THE EMERGENCE AND DEVELOPMENT OF CORPORATE GOVERNANCE AS AN ECONOMIC AND INSTITUTIONAL PHENOMENON

Ilona Bažantová

Charles University in Prague, Faculty of Law, Curie Sq. 7, 116 40 Prague, Czech Republic

Abstract

The article analyses how has been corporate governance formed – it shows a view of history of economic thought on this problem. It describes Adam Smith's opinions on corporations, the Agency Theory and the Principal-Agent Theory. Then, the article provides interpretation of OECD´s definition of corporate governance, it presents the dualistic (two-tier) model and the monistic (one-tier) model and the current institutional concept of corporate governance in the Czech Republic.

Key words: *Corporate Governance, Principal-Agent Theory, OECD, Czech Laws*

INTRODUCTION

The concept of corporate governance appeared in the Czech Republic and post-communist Europe in the mid-1990s with a development of the market system and forms of large capital enterprises. However, the concept of corporate governance is much older, it is connected with existence of large corporations, typically joint-stock companies. It appeared in the process of professionalization of corporate management, when the ownership of corporation is institutionally, economically and legally separated from its control. The problem of corporate governance is multidimensional and interdisciplinary. This article analyses the phenomenon of corporate governance in its history and development, both from the perspective of history of economic thought and from the international point of view. The legal establishment of corporate governance in the Czech Republic will be mentioned, too.

1. A SHORT HISTORICAL EXCURSION FROM THE PERSPECTIVE OF HISTORY OF ECONOMIC THOUGHT

1.1 The United Kingdom

Classical economics, which was dominating as a theoretical school in developed Europe with a market economy from the last third of the 18th century to the second third of the 19th century, did not theoretically deal with the problem of large companies and their management in a systematic way. It merely stated their existence. That is understandable, large corporations were not typical in economy at that time. Nevertheless, Scottish moral philosopher and founder of economics as a science, *Adam Smith* (1723–1790), analysed different types of companies engaged in international trade, described their foundation, functioning and impact on economy in his work "*An Inquiry into the Nature and Causes of the Wealth of Nation*" in 1776. It was in a chapter examining institutions necessary for facilitating particular business sectors. Smith distinguished regulated companies ("when companies do not trade upon a joint stock, but are obliged to admit any person, properly qualified, upon paying a certain fine, and agreeing to submit to the regulations of the company, each member trading upon his own stock, and at his own risk, they are called regulated companies." (Smith 1922, p. 124). According to him, they are similar to guilds and they behave in the same way by creating professional monopolies. He mentioned the Hamburgh Company, the Russia Company, the Eastland Company, the Turkey Company, and the African Company as chartered companies in an international trade. All of them were restricted by statutes and another acts during time and were used to facilitate functioning of government outside the United Kingdom.

One of the companies described by A. Smith was a joint-stock company: "When companies trade upon a joint stock, each member sharing in the common profit or loss in proportion to his share in this

stock, they are called joint stock companies. Such companies, whether regulated or joint stock, sometimes have, and sometimes have not, exclusive privileges.“ (Smith 1922, p. 124-125).

He precisely expressed the nature of a joint-stock company, its ability to gain larger capital than a sole proprietorship. Smith also described behaviour of shareholders: “The trade of a joint stock company is always managed by a court of directors. This court, indeed, is frequently subject, in many respects, to the control of a general court of proprietors. But the greater part of those proprietors seldom pretend to understand any thing of the business of the company; and when the spirit of faction happens not to prevail among them, give themselves no trouble about it, but receive contentedly such half yearly or yearly dividend, as the directors think proper to make to them. This total exemption from trouble and from risk, beyond a limited sum, encourages many people to become adventurers in joint stock companies, who would, upon no account, hazard their fortunes in any private copartnery. Such companies, therefore, commonly draw to themselves much greater stocks than any private copartnery can boast of.” (Smith 1922, p. 232).

Smith expressed and described behaviour and motives of large corporations management even better: “The directors of such companies, however, being the managers rather of other people’s money than of their own, it cannot well be expected, that they should watch over it with the same anxious vigilance with which the partners in a private copartnery frequently watch over their own. Like the stewards of a rich man, they are apt to consider attention to small matters as not for their master’s honour, and very easily give themselves a dispensation from having it. Negligence and profusion, therefore, must always prevail, more or less, in the management of the affairs of such a company.” (Smith 1922, p. 233). The British East India Company and others like The Royal African Company, The Hudson‘s Bay Company, The South Sea Company were presented as a typical example.

It is startling that these Smith’s thoughts on behaviour of large joint-stock companies remained unnoticed by theory, including his followers, for decades.

Large corporations started to prevail over sole proprietorship in economy of the United Kingdom not until the 19th century. Law responded to this fact, but British economic schools and their proponents like *John Stuart Mill* (1806–1873) for late English classical economics or *William Stanley Jevons* (1835–1882) and *Alfred Marshall* (1842–1924) as founders of Cambridge school did not react to development of large joint-stock companies. The emerge of industrialisation reflected in legislative changes: “In 1844 the British Parliament passed the Joint Stock Companies Act, which allowed people to form private companies without a Royal Charter or Act of Parliament. In 1855 Parliament passed the Limited Liability Act, which insulated the directors of a company from full responsibility for the legal or financial failings of the company.” (Bevir 2012, p. 38).

1.2 The USA and Discovery of the Concept of “Corporate Governance” in the Theory

Industrial revolution and modern industrial methods progressed in the USA from the end of 1890s. The concentration of capital and business increased and the view of large corporations, their position and impact has changed. The new theoretical school of “Institutionalism” criticising the position, role and functioning of large joint-stock companies started to emerge. Modern American industrial technologies have increased a labour productivity and created conditions for the rise of social welfare. Theory had to react to this fact, it was also necessary to solve practical problems of economy. “Institutions” were defined as rules, customs, traditions and social organisation during time. Institutionalism as a social economic theory strictly rejected economic liberalism. Theoretical foundations of this school were described in the work of *Thostein Veblen* (1857–1929), an author of books “*The Theory of the Leisure Class*” (1899), “*The Theory of Business Enterprise*” (1904) and “*Absentee Ownership and Business Enterprise in Recent Times*” (1923). “Veblen began his formative thinking in the 1880’s, when trusts were emerging and the new ‘dynamic corporation’ was planting itself squarely in the path of the traditional political ideals. His first published economic essay appeared in 1892, two years after the Sherman Anti-Trust Act.” (Lerner 1958, p. 1). As soon as in 1899, Veblen condemned an exploiting character of large businesses in his book “The Theory of the

Leisure Class". He described methods of growth of firms by mergers with the only aim to increase capital power and profit. The Leisure Class ("business") causes crises and destruction of society.

In 1932, a distinguished American institutionalist and co-author of the New Deal – *Gardiner Coit Means* (1896–1988) – used the concept of "corporation" in the contemporary meaning for the first time. Means, together with another institutionalist, lawyer *Adolf A. Berle* (1895–1971), described the position and behaviour of large corporations in the work "*The Modern Corporation and Private Property*". They regarded a corporation as a large capital (joint-stock) company with separation of ownership on one side and control together with management on the other, due to dispersed ownership, which is a fact generally determining its behaviour. "Their study was of the management and control of the modern large enterprise, and it told with compelling statistical force of the current concentration in American industry: the two hundred largest nonbanking corporations were estimated to possess close to one half of the nonbanking corporate wealth of the country, almost one quarter of the total national wealth. And, an equally urgent point, in half of these firms, the stockholders had ceased to have any significant role. Power, for all practical purposes, had passed, and irretrievably, to the management, which was responsible, if at all, to a board of directors of its own selection." (Galbraith 1991, p. 198). Functioning of such corporation with separated ownership on the one side and control together with management on the other was called "corporate governance". The concept of corporate governance was further developed by G. C. Means in his work "*The Corporate Revolution in America*" in 1964.

One of the followers of the original institutional school after the World War II was, apart from G. Means, *John Kenneth Galbraith* (1908–2006). Galbraith followed mainly Thorstein Veblen. According to Galbraith, technical progress and science enabled development of large corporations, which are directed by the so called technostructure. It does not have a profit as a primary aim (except for a satisfaction of shareholders), but strives for turnover, its own benefits and prestige given by a size of a corporation and number of employees. Methods of non-price competition prevail, corporations do not have to respect consumer demand, on the contrary, they manipulate demand. However, large manufacturing corporations unintentionally create opponents in large consumer and business organisations, trade unions, consumer protection organisations etc. He described this in his book "*American Capitalism: the Concept of Countervailing Power*" (1952).

1.3 The Principal-Agent Problem

As early as in 1930s, G. Means and A. Berle pointed out that direct investors are largely replaced by portfolio investors and are not able to efficiently exercise their control rights. This has been mainly the case of public companies and it is typical to Anglo-American setting with usual use of capital markets to gain capital. These facts led to the development of the Agency theory between 1960s and 1980s, which formulated and dealt with the Principal-Agent Problem. The separation of ownership and control creates a potential conflict of interests between owners ("principals", shareholders) and the managers ("agents"), with existing an information asymmetry in favour of "agents". Corporate managers are the agents of shareholders, it is a relationship fraught with conflicting interests. The interest of owners is a financial profit (having a form of dividends or yield from selling shares). The interest of managers may be even contrary to profitability of a company (managers have interest in increasing their benefits etc.). The payout of cash to shareholders creates major conflicts. Payouts to shareholders reduce the resources under managers'control, thereby reducing managers' power.

Kenneth Joseph Arrow (*1921), an economist and proponent of the public choice school, developed a phenomenon of partial interests, motivation of interest groups and information asymmetry in his book "*Social Choice and Individual Value*" in 1951. It, among others, allowed a development of "Agency Theory". Arrow continued to engage in the agency problem, e.g. in articles "*Control in Large Organization*" (1964a) and "*The Role of Securities in the Optimal Allocation of Risk Bearing*" (1964b).

The next author was *Armen A. Alchian* (1914–2013), representing the new institutional economics, with his study "*Corporate Management and Property Rights. Economic Policy and the Regulation of*

Securities" (1968). The philosophy of this book and most of his works about property rights can be summed up in one sentence: "You tell me the rules and I'll tell you what outcomes to expect." According to him, the principal-agent problem occurs only in situations where property rights are not divisible and tradeable, e.g. in public enterprises, cooperatives, nonprofit organisations and companies owned by employees. The next proponent of the new institutional economics – *Harold Demsetz* (*1930) – developed a theory of property rights (1967) and wrote an article "*Production, Information Costs, and Economic Organization*" (1972) together with his colleague Alchian. The problem of functioning of corporations was also examined by *Stephen A. Ross* (*1944) in his article "*The Economic Theory of Agency: the Principal's Problems*" (1973).

An interest in principal-agent theory began to increase in the middle of 1970s, also in connection with an occurrence of crisis elements in global economy and corporations. *Michael C. Jensen* (*1939) has been involved in the analysis of the principal-agent problem for a long time. It is symptomatic that after writing an article "*Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*" together with *William H. Meckling* (1922–1998) in 1976, economic science did not pay attention to it from the beginning, citing it in just a few tens of works. Since 2005, it has been cited more than thousand times a year according to citation database (already 50 thousands citations in half 2015 in total), which shows a growing interest in this field. According to Jensen and Meckling, their paper (1976) analysed recent progress in the theory of (1) property rights, (2) the agency, and (3) finance to develop a theory of ownership structure for the firm. In addition to tying together elements of the theory of each of these three areas, they analysed new view of the implications for a variety of issues in the professional and popular literature, including the definition of the firm, the "separation of ownership and control," the "social responsibility" of business, the definition of a "corporate objective function," the determination of an optimal capital structure, the specification of the content of credit agreements, the theory of organizations, and the supply side of the completeness of markets problems. M. Jensen also dealt with a principal-agent problem in banking and financial sector together with *Eugene F. Fama* (*1939), (e.g. Jensen & Fama 1983; Jensen 1989, 1991), reflecting the role of institutional investors and managers remuneration (Jensen 2015).

According to Jensen (1986, p. 323), "Corporate managers are the agents of shareholders, a relationship fraught with conflicting interests. Agency theory, the analysis of such conflicts, is now a major part of the economics literature." Indeed, this concept became generally known: the headword "Principal and Agent" appeared in the "*Dictionary of Economics of the New Palgrave*" in 1987. This headword was written by *Joseph E. Stiglitz* (*1943).

The key problem in a principal-agent relation (shareholders-managers relation) is a regulation of this relation in a sense of creating and arranging a functional model of corporate governance. This has become a subject of further contemporary economic, institutional and legal research.

2. INSTITUTIONAL CONTEXT OF CONTEMPORARY CORPORATE GOVERNANCE

Besides economic explanations occurring from 1960s to 1980s and following thoughts of T. Veblen, J. R. Commons, R. Coase, O. Williamson, A. Alchian, H. Demsetz and others (Bažantová 2012, pp. 31-50; Klusoň 2010, pp. 111-126; Sojka 2010), new definitions of corporate governance and recommendations for "good governance" of corporations aiming at harmonisation of this field began to appear from 1990s. This corporate governance harmonisation effort and support for market integration of individual countries may be demonstrated by a fact that some important documents and codes dealing with corporation management have been adopted by the European Union:

1992 – The Cadbury Report on the Financial Aspects of Corporate Governance;

1995 – The Hampel Report on the Final (UK) Corporate Governance;

1999 – The Turnbull Report (Internal Control: Guidance for Directors on the Combined Code, UK);

1999 – The OECD Principles of Corporate Governance;

2003 – The Higgs Review (Review of the role and effectiveness of non-executive directors, UK);

2003 – The Action Plan EU ("The Action Plan on Modernising Company Law and Enhancing Corporate Governance in the European Union", COM 2012/740);

2004 – The OECD Principles of Corporate Governance (revision).

The first version of the UK Corporate Governance Code was produced in 1992 by the Cadbury Committee. Its paragraph 2.5 is still considered for the classic definition: "Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders' role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place. The responsibilities of the board include setting the company's strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board's actions are subject to laws, regulations and the shareholders in general meeting." (FRC 2012, p. 1).

The Organization for European Cooperation and Development ("OECD") Principles are a result of efforts to create an internationally recognised document without a clearly specified scope of application, which can be voluntarily joined by individual countries. "The OECD Principles of Corporate Governance were originally developed in response to a call by the OECD Council Meeting at Ministerial level on 27-28 April 1998, to develop, in conjunction with national governments, other relevant international organisations and the private sector, a set of corporate governance standards and guidelines. Since the Principles were agreed in 1999, they have formed the basis for corporate governance initiatives in both OECD and non-OECD countries alike. Moreover, they have been adopted as one of the Twelve Key Standards for Sound Financial Systems by the Financial Stability Forum. Accordingly, they form the basis of the corporate governance component of the World Bank/IMF Reports on the Observance of Standards and Codes. The OECD Council Meeting at Ministerial Level in 2002 agreed to survey developments in OECD countries and to assess the Principles in light of developments in corporate governance. This task was entrusted to the OECD Steering Group on Corporate Governance, which comprises representatives from OECD countries. In addition, the World Bank, the Bank for International Settlements and the International Monetary Fund were observers to the Group. For the assessment, the Steering Group also invited the Financial Stability Forum, the Basel Committee, and the International Organization of Securities Commissions as ad hoc observers. In its review of the Principles, the Steering Group has undertaken comprehensive consultations and has prepared with the assistance of members the Survey of Developments in OECD Countries." (OECD 2004, p. 9).

Appropriate tools are needed for right and effective exercise of corporate governance. Approximately three sets of tools can be defined in the practice of corporate governance (Malý et al. 2002; Bažantová 2009):

(1) the market tools subject to the condition of functioning capital and other markets, based on the balance of the interests of the owners and management of the company with the profit motivation being dominant;

(2) the regulation (public) tools determined by the legislation based on public regulation taking into account the interests of the whole society; and

(3) the voluntary self-regulation tools that are created as a support and are based on certain impulses, mostly ad hoc, and are not controlled by the government. The voluntary tools mostly occur when the first two tools are ineffective or insufficient, by initiative of some interest groups, e.g., investors, small owners-shareholders, professional and interest associations, etc.

In general, the voluntary self-regulation tools can be divided as follows:

– the independent studies and reports;

– a description of good practices of specific companies;

– the recommendations of good practices and ethical codes of independent professional and interest associations and organizations;

– the recommendations and good practices of institutional investors;

– the recommendations of best practice or good practice of state and public regulators and audit institutions;

– the official procedures and ethical codes of state and public regulators.

According to the OECD, corporate governance includes a set of rules of behavior and conduct between the management, administration bodies, shareholders and other interest groups such as business partners, customers, etc. "Procedures and processes according to which an organisation is directed and controlled. The corporate governance structure specifies the distribution of rights and responsibilities among the different participants in the organisation – such as the board, managers, shareholders and other stakeholders – and lays down the rules and procedures for decision-making." (OECD, Stat Portal). The corporate governance is only part of the larger economic context in which firms operate that includes, e.g. macroeconomic policies and the degree of competition in product and factor markets. The corporate governance framework also depends on the legal, regulatory, and institutional environment, too. In addition, factors such as business ethics and corporate awareness of the environmental and societal interests of the communities in which a company operates can also have an impact on its reputation, its success and its long-term profit (OECD 2004, p. 12).

This modern view of the administration and management of a company is based on a broader view of the company rather than just the relationship between the owners and managers. In a concentrated form, it is represented by the so-called stakeholder theory, which is today closely related to the concept of corporate social responsibility. Corporate social responsibility typically relies instead on non-binding agreements and understandings within networks. Corporations voluntarily consider environmental and social factors when making business decisions. The motives for corporate social responsibility often combine moral and practical considerations. A corporation is more profitable if it maintain mutually beneficial relations based on trust with its suppliers, creditors and customers, as well as with local communities and local government. The reputation of a corporation is one of its most important financial assets (Bevir 2012, p. 49).

3. ORGANISATIONAL AND LEGAL STRUCTURE, CORPORATE GOVERNANCE MODELS

The well-known accounting scandals in large corporations (Enron, Tyco International, Adelphia Communications, Anderson, Global Crossing, Putnam, Computer Associates, Qwest Communications, Parmalat, WorldCom, Xerox …) were discovered in the beginning of the 21st century. The scandals started discussions about the role of public governance in the private corporate (Coffee, 2005). Many states introduced new regulatory laws and regulatory institutes. In the USA, Sarbanes-Oxley Act (2002) was adopted as a reaction on fraudulent behaviour of companies such as Enron, WorldCom and others (account misstatement and forgery).

In the European Union, Directive 2006/43/EC of the European Parliament and of the Council of 17 May 2006 on statutory audits of annual accounts and consolidated accounts also reacted to forgery of accounting documents. The implementation corporate governance was concentrated on increasing the competitiveness of European undertakings and on supporting an improved standard of Community regulation, so called "better regulation", especially as regards the Company Law Directives.

Some other acts were a response to financial crisis from 2008 to 2010. Very extensive is the Dodd-Frank Wall Street Reform and Consumer Protection Act (2010), which also directly affects corporate governance of American joint-stock companies. The UK Corporate Governance Code (2010) was built on a "comply or explain" principle precised in amendments from 2012 and 2014 (FRC 2014, p. 4, pp. 27-29).

3.1 The Main Principles of the UK Corporate Governance Code 2014

The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company. The main Principles of the UK Corporate Governance Code (FRC 2014) are as follows:

(1) Leadership

– *The Role of the Board* (Every company should be headed by an effective board which is collectively responsible for the long-term success of the company.)

– *Division of Responsibilities* (There should be a clear division of responsibilities at the head of the company between the running of the board and the executive responsibility for the running of the company's business. No one individual should have unfettered powers of decision.)

– *The Chairman* (The chairman is responsible for leadership of the board and ensuring its effectiveness on all aspects of its role.)

– *Non-Executive Directors* (As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy.)

(2) Effectiveness

– *The Composition of the Board* (The board and its committees should have the appropriate balance of skills, experience, independence and knowledge of the company to enable them to discharge their respective duties and responsibilities effectively.)

– *Appointments to the Board* (There should be a formal, rigorous and transparent procedure for the appointment of new directors to the board.)

– *Commitment* (All directors should be able to allocate sufficient time to the company to discharge their responsibilities effectively.)

– *Development* (All directors should receive induction on joining the board and should regularly update and refresh their skills and knowledge.)

– *Information and Support* (The board should be supplied in a timely manner with information in a form and of a quality appropriate to enable it to discharge its duties.)

– *Evaluation* (The board should undertake a formal and rigorous annual evaluation of its own performance and that of its committees and individual directors.)

– *Re-election* (All directors should be submitted for re-election at regular intervals, subject to continued satisfactory performance.)

(3) Accountability

– *Financial and Business Reporting* (The board should present a fair, balanced and understandable assessment of the company's position and prospects.)

– *Risk Management and Internal Control* (The board is responsible for determining the nature and extent of the principal risks it is willing to take in achieving its strategic objectives. The board should maintain sound risk management and internal control systems.)

– *Audit Committee and Auditors* (The board should establish formal and transparent arrangements for considering how they should apply the corporate reporting and risk management and internal control principles and for maintaining an appropriate relationship with the company's auditors.)

(4) Remuneration

– *The Level and Components of Remuneration* (Executive directors' remuneration should be designed to promote the long-term success of the company. Performance-related elements should be transparent, stretching and rigorously applied.)

– *Procedure* (There should be a formal and transparent procedure for developing policy on executive remuneration and for fixing the remuneration packages of individual directors. No director should be involved in deciding his or her own remuneration.)

(5) Relations with shareholders

– *Dialogue with Shareholders* (There should be a dialogue with shareholders based on the mutual understanding of objectives. The board as a whole has responsibility for ensuring that a satisfactory dialogue with shareholders takes place.)

– *Constructive Use of General Meetings* (The board should use general meetings to communicate with investors and to encourage their participation.)

3.2 The Main Models of Corporate Governance

Main distinctions between countries lie in a different way of corporate regulation. New models of legal structures are developing nowadays, analysing not only the problem of a corporate legal form, but also the role of top management and its relation to owners. The boards of a joint-stock company represent important part of the whole corporate governance model. Their main task is to shape organisational structure, enabling smooth functioning of corporate governance. The main subject of corporate governance is a good relationship between managers and stakeholders, including owners, which guarantees reaching their expectations. Contrary to management, its main task is to manage the company and fulfill the planned goals.

Extensive analyses resulted in legal structures of corporate law. Two main models of corporate governance are used in Europe. The first model is Anglo-American (monistic, one-tier). The general meeting of shareholders votes the board of directors (executive and non-executive). This model emphasises shareholders' interests. The tradition of corporate financing by issuing financial instruments in stock markets prevails in Anglo-American countries. The board of directors is composed of executive directors and professionals nominated from outside the company (nonexecutive independent directors) in different proportions. The control function is fulfilled mainly by independent directors. Independence of these members is ensured by many formal and informal standards. In Europe, the monistic model is used especially in the United Kingdom (FRC 2012, 2014) and Spain.

The second model is a continental one (dual, two-tier), also called the German model. It emphasises more the interests of involved parties. Decision-making is separated from control, the general meeting votes the supervisory board, which then appoints the management board. One third of the supervisory board members is voted by company employees. This model separates the responsibility for company management between the management board formed by only executive or a combination of executive and non-executive members and the supervisory board formed by shareholders and independent members. The bank loans financing of corporations prevails in continental Europe including the Czech Republic and there is a tradition of the dual model (Bažantová & Hraba 2006; Bažantová 2008).

4. CORPORATE GOVERNANCE IN THE CZECH REPUBLIC

In the Czech Republic, the Corporate Governance Code, following the OECD Principles of Corporate Governance (2004), was adopted also in 2004. The formation of this Code was instigated by the Czech Securities Commission. Besides the OECD materials, some others resources including the Combined Code of the London Stock Exchange were used. The Czech Corporate Governance Code was a collection of the best practices and standards, which should have been adopted by corporations and did not require the statutory form. This approach has been used also in another countries, e.g. in the United Kingdom. The Czech Corporate Governance Code (2004) however contained some recommendations, which were also corporate duties imposed by statutes. Thus, the Code did not become a dominant part of the Czech Corporate Governance. The statutes have the dominant impact.

From 1992 to 2014, the Act No. 513/1991 Coll., the Commercial Code, regulated only the dualistic (two-tier) model of joint-stock companies internal structure. Currently, the dualistic model is regulated in the new Act of 25 January 2012 on Commercial Companies and Cooperatives ("the Business Corporations Act") No. 90/2012 Coll., which came into effect in January 2014. The act regulates the general meeting, the board of directors and the board of supervisors as compulsory bodies of the joint-stock company. The general meeting shall be an assembly of shareholders, it is the ultimate body of the company. The board of directors shall be an authorized representative body to act on behalf of the joint-stock company and the body in charge of the business management of company. Director shall be removed by a simple majority of votes of present shareholders at the general meeting. The board of directors shall elect their president. As well as directors, the board of supervisors shall be the supervisory body of the joint stock company. Supervisors shall be elected and removed by a simple majority of votes of present shareholders at the general meeting.

The newly regulated Czech monistic (one-tier) model of a joint-stock company is under the Business Corporations Act, which came into effect in January 2014.

Also, there is a new legal regulation of the liability of statutory bodies (for both models). The so called business judgement rule, which defines the content of due managerial care, is, among others, introduced by the new regulation. The duty of loyalty, the duty of obedience, the binding orders and the business judgment rule are the new components of the fiduciary duties (Hurychová & Borsík 2015). According to the Business Corporations Act, the due managerial care is defined in Sec. 51 subsection (1) and Sec. 52 subsection (1) of the Act: "A person shall be deemed to act with due care and the necessary knowledge where, in business-related decisions, he or she could in good faith and reasonably assume to be acting on an informed basis and in justifiable interest of the business corporation. The foregoing shall not apply in cases where such decision-making was carried out without the necessary loyalty." [...] "When assessing whether a member of a body acted with due care, the care that would be exercised in a similar situation by another reasonably diligent person if they would be in the position of a member of a similar body of the business corporation shall always be taken into account." A violation due managerial care is defined in Sec. 53 of the Act: "A person who violated the duty of due care shall return to the business corporation any benefit obtained in connection with such behaviour. Where such return of the benefit is impossible, the obliged person shall pay an equivalent amount to the business corporation in cash." Sections 54-58 define the rules of conflict of an interest, Sections 59-62 define the rights and duties between a business corporation and a member of its body (the so called executive service agreement).

Besides the Business Corporations Act, some other statutes affect the Czech corporate governance: the Civil Code (No. 89/2012 Coll.); the Act on European Cooperative Society (No. 307/2006 Coll.); the Act on Transformations of Commercial Companies and Cooperatives (No. 125/2008 Coll.); the Act on Public Registers of Corporate Entities and Individuals (No. 304/2013 Coll.); the Act on Accountary (No. 563/1991 Coll.), the Act on Auditors (No. 93/2009 Coll.); the Act on Criminal Liability of Legal Persons and Procedure against them (No. 418/2011 Coll.); the Act on Insolvency and Methods of Resolution Thereof (No. 182/2006 Coll.); the Act on European Company (No. 627/2004 Coll.); the Act on European Economic Interest Grouping (No. 360/2004 Coll.) and others. If the corporations are active in the financial market, a supervisory authority of the financial market will be the Czech National Bank by the laws: the Act on the Czech National Bank (No. 6/1993 Coll.); the Act on Banks (No. 21/1992 Coll.); the Act on Management (Investment) Companies and Investment Funds (No. 240/2013 Coll.); the Act on Business Activities on the Capital Market (No. 265/2004 Coll.) and others. (The Czech National Bank supervises the banking sector including credit unions, the capital market including the Prague Stock Exchange, the insurance companies, pension funds and payment system institutions.) The Czech National Bank is a part of the European System of Financial Supervision and cooperates with the European Systemic Risk Board and with European Supervisory Authorities.

CONCLUSION

Corporate governance incorporates the whole complex of relations between owners, management bodies and corporate managers. Corporate governance is a set of legal and institutional rules establishing what companies can (and what they should) do in the economics; they determine who manages corporations, how is this management conducted, how is a return of owner´s capital ensured and risks eliminated. In this context, the article briefly analysed a history of the corporate governance phenomenon and also showed its interdisciplinary overlap.

Presently, the concept of "corporation" encompasses a capital company, typically a joint-stock company. It is not often, but it is possible to match large cooperatives and partially also limited liability companies under continental law to economic signs of "corporate" behaviour. During the new millennium, corporate governance has been extended by the concept of corporate social responsibility as a relation between a corporation and external involved groups.

The separation of exercise of ownership rights and corporate management occurs in large corporations because of dispersed ownership structure. This has been systematically analysed by economic theory since 1960s. Problems of this separation and information asymmetry between owners and managers are described by the Agency theory, specifically the Principal-Agent theory.

The necessity of defining and creating the corporation management rules led to formation of differently oriented good practice policies and publishment of different reports by various institutions and organisations from 1990s to 2004. During the last 10 or 15 years, corporate governance has been developed and simultaneously regulated by law. The new statutes have been adopted around the world and also in the Czech Republic. Corporate governance is developing in two institutionally-legal models, dual and monistic, depending on the legal structures, which stem from typical (historic, institutional and international) characteristics of capital market in a particular country. In continental Europe, including the Czech Republic, bank loan financing prevails and there is a tradition of a dualistic (German) model. In Anglo-American countries, the monistic corporate governance model prevails and there is a tradition of financing by issuing financial instruments in stock markets.

Corporate governance rules in the Czech Republic are present predominantly in binding statutes, other rules (e.g. recommendations of international organisations, codes of ethics etc.) have a general form of recommendations and are not legally enforceable. Current corporate governance rules are embodied in statutes. They are contained mainly in the Business Corporations Act and other statutes regulating the operation of corporations. In the Czech Republic, it is possible to choose between a monistic and a dualistic model.

REFERENCES

Arrow, K. J. 1951, *Social Choise and Individual Values*. Wiley, New York.

Arrow, K. J. 1964a, Control in Large Organizations. *Management Science*, 1964, 10 (April 1964), pp. 397-408.

Arrow, K. J. 1964b, The Role of Securities in the Optimal Allocation of Risk Bearing. *Review of Economic Studies* 31, no. 86 (January 1964), pp. 91-96.

Alchian, A. A. 1968, *Corporate Management and Property Rights. Economic Policy and the Regulation of Securities*, Washington, D.C., American Enterprise Institute.

Alchian, A. A. & Demset H. 1972, Production, Information Costs, and Economic Organization. *American Economic Review*, vol. 62, no. 5, pp. 777-795.

Baker, H. K. & Anderson, R. 2010, *Corporate Governance: A Synthesis of Theory, Research, and Practice*. John Wiley & Sons, Inc.

Bažantová, I. & Hraba, Z. 2006, (eds.), *Corporate Governance – aktuální problémy teorie a podnikové praxe*. Praha, Prospektrum.

Bažantová, I. 2008, (ed.), *Corporate Governance ve veřejném sektoru*. Praha, Prospektrum.

Bažantová, I. 2009, Corporate Governance in today's banking sector in the Czech Republic. *Strategic Management*, vol. 14, no. 3, pp. 15-20,

Bevir, M. 2012, *Governance. A Very Short Introduction*. Oxford University Press.

Cadbury, A. 1992, *Report of the Committee on the Financial Aspects of Corporate Governance.* The Committee & Gee, London.

Coffee, J. C. 2005, A Theory of Corporate Scandals: Why the U.S. and Europe Differ. *Oxford Rewiew of Economic Policy*, no. 2.

Czech Corporate Governance Code 2004, *Kodex správy a řízení společností založený na Principech OECD (2004)*, Komise pro cenné papíry, Praha, available from: www.mpo.cz.

Demsetz, H. 1967, Toward a Theory of Property Rights. *American Economic Review*, LVII, (May 1967), pp. 347–359.

Dodd-Frank Wall Street Reform and Consumer Protection Act 2010, H. R. 4173 (111th), available from: www.govtrack.us/congress/bills/111/hr4173.

Fama, E. F. & Jensen, M. C. 1983, Separation of Ownership and Control. *Journal of Law and Economics*, vol. 26, no. 2, pp. 301-325.

FRC 2012, *The UK Corporate Governance Code 2012*. Financial Reporting Council, (September 2012), London, available from: www.frc.org.uk.

FRC 2014, *The UK Corporate Governance Code 2014*. Financial Reporting Council, (September 2014), London, available from: www.frc.org.uk.

Galbraith, J. K. 1991, *A History of Economics. The Past as the Present*. Penguin Books, London.

Greenbury, R. 1995, On Board Meetings. *Corporate Governance: An International Review*, Blackwood, Oxford, Vol. 3, No. 1, pp. 7-8.

Hampel, R. 1998, *Committee on Corporate Governance: Final report*. The Committee & Gee, London.

Hurychová, K. & Borsík, D. 2015, (eds.), *Corporate Governance*. Praha, Wolters Kluwer.

Jensen, M. C. & Meckling, W. H., 1976, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure. *Journal of Financial Economics*, October 1976, vol. 3, No. 4, pp. 305-360.

Jensen, M. C. 1986, Agency Cost of Free Cash Flow, Corporate Finance and Takeovers. *American Economic Review*, Vol. 76, No. 2, pp. 323-329.

Jensen, M. C. 1991, Corporate Control and the Politics of Finance. *Journal of Applied Corporate Finance*, vol. 4, no. 2 (summer 1991), pp. 13–33.

Jensen, M. C., 2015, publishing – available from: www.people.hbs.edu/mjensen/.

Klusoň, V. 2010, *Moderní korporace v soudobém kapitalismu*. Karolinum, Praha.

Lerner, M. 1958, Editor's Introduction. *The Portable Veblen*. The Viking Press. New York.

Malý, M. & Theodor, M. & Peklo, J. 2002, *Corporate Governance*. VŠE, Praha.

OECD Stat Portal, *OECD Glossary of Statistical Terms*, available www.stats.oecd.org/glossary/detail.asp?ID=6778.

OECD 2004, *OECD Principles of Corporate Governance*. Organisation for Economic Co-Operation and Development, Paris, available from: www.oecd.org.

Ross, S. A. 1973, The Economic Theory of Agency: The Principal's Problems. *American Economic Review* LXII (May 1973), pp. 134-139.

The Sarbanes Oxley Act 2002, H. R. 3763 (107th), available from: www.sec.gov/about/laws/soa2002.pdf.

Smith, A. 1922, *An Inquiry into the Nature and Causes of the Wealth of Nations*. Book IV. and V., Third Edition, Methuen & Co. Ltd., London.

Sojka, M. 2010, *Dějiny ekonomických teorií*. HBT, Praha.

Stiglitz, J. E. 1987, Principal and agent. *The New Palgrave: A Dictionary of Economics*. First Edition. Eatwell, J. & Milgate, M. & Newman, P. (eds.). Palgrave Macmillan, pp. 966-971.

Turnbull, S. 1997, Corporate Governance: Its scope, concerns and theories. *Corporate Governance: An International Review*, Blackwood, Oxford, Vol. 5, No. 4.

Turnbull Committee, 1999, *Internal Control: Guidance for Directors on the Combined Code*, ICAEW, London.