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STUDENT'S NAME: Arisa Kiyomi Yamamoto Leija
SUPERVISORS'S NAME: Marios Koutsias
DISSERTATION TITLE The need for Mexico to reform its Corporate Governance system and incorporate employee representation in the supervisory board through a two-tier board system

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DISSERTATION

The need for Mexico to reform its Corporate Governance system and incorporate employee representation in the supervisory board through a two-tier board system

Name: Arisa Kiyomi Yamamoto Leija
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Chapter 1 -. Introduction

The thesis of this paper is that the Corporate Governance (CG) system in Mexico must change to a two-tier board system that includes employee representation in the supervisory board of the companies when the number of employees is equal or more than a 1000.

The CG regulation in Mexico contained in the dispositions of the Mexican General Corporations Law as well as in the Mexican Securities Market Law, is shareholder primacy oriented, where managers of the company have fiduciary duties towards the shareholders, and the managers are held accountable for the share value[1].

In connection with the same, Mexican companies are mostly family owned, and the ownership structure is concentrated in a few controlling shareholders, which rarely find opposition to their interests. Furthermore, there is not a prohibition for shareholders to have seats in the management board of companies, and simultaneously be the CEOs of such company, which can lead to serious conflicts of interests, since the boards are supposed to monitor the executive officers.

Consequently, there is not a clear separation between the duties of strategy and control within the company, nor a separation between the actors that carry out the control of the company, with the actors that hold the ownership.

Throughout this work, it will be argued that the shareholder primacy model is outdated, and Mexico must shift to a stakeholder approach. This stakeholder approach must be implemented taking into account that the employees and the shareholders are the most important stakeholders within the company, therefore both their interests must be considered in the management.

The above being said, since the employees bear a great risk in case that the company fails, in view that it would mean that they lose their main source of income.

Regarding the same, in Mexico, employees only have representation through the labour unions. However, as it will be furtherly explained in chapter 3, labour unions are not an effective mechanism for protecting nor defending the labour interests.

Alongside with this, poverty in Mexico has increased throughout the last decades, as a result of neoliberal policies that increased the polarization of social classes, making the rich richer, and making

[1] San Martín, R. Durán and A. Valdés, 'Corporate Governance, Ownership Structure and Performance in Mexico' (2012) 5 International Business Research 12.

the poor poorer[2]. This situation, led to a drastic change in the political party that holds the power within the country, and for the first time in Mexico's history, in 2018 a left-wing candidate was elected president (Andres Manuel Lopez Obrador).

The main objective of Lopez Obrador is to achieve democracy and eradicate corruption[3]. However, if a real democracy is to be achieved, then all of the members of the society must cooperate in order to achieve it. Specially, the members of the society that are believed to be the most powerful, which in this case are the wealthy economic groups in Mexico.

In regard of the above, it's important to point out that the law is an organic concept that is created, reformed and altered within a certain social, political and economic reality. Therefore, it has become evident that in order to achieve harmony between the new political regime and the private sector of the economy, the CG system in Mexico must improve and adapt to the new political, social and economic background.

All of the above being said, herein will be argued that it is necessary for Mexico to adopt a CG model that guarantees representation of the interests of employees, therefore, shifting from a shareholder primacy model to a stakeholder approach in the CG system.

In order to do that, it shall be taken into account that Mexico, just as Germany, is a country whose industrial working sector plays an essential role in the economy[4], and since labour unions have been failing to achieve well representation of the employees' interests, a two-tier board system must be implemented.

Throughout this paper it will be argued that the Mexican General Corporations Law *(Ley General de Sociedades Mercantiles* or LGSM*)* as well as the Mexican Securities Market Law *(Ley del Mercado de Valores* or LMV*)* and the Code of Best Corporate Practices must be reformed in order to implement a two-tier board system which includes employee representation in its supervisory board, when the number of employees exceeds 1000.

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[2] A. Morton, 'Structural change and neoliberalism in Mexico: 'passive revolution' in the global political economy' (2003) 24 Third World Quarterly 631.

[3] Consejo General del INE, 'Estatuto de MORENA' (INE, 2018) <https://repositoriodocumental.ine.mx/xmlui/bitstream/handle/123456789/100091/CGex201812-19-rp-10-a1.pdf> accessed 05 June 2019.

[4] A Miranda, 'La industria automotriz en México: Antecedentes, situación actual y perspectivas' (2007) Contaduría y Administración <http://www.redalyc.org/articulo.oa?id=39522110> accessed16 June 2019.

This, in order to improve the negotiation possibilities of employees within the corporate structure, reduce conflicts, increase productivity, lower employee turnovers and layoff, but also achieve a better system of surveillance, and a separation of ownership and control within the company. All of these, while taking into consideration that the purpose of the company is to be sustainable, which implies that a company must be profitable while balancing the stakeholder's interests.

The argument will be developed throughout four chapters, in chapter 2 of this paper the main CG theories and models will be analysed.

It will include an analysis of the shareholder primacy model, the stakeholder approach, the enlightened shareholder and the views against each theory. In this chapter it will be demonstrated that the shareholder primacy model is obsolete and jurisdictions must develop ways of implementing a stakeholder approach.

This chapter is necessary in order to set the base as to which CG systems exist and why the CG system in Mexico must change.

Afterwards, chapter 3 will explain the CG system in Mexico and the legal framework around it; it will also include an analysis of the ownership structure of Mexican companies, a description of the economic and political context that led to the current socialist administration, as well as an explanation of why is it said that labour unions have failed their task of representing employees interests.

This, in order to show that the CG system in Mexico must change to a two-tier board model, in order to implement an effective surveillance system, and to balance the interests within the stakeholders, but also for serving a greater purpose that is to achieve democracy within the country.

Chapter 4 will contain the reform proposal to the LGSM and the LMV; it will also state why is a reform needed, and why will a two-tier board be beneficial for the country.

It will explain which articles would have to be amended, or added, in order for the companies that have more than 1000 employees, adopt a two-tier board system, and include employee representation in the supervisory board.

This chapter will also include the possible consequences and the impact of the reform.

Chapter 5 will include the conclusion of the paper. It will contain a brief summary of the main arguments that supported the thesis; which states that the CG system in Mexico must change to a two-tier board system that includes employee representation in the supervisory board of the companies when the number of employees is more than a 1000.

Chapter 2-. Corporate Governance Theories and Models

This chapter will introduce the basic concepts of the corporation and the most relevant theories of CG. The argument developed in this chapter is necessary in order to demonstrate that the shareholder primacy model is out-dated and a stakeholder approach must be taken into account when developing CG framework. This chapter is needed since the Mexican model of CG is a shareholder primacy model.

2.1 Theory of the corporation

The corporation is the dominant form of business organization, and it has been the prime vehicle of capitalism over the last century[5]. Moreover, as a prime vehicle of capitalism, corporations have become increasingly powerful, to the point that some corporations produce more wealth than some emerging countries (e.g. apple company has a market value of $961.3 billions of USD[6], while the GDP of Venezuela was of $482.3 billions of USD in 2014[7]), which mean that a greater focus needs to be posed in the way companies are governed and regulated; otherwise, weak and poor regulations in the private sector can lead to major financial crisis like the Global Financial Crisis of 2008.

There are different definitions of a corporation, Eisenberg defines it as a 'profit seeking enterprise of persons and assets organized by rules'[8] which seems like a basic definition of what a company is; however, the definition of corporation changes in regard of the nature attributed to such legal entity.

The concession theory, views the corporation as an artificial being, created by law, which arose as a delegation of state power, for it to become an instrument of economic growth[9], this theory views

[5] H. Butler, 'The Contractual Theory of the Corporation' (1989) 11 George Mason University law Review 99.
[6] A. murphy et al, 'The World's Largest public Companies' (*Forbes,* 15 May 2019) <https://www.forbes.com/companies/apple/?list=global2000#1c244ff55355> accessed 14 of August 2019.
[7] World Bank, 'Data for Venezuela' (*World Bank,* 2016) <https://data.worldbank.org/?locations=MX-VE> accessed 14 of August 2019.
[8] M. Eisenberg, 'The Structure of Corporation Law' (1989) 89 Columbia law Review 1461.
[9] D. Millon, 'Theories of the Corporation' [1990] Duke Law Journal 201.

the corporate status as a subsidy, because of the limited liability provided to the owners, which is a protection granted by the state in favour of the shareholders[10]; the aggregate theory views the corporation as an aggregate of its shareholders, and it rejects the fiction of the corporation as an artificial entity[11]; the real entity theory (also known as natural entity theory), views the corporation as a separate entity (independent from its shareholders and from the state) which is controlled by its managers[12]; and the contractual theory of the corporation, states that the company is a nexus of contracts, where the role of the state is limited to enforcing such contracts, through legal and constitutional protections[13].

In regard of these definitions, the variations that rise between them in regard of its nature, determine the way companies are treated in each jurisdiction, primarily as to define the intervention of the state in the private relationships within a company and to define the obligations attributed to the company.

In relation with the same, the microeconomic definition of company is an institution that uses factors of production (such as land, labour, capital and business skills) in order to produce wealth[14]; the way the factors of production are organized in order to produce wealth is called business strategy. On the other side, the way in which the relations within a company are regulated, and how decision-making is undertaken and controlled is called Corporate Governance[15].

Corporate Governance ('CG') can be defined as the set of institutional arrangements, by which companies resolve disputes that arise from the interplay of stakeholders, by defining a clear structure of ownership and control[16]. Therefore, CG is the system by which companies regulate the relationship of their group of interests, specifically by defining in which way will the owners coordinate their tasks with the controllers of the company, in order to perform the business strategy.

In regard of the ownership and control of the company, it shall be pointed out that CG theories have evolved and with such evolution, the roles of ownership and control have been separated in order

[10] S. Padfield, 'Corporate Social Responsibility & Concession Theory' (2015) 6 William & Mary Business Law Review 01.
[11] Ibid.
[12] R. Avi-Yonah, 'The cyclical Transformations of the Corporate Form: A Historical Perspective on Corporate Social Responsability' (2005) 30 Delaware Journal of Corporate Law 767.
[13] H. Butler (n 5).
[14] M. Parkin, *Economy* (11th edn, Pearson Education 2014) 224.
[15] 'Corporate Governance' Jowitt's Dictionary of English Law 4thedn 10 December 2015 Sweet and Maxwell.
[16] J. Pelayo and J. Sanchez, 'The Institutional Context of Corporate Governance structure that Generates Collaborative Practices And Distinctive Competencies in Human Resources: A study of Mexico and Colombia' (2013) 11 Competition Forum 102.

to improve transparency and performance, since the owners do not always have the skills to run a company, and skilled leaders do not always have the capital to start a business.

Berle and Means' work[17], states that the modern corporation has separated ownership and control, through the dispersion of stock ownership in large publicly traded companies. Therefore, share ownership, has become purely legal, and shareholders of a company no longer hold the control of such company. Rather, the ones with the control are the managers of the company, but the interests between the managers and the shareholders are conflicted, because, the managers (as agents) of the shareholders (principals) can make decisions for their personal interest that may be inconsistent with maximizing shareholder wealth[18] which is the basis of the agency theory.

The problem of ownership and control has evolved through time, with the evolution of the corporation. As stated by Avi-Yonah, the corporation has its origins in Roman law, and it has had four major transformations: (i) first, the corporation as a separate legal person from its owners; (ii) second, the shift from non-profit membership corporations to for-profit business corporations, (iii) third, the shift from closely-held corporations to corporations whose shares were widely held and publicly traded; (iv) and fourth, the rise of multinational enterprises[19].

In relation with the same, before big corporations were developed, in the 19th century, the classical economic view of the corporation was of a small enterprise, directly managed by its owners, whom were motivated by the incentive of profits and hazard of losses in order to produce wealth[20]. However, with the evolution of the corporation, companies have grown to be in some cases larger than countries, and therefore, the previously mentioned conflict of interests between the management and the owners of the company has gained importance.

In connection with the same, the agency theory, establishes that in large companies, the ownership is diversified in multiple shareholders, who transfer the authority of decision making to the managers (agents of the principal), who must maximize shareholder wealth. Moreover, this theory

[17]A.Berle and G. Means, *The Modern Corporation and Private Property* cited in C. Daily and D. Dalton, 'Governance through ownership: centuries of practice, decades of research' (2003) 46 Academy of Management Journal 151.
[18]C. Daily and D. Dalton, 'Governance through ownership: centuries of practice, decades of research' (2003) 46 Academy of Management Journal 151.
[19] R. Avi-Yonah (n 12).
[20] R. Hessen, 'The modern corporation and private property: A reappraisal' (1983) 26 The Journal of Law & Economics 273.

states that the agent - principal relationship causes difficulties for the shareholders to obtain information in respect of the management of the business.

In addition, this theory previews the existence of the agency problem, which means that managers may act opportunistically in order to pursue their own interests, at the expense of the shareholders[21].

Having said the above, the way the agency problem is addressed within a corporation, defines the CG model of such company. This, because one of the main characteristics of the corporation, is such separation of ownership and control, and therefore, the jurisdiction where a corporation resides, (or the corporation itself) must decide the CG model, in order to establish a clear way in which the interests of the management and of the shareholders will be aligned, in order for it to function, and in order for them to obtain a proper representation and defense of interests.

Furthermore, there are theories that establish that the principals in the agent - principal relationship of the corporation are not only the shareholders, but rather other interest groups that are affected by the actions of the company. Therefore, related with the agency theory, other questions such as who should control the corporation? and for the pursuit of whose interests?[22] must be addressed in order to define a CG model.

In the following paragraphs, the main models of Corporate Governance will be analysed, this being the shareholder primacy model, the stakeholder approach and the enlightened shareholder.

2.2 Shareholder Primacy Model

The standard model of CG is the shareholder primacy model, which states that a corporation should be managed exclusively in the interests of its shareholders, and the market value of the share will be the principal measure of an effective management of the company[23].

One of the main proponents of this theory was Milton Friedman, who stated in the 1970's that in a free enterprise system, a corporate executive is an employee of the business[24]. In other words, in

[21] J. Pelayo and J. Sanchez (n 16).
[22] H.Mintzberg, 'Who should control the corporation?' (1984) 27 California Management Review 90.
[23] H. Hansmann and R. Kraakman 'The end of history for corporate law' (2001) 89 Georgetown Law Journal 439.
[24] M. Friedman, 'A Friedman Doctrine' *New York Times Magazine* (New York, 13 September 1970) <https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html> accessed 08 September 2019.

a neoliberal economy, managers of companies should seek exclusively to attend the interests of its shareholders, and no one else's. This, because managers are making day to day decisions to run a company, using the shareholder's money, and therefore, Friedman concludes that if the capital provided by the shareholders is used for different intentions rather than maximizing the share value, then the manager is acting unlawfully.

What this model of CG implies, is that managers have a fiduciary duty to run the business in accordance with the shareholders' interests[25], and the shareholders' interests will generally be to 'make as much money as possible while conforming to their basic rules of society'[26]. Ultimately, what this model intends is to maintain the control of the company within the shareholders' power, through its agent that would be the manager.

This model is called the standard model, since it entails the idea that shareholders must control the corporation through its managers[27], which is the way small companies are conducted, and is the starting point of CG; simply being governed by the desires of its owners[28].

Also, this theory is part of the underlying arguments of the agency theory, since it states that the agency problems begin when the manager as the agent of the principal, wants to attend his or her personal interests instead of the interests of the shareholders.

The shareholder primacy theory, arose with modernity and industrialization[29], and this model establishes the main responsibility for all directors, to be held accountable for the share value[30], and it may be enforceable by the shareholders (whom also have special monitoring rights such as voting).

The US has got this model of CG, and it has been developed through case law, in order to clearly establish the duty of loyalty and the duty of care that the managers of a company have towards the shareholders. The dominance of this model in the US, has got its explanation in the US post-war era, where the purpose was to make every citizen a stockholder, in order for them to buy shares in the New York Stock Exchange, and therefore companies would get capital from a widespread of shareholders, and shareholders would expect profits in return[31].

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[25] N. Smith and D. Rönnegard, 'Shareholder primacy, corporate social responsibility and the role of business schools' (2013) 134 Business Ethics Journal 463.
[26] M. Friedman (n 24).
[27] H. Hansmann and R. Kraakman (n 23).
[28] R. Hessen (n 20).
[29] E. Engle and T. Danyliuk, 'Emulating the German Two-Tier Board and Worker Participation in U.S. Law: A Stakeholder Theory of the Firm' (2015) 45 Golden Gate University Law Review 69.
[30] R. Rhee, 'A Legal Theory of Shareholder Primacy' (2018) 102 Minnesota Law Review 1951.
[31] R. Monks and N. Minow, *Corporate Governance* (4thedn, Jon Wiley and Sons Ltd 2008) 99.

Furthermore, the shareholder primacy model in the US is reflected in *Dodge v Ford Motor Co*[32], which stated that the directors' powers were to be employed primarily for the profit of stockholders.

In relation with the same, the director's duty of care as well as the duty of loyalty are relevant in this theory, since such duties are part of the fiduciary duty owed by the managers to the shareholders, and the breach of these duties by the director while making decisions in regard of the business management, will hold a director liable.

The duty of care, 'implies that managers are expected to make decisions that ordinary, prudent individuals in a similar position would make under similar circumstances for the benefit of shareholders'[33] while the duty of loyalty, implies that directors should promote the interest of the shareholders and must not put themselves in a position in which their interests might conflict with the shareholders' interests[34].

However, regardless of the fact that under this theory, directors must act in good faith when carrying out business operations in order to maximize profit and regardless of the fact that shareholders hold a fiduciary protection that is enforceable against managers; directors do not always act in good faith, and shareholders do not always exercise their judiciary actions against managers.

Regarding the same, in the 2000's different CG scandals led to tough criticism to this model. For instance, in 2001 and 2002, managers of companies in the US were inflating the earnings in the financial reports in order to gain more compensations, which led to the emission of the Sarbanes Oxley Act of 2002[35].

What happened was that with the intention of solving the agency problems of conflict of interests between the directors of a company and the shareholders, directors were being compensated with stock equity. Later, this led to a false inflation of the earnings within the reports elaborated by the managers, in order for them to obtain a bigger compensation[36], and this inflation of earnings was reportedly present in hundreds and hundreds of companies within the US.

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[32] 204 Mich. 459, 170 N.W. 668 (Mich. 1919).
[33] N. Smith and D. Rönnegard (n 25).
[34] ibid.
[35] G. Benston, 'The quality of corporate financial statements and their auditors before and after Enron' (2003) CATO Project on Corporate Governance Audit, and Tax Reform Policy Analysis No. 497 <https://www.cato.org/publications/policy-analysis/quality-corporate-financial-statements-their-auditors-after-enron> Accessed 06 November 2003.
[36] J. Coffee, 'What went wrong? An initial enquiry into the causes of the 2008 financial crisis' (2015) 9 Journal of Corporate Law Studies 1.

In connection with the above, the ENRON case was the biggest case of financial fraud and audit failure, where a company that was America's most innovative firm for 5 consecutive years went bankrupt due to the manager's share-value-maximizing unethical actions that led to financial fraud[37].

Furthermore, another scandal that turned the glance to the ineffectiveness of the shareholder primacy model of CG, was the Global Financial Crisis of 2008, which was caused by the profit maximization interest of investment banks, poor performance of credit rating agencies and disregard to stakeholder interests in the mortgage loan markets[38].

One of the causes of such crisis, was that lenders were not taking into account the debtors background, and started granting mortgages without studying the background without properly evaluating the payment compliance capacity of the borrower, later the borrowers stopped paying their debts, and then a domino effect followed: banks began to fail, the real estate prices raised, people lost their houses[39], and then other countries went into recession period as well[40].

Regarding such financial crisis, A. Greenspan stated that the risk management of financial institutions must be improved, since such risk management rested in the premise that owners and managers of such institutions would act in an enlightened way, which would lead them to maintain a monitoring position of the firm's' capital and risk[41].

In other words, the CG of financial institutions, relied in the premise that the shareholder primacy model worked perfectly, and that managers would always act in good faith, and the shareholders would monitor their actions, in order to ensure good business management. Needless to say, this premise was proven wrong, and directors do not always act in good faith, and shareholders do not always comply effectively with a monitoring function.

Having said all of the above, it has become clear that the shareholder primacy model is severely flawed and contains loopholes which are not always solved in the best way. This, because imposing an obligation of maximizing share value to directors, has led to management illicit actions. Consequently,

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[37] W. Bratton, 'Enron and the dark side of shareholder value' (2002) 76 Tulane Law Review 1275.
[38] J. Coffee (n 36).
[39] S. Nelson and P. Katzenstein, 'Uncertainty, Risk and the Financial crisis of 2008' (2014) 68 International Organization 361.
[40] Mexico was severely affected by the 2008 financial crisis, and by 2009 the GDP decreased in a 6%, OECD, 'Economic Studies of the OECD: Mexico 2011' (*OECD,* May 2011) <https://www.oecd.org/centrodemexico/47905766.pdf> accessed 20 August 2019.
[41] A.Greenspan, 'We need a better cushion against risk' *Financial Times* (London, 26 March 2009) <https://www.ft.com/content/9c158a92-1a3c-11de-9f91-0000779fd2ac> accessed 04 September 2019.

in front of the failure of this system, new theories began to emerge, such as the Stakeholder approach theory.

2.3 Stakeholder Approach

A stakeholder is defined as 'any group or individual who can affect or is affected by the achievement of the organization's objectives'[42], the term stakeholder was introduced in order to englobe the concept of any individual or group that maintains a stake in an organization, in the same way that shareholders hold a share[43]. This means that stakeholders of a business can be its employees, clients, suppliers, creditors, communities, governments and the environment[44].

The stakeholder approach model was developed as a response of the weaknesses of the shareholder primacy model, and it was first introduced by R. Freeman, who called for a re-think of business organizations, in order to promote the idea that the corporation should have social and economic inclusion[45].

This model, implies that businesses have a responsibility to attend the interests of all of their stakeholders[46], since it recognizes that business organizations 'control vast resources, cross national borders and affect every human life'[47]. Consequently, this model states that managers must take into consideration the interests of these stakeholders when running a business, being that they all share the risk of a corporate failure[48].

The arguments in favour of this model, state that it reflects a more actual market practice than the shareholder value model, since big companies are increasingly required to balance social, economic and environmental components of their business, through Corporate Social Responsibility[49]; also, another argument in favour is that it is consistent with the actual view of the company, that states that

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[42] E. Freeman, *Strategic Management: A Stakeholder Approach* (1st edn, Pitman 1984) 31-32, 46.
[43] Y. Fassin, 'The Stakeholder Model Refined' (2009) 84 Journal of Business Ethics 113.
[44] Ibid.
[45] A.Keay, 'Ascertaining the corporate objective: an entity maximisation and sustainability model' (2008) 71 The Modern Law Review 663.
[46] E. Freeman, *Strategic Management: A Stakeholder Approach* (1st edn, Pitman 1984) in E. Freeman and others, 'Stakeholder theory: The state of the Art' (2010) 4 The Academy of Management Annals 403.
[47] R. Phillips, *Stakeholder Theory and Organizational Ethics* 11 (1st edn, Berrett-Koehler Publishers 2003) 12.
[48] M.Mahmudur, 'The Stakeholder Approach' to Corporate Governance and Regulation: An Assessment' (2011) 8 Macquarie Journal of Business Law 304.
[49] E. Engle and T. Danyliuk (n 29).

in order to achieve a sustainable long term focused existence, it must attain an optimum welfare distribution to all of its stakeholders, through a maximization of value of the company as a whole, and not only for the benefit of shareholders' wealth[50].

Regarding the applicability of this model, it shall be pointed out that some jurisdictions have included stakeholder approach to its corporate law framework.

Germany, through its two-tier board model, gives the employees the right to representation within the supervisory board, therefore including their interests in the decision-making of the business[51]. Also, the corporate law of Austria and the Netherlands establish that the company's management has to steer the company in the interest of the enterprise as a whole[52].

Another example of incorporation of the stakeholder approach in the CG of the company is India, who established in its Companies Act 2013, the obligation of constituting a Stakeholders' Relationship Committee, which resolves the grievances of security holders, as well as the obligation of constituting a Corporate Social Responsibility Committee, which would be responsible for devising, recommending, and monitoring CSR initiatives of the company[53].

In relation with the same, in 2001, the European Union issued a Directive on Involvement of Employees[54], which established that the European Company had to implement a negotiating body in their CG structure, which would represent the employee's interests in front of the managers, and also, such directive included different levels of employee participation rights.

Therefore, an international effort of implementing a stakeholder approach in CG has become clear, through the support of legislative forces in different jurisdictions; but also, through the efforts of international organizations which are also pushing forward to an increasingly stakeholder-oriented view of the corporation.

In relation with the same, the OECD stated that:

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[50] Ibid.
[51] K. Hopt 'Comparative corporate governance: The state of the art and international regulation' (2011) 59 The American Journal of Comparative Law 1.
[52] Ibid.
[53] A.Choudhuri, 'Effectiveness of board structure in India and Germany' (2017) 16 The IUP Journal of Corporate Governance 46.
[54] Council Directive 2001/86/EC of 8 October 2001 Supplementing the Statute for a European Company with regard to the involvement of employees [2001] OJ L 294/22.

> There is a general agreement that in a global economy, businesses are often playing a greater role beyond job and wealth creation and CSR is business's contribution to sustainable development. Consequently, corporate behaviour must not only ensure returns to shareholders, wages to employees, and products and services to consumers, but they must respond to societal and environmental concerns and values.

Therefore, the OECD supports the idea that corporations must take into account the implications of its activities, to the social concerns and values of the community. Another international organization that has supported the stakeholder approach as an effective form of CG is the International Standards Organization, through the ISO 26000 Guidance on Social Responsibility[55].

Having said all of the above, it becomes clear that the stakeholder approach has gained importance during the last decades, and the development of soft law as well as legislation efforts support the involvement of stakeholders' interests within the company's management. But on the other hand, this theory has been criticized, for the following reasons: (i) it is not clear whom shall the company consider as its stakeholders, and therefore it is unclear whose interests must the management take into account[56]; (ii) some stakeholders are more important than others within a company, but there is not a way to determine their level of importance; (iii) the theory does not establish who holds a judicial protection of their interests, in other words, there is no clear definition of the director's responsibility towards the stakeholder of the company, and which stakeholders can exercise an action against them, (iv) there is not a clear established way in which director's must balance the interests of the stakeholders[57].

Regarding all of the above, the development of a stakeholder approach that imposes an obligation for the company's management to take into account the interests of other groups that were affected by the course of action of the corporation was needed, since the adoption of the shareholder primacy model was leading to irresponsible decisions to maximize profits, at the expense of the whole

[55] This guidance established that the objective of social responsibility is to obtain sustainable development, and that a corporation must take into account the society in which it operates, since they depend in the health of the world's ecosystems. International Standards Organization 'ISO 26000' (*ISO,* 2010) <https://www.iso.org/obp/ui/#iso:std:iso:26000:ed-1:v1:en> accessed 12 August 2019.

[56] Y. Fassin (n 43).

[57] A.Keay (n 45).

society. However, the material implementation of the stakeholder approach becomes difficult if the director's duties towards the stakeholders are not properly narrowed and defined.

Also, it shall be pointed out that even when it is undeniable that a company exists within a society, and that the actions of the company affect other groups rather than just its shareholders, the objective of a company is to produce income in order to be sustainable, otherwise, the company that is not producing income is eliminated or acquired by other sustainable companies[58]. Therefore, it is concluded that a corporation must take into account the stakeholders' interests when running a business, however this shall be done in specific ways that do not affect the company's business objective, since profit is also what makes a business sustainable.

2.4 Enlightened shareholder value

In light of the arguments against the shareholder primacy and the stakeholder approach model, a new form of CG that took into account the stakeholders interest, while prioritizing the profit making objective of the company emerged, and is called the enlightened shareholder value model. This model was introduced in the UK Companies Act of 2006, and what it implies is that for a company to ensure a long-term shareholder wealth, then it must pay attention to its stakeholders such as employees, the environment and local communities[59].

This model involves the duty of the directors of a company to balance the interests of the different stakeholder groups, building long-term relationships, in order to benefit the shareholders in the long run[60].

The underlying argument of this theory, is that although shareholder value must be ensured, a careful consideration of the interests of other stakeholders, will benefit the company as well[61].

The UK Companies Act of 2006 in its Section 172 (1) states that:

[58] M. Parkin (n 14) 228.
[59] V. Harper, 'Enlightened Shareholder Value: Corporate governance beyond the Shareholder-Stakeholder divide (2010) 36 The Journal of Corporation Law 1.
[60]A.Keay, 'Tackling the issue of the corporate objective: An analysis of the United Kingdom's enlightened shareholder value approach' (2007) 29 Sydney Law Review 577.
[61] M. Mahmudur (n 48).

(1)A director of a company must act in the way he considers, in good faith, would be most likely to promote the success of the company for the benefit of its members as a whole, and in doing so have regard (amongst other matters) to: (a)the likely consequences of any decision in the long term; (b)the interests of the company's employees; (c)the need to foster the company's business relationships with suppliers, customers and others; (d)the impact of the company's operations on the community and the environment; (e)the desirability of the company maintaining a reputation for high standards of business conduct, and (f)the need to act fairly as between members of the company.[62]

Furthermore, the UK Corporate Governance Code states that 'A successful company is led by an effective and entrepreneurial board, whose role is to promote the long-term sustainable success of the company, generating value for shareholders and contributing to wider society[63]'. Therefore, it supports the idea that for a sustainable business strategy, stakeholders' interests and profit making should go hand in hand.

However, the problem with this model is that there is a lack of case law founded on a breach of the director's duty to take into account environmental, societal, and community issues, as well as their employee's interests[64]. Which means that even though that a simple lecture of the section 172 could be interpreted in the way that it holds a director liable for not taking into account the interests of the stakeholders, no application has been given to such subsection yet, and therefore, there is no way to prove whether or not such disposition has been effective in protecting the stakeholders' interests. Although it shall be recognized the effort to include stakeholders' interests in UK corporate law.

2.6 Conclusion

Now that the theories of the corporation have been explained, it becomes evident that in the present, there should no longer be a discussion as to whether or not the CG systems should adopt a

[62] Companies Act 2006, s 172(1).
[63] The UK Corporate Governance Code, Principle A.
[64] A.Keay, 'Having regard for stakeholders in practising enlightened shareholder value' (2019) 19 Oxford University Commonwealth Law Journal 118.

stakeholder approach in which the management poses a greater focus in matters that affect their interest groups.

The above is supported by the experience that shows that when a company's management only seeks to maximize the share value, severe problems can occur, such as the financial crisis of 2008.

However, there has not been evidence that a stakeholder approach in its pure form can lead to sustainability, and overall, the corporation objective is to generate profit. Therefore even though the shareholder primacy model is an out of date model of CG, and stakeholder approach does not define clearly the manager's duties, the conversation in regard of CG should no longer be about stakeholder approach vs shareholder primacy, instead, lawmakers and directors should be developing ways of implementing the stakeholder approach in the company law, taking into account the particularities of each jurisdiction.

Chapter 3-. Corporate Governance in Mexico

Recently, CG in Mexico has gained importance, and in the last two decades, it has been suffering a series of reforms. One of the most important improvements in Mexico came with the introduction of the Mexican Code of Best Corporate Practices[65] (C*ódigo de Buenas y Mejores Prácticas Corporativas*, hereinafter the 'Code'). This Code was issued in 1999 by the Businessmen Council (*Consejo Coordinador Empresarial*), a private organization composed by Mexican businessmen that works for promoting the free market and the corporate social responsibility with the objective of coordinating the policies and actions of companies and identifying specific solutions that contribute in developing public policies to increase economic growth and the level of competitiveness in Mexico[66].

Even though this Code was issued in order for it to be a best practice guide for all types of companies, it is not of compulsory application[67], therefore, not all companies follow the CG practices contained in such Code.

The legal framework around CG in Mexico is the LGSM that regulates all types of companies, and the LMV that regulates public listed companies. In relation with the same, it is important to mention that even though the Code is of voluntary application, the General Rules of the Mexican Stock Exchange (*Reglamento de la Bolsa Mexicana de Valores*) establish that the public listed companies have a duty to report to the stock exchange the level of compliance of the listed company with the Code[68]. Therefore, it can be concluded that the Code is compulsory for public listed companies, and as of today, 20 years after it was published, the main purpose of the Business Council is to increase the level of compliance of companies in Mexico with such code.

In addition, it is important to mention that the most relevant corporate practices contained in the Code were later introduced in the dispositions of the LMV.

However, before furtherly explaining the background of CG in Mexico, the general notes of company law in Mexico must be pointed out.

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[65] J. Pelayo and J. Sánchez (n 16).
[66] Consejo Coordinador Empresarial, '¿Qué es el Consejo Coordinador Empresarial?' (Consejo Coordinador Empresarial, 01 July 2008) <https://www.cce.org.mx/que-es-el-consejo-coordinador-empresarial/> accessed 12 August 2019.
[67] Introduction, Mexican Code of Best Corporate Practices (CMPCM).
[68] Disposition 4.033.0 section XXI of the General Rules of the Mexican Stock Exchange (RBMV).

3.1 Private companies in Mexico

A company in Mexico is defined as a legal entity constituted in accordance with the LGSM, that will be able to carry out the business activities needed in order to accomplish its corporate purpose[69].

The LGSM establishes different types of corporations: Limited Liability Stock Company (*Sociedad Anonima* or *SA*), Simplified Shares Corporation (*Sociedad por Acciones Simplificada* or *SAS*), Limited Liability Company (*Sociedad de Responsabilidad Limitida* or *SRL*), Cooperative Associations (*Sociedad Cooperativa*), General Partnership (*Sociedad en Nombre Colectivo*), Limited Partnership (*Sociedad en Comandita Simple*), and Limited Partnership by Shares (*Sociedad en Comandita por Acciones*). However, the most commonly established types of corporations are the SA and the SRL because of the benefit of limited liability that separates the company's capital from the partner's personal equity[70].

In regard of the above, even though both type of companies are limited liability companies, they have several differences.

3.1.2 SRL

The SRL is a legal entity that will be incorporated between the members (no less than two, no more than fifty[71]) that are liable only to the extent of their capital contributions. The capital of the company will be divided into as many equity quotas as the number of members. The member's equity quota cannot be represented through negotiable instruments[72] due to the fact that those equity quotas will not be transferable unless certain requirements are fulfilled. A member's equity quota can only be transferred if the equity holders that represent the majority of the company's equity agree on transferring such quota. Also, a new partner will be admitted only if such majority admits it[73].

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[69] Article 4 of the General Law of Commercial Companies (LGSM).
[70] Subsecretaria de Competitividad y Normatividad, 'Corporations in Mexico' (*Secretaria de Economia,* August 2016) <https://www.gob.mx/cms/uploads/attachment/file/202845/Corporations..pdf> accessed 20 July 2019.
[71] Article 61 of the LGSM
[72] Article 58 of the LGSM
[73] Article 65 of the LGSM.

This legal entity was originally created to cover the needs of small companies[74], however, it shall be pointed out that there is no statutory limit established in the LGSM to the equity that this company can hold. Therefore, the SRL can be as big (in terms of capital or in terms of employees) as it wants to be, as long as the members do not exceed the number of 50.

The SRL will be managed by a sole manager or by a board of managers, which can be members and may be designated for an indefinite period[75]. The manager or the board of managers will be in charge of the company's management as well as of the legal representation of the company[76].

The general members' meeting is the supreme corporate body of the company, it must be held at least once a year and their faculties include taking decisions regarding allocation of profit, electing and removing the directors of the company, modifying the articles of incorporation approving the assigned equity quotas, approving new members, approving the increase or diminished to the company's equity and taking decisions on regard of the liquidation of the company and any other faculties or obligations that the articles of incorporation grant to them.

Every member has the right to vote, and they get one vote for every thousand Mexican pesos they invest in the company[77].

The fact that there is no limit to the size of the SRL Company is relevant, due to the fact that because of its legal nature, the LGSM does not establish an obligation to the SRL company to appoint an examiner or a surveillance committee. However, the members can opt to appoint one through the articles of incorporation[78]. This aspect of the SRL in Mexico has raised certain concern, because the lack of regulation to the supervision of this type of company gives the shareholders the widest liberty to establish their own duties and attributions[79].

3.1.3 SA

[74]M. García, *Sociedades Mercantiles* (2nd edn,Oxford University Press 1999) 239.
[75] Article 45 of the LGSM.
[76] M. García (n 74) 243.
[77] Articles 76-82 of the LGSM.
[78] Artlce 84 of the LGSM.
[79] M. García (n 74) 247.

On the other side, the SA is a legal entity established between at least two shareholders[80] that are liable up to the amount that their capital contributions represent. The shares in this type of company may be transferred freely and there is no limited number of shareholders.

The SA can be managed by a sole director or by a board of directors, which may or may not be shareholders[81]. Whether a single director or a board of directors manages, the SA has to be determined in the by-laws, and in case it is determined that a board will manage it, then they will act as a collegiate organ for the decision-making.

In the SA, the director (or board of directors if it's the case) has the possibility of appointing an executive officer (or CEO) to be in charge of the day to day operation, who will be supervised by the sole director or the board of directors; but the appointment of such executive officer is not compulsory. In such case, either the sole director (or board of directors) and the general shareholder meeting will be in charge of appointing the officer or officers of the company which can also be shareholders[82].

The CEO of the SA will have the obligations and authorities expressly stated in the by-laws; it will not require the sole director to approve its decisions, as long as it acts within the scope stated in the by-laws, but the sole director (or board of directors) will be the legal representative of the company[83].

The directors of the company will have the responsibilities inherent to their mandate, as well as whatever responsibility contained in the by-laws.

The directors in the board shall keep confidentiality regarding the information and matters that they have knowledge because of their position in the company, when said information or matters are not public (except in the case where the information is requested by the authorities). This duty of confidentiality will be in force during the time of their administration, and up to one year after its conclusion[84].

The directors in the board will be held jointly and severally responsible with the company: (i) of the genuineness of the capital contributions made by the shareholders; (ii) the compliance with the requirements provided by the LGSM and the by-laws in connection with the dividends to be paid to the

[80] Article 89 of the LGSM.
[81] Article 142 of the LGSM.
[82] Article 145 of the LGSM.
[83] Article 146 of the LGSM.
[84] Article 157 of the LGSM.

shareholders; (iii) of the existence and maintenance of the company's accounting and other books required by the LGSM; (iv) and due compliance of the resolutions of the shareholders[85].

The LGSM does establish a surveillance committee to the management of the company that will be composed by at least one statutory examiner, which could be a shareholder or an external person[86]. On the other side, nor employees nor a person with a family relationship with any of the directors can be statutory examiners[87].

The surveillance committee has the general obligation of supervising the management, and execution of the company's operations; this includes asking the board of directors for a monthly financial report, being in charge of the annual report for the shareholders which will include their personal opinions on regard of the information that the management board prepared for the shareholders, attending to the general shareholders meeting and attending to the management board's meetings[88].

The reason why two types of limited liability companies in Mexico exist, is because there was a need for a legal entity that established a basis of trust between the shareholders, due to the fact that the country has a high percentage of small and medium businesses that besides needing the separation from the company's capital from that of the shareholder, needs to put a lock on the transfer of the shares[89]. Therefore, the SRL is a kind of small SA company that cannot transfer the shares as easily as the SA can.

Due to its nature, only the SA can become a public company, which would be then called *Sociedad Anonima Bursatil* (SAB).

3.2 The Mexican public listed company

The LMV is the Act that regulates companies that are listed in the Mexican Stock Exchange. This Act establishes two types of SAs: the SAB and the Investment Promotion Corporation (*Sociedad Anónima Promotora de Inversión* or SAPI). The SAB is a public company that is listed in the Mexican Stock Exchange, while the SAPI is a SA that through a shareholders' general meeting decided to adopt

[85] Article 158 of the LGSM.
[86] Article 164 of the LGSM.
[87] Article 165 of the LGSM.
[88] Article 166 of the LGSM.
[89] M. García (n 74) 215 - 217.

the SAPI legal structure established in the LMV, with the purpose of encouraging investment and growth of the Mexican securities market[90], however, the SAPI does not sell its shares in the stock Market.

The SAPI was first introduced in the LMV in 2006[91], with the objective to promote investment, giving shareholders greater minority rights[92]. The purpose of the SAPIs is to eventually become a public company[93], however, as it does not sell its shares in the stock exchange (yet), it is not subject to supervision by the National Banking and Securities Commission, neither is it obliged to publish its financial statements[94] like the SAB.

In Mexican Company law, different rules apply to public and private companies. The Mexican public company will be regulated by the LMV and the code of best corporate practices.

3.2.1 Management of the SAB

The management of this type of company will be in charge of a management board and a CEO (or general director)[95].

The management board will be composed by a maximum of 21 members, from which at least the 25% must be independent[96]. The members can be designated for a definite or an indefinite period[97].

The management board will designate a committee of audit and a committee of best corporate practices that will assist them in their duties; both of them will have to be formed by at least 3 independent members each (external auditors)[98]. These independent members have to be selected by their experience, ability and professional prestige, while also taking into account that they cannot have any conflict of interest[99].

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[90] A Franck, 'New Mexican Corporate Structure sociedad Anónima Promotora de Inversión' (2007)13 Law and Business Review of the Americas 231.
[91] V. Robleda, 'Sociedades Anónimas Promotoras de Inversión' (*Colegio Mexicano de Contadores Públicos*, 2015) <https://www.ccpm.org.mx/avisos/sociedades_anonimas.pdf> accessed 03 Augusr 2019.
[92] Ibid.
[93] Article 19 of the LMV.
[94] A Franck (n 90).
[95] Article 23 of the LMV.
[96] Article 24 of the LMV.
[97] Ibid.
[98] Article 25 of the LMV.
[99] Article 26 of the LMV

Under no case, will an employee or a CEO of any other subsidiary of such company, be allowed to be a part of the committees that assist the management board[100]; neither will clients, suppliers, debtors or creditors will be allowed to be an external auditor of the management board[101].

3.2.2 The Management Board tasks

The management board will be in charge of: (i) establishing the business strategy; (ii) monitoring the management and conduct of the society; (iii) approving the policies and guidelines for the use or enjoyment of the assets of the society; (iv) and it will be in charge of monitoring the compliance with the agreements of the general shareholders' meeting (but this specific obligation can be carried out through the audit committee that assists the board)[102]. The members of the board will perform their duties seeking value creation for the benefit of the society[103].

3.2.3 The management board duties and responsibilities

The members of the board have a duty of care and a duty of loyalty towards the shareholders. The duty of care requires the members to act in good faith and in the best interest of the company[104]. Regarding the same, the members of the board will be held liable: (i) if they refrain from attending to the board meetings and when due to their absence the meeting does not meet the quorum to be held; (ii) if they do not disclose relevant information to the company when it is necessary to the decision making, unless such information was confidential and they are legally bound to secrecy[105].

The duty of loyalty for the members of the board requires them to keep confidentiality in regards to the information and matters that they are aware of because of their position in the company, when said information is not public[106].

3.2.4 The duties of the CEO

[100] ibid.
[101] Ibid.
[102] Article 28 of the LMV.
[103] Article 29 of the LMV.
[104] Article 30 of the LMV.
[105] Article 32 of the LMV.
[106] Article 34 of the LMV.

In a public company, the general director of the company will be in charge of the day-to-day operations, the conduction and execution of the business of the company and of the legal entities that it controls; subject to the guidelines and policies that the board approves[107]. It is also in charge of submitting an annual report to the general shareholders' meeting, in regard of the operations of the year, the accounting of the company, the financial statements and the analysis of these[108].

3.2.5 Surveillance of the SAB

The surveillance of the company is attributed to the management board through the best practices and auditing committee[109]. The president of each committee will be required to submit an annual report to the management board, on regard of the company's best practices and in regard of the audit carried out.

The best practices committee is in charge of assisting the management board in specific topics like monitoring the director's actions, make observations regarding the performance of the relevant executives, the transactions of the companies with related persons during the reporting period and the remunerations granted to the CEO[110].

On the other hand, the audit committee is in charge of evaluating the company that carries out the external audit, and analysing its report, discuss the company's financial statements with the general director, and discuss its approval with the management board, inform of any irregularities that it detects, etcetera. The annual report of this committee will include: the evaluation of the external auditor, the results of the analysis to the financial statements submitted by the general director, the follow up to the agreements of the general shareholders' meeting, etcetera[111].

3.3 Mexican Code of Best Corporate Practices

[107] Artice 44 of the LMV.
[108] Article 172 of the LGSM.
[109] Article 41 of the LMV.
[110] Article 42 of the LMV
[111] Article 43 of the LMV.

As it was above mentioned, the Code was published with the objective of creating a unified framework of CG for all types of companies in the Mexican jurisdiction. The Code includes 60 recommendations in regard of management and best practices.

In regard of management, the Code suggests that within the functions of management board of any company the following are included: ensuring that all shareholders receive equal treatment, and ensuring their access to the information; ensuring the generation of economic and social value for shareholders; promoting the consideration of the interests of third parties when making management decisions; ensuring honest management; monitoring and preventing conflicts of interest; appointing a general director and other high level executives as well as evaluating them and supervising their performance; supervising the operation of the company; establishing internal control and information quality mechanisms, give certainty and confidence to investors and interested parties about the honest and responsible management[112].

It is recommended that in the management board there is at least 25% of independent directors[113]. It is suggested that the board of directors should develop the functions of audit, evaluation and compensation of the general managers, finance, risk and compliance, through the creation of committees of assistance[114].

3.4 Background of Corporate Governance in Mexico

Having analysed all of the above, it shall be pointed out that even though Mexico adopted new CG reforms that increased the supervision in public listed companies, adding external auditors and external members to the management board and implementing certain suggestions made by the Businessmen Council in the compulsory CG framework (e.g. the obligation contained in the LMV for the SAB to establish an audit committee and a best corporate practices committee); through a study carried out in 2014, it was shown that these better corporate practices did not translate in a significant better business performance[115].

[112] Best Practice 8 of the CMPCM.
[113] Best Practice 13 of the CMPCM.
[114] Best Practice 17 of the CMPCM.
[115] A.Macías and F. Roman carried out a study in 2014 taking into account the return over assets from the company and their evaluation in the Tobin's Q. A.Macías and F. Román, 'Consecuencias

This, because as Macías and Roman state in their study, due to the high concentration of share ownership within the members of the founder families; even when the best corporate practices contained in the Code where applied in the CG of a company, the family members and shareholders continued to hold the power and control of the business, which translated in an obstacle in the improvement of CG in Mexico[116]. Also, another reason is because normally, the auditors of the companies, or the independent members of the board, have different types of relationship with the owners of the company, therefore, the surveillance may be compromised[117].

In other words, one of the obstacles to effective Corporate Governance in Mexico is the fact that the important companies in Mexico are family-owned and with large block holding shareholders, and both the strategy and control of companies, lie in the hands of the few dominant shareholders, which can hold positions as executive officers, examiners, and management board or directors board members, which therefore means that there may be no unbiased opposition of interests within the decision-making in the company.

Furthermore, the ownership structure of companies in Mexico, creates institutional problems that make it difficult to establish a system of CG that takes into account the interest of other stakeholders like employees, suppliers, clients, and not just shareholders; which creates tension in the Company, specially within the owners and their employees, since employees do not have representation in the company's management.

This argument will be furtherly explained in the following section.

3.4.1 Evolution of CG in Mexico

Just as in the US and the UK, the development of CG in Mexico has been closely linked to the development of its stock market[118], and it has prioritized the shareholders' interests.

The legal framework around the CG in Mexican Companies finds its starting point within the LGSM, which was published in 1934, and as it was shown in the above paragraphs, this body of law

económicas de la reforma de gobierno corporativo en un mercado de capitales Emergente, pruebas de México' (2014) 81 El Trimestre Económico 357.

[116] Ibid.

[117] J. Manzanilla *Gobierno Corporativo en las Sociedades Mercantiles* (Thomson Reuters, 1st edn, Dofiscal Editores 2018) 20.

[118] G. Larrea and S. Vargas, *Apuntes de Gobierno Corporativo* (Primera Edición, Porrúa 2009) 8-21.

contains only the minimum requirements of Corporate Governance for private companies that are not listed in the Stock Market.

Then, in 1976 the first LMV was issued, which established a legal framework for listed companies and gave autonomy to the Mexican Stock Market.

Later, in 1988, a Code of Ethics was created for the compliance of companies within the Mexican Stock Market, but then it was replaced in 1999 with the Best Corporate Practices Code, which was elaborated and published by the Businessmen Council (CCE).

The Best Corporate Practices Code was originally intended to be for the SAB's Corporate Governance, but then, when it was issued, it stated that its practices were in order to achieve a good CG in every type of legal entity (but it was not of compulsory compliance).

In 2001, the LMV is reformed, and it included a great part of the Code of Best Corporate practices, in order to make it compulsory for public listed companies.

Afterwards, the modern principles contained in the Cadbury Reports and the Principles of Corporate Governances published by the OCDE were recognized in the second LMV of 2005, which abrogated the LMV of 1976, and it included the duty of due diligence and the duty of loyalty for the company's directors, as well as minority shareholders rights[119].

In the present, the basic conditions of structure within Mexican companies still hold the structure of a family business, where the ownership is highly concentrated, and within SAB's there's a common practice of issuing shares with no voting rights, which leaves the controlling shareholders with complete freedom of decision making[120].

In regard of the above, it is important to mention, that since the first Code of Best Corporate Practices was published, the CCE has been the organization in charge of spreading and developing dispositions of soft law that ensure good corporate governance.

However, it has become clear that Mexico's efforts in Corporate Governance have only been directed to companies that are listed in the Stock Market, with no mandatory dispositions of best corporate practices for private companies; nor a mandatory procedure of audit for SA companies nor for SRL companies.

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[119] G. Larrea and S. Vargas, *Apuntes de Gobierno Corporativo* (Primera Edición, Porrúa 2009) 8-21, 159-161.

[120] R. Chavarin, 'Los Grupos Económicos en México a partir de una Tipología de Arquitectura y Gobierno Corporativos' (2011) 78 El Trimestre Económico 193.

In other words, the development of CG in Mexico has been focusing in public listed companies in order to protect the shareholders, and in order to create effective mechanisms of strategy and control that ensure a greater return for shareholders. However, no attention is being paid in regards of corporate practices that ensure the protection of interests of other stakeholders like clients, suppliers, the community and most importantly, to its employees.

3.4.2 The concentration of power in CG structures in Mexico

One of the big issues of Mexico is the wealth concentration[121], which is reflected specially in the business sector where Mexico has billionaire businessmen[122], as well as private monopolies in telecommunications, cement industry, glass industry, banking and mining, dominated by powerful economic groups[123] and by companies, which are mostly family owned[124].

This, whilst having a percentage of 41.9% of the country's population living in poverty[125] according to official records of 2018, published by the National Council for Evaluation of Social Development Policy (*Consejo Nacional de Evaluación de la Política de Desarrollo Social* or CONEVAL).

Additionally, it is important to mention that an institutional problem within Mexican companies, besides the ownership concentration, is the lack of counterweight in the balance of interests in the management of a typical Mexican company. Due to the fact, that it is a common practice in CG in Mexico, that the members of the management boards (in the SAB), or the board of managers/directors (in the SRL and SA) of companies, which are the ones with the obligation of supervising the executives of the company (which are normally part of the family that owns it) are related to the controlling shareholders through family ties, friendship and/ or business relationships[126].

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[121] J. Manzanilla (n 117) 269.
[122] Such as Carlos Slim, the fifth wealthiest man in the world, he is the owner of the main telecommunications companies in Mexico. Forbes, 'Billionaires 2019 'El Eterno Carlos Slim Helú, el Quinto más rico del mundo' (*Forbes*, 05 March 2019) <https://www.forbes.com.mx/billionaires-2019-el-eterno-carlos-slim-helu/> accessed 25 August 2019.
[123] N. Hamilton, *Mexico, Political, Social and Economic Evolution* (1st edn, Oxford University Press 2011) 282.
[124] A.Macías and F. Román (n 115).
[125] CONEVAL, 'Medición de la Pobreza 2018' (*CONEVAL,* 31 July 2019) <https://www.coneval.org.mx/Medicion/Paginas/PobrezaInicio.aspx> accessed 09 August 2019.
[126] J. San Martín, R. Durán and A. Valdés, 'Corporate Governance, Ownership Structure and Performance in Mexico' (2012) 5 International Business Research 12.

The aforementioned because in Mexico it is considered a matter of prestige, to be part of a big company's management board, which leads to a complicated entrenchment of board members.

Regarding the same, the most important owners of the companies usually have a seat in the Board of many other companies[127]; as exemplified in the work of C. Serrano and B. Husted, where it was shown that the most prestigious directors among the 90 largest companies in Mexico, seat on at least 10 different boards of those companies[128].

This company structure is normal in Latin-American countries, where family members retain the executive roles in the company, and the board members are also family friendly and lack independence[129].

However, Mexico is an important economy, being the third largest country in Latin America[130], with big multinational companies, and an industrializing economy[131] in which the working class holds an important political role.

These, coupled with the fact that a big part of the country's wealth is produced and distributed within a small part of the population has been generating historical political frictions between the working class and the business owners class, a generalized mistrust from the employees to the management of big companies[132], which has led to discontent, increased employee turnover[133] and strikes in the industrial sector[134] that have been brutally repressed in the past[135].

3.4.3 Business environment in Mexico

[127] G. Castañeda, *La Empresa Mexicana y su Gobierno Corporativo* (1st edn, Alter Ego Editores 1998) 244.
[128] C. Serrano and B. Husted, 'Corporate Governance in Mexico' (2002) 37 Journal of Business Ethics 337.
[129] L. Austen, J. Reisch and L. Seese 'Actions speak louder than words, a case study on Mexican Corporate Governance' (2007) 22 Issues in Accounting Education 661.
[130] N. Hamilton (n 123) 6.
[131] Ibid 7.
[132] J. Manzanilla (n 117) 18.
[133] Ibid.
[134] Such as the Volkswagen strike of 15,000 employees in 1992, which concluded with the termination of such employees. C. Greer and G. Stephens, 'Employee relations issues for US companies in Mexico' (1996) 38 California Management Review 121.
[135] Another example was the strikes of the employees of General Motors in 1980, which lasted a 106 days and 3,700 employees were involved, in order to achieve an increment in the salary, but the objectives were not achieved, and the strike ended with the termination of the working contracts of the leaders of the strike, one of them was called Aaron Zarza Peña who was later abducted reported ly by police officers. J. Aguilar, 'Enseñanzas de la huelga de 1980 en General Motors de México' (1982) 41 Investigación Ecónomica 161.

Mexico is a country, which has a large number of private companies, classified as micro, small and medium companies (MiPyMes) and big companies; micro companies occupy 1 to 10 people, small companies occupy 11 to 50 people, medium companies occupy 51 to 250 people, and big companies occupy more than 251 people[136].

Micro companies in Mexico are very abundant, and they constitute 94.3% of the total private companies, and they generate 4 of every 10 employments[137]. However, Mexico's big companies (which occupy more than 251 people) generate the most wealth, producing the 64.1% of the Gross Domestic Product of Mexico[138].

Mexico's most important economic activities are the manufacturing industry and the sales of goods and services. According to the 2014 Mexico's Economic Census, the manufacturing industry in Mexico produces 48.2% of the GDP and occupies 23.5% of the general occupied personnel in Mexico, and the economic activity of sales of goods and services occupies the 29.7% of the general occupied personnel in Mexico[139]. Furthermore, within the 1000 biggest companies in Mexico, the most recurrent type of company is the manufacturing company for the automobile industry[140].

In relation with the same, it shall be pointed out that since it is the big companies that generate the most wealth in Mexico, and have the greater impact in their stakeholders, especially because of their number of employees and their involvement in society, it is of utter importance that these type of companies adopt a stakeholder approach of CG, for them to take into account the interests of their employees, since it is these type of companies which have had important strikes in the past, in the manufacturing industry[141].

In relation with the above, it shall be pointed out that the economic group is a common type of business structure within the Mexican economy; and business conglomerates are a recurrent type of economic group in Mexico.

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[136] INEGI, 'Resultados definitivos Censos Económicos 2014' (*INEGI,*2014) <https://www.inegi.org.mx/contenidos/programas/ce/2014/doc/pprd_ce2014.pdf> accessed 21 august 2019.
[137] Ibid.
[138] Ibid.
[139] INEGI (n 136).
[140] Ibid.
[141] J. Aguilar (n 135).

Business conglomerates are formed by a number of companies that are centrally controlled and attached through a production process, or the different companies within the conglomerate produce for related markets in order to benefit from economies of scope[142].

This type of business structure in Mexico normally has a small group of shareholders that have the ownership and control of the conglomerate, and regardless of the fact that this group of companies have a seemingly corporate structure, such groups are owned and managed as family business, and the family members hold around 60% to 70% of the shares[143].

3.4.4 Economical and Political background in Mexico

Having said all of the above, it shall be pointed out that the family owned type of business organization has been present throughout Mexico's history, and the concentration of wealth that generates tension within the country has also been frequent. As stated by Nora Hamilton:

> The concentration of economic power in Mexico can be traced to the colonial period, when small elite of landowners, mine owners and merchants controlled much of the wealth of the colony (...) The Socio-Economic elite changed over time, becoming more complex, but continuing to have a dominant role in Mexico's economy.

This means that, ever since colonial times, a constant struggle and cause for inequality in Mexico has been the concentration of wealth and power within a small group of people. This struggle has been stated as "Mexico's permanent revolution", because ever since the country's fight for independence from Spain in 1821, the main objective has been to reach equality and justice between the Mexicans. This same drive was what led to the 1910 Mexican revolution against President Porfirio Díaz, when high levels of poverty, and the expropriation of peasant land, led the citizens to revolt[144].

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[142] G. Castañeda (n 127) 24.
[143] Ibid 25.
[144] P. Weizenmann, 'Mexico's Clamor for change, Lopez Obrador and his people's Expectations' (2018) 39 Harvard International Review 9.

Regarding the same, Mexico´s changes in economic policies have traced the way to the creation of powerful economic groups, which started being the predominant form of business organization during the late 21st century[145].

But before the creation of powerful economic groups, around the 1950's an Import Substitution Industrialization (ISI) policy took place in the economy, in order to protect the market from the competition of imports, by introducing tariff duties on imports, but also through the establishment of manufacturing plants along the Mexico - US border, in order to favour exports[146] to the US, which was known as Maquiladora programme. These industrialization efforts transformed the country from an agrarian economy to an urban semi-industrial society[147].

These efforts took place during what it is known as the Mexican Economic Miracle, between 1940 and 1980, when the country grew at a 6% rate, and the industry grew from 25% of the GDP to 34% of the GDP in 1970; also, the industrial labour force increased and the agricultural labour force declined[148]. During these years, one of the essential elements of the growth was the intervention of the state in the economy.

For instance, controlling the railroads and the oil industry, or providing services to other companies and individuals at subsidized prices[149]. But the problem with this, was that Mexico started having a dependency on foreign borrowing in order to finance its projects (because the amount collected by taxes was not enough), and in 1970 the public debt increased to over $4 billions of dollars[150].

Then, around the 70's, Mexico had an economy of expansion, and economic groups already dominated the private sector, these groups were mostly industrial firms, banks and real estate firms; most of them had participation of the government within their shares.

Some of these groups began since the administration of Porfirio Díaz, like the Garza-Sada group in Monterrey city, that established a brewery and a glass factory in the beginning of the 20th century, and then established additional manufacturing companies within the steel industry. This

[145] R. Chavarín (n 120).
[146] J. Moreno, J. Pardinas and J. Ros, 'Economic development and social policies in Mexico' (2009) 38 Economy and Society 154.
[147] Ibid.
[148] N. Hamilton (n 123) 76 - 83.
[149] Ibid 74.
[150] Ibid 76 - 83.

economic group remains to this day, still being family owned, and by the 1970's the grandchildren of the original founders were managing the firms. [151]

Regardless of the above, the economic miracle did not favour everyone, and high levels of poverty and unequal distribution of wealth remained.

Another issue generated within the Mexican economic miracle, was that Mexico's dependency to the US increased, as it became 'Mexico's major trading partner as well as the major source of foreign capital'[152] (by 1973, the US direct investment in Mexico increased to $2.4 billions of dollars)[153].

In an attempt to fix the issues created during the ISI policy, President Lopez Portillo (whose administration period was from 1976 to 1982) started to exploit new oil reserves that had been discovered in Mexico, and the country became a major oil exporter, which led to an economic growth for the country. But only for a while, because by the end of Portillo's administration, Mexico was in an economic crisis[154].

This crisis happened because Mexico became dependent to the oil exportation, and the oil prices dropped in 1981. Then, as a consequence of this, the peso was devalued and the government announced that it would no longer be able to repay its foreign debt[155].

This crisis devastated the Mexican population, and by 1982, the inflation rate was of 70%. The government took austerity measures, it cut back the social expenditures and around a million workers lost their job. This, forced Mexico to seek financial help from US banks, Europe and Japan, also from the International Monetary Fund and the World Bank. In the other side, the IMF demanded from Mexico a restructuring of its economy, in order to introduce economic liberalization policies, this "structural adjustment program" included the privatization of state assets, the reduction/ elimination to trade tariffs, removal of restrictions of foreign investment and a shifting to an economy of production for export[156]

These effort of liberalization in Mexico continued during the administration of President Carlos Salinas de Gortari, and during this period, public enterprises formerly controlled by the government were privatized (examples of this are the telecommunications companies and the whole national banking system that was privatized)[157].

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[151] Ibid.
[152] Ibid, 105.
[153] ibid.
[154] Ibid 103-105.
[155] Ibid 107-109.
[156] ibid, 103 - 105.
[157] J. Moreno, J. Pardinas and J. Ros (n 157).

Also, there was a reduction of the state's intervention in the economy; Mexico became a member of GATT in 1995 and then the North American Free Trade Agreement was launched in 1994 between Mexico, USA and Canada[158].

Regardless of the macroeconomic reform, and the fact that it was supposed to bring economic benefits to Mexico, the new model of liberalization did not benefit everyone, and it increased the polarization within social classes.

By 1994, the income of the 10% of the wealthiest people in Mexico increased, while the income of the rest of the 90% of Mexico's population decreased, and the levels of poverty in Mexico overall increased[159].

Finally, due to these amendments, the concentration of wealth in "economic groups" was propitiated. For example, during the 1990s, CEMEX (Cementos de México, SA. de C.V.), a cement company, controlled 70% of the cement production in Mexico, and VITRO, a business conglomerate, controlled 90% of the glass production; in other words, the privatization of certain industries led to some type of private monopolies[160].

All of these changes in the economy started creating class conflicts, discontent and protests. There were labour movements struggling for democracy, student movements that criticized the government's actions and its legitimacy for not putting enough effort in reducing inequality, pro-democracy movements started all around the country[161]. Overall, the Mexican population demanded for a change in the political party that held the federal executive party, since the same political party ran the presidency from 1930 to 2000[162].

Finally, a shift in the political party behind the federal executive was achieved in the 2000 elections, when a candidate from the party called Partido Acción Nacional (National Action Party or PAN) was elected as the president. However, this party lasted only 12 years holding the power (two presidential administrations, first by President Vicente Fox and then President Felipe Calderón). Since the administration of President Felipe Calderón was marked by severe violence, due to its "Guerra Contra el Narco" (war against narco) policy, which intended to end with the drug dealing problem within

[158] Ibid.
[159] N. Hamilton (n 123) 130.
[160] Ibid 131.
[161] Ibid 136 - 138.
[162] This was the PRI (Partido Revolucionario Industrial, Industrial Revolution Party) which was said to hold a 'perfect dictatorship', a main characteristic of this part was its hegemony and lack of political opposition. P. Weizenmann (n 144).

the country, but as an outcome, his administration is considered the most violent of the last 50 years[163], with the highest rate of intentional homicides, peaking in 2011, with an average of 22,281 intentional homicides per 100,000 people[164].

Afterwards, in 2012, a candidate from the PRI party was elected president; Peña Nieto's administration was marked by corruption scandals that decreased his approval ratings[165].

Finally, in 2018, the presidential election marked a change in the political history of Mexico, when Andres Manuel Lopez Obrador (AMLO) was elected. This candidate is from the *Movimiento Regeneración* Nacional (National Regeneration Movement or MORENA) party, which has the objective of a peaceful transformation of the country in order to achieve democracy, and eliminate oppression, inequality, injustice, privilege and exclusion[166].

The election of 2018 was a result of profound discontent of the society with the government, because almost 50% of the population was living in poverty, and not enough actions were taken by past administrations to eradicate this problem. Alongside with the fact that ever since the 1980's, a neoliberal model was adopted in Mexico's economy; however, this model did not work out for everyone, and even though it increased the GDP, it did not diminish the degree of poverty in Mexico. All of these reasons, explain the discontent that led to the imminent election of AMLO, the left-wing presidential candidate, who got a total of 52% of the votes[167].

Therefore, as a summary, Mexico's economy has suffered great changes and amendments throughout its history, from an ISI policy with state intervention, to a market liberalization policy, to the election of a socialist party that has the objective of closing the gap of inequality with the Mexican society and achieving democracy.

3.4.5 Workers representation and discontent throughout Mexico's history

[163] R. Yunuen and M. Somuano, 'El periodo presidencial de Felipe Calderón Hinojosa' (2015) 55 Foro Internacional 5.
[164] World Bank, 'Intentional Homicides' (*UN Office on Drugs and Crime's International Homicide Statistics Database,* 2 December 2017) <https://data.worldbank.org/indicator/VC.IHR.PSRC.P5?locations=MX> accessed 23 August 2019.
[165] P. Weizenmann (n 144).

[166] MORENA, 'Estatuto de Morena' (*MORENA,* 05 November 2014) <https://morena.si/wp-content/uploads/2014/12/Estatuto-de-MORENA-Publicado-DOF-5-nov-2014.pdf> accessed 28 July 2019.
[167] P. Weizenmann (n 144).

In relation with all of the above, in order to explain why is employee participation in the management of the Mexican companies needed, the discontent of this interest group must be explained.

In Mexico, the protection of the employees' interests is attributed to worker unions. The right of the workers to form unions is recognized in the Federal Constitution[168], which states that in order to defend their interests, workers have the right to form unions.

Likewise, the Mexican Constitution states that the employees of a company will have the right to obtain an annual retribution derived from the company's profits called the "annual sharing in the profits". However, it expressly says that 'The right of the workers to participate in the annual sharing in the profits does not imply the faculty of intervening in the company's management'[169].

Unions will be recognized as legal entities, if they comply with the requirements established in the Federal Labour Law (*Ley Federal del Trabajo*), and they will have the faculty of acquiring goods in order to accomplish their objective, which is to defend the workers' rights and interests[170]. Nevertheless, it is important to point out that being part of a union is a right and not an obligation or a predetermined clause in the contract of employment, which means that not all of the Mexican workers have their interests represented through a union.

The right to form workers Unions was acquired since the ending of the Mexican revolution in the end of the 20's decade[171], however, this form of representation has been widely criticized, since history has shown that Unions often represent the interests of the state, or the interests of the business owner, rather than the interests of the employees.

This, because historically, the most important worker unions within Mexico like the CTM (*Confederación Nacional del Trabajo*) and the SNTE (*Sindicato Nacional de Trabajadores de la Educación)* which is the largest workers' union in Latin America[172], have been closely linked to the dominant political party, the PRI (Industrial Revolution Party) which we mentioned in the above paragraphs.

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[168] Article 123 fraction XVI of the Constitución Política de los Estados Unidos Mexicanos.
[169] Article 123 fraction IX section f) of the Constitución Política de los Estados Unidos Mexicanos.
[170] Article 356 - 358 of the Ley Federal del Trabajo
[171] G. Bensusán and K. Middlebrook, 'El Sindicalismo y la Democratización en México' (2012) 52 Foro Internacional 796.
[172] D. Baldillo 'La Historia del SNTE´ *El Economista* (Ciudad de México, 16 April 2013) <https://www.eleconomista.com.mx/opinion/La-historia-del-SNTE-Primera-de-tres-partes-20130416-00º02.html> accessed 20 August 2019.

Such political party, usually controlled different worker unions throughout the country, by being colluded with their syndicate leaders[173].

Furthermore, members of the worker unions, usually hold powerful political positions, for example, from 1979 to 1985 more than 90 of the members of the chamber of deputies were members of the CTM[174] (being that the chamber of deputies has a total number of 500 members).

Another example of the union's influence in Mexican politics is that, during the elections of 2006, the support of the SNTE led by the syndicate leader Elba Esther Gordillo, led to the election of the candidate Felipe Calderón (who was President from 2006 to 2012). During his administration, Elba Esther's son in law became the Subsecretary of the Basic Education Commission in Mexico, and positioned her allies in the direction of the National Lotery, and the Comission of Social Security and Welfare in Mexico[175].

All of the above proved that worker unions are powerful in Mexico, and they could hold pressure against the state in order to obtain better working conditions for their employees. But even though unions have the power to do that, no improvement in the salaries has been achieved by them, neither have they been effective in preventing massive termination of working contracts in the past or in improving the working conditions for the Mexican workers.

Another example of the union's failure in defending the worker's interests is explained by Zapata, who states that around 1987, Mexico was taking a privatization focus in their politics, and several companies that used to be state owned companies, where now being sold to private owners. These owners would then remove the past employees in order to establish new ones[176], and the CTM did not make any action in order to frown the unemployment or defend the worker's rights.

In relation with the same, the association of worker unions with political parties produces allegiances to the interests of the state and companies, while leaving employees feeling like their interests and welfare is not being properly represented[177].

As stated by an interviewee in the Greer and Stephens' study:

[173] G. Bensusán and K. Middlebrook (n 171).
[174] Ibid.
[175] ibid.
[176] F. Zapata, '¿Crisis del sindicalismo en México?' (1994) 56 Mexican Journal of Sociology 59.
[177] C. Greer and G. Stephens, 'Employee relations issues for US companies in Mexico' (1996) 38 California Management Review 121.

> Given the way Mexican unions organize at many companies, it is quite possible that Mexican workers will not feel represented even while union and government officials are telling the company differently (…) Be aware that just because it is called a 'union' it does not necessarily function the way unions do elsewhere.[178]

In addition, another fact that illustrates the argument that worker unions do not really work effectively in order to pursue the employees' interests is the fact that the minimum wage has lost two thirds of its purchasing power from 1982 to 2012[179]. Since the low wage of workers' in Mexico has been used as an attractive offer to foreign investment, especially by using cheap labour in order to manufacture (low cost) goods in maquiladoras, which are later exported to USA[180]. This economic strategy may benefit Mexico as a whole, but decreases the quality of life of the workers.

All of the above has set a precedent into concluding that the current form of worker representation in Mexico lacks legitimacy and effectiveness in seeking the best interests of employees.

Academics like G. Bensusán support the argument that in order to reduce the degree of social inequality in Mexico, it is necessary to establish new forms of representing the working class interests within companies, which in the long term, will stimulate workers to seek an increment in productivity, and will favor both the company and the employee[181].

Conclusion

The Mexican company has a concentrated ownership structure, in which founding families hold most of the shares, and therefore, exercise the control within a corporation, without any significant counterweight in the company's governance structure.

This, because corporate law in Mexico has got a contractual view of the corporation, and a shareholder primacy model underlying its corporate laws, which hold some similarities with the US model, for example in the fiduciary duties of directors towards the shareholders in public listed

[178] Ibid.
[179] G. Bensusán and M. Subiñas, 'Representation and mediation in the workplace: Actors, Resources and Strategies' (2014) 59 Revista Mexicana de Ciencias Políticas y Sociales 55.
[180] G. Bensusán and K. Middlebrook (n171).
[181] G. Bensusán and M. Subiñas (n179).

companies, as well as the share value maximizing objectives contained in the LGSM as well as in the LMV and in the Code of Best Corporate Practices.

Also, another reason for this is the historical background that allowed the constitution of large conglomerates that hold great importance and power within the country, and are also family owned.

Additionally, another important factor in the current business background in Mexico, is that the semi industrial economic model, has made cheap labour and cheap exports as one of its main competitive advantages in front of other economies; and this, alongside with the fact that employees are not well represented by labour unions, has increased tensions over the years, has made evident a lack of trust towards big company's management and a general discontent of the working class.

Furthermore, the poverty problems in Mexico, and the exacerbated inequality that has characterized Latin American countries, have made it evident that drastic measures must be adopted, in order to achieve social justice within the country's population.

Therefore, it becomes clear that the CG of companies in Mexico is inaccurate for properly regulating the Mexican company, since currently, the CG does not take into account the interests of a crucial group of stakeholders, which is their employees. Therefore, in order to achieve a model that implies justice and a balance of interests between the stakeholders, employee representation must be incorporated within the company's management.

Chapter 4-. Implementation of a two-tier board in Mexico

Now that the CG background in Mexico has been explained, in the following sections the CG model in Germany will be analysed, in order to complete the argument as to why must the CG structure in Mexico must change into a two-tier board model that includes employee representation. Lastly, this chapter will include the reform proposal for company law in Mexico in order to implement the changes herein suggested.

4.1 Germany's CG model

The German system of CG is defined by its laws of codetermination (Mitbestimmungsgesetz), 'which involve a reallocation of corporate control giving nearly equal representation to labour and ownership in the board of directors'[182]. This implies that employees will have representation in the management of a company, and moreover, that their interests will be given the same degree of importance as the shareholders' interests.

Codetermination in Germany is mandatory for limited companies[183], including the limited liability private company (Gesellschaft mit beschränkter Haftung or 'GmbH') and the joint stock company (Aktiengesellschaft or 'AG').

They are regulated by different Acts; the GmbH is governed by the Limited Liability Companies Act (*Gesetz betreffend die Gesellschaften mit beschränkter Haftung* or 'GmbHG') and the AG is governed by the Stock Corporation Act (*Aktiengezets* or 'AktG').

This codetermination obligation, entails a stakeholder approach in the CG of a company, in which the employees' interests are recognized as a crucial element for the sustainability of the company.

This CG structure has been criticized, since academics argue that the application of codetermination laws may lead to inefficiency in decision making as well as a costly implementation[184].

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[182] W. McPherson, 'Codetermination: Germany's move towards a new economy' (1951) 5 Industrial and Labour Relations Review 32.
[183] D. Block and A. Gerstner, 'One-Tier vs Two-Tier Board Structure: A Comparison Between the United States and Germany' (2016) Comparative Corporate Governance and Financial Regulation Paper 1 <https://scholarship.law.upenn.edu/fisch_2016/1/> accessed 13 August 2019.
[184] H. Hansmann and R. Kraakman (n 23).

However, despite criticism, this model has prevailed, and it led to prosperity within the German industrial sector, and even more so, it is argued that the CG system of Germany has enhanced investment[185].

Furthermore, this CG model has motivated reforms within the EU, in order to include different forms of employee participation within the company's management[186].

It is believed that one of the main reasons why this model has been proven effective in Germany, is its particular socio-economic context, and a genuine belief that co-determination is socially desirable and economically beneficial, since it counteracted the inequality of bargaining powers between employers and workers[187].

In connection with the same, herein is argued that employee representation within the management of Mexican companies is needed, and a reform inspired in the two-tier board model of CG of Germany is proposed.

Codetermination in Germany was introduced around the 1950's as a response of labour democratization efforts around Europe after the First and Second World Wars. Additionally, codetermination was an outcome of the major strikes in the iron, steel and coal industry[188]; whose unions, through bargaining processes[189], achieved the first codetermination model (which was only applicable to firms within such industry)[190].

Afterwards, the German Stock Corporation Act of 1965 brought a reform to the CG of German companies, which reflected a social inclusion view of the corporation[191]. This reform established the mandatory obligation of establishing a two-tier board model for stock companies. These boards would be the supervisory board (*Aufsichtstrat*) and the management board (*vorstand*)[192].

4.1.1 Two-Tier Board Model

[185] A. Choudhuri (n 53)
[186] Council Directive 2001/86/EC.
[187] E. McGaughey, 'The codetermination bargains: The history of German corporate and labour law' (2015) LSE Law, Society and Economy Working Papers 10/2015 <www.lse.ac.uk/collections/law/wps/wps.htm> accessed 01 August 2019.
[188] K. Hopt, 'New ways in corporate governance: European experiments with labor representation on corporate boards' (1984) 82 Michigan Law Review 1338.
[189] E. McGaughey (n 187).
[190] H. Mertens and E. Schanze, 'The German Codetermination Act of 1976' (1979) 2 Journal of Comparative Law and Securities Regulation 75.
[191] W. Frisch, *La Sociedad Anónima Mexicana* (5th edn, Oxford University Press 1999) 19.
[192] § 30 Aktiengezets (AktG) 06.09.1965, BGBI. I S. 2446

This model of CG separates management and control functions within companies, and establishes different duties for each board.

The management board is in charge of managing the affairs of the company[193], and it will be in charge of the company's strategic direction, manages the workforce, coordinates tasks and plans the operations[194].

The number and composition of the board varies according to the company's size, codetermination rules, and its' own by-laws[195]. The members of this board will be appointed and removed by the supervisory board[196], and this board represents the company in and out of court.

On the other side, the supervisory board, is in charge of the control of the company. It will be composed by shareholders representatives and by employee representatives[197].

The main task of this board is to monitor the management board, as well as appointing and dismissing its members[198].

This board can exercise actions against the members of the management board, approve annual accounts, advise the management, and in general act as consultants of the management [199].

The supervisory board cannot directly be involved in the management; however, the by-laws of the company can establish specific decisions in which the approval of supervisory board will be mandatory[200]. Also, the members of each of the boards, cannot simultaneously be part of the other board[201].

Moreover, in addition to the public listed companies' obligation to establish a two-tier board model in their CG structure, the limited liability corporation (GmbH) also has an obligation of including labour representation in their management depending on the company's size.

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[193] § 76 Aktiengezets (AktG) 06.09.1965, BGBI. I S. 2446
[194] D. Block and A. Gerstner (n 183).
[195] ibid.
[196] C. Jungmann, 'The Effectiveness of Corporate Governance in One Tier and Two-Tier Board Systems - Evidence from the UK and Germany' (2006) 3 European Company and Financial Law Review 426.
[197] § 96 Aktiengezets (AktG) 06.09.1965, BGBI. I S. 2446
[198] C. Jungmann, (n 196).
[199] D. Block and A. Gerstner (n 183).
[200] K. Hopt and P. Leyens, 'Board Models in Europe Recent developments of internal corporate governance structures in Germany, the UK, France and Italy' (2004)1 European Company and Financial Law Review 135.
[201]C. Jungmann (n 196).

In relation with the above, this CG system, regardless of its costly implementation, has worked and has been proven efficient, due to greater labour performance and transparency of governance that prevents frauds[202].

One of the reasons why this CG system has worked, is that Germans believe that corporations have a personal component to it, and its operations will produce a benefit for the whole community[203]. Furthermore, there is a general belief that cooperation rather than confrontation is an important value within the German society[204].

Another reason why this CG system works, is that the codetermination act was only achieved after long strikes of the whole steel industry sector; and after the enactment, workers within companies demonstrated an increase in commitment and sense of responsibility towards their firms[205].

Furthermore, another reason is that before codetermination, representation through unions was bureaucratic, and only served the purpose of negotiating industry-wide agreements, but did not have an actual power to achieve better working conditions such as a higher wage[206].

The above being said, it shall be pointed out that all of these factors which led to the successful implementation of worker representation in the management of companies in Germany, hold similarities with the context in Mexico. Since Mexico, is a semi industrialized country, where the labour force occupies a crucial role in the corporation, but does not have an effective mechanism of representation of interests.

4.2 Comparison between Mexico and Germany's business context

Currently, Mexico's system of Corporate Governance is similar to the US, as it has a share-value maximizing priority as the objective of the company; the directors have fiduciary duties of care and loyalty towards the shareholders (and only towards the shareholders). The company is viewed as a nexus of contracts[207], and other stakeholders' interests are not taken into account within the company's management.

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[202] E. Engle and T. Danyliuk (n 29).
[203] M. Spisto, 'Unitary board or two-tiered board for the new South Africa?' (2005) 1 International Review of Business Research Papers 84.
[204] Ibid.
[205] W. McPherson (n 182).
[206] Ibid.
[207] M. Garcia (n 74)15.

However, even if this model may be suitable for the US, it is not suitable for Mexico. Because a shareholder primacy model is only suitable for a country with a predominance of numerous widely held public companies with dispersed share ownership, such as the US or the UK [208].

On the contrary, Mexico does not have numerous widely held public companies, rather, companies tend to have a concentrated ownership, with large family related block holders, big economic groups, and a smaller stock exchange, just as in Germany[209].

In connection with the same, Germany as well as Mexico, are both industrialized (Mexico semi industrialized) countries, which have as one of its distinctive factors, the presence of large industrial firms. In these industrialized jurisdictions, workers within large manufacturing firms were perceived as exchangeable pieces in the production process, and therefore, the only purpose of the corporation was to offer greater yield to their owners[210]. Nevertheless, after the Second World War finished, the perception of the company changed to a social organization, that owed part of its value creation to an interaction of different factors within a society[211].

In this terms, after the Second World War, the Unions within Germany pushed for participation in the management board, since the Union form of representation was no longer being enough to achieve proper defense of the workers' rights. In that same sense, Mexico's workers have been unsatisfied for decades, with Union representation, since they serve political interests rather than labour interests.

Furthermore, labour participation was introduced in Germany, in order to achieve industrial democracy, and in order to promote social inclusion[212], that led to higher salaries and benefits for workers. This, because codetermination in Germany 'appeared at the critical historical moments to resolve a significant market failure: it counteracted the inequality of bargaining power between employers and workers'[213], in other words, codetermination placed a balance of interest between the corporation and its employees, since a simple employment contract couldn't ensure the protection of interests of the workers.

[208] K. Hopt (n 51).
[209] Ibid.
[210] G. Castañeda, *La Empresa Mexicana y su Gobierno Corporativo* (1st edn, Alter Ego Editores 1998) 23-26.
[211] Ibid.
[212] K. Hopt and P. Leyens (n 200).
[213] E. McGaughey (n 187).

This situation, which led to codetermination, is comparable with the current situation in Mexico, where workers do not have equal bargaining power in front of companies, and therefore, the contractual theory of the corporation that regulates stakeholders' interests within Mexican companies, is not suitable for regulating fair labour conditions in Mexico.

Regarding the same, labour precariousness in Mexico has increased, as a result of: (i) the neo liberal economic policies introduced in the 80's, and (ii) cheap manufacturing labour that has characterized Mexico's semi industrialized economy[214].

Moreover, cheap labour has been a result of lowering the cost of hiring employees, to increase profitability for enterprises in Mexico. Which has been achieved through (unethical) corporate practices of outsourcing, by which a company, hires its employees through another company, in order to pay less social security contributions215.

Furthermore, another fact that supports the argument that labour representation in the management is needed, in order to take into account, the interests of workers and achieve democracy is the fact that employees in front of big corporations hold very little or no power to defend their interests. Because even though in Mexico, the LFT establishes the right of strike216, this is only a formal recognition of such right, with no real application, since the low cost and easy interchangeable nature of labour in Mexico makes it effortless for employers to discharge employees that engage in union activities, or organize strikes[217].

All of these situations, alongside with the fact that the unequal distribution of wealth in Mexico has polarized the social classes, and has challenged legitimacy of democracy within the country218, led to a radical change in the political leadership with the election of a president with left-wing ideology.

The shift from a right-wing directed political environment in Mexico, to a left-wing government has been a result of a general frustration of the majority of the population that has been affected by the

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[214] J. Pérez and G. Ceballos, 'Measuring precariousness at work in Mexico from 2005 to 2015, through Generalized Ordinal Logistic Model' (2017) 28 Revista de Ciencias Sociales y Humanidades 109.
[215] Ibid.
[216] Article 2 of the LFT.
[217] An example of this is the strike of Volkswagen's employees, led to the cancellation of the contract of 90% of its workforce. Also, it has been reported that US companies such as Honeywell and General Electric have terminated contracts with employees that were involved in organizing efforts for an independent union called *Frente Auténtico del Trabajo.* C. Greer and G. Stephens, 'Employee relations issues for U.S. companies in Mexico' (1996) 38 California Management Review 121.
[218] Alberto Arellano Ríos, 'El Estado de derecho y la calidad de la democracia en México' (2018) 73 Estudios sobre Estado y Sociedad 235.

neo liberal policies that only favoured the financial capital and specific business sectors, while increasing the percentage of poverty, that by 2016 was in 50.6% of the population219.

Therefore, if the goal of the current president is 'to establish an authentic democracy'220; then, the introduction of a two-tier board model that promotes social justice and supervises the actions of management boards within the biggest companies in Mexico through labour representation in the management, becomes necessary. This, due to the fact that 'democracy will never thrive if rich agents are able to subordinate citizens'[221], which is the current reality of economic groups in front of the society.

Regarding the same, for Mexico to achieve democracy without affecting the performance of companies nor their production; cooperation (instead of confrontation) should be the factor of change. Because a true change that leads to an overall welfare, with a reduced differentiation within social classes, can only be achieved through joint efforts of the political, legislative, private and citizen power within a jurisdiction.

At this point, before introducing the reform proposal, it shall be pointed out that studies have been carried out in Mexico, in order to test whether or not participative management can have positive impacts. In these studies, it has been concluded that participative management programmes lead to greater performance, employee satisfaction, and bring benefits derived 'from ideas coming from those who are closer to the production processes'[222]. Also, it generates a sense of commitment with the organization and long-term focused relationships223.

4.3 Reform proposal

This work proposes a reform to the CG framework in Mexico, in order to make it mandatory for public listed companies to divide its management and control tasks, through the implementation of a management board and a supervisory board. Also, this paper proposes to impose a mandatory

[219]A. Damian 'Poverty and inequality in Mexico: The ideological and factual construction of diverse and unequal citizenships' (2019) 86 El Trimestre Económico 623.
[220] A. Lopez, 'Discurso de Andres Manuel Lopez Obrador con motivo del triunfo electoral' (Mexico city 2018) <https://lopezobrador.org.mx/2018/07/02/palabras-amlo-con-motivo-del-triunfo-electoral-del-1-de-julio/> accessed 20 August 2019.
[221] M. Koutsias, *The Nature of Corporate Governance* (1st edn,) 8.
[222] L. Hope and K. Hill 'Participative management in Northern Mexico: A Study of Maquiladoras' (1997) 8 International Journal of Human Resource Management 197.
[223] W. Lewchuk and D. Wells, 'Transforming worker representation: The Magna model in Canada and Mexico' (2007) 60 Labour 107.

obligation of employee representation in the management, for SAs and SRLs (private companies), if they employ more than 1000 people.

Before going further in the reform proposal, it shall be pointed out that is not within the scope of the present work, to exhaustively and precisely describe the way in which the reform would have to be carried out in order to make a shift from the current CG system to a two-tier board model that incorporates employee representation.

Neither is it the objective of this paper to propose an exact copy or imitation of the Germany's model in the Mexican jurisdiction, since it is not advisable for a country, to exactly duplicate a determined legal system that was developed under a different socio political context, and also because Germany's model of employee representation is a result of interconnection between codetermination laws[224] and the company law framework; but such codetermination laws are far too specific and only suitable for such jurisdiction.

That being said, this work proposes the implementation of some of the essential dispositions of German company law, that establish mandatory employee representation through a two-tier board model in CG. This, while making some connotations to the application in order for the proposed reform to attend the peculiarities of the Mexican corporate context.

In connection with the same, the following paragraphs will explain the essential modifications to the CG system in Mexico, in order to implement a two-tier board model with employee representation.

4.3.1 Reform proposal for the SABs legal framework

First, the LMV and the Mexican Code of Best Corporate Practices will have to be modified in order to change the current CG structure of SABs, which currently imposes an obligation of establishing a CEO and management board (which monitors the actions of the CEO), to a CG structure that establishes a management board, and a supervisory board.

Furthermore, in the German system a simultaneous membership of the management board and the supervisory board is not permitted[225], this prohibition is necessary in the Mexican CG legal

[224] For example, the Act of Codetermination OF Employees in the Supervisory Boards and Management Boards of Mining Enterprises and Enterprises in the Iron- and Steel-Producing Industry, or the Codetermination Act, the Act on Employee Co-Determination in the Case of a Cross-Border Merger. Section 96 of the Stock Corporation Act.
[225] C. Jungmann (n 196).

framework, since currently, duplicity of roles within companies is allowed, and very common, therefore a clear separation between the monitoring and the management function is recommended[226].

Additionally, for the composition of such boards, the German Corporate Governance Code can be used as a model.

This code imposes an obligation for public listed companies that have from 500 to 2000 employees, to have a supervisory board, in which 30% of its members are employee representatives. If the company has more than 2000 employees, then half of the board will be composed by employee representatives and the other half will be composed by shareholder representatives, however, there will be one extra member of the board, which will be a shareholder representative and will hold the casting vote[227].

Taking such disposition into consideration, it is proposed that for Mexico's reform, the threshold should be of 1000 employees, due to the fact that implementing such reform would be very costly. Therefore, as a starting point it is recommended that such obligation is imposed only to companies of that size or bigger. This threshold is recommended, since the latest economic census revealed that the average of employees within the 1000 biggest companies in Mexico, is of a 1,816 for single-establishment companies[228], therefore, a threshold of 500 may be too low for the implementation of this CG structure.

Furthermore, in regard of public listed companies, an addition to the LMV will have to be implemented in order to establish the obligation for the general shareholder meeting to appoint their representatives that will be part of the supervisory board, in accordance with section 101 of the German Stock Corporation Act.

Also, this paper recommends to establish the requirement for both private and public listed companies, of having a minimum of 3 members in the supervisory board, in order to avoid a deadlock. This in accordance with section 95 of the German Stock Corporation Act, since the LMV, currently does not establish a minimum of members for the management board.

Another modification proposed, is the independency of the members of the supervisory board, since currently, the LMV does not require the independency of the whole board, and rather it only

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[226] Daniel Aguiñaga, 'Doble rol: Presidente de Consejo y Director General' (*Deloitte,* September 2014) <https://www2.deloitte.com/mx/es/pages/risk/articles/buenas-practicas-vs-ineficientes.html> accessed 10 August 2019.
[227] Foreword, German Corporate Governance Code (*Deutscher Corporate Governance Kodex)*.
[228] INEGI (n 136).

requires the independency of 25% of the members, which compromises the independency itself, due to concern of the chosen independent members of losing the board seat and its associated benefits[229].

Moreover, it is proposed for the Mexican CG framework to implement the prohibition for shareholders representatives to be a part of more than 10 supervisory boards simultaneously, in accordance with section 101 of the German Stock Corporation Act. This being proposed, since currently it is a common practice for Mexican businessmen to be part of multiple management boards of public listed companies, which leads to ineffective supervision.

Lastly, it is proposed for Mexican companies with the obligation of establishing a supervisory board, to determine in their by-laws the specific requirements that will be imposed to members of the supervisory board, attending the particularities of the respective company.

4.3.2 Reform proposal for the SA and SRL legal framework

Furthermore, in Germany, the Limited Liability Corporations are also required to establish a two-tier board model of CG if it has more than 500 employees, and employee representatives will hold one third of the supervisory board's seats.[230]

Taking this into consideration, a reform to the LGSM is proposed, in order to modify the dispositions that establish the CG of SAs and SRLs, for them to have the obligation of establishing a supervisory board and a management board, when they have a 1000 or more employees. Also, in order to establish the obligation of implementing employee representation in the management, in private companies as well.

This being said, since currently the LGSM does not establish an effective organ of surveillance, nor a clear separation of management and control for private companies, which then is translated in a lack of balance of interests of the stakeholders of a company.

Also, it is important to mention that this reform is needed, since the CG development efforts in Mexico, have only been directed to public listed companies, however, this is no longer acceptable, since the Mexican Stock Exchange only has 146 companies[231], whereas the economic census of 2014

[229] A. Choudhuri (n 53).
[230] Ibid.
[231] J. Santiago, 'En México la BMV tiene 146 empresas listadas' (Ciudad de México,16 July 2017) <https://www.eleconomista.com.mx/mercados/En-Mexico-la-BMV-tiene-apenas-146-empresas-publicas-20170716-0074.html> accessed 13 September 2019.

revealed that the 1000 biggest companies in Mexico, have an average of 1812 employees[232]. Therefore, it becomes clear that only a minimum percentage of big companies in Mexico are part of the stock exchange, but this does not mean in any way that private companies are not big, or that they do not need effective structures of CG.

Also, it is argued that employee representation in the management of these companies is needed, in order to reduce the counter effects of outsourcing, that lower the social contributions that employees are entitled to receive, in terms of the LFT.

Conclusion

This reform is proposed in order to improve the surveillance systems in companies, achieve a stakeholder approach within CG, increase the quality of working conditions, and in the long run support the sustainability of Mexican corporations.

This model pretends to increase the protection of the employee's interests within a company, (as this group is one of the most important stakeholder group within a company), at the same time that it increases productivity by 'softening hierarchy and improving coordination of productive inputs through better feedback'[233].

Also, this reform is proposed in order to improve surveillance, independency of board members and a clear separation of responsibilities of strategy and control within Mexican companies.

The implementation of this reform may bring disruptive changes and an initial resistance from businessmen. However, this reform is not of a merely 'stakeholder approach' nature, since the main objective is to align the interests (or achieve agreements) between the shareholders, the management, and the employees, in order to achieve greater productivity that increases profit.

Chapter 5-. Conclusion

[232] INEGI (n136).
[233] E. Engle and T. Danyliuk (n 29).

Having said all of the above, it has been demonstrated that the CG of Mexican companies must change.

First, it was explained the need to implement a stakeholder approach that recognizes the employees as the most important stakeholder group besides shareholders.

Then, it was shown that the ownership structure of a Mexican companuy, in trlation with the multiplicity of roles developed by the shareholders, the managers, and the executive officers, prevents the company of achieving an effective balance of interests as well as an effective mechanism of surveillance.

Furthermore, it was observed that the current CG framework is only focused in public listed companies, and the LGSM only imposes minor requirements of CG for private companies. However, herein it was argued that private companies also need to adopt best CG practices, and they need to adopt a two-tier board model with employee representation in the supervisory board, when they employ more than a 1000 people.

Moreover, it was shown that labour unions serve political interests, rather than labour protection. Therefore, it is concluded that a better mechanism of employee representation is needed.

Lastly, it was argued that the current political context in Mexico, should lead to cooperation for establishing a democracy.

In regard of all of these arguments, it is to be concluded that the adoption of two-tier board model in the CG framework in Mexico is needed, and will be beneficial for all of the stakeholders of a company, and for the country as a whole.

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