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Corporate Governance Convergence and Divergence among Countries and Companies: A Conceptual Analysis

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1. Introduction

The Cadbury Committee (1992, cited in Mintz, 2005, p. 584) defines corporate governance as the system by which companies are directed and controlled. Countries and companies alike have realized that corporate governance has become center stage. The prominent driver of change to corporate governance codes has been due to corporate collapse (United Nations, cited, 1999, cited in Davies, 2008, p. 533). In addition, the growing number of institutional ownership and the internationalization of capital markets (Elsayed, 2007) have made corporate governance to become very critical. Many countries have adopted corporate governance practices and while there are similarities in their approaches, there are also differences. This article provides a conceptual analysis of their similarities and differences. This article serves to enlighten undergraduate students studying corporate governance, students of ACCA studying the Strategic Business Leader subject, post-graduate students and practitioners on the foundations of convergence and divergence of corporate governance.

The next section of this article will provide the reasons why there are similarities in countries' corporate governance. This is followed by reasons, that despite some similarities, there are also factors that results in differences in corporate governance. The last section wraps up with a conclusion of the article.

2. Convergence of corporate governance

There are many reasons why corporate governance among countries and companies may converge. Among them are the rise of capitalism, globalization (Economist, 2003), the global diffusion of corporate governance codes (Peng, 2006), market liberalization, emergence of powerful foreign investors, and recommendations on global practices by transnational institutions such as World Bank (Cuervo, 2002; Reid, 2003; cited in Aguilera & Cuervo-Cazurra, 2009).

Other reasons cited for convergence are integration of financial markets, product market integration and harmonization of accounting rules (Yoshikawa & Rasheed, 2009). This convergence had also been due to isomorphism of structure, thought and action within institutional environments (Judge, Li & Pinsker, 2010).

Some researchers have also made a distinction between form convergence and function convergence as well as between de jure convergence and de facto convergence. Form convergence occurs due to similarity in terms of legal framework and institutions while function convergence implies that although countries may differ in rules and institutions, they are still able to perform the same functions such as fair disclosures and the practice of accountability. De jure convergence implies that two or more countries adopting similar corporate governance laws and when actual practices converged, it is referred to as de facto convergence (Yoshikawa & Rasheed, 2009).

Some of these are discussed below for greater clarity.

2.1 The rise of capitalism, globalization, market liberalization and product market integration

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Due to changes in political, economic and social movements, emerging economies, African countries and existing liberal market economies are embracing capitalism. Alongside this acceptance of capitalism, corporate governance practices have to be changed to attract investors. These changes may result in some similarities in corporate governance. The convergence may be in form or function or maybe even in de jure or de facto convergence.

Globalization can occur due to foreign direct investment (FDI) and foreign portfolio investment (FPI). FDI's can take many forms such as acquisitions and equity alliances (examples being joint ventures, strategic investments, and cross-shareholdings). The joint venture between Fujifilm and Xerox that started in 1962 to form FujiXerox and finally the investment of Fujifilm in Xerox and the subsequent ownership of FujiXerox by Xerox in 2018 (Fujifilm Holdings, 2018) will definitely result in corporate governance amalgamation.

When Kraft (now KraftHeinz) acquired Cadbury in 2011 (Moeller, 2012), the corporate governance of Cadbury will inevitably incorporate the corporate governance of Kraft. Hence through the passage of time, such FDI's will result in the convergence of corporate governance among companies and ultimately countries.

The presence of foreign institutional investors will result in better corporate governance (Mengoli, Pazzaglia & Sapienza, 2009). One reason to explain this is that foreign institutional investors will expect the companies to be well managed, and one way this can occur is through adopting best practices in corporate governance, thus encouraging some kind of convergence. Codes of good governance are also more likely to emerge with the presence of foreign institutional investors (Aguilera & Cuervo-Cazurra, 2009). All these imply that some similarity will arise in corporate governance with the pervasive occurrences of FPI's.

At the institutional level, it is argued that governments compete to attract firms to locate their operations in their country. This leads each government to introduce attractive regulations including those on corporate governance. At the firm level, as global product market competition intensifies, corporate governance systems also become more similar as firms adopt more efficient elements of corporate governance systems.

2.2 Diffusion of corporate governance codes prompted by Cadbury Code and transnational entities

The first code of good governance was issued in 1978 in the US, followed by Hong Kong in 1989, and third was Ireland in 1991. The fourth was the influential Cadbury Report by England in 1992 (Aguilera & Cuervo-Cazurra, 2009). Cadbury code had had a profound impact on countries and many countries had used the Cadbury code as a benchmark to improve their countries' respective corporate governance.

The spread of good governance around the world was also aided by international entities/transnational entities such as OECD, World Bank (Aguilera & Cuervo-Cazurra, 2009), ICGN and CACG (Davies, 2008). The OECD was the first international body to produce globally acceptable standards of corporate governance (Solomon & Solomon, 2004 cited in Davies, 2008, p.533). The International Corporate Governance Network (ICGN), a global organization that comprises key international investors such as individual investors, financial companies and intermediaries adopted the OECD principles as a foundation stone and provided further guidance on how to put the principles into practice (Davies, 2008). The Commonwealth Association of Corporate Governance (CACG) had produced a set of corporate governance principles in 1999 which were similar to the

OECD principles. The evolution of corporate governance in a number of developing African countries had been based on CACG (Davies, 2008).

These corporate governance principles disseminated by transnational entities and the Cadbury Code have some key universal principles for effective corporate governance such as balance of executive and non-executive directors, no duality of posts between the chief executive and chairman, need for timely and quality information being provided to the board, formal and transparent procedures for the appointment of new directors, balanced and understandable financial information, maintenance of a sound system of internal controls, among others (O'Shea, 2005, cited in Aguilera & Cuervo-Cazurra, 2009). The dissemination of such best practices in corporate governance had influenced many countries and as such, their corporate governance principles will have some degree of convergence.

2.3 Integration of financial markets

Integration of financial markets may take many forms such as listing by firms from one country in the stock exchanges of other countries, thus increasing FPIs, cross-border mergers and acquisitions, and free capital flows across countries. Each of these has implications for convergence because they bring about a fundamental transformation in the ownership structure of corporations (Yoshikawa & Rasheed, 2009). One of the reasons for foreign listing either through cross-listing or initial public offerings (IPO's) is to engage in bonding. One example of a foreign IPO is Alibaba, being listed in the US (Reuters, 2018). Cross-listing is the process by which a firm incorporated in one country elects to list its equity on the public stock exchange of another country (Ferris, Kim & Noronha, 2009). This signals to investors that firms are willing to comply with higher standards than required in their home country (Vaaler & Schrage, 2006 cited in Yoshikawa & Rasheed, 2009, p. 391). Bonding is found to increase firm's share value (Coffee, 2002 cited in Yoshikawa & Rasheed, 2009, p.391) and improve a firm's corporate governance (Ferris et al., 2009, p. 338). Other reasons for cross-listing include a desire to obtain investment capital at a lower rate, achieve higher share valuation (through legal and reputational bonding), enjoy increased liquidity and market depth for its shares, and obtain a greater market share for its products and services (Karolyi, 2006 cited in Ferris et al., 2009, p.338). Hence if many firms undertake cross-listing and subsequent bonding as well as undertaking foreign IPO's, in the long-run, in aggregate, the corporate governance of such firms, and ultimately countries will converge.

2.4 Harmonization of accounting rules

The development of a core set of international accounting standards by the International Accounting Standards Committee can greatly facilitate the convergence of corporate governance (Yoshikawa & Rasheed, 2009). The concept of isomorphism as cited by Judge et al. (2010, pp. 163-164) stems from the work of Di Maggio and Powell (1991) where three types of isomorphism were identified. These are coercive, mimetic and normative isomorphism.

Coercive isomorphism arises from resource dependence and legitimacy concerns. Mimetic isomorphism refers to the tendency of social actors to imitate those other social actors (individuals, organizations and nations) which are viewed as successful and legitimate. Normative isomorphism on the other hand, refers to collective values that bring about conformity of thought and deed within institutional environment. Of these forms of isomorphism, coercive isomorphism is often used by the International Monetary Fund

(IMF) when providing financial aid to developing countries or countries in financial aid with the demand that reform be enacted in the public and private sectors. Quite often IMF aid is often tied to demands that IFRS accounting standards be adopted (Judge et al., 2010, p. 163). Egypt's and Pakistan's adoption of IFRS were prompted by IMF's aid to these countries (Judge et al., 2010, p. 163). As a result of similar financial reporting standards, through the passage of time, the corporate governance of countries may also converge.

3. Divergence of corporate governance

Although there can be similarities between corporate governance, there can also be some impediments that make the corporate governance among countries be divergent. Among them are differences in national culture, corporate ownership, financing options, and legal origin (Zattoni & Cuomo, 2008). Countries can also be classified as liberal market economies (LME's) and coordinated market economies (CME's) and these countries have differences in corporate governance practices (Waring & Edwards, 2008).

Differences can also arise due to path dependence, complementarities, rent seeking by interest groups, differences in property rights and regime, and economic nationalism (Yoshikawa & Rasheed, 2009). These are articulated below.

3.1 National culture

According to Hofstede (1993, p.91 cited in Senior & Fleming, 2006, p. 166), there are five dimensions of national culture, namely, power distance, individualism-collectivism, masculine-feminine, uncertainty avoidance and long-term-short-term orientation. National culture has a significant influence on corporate governance structure (Li & Harrison, 2008).

The US has low uncertainty avoidance and therefore, in such a nation, organizations are less sensitive to risks (Li & Harrison, 2008). High uncertainty avoidance has also resulted in a smaller variable/performance related component of CEO compensation/remuneration package (Li & Harrison, 2008, p. 377).

For example, the research by Watson Wyatt Worldwide (2009 cited by Filatotchev & Allcock, 2019) shows the following:

Country	Base salary	Incentive plan
USA	23%	60%
Germany	39%	14%
Japan	71%	17%

Thus differences in national culture can affect executive directors' performance related component remuneration. On the other hand, Germany is characterized by a high collectivism and high uncertainty avoidance culture. The corporate governance of Germany emphasizes cooperative relationships among banks, shareholders, boards, managers, and employees in the interests of labour peace and corporate efficiency (Li & Harrison, 2008, p. 377). The national culture can also affect board structure where Germany, and even Finland and Denmark have a two-tier board.

Scandinavian countries tend to have a culture high in feminism and as such there are more women on board. For example, the Norwegian government requires that board of directors of publicly held firms be comprised of at least 40% women (Hoel, 2008 cited in Terjesen, Sealy & Singh, 2009, p. 321) and the Spanish government has also committed to 40% (De Anca, 2008 cited in Terjesen et al., 2009, p.321).

Hence these differences will inevitably affect a company's and a country's corporate governance arrangements.

3.2 Corporate ownership and financing options

One commonly used model for corporate governance classification is the insider/outsider model (Mallin, 2004, cited in Davies, 2008, p. 534). In an outsider model, there is dispersed ownership of corporate equity among a large number of outside investors (Li & Harrison, 2008) and a clear separation of ownership from control. This outsider model is also known as diffused ownership structure (Stulz, 2005, cited in Peng, 2009, p.381). The vast majority of firms in the US and UK are characterized by diffused ownership (Li & Harrison, 2008; Peng, 2009).

In an insider model, also known as concentrated ownership model, ownership is often concentrated within a small number of directly related firms, banks and families (Li & Harrison, 2008). The vast majority of large firms throughout continental Europe, Asia, Latin America and Africa features concentrated family ownership and control (Peng, 2009, p. 382).

The corporate governance issues in a diffused and concentrated ownership will be different. Since ownership in a concentrated structure is small, there may exist a controlling shareholder. Controlling shareholders are created either through dual-class or triple-class shares or through a pyramidal structure

News Corp, for example, practices dual-class shares. In a dual-class share, as the name implies, there are two classes of shares, type or class-A and class-B. Both shares have cash-flow rights but class-B shares have more voting rights than class-A. Facebook too has a dual-class share structure while Zynga has a triple-class share, comprising class-A, B, and class-C (Colvin, 2011). Old line media such as the New York Times and the Washington Post also have a dual-class share (Rivlin, 2011).

The corporate governance issues in a diffused and concentrated ownership are different. With the existence of controlling shareholder(s) in a concentrated ownership, the conflict that occurs may be a principal-principal conflict, i.e. a conflict between the controlling shareholder and the minority shareholders in which controlling shareholders may advance their interests at the expense of minority shareholders (Peng, 2009).

On the other hand, in a diffused ownership, the conflict is more likely to be an agency conflict (Berle & Means, 1932 cited in Chen, Elder & Hung, 2010, p. 93) i.e. a conflict between the agent(s) and shareholders due to adverse selection of agents. There are external systems in place for controlling agency problems, namely, the stock market, the market for corporate control and the labor market (Cennamo, Berrone, Gomez-Mejia, 2009).

Related to corporate ownership is the financing options companies choose. Firms with insider model tend to adopt long-term borrowings so as not to dilute its voting rights while those that adopt an outsider model tends to issue shares.

Due to the differences in corporate governance issues in both an insider and an outsider model, these companies' corporate governance cannot be exactly identical and the countries' corporate governance where these companies are found also cannot be exactly identical.

3.3 Legal origins

The legal framework (civil or common law) will affect a country's corporate governance arrangements (Davies, 2008). According to Zattoni and Cuomo (2008), common law countries issue codes of good governance faster than civil law countries.

The first common law country to recommend good corporate governance was the US in 1978 while the first civil law country to come out with codes of good governance was Sweden in 1994 (Aguilera & Cuervo-Cazurra, 2009).

Civil law countries have weaker investor protection as compared to common law countries (La Porta et al., 1997 cited in Davies, 2008, p. 535). In countries where the protection of shareholders is weak, the controlling shareholders usually use the excess control rights to weaken the ability of internal control mechanisms. In such circumstances, external control mechanisms may be the only recourse available for remedying the problem. Unfortunately, one of the external control mechanisms, the market for corporate control is weak in countries where shareholder protection is weak (i.e. in civil law countries) and excess control rights are prevalent. This situation leaves creditors as the only viable monitoring mechanism to protect shareholders (Shyu & Lee, 2009). This problem does not arise in common law countries as frequent as in common law countries.

However the upside for civil law countries is that recommendations of code of good governance extend to non-listed companies more often than common law countries (Zattoni & Cuomo, 2008).

Hence, the different laws being adopted in countries definitely impact the corporate governance of countries and therefore there are divergences in corporate governance practices.

3.4 Liberal market economies (LME's) and coordinated market economies (CME)

In relation to the legal framework as discussed above, another way to classify countries is whether their market economies are liberal or coordinated. Common law countries tend to have a liberal market economy while civil law counties have coordinated market economies. The UK, USA and Australia are often cited examples of LMEs.

In an LME, there are better developed equity markets, competitive market relationships, and formal contracting. In a CME, there is more reliance on collaborative relationships, and non-market modes of coordination (Hall & Soskice, 2008, p.8 cited in Waring & Edwards, 2008, p. 136). Germany and Japan are typical examples of CMEs.

The presence of socially responsible investors are more in LMEs than in CMEs and in a CME like Germany, bank representatives sit on the supervisory board and acts as proxy to minority shareholders. Germany has its own code of corporate governance, the Cromme Code (Hackethal et al., 2005 cited in Davies, 2008, p. 538). German system of corporate governance has long emphasized cooperative relationships among banks, shareholders, boards, managers, and employees in the interests of labour peace and corporate efficiency (Li & Harrison, 2008, p. 377).

Thus these differences will sure render the corporate governance codes of LMEs and CMEs to be different.

3.5 Path dependence and complementarities

Path dependence refers to a situation where the current state of a system is determined not only by its initial condition but also by the path it took. The evolutionary trajectory of the governance system of a country is the result of thousands of individual historical events and policy responses to them. The net result is a divergence across corporate governance systems.

The existence of complementary systems can also result in divergence. For example, in US, independent directors, information disclosure and takeover markets are a key set of complementary elements in Anglo-American form of corporate governance. In Japan, high reliance on debt, absence of a market for corporate control, cross-shareholdings by firms, and long-term employment practices shape corporate governance in Japan (Yoshikawa & Rasheed, 2009). While these may change in the future, these differences are sufficient to cause the corporate governance arrangements be dissimilar.

3.6 Rent seeking by interest groups and differences in property rights and regime

Rent-seeking actions by interested groups may prevent the convergence of corporate governance. Rent seeking actions could come from a wide range of actors such as labour unions, banks, controlling shareholders and lawyers. For example, many European countries have laws in place that allow unequal voting rights, specifically designed to protect family control. For such family controlling shareholders, they would definitely oppose the one share, one vote system (Yoshikawa & Rasheed, 2009).

Where property rights regimes are weak, that is in countries where governments retain considerable control rights, firms invest in "political capital" which can only be recovered in the long-term. Firms will not have any incentives to change the status quo as it wants to recover all its "political capital" (Yoshikawa & Rasheed, 2009).

All these will result in differences in countries' corporate governance systems.

3.7 Economic nationalism

Economic nationalism and differences in social norms in Japan and US, say, will vary and this will affect convergence of corporate governance systems. These differences in social norms can also result in a lack of consensus on what an ideal corporate governance system should look like (Yoshikawa & Rasheed, 2009).

4. Conclusion

This article highlights that a country's corporate governance can have similarities as well as differences with another country's corporate governance.

Since corporate governance has gained more prominence as more countries try to improve their economic growth, countries and organizations alike will have to ascertain what model of corporate governance suits them after taking into account the institutional environment of a country that will include formal rules (laws, regulations, professional standards, procedures) and informal constraints (customs, norms, cultures) (North, 1990 cited in Young, Tsai, Wang, Liu & Ahlstrom, 2014, p. 333).

Organizations operating in countries near and far have also realized the importance of corporate governance as a means of increasing its share price as well as attracting potential investors. Therefore governments of countries and agents of companies need to consider the right corporate governance structure it needs to remain relevant and competitive.

This article also hopes that aspiring practitioners and future leaders will be sensitize to corporate governance and will give due consideration as it implements formal rules and influence informal constraints as countries' economic growth, among others, may be contingent on its corporate governance.

As mentioned in the introduction section of this article, this article also aims to enlighten undergraduate students studying corporate governance, students of ACCA studying the Strategic Business Leader subject, post-graduate students and practitioners on the foundations of convergence and divergence of corporate governance.

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