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**DUAL GOVERNANCE
IN STATE-OWNED BANKS**

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ABSTRACT

State-owned enterprises set a clear example of a mixed governance, in which the public and private realms blend together to bring about a complex structure we are going to define as dual governance. This paper puts forth a new design of governance for state-owned banks. Firstly, the whole subject is framed within the transaction costs approach to financial intermediation. Next, we move on to the formal governance of state-owned banks. Afterwards, we focus on dual governance and expand on agency problems that arise from the fiduciary role, accountability, transparency, rent-seeking and soft-budget constraints. The paper's proposal hinges upon the subsidiarity portfolio, to which the state-owned bank should manage as a trustee only, so that dual governance could be enhanced. We conclude bringing forth a minimal set of dual governance principles.

JEL: G34, G21, D23, D73, H20

Key words: governance, public governance, dual governance, state-owned banks, subsidiarity.

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In all cases and for likely mistakes, the author is the only one to bear the blame.

DISCLAIMER

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1. THE TRANSACTION COSTS APPROACH TO FINANCIAL INTERMEDIATION

In a foundational paper, George Benston y Clifford Smith (1976) argued that transaction costs¹ are of the essence to explain financial intermediation.

Banks, investment funds and dealers attempt to lessen their investors and customers transaction costs. In so doing, they provide a service, enhance market efficiency and reap a profit. There are three features that contribute to make financial intermediaries so distinctive:

- their specialization brings about economies of scale;
- in running their organizations, and whenever they deal with single, retail or wholesale transactions, intermediaries become more cost-efficient than customers;
- in contradistinction to their customers, however, as financial intermediation is heavily regulated, banks as well as investment funds and dealers face distinctive transaction costs², namely:
 - costs of certification for an intermediary to be authorized to do his job;
 - costs stemming from the supply of financial products, by which some intermediaries can offer determined financials, while others are allowed to only engage with a different set of securities;
 - regulations about pricing, loan volumes restraints, capital requirements, reserve ratios;
 - paperwork costs to meet compulsory requirements on information disclosure from the Central Bank, the Securities and Exchange Commission, and other agencies;
 - last but not least, the processing, valuation and submission of information for the auditing of financial intermediaries are increasingly costly.

¹ Topical developments of the transaction costs approach are to be found in Williamson (1996, 1988, 1985).

² For more background on this issue the reader is referred to Apreda (2005b)

Therefore, **financial intermediation is grounded on a system of constraints, sanctions and rewards, underpinning a wide array of transaction costs.**

One of the most striking features in the financial system when state-owned banks become powerful players, it seems to be the asymmetric and unfair advantages they are entitled to against their counterparts in the private sector. This is a deeply seated pattern of behavior in Latin American countries and most of the European social democracies alike³.

If we regard these entitlements enjoyed by state-owned banks more closely, some of them will be particularly overbearing for the amount of transaction costs ultimately incurred by the private sector on the one hand and tax payers on the other:

- in most countries, state-owned banks are vouchsafed with tax privileges;
- in **social democratic governances**⁴, trade unions and political vested interests have turned labor rights into job-ownership rights; massive layoffs or far-reaching reorganizations seem out of the question in state-owned banks;
- at granting endorsements and guarantees, many times on the ground of the subsidiarity principle⁵, the requirements are softer than in the private sector;
- opening of new branches does not follow the same restraints and standards the Central Bank prescribes for the private sector⁶;
- these institutions have the underlying privilege, sometimes explicitly stated in the Charter, that in any case and whatever the circumstances, the State will stand by ready to help the bank and its depositors. Not only does it hold true that "the bank is too big to fail" but also that "the bank never could fail", which

³ Mark Roe (2003) gives an insightful picture of how political systems interlace with governance issues.

⁴ Roe defines them as "**nations committed to private property but whose governments play a large role in the economy, emphasize distributional considerations, and favor employees over capital-owners when the two conflict**". And he adds further that "public policy emphasizes manager's natural agenda and demeans shareholders' natural agenda."

⁵ We are going to enlarge upon this principle in section 5.

⁶ An oft-quoted rationale for the opening of new branches is analysed in section 2f.

wedges an open gap between the financial intermediation carried out by private banks and the performance of a commercial franchise that benefits state-owned banks bearing no risks whatsoever over the shoulders of both directors and senior management.

2. THE FORMAL GOVERNANCE OF A STATE-OWNED BANK

In this section we are interested in the formal governance of a state-owned bank⁷, through the analysis of some issues closely interlaced among them:

- the particular kind of organization we have to deal with;
- its founding Charter and ownership structure;
- the nature of the residual cash flow rights;
- the Board of Directors;
- the case for voting rights;
- the role of management;
- the allocation of control and decision rights;
- the separation of ownership and control.

a) Featuring the organization

A state-owned bank with national range⁸ shows up as a hybrid organization that carries out three distinctive tasks:

- it behaves as a political entity to grant subsidies and foster economic activities and, from this point of view, it could be labelled a non-profit organization⁹;

⁷ In the appendix at the end of this paper, we are going to recall what corporate and public governance amount to, so as to make the reading of this paper as self-contained as possible. On a more general background, we refer the reader to a paper published by the OECD, *Guidelines on the Corporate Governance of State-Owned Enterprises* (2005). For financial institutions in Argentina, CEF research is worthy of being surveyed (see references at the end of the paper).

⁸ We choose a bank with national range for the sake of argument. With the same frame of analysis we could have addressed the case of a regional or municipal bank in the realm of those jurisdictions. As particular examples for the discussion that follows, we could point to Banco República Oriental del Uruguay (BROU) or Banco de la Nación Argentina (BNA).

⁹ As far as citizens become principals in the basic agency relationship of a representative democracy, these institutions could be regarded mutuals or beneficencies within the realm of the State.

- at the same time, it furnishes the Treasury with cash flows and fulfils the role of financial agent for the Government, either in domestic or foreign operations;
- to all intents and purposes, it performs like a commercial bank seeking for a profit.

b) The founding Charter and ownership structure

Whereas the State is the owner of the bank, the political constituency that stems from the bulk of citizens stands for an ownership structure that becomes widespread and indirect, as portrayed in Exhibit 1. In point of fact, most of the time the State do not get access to residual property rights as conveyed in ordinary stock issued by a corporation, or participation shares as in cooperatives or partnerships¹⁰.

On the other hand, the constituency is a stakeholder that only could make a claim for a notional share of fiduciary responsibility. This sort of claiming vehicle cannot be assimilated to a full security, even less to an ownership entitlement. Only as a last resort, the State becomes accountable from a legal and constitutional standpoint¹¹ on the funding, management, control and liquidation of the financial institution.

After these remarks, we can't help addressing the issue of a state-owned bank's charter¹², which is at the core of its governance, being the founding contract that sets into motion the organization, providing its meaning and scope eventually.

The charter establishes objectives as well as responsibilities, also pointing to relationships with the Government, the Ministry of Economy and the Central Bank.

For the sake of illustration, let us review the wording of article 1 in the BNA's Charter¹³:

¹⁰ We further deal with this issue in next subsection.

¹¹ An interest group, political party or even a single citizen could start legal actions against the State on the grounds of crimes, incompetence, outright corruption, and the breach of its fiduciary role.

¹² In Spanish-speaking countries, the founding contract for state-owned banks, even their central banks, is labeled "Carta Orgánica". Usually they are framed as Acts passed by the Congress.

¹³ Law 21.799, modified by Law 25.299 (2000)

The BNA is an entity with autarchy, and the State grants its own budget and administrative independence. The bank will be ruled by the Financial Entities Law, this Act itself, as well as related statutes. It will coordinate its own activities with the political and economic policies enacted from the National Government.

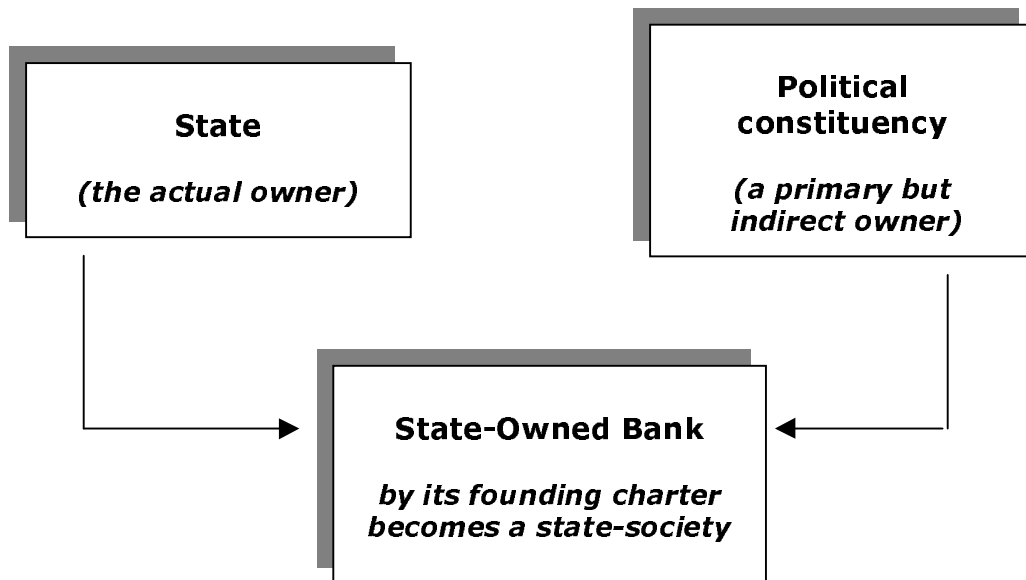


Exhibit 1 Ownership Structure

Article 3 depicts the main objective for the BNA to accomplish:

The essential goal of the bank is to provide small- and medium-sized companies with financial assistance, whatever the line of business they deal with¹⁴.

Taking advantage of the perspective of analysis offered by Gary Miller (1992), we see that a state-owned bank is grounded on the following characteristics:

- a hierarchical and authoritarian framework;
- that accomplishes the role of a commercial bank¹⁵;

¹⁴ This explicit goal has been changing since the bank foundation on the grounds of political convenience or fashionable ideologies.

¹⁵ Either the BNA or the BROU become multinational financial institutions and, from this point of view, they are markedly different from cooperative banks.

- but it claims a social mission and also behaves as if it were a non-profit organization;
- whose vertical integration is nurtured by an ideological standpoint through the rhetoric of a public service.

c) The nature of residual cash flow rights

Following Hansmann (1996), by owners of an organization we mean those economic actors who share two formal rights:

- the right to control the organization;
- the right to appropriate the organization's profits, or residual earnings.

It seems worthy of being remembered that formal rights do not entail, however, effective control ¹⁶.

When we look at state-owned banks, we know that it would be for the State to make a formal claim to residual sets. Nevertheless, most Charters draw up a constraining mechanism to allocate "internally" those residual rights at the discretion of Boards or management that turn distribution of benefits into retained earnings, the cleaning of non-performing accounts, or the building of special purpose funds to be used in the future with social purposes.

If we gave heed to distribution of end-of-the-year benefits, it could be helpful to recall what the Charter of one important state-owned bank in Latin America, the BNA (Banco Nación Argentina), spells out in its Article 5:

From benefits out of the annual financial statements, after depreciations, provisions, penalties and reserve requirements required by the Board, the following allocations will ensue:

- *50% of them to increase the Bank's equity;*
- *25% to set up a Subsidy Fund intended to lessen interest rates in loans for small- and medium-size firms;*

¹⁶ Hansmann underlines that "in large business corporations the shareholders, who hold formal control, are often too numerous and too dispersed to exercise even [these] limited voting rights very meaningfully, with the result that corporate managers have substantial autonomy."

- *25% to set up a Subsidy Fund intended to lessen interest rates in loans to Councils and Provinces.*

From this viewpoint, the state-owned bank seems to perform as a non-profit that, according to Ricketts (1994), could be defined this way:

*Institutions which cannot distribute residual profits and issue no-exchangeable or non-exchangeable claim to profits are **non-profit enterprises**.*

Needless to say, this discretionary mechanism to grab the profits of the entity (with no binding contract towards any stakeholder whatsoever), wedges open a tempting gap for opportunistic behavior from the Board of Directors, the management and the next empowered stakeholder within state-owned companies, that is to say, trade unions.

It is at this juncture that the concept of **slack** in the public sector becomes fully operational for Moe (1984):

Is there any quantity that might play essentially the same role as the residual? The obvious candidate is slack, the difference between the true minimum cost of service provision and what the bureau actually expends. [...] It represents a cushion of resources available for the leader's personal consumption or for payoffs (perquisites, leisure, new equipment) to allies for their policy support or subordinates for this compliance.

d) The Board of Directors

The design of control mechanisms in the state-owned bank runs at variance with customary procedures in the private sector, which nurtures idiosyncratic conflicts of interests that are very difficult to cope with in a successful way. Exhibit 2 portrays a plausible structure of main roles in a state-owned bank:

- The bank's President is usually appointed by the Executive power, although the Minister of Economy plays an advisory role in the screening and final nomination of the candidate¹⁷.

¹⁷ The Executive has no obligation to seek any advise on this regard. It is a procedure that follows from political grounds. However, the Minister of Economy has usually a say in the Board integration.

- The bank's President, to all intents and purposes becomes the CEO and the Chairperson of the Board.

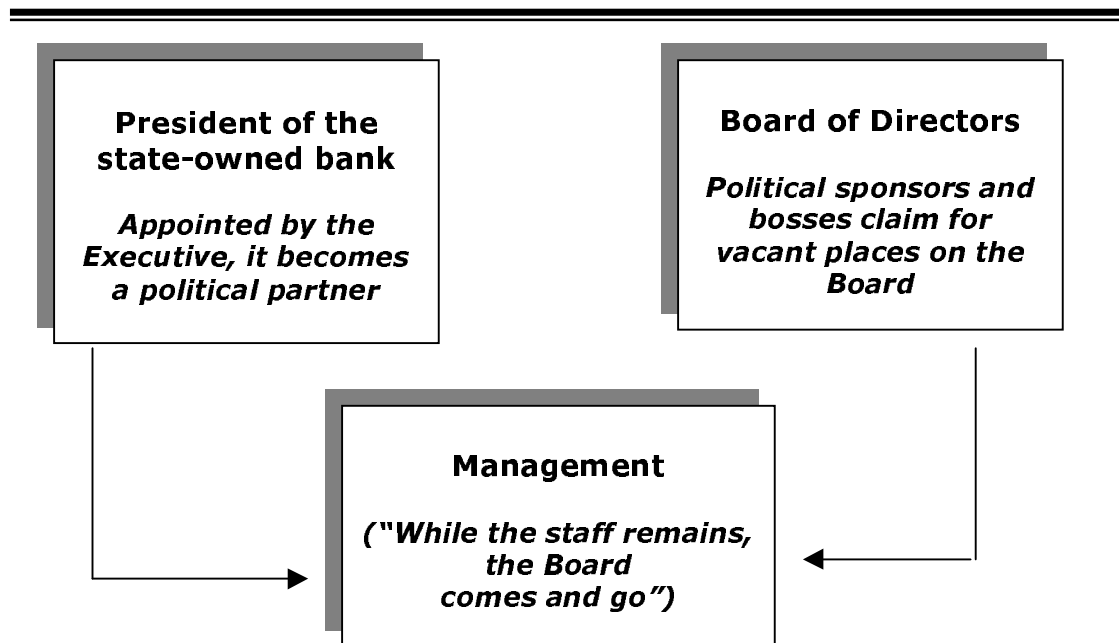


Exhibit 2 Hierarchical Structure and Control

- The Board of Directors handles an appointment scheme of mixed nature, for which the Executive keeps the right to designate some members of the board so as to fill the places with political partners. The remaining members stem from a list at the discretion of the bank's President after an agreement with the Minister of Economy.

However, this selection procedure is guided by a golden rule stemming from the founding charter that establishes for the composition of the Board a balance of representation from different economic sectors in the country. In Latin American countries, however, such requirement has been emptied of meaning any time the incumbent government calls for practices that set up what is called Crony Capitalism, by which friends and relatives are vouchsafed appointments, budgets and fringe benefits in the core institutions of the state¹⁸.

¹⁸ Apreda, Rodolfo (2004). *Governancia del Sector Público y del Sector Privado*. La Ley, 3 de Agosto de 2004 (in Spanish).

By way of summary, if we wanted to highlight the Board basic features, we should stress the following ones:

- Most of the time, members of the Board including the Chairperson do not come from the banking sector.
- Neither do they claim any expertise in the management of big corporations.
- As nominations turn out to be political, they are short lived and committed to follow agendas set up by sponsors or bosses.
- Among the main tasks Directors carry out, we find the control of the institution, the fulfilment of the Charter and related statutes, the direction of the management, and the drawing up of guidelines to put the government demands into practice.
- The President of the bank and the members of the Board can be ousted at any moment. In fact, when a Minister of Economy steps down, the new one often appoints another Board.
- Therefore, there is not a direct matching in the timing of elections and any prospective reshuffling of the Board.

In the public sector, the political linkage with Boards of Directors, has been sharply highlighted by Moe (1984):

Politicians are the decision-makers with authority to determine whether public bureaus will be established to deliver governmental services, and, in general, how these bureaus will be structured. They play the entrepreneurial role. [...] Most obviously, electoral considerations prompt concern for constituency service, pleasing interest groups, rewarding contributors, avoiding conflict, taking symbolic stands, and claiming credit for popular outcomes.

e) The case for voting rights

When constituents vote, either citizens in a country or shareholders in a company, they exercise a fundamental power: to appoint, renew, fire, compensate, and set the tasks for the whole body of their representatives. Even more, they choose a governance blueprint to hold through a definite span of time.

Whereas shareholders do not dissent from the foundational goals of any company, citizens in democratic regimes usually dissent from the basic goals, about the means and the ends of the political endeavor. The more liberal the system, the deeper the overlapping consensus that allows them to build up political stability in spite of disagreement and opposition, which stem from particular standpoints in politics, morals, philosophy or religion¹⁹.

While seldom do the shareholders contest the corporate issues at stake, which would unleash a power struggle for sure, almost ever voters contest adversarial political viewpoints and proposals because, as Przeworski et al. (1999) clearly stated:

elections are a contingent renewal accountability mechanism, where the sanctions are to extend or not the government's tenure.

In state-owned banks voting rights function like entitlements vested in the Board of Directors, which becomes hence the political decision-making center for the institution.

f) The Management

The bureaucracy and the managers in a state-owned bank share some traits with their opposites in corporate banks of the private sector:

- an impressive number of executives, office workers, professional staff, and maintenance agents²⁰ crowd altogether into the bank's payroll;
- from a threshold level upwards, staff members have high educational backgrounds and university degrees, to the extent of being encouraged to take up master's programs or extensive training courses²¹.

But there are noticeable differences when we take into account particular features of state-owned banks:

¹⁹ The idea of "overlapping consensus" was carefully developed by John Rawls, in his landmark work *Political Liberalism* (1996).

²⁰ A qualification is due here: we are thinking in state-owned banks with a national range that makes of them organizations that stand comparison with big corporate banks.

²¹ In the case of the BNA, there is an in-house training institute, while the BROU has internal training but can also send officials to share the benefits of some programs held, for instance, at the Central Bank of Uruguay.

- **The career ladder is designed by statute**, following the pattern of public service procedures and practices. This stresses not only seniority for the officials to work their way up the ladder, but also conformity to the Ethos of the public administration. As Miller (1992) argued, it should not come as a surprise that in such environment the economic actor may stand to gain by concealing information.
- *"While the staff remains, the Board comes and goes"*. This statement is deeply engrained in the organizational culture and fosters the belief that it is for the staff that the bank stands resilient and with full resolve to achieve the goals framed in the founding charter. The underlying metaphor just narrows down that the board is expected to sign the bank's decisions, fulfil the requirements put forth by their sponsors and bosses, and to enjoy the fringe benefits conveyed by the consumption of reputational goods, while making use of selfish personal agendas and self-dealing.
- **The branch structure is widespread over the country**, because the bank must accomplish both social and paternalistic roles that culture and history have vested in the institution. (In the mainstream rhetoric, an often-cited piece of wishful-thinking tells that *"At any place where a private bank would not open a branch because a cost-benefit analysis, there we are going to meet our mission by opening such branch eventually"*).
- A manager in any branch of the bank, mainly in the inland villages and cities, attains a discretionary power that overlaps with the social influence such job entails for the community.
- **The Management is a natural Veto-Player**²², to the extent of refusing to agree with certain decisions of the Board to prevent themselves from legal, ideological, professional or reputational consequences of those decisions that might be borne eventually by officials and not by transient political delegates²³.

²² By **Veto-Player** we mean the economic or political actor, singular or plural, that can say NO and reject measures that had been agreed by other economic or political actors. On the side of politics, the three countervailing powers in a representative democracy, and also the opposition parties and groups of interest provide good examples of veto-players. In the private sector, the Board of Directors is a key veto-player. In the case of a state-owned bank, the management is entitled to behave as veto-player on the grounds of the Banks Law and the charter of the bank.

²³ Within this context, we can point to the outrageous scandal that sprang out of the relationship between IBM and the BNA in the 90s.

- Civil service rules, legal restrictions on compensations, and also the strong union's voice refrain managers from nurturing the internal culture we usually find in the private sector, which is grounded on incentives for cost reduction and quality innovation, team working and customers service, profit seeking and self-promotion.
- By and large, the main outcome of this management culture in a state-owned company seems to be the building up of pervading entrenched interests to keep their members isolated and safe from the contingencies of everyday life. It means a tenure, along the lines of public employment.

g) Control and decision rights

Control is an issue of the utmost relevance in organizations. As Hansmann (1996) remarked, it consists in

" [...] the authority to determine those aspects of firm policy that, because of high transaction costs or imperfect foresight, cannot be specified ex ante in contract but rather must be left to the discretion of those to whom the authority is granted."

The charter of a state-owned bank grants the Board of Directors full control rights and voting rights, as well the exercise of veto-playing. But for the management there are no voting rights, and decision rights and veto-powers are restricted. Exhibit 3 helps to understand this point.

It is worth relating the perspective of analysis introduced by Fama and Jensen (1983a, 1983b, 1985) with the particular organization we are dealing with. They highlighted four primary groups of decisions to be made over a wide array of organizations:

initiation;
ratification;
implementation;
monitoring.

In this paradigm, two of these groups of decisions are attributed to the controlling Board, while the remaining ones fall in the field of the management:

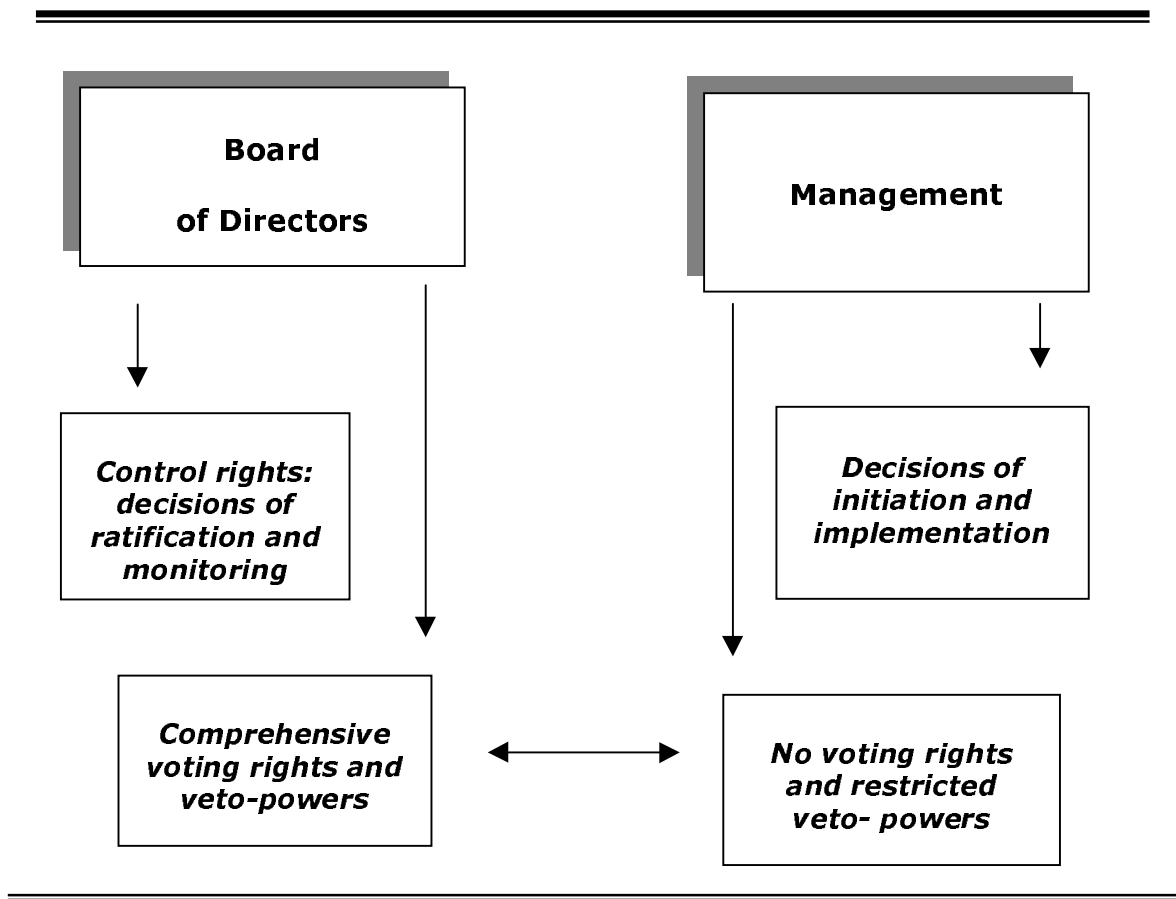


Exhibit 3 Control and decision rights

- The board becomes accountable for the control rights about
 - ratification decisions;
 - monitoring decisions.
- The management becomes accountable for the decisions rights on
 - initiation decisions;
 - implementation decisions.

This environment brings about typical conflicts of interest in state-owned companies: the Board of Directors and the management set up different and opposing agendas. This is a striking fact that upholds what Alchian-Demsetz (1977) noticed about the double-agenda as a

powerful driver for shirking, which comes to be a reactive mechanism between the actors actually involved in the power game.

h) Separation of ownership and control

A state-owned bank provides a striking example of separation of ownership and control. On the one hand, the State is the owner, but it performs such role vicariously. In reaching this point of the analysis, it seems that we face an institution without owners, because the big players are directors and managers that enjoy a franchise to run the going concern. From the point of view of control, it is accomplished in two levels (see Exhibit 3):

- there is what we can call "layer-1 of control" that remains in the hands of the Board of Directors;
- while it is by means of a "layer-2 of control" that decision rights are exercised, most of the time, by the managers.

3. DUAL GOVERNANCE

From sections 1 and 2 it follows that the governance of a state-owned bank blends features from both the public and private realms. Such an example of mixed governance leads to a distinctive definition²⁴, focused on the idea of structure or system, that is to say, a set of components that become interlaced by explicit relationships that lead towards the attainment of a shared and feasible goal (see Exhibit 4).

*By **dual governance** we are to understand a system whose main components are*

- *a setting that stems from public governance;*
- *another one that is peculiar to private governance;*

whose main connections arise from

- *functional relationships and mappings;*

towards the fulfilment of overall objectives which come defined by political design and not by necessity.

²⁴ A comprehensive development of dual governance can be followed in our forthcoming book devoted to Public Governance (Aprea, 2007).

In sections 4 and 5, we are going to expand on the functional relationships and mappings, which are the connectors between the public and private governances. In the remainder of this section, we focus on the overall objectives for state-owned banks that are usually politically designed.

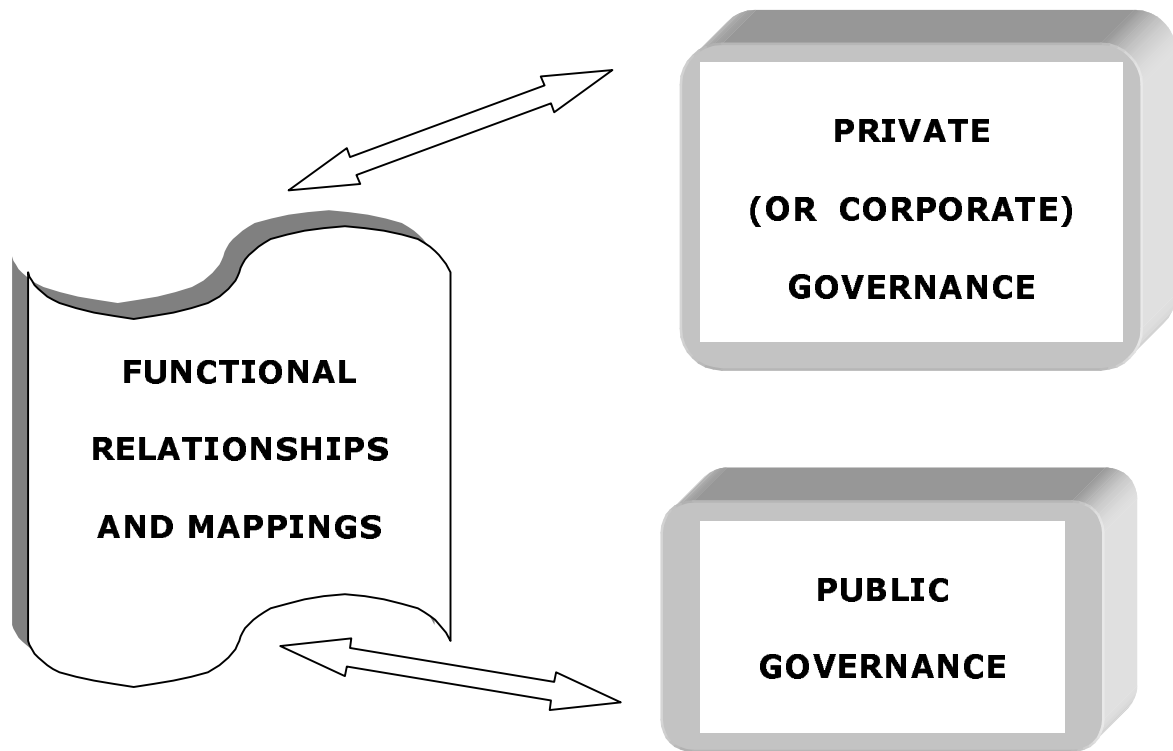


Exhibit 4 Dual Governance

If we regard the bank from the perspective of a commercial institution in competition with private banks, there seems to be a minimal set of expectations and duties, namely:

- economic survival;
- sustainable growth;
- competitiveness;
- service orientation;
- economic efficiency;
- reputation building;
- human capital investment;
- profit-seeking.

Besides, it has to meet regulatory requirements, among which:

- compliance with the Banks Law and related statutes (for instance, the Companies Law, Commercial and Civil Codes);
- Central Bank regulations on bank capital structure, liquidity ratios, solvency covenants, auditing procedures, accounting reporting, superintendency controls;
- Securities and Exchange Commission regulations for the capital market, in case the bank issues stock to set up its ownership structure, or bonds to fund new credit lines to business firms.

From the point of view of a state-owned bank, it has to abide by other kind of expectations and duties:

- firstly, in compliance with the foundational Charter, it must provide with financial support to distinctive fields of economic activity;
- secondly, it must be concerned with the routing of private savings stemming of households in the lower bracket of income earning;
- next, it must perform as financial agent of the State in clearly specified contexts (at federal, provincial or county level);
- also, it must secure compliance with Public Administration Statutes, the Ethic Law for the Public Service²⁵, and related statutes.
- lastly, it performs the role of arbitrageur in the money market at the will of the Ministry of Economy (at federal, provincial or county level).

Two remarks are worth of being highlighted in relation with the above-mentioned features:

- a) Among the most favoured economic activities to be fostered by the state-owned bank, the following come top of the list:

regional economies;
underperforming industries;

²⁵ We mean here what has been called "Ley 25.188: Etica en el ejercicio de la función pública", (Public Service Law on Ethical Performance) passed by the Congress on September 29, 1999.

house building as a social good;
small- and medium-size companies;
cooperatives;
pension schemes;
foreign trade.

It is generally understood that the bank is a sort of finance provider and caretaker in compliance with the so-called subsidiarity principle, an issue that we are going to undertake in section 5.

- b) It has often been criticized the role of the state-owned bank as a trend-setter in the money market. What is a plain fact, beyond the political discourse, is the pervading and powerful influence these institutions have when the Ministry of Economy or the Central Bank ask them to support rates of exchange, rates of interest, or desirable levels of liquidity in the system.
- c) We must bear in mind that the national bank in Uruguay has been leading for many years the ranking of domestic term deposits in that country financial system. Likewise, we find in Argentina that the BNA, altogether with the Buenos Aires Province bank and the City of Buenos Aires bank, have been stacking up for decades more term deposits than the rest of institutions altogether.

3.1 *THE CONTRIBUTION OF COMPARATIVE ECONOMICS TO THE ISSUE OF BANKS OWNED BY GOVERNMENTS*

Comparative Economics is the attempt of laying bare the connections and opposing views about any economic issue that is worthy of being researched when comparing different nations and institutional traditions. So far, only a few number of papers have addressed the subject of state-owned banks or state-controlled banks from the standpoint of comparative economics. One of them, written by La Porta, Shleifer and Lopez de Silanes (2000), exhibits the final outcome of an extensive data research from 92 countries around the world. They tried to deal with the following problems:

- relevance of government ownership of banks in different countries;
- what types of countries have more government ownership of banks;
- relationships between government ownership and financial development;

- the consequences of such ownership for the economic growth, factor accumulation, savings, and productivity.

As we can see, the thrust of this research has only a complementary linkage with the main concern of our paper, which focuses on the governance of state-owned banks, but we feel that is good to refer this work to the interested reader. In point of fact, it provides impressive evidence for the economic connotations that certainly stay in the background of our subject. That is why we think suitable to our goals to brief the main consequences that La Porta et al. claim in their work:

- a) Government ownership of banks is large and pervasive around the world.
- b) Such ownership is larger in countries with low levels of per capita income, poor protection of property rights, underdeveloped financial systems, as well as inefficient and corrupt governments.
- c) Government ownership politicises the resource allocation process and reduce efficiency to the extent of hindering financial and economic development.

In another paper with foundations in comparative economics²⁶, this sort of enquiry is deepened and it takes a wider-angle perspective, since it contrasts private with state ownership. The following quotation brings forth some issues that overlap with a governance frame of mind at dealing with state-owned banks:

Since politicians typically like to remain in power and enjoy the perquisites of their office, a significant element of the goals of any government is to maintain political support. In democracies, such political support usually takes the form of votes, though less democratic governments also need loyalists who can provide manpower to suppress the potential opposition. Governments throughout the world have long directed benefits to their political supporters, whether in the form of jobs at above-market wages or outright transfers. Governments have used their control of state firms and other assets as a means of channelling these benefits, by forcing excess employment at state firms and agencies, creating government projects that transfer wealth to supporters, and so on. In other words, state firms are inefficient not just because their managers have weak

²⁶ Andrei Shleifer (1998), *State versus Private Ownership*.

incentives to reduce costs, but because inefficiency is the result of the government's deliberate policy to transfer resources to supporters.

4. OUTSTANDING AGENCY PROBLEMS IN THE DUAL GOVERNANCE

We are going to choose a few agency problems that, in our viewpoint, hinder the dual governance exhibited by state-owned banks. There are certainly many others, but the fact remains that they do not seem as relevant to the goals of this paper as the following ones:

- infringements to the fiduciary role;
- accountability and transparency failures;
- opportunistic behavior with guile, through rent-seeking and soft-budget constraints.

a) Infringements to the Fiduciary Role

It is of the essence that the bank could perform as an agent for the political constituency, which is a multiple-principal and whose participation takes place by means of a "voice-exit" mechanism enforced at election dates (Hirschmann, 1978). In practice, what is at stake when elections come up it should be regarded as different party proposals around the functions and goals of the bank.

There are three main roles through which we can witness inherent conflicts of interests evolving and marring dual governance, and to which a good governance design will attempt to curb eventually:

- The Board of Directors carrying out a fiduciary role on behalf of the State (in principle) and the incumbent government (in actual fact).
- The Board of Directors performing as principal of the senior management, which becomes most of the time an unfriendly contestant of the agency relationship.
- The fiduciary role the state-owned bank owes to its creditors (depositors as well as bondholders).

We have seen that the dual governance entitles the Board to make appropriations of cash-assets to match up to the subsidiarity principle at best, or to pursue opportunistic behavior with guile at worst.

Therefore, to the extent that such appropriations come out of depositors' resources, the principal-agent double binding of the Board leads its members to a likely breach of fiduciary commitments. Otherwise, could we be upholding the debatable and dubious statement by which depositors actually lend to the bank so as to grant the institution the accomplishment of its subsidiarity mission?

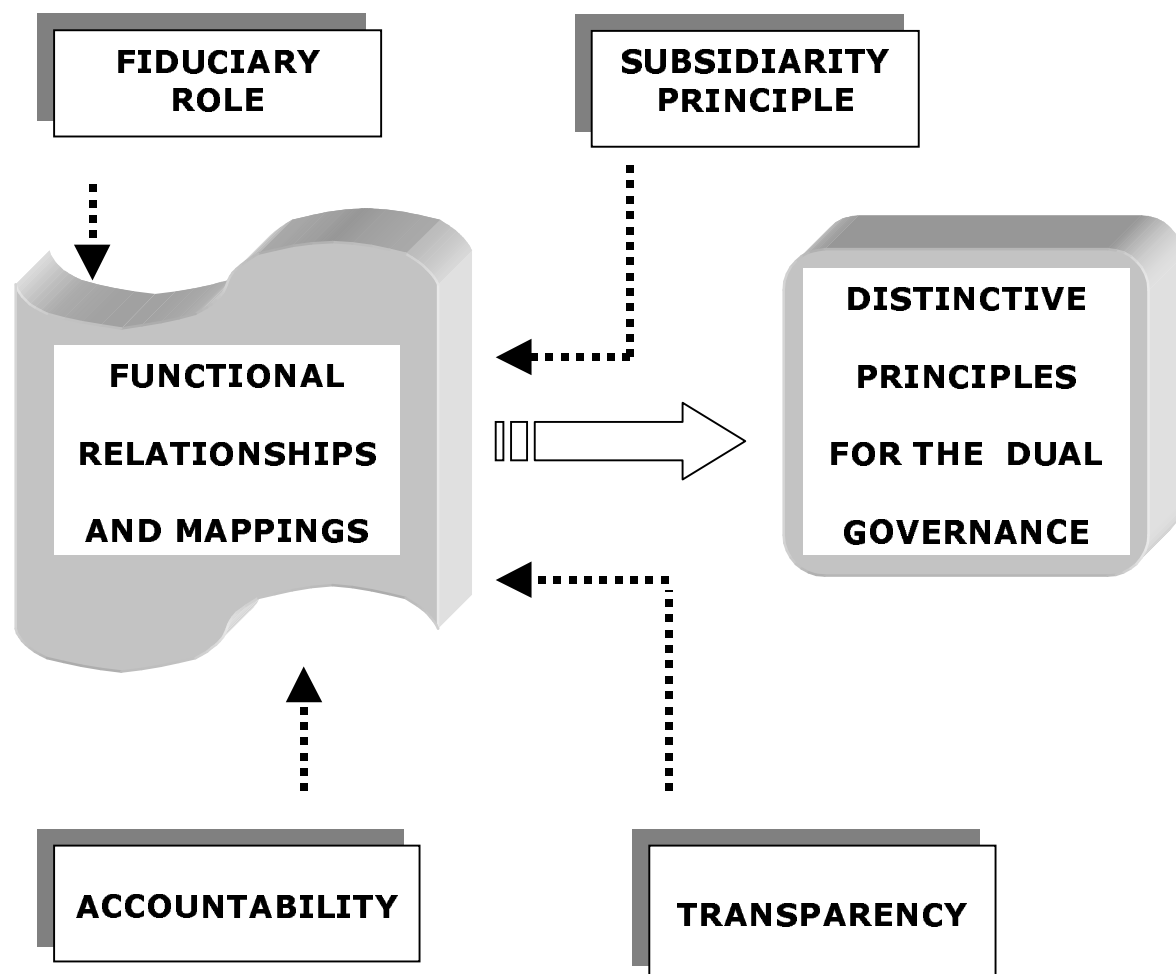


Exhibit 5 Functional Relationships and Mappings in the Dual Governance

b) Accountability²⁷ and Transparency Failures

On the side of the commitments, the state-owned bank must comply with direct and indirect ones:

direct commitments that spring out of the Charter, mainly through its links with the Ministry of Economy, regulators in the financial system, depositors and creditors alike;
indirect commitments that arise from political interests and party demands.

On the side of the responsibilities and as a commercial bank, the state-owned bank is liable to the Central Bank, the Securities and Exchange Commission, and the Judiciary. As an agency of Government, it must report to its counterparts in terms of the Public Administration laws and the foundational Charter²⁸. Lastly, it becomes accountable to the citizenship.

It has been an outrageous and long-standing tradition of Latin American governments in the XX century to openly flout the law, disregard constitutional tenets, and trespass any standard of good accountability. It could not come as a surprise that state-owned banks had become easy-going partners in such patterns of misbehavior, reinforced by their autarchy that amounts to budgetary independence and its inbuilt no-bankruptcy covenant.

As far as **transparency** is concerned, it has to do with information about actions and characteristics deployed by the actors through any kind of relationship. **For the information to be transparent, we request from it to be timely, reliable, testable, and meaningful²⁹.**

The more transparency we assure, the more functional our information contributes to high levels of accountability.

It goes without saying that state-owned banks, in compliance with their Central Banks regulations, become more transparent than other state-owned companies. But the disclosure mechanisms are marred by

²⁷ By **Accountability** we mean the commitments we set up with third parties, and the responsibilities they can claim on us with regard to the way we have carried out those commitments. A detailed analysis of this topic in Apreda (2003, 2006b).

²⁸ The State General Auditor Office, for instance.

²⁹ This rendering of the notion of transparency closely matches the one stated by Basle recommendations on transparency (ISB, Basel, 2005)

soft procedures that allow the information be formatted to such consolidation levels that it becomes useless for any objective pursuit of truly relevant information. Besides, pervasive uses and sources of cash flows, to care for subsidiarity targets out of depositors' accounts, make the information blurry and deceitful³⁰.

c) Opportunistic behavior with guile through rent-seeking and soft-budget constraints

The state-owned bank performs as a commercial bank, getting access to resources offered by households and companies, either in current accounts, saving accounts or term deposits. In case the bank had issued bonds, it would have also drawn resources from investors in the capital market. After compliance with reserve requirements, the bank grants loans to borrowers.

But this raises a daunting problem:

- i. While the liabilities-capital portfolio of the state-owned bank follows standard procedures in the banking system, what does it happen with the management of the bank's assets-portfolio?*
- ii. Does the Board of Directors ever rate any prospective loan not only matching the Central Bank regulations, but also constraining itself to the duties of loyalty and care as directors do in the case of private banks?*
- iii. Is the bank using depositors and bondholders resources so as to meet its subsidiarity mission?*

The resolution of this problem is far from being easily accomplished. The political component of the dual governance seems to be the main obstacle, but not the only one. Other driving forces loom large, by which a party A could shift value to itself at the expense of party B. We are speaking, of course, about rent-seeking and soft-budget constraints³¹.

³⁰ Bear in mind, as a case in point, the impressive amounts of contingent assets and contingent liabilities that Latin-American state-owned banks usually display in their financial statements. These off-sheet transactions are likely sources of quasi-fiscal deficits, as it has been pointed out by the International Monetary Fund in its *Manual on Financial Transparency*, 1999.

³¹ A way of dealing with both problems seems to be a framework of analysis based in incremental cash flows that has been recently made known (Apreda, 2005a).

c1) Rent-seeking

Notionally introduced by Tullock (1967, 1993), the term as such was firstly coined by Krueger (1974). It primarily conveys the idea of rational and self-seeking behavior that redistributes resources available to society.

Tullock highlighted that lobbies are encouraged to effect wealth transfers by means of the government in a negative sum game as economic agents invest resources to profit from those transfers or forestall them from taking place. On the other hand, he laid stress on the fact that rent-seeking behavior has double costs: the distortionary effect of the rent itself, and the diversion of productive resources towards competition for the prize of the rent.

Bringing the subject home, the state-owned bank must be regarded as the place where contestant groups of interest try to extract rents for their own side, namely

- business firms in pursuit of subsidized loans, with longer maturities than similar ones from private banks, albeit with substandard risk qualifications;
- state-owned companies that get easier terms for financing their short-term cash strictures, and roll over former non-performing loans;
- the oversized bureaucracy³² that is ready to claim, through the union³³, a slice of any increment in cash flows from the bank operations;
- as managers are counted by dozens in any state-owned bank, due to the widespread network of branches over the country and abroad, as well as the huge crew working at headquarters, they nurture an implicit collusion for diverting loan capacity to their own customers and business firms;
- being the bank chartered as a financial agent of the State, its resources are open to the abuse of any incumbent government;

³² To all intents and purposes, it is almost always an oversized work force if we confront numbers and productivity of their opposing partners in the private sector.

³³ In Latin American and European social democracies, unions are usually strong in the state-owned companies and utilities, with high rates of enrollment and widespread political clout [further background on this issue in Roe (2003)].

- last, but not least, the Board plays a key role at any decision-making process that entails cash flow appropriations, on which political demands and the Directors' own political agendas have a final say.

All in all, if any distinctive economic rent arose out of the bank's operations, it would be unlikely they may contribute to further value enhancement, since rent-seekers stand by to grab them eventually.

c2) Soft-budget constraints

This notion refers to the following environment: an unprofitable and failing company is bailed out either by the government or the company's creditors, regardless whether it is a company in the private or the public sector of the economy. In other words, instead of keeping a tight budget, managers can soften the underlying constraints because additional cash flows are likely to come out of the government or creditors' pockets, discouraging therefore a culture of financial discipline. This was an issue firstly advanced by Kornai (1979) in the context of socialist economies, and then it was extended to capitalist economies, an updating of which can be found in Maskin (1999) and, more recently, in Kornai et al. (2003).

In the case of a state-owned bank, this is a double-edged instrument that nurtures opportunistic behavior with guile:

- as the bank cannot go bankrupt (this being a provision in its own Charter), there is a primary soft-budget constraint that becomes functional to the sustainability of the institution, which wedges a gap open either to mismanagement, even to abuse of power;
- the Board takes advantage of the slack³⁴ in the incremental cash flows structure of the bank, under the shelter of the subsidiarity principle;
- as the bank lays claim on its subsidiarity duties, cash flows are allocated with an underlying pledge to rescue the beneficiaries of the loans, endorsements³⁵ or subsidies granted, even to the extent of redressing any budgetary misdoing with an ultimate impact in the bank's own books;

³⁴ The notion of *slack* was introduced in section 2c.

³⁵ Endorsements ("avales") issued by a state-bank to guarantee payment of a draft or promissory note.

- managers and the bureaucracy, not bearing tight budget constraints and with the trade union on their side, encourage and advocate the opening of new branches as well as tapping into job placement services;
- at last, but not least, we have to account for quasi-fiscal activities and the management of contingents assets and liabilities³⁶.

5. THE SUBSIDIARITY PORTFOLIO

The main outcome of our line of analysis will consist in a portfolio management approach to coping with agency problems arising from the dual governance in state-owned banks. As we extensively discussed in section 4, those problems were mainly centered around infringement to the fiduciary role, accountability and transparency failures, rent-seeking and soft-budget constraints.

Our portfolio approach regards the state-owned bank as a construct comprising at least three tiers:

- the commercial bank portfolio;
- the subsidiarity portfolios, under the guise of a trust fund to which the bank performs as its trustee;
- other funds the bank is able or allowed to manage, like mutual funds, a pension fund, or insurance companies.

We are going to outline, firstly, the principle of subsidiarity, moving on to the current usage of such principle in state-owned banks and, finally, to set up the subsidiarity portfolio.

5.1 THE PRINCIPLE OF SUBSIDIARITY

The principle of subsidiarity, turns out to be a double-edged expression.

a) On the one hand, it conveys the meaning of both "devolution" and "entitlement".

³⁶ International Monetary Fund (1999). *Manual on Fiscal Transparency*.

For instance, devolution arises when the federal government hands over the management of schools or the collection of taxes to lesser units at the local level, either states or municipalities. As the old saying goes: "locals know better".

By the same token, entitlement follows when the government grants incorporation to a company, or empowers certain community to set up cooperatives for running their local utilities (see Exhibit 6).

This dimension of subsidiarity goes back to the core tenets of Federalism and features the following targets:

- To downsize central governments, making them more efficient.
- To strengthen Public Governance³⁷ structures, delivering better accountability, transparency, and political practices.
- To stick with the well-known approach to decision-making usually labeled "from the bottom to the top".

In the United States, the Founding Fathers drew out a Federalist framework of values and ideas on top of which we find the Tenth Amendment³⁸ that stands for a clear statement about subsidiarity as a devolution process:

The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.

Although it is usually attached to the public realm, subsidiarity pervades the private realm as well, being advocated for many innovative strategies and policies in organizations, from empowerment to outsourcing, from co-optation to horizontal subsidiarity.

b) On the other hand, the principle of subsidiarity also refers to a different meaning that encompasses both the idea of "granting subsidies" and "achieving social solidarity".

It must be acknowledged that a wide variety of wrongdoings and unfair practices have been redressed for the last two centuries through a sensible and prudential exercise of the principle of subsidiarity, in the

³⁷ Expansion on the subject of Public Governance can be found in Aprea (2005d).

³⁸ The first ten Amendments comprise the Bill of Rights, which was ratified in 1791. See *"The Words We Live By"*, Linda Monk, Hyperion, New York, 2003.

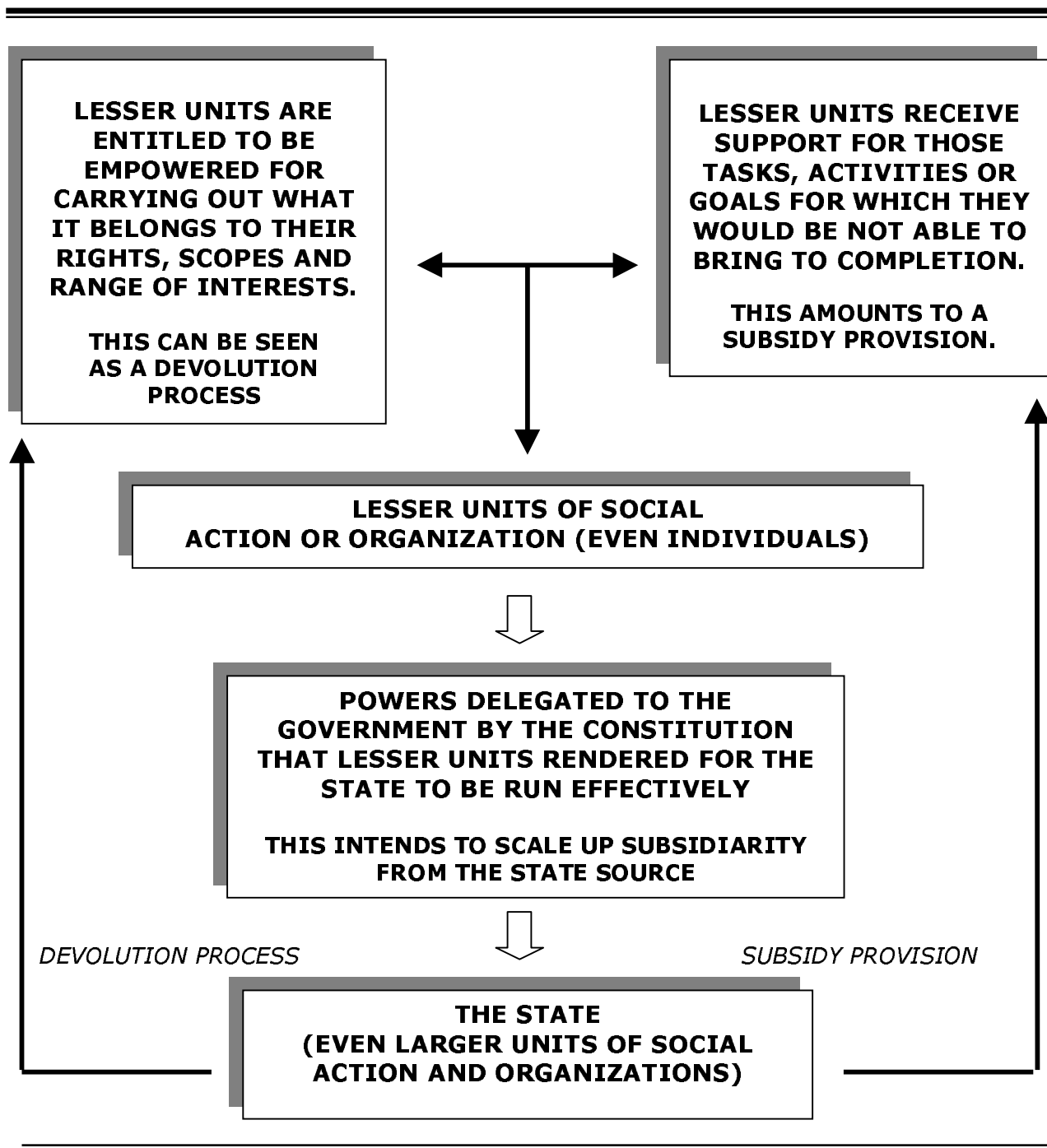


Exhibit 6 The twofold nature of the principle of subsidiarity

dimension of “devolution” as well in the one pertaining the idea of “granting subsidies”³⁹.

³⁹ On this account, landmark achievements in Continental Europe were the offsprings the Catholic Social Thought (from the encyclical *Rerum Novarum* in 1891 till the

In contradistinction to this positive development that “righted so many wrongs”, we must point out that in the name of subsidiarity groups of interest and politicians systematically cover up deviant patterns of behavior, among which we wish to highlight the following⁴⁰:

- political clientelism;
- rent-seeking;
- soft-budget constraint;
- crony capitalism practices;
- the capture of the state;
- corruption.

5.2 THE CURRENT USAGE OF THE PRINCIPLE OF SUBSIDIARITY IN STATE-OWNED BANKS

When a state-owned bank is chartered, most often than not the principle of subsidiarity is invoked, regardless of being explicitly embedded in the charter or not. The distinctive feature remains, however, whether the principle would be used or misused.

When the bank is state-owned, it fulfills a subsidiarity role whose actual nature is lessened to the extent of meaning nothing else but outright subsidy giving, by committing cash flows to a subsidiarity center (see Exhibit 7).

We cannot help but wonder why this subject matter becomes so important when we deal with state-owned banks? Because those banks become a clear-cut example of mixed governance, where the realm of the public overlaps with the one of the private in a disturbing fashion.

The principle of subsidiarity turns out to be the rationale that allows the bank to accomplish transactions or transferences on the public side, albeit the resources to be used may be diverted from the private side. Let us expand further on this point.

The ultimate funding of any bank stems from depositors and other lenders to the bank (see Exhibits 7 and 8). Those monetary inflows are applied to meet the needs of borrowers from the bank, while idle cash

Centessimus Annum in 1991), and also to socialists and reformers, ending in the Maastricht Treaty that placed the principle of subsidiarity second to Human Rights only. Centessimus Annum is particularly noticeable, because it attempts to blend both sides of subsidiarity: devolution and social solidarity.

⁴⁰ Further analysis of these deviant patterns of behavior in Apreda (2005d).

balances may be allocated to a portfolio consisting of temporary investments, mainly through purchases of government bonds, as well other financial assets within the boundaries of the regulatory framework enforced in each country.

How could the bank draw resources from its ultimate providers of funding so as to meet subsidiarity commitments? There are several thorny and daunting questions for which state-owned banks charters and boards of directors must be held accountable, among which we could highlight three of them:

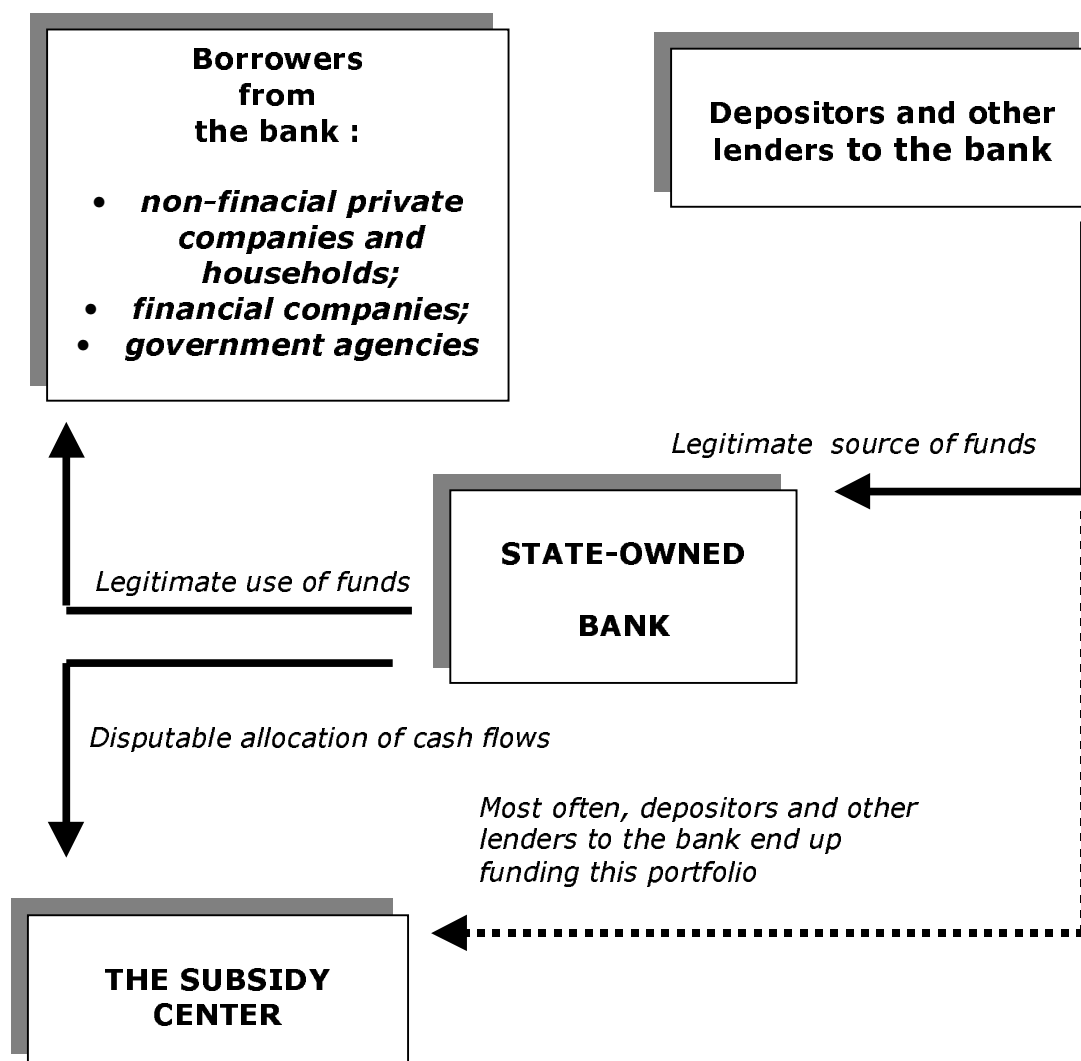


Exhibit 7 Monetary flows through the commercial side of the state-owned bank, and the subsidy center.

a) Where should the bottom line be drawn?

b) When is the threshold of fairness ultimately trespassed, wedging open a gap that nurtures discretionary decision-making, pervading soft-budget constraints, widespread political clientelism, shameful law infringement and corruption?

c) How does the bank become accountable for decisions that make use of public and depositors' resources?

5.3 THE SUBSIDIARITY PORTFOLIO

At this juncture, we set forth a new perspective to cope with the failing governance state-banks have been currently carrying out so far. We suggest to embed all subsidiarity activities into a distinctive trust fund to which we label the **Subsidiarity Portfolio**⁴¹ (see Exhibit 8):

- The subsidiarity portfolio makes use of a special purpose vehicle, under the guise of a mutual fund.

To deal with a trust fund seems suitable to the fiduciary role we expect from the state-owned bank on behalf of the subsidiarity portfolio.

- There follows a clear-cut separation of portfolios between those that the commercial bank actually runs, and the one devoted to meet the subsidiarity goals.

In point of fact, as a commercial bank it stands to manage manifold investment portfolios, like mutual funds, pension funds, and financial trust funds⁴².

6. A MINIMAL SET OF DUAL GOVERNANCE PRINCIPLES FOR THE STATE-OWNED BANK

In this section, we attempt to put forth a blueprint of principles stemming from the two-tier portfolio approach to the dual governance of a state-owned bank and related to the following issues:

⁴¹ The subsidiarity portfolio has been introduced for the first time by Apreda (2005c, 2006a).

⁴² In Argentina, the BNA is allowed to run a pension fund (although this is not the case for Chile). The BNA also can take financial trusts to the market, under the current Fiduciary Law.

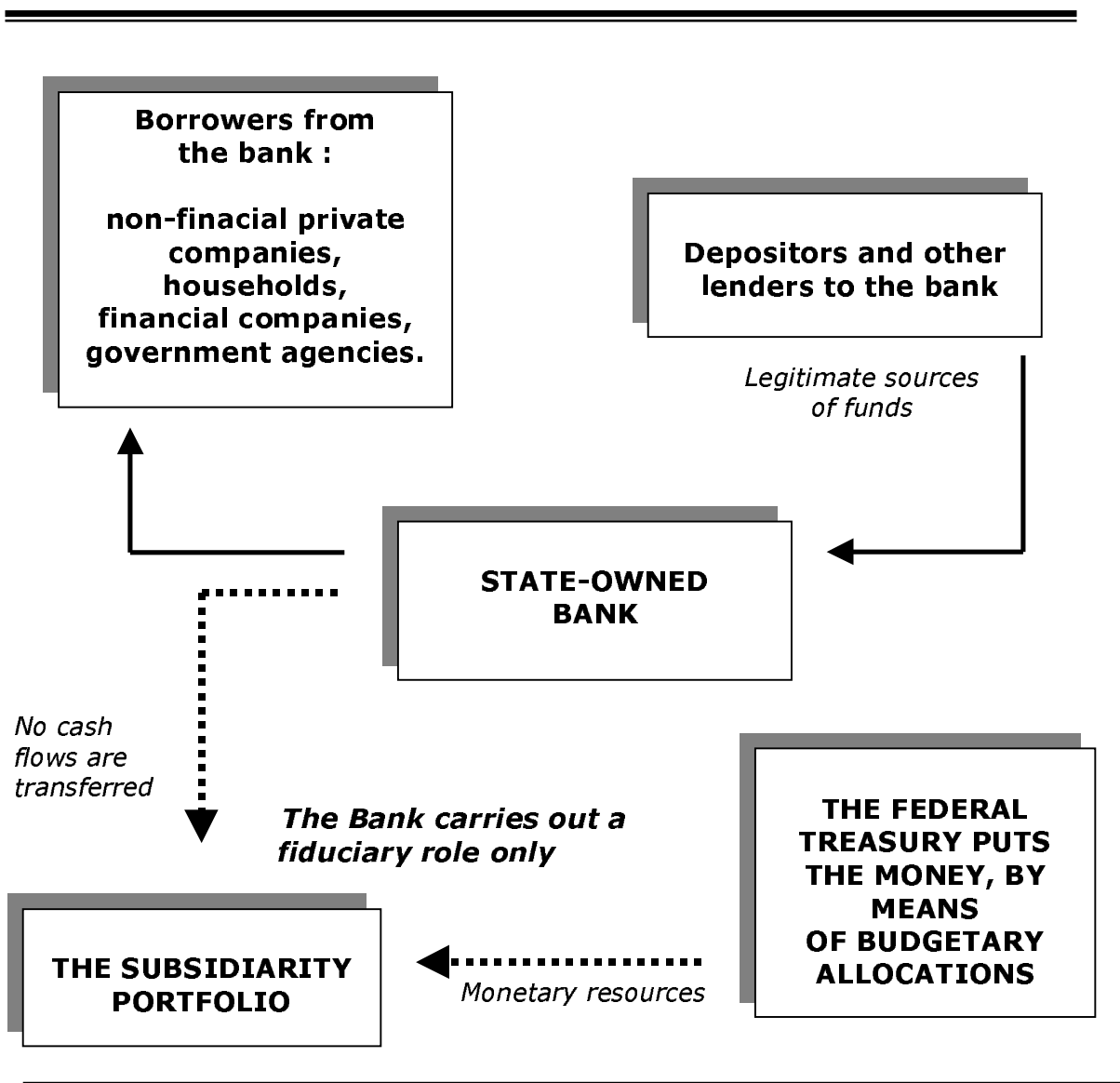


Exhibit 8 Monetary flows through the commercial side of the state-owned bank, when the subsidiary portfolio is financed by the Treasury.

the Charter,
separation of portfolios,
the Board of Directors,
separation of Boards,
accountability,
transparency,
the management,
the compliance function,
good practices.

Therefore and in our viewpoint, the following principles are at the core of the dual governance, notwithstanding the fact that many others should be added for the sake of completion⁴³.

a) RELATED TO THE CHARTER

- ***First principle***

The state-owned bank stands for a whole legal entity that is able to perform as a commercial bank. Among its tasks, it is allowed to manage investment funds on behalf of its customers (fiduciary funds, trust funds, and likewise), and to also manage the subsidiarity-portfolio on behalf of the State.

- ***Second principle***

The state-owned bank enters into a partnership contract with the State to establish an agency relationship regarding the management of the subsidiarity-portfolio.

- ***Third principle (on the Separation of Portfolios)***

The state-owned bank is not allowed to either allocate funds or draw funds from the subsidiarity-portfolio.

According to current procedures in similar partnerships, the trustee keeps separate ownership entitlements, as well as accountancy and auditing mechanisms, without any overlapping of tasks (see Exhibit 9).

b) RELATED TO THE BOARD OF DIRECTORS

- ***Fourth principle***

Boards in the state-owned bank and the subsidiarity mutual fund must consist of independent, non-executive directors only.

Membership is restricted to qualified and proficient people, recruited from non-governmental organizations, Business Chambers, even Academics and Practitioners in the Financial System. Membership on the grounds of political affiliation only is strictly forbidden.

⁴³ For instance, by following the prescriptions laid down by the Bank for International Settlements, at Basel.

Tenure is granted for three years, with renewal option. The choice of three years grants overlapping with successive governments, and a mechanism for staggering directors is encouraged, as in many corporate banks around the world.

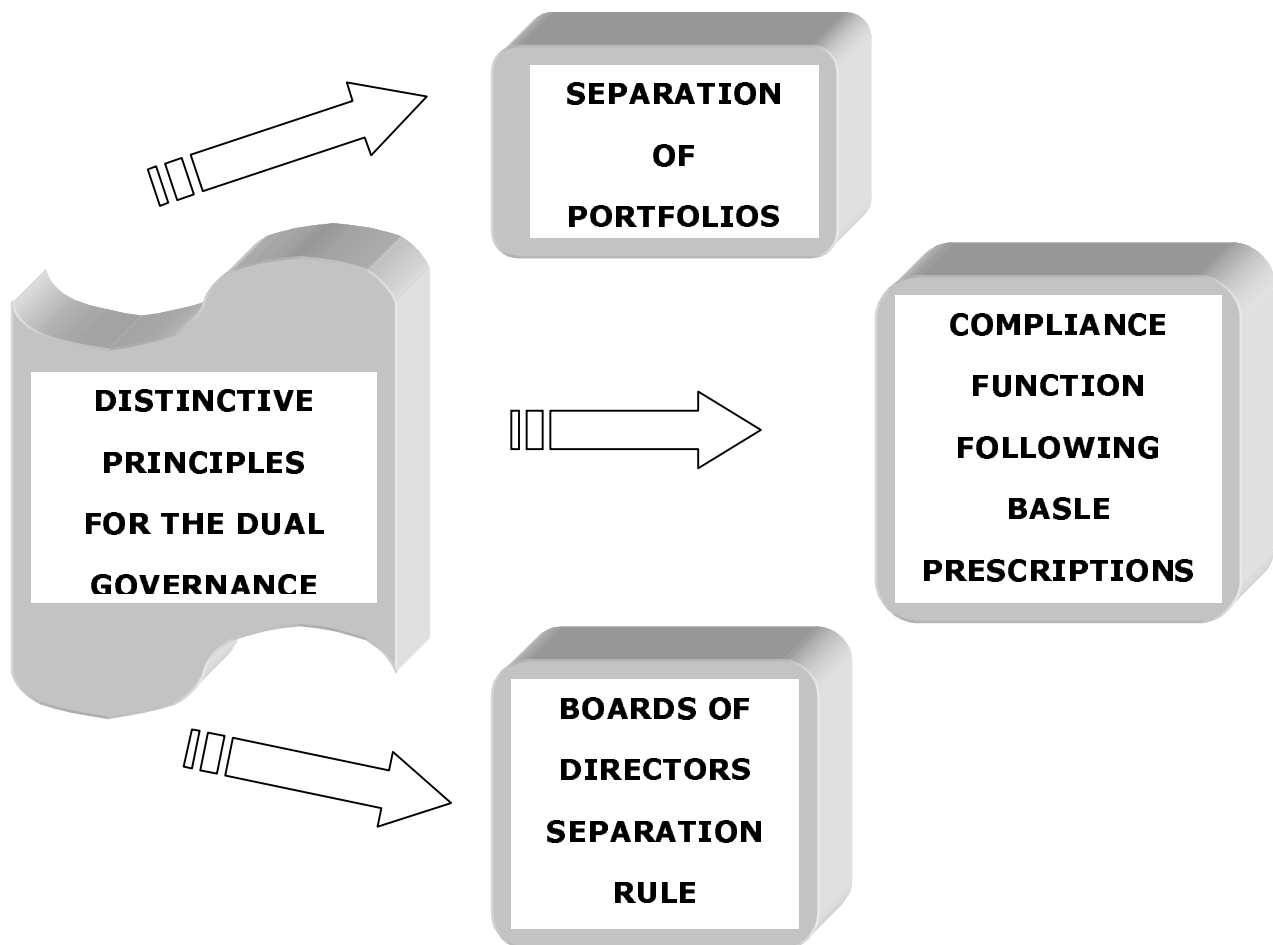


Exhibit 9 Distinctive Principles for the Dual Governance

- ***Fifth principle (on the Separation of Boards)***

Under no circumstances the Board of Directors in the state-owned bank could have any overlapping with the Board of Directors in the mutual fund that runs the subsidiarity portfolio.

Both boards are independent of each other, and no member in one of them can perform as director in the other.

c) RELATED TO ACCOUNTABILITY

- ***Sixth principle***

The Charter and by-laws must state, in detail, which are the commitments of the state-owned bank, for the fulfillment of both roles:

- the one of a commercial bank,
- and the other one of performing as an agent to the subsidiarity mutual fund.

By the same token, it must be specific about who is accountable for what. In this way, directors and managers must account for their deeds, during and after tenure, in the terms of judiciary, administrative and control institutions. Tenure in a state-owned bank should qualify as public service.

Stakeholders must get access to full disclosure, and a reasonable of how well or bad officials and directors meet their responsibilities.

The Board can request, and the bank must pay for, the so-called "**fairness opinions**"⁴⁴ from independent gatekeepers, any time an accountability issue should arise, casting doubts on certain decision-making task still in progress.

d) RELATED TO TRANSPARENCY

- ***Seventh principle***

The annual report, and the annual budget, must disclose the noncommercial services that the state-owned bank intends to provide.

⁴⁴ A **Fairness Opinion** consists of a report submitted by an independent gatekeeper to the Board. It certifies the fairness to shareholders, or the fulfillment of fiduciary duties, for any prospective transaction for which the Board could feel afraid of becoming liable eventually if due care and prudence were not granted in dealing with the transaction. In general, gatekeepers that play this role are law firms, auditing firms, investment banks, credit and risk rating agencies, experts from industry, research centers and universities. This widespread instrument became topical after the renowned court ruling in the case Smith v. Van Gorkom, 1985, Delaware Supreme Court. It is also called **Opinion Letter** (on this regard, see the Black's Law Dictionary).

- ***Eighth principle***

The state-owned bank must fully disclose information to the public, certified by two external auditors:

- a private one chosen for fixed terms not renewable, among the best auditing firms;
- an international auditor, like the International Monetary Fund.

The subsidiarity mutual fund must disclose information to the public, certified by two external auditors:

- the Pension Funds Superintendent Agency (or similar);
- an international auditor, like the International Monetary Fund.

Investors and analysts, watchdogs and regulatory agencies must get access to the full review of the credit and risk ratings, which must be given on a periodical basis.

All information disclosed by the bank, and certified by external auditors, must also bring the certification and liability commitments from the Board of Directors and the Chief Executive Officer⁴⁵.

e) RELATED TO THE MANAGEMENT

- ***Ninth principle***

The Chief Executive Officer must belong to the Management, although it can be hired outside the bank, as it happens in the corporate world. Under no circumstances the CEO ought to be appointed politically.

f) RELATED TO THE COMPLIANCE FUNCTION

If compliance risks matter for private banking, this should become an issue of the utmost relevance for state-owned banks on the grounds of the complex setting that underlies their dual governance structure.

⁴⁵ As in Sarbanes-Oxley Act (2002) and the New York Stock Exchange subsequent prescriptions.

- ***Tenth principle (on the Compliance Function)***

The state-owned bank must set forth and make operational the compliance function as has been framed by the Bank for International Settlements, at Basel⁴⁶.

Such function, whose main objective is to cope with compliance risks⁴⁷, has to be an independent area reporting to the General Manager, but also to the Auditing Committee in the Board of Directors.

g) RELATED TO GOOD PRACTICES

Codes of good practices are topical to governance. They are like the factual translation of governance principles. It might be worthwhile taking this matter further.

Generally speaking, a code is a set of rules about how something should be done or how people should behave. On the other hand, a good practice comes to be a leading example of how a regular task or activity in a particular profession or job should be done⁴⁸.

However, since codes of good practices arise from an underlying governance design, it seems more suitable to set forth an alternative format of definition (Apreda, 2004, 2002a).

*By a **Good Practices Code** we mean any set of rules of behavior that allow a distinctive governance structure to be put into practice and held accountable, provided that such rules meet the following constraints:*

- *by necessity, they stem from the underlying governance structure;*
- *they match the institutional framework within which the organization not only lives and develops, but also abides by the law;*

⁴⁶ Basel Committee on Banking Supervision. (2005). *Compliance and the Compliance Function in Banks*.

⁴⁷ Compliance risk is defined by the IBS as "the risk of legal or regulatory sanctions, material financial loss, or loss to reputation a bank may suffer as a result of its failure to comply with laws, regulations, rules, related self-regulatory organization standards, and codes of conduct applicable to its banking activities."

⁴⁸ For a cash flow model to cope with corporate governance issues like those of accountability and good practices, see Apreda (2003, 2005b).

- *they are in agreement with the organization Charter and by-laws;*
- *they become fully operational: the rules are set up within a framework that allows monitoring, assessment, enforcement, updating and improvement.*

Although liability, representation and reputation should hold gatekeepers and watchdogs within the scope of their expected mission, recent events in the United States and some European countries cast doubts on the extent to which such deterrents could be successful. And this is why some people contend⁴⁹ that unless the governance of gatekeepers might be improved, little hope of real changes in corporate governance should be expected.

- ***Eleventh principle***

The bank must issue a fully operational Code of Good Practices, that is to say, a code allowing for the monitoring, assessment, enforcement, updating and improvement of desirable practices.

CONCLUDING REMARKS

A state-owned bank is a shining example of mixed governance. In fact, the institution attempts at the same time to perform as a commercial bank, and to convey social duties and political demands that hinge upon the subsidiarity principle.

After reviewing the main features around what we have defined as dual governance, this paper laid the foundations for the following statements:

- The subsidiarity principle is a two-edged sword, ready to meet truly social commitments but, at the same time, wedging open a gap for malfeasance and political opportunism.
- The dual governance faces at least three big agency problems, which are focused on the fiduciary role, accountability and transparency, and it must cope with the opportunistic behavior that rent-seeking and soft-budget constraint bring about eventually.
- To change and sharpen up the dual governance, this paper introduces a portfolio management approach, by which the state-

⁴⁹ For instance, Coffee (2001).

owned bank comes split up into a commercial bank, and a subsidiary-portfolio under the guise of a mutual fund. The former acts upon the latter's benefit, keeping the fiduciary role of a portfolio manager.

- Finally, this system of governance may be positively enhanced if we put forward a comprehensive set of distinctive principles to match the manifold issues arising from the dual governance of state-owned banks.

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APPENDIX

We include in this appendix our own definitions of private and public governance. Further details and enlargement in Apreda, R. (2006b) *The Semantics of Governance (The common thread running through corporate, public and global governance)*. Corporate Ownership and Control, volume 3, number 2, pp. 45-53. (downloadable from the author's personal web page: www.cema.edu.ar/u/ra)

a) By **Corporate Governance** is meant a field of knowledge and practice within corporations and nearly alike organizations (including state-owned firms) that brings to focus the following subjects:

- Ownership structure.
- Company's founding Charter, by-laws, statutes, and codes of good practices.
- Board of Directors and Trustees; allocation of control and board's decision rights.
- Managers' fiduciary duties towards owners and their management decision rights.
- Investors' property rights and protective covenants.
- Conflicts of interest between managers, creditors, owners and other stakeholders.
- Managers' performance and incentives.
- Rent-seeking and soft-budget constraints.
- Production and disclosure of transparent information to markets, regulators and stakeholders
- Accountability to regulators, stakeholders and investors
- Private, public and global gatekeepers (the so-called reputational intermediaries)

- National and international institutional constraints (the Judiciary, traditions, regulations, and law enforcement)

b) By **Public Governance** is meant a field of knowledge and practice in organizations of the public realm of representative democracies that deals with the following matters:

- The Founding Charter, Bill of Rights and the legal system of the underlying political system.
- Institutional architecture for representation mechanisms; the fiduciary role; the exercise of authority; the structure of power division; the whole array of checks and balances.
- The processes by which government officials, representatives, and the judiciary are elected, appointed, monitored, and replaced; the design of the governmental bureaucracy and its management.
- Integrity of the Judiciary; law enforcement; property rights.
- Accountability, transparency, conflicts of interests, good practices.
- Rent-seeking, soft-budget constraints, political clientelism, state-capture, corruption.
- The role of collective action: groups of interest, veto-players, gatekeepers, media, political parties.