Are we all in it together or is it every man for himself? A few thoughts about the prospects of convergence in corporate governance

Contents

1. Introduction

This article will start with the definitions of corporate governance, convergence and globalisation and then will touch upon the theoretical framework for discussion.

This will be followed by a brief outline of the main arguments and evidence for and against the convergence of national corporate governance systems and a discussion of the key tensions, paradoxes, problems and issues highlighted by the recent studies of corporate governance world-wide.

This approach will enable us to draw conclusions as to whether or not the convergence of national corporate governance systems upon a single model is inevitable.

2. Key definitions

For the purpose of this article, the following definitions of terms corporate governance, convergence and globalisation will be used.

To date, there is no generally accepted single definition of corporate governance. Brian Coyle (2006) defined *corporate governance* as the way in which companies are governed and to what purpose. It is concerned with practices and procedures aiming to ensure that a company is run in such a way that it achieves its objectives. Aguilera and Jackson (2003) and Letza et al. (2004) offered a more narrow definition of this term. In their view, corporate governance is concerned with the institutional arrangements for relationships/structure of rights and responsibilities among the various parties that have a stake in a firm.

Broadly speaking, in the context of corporate governance, *convergence* refers to increasing isomorphism in the governance practice of public corporations from different countries (Yoshikawa and Rasheed, 2009). Academics distinguish between convergence in ‘form’ (increasing similarity in terms of legal frameworks and institutions) and convergence in ‘function’, suggesting that different countries may have different rules and institutions but may still be able to perform the same functions in relation to corporate governance (Gilson, 2004).

The Online Business Dictionary (2011) defines *globalisation* as a ‘worldwide movement toward economic, financial, trade, and communications integration’. Guillen (1998) noted that globalisation is associated with increasing cross-border mobility of capital, services, products, labour, information and culture. Khanna *et al*. (2001) pointed out that globalisation is leading to the intensification of competition for those factors across borders by firms and countries.

3. Theoretical perspectives on convergence in corporate governance

The agency theory (shareholder model) and the stakeholder theory/model are underpinning the concept of corporate governance and discussions around the convergence.

The shareholder model sees the maximisation of shareholder wealth as the primary objective of the company (Sundaram and Inkpen, 2004) and the key role of corporate governance as providing a set of solutions to the principal (shareholder) /agent (manager) problem which arises from the separation of ownership and control in the modern company (see, for example, Shleifer and Vishny, 1997; Worthington, 2001 and MacNeil, 2002).

The stakeholder model views a company as being responsible to a wider constituency which, sometimes, could be regarded as too open-ended. Blair (1995) and Parkinson (1997) highlighted the need to adopt a more restrictive approach, categorising internal and external stakeholders as those who have contributed firm-specific assets or those who enter into long-term relationships with the company (this approach is known as ‘new’ stakeholder model). MacNeil (2002) noted that the nature of a stakeholder’s interest in a company differs from that of shareholder (there is no convenient unit for measuring stakeholder interest analogous to the role performed by the company share; and there is no presumption of equality between different stakeholders); and that in common law legal systems, the tendency was for the shareholder model to predominate.

Condon (2011) stated that national corporate governance systems are determined by a combination of internal factors (such as corporate ownership structure, state of economy, legal system, government policies, culture and history) and external factors (such as extent of capital inflows from abroad, global economic climate and cross-border institutional investment). Therefore, as Solomon (2010) pointed out, every country exhibits a unique system of corporate governance and that, as the result of a wide array of internal and external influences, there are as many corporate governance systems as there are countries.

The ‘insider/outsider’ model (Franks and Mayer, 1994; Short et al., 1998) provides a useful framework for categorising corporate governance systems, discussion and research. This approach describes two extreme forms of corporate governance - the Continental (insider) model which is stakeholder centred and based on civil law system; and the Anglo-Saxon (outsider) model which is shareholder centred and based on a common law system. Solomon (2010) argued that, in reality, most systems of corporate governance fall somewhere in between these two, sharing some characteristics of both models. She also pointed out that international harmonisation is now common in all areas of business and that countries are attempting to reduce the differences in corporate governance systems. According to Solomon, countries with traditionally outsider-dominated systems already have made a lot of efforts to address the main (agency) problem associated with the outsider systems. In her view, this indicates that there might be a possibility that corporate governance will converge at a global level somewhere in between the traditional insider/outsider extremes.

Gilson (2004) and Khanna *et al. (*2001 and 2006) distinguished between convergence ‘*in form’* and convergence *‘in function’.*

The concept of ‘*convergence in form’* is based on belief that the efficiency-enhancing effect of global competition (especially in the capital markets) will dictate that all nations will ultimately adopt the same corporate governance system, which is likely to be based on the US model (see, for example, Karmel, 1991; and Hansmann and Kraakman, 2000). However, Bhide (1993) and (Yoshikawa and Rasheed, 2009). pointed out that there is no common agreement on the end-state of convergence which makes the idea of '*convergence in form'* questionable. Bebchuk and Roe (1999) also argued that path dependence has lead different economies to very different corporate governance systems and that these are not easily dislodged, not even by global competition.

Another perspective – '*functional convergence'* - is based on the idea that each country's institutions have enough flexibility to ensure that key functions of corporate governance – the protection of resource providers – can be largely achieved within the constraints of the country's institutions (for example, according to Kaplan (1994), statistically, poorly performing CEOs appear equally likely to be dismissed in the US, Germany and Japan, despite the very different formal systems in place). It should be noted that the idea of *'functional convergence'* is not particularly new. It has been previously explored in social science (Merton, 1968) and applied to financial systems more generally (Crane *et al.*, 1995). Shleifer and Vishny (1997) and Tirole (2001) highlighted a number of considerable disagreements about the functions of corporate governance, thus challenging even the '*functional convergence'* idea.

Academic literature describes many other types of convergence. For example, Khanna *et al. (*2006) pointed out differences between *de jure* convergence (when two or more countries adopt similar corporate governance laws) and *de facto* convergence (when practices are actually implemented). Gilson (2004) also referred to *contractual convergence* (using the contracts as an alternative when institutions are lacking flexibility to respond without change and when political barriers limit the capacity for formal institutional change). However, the size limitation of this article does not allow for the provision of details on these and other types of convergence.

4. Empirical evidence for and against convergence

Solomon (2010) pointed out that rising international trade; transnational business links, the existence of forces leading to international harmonisation in financial markets, with increasing international investment, foreign subsidiaries and integration of the international capital markets, drive the need for a global convergence in corporate governance. A proliferation of corporate governance codes of practice and policy guidelines across the globe over the last decades was a response to this need.

Solomon analysed the following key initiatives aimed at standardising corporate governance at a global level which were introduced follofing the publication of :

- the Cadbury Report in 1992: the OECD Principles;
- the ICGN statement on the OECD Principles and the CalPERS principles in 1999;
- the Revised OECD Principles;
- the European Union standards for corporate governance good practice; and
- the United Nations Conference on Trade and development (UNSTAD) guidance on corporate governance disclosure in 2004.

She concluded that the European Commission acknowledged the diversity of the national corporate governance systems based on the differences in their legal frameworks, their economies, their individual markets and their culture, and adopted the view that one size cannot fit all. It followed the UK ‘comply or explain’ approach to corporate governance for all member states rather than a US-style approach of regulation. As Nestor and Thompson (2002) pointed out, the open-ended and non-prescriptive character of the OECD Principles makes them a very valuable tool for the development of international dialogue for the promotion of better corporate governance.

Numerous studies of corporate governance and magnitude and direction of convergence in governance practices were undertaken worldwide both at national and company levels in recent years.

Guillen (1999 and 2000) acknowledged that the globalisation of financial investments and money managing starting in the early 1980s – and the decline of the Japanese economy during the 1990s – has spurred a round of arguments predicting a convergence on the US model. However, he argued that while this seems to confirm a conventional wisdom that corporate governance is (or will be) converging across the world as the result of global pressures, the existing literature has not produced longitudinal evidence documenting such a change. Opposing this view, some literature emphasised great cross-national variations in terms of essential aspects of corporate governance such as the importance of large stockholders, the legal protection of shareholders, the extent to which relevant laws are enforced, the treatment of stakeholders such as employees and the community, the reliance on debt finance, the structure of board of directors, the way in which executives are compensated, and the frequency and treatment of mergers and takeovers, especially hostile ones. Furthermore, despite financial arguments and shifts in world economic leadership, corporate governance patterns continued to differ significantly across countries despite the decades of economic and financial globalisation.

In their cross-country analysis, Khanna *et al. (*2001 and 2006) found robust evidence of *de jure* convergence in form at the national level (interestingly, this is not driven by a convergence to US standards, rather to pairs of economically interdependent countries appearing to adopt common corporate governance standards) with virtually no evidence of *de facto* convergence in corporate governance in form or function in a range of estimates at the national, industrial and corporate levels. They, therefore, concluded that globalisation may have induced the adoption of some common governance standards, but there is little evidence that these standards have been implemented.

A number of academics examined the impact of globalisation on organisational patterns such as corporate governance systems. They acknowledged a growing inter-dependency of national economies in terms of trade, finance and macroeconomic policy (Gilpin, 1987) and the fact that different parts of the world are not being affected by economic, political or cultural globalisation to nearly the same extent (see, for example, Hirst and Thompson, 1996). Furthermore, comparative organisational sociologists have presented qualitative and quantitative evidence that companies pursue different modes of economic action and adopt different organisational forms depending on the institutional and social structures of their home countries even as globalisation increases (Biggart and Guillen, 1999; Guillen, 2000 and 2001).

Quantitative analyses confirm that differences in corporate governance across advanced industrial economies are not associated with differences in financial or sales performance at company level, after controlling for industry and firm size (Thomsen and Pedersen, 1996). According to Guillen (1999), a similar diversity of patterns is also evident among newly industrialised countries in Asia, Latin America and Southern Europe.

La Porta *et al.* (1998 and 1999) argued that no evidence exists that a difference in corporate governance systems affects GDP growth in the long run. Therefore, one should not expect competitive pressure to force a convergence in corporate governance. They also argued that the internalisation of capital markets is not enough to change the existing ownership structures based on the domestic legal environments that companies operate in. Given that concentrated ownership produces a centralisation of power, they questioned the imminence of convergence of corporate ownership patterns, and of governance systems generally.

In contrast to the views discussed earlier, Coffee (2001) argued that there is evidence, even if it tends to be anecdotal, that the world's corporate governance systems are converging. He listed four areas where the convergence is evident:

- formal legal reforms;
- the dispersion of ownership in Europe and Japan;
- the rise of an international market for corporate control; and
- the growth of European stock markets.

5. Conclusions

A brief discussion of theoretical perspectives on convergence in corporate governance and the empirical evidence for and against convergence gathered by the academics to date, leads to the conclusion that one size cannot fit all. Therefore, it is unlikely that we will see a global convergence to one corporate governance model in the near future. Instead, there is likely to be some convergence at the margins of the framework (Collier and Zaman, 2005; and Solomon, 2010) and somewhere in between the traditional 'insider'/'outsider' extremes (Solomon, 2010).

As Mintz (2005) pointed out, 'we may never achieve true convergence of corporate governance systems given the differences in underlying financial and cultural variables in countries such as the US, the UK and Germany. Perhaps this is the wrong goal to pursue. After all, even if a foreign company, or a US company for that matter, complies with all governance standards that exist locally and internationally, it still does not ensure that the financial statements are free of material misstatement and the internal control system is operating as intended'.

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