CORPORATE GOVERNANCE PATTERNS IN OECD ECONOMIES: IS CONVERGENCE UNDER WAY?

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I. Introduction

Neo-classical economics suggests that a firm which operates in a competitive product market and meets its capital needs in an efficient capital market should maximise the welfare of its owners (as they would otherwise not supply it with capital) and that of its customers (by pricing its products at their marginal cost): the enterprise is thus the proverbial "black box". But,

"... in the real world things are not that simple...Creditors want to be sure that they will be repaid, which often means firms taking on less risky projects ... managers would rather maximise benefits to themselves (by) preferring policies that justify paying them a higher salary, or divert company resources for their personal benefit or simply refuse to give up their jobs in the face of poor profit performance .... Large shareholders with a controlling interest in the firm would, if they could, increase their returns at the expense of ... minority shareholders." (Prowse 1996)

The list could be longer: employees, suppliers, customers, the community as a whole. There are substantial costs that result from the divergence of the interests of different agents. Corporate governance is the outcome of the relationships and interactions between these agents. An optimal corporate governance structure is the one that would minimise institutional costs resulting from the clash of these diverging interests.

Costs are the result of two main incidences: the long string of agency relationships that characterise today's large firms; and the impossibility to write complete contracts between principals and agents on the exact tasks of the latter. Hence, in the words of Professor Hart (1995):

"governance structures can be seen as a mechanism for making decisions that have not been specified by contract".

But why do these costs matter? Because the performance of the enterprises might be significantly influenced by their size and the identity of their bearer[1]. For example, if too many of these costs are borne by shareholders, the cost of equity financing will rise and the structure of the capital market will be seriously tilted towards debt financing and/or direct or indirect state subsidies. Employment and labour relations might also be shaped by governance structures: where labour has an important role in defining company strategy there might be losses in the efficient redeployment of resources; on the contrary, where employees are kept completely outside the information flow and decision making process within the firm, there may be a lower commitment to the firm's development and more social costs may arise down the line.

And if these costs matter to corporations, why do they matter to governments? Everybody would agree that corporate governance regimes are (and should remain) the product of private, market-based

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[1] A substantial amount of literature has focused on the relationship between governance and performance. Findings are often contradictory, which may be largely due to insufficient data. Millstein and Mac Avoy (1997) find that good governance at board level has a non-trivial impact on share prices. In a survey of the literature, Patterson (1998) finds little qualitative evidence to either prove or disprove such a link.

practices. There are however important policy angles. From an economic policy perspective, rising institutional and transaction costs in the realm of corporate decision-making and finance impacts on the competitiveness of economies, on the corporate investment levels and on the allocative efficiency of capital markets. From an institutional perspective, corporate governance is of direct relevance to policy makers because laws, institutions and regulations are one of its most important sources (and of its costs). Company law, securities regulation, prudential regulation of banks, pension funds and insurance companies, accounting and bankruptcy laws impact on the way corporations make their decisions and behave in the market -- and towards their different constituents. To come back to Hart's aphorism, the legal and institutional framework shapes most of the relationships that are outside the contractual realm. Policy makers are responsible for striking the best balance between mandatory law and contract in each jurisdiction thus providing the optimum mix between flexibility and predictability.[2]

There is a wide variety of corporate governance regimes in OECD countries. Over the years, individual economies developed different capital market mechanisms, legal structures, factor markets and private or public institutions to act as owners or corporate governance principals in the economy. These arrangements might vary even within the same country according to the sector. They are very often the result of institutional, political and social traditions. Understanding and accepting this variety of approaches is a fundamental first step for analysing the impacts of increasing globalisation on national systems.

Despite different starting points, a trend towards convergence[3] of corporate governance regimes has been developing in recent years. Pressures have been rising on firms to adapt and adjust as a result of globalisation. Their products are having to compete directly on price and quality with those produced internationally, which mandates a certain *de facto* convergence of cost structures and firm organisation that, in its turn, might spill-over on firm behaviour and decision making. But most important, convergence might be the result of globalisation in the capital markets: new financial instruments (such as ADRs and GDRs), deeper integration of markets, stronger, international competition and the emergence and growth of new financial intermediaries have radically changed the corporate finance landscape in a global way, at least for the larger enterprises. The latter, along with the governments of their countries, are increasingly conscious that, in order to tap this large pool of global financial resources, they need to meet certain governance conditions.

In this paper, we survey the patterns of corporate control, that are found in major OECD countries in order to arrive at a general taxonomy of governance regimes and trace their evolution through time. We will start by providing for a stylised description of different patterns of governance (keeping in mind that every country has ultimately its own unique arrangements). There are those that are founded on arm's length, market-based relationships between firms and their investors (who are thus "outsiders"); and those whose accountability trail leads to specific interests of "insiders": major shareholders, banks, workers. We will then provide for an overview of how the role of the various corporate governance agents has changed over the last couple of decades in different systems. We will further try to identify why the behaviour and positioning of these agents is changing and whether the different patterns are converging. Finally, we will provide for some tentative conclusions and contain some thoughts on the shape of the future policy debate on corporate governance.

[2] See Black and Kraakman (1996) and Black (1999).

[3] Gilson (1998) looks at convergence in terms of function (when existing governance institutions are responsive to change without a change in the rules), formality (when the legislative framework is adapted) and contractual (when companies have to adapt contractually as domestic institutions are not flexible enough to accommodate change and political obstacles will not allow formal convergence). We use the term convergence in a more generic fashion, which encompasses all of these three aspects.

II. The different systems of corporate governance

In this section we survey the observed patterns of corporate control that are found in the major OECD countries in order to arrive at a general characterisation of the different categories of governance regimes and trace their evolution through time. While it will be argued below that the systems may be converging today, it is clear that if one goes back a few decades, patterns of corporate governance differed drastically among OECD countries. The ways in which large, widely-held limited liability companies are governed reflect a wide variety of ownership structures in equity markets, of patterns of corporate finance, and of company laws and securities regulations. One traditional way of describing governance regimes has been to distinguish between “insider” and “outsider” systems.[4]

[4] See OECD (1996).

Table 1. Distribution of outstanding listed corporate equity among different categories of shareholders in selected OECD countries

per cent at year-end-1996

	United States	Japan	Germany	France	United Kingdom 2	Sweden	Australia 3
Financial sector	46	42	30	30	68	30	37
Banks	6	15	10	7	1	1	3
Insurance companies and pension funds	28	12	12	9	50	14	25
Investment funds	12	..	8	11	8	15	..
Other financial institutions	1	15 [1]	-	3	9	-	9
Non-financial enterprises	-	27	42	19	1	11	11
Public authorities	-	1	4	2	1	8	-
Households	49	20	15	23	21	19	20
Rest of the world	5	11	9	25	9	32	32
TOTAL	100	100	100	100	100	100	100

1. For Japan, pension and investment funds are included in Other financial institutions.
2. United Kingdom figures are for end-1994.
3. Australian figures are for end-September 1996. Investment funds are included in Other financial institutions.

Source: OECD Financial Accounts, The Conference Board International Patterns of Institutional Investment (New York 1997), Banque de France, G.P. Stapleton Ownership of the Australian Share Market and Implications for Securities Regulation (forthcoming), and OECD Secretariat estimates.

The outsider model

The classic “outsider" systems are found in the United States and the United Kingdom. The distinguishing features of the outsider model are 1) dispersed equity ownership with large institutional holdings; 2) the recognised primacy of shareholder interests in the company law; 3) a strong emphasis on the protection of minority investors in securities law and regulation; and 4) relatively strong requirements for disclosure. In these countries, equity is typically owned by widely dispersed groups of individual and institutional investors. Although these countries have long traditions of equity ownership by individuals, a phenomenon of institutionalisation of wealth is occurring in which an increasing share of national income is managed by institutional investors (i.e. mutual funds, pension funds and insurance companies) (See Table 2). Institutional investors are emerging as the largest owners of equity in the United States and already are the dominant owners of industry in the United Kingdom (see Table 1). Institutional investors tend to operate on the principle of portfolio diversification. They have one basic objective, which is to maximise the return to their investors in keeping with their mandates and in doing so employ the most modern techniques in pursuing their investment strategies. Typically, they have no interest in running the company and have no other relation to the company except for their financial investment.

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Table 2. **FINANCIAL ASSETS OF INSTITUTIONAL INVESTORS**

AS A PERCENTAGE OF GDP

	1990	1991	1992	1993	1994	1995	1996	1997 [p]
Australia	49.3	58.3	60.2	74.5	73.2	75.3	83.8	83.9
Austria (1)	24.3	25.9	24.3	27.8	31.8	35.5	39.4	..
Belgium	44.4	48.9	47.0	56.3	59.4	59.1	63.0	..
Canada	58.1	63.8	66.3	76.0	79.8	85.8	94.6	102.0
Czech Republic (2)	..	..	..	23.0	18.2	..	..	..
Denmark	55.6	59.4	53.7	61.2	65.1	64.1	67.1	..
Finland	33.2	37.1	35.8	44.2	55.5	49.6	57.0	..
France	54.8	62.4	60.5	72.5	75.6	75.9	83.1	90.6
Germany	36.5	38.2	33.7	38.1	44.1	46.3	49.9	57.5
Greece (3)	6.5	8.8	8.5	14.3	18.8	23.4	28.5	..
Hungary	..	2.5	2.5	3.1	3.7	4.0	5.7	..
Iceland	45.7	49.9	49.9	57.8	68.8	71.1	78.7	85.3
Italy	13.4	22.4	18.5	26.3	32.1	33.2	39.9	53.2
Japan	81.7	79.4	78.1	81.3	84.8	76.9	77.6	75.3
Korea	48.0	47.8	52.3	56.7	57.5	57.9	57.3	37.2
Luxembourg (4)	926.8	1237.5	1630.5	2166.5	2170.2	2139.1	2310.4	..
Mexico (5)	8.8	9.4	5.6	7.4	3.5	3.8	4.5	4.7
Netherlands	133.4	143.6	132.8	148.5	157.7	161.0	169.1	183.8
New Zealand	..	..	..	..	..	36.6	38.1	34.3
Norway	36.0	38.0	32.6	39.6	43.2	42.5	43.4	..
Poland (6)	..	..	..	0.5	1.9	1.6	2.0	0.4
Portugal	9.0	14.9	17.3	25.7	31.9	31.9	34.4	31.7
Spain	16.0	22.9	22.8	29.9	36.4	38.1	45.4	56.1
Sweden	85.7	93.8	75.6	102.6	105.4	114.5	120.3	..
Switzerland (7)	119.0	61.1	119.4	69.9	148.6	77.3	152.4	92.7
Turkey	0.6	0.5	0.5	0.9	1.0	0.8	1.3	0.6
United Kingdom	114.5	126.3	115.3	164.1	149.3	164.1	193.1	..
United States	123.8	137.2	141.3	151.6	149.7	167.0	181.1	202.8

Note: There are no data reported for Ireland.

(1) 1990: Excluding pension funds.

(2) 1995-97: Data not available.

(3) 1990: Excluding insurance companies and investment companies.

1991-92: Excluding investment companies.

(4) 1990-94 and 1996: Excluding insurance companies.

(5) Excluding pension funds.

(6) Excluding pension funds. 1990-93 and 1997: Excluding insurance companies.

(7) 1991,93,95,97: Exluding pension funds.

Source : OECD (1998b)

The “outsider” system can be also characterised as a market-based system, inasmuch as it relies heavily on the capital market as a means of influencing behaviour. The system is also characterised by a legal and regulatory approach that favours use of the public capital markets and is designed to build confidence among non-controlling investors. In countries with outsider systems, the legal framework supports clearly the right of shareholders to control the company and makes the board and the management explicitly accountable to the shareholders.[5]

The legal and regulatory regime was developed on the assumption that a dispersed body of investors own the company, that these investors act in isolation from each other and that they need reliable and adequate information flows in order to make informed investment decisions. Regulation has traditionally been structured to provide relatively complete information to investors and to create relative equality among investors regarding access to information. Thus, the system can be described as “disclosure-based”.[6] Some market-based systems have elaborate rules to prevent groups of shareholders from communicating and sharing information among themselves without making information available to all shareholders. Regulatory authorities have traditionally been willing to allow investors to assume risk as they see fit, even though they have usually enforced strict disclosure standards to prevent investors from being deceived about the actual amount of risk being assumed.

Unlike many insider systems, which thrived in bank-dominated environments, there have traditionally been two channels of financial intermediation in outsider systems. In the banking sector, finance has tended to be short-term and banks have tended to maintain “arms’ length” relationships with corporate clients. Most of these countries had traditions of an independent investment banking (or merchant banking) sector as well as specialised securities market intermediaries. Equity finance also tended to be relatively important with low debt equity ratios being the norm. Also, reflecting the tradition of wide equity ownership, equities tended to represent a high share of financial assets and a high share of GDP (see Table 3).

[5] See La Porta et al (1997).

[6] See Fox (1998).

Table 3. Market capitalisation of listed domestic equity issues

as per cent of GDP at year-end

	1975	1980	1985	1990	1993	1994	1995	1996
Australia (Assoc. of SE)	22	40	37	37	71	67	70	80
Austria	3	3	7	17	16	16	14	15
Belgium	15	8	26	33	37	36	37	44
Canada (Toronto and Vancouver)	30	45	45	43	61	59	66	86
Denmark	11	8	26	30	31	34	33	41
Finland	..	..	..	17	28	39	35	49
France	10	8	15	26	36	34	33	38
Germany (Assoc. of SE)	12	9	29	22	24	24	24	28
Greece	..	..	..	..	..	..	14	19
Ireland	..	..	..	..	..	..	40	49
Italy [1]	5	6	14	14	15	18	19	21
Japan	28	36	71	99	68	77	69	66
Korea	..	..	..	43	42	50	40	29
Mexico	..	..	..	16	50	31	32	32
Netherlands	21	17	47	42	58	67	72	95
New Zealand	..	..	39	20	56	53	53	56
Norway	..	..	16	23	24	30	30	36
Spain	32	8	12	23	25	25	27	33
Sweden	3	10	37	40	58	66	75	95
Switzerland [2]	30	42	91	69	114	109	129	136
Turkey	..	..	..	..	20	17	12	17
United Kingdom	37	38	77	87	122	114	122	142
United States (NYSE, Amex, and Nasdaq) [3]	48	50	57	56	81	75	98	114

1. Italy - All Italy on a net basis since 1985
2. Switzerland - only Zurich through 1990.
3. United States - including foreign shares in 1975.

Source: Fédération internationale des Bourses de valeurs and OECD Secretariat estimates.

Theoretically, the shareholders, through the use of their voting rights, have the power to select the members of the board and to vote upon certain key issues facing the company. In practice, the fragmentation of ownership has proven to be a serious impediment to the actual exercise of such control. In the past, investors in outsider systems were not especially concerned with corporate governance inasmuch as it was presumed that they could not and did not wish to exercise their governance rights. The main means for investors to discipline management has been the buying and selling of company shares. The capital market has provided the ultimate means for shareholders to discipline management. If the company is poorly managed and/or if shareholder value is neglected, investors react by selling shares, thereby depressing prices and exposing the company to hostile take-overs. Such a model presumes ample disclosure of information, strict trading rules and liquid stock markets.

Much of the early thinking about corporate governance evolved in the context of the outsider model. It was the separation between ownership and management that led analysts as long ago as the 1930s to identify the potential agency problems when a dispersed group of shareholders were unable to monitor and to control the behaviour of management.[7] Indeed, as recently as the late 1980s, many analysts had concluded that the agency problems that characterised outsider systems might inevitably lead to poor corporate performance.[8] Management was thought to have effectively shielded itself from accountability while shareholders were thought to be focused on short-term results. Many analysts compared the market-based system unfavourably with the insider systems in which corporate control was exercised by agents having more permanent economic linkages to the company. In more recent years, the pendulum has swung the other way, as companies in the US and the UK have managed to carry out sizeable restructuring and show impressive gains in profitability. Thus, more recently observers have become much more positive about the capacity of the capital markets to encourage efficient economic behaviour.

The insider model

In most other OECD countries and nearly all non-Members, ownership and control are relatively closely held by identifiable and cohesive groups of "insiders" who have longer-term stable relationships with the company.[9] Insider groups usually are relatively small, their members are known to each other and they have some connection to the company other than their financial investment, such as banks or suppliers. Groups of insiders typically include some combination of family interests, allied industrial concerns, banks and holding companies. Frequently, the insiders can communicate among themselves with relative ease to act in concert to monitor corporate management, which acts under their close control. Furthermore, the legal and regulatory system is more tolerant of groups of insiders who act together to control management while excluding minority investors. Hence, the agency problem, which characterises the outsider system, is of much less importance.

Patterns of equity ownership differ significantly from "outsider" countries. One characteristic of countries with insider systems is that they have generally experienced less institutionalisation of wealth than the English-speaking countries. Until recently, no class of owners was found comparable to the pension funds, mutual funds and insurance companies of the US and the UK who have emerged as the largest and most active class of shareholders (see Table 2). Additionally, those institutions that do exist often face regulatory limits on their ability to invest in equity.[10]

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[7] See Berle and Means (1933), and Dodds (1932).

[8] See Porter (1992).

[9] La Porta et al (1998).

[10] OECD (1997).

Insider systems have usually been bank-centred. Patterns of corporate finance often show a high dependence upon banks and high debt/equity ratios. Instead of arm's length lenders, banks tend to have more complex and longer term relationships with corporate clients. Capital markets are in general less developed than in outsider systems. In contrast to the market-based system, which insists upon public disclosure of information, the insider system is more willing to accept selective exchanges of information among insiders. This confidential sharing of information is typical of the way a bank interacts with borrowers[11]. Reflecting the reliance on bank finance and the lack of sophisticated institutional investors, the range of financial assets available to the public has been comparatively narrow and banks have dominated financial intermediation. Regulatory policy often functions by prohibiting "speculative" activity rather than by insisting on strong disclosure. The elaborate systems to regulate capital markets that are found in market-based countries did not develop fully in bank-centred systems. For example, Germany did not have a national securities markets regulator until very recently; securities market regulation was left to the state *(länder)* governments or to the exchanges.

Insiders may control a company either by owning an outright majority of voting shares or by owning a significant minority holding and using some combination of parallel devices to augment their control over the company. Among the devices that are commonly used to redistribute control one can mention corporate structures, shareholder agreements, discriminatory voting rights and procedures designed to reduce the effective participation of minority investors. In general, the legal and regulatory system tends to be relatively permissive of such mechanisms.

Some corporate structures, particularly "pyramid structures", enable those with dominant positions in the parent company to exercise control with only a small share of the total outstanding equity of the firm. Other common ways of redistributing control are through issuance of multiple classes of shares with the insider group having increased voting power. Capped voting is used to limit the number of votes that investors may cast regardless of their equity ownership[12].

In some governance systems, cross-shareholdings are used to create significant shareholder cores, which are often used in combination with devices such as cross-guarantees and shareholder agreements to diminish the influence of non-controlling investors on corporate policy. This potential may be increased if the informal group has special linkages to other participants in the governance process (e.g. banks or government) or to management.

Shareholder agreements are a common means for groups of shareholders, who individually hold relatively small shares of the total equity, to act in concert so as to constitute an effective majority, or at least the largest single block of shareholders. Shareholder agreements usually give those participating in the agreements preferential rights to purchase shares if other parties in the agreement wish to sell and can also contain provisions that require those accepting the agreement not to sell their shares for a specified time. Shareholder agreements can cover issues such as how the board or the chairman will be selected and can oblige those in the agreement to vote as a block.[13]

In addition to outright redistribution of voting rights, some companies have voting procedures that place practical obstacles in the way of shareholders who wish to vote. In the past, many companies had tended to see the AGM as a formal exercise, which was tightly controlled by management. There may have been some possibility for shareholders to be informed by management, but the capability of shareholders to

[11] Reflecting the reliance of bank finance, Schmidt (1998) also notes that "accounting and disclosure in Germany is not primarily aimed at...investors but...the protection of creditors...".

[12] Pinto and Visentini (1998) provide for a fairly thorough review of such arrangements in their country reviews.

[13] See Fukao (1995).

voice their views, query management and directors and participate in decisions was narrowly circumscribed.

The combination of corporate finance patterns (i.e. high levels of debt finance) with ownership concentration and additional devices to shield management from outside pressure resulted in considerable cohesion within the insider group, which was virtually immune from discipline by minority investors. Even if the share price was bid to low levels, as long as the insider group maintained a consensus on appropriate corporate policy, outsiders were powerless. The fact that management could be controlled by a comparatively small identifiable group does not necessarily mean that the insiders were able to formulate and pursue better policies. In the absence of a clearly agreed long-term objective, such as financial returns to shareholders, "insider" companies seem to have considerable difficulties in specifying long-term goals. Since the interests of many stakeholders have to be reconciled, the company may tend to pursue a more diffuse, and possibly conflicting set of goals.[14]

Insider systems exist in several varieties. In some European countries, commercial banks play a leading role, with Germany being the classic example. It is worth emphasising that in these cases the banks are powerful, independent and mostly private institutions. The universal banking system enabled them to dominate all facets of financial intermediation, with the capital market remaining considerably less developed than in other high income countries. The German tradition is for each firm to have a “house bank” which took responsibly for most financial transactions of the company. We have already noted that bank- based systems often rely on confidentiality as information is shared between the bank and its corporate clients, an attitude which to some degree runs counter to that of outsider regimes which requires strong public disclosure.

In addition to holding considerable equity portfolios themselves, banks name representatives to the boards of the companies and are seen as exercising a leadership role in non-financial companies or among groups of companies. They are often seen as representing all shareholders: their power extends beyond direct share ownership, as they hold and vote shares for individual investors.

While Germany has the classic bank-centred system of governance, several other European countries, such as Austria, Switzerland, the Netherlands and the Scandinavian countries also display important features of this system. However, in the Netherlands, Switzerland and some Scandinavian countries, domestic institutional investors are significant and have some voice in corporate governance.

In some countries (e.g. France and Japan), the pattern has been one of interlocking share ownership among groups of financial and non-financial companies. In France, the process of privatisation that began in the mid-1980s posed a problem for the authorities of how corporations would be monitored after having been sold to private investors. Lacking powerful domestic institutional investors and wishing to develop a transitional form of governance, systems of inter-company holdings were elaborated that enabled French industry to maintain stable ownership and control. These cross holdings were supplemented by shareholder agreements.[15] In Japan the technique of control has been through *keiretsu* structures which brought together groups of industrial and financial companies and customers with suppliers. The Japanese system also had a central role for banks in which the main bank was expected to assume a leadership position within the group.[16]

[14] See Roe (1998).

[15] See Morin (1998).

[16] See Kanda (1998).

Numerous national variations on these models can be identified and all systems are undergoing rapid change. In the first place, it is worth mentioning that there have always been a number of systems, which stand somewhere between insider and outsider models. In particular, in the smaller English-speaking countries, such as Australia, Canada and New Zealand, the pattern of ownership is more concentrated than in the US or the UK with family-owned companies often predominating. However, the strong recognition of shareholder rights, institutional ownership of wealth, the tradition of strong legal regulation of securities markets and heavy insistence on transparency in accounting give these systems many points in common with the US and UK. Countries with this kind of system in general have less experience with the phenomenon of activism by major institutional investors as a factor influencing change in corporate governance. On the other hand, they have extensive experience in dealing with the problem of balancing the interests of controlling investors with those of minority investors, particularly through strong systems to promote securities regulation, rules governing transparency and disclosure and strong requirements of independence for board members

The family/state model

The main characteristic of this sub-category of the insider system is, on one hand, the important role of a small number of "founding" families of entrepreneurs in many areas of the economy, and the pervasive role of the state on the other.

The founding families and their allies usually exercise control over an extensive network of listed and non-listed companies. They are often shielded from risk by directly holding only a limited number of shares. Most of the rest is held by other corporations in the group or other "friendly" agents. Often, a minority is floated on the local exchange. The families that control the Korean *chaebols* own an average of less than 15% in group companies, the rest of the controlling blocks being held by other affiliates in a complex web of cross shareholdings.[17]

A common characteristic of such systems is that the concept of limited liability, i.e. the separation between the shareholders and the corporation (which has its own decision-making mechanism and assets/liabilities), is weak. In Greece, it was standard practice for the banks to ask for guarantees by the individual family shareholders for the granting of loans. In Korea, one of the most important hidden liabilities within *chaebols* was the cross-guarantees for bank loans between *chaebol* affiliates. All decisions related to the strategy of different affiliates within the group, including the ones that are publicly quoted, are taken by a small group of family-related individuals in an informal way - i.e. outside the governing instances of the corporations (board and general meetings).

Sweden is an example of a traditionally family-dominated ownership system which through evolution over time now contains elements of both the "market-based" and the "insider" systems. The Swedish stock market is highly liquid and supported by a market-oriented legal framework of company law, securities regulations and disclosure practices. As in many other countries, institutional investors have successively come to dominate the scene with direct private ownership falling from about 70% of the market value in the early 1960s to less than 20% today. Foreign investors hold approximately one-third of the market value. Despite these distinct features of a market-based system, the owners of Swedish companies have generally been able to maintain and exercise considerable influence over corporate affairs. This is partly due to the role of intermediary investment companies. These investment companies are themselves listed joint-stock companies and serve as financial intermediaries undertaking minority investments in a few selected companies, which they actively monitor. The ownership function is also upheld by the system of multiple voting rights which reinforces

[17] See OECD (1998).

the role of active owners. By 1992, the largest owner controlled on average 46% of the voting rights in the 62 largest Swedish corporations, and the five largest controlled on average 72%. The regulations regarding voting rights coupled with strong protection of minority shareholders, illustrate the emphasis Swedish authorities have placed on enabling active ownership to be established in Swedish corporations.

Alongside the few large family conglomerates there is often a pervasive influence of the state in the economy. The entire infrastructure as well as large parts of heavy industry and the financial system are usually in the hands of the state. This can be seen both as a result and a cause of the rise of family-based conglomeration: on one hand, the state has to be able to counter the concentrated power of these Shumpeterian giants. On the other hand, family-based businesses feel that they have to acquire political weight against such an overwhelming state presence by branching out in as many sectors as possible. There is a premium for sheer size, employment capacity and political voice.

In these systems, outside financing of the firm is overwhelmingly bank-based, as equity and the corporate bond markets are underdeveloped. Hence, the behaviour of the banks as monitors of corporate behaviour is very important. But banks are rarely the solid, independently governed and tightly regulated institutions that have become the norm in most OECD countries. Very often, banking systems are state-centred. In Italy, Greece and Turkey more than 50% of banking assets were under state ownership until the early 1990s. Frequently, banks had ownership ties to their main corporate borrowers. In Korea, banks were only nominally privatised in the early 1990s, with control being left largely to the state.[18] Controlling the banking sector is crucial because it is used as a conduit to direct credit to selected sectors or, alternatively, to control the expansion of non-state industry. This credit rationing function has resulted in weak corporate governance of banks, a very low capacity to analyse credit risk and inadequate regulatory supervision of the banking sector. Competition has been kept at bay with strict restrictions or total bans on commercial banking for foreign financial institutions. At the end of the day, banks become either conduits of state subsidies or captives of the family controlled conglomerates.

A common trend in most of these systems has been the persistence of deficient market exit arrangements. High entry barriers, hidden subsidies to the local industry, and (usually indirect) obstacles to foreign direct investment lower contestability; hence, exit becomes less likely. Often the state steps in to either arrange marriages between failing corporations or take over failing firms in order to restructure them. The social safety net that usually serves as a counter weight to labour flexibility is weak or non-existent. Last but not least, insolvency legislation is rarely used as a means of reallocation of resources. Most of the time, it remains an antiquated mechanism, punishing debtors without benefiting the creditors.

But the family/state model has also produced some notable benefits, especially at the early stages of development of these economies. The stability of ownership, high degrees of reinvestment of earnings, long-term commitment and firm-specific investment by stakeholders in firms has contributed to high rates of growth. Where the state managed not to be captured by either the interests of the "founding" families or of its own expanding bureaucracy, its presence may have actually encouraged investment and lowered the cost of capital. However, as these economies moved to a higher gear in terms of value-added and capital intensity, they also moved away from these arrangements in order to tap into international capital markets. This has caused some important institutional shocks.

[18] Thompson (1999).

III. The changing role of corporate governance principals

Families, corporations and other blockholders

In the previous part, we briefly examined some stylised versions of ownership and control systems to be found in the OECD area. In some of them concentrated ownership plays a predominant role in the way enterprises are governed. Controlling owners are the centres of gravity in these systems, high in stability and long-term commitment but low in flexibility and the capacity to attract outside investment. There seems to be growing evidence that the role of these agents - we could generically name them "blockholders" - in both insider and outsider systems, is evolving.

Firms are beginning to address the obstacles to outside investment that cross shareholding arrangements represent. In France, the last few years have seen a systematic trend at unwinding such positions in every sector. From 1993 to 1997, inter-company holdings declined from 59% to less than 20% of total market capitalisation. Core shareholdings, or *noyaux durs*, in French companies declined by almost a third during the last decade.[19] The same wind seems to be blowing in Japan, where the simmering crisis in the financial sector seems to have shaken the foundation of several *keiretsu* and has signalled the beginning of the end (through the unwinding of complex cross-shareholding) for some of them. From 55.8% of total market capitalisation, Japanese cross-shareholdings have come down to 45.7% in 1997, while anecdotal evidence suggests that this trend has accelerated substantially in 1998-1999.[20]

This trend has also been reflected in the tighter regulation of other control devices such as interlocking directorates. Directors in French and Italian publicly-held companies have been subject to stricter rules in recent years, as regards the number of board seats that they can occupy in different corporations.

Transparency related to ownership patterns (such as consolidated or combined balance sheets) has been the order of the day since the early 1980s in many OECD jurisdictions; the 7th European Company Law directive dates from that time. Better disclosure of business combinations has been one of the less acknowledged yet fundamental causes of the development of equity markets in economies dominated by complicated, obscure ownership arrangements and blockholder control. Intensified disclosure of off-balance sheet transactions (such as debt guarantees or, recently, derivatives) is also becoming the norm in most OECD countries.

The fullest glimpse of the forces of convergence at work can be had by looking at the behaviour of blockholders in some of the countries concerned. In Sweden, the Wallenberg family is restructuring its whole portfolio of holdings with the aim of becoming an arm's length investor with a mainly financial perspective and more international portfolio diversification. Japan and, since last year, Korea, have allowed the formation of holding companies (previously prohibited) with the goal of rationalising equity holding by blockholders. At least in their public pronouncements, some owners of Korean *chaebol* are slowly coming to realise that a shareholder-, rather than firm-driven diversification strategy is better adapted to global, open capital and product markets.

Convergence forces are also working in outsider systems. Alongside the evolution of rules-based governance mechanisms for the established "blue chip" companies, there has been a greater recognition of the possible benefits of continuing involvement by the founders of the firm and the resulting concentrated control patterns. Most of the hugely successful, high-tech firms are still closely-controlled, albeit publicly

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[19] See Loulmet and Morin (2000).

[20] See Yasui (2000).

quoted. Private equity, venture capital and other forms of “patient” capital have adapted to this type of ownership and control arrangements. The willingness to accept “close” control arrangements has not been limited to private, closely-held corporations. Exchanges that specialise in newer and more innovative firms, notably NASDAQ, are often accommodating to closely controlled companies, mainly by recognising multiple voting structures and different classes of common stock.

Management

The corporate governance discussion started along the lines of the Berle and Means paradigm of large corporations with their share ownership dispersed among millions of small shareholders, and effectively run by their management. Management is seen to wield enormous power because of the high monitoring costs and pervasive free rider problems encountered by the shareholders/principals. Effective control by managers allows them to pursue their own opportunistic goals instead of maximising the present value of the firm to its shareholders.

When management succeeds in de-linking its welfare from the interests of the shareholders, the only real means of enforcing accountability to shareholders is through the take-over mechanism. But transparency, technology and institutional ownership are rapidly changing the assumption about exit being the only way for shareholders to deal with a badly-managed, broadly-held corporation (see next section). As for transparency, increasing disclosure on how firms generate and use their cash flow as well as various forms of non-financial disclosure have rendered managerial intentions and strategy more accessible to shareholder scrutiny. Direct disclosure of executive compensation and a widespread effort to align managerial pay schemes with shareholder interests have also contributed to higher constraints on managerial opportunism. Exchanges in the UK and Australia have put forth self-regulatory codes of conduct on executive compensation. Most of these codes provide for a compensation committee headed by independent (i.e. non-insider) board members and accountable directly to shareholders.

Transparency would be both expensive and meaningless without adequate technology. The amount of disclosure that a firm can easily provide today by using sophisticated computer systems would have been prohibitively expensive but to the largest of firms only a decade ago. On the other hand, the information currently generated by publicly-quoted firms would be largely meaningless if the corresponding software models for processing it were not available. The possibility to understand managerial behaviour through the available information and to offer to shareholders the possibility to vote or otherwise sanction management relatively cheaply is a key driver of the current trend to exercise shareholder “voice” rather than “exit".

Again, convergence is not only happening at one end of the spectrum. “Insider” countries used to experience low levels of managerial opportunism, due to concentrated ownership patterns. However, managers would be more attuned to blockholder interests rather than those of the shareholders as a whole. But recent trends in many European economies and in Japan to enhance performance-based pay might be about to change all that. Managers are increasingly becoming residual claimants. Consequently, their interests are more and more aligned to those of shareholders in seeking to maximise the present value of the firm.

Financial institutions

Market developments are obliging many financial institutions to adapt their governance-related strategies. With deregulation and growing international competition, the financial services industry confronts the prospect of consolidation and a requirement to generate profits. In pursuit of this goal, financial institutions are trying to find their optimal size and product mix. In this process of refocusing, corporate governance activities are seen more and more as distracting banks from their primary mission of financial intermediation and credit selection while creating conflicts of interest. Banks increasingly find that they have been expending considerable energies in exercising governance rights over companies. In recognition of this new reality, the two largest German banks have separated their long-term equity holdings into separate companies; this is possibly a first step to divestiture. Similarly, in Japan the traditional ties of banks to industrial companies are loosening, as companies go directly to the international capital market for financing while the main banks have been seeking to disentangle themselves from non-financial affiliates in the recent banking restructuring.[21] In many European bank privatisations, the share issue has been accompanied or preceded by the sale of bank equity positions and a tightening of bank balance sheets.

Perhaps the most radical change of all can be found among the institutional investors. In those countries where institutional investors have not been significant, there is a considerable growth, especially in the mutual fund industry. With pension reform, a considerable growth in pension funds is also likely to occur, especially in countries that have up to now relied on pay-as-you-go, state pension systems.[22] In countries where institutional investors are already important, they tried to pursue "arms-length" relationships with companies in which they invested and, to defend their interests by selling shares when performance failed to live up to expectations. They could be characterised as "buy and sell" investors or active portfolio managers. A significant part of the institutional investor community, especially the pension funds, now finds this strategy unrealistic. This is because most of the pension fund assets are in portfolios that track indexes, thus limiting the possibilities of exit as regards individual firm shares.

In order to address limited exit possibilities, funds have found it useful to engage in "relationship investing."[23] In the US, the private pension funds have also faced the legal obligation to vote their shares and to make efforts to cast informed votes, thus requiring a certain amount of investor activism. Many public pension funds embarked on investor activism by targeting under-performing companies and seeking to induce the management of these companies to change their behaviour. In the UK, the legal requirements to become active have been less, but the concentration in the funds management industry has been even greater, meaning that exit is now a less realistic strategy than in the past. Additionally, the insurance industry in the UK has adopted an activist position.

A significant share of the institutional investor community has in effect altered its traditional "outsider" approach to investment. In a stylised manner, one could say that in the past fragmented investors each studied carefully the reports issued by companies and occasionally voted at annual general meetings while contact with management was to be scrupulously avoided since it carried the risk of conferring insider status, the main defence being to sell the shares of under-performing companies. Today, by contrast, investors have a far wider range of weapons in their arsenal. They have formed associations to share information, communicate with management and occasionally urge management to change its behaviour radically. An entire industry has emerged to support the activist investor community, by producing and sharing company information and by forming groups to advocate changes in law and regulation, to define and to advocate better corporate governance practices and to highlight needed changes in practice on the part of corporations.[24]

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[21] See Yasui (2000).

[22] See OECD (1998b).

[23] For a description of what a large institution wants to see in a company in which it invests and the kind of relationship it wants to develop with it over time, see Clapman (1998), who describes the corporate governance policy of the largest US pension fund, TIAA-CREF.

[24] See Latham (1998) and Gilson-Kraakman (1993).

Not all investors have adopted a strong activist stance. The mutual fund industry, one of the fastest growing sectors of the financial services industry, is generally far less committed to activism than the pension fund industry. This partly reflects the fact that the mutual funds must differentiate their products by applying their skills in assembling portfolios that are different from those of competitors and must demonstrate their portfolio management skill; they thus do not emulate but try to beat indexes. On balance, this sector is more likely to continue to pursue “buy and sell strategies”. Nevertheless, while on average the mutual fund industry is less committed to activism than the pension fund industry, the trend among all mutual funds is to engage in some forms of activism, particularly by voting their shares.

In summary, banks in the insider systems are increasingly taking on many characteristics of the market-based outsider system. Meanwhile, the outsider system is evolving considerably, as a significant share of the investor community has moved away from the traditional “arm's length” relationship towards “relationship investing” and more active interaction with corporate management.

The state

In the post World War II years, the state assumed an important role in the economy of most OECD Member states as a regulator and (with the exception of the US) as an important owner of productive assets in the economy. This role has been radically redefined in recent years through the twin processes of deregulation and privatisation.[25] The reasons for a big state were multiple: there was a strategic and political economy dimension in the context of the cold war; there was a need to address income inequality in earlier forms of unbridled capitalism; there were concerns with consumer welfare, as natural monopolies were deemed hard to contain within “generic” competition rules; there were also financial considerations in a world where large capital flows were mostly state-related and the vast sums of capital needed to finance infrastructure investment could only be supplied with the direct participation of the state.

It is not within the scope of this paper to analyse the enormous changes that occurred in all of the above areas, generating privatisation, deregulation and commercialisation. We should nevertheless delve briefly upon certain corporate governance aspects of this equation. Privatisation was largely a response to enormous flaws in the corporate governance of state-owned enterprises (SOEs).[26] In most OECD countries, the process of decision-making, of the appointment and firing of the directors and managers, and the setting of objectives were largely politicised.[27] Economic efficiency receded into the background as the short-term interests of political agents became the principal motivation behind corporate strategy. Even in the few OECD countries (like France, for example) where an economically sophisticated bureaucracy and highly specialised and educated class of SOE managers emerged, the accountability problem did not go away: SOE corporate governance has been likened to a series of agents without principals.

Widespread state ownership in the economy resulted on the blurring of the lines between a legitimate public interest in the way certain goods and services (especially infrastructure and utility services) are supplied to the population and the commercial character of the production of such goods; firms found themselves following conflicting incentives; neither the public interest nor the commercial objectives were met.

In answer to the above shortcomings, OECD Member countries undertook an enormous privatisation effort. While privatisation in these countries as a whole had given proceeds of no more than US$ 20

[25] See Nestor and Mahboobi (1999).

[26] See Estrin (1998).

[27] See Boycko et al (1996).

billion in 1990, by 1997, this figure had increased to more than US$ 100 billion. The global figure (i.e. including non-OECD Members) for privatisation in 1997 was US$ 153 billion.[28]

Privatisation has resulted in one of the most swift and dramatic changes of context for utilities and infrastructure industries. Intense global competition between large multinational companies (both for markets and capital) with deep roots in the capital markets has replaced a landscape of national, over-regulated monopolies in fragmented markets, financed primarily through budgetary sources -- mostly, deficits.

Evidence on privatisation experience to date has consistently shown that change in ownership improved performance considerably at the firm level, in terms of both productive efficiency and profitability.[29] This is largely the result of vast improvements in corporate governance. In terms of wider objectives, such as fostering the development or further expansion of equity markets, privatisation has also been a great success. Countries like Italy, Spain and Portugal have seen the capitalisation of their stock markets more than quadruple as a result of privatisation in recent years. Hence, privatisation has created the conditions for a profound change in the corporate governance context.

Commercialisation of corporate governance of SOEs is a twin development to privatisation in many countries, including France, New Zealand and most of the Nordic countries. While some firms were kept in the public sector for a number of different - mostly, political - reasons, important reforms took place in the way these firms are governed. A clear regulatory and institutional separation between public interest and commercial objectives took place. The state as owner (through the treasury institutions that were mandated to pursue these interests) concentrated on maximising shareholder value; this task was facilitated by the partial floatation of companies, which gave them a market value. Public interest and consumer welfare objectives (i.e. public policy issues) were assigned to different institutions. This has helped to clarify objectives and contributed to SOEs coming closer to private commercial firms, in terms of corporate governance.[30]

Employees and other stakeholders

By "stakeholders" the corporate governance literature has come to refer to a host of different interest groups intimately linked to the development of a corporation other than its management, its board and its shareholders; we have already discussed the role of the banks. We will now discuss briefly the role of the employees and also allude to other interests that in some cases have laid a claim as corporate governance principals, such as main suppliers or communities.

Many countries have long recognised the importance of stakeholders in their corporate governance systems, in various ways. Germany, Netherlands, Belgium and Austria provide for seats in their supervisory boards[31] for employee representatives. In Japan, the supply chain is intimately linked through cross shareholdings, the backbone of the *keiretsu* system. In the US, employees are the beneficiaries of Employee Stock Ownership Plans (ESOPs), which might wield considerable corporate power and in some cases even control the corporations.

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[28] See OECD (1999c).

[29] See, among others, Megginson et al (1994).

[30] See Nestor and Mahboobi (1999).

[31] In two-tier board systems, the supervisory board is responsible for hiring and overseeing the management board. The latter is actually running the day-to-day business of the corporation.

There are two issues here and they are often confused. One is whether employees can be viewed as something more than salaried labour from a governance perspective. Employees in OECD countries, where the economy is more and more knowledge-based and centred on the generation of higher added value, are seen as making firm-specific investments that complement monetary investments by shareholders. The same can be said of long-term suppliers - especially exclusive ones, franchisees and communities that play host to one firm/factory.[32]

On the other hand, the concept of firm-specific investment should not be confused with that of incomplete, uneven or unfair labour contracts: for example, the fact that labour is affected in a more direct way by certain corporate decisions and its inability to contract these away is recognised and protected by states through a set of mandatory provisions - labour law.

The second issue is how to address the reward of those investments. Most (if not all) corporate law systems recognise that the reward of investment (monetary, in-kind, firm-specific or other) is participation in the residual gains of the firm. This residual reward is present in the case of the *keiretsu* and the US/UK ESOPs. In fact, high firm-specificity of employee contributions is directly reflected in the relatively high share ownership by employees in the US high tech/software industry. On the other hand, there is little specificity in employee contributions in older, smokestack industries.

Direct (i.e. devoid of ownership) control rights, such as co-determination in Germany and other countries, do not seem to address the firm-specificity issue as they do not discriminate between industries or the nature of employment. Most commentators seem to agree that there are specific social/historical reasons for co-determination.[33] These reasons are illustrated by a strong history of "public interest" and often heavy state control of corporate chartering in Germany[34]. One consideration, pointed out by Hopt (1998) is that in the hitherto dominant model of corporate governance in Germany, co-determination may have "…fulfilled a consensus building function between capital and labour". But as capital becomes less and less bank-sourced and more market-based, co-determination may hinder adequate representation of these "new" capital providers.[35]

IV. The main causes of convergence

The globalisation of markets

The growing integration of financial markets is a key factor of convergence of corporate governance systems. Investors in most countries increasingly accept the proposition that holding an international equity portfolio leads to higher returns and lower risk than a purely domestic portfolio. As a result, many pension funds now allocate a certain portion of their portfolios to international equities while a large number of specialised mutual funds have been developed to allow individuals to participate in foreign equity investment. As of now, this phenomenon of international diversification is mostly visible in countries which already have strong institutional investor communities, but as other countries succeed in developing institutional saving, one would expect it to be generalised.

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[32] See Blair and Stout (1997).

[33] See Hopt (1998), Pistor (1996) and Roe (1998).

[34] Pistor (1998) argues convincingly that co-determination was "purely" political. Corporate governance considerations were viewed as externalities by its designers.

[35] Roe (1998).

At the same time, non-financial companies realise that broadening the investor base will lower their cost of capital and may also lessen volatility in the price of the company's stock. The desire of non-financial companies to attract international investors is manifested in several ways. Many companies are seeking to be listed in overseas markets. Special international tranches of public offering are frequently targeted to overseas investors. Facilities such as depository receipts have been developed to facilitate foreign investment.

The decision to rely on the public equity markets automatically increases the importance of institutional and foreign shareholders thus obliging management to give more consideration to the values of the new owners. The pattern of privatisation, high equity issuance and loosening of traditional inter-company ties has led to some remarkable changes in the equity ownership in some countries. In France, the combined share of foreign shareholders and financial institutions (banks and institutional investors) rose from 27% in 1993 to 55%[36] in 1997 while in Sweden those two sectors rose from 34% to 64% of total equity holdings during the same period.

The growing wish of both investors and issuers to operate in the international capital market requires some degree of acceptance of common values and standards. Institutional shareholders have brought with them expectations about shareholder value and are requiring firms to establish profit targets and to produce competitive returns on equity. Institutional investors also insist that companies respect international norms of governance, particularly concerning the duties of management and controlling shareholders to respect demands of minority investors concerning transparency and the procedures for exercising corporate control, especially at the shareholders meeting. Thus, in addition to the legal and institutional changes which are occurring in their home countries, companies are forced to adapt their behaviour in order to be able to tap global capital markets. Another big change that is favouring international convergence in corporate governance norms is the globalisation of product markets. Although trade liberalisation clearly predates financial market globalisation, its impact on corporate governance has not always been discernible.

There seem to be two powerful incentives for better corporate governance connected with the globalisation of product markets as well as with domestic deregulation. The first one is linked to the proposition that in a monopolistic environment there is less of an incentive to promote better corporate governance. A monopolist may be under less pressure to produce profit than a competitive firm and, in any case, will have greater capability to attain profit without basic adaptations of corporate strategy due to relatively weak competitive pressures. Hence monopolists may be more likely to retain older patterns of corporate organisation, cost and financial structures. But openness to competition makes it hard to retain old patterns. As competition intensifies, companies soon realise that there is a whole "corporate governance technology" that needs to be imported in order for production to become more efficient. This might include the way stakeholders (for example, employees and suppliers) interact with the firm; the ways in which corporate finance (and the resulting governance rights of outsiders) is intimately linked with innovation and research and development; and that, ultimately, higher productivity and the resulting competitive advantages depends on the effectiveness of corporate institutions that take decisions and develop strategies.

An example of the impact of product market globalisation on governance patterns might be found in the changing role and diminishing importance of firm-specific suppliers. Globalisation coupled with the communications revolution allows even smaller enterprises to locate suppliers easily in remote parts of the world. This reduces the need to develop close ownership or control links with hitherto long-term suppliers. Firms in many countries (for example the members of Japanese *keiretsu*) find it more beneficial to divest

[36] See Morin and Loulmet (2000).

their stakes in suppliers (or major customers) and concentrate on providing more returns to their shareholders.

Market-driven or functional convergence[37] may be the most important force behind the emergence of international principles, such as the OECD Principles of Corporate Governance. The Principles are the first multilateral instrument in the area of corporate governance and the most important attempt to date at establishing elements of a global corporate governance language. Their preamble, however, suggests that a systemic convergence of legal systems is not part of their direct objectives:

“The (Principles') purpose is to serve as a reference point. They can be used by policy makers as they develop their legal and regulatory frameworks for corporate governance that reflect their own economic, social, legal and cultural circumstances, and by market participants as they develop their own practices".[38]

Path dependency and the politics of governance

The political and historical reasons for national idiosyncrasies in economic organisation have been the topic of many discussions among scholars. Some[39] have argued that history has sowed considerable divergence into national systems which are “path-dependent” and, hence, unlikely to converge at least in the medium-term, notwithstanding pressures from the capital markets. In other words, the dynamics of history should not be taken lightly when it comes to the shape of legal norms and institutions.

While political and institutional resistance to alien concepts, irrespective of their perceived efficiency, is a considerable constraint to convergence[40], these factors should not be overestimated in OECD countries, especially in our post-cold war, Internet era. Citizens are increasingly open to foreign ideas, customs and norms. The acquisition of major industrial companies (for example, Chrysler by Daimler Benz) or financial institutions (see the fate of the quasi totality of the British merchant banks) by foreign competitors does not seem to have caused any political problems. Shareholder activism *a l’americaine* seems to be paying well even in such a staunchly “continental” corporate governance environment as Switzerland’s; and recently a company which only two years ago was a state-owned telecom monopoly was subject to a highly contested hostile take-over bid in Italy.

There is also top-down convergence. The increasing exposure of policy makers to regional and global policy debates and the importance of international dialogue in shaping leaders’ minds about reforms is more intense today than it was just a decade ago. European integration has made possible the implementation of a number of policies - such as widespread privatisation - that were hitherto politically unthinkable. The availability of other countries' experience and the wish to be part of an open world has made a lot of changes possible. Korea is a case in point: previous governments would have thought of announcing the sale of two of Korea's largest commercial banks to foreigners within the same month as nothing short of political suicide. Finally, the fact that a group of government officials negotiated a “universal” text such as the OECD Principles in one year’s time speaks volumes about the political trends of convergence that are developing.

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[37] See Gilson (1998).

[38] OECD (1999).

[39] Bebchuk and Roe (1998).

[40] See Charny (1998).

Legal convergence

Finally, there is the issue of laws and regulations. Legal infrastructure and its dynamics are included in the path dependency argument as they are an important part of the institutional apparatus, but it might make practical sense to look at them separately from the rest of political and social institutions. Widely differing systems of corporate law and securities regulation have been credited with an important role in explaining divergences between national ownership and control environments. Some commentators have made a distinction between common law and civil law countries and have analysed the impact of the two systems on governance. Under common law, the firm can contract out of most legal norms. In contrast, civil law, with its more rigid statutory rights, is perceived as less flexible in terms of economic decision making.[41]

Company law itself comes in many different shapes. The central concept of limited liability may be treated differently in different jurisdictions. In some countries, the "firewall" between a corporation and its shareholders is impenetrable, but for the worst kind of abuse. Others take a less austere view. In Germany, group legislation allows for piercing the corporate veil in situations where one firm in practice assumes decision-making functions of another.[42]

In the Anglo-Saxon tradition, the corporate concept is based on a fiduciary relationship between shareholders and the managers. In the continental tradition, the company has an independent will, i.e. in theory, what is good for the corporations might not be good for its shareholders. These differences penetrate down to company law particulars such as shareholder rights, the role of statutory capital and the responsibility of the board, just to mention a few.

However, these differences might not be as important as they look and they might be getting less and less important. All countries recognise the preponderance of owners as the final arbiters of corporate strategy and make the concept of residuality central to the governance structure of the corporation, albeit at differing degrees. In addition, the increasing importance of equity markets have subject a large segment of the corporate sector to securities regulation - statutory law that firms cannot contract out of and that is fairly similar in common and civil law countries[43].

It seems that corporate governance-related legislation has been converging over the past few years. Recent German legislation has substantially tilted the control of the decision making process toward shareholders and has increased transparency in the way accounts are prepared, especially as regards consolidation; it has also made important steps in facilitating take-overs. In France, the 1997 Marini Report on company law reform, recognised the need for a "contractualisation" of French company law, by allowing firms more liberties in the way they shape their financial structures. In Italy, the so-called "Draghi" law of 1997, significantly increased shareholder rights. In all of the above countries share buy-backs were allowed, in recognition to the fact that companies need more flexible tools to return money to their shareholders. At the other side of the spectrum, the US Securities and Exchange Commission is becoming more tolerant of "relationship" investors and is more and more willing to grant so-called "safe harbours" for consultations between them and company management.

Finally, convergence is also the result of an increasing tendency of large firms to "choose" their regulatory environment. This, of course, is not due to legal eclecticism but rather to the need to tap the most liquid

[41] See La Porta et al (1997).

[42] See Hadden (1983).

[43] Coffee (1998) points out that "... convergence can occur (and is arriving) at the level of securities regulation, even while corporate law convergence has been largely frustrated".

and cheap sources of capital. By choosing, for example to list their shares in the NYSE, large companies from a growing number of jurisdictions become subject to US securities rules and accounting norms. This will in time have a powerful impact on the shape of rules and institutions in their home countries.[44]

V. Conclusions

We have seen from the above discussion that convergence is indeed taking place for reasons related to the globalisation of financial and product markets, an increasing proximity of legal and institutional norms and a more open circulation of and attitude towards foreign ideas. Having said this, one should not expect uniform corporate governance institutions and arrangements in the world, just as one cannot expect the end of nation states in the foreseeable future. Ownership and control arrangements are still a part of a society's core characteristics and will remain to a considerable degree idiosyncratic.

More cross-border equity investment and the growth of domestic and international market institutions should be expected to result in a better mutual understanding between overseas investors and companies and consequently in an increased capacity for companies to access international sources of finance. Investors need to understand and assess their investments. Convergence in transparency and useful disclosure norms is therefore a key area where a lot needs to be done.

A growing consideration of stakeholder interests is viewed increasingly as a key growth factor in the long-term value of companies. In multinational companies, stakeholders come from many different countries. The emergence of unified strategies to deal with these issues across national boundaries is in itself another driver of convergence.

The OECD Principles of Corporate Governance are both a result and a facilitator of convergence. Without the latter, the need for a common language between the 29 Member states of the OECD and beyond would not have emerged. The multilateral character of this instrument testifies to the strong consensus emerging for the need of a common understanding on these issues. On the other hand, 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. As this article has demonstrated, the variety of corporate governance arrangements found among OECD countries gives the Principles a universal character that transcends the developed/developing demarcation line.

Last but not least, convergence does not mean victory of one system over another. It should rather be seen as giving more choices to the enterprises, when it comes to following a corporate finance and governance "path". In fact, the patterns of ownership and control should ultimately correspond more to the needs and characteristics of a particular enterprise than to the "system" prevalent in the country. Firms should have the possibility to move smoothly from one regime to another as they grow and their needs and constituencies change.

[44] See Coffee (1998).

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