Therefore, they need to handle competing interests between stakeholder groups with great care.

For the Hong Kong case-study (MTR), railway operators often face opposition in many projects that are environmentally sensitive. For example in 2002, the KCR (another major rail operator of Hong Kong)⁴²⁷ had one of its rail extension projects rejected due to its location. The extension would cross over the Mai Po Marshland, in the outskirts of Hong Kong, which is a conservation zone providing natural habitats for migratory birds from northern China during the winter months. The project was heavily criticised by various green groups and was eventually rejected by the Environmental Protection Department of Hong Kong on the ground that it would damage the ecological cycle of the surroundings. The MTR admit that they have learned from that experience, and as a result the company takes a more inclusive approach in its planning process. Since 2003, the MTR has been engaged in two major projects in Hong Kong, the Tung Chung Cable Car Project and the West Island & South Island Line Projects.

For the Tung Chung project, all parties (incl. green groups and local communities) were provided with working papers and the draft EIA (Environmental Impact Assessment) Report. Their comments were taken on board throughout the study. MTR argued that the key objective of consulting these groups is to ensure smooth running of the project by avoiding conflicts. One successful example which benefited from this consultation is the diversion of a stream course. At the Ngong Ping terminal site a stream course runs through the site boundary and was initially considered to be a highlight of the Theme Village. Observations over a long period of time indicated that the water course was stressed through the effects of pollution primarily from domestic sources and would pose a health and safety risk to the public. As a consequence of MTR's briefing, the Green groups raised their concerns to Government that MTR was not

⁴²⁷The MTR and KCR have successfully merged on Oct. 9th, 2007 after voting by shareholders of the MTR at a special meeting. The merged operator shall change its name to the Hong Kong Railway Corporation in early 2008.

following the correct procedures. In response MTR applied directly to the Environmental Protection Department and obtained an Environmental Permit for this diversion.

MTR also provided the findings from these consultations to the Sustainability Advisory Board (SAB) which is run by Hong Kong University. The SAB comprised of 16 government departments, the Po Lin Monastery (a key tourist spot of the local area) and green groups and was responsible for producing annual sustainability reports for the Tung Chung Cable car project. The SAB also focused on longer-term development of Ngong Ping and the sustainability of the local tourism industry.

As for the proposed Western & Southern Island lines, they consist of 11 planned stations and 16.2 rail km, serving nine regional districts. The public consultation exercise was conducted in conjunction with the Feasibility study. Views from the public have been considered and where appropriate, incorporated into the scheme being developed.

The Key parties consulted during the Feasibility Study included the District councils where the railway will be serving, Legislative Council Transport Panel, professional bodies such as the Hong Kong Institute of Planners and other statutory bodies such as the Advisory Council on the Environment (ACE) and the Town Planning Board.

MTR argued that most of the parties consulted expressed their support for the project. Many of them gave their views on railway alignment, station locations, interchange arrangement, inter-modal co-ordination, fares and funding. Some also expressed concerns on the possible impacts of the railway such as noises and air quality during construction and operation phase. As a result of the continuing public involvement, the majority of the new railway lines are underground with most stations constructed as rock caverns to minimize the environmental impacts during construction.

The public consultation continued after submission of the Project Proposal⁴²⁸. MTR continues to report back to the consulted parties and stakeholders on the latest proposed scheme of the project.

The company firmly believes that this exercise has provided a “better railway project” that will enable an earlier public endorsement of the proposal and will pave the way for early implementation of the project, which the company believes that it is the “most important demand” of the residents of Western and Southern Districts. The company has also pledged that when the projects are underway, a sustainability advisory committee, based on the SAB model used for the Tung Chung Cable Car Project, will be established to keep the community involved and active in the development of these lines.

With regards to the Dutch case study, DSM, the company admits that as a result of globalization and corporate restructuring, redundancies and lay-offs are necessary and these changes are not without objections. As mentioned in chapter 5, the company reported that on 12th March 2004, the Dutch trade unions organized a demonstration by the staff of DSM Limburg to protest against the plans for the Copernicus project, costing about 300 jobs. In response to such concerns, the company drew up its social plans in consultation with internal consultative bodies and the trade unions, which it has always done for layoffs and redundancies. Special plans were drawn up to help as many redundant workers as possible to find alternative work and a mobility centre was also established to help employees find jobs elsewhere. The company also tries to manage the restructuring and reorganization processes in a way that is fair and transparent. Apart from employees, DSM also receives pressure from its shareholders from time to time. One example which the company gives is also mentioned in chapter 5, when it sold its petrochemical unit in 2002, the company received €3 billion and institutional investors

⁴²⁸The proposal was submitted in 2006.

demanded a share buyback and a super dividend from DSM. But DSM resisted that pressure by telling the investors that it would transform the company and use the money to re-invest in the company. Investors only retreated from their demand when the company agreed that they will continue to receive their dividends and even when the company actually shrunk in 2003, the shareholders still received a high dividend.

In the UK case study, WSP, the company's representative in his response believes that there are ways where they can balance profit and environmental protection such as reducing the environmental impact in its operation and minimizing pollution by setting various targets. However, it also acknowledges that there are certain factors which businesses like WSP have no influence. That is, as a company, they cannot dictate how people in other parts of the world choose to live their lives. One example which he gives is that there are over 700 million people living in rural China and they all want to make things better for their families. For them, this means living in large cities such as Beijing and Shanghai and this sort of rural-urban migration will put pressure on cities and have significant social and environmental implications on a global scale. As businesses, all they can do is to monitor that development and contribute in whatever way they can to reduce social and environmental impact which economic development may bring.

Despite some of the challenges faced by these companies in balancing the different interests between shareholders and other stakeholders, based on the findings from my case studies, I believe the answer for both my research question and the hypothesis are positive. For the HK MTR, the analysis and findings in chapter 4 illustrate many of the benefits which the company's policy has brought to both the community and also financial advantage for the company. In maintaining dialogue and involving other non-shareholding constituents in its

decision-making and operational processes, the company has earned the respect of its stakeholders such as employees, customers and the community as a whole. In March 2005, the South China Morning Post, a leading English newspaper in Hong Kong conducted a poll about public perception of large companies. Thirty-three of the biggest publicly listed companies were evaluated according to their standards of corporate governance, contribution to the community, their use of environmentally friendly practices, how well they treated their staff and respect for public opinion and MTR came top of the list.

At the same time, the company has also managed to bring a high-level of profitability for itself and achieved a good level of investment return for its shareholders, despite an overall economic downturn which Hong Kong experienced between 1998 and 2003, as mentioned earlier in chapter 4. Since its IPO in 2000 and until the latest financial year measured (2004), the company's share price has outperformed the local Hang Seng Index and returned to shareholders an average of 9.8%. Meanwhile, it consistently pays dividends and in 2004 announced a full-year dividend of HK\$ 0.42 (just above US\$ 0.05) per share, more or less on par with previous years⁴²⁹. The approach adopted by the MTR shows that a balance can be struck between shareholder and non-shareholder interests.

During the peak of the economic recession and bear market between 2000 and 2003, the local Hang Seng Index lost over 2,400 points and a total shareholder return of -15% and -5% respectively. Even when the market started to recover in 2004, the local index still had a total shareholder return of -2.35% and -0.6%.

However, in contrast, during the peak of the recession (2000 to 2003), the MTR still had a shareholder return of 23.8% and 6.8% respectively. When the market recovered in 2004, the

⁴²⁹Sources: MTR Sustainability Report 2003, p. 57.
MTR Sustainability Report 2004, p.35.

total shareholder return of the company was an astonishing 48.7%, giving it an average shareholder return of 9.8% between the year 2000 and 2004.

In recognising the company's commitment to economic sustainability the MTR's Sustainability Report 2003 and 2004 have won the ACCA Hong Kong Best Sustainability Report award for two consecutive years. The aims of the ACCA Hong Kong Awards for Sustainability Reporting are to encourage and recognise those organizations which report and disclose environmental, social or full sustainability information⁴³⁰. This further proves how committed the company is in promoting sustainability, which provide values for its other stakeholders (employees, customers and the community) and yet at the same time pursue a business model which nurtures long-term economic and financial viability for itself and its shareholders.

As for the Dutch case study (DSM), between 2000 and 2004, its share prices measured at year-end on Euronext Amsterdam have risen from €37.31 to €47.62. Its final dividend has also remained constant, lying between €1.17 and €1.24 for the same period. Moreover, its pay-out to shareholders as percentage of net profit has also risen from 32% in 2000 to 70% in 2004. These statistics show that DSM has performed well in satisfying the interest of its shareholders relative to the market⁴³¹.

Between the year 2000 and 2004, DSM performed well on the stock market. In 2001 and 2002, it was the best performing stock in the AEX index on Euronext Amsterdam in terms of shareholder return. In 2004, it was the third best performing stock on the AEX with a total shareholder return of 27%. This is despite an overall bear market during the same period.

As mentioned in chapter 5, according to DSM's Investor Relations Report 2004, DSM has started to recover in 2004 from the setback suffered between 2001 and 2003. Despite being a

⁴³⁰For further details on this award please refer to the ACCA Hong Kong website:
<http://www.accaglobal.com/sustainability/awards/hkera/>

⁴³¹Source: Presentation to Investors, DSM Annual Results 2004, p. 1

difficult business year due to high oil prices and the further weakening of the US dollar. the company achieved an autonomous volume growth of 8% in 2004 and this was due to its restructuring and improvement projects, including the shedding of employees. The company claimed that it continued its programmes of structurally improving its profitability in 2005 and beyond.

After analysing/comparing the views expressed by both DSM and the local government representative of Limburg in chapter 5, it can be seen that both sides hold similar views in terms of stakeholder engagement and CSR practices. Local government believe that business decisions should be left to be made by businesses. The role of the local government is to provide an environment that creates opportunities for businesses to prosper.

Moreover as mentioned in chapter 5, both DSM and the Limburg provincial government believe that a balance can be struck between profit and social needs. The “Triple P” principle is endorsed by both parties. From its origin as a state-owned mining corporation to its transformation as a publicly-listed worldwide scientific-based chemical and performance material company, DSM has always tried to balance the interests of different stakeholders and this seems to have made it as one of the most successful companies in the Netherlands and Europe. According to a report published by European based **CSR Wire** on September 9 2005, DSM topped the list for the Chemical Industry sector on the Dow Jones Sustainability World Index for the second year in a row, making it the worldwide sustainability leader in the chemical industry⁴³². According to the report, the company was able to retain its top position because it has integrated sustainability into its decision-making and management processes to a very high level. This integration of sustainability into the company's core activities has resulted in stable high scores for all criteria.

⁴³²<http://www.csrwire.com/article.cgi/4383.html>

As for the UK case study (WSP), as mentioned earlier in chapter 6, between the year 2000 and 2004, the company's turnover has increased from £137.9 million to 308.2 million, a rise of more than 50% in 5 years. Its operating profit has increased from £10.9 million to £17.8 million in the same period, a rise of almost 40%. Although its profit level has fallen between the year 2001 and 2003, yet this was largely due to the economic slowdown in its major markets such as the United States, Asia-Pacific and elsewhere in Continental Europe. Since then, its profitability has risen again significantly from £16 million to £17.8 million.

The company's earnings per share has increased from 17 pence in the year 2000 to over 22 pence in 2001. Although it drastically reduced to around 15 pence in both 2002 and 2003, yet it was largely due to bear market conditions. The situation has improved since then and in 2004, it risen to over 16 pence.

According to WSP's annual report 2004, the group's overall financial performance has started to recover in 2004 from the setback suffered between 2001 and, which saw operating profit increased by 46%, and its earnings per share increasing by 29% from 12 pence to 16 pence between 2003 and 2004. The above results show that despite economic difficulties, WSP was still able to maintain stable profit and earnings for its shareholders and generate healthy return.

Throughout its operation, WSP has shown how profitability can be achieved while satisfying the interests of various stakeholders. According to the representative of WSP (Mr. Peter Sharatt), due to the nature of business that WSP is in, the company is very rarely in a position where different stakeholders are in conflict. WSP is a consultancy service, therefore it is only involved in projects where employees have the expertise and enjoy working. This makes both employees and clients satisfied, and yet at the same time allows the company to make profit which ultimately benefits the shareholders.

Furthermore, WSP is also a member of the Business Council For Sustainable Development (BCSD) UK, which is a non-profitable organization made up of companies from a diverse range of businesses. The Environmental Director of WSP group is also a Director of the BCSD Management Committee⁴³³. This shows how committed the company is in contributing to sustainable development.

There is a broad consensus that an effective measurement system of corporate performance or financial performance ought to be driven by customer needs, has a strategic orientation and reflects critical success factors. It must be balanced between financial and non-financial, quantitative and qualitative, objective and subjective measures⁴³⁴. It must also be comprehensive yet simple and transparent and measures should relate to variables that can be influenced by those whose performance is measured⁴³⁵. There is also a general consensus that there is no universal “solution” and that a performance measure must be customised and used appropriately for each situation. Performance measure is not just a ‘technical’ exercise. The metrics directly influence behaviour which is the major reason for the preoccupation with measures. There is also a broad agreement within the large literature on performance measure that effective metrics are, above all, well integrated and balanced between strategy and operations and reflect accurately the objectives of the key perspectives⁴³⁶.

As can be seen from the above analysis, all three companies have illustrated that it is possible for them to attain healthy financial and yet at the same time consider the interest of

⁴³³<http://www.bcsd-uk.co.uk/AboutUs/tabid/101/Default.aspx>

⁴³⁴Nanni et al., 1992

⁴³⁵Kaplan & Norton, “The balanced scorecard: measures that drive performance”.
Harvard Business Review 1992, 70: 71-79.

⁴³⁶Kaplan & Norton, “The strategy focused organization”.
Harvard Business School Press, Cambridge, MA, USA, 2000.

stakeholder constituencies, where improvements to corporate performance are largely based on balancing the joint welfare of multiple stakeholders.

3). Limitations of research and Future Implications

The research of this thesis is conducted via the case study approach as applied on three companies selected from three different jurisdictions – Hong Kong, Netherlands and the United Kingdom. As mentioned earlier in chapter 3, the abovementioned jurisdictions are chosen due to their legal, economic and political values and uniqueness. The reasons for selecting companies from these three societies have been discussed earlier and it is not the intention of this section to repeat them again. Instead I shall focus on discussing the limitations of selecting them for the thesis.

All three of the case studies are based in relatively developed and matured economies. Hong Kong, Netherlands and the United Kingdom all have a GDP per capita of more than US\$ 25,000. While the rationale for this choice is to maintain consistency for the research, yet the main problem with it is that the research findings may have little significance or implications for the developing world where the level of economic and social development is much lower. In more advanced societies like Western Europe for example, both education and income level are a lot higher. Therefore, the general public may be in a better position to make better choices as to what they want to buy or where they want to work. As a result, they are in general more socially concerned with their activities and their attitudes may have influenced many companies to take a more inclusive approach in their decision-making process such as being more environmentally friendly, better work-life balance or more competitive products/services for customers. Yet in contrast, consumers in the developing world may not be able to influence corporate activities at

the same level. All 3 companies have investment and business activities in developing countries, yet given the time and resource constraint, it was not possible in this thesis to accurately assess the impact of their activities in these economies. Although, throughout the case study chapters, I have mentioned how these companies have tried to take into consideration of local communities in where they conduct businesses, yet given the growing impact which the developing world is having on the world economy, further exploration is needed because as mentioned earlier, approaches that work in developed countries do not necessarily apply in less developed ones.

In planning for my research at the beginning, I did consider selecting at least one case study company based in the developing world, but eventually due to time and resource constraints, it was not practicable to do so. In the future, given more time and resources, it may be better to elaborate this research by extending it to companies and organizations based in less developed economies.

Another limitation with the selected case studies is that they are from different industrial sectors. This may not have been ideal as explained earlier but the finding of this research is not intended to be a generalisation as to how companies in identical sector operate and make decisions in various jurisdictions. The purpose of this research as mentioned earlier, is to look at the approach adopted by different businesses in separate jurisdictions and whether or not these approaches enable them to strike a balance between healthy financial performance and accountability to various stakeholder groups in a globalizing world..

As discussed earlier in chapter 3, the case study method is more appropriate for the current research because it stems from the desire to understand complex social phenomena⁴³⁷. One major concern about case studies is that they provide little basis for scientific generalization.

⁴³⁷Bryman, "Social Research Methods".
Oxford University press, 2004, 2nd edition, p. 50

However, when conducting a case study, the aim is to expand and generalize theories and not to enumerate frequencies and this is what this research is about⁴³⁸.

This research provides examples of how companies are accountable to different stakeholders at the practical level. But in conducting the research, only the senior representative of the companies were interviewed, although I have tried to resolve this issue by interviewing other stakeholder groups such as NGOs and government representative in order to get a more balanced view, yet it would still have been better to interview other members and stakeholders of the company such as lower level employees or even customers to gain a broader perspective, due to time and resource constraints this was not possible. Furthermore, the business approaches applied by the selected companies are just few examples and that further research is required to assess whether their approaches could be adopted by more companies or whether there are barriers to its use in various contexts.

Another limitation of this thesis is with regards to the literatures. In chapters 1, 2 and 3, I have tried to cover as many literatures as possible which are related to this topic. However, with the benefit of hindsight, I believe there are still many relevant literatures which I have not covered due to the breadth and depth of the topic. In chapter 2, I have explored some literatures which discuss the relationship between globalization and corporate governance, and how corporations have had to adapt their operations in different parts of the world. However, due to the rising importance of the topic, a lot of literatures have been written between the time when I began conducting this research and the completion of it. Therefore, there may have been some very recent literatures which I have missed out. In retrospect, these literatures should have been included and for future research, they should be taken into account.

⁴³⁸Yin, "Case Study Research Design & Methods".
Applied Social Research Methods Series, 2003, Vol. 5, 3rd edition, p. 10

Throughout this research, I have contributed by illustrating with selected case-studies as to how companies can be accountable to various stakeholder groups and maintain a healthy financial performance in a globalizing environment.

The case-studies illustrated in this thesis suggest that corporate performance evaluation is a synthesis of “financial and non-financial” measures, which can be historic, real-time and future oriented. In a rapidly competitive and changing world, management needs more detailed measures to plan and control activities. The measurement system of an organization is influenced by factors including the dominant legal/economic ideology in the organization’s home-country (as illustrated in the case-studies) for example, free market or social market economics, the corporate culture of the organization, the organization structure, the degree of turbulence in the external environment, and the nature of strategic objectives. These are very large and complicated topics and it was not possible to discuss them in too much detail in the thesis. Perhaps in future research, these issues should be taken into account.

Also as mentioned earlier, due to globalization, the distinction between each corporate governance model is becoming more blurred by the day. National identities in terms of corporations will become less important as multinational corporations operate throughout the world. Thus the main research objective of this thesis is to explore ways in which we could bring the best out of different models so that they can be converged to be more accountable to different conflicting interests.

Over the last 10 to 15 years, many corporations have had to downsize and restructure because modern corporations require swift decision-makings⁴³⁹. More and more, organizations are subcontracting out much of their work in order to achieve the advantages of smaller size and

⁴³⁹Byars et al., “Strategic Management”
Irwin 1996, p. 206

flexibility. It is possible that an organization could contract out so much of its work that it becomes a shell or umbrella organization. This is sometimes referred to as a “virtual organization”⁴⁴⁰. This has led to the emergence of the extended enterprise concept where at the heart of the virtual organization is a core organization that carries out some critical functions to which the organization is particularly well suited. Functions outside this core area of competence may be performed by temporary or contract workers, or farmed out to other organizations with which the core organization has formed alliances or affiliations. In many respects the virtual organization is an extension of the inter-organizational external control strategies⁴⁴¹.

The increasing of virtual organizations for example, has created many social and economic concerns. These organizations require a cadre of temporary and part-time workers, future workers will move between more jobs and often hold several jobs simultaneously. There is also fear that the organizational stratification of workers into core and others will result in further economic stratification of society⁴⁴². One may wonder what is the relevance of this to the research thesis? It affects who may (or may not) be regarded as stakeholders of the corporation. This relates back to the issue of power, legitimacy and urgency of a particular stakeholder group to the well-being of a corporation, which was extensively discussed in chapter 2. All these issues are critical and will need to be answered as our economy becomes more global and corporations become more extended and “virtual” in the workplace. Therefore, with regards to future research, perhaps the rights and responsibilities of respective stakeholders need to be teased out

⁴⁴⁰Hodge et al., *Organization Theory: A Strategic Approach*
Prentice Hall Inc. 1996, p. 202

⁴⁴¹Ibid., at 225

⁴⁴²Ibid., at 225-226

and more precisely defined. Once you can define them, then you will be at a better position to balance them when conflicts arise and start to identify who your major stakeholders are.

Moreover, over the last 10 to 15 years, we often hear the phrase “triple bottom line”, which focuses not just on the value generated by corporations, but also on the environmental and social value that they add⁴⁴³. This concept promotes a fully developed approach to stakeholders, involving a mapping of the range of issues with which they are concerned in their role as stakeholders. Taking all of the issues identified by all stakeholders together, they can be analysed as to the content of concern. And it is at this level that stakeholder issues can be grouped as environmental, social or economic⁴⁴⁴. Any issue will have a stakeholder (or several) who owns it; and any stakeholder is likely to have a range of different issues of concern. This suggests that for corporations to have the greatest confidence that no relevant sustainability issues have been overlooked, it is crucial for them to be accountable and work with the full range of their stakeholders. The related element of meaning is that all such stakeholders should be regarded as entitled to some kind of account of company activities. Currently, there is very limited support in law for such a wider accountability in most national jurisdictions. Although in the UK, section 172 of the new Companies Act 2006 now introduces the concept of “enlightened shareholder value” into the corporate law of the UK, together with a non-exhaustive list of factors that directors must take into account when making decisions. These include wider factors such as employees, environment, suppliers and customers. Some commentators argue that this is

⁴⁴³Henriques & Richardson, “The Triple Bottom Line: Does it all add up?”

Earthscan 2004, p. 3

⁴⁴⁴*Ibid.*, at 27

likely to influence directors' decision-making, leading to an inclusive long-term approach in corporate decision making⁴⁴⁵.

This illustrates that the balance of power within corporations is shifting. Increasingly, the people who hold the key to the marketplace of corporations are no longer just top-management. Therefore, corporations need to adjust their strategies in order to compete in the global marketplace and take into consideration of those stakeholders who may have the greatest "stakes" to the well-being and survival of their businesses. This is accountability of modern corporations in a globalizing environment which this research thesis has been exploring throughout and future research should attempt to develop this further.

Hopefully, this research has at least provided a starting point for similar research projects to be conducted in the future. As mentioned earlier, one major limitation with this research is that the case-studies may be relatively narrow because they are all based in developed economies. In the future, perhaps a similar research can be conducted of companies based in less developed economies, particularly the likes of China and India, as both of them are becoming more influential in world economy. Furthermore, all three of the case studies are publicly-listed companies in their various jurisdictions. Perhaps future research can focus on the management approach of private limited companies and explore whether they have a different perspective to the issue.

Also, given more time and resources, it would be more ideal to conduct a higher number of cases and interview more people or stakeholder groups. Increasing the number of cases may produce results that are generalizable if the sample is big enough for statistical analysis. Moreover, increasing the number of people interviewed in each case study may mean that

⁴⁴⁵Loughrey et al., "Legal Practitioners, Enlightened Shareholder Value And The Shaping of Corporate Governance". *Journal of Corporate Law Studies*, Apr. 2008, 79-111.

different research questions can be asked, for example, about perceptions of sales, managerial's viewpoint on employees' performance and R&D investment.

The business approaches adopted by the three selected companies are just examples and further research is required to assess whether similar approaches could be adopted by more companies in different sectors or countries, or whether there are barriers to their use in various contexts.

Appendix

MTR Interview Questions

- 1). MTR was originally founded as a government-owned railway corporation in the mid 1970s. yet it has now become a publicly listed company on the Hong Kong Stock Exchange. How has that transition come about? And what sort of challenges did it encounter in the process?
- 2). MTR claims to be a “stakeholder company”. Can you please elaborate on this and explain how your company put this into practice?
- 3). Unlike many Hong Kong companies, MTR has a two-tier management structure, the Board and the Executive Directorate. What are their distinctive roles and functions?
- 4). The MTR adopts a fairly unique business model, the so called “rail+property” model. What is so distinctive about this model and how does it benefit the company and Hong Kong in general?
- 5). The Hong Kong MTR is one of the most utilized mass transit railway systems in the world. What sort of measures does the company take to facilitate the commuting of the general public?
- 6). The nature of MTR’s business could have serious social and environmental implications for its surroundings. How do you convince local communities that your company’s activities are both beneficial and environmentally friendly to them?
- 7). In 2002, the Hong Kong KCR has its railway extension project rejected on the ground that it would damage the natural habitat of the Mai Po Marshland. What do you think railway operators have learned from this experience? Also, as the major rail operator of Hong Kong, how do you think we can strike a balance between economic development on one hand and environmental protection on the other?
- 8). Since being publicly listed in the year 2000, how has the share prices of the MTR performed in comparison to other companies or the major index of Hong Kong?
- 9). It is inevitable that there may be tensions between different stakeholder groups such as shareholders, employees, customers and environmentalists. If tensions arise, how is this tension reduced?
- 10). There are now a growing number of institutional investors in many publicly-listed corporations like yours. These investors are traditionally more focused on share price performance and profit maximization. What sort of pressure do you think companies may face from them?

DSM Interview Questions

- 1). DSM was originally founded as a state mining corporation over a century ago, yet it has now become a global corporation in life science products, performance materials and industrial chemicals. How has that transition come about? And what sort of challenges did it encounter in the process?
- 2). Like most Continental companies, DSM has a two-tier board structure, the Managing Board and the Supervisory Board. What are their distinctive roles and functions? If there was a conflict between the two boards what would happen?
- 3). DSM claims to be a “stakeholder company” and believes in the three P’s principle (People, Planet, Profit). Can you please elaborate on this and explain how your company put this into practice?
- 4). Being a scientific-based corporation, it is very important to retain and manage employees of the highest quality. How does your company manage the needs and interests of its employees? Do you conduct employee surveys and are their interests represented in either the Management or Supervisory Board?
- 5). DSM products are sold worldwide to a very large customer base. What sort of measures does the company take to maintain the quality of the products and ensure that they are safe for customers to use?
- 6). The nature of DSM’s business could have serious social and environmental implications for its surroundings. How do you convince local communities that your company’s activities are both beneficial and environmentally friendly to them?
- 7). DSM shares are traded in the Netherlands, Switzerland and the US. What sort of benefits and challenges does this multiple listing provide? For example, what difficulty does it face in complying with the regulations of each exchange and has the Sarbanes Oxley Act in the US affected your company in any way?
- 8). DSM shares are owned by a growing group of international and institutional investors. What sort of pressure (if any) do you get from them in the way you operate your business?
- 9). It is inevitable that there may be tensions between different stakeholder groups such as shareholders, employees, customers and environmentalists. If tensions arise, how is this tension reduced?
- 10). There are now a growing number of Anglo-American investors in many European corporations like yours. Anglo-American investors are traditionally more focused on share price performance and profit maximization. What sort of pressure do you think European companies may face from them? If conflict arises between the institutional investors and the management, what measures would be taken to resolve them?

WSP Interview Questions

- 1). According to your corporate information, your vision is to be the outstanding supplier of specialist and integrated services to the built and natural environment. Can you please explain what that entails?
- 2). The company takes a more stakeholder approach in conducting its business and actively promotes the all-round benefits of CSR. How does your company define stakeholder approach?
- 3). There has traditionally been a conflict between shareholders and other stakeholders. What sort of measures does your company adopt in managing the relationship between different stakeholders?
- 4). Being in the consultancy business, it is very important to retain and manage staffs of the highest quality. How does your company manage the needs and interests of employees? For example, do you conduct employee surveys and what is your employees' turnover ratio in comparison to the sector?
- 5). I realise that many of your clients in the UK and other parts of the world are government and public authorities and that you are involved in many Public and Private Partnership projects. What sort of measures do you take in managing relationship with your clients and how do you establish trust with them?
- 6). Many of your projects have serious social implications such as the redevelopment of schools in the UK and the Bath regeneration project. How do you convince the locals that these multi-million pounds projects would actually benefit them and the local communities in the long-term?
- 7). Many of your major shareholders are institutional investors such as Standard Life and Morley Fund. What sort of pressure (if any) do you get from them in the way you operate your business?
- 8). It is inevitable that there would be tensions between different stakeholder groups such as shareholders and employees. If tension does arise, what is the pecking order? Who do you think should have priority?
- 9). In recent years, there have been many cases in the UK where institutional investors have put pressures on management to make certain changes such as GlaxoSmithKline. In your opinion how do you think the relationship with investors be managed and how would you respond to investors who are constantly demanding high level of return at the expenses of other stakeholders? For example, do you have evidence to show that your business approach actually give you competitive advantage over your rivals?
- 10). As the Environmental Director of a PLC, how do you think we can strike a balance between environmental protection and economic development? Do you or your company have a general view on that?

Community Business Interview Questions

- 1). In your opinion, how would you define corporate stakeholder engagement and good CSR practice?
- 2). On a scale of 1 to 10 (1 being the lowest and 10 being the highest), how would you rate the performance of HK companies in general in terms of engaging major stakeholders in their decision-making processes?
- 3). The Hong Kong MTR prides itself as a stakeholder company and is often perceived as a leading company in this aspect. Do you agree and why? For example, is there any factual evidence?
- 4). Even if a company claims that it is highly committed to CSR and stakeholder engagement, how can the public be convinced that it is genuine and not just simply a marketing or publicity gimmick?
- 5). It has often been argued that even the government of Hong Kong does not actively promote stakeholder engagement and CSR, so why should businesses bother? What benefits would they bring?
- 6). Some would argue that Hong Kong is a free-market economy and that its economic success is due to its pro-business economic policies. Do you think that an overemphasis on CSR or stakeholder engagement would in fact deter business investments overall?
- 7). It is widely known that Hong Kong has one of the worst air qualities in the region. However, this is largely due to rapid industrialization in Southern China which is beyond the control of HK. Therefore, what can companies in Hong Kong do to resolve the problem? Moreover, would it be fair to allocate blame on the business sectors of HK on this issue?
- 8). In September 2005, Community Business launched the Hong Kong Corporate Social Responsibility Charter which many businesses including the HK MTR have signed up to. What does the Charter entail and how does it help businesses to promote CSR?
- 9). A few years ago, the KCRC had its rail extension project in Mai Po rejected due to an environmental issue. What lessons do you think rail operators or other big businesses in Hong Kong have learned from that incident? How do you think such a mistake can be avoided in the future?
- 10). The concept of sustainable development has become a major theme in many societies. But at a practical level, do you think that it is possible to strike a balance between the need for economic development and the promotion of social values?

SustainAbility Interview Questions

- 1). SustainAbility was originally founded on the “green issue”. Over the years it has gradually evolved to becoming an independent think-tank and consultancy specialising in corporate responsibility and sustainable development. How has that change come about?
- 2). What makes SustainAbility different from other consultancies or NGOs who also claim to be promoting and helping businesses on CSR and sustainable development?
- 3). In your opinion, how would you define corporate stakeholder engagement and good CSR practice?
- 4). On a scale of 1 to 10 (1 being the lowest and 10 being the highest), how would you rate the performance of UK companies in general in terms of engaging major stakeholders in their decision-making processes? For example how do UK businesses perform in comparison to other economies?
- 5). Over the years both the UK and EU governments have been actively promoting CSR and stakeholder engagement. Do you think some businesses are merely promoting the concepts for the sake of it?
- 6). Even if a company claims that it is highly committed to CSR and stakeholder engagement, how can the public be convinced that it is genuine and not just simply a marketing or publicity gimmick?
- 7). Some would argue that the UK is a free-market economy and that its overall economic success is due to its pro-business policies. Do you think an over-emphasis on CSR or stakeholder engagement would in fact deter business investments overall?
- 8). Due to globalization, many multinational corporations now have operations in a number of emerging and developing economies. What measures do you think they should adopt to ensure that these economies are not exploited and how can the public ensure that these corporations are complying with those standards?
- 9). SustainAbility has recently launched the “Engaging Stakeholders Program”. What does the program entail and how does it help businesses to promote CSR and stakeholder engagement?
- 10). One of SustainAbility’s aim is to help organizations deliver to shareholders and future generations in the developed world and emerging economies by claiming that it’s the only way to grow true long-lasting value. But at a practical level, do you think that it is possible to strike a balance between the need for profit-maximization and economic development and the promotion of social values?

Limburg Government Interview Questions

- 1). The Dutch economic model is based on the cooperation between government, employers and employees. How does that affect business activities in general?
- 2). Is Corporate Social Responsibility (CSR) and Stakeholder engagement high on the agenda of the Limburg Provincial Government? How would you define good CSR practice?
- 3). When a business invests in the Limburg Region, what sort of contribution or commitment does the government expect it to make to the local areas?
- 4). DSM Group has been based in the Limburg region for over a century and prides itself as a stakeholder company who contributes significantly to the local areas. Do you agree and why? For example is there any factual evidence?
- 5). Although DSM is still headquartered in Limburg, yet it is no longer as economically active as it used to be. What sort of long term implications would that have on the local areas? What measures are the government taking to resolve this problem?
- 6). The majority of commercial activities in the Netherlands are concentrated in the Amsterdam and Rotterdam region. What sort of incentives does the Limburg government provide for large companies like DSM to operate in the region?
- 7). Corporate Social Responsibility and sustainable development are currently very high on the European Union agenda. At a practical level, what measures do you think regional government like Limburg and other local businesses can adopt in order to promote such concepts?

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