

Editorial introduction

Convergent and divergent trajectories of corporate governance

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Abstract: This Special Issue revisits the classic question of comparative corporate governance research, namely whether national corporate governance systems are converging. More specifically, it focuses on several ‘convergence vectors’ which comprise the political, legal, economic and social arrangements that influence or drive the international trajectories of governance systems toward a common denominator. Taken together, the contributors to this Special Issue invite us to think critically about the functional explanations commonly mobilized in favour of convergence and consider instead the convergence debate from a broader and more interdisciplinary point of view.

Keywords: Corporate governance, convergence, divergence, codes, accounting standards, banking, performativity

Introducing the issues

The prevailing consensus in the UK and other countries influenced by an Anglo-American approach to corporate governance is that companies ought to be run in the collective interests of their shareholders. This is generally taken to imply that the best way to approach the question of corporate governance reform is to consider ways that enhance shareholder power in a manner that is congruent with self-regulation. While the idea of strengthening the voice of non-shareholder stakeholders is regularly mentioned by policymakers, actual policy reforms invariably rest on the extension of shareholder influence. This was certainly the dynamic in the recent drive to reform corporate governance in the UK. The Department of Business, Energy and Industrial Strategy, for example, considered stakeholder involvement in governance at the consultation and Parliamentary debate stages (Department of Business, Energy and Industrial Strategy, 2016, 2017; Business, Energy and Industrial Strategy Committee, 2017), but little or no changes in this direction were visible in the new Corporate Governance Code subsequently released by the Financial Reporting Council.

The reluctance to deviate from the so-called ‘shareholder primacy norm’ is underpinned by a set of theoretical, empirical and normative arguments. One of the most potent among these is the belief that the market forces unleashed by financialization and globalization have produced a convergence toward a common denominator. Given the nodal as well as ideological centrality of Wall Street and the City of London, many believe this denominator to be the shareholder-centric model typical of Anglo-American capitalism, a state of affairs hyperbolically described as ‘the end of history’ (Hansmann & Kraakman, 2001). The conclusion is thus drawn that unilateral policy deviations from this global benchmark are ill-advised. For example, it is surmised, attempts to move toward employee or stakeholder representation on boards can only lead capital and talent to move to more

accommodating shores, eroding competitiveness and ultimately harming the very same stakeholders in whose name the reforms were proposed.

This paternalistic logic is buttressed by the belief that in countries whose corporate governance systems are not geared to the maximization of shareholder value, agency costs are rife, investor protections are weak and capital markets fail to allocate resources efficiently, with adverse effects on growth and innovation. Not surprisingly, in line with one of the key implications of the ‘law and finance’ literature (La Porta *et al.*, 2000), such countries seek to replicate the superior Anglo-American system. These countries do not really have that much of a choice, the thinking goes. As writers in the ‘law and economics’ tradition have argued, capital mobility creates the possibility of regulatory arbitrage among corporate law and governance rules (O’Hara & Ribstein, 2009). The same forces that explain why most US states tend to replicate Delaware’s General Corporation Law operate at the international level. When some countries successfully attract corporations, often through a combination of tax exemptions and investor-friendly policies, their competitors have a strong incentive to replicate the conditions of that success. The greater the number of imitators, the stronger the bandwagon effects which result in the widespread adoption of given bundles of rules.

It is easy to be seduced by such functional explanations, particularly given the observable operation of various political, legal, economic and social forces that drive the international trajectories of governance systems. Some ‘convergence vectors’ are directly concerned with corporate governance. For instance, stock exchanges around the world now systematically require that international standards regarding board independence, information disclosure, auditing procedures, and other ‘best practices’ originating in Anglo-American corporate governance codes be complied with as a condition for listing. Parallel developments include the globalization of financial reporting standards pushed by the

International Accounting Standards Board and other organizations, as well as the emergence of non-financial reporting standards pushed by the Global Reporting Initiative and others. Other vectors relate to broader trends which exert an indirect influence on the evolution of corporate governance rules and practices. One such vector is the partial harmonization of contract law produced by arbitration practices in international trade, a development also pushed by organizations such as the International Institute for the Unification of Private Law, whose Principles of International Commercial Contracts complement the OECD Principles of Corporate Governance. And another is of course the emergence and organization of global value chains.

However, such isomorphic tendencies do not, and doubtless will not, lead to anything resembling homogeneity. As the large literature on the varieties of capitalism and the related varieties of business systems (Crouch & Streeck, 1997; Whitley, 2009; Hall & Soskice, 2001; Amable, 2003; Crouch, 2005; Morgan et al, 2005; Hancke, 2009; Morgan & Whitley, 2012; Clift, 2014; Farkas, 2016) has emphasized, although some degree of convergence has occurred in some areas of corporate governance, there is strong evidence of persistent divergence in other areas of governance. This point has been widely recognized by comparative corporate lawyers (McCahery *et al.*, 2002; Milhaupt, 2003; Gordon & Roe, 2004; Siems, 2008; Fleckner & Hopt, 2012; Magnier, 2017) and has become an essential part of the conversation among corporate governance, human resource management, global value chains and international political economy scholars (Van den Berghe, 2002; Clarke, 2004; Lane & Probert, 2009; Rasheed & Yoshikawa, 2012; Noorderhaven *et al.*, 2015; Nölke & May, 2018). Whether they are explained by path dependence, institutional complementarities or political economy considerations, national differences, especially in the immediate post-Covid context, are likely to remain and potentially strengthen.

Introducing the contributions

The five articles collected in this Special Issue make an original, interdisciplinary contribution to comparative corporate governance studies. Several of the convergence vectors mentioned above are critically examined in both their formal and narrative dimensions. Special attention is given to the political economy aspects of the convergence process. Each article can be read independently but is more usefully seen as one of a set of complementary contributions.

The Special Issue opens with the provocative suggestion that the narratives and conversations about the legitimacy and suitability of imported norms, which must be involved in any process of convergence (and institutional change more generally), may have potentially performative powers. From this perspective, Jeroen Veldman and Hugh Willmott (2020) show how the widespread acceptance of agency theory and the attendant shareholder primacy norm, in the name of which convergence has more often than not been championed, can be understood using Emilio Marti and Jean-Pascal Gond's (2018) process model of self-fulfilling theories, which captures how social-scientific theories become performative in the generic, effective and Barnesian senses identified by Donald MacKenzie (2006). Generic performativity emerges whenever actors use a theory. Effective performativity arises when those uses have some effect on social reality. Barnesian performativity (named in honour of Barry Barnes's important work on self-referential and self-validating feedback loops known as 'bootstrapped inductions') occurs when those effects bring social reality closer to the assumptions or predictions of the theory. A theory becomes truly performative, Marti and Gond suggest, when certain boundary conditions are met at each of these three steps. Veldman and Willmott apply these ideas to the recent history of the theorization of the corporation.

Theories of the corporation have always relied on contingent and contested political economy claims regarding its status, purpose and governance. The complex narratives, behaviours and institutional changes that accompanied the weakening of managerial capitalism in the 1970s and its gradual replacement by the agency-theoretic shareholder value maximization approach, Veldman and Willmott contend, present a particularly clear case of ‘performativity in action’ where, in this example, agency theory contributes to creating conditions that lend credibility to its claims. The re-description of the corporation as a nexus of contracts and the depiction of shareholders as principals whose interests directors must serve (Jensen & Meckling, 1976) was eagerly embraced and effectively promulgated by powerful interest groups and norm entrepreneurs who gained positions of economic, legal and political influence. These actors have championed the radical reform of managerial education and have developed the financial instruments, corporate governance codes and accounting standards that determine the way governance, and its potential reform, are conceived. Crucially, this account challenges accounts of growing convergence that are couched in ostensibly apolitical, purely functional terms. Convergence, Veldman and Willmott conclude, must be viewed in light of the conditions shaping and legitimizing certain political economy outcomes.

The remaining contributions to the Special Issue are not expressed in terms of performativity, but underline, to varying degrees, the importance of these conditions. The globalization of financial reporting norms is a case in point. The economic rationale for compliance with International Financial Reporting Standards (IFRS) – with which listed companies in more than half of the world’s countries comply – focuses on how these facilitate financial transparency, reduce information asymmetries, foster convergent expectations, enable the cross-country comparability, lower the costs of capital and enhance

capital market efficiency.¹ The existence of such potential benefits, however, is insufficient to explain how local actors, in this case national accounting professionals, came to accept the legitimacy of imported standards and eventually adopted them. Andreas Jansson (2020) shows that in the Swedish case, prior to its formal adoption across the EU in 2005, the gradual integration of IFRS was accomplished on a voluntary basis and accompanied by narratives revolving around the importance of capital markets and the inevitability of global standards, which political economy scholars have long argued are essential to the process of financialization (e.g. Nölke & Perry, 2007).

It is important to understand, Jansson argues, that the formal requirement to align with certain regulatory standards is often the end point rather than the beginning of a convergence trajectory. This is particularly the case with IFRS, which introduced a fundamental cultural-cognitive shift away from historical cost measurement to a capital market-based view of asset valuation (known as ‘fair value’ accounting). In line with the institutional perspective associated with Richard Scott (2001) and others, for such a shift to occur, powerful actors, including senior auditors, accounting academics and high-ranking corporate managers, must first embrace the normative foundations of fair value accounting and lead a process of discursive delegitimation and deinstitutionalization of existing practices, which makes room for the legitimation and institutionalization of a new set of practices. These changes are difficult to observe directly, but Jansson’s recourse to discourse analysis to study a corpus of articles published in the journal of the Swedish association of chartered accountants in the years leading up the formal adoption of IFRS reveals how they played out.

¹ See <https://www.ifrs.org/about-us/who-we-are>.

Part of the narrative process that allows the legitimation and institutionalization of new standards or rules that lawmakers and regulators propose to import involves presenting these novelties as necessary steps on the pathway toward efficiency. Tellingly, the rationale for introducing a corporate governance code invariably relies on the influential empirical research conducted by economists Rafael La Porta *et al.* (2000), which shows that this facilitates external finance, favours capital market liquidity and more generally enhances a country's attractiveness to business. One key problem with this approach is that it is assumed that the transplantation of legal rules from one institutional context to another is a seamless process which yields the expected outcome. Ulf Larsson-Olaison (2020) takes issue with this simplistic view. Legal transplants, he argues, are not merely products of technical or functional fine-tuning but typically result from complex political processes and compromises. They tend to be experimental and often lead to unexpected consequences. Furthermore, there are different ways to assess the degree to which a transplant is successful. Different criteria may be employed to evaluate a given legal transplant at different points in time.

Alternative evaluation criteria can be usefully depicted thanks to what Larsson-Olaison calls a 'transplant staircase', which comprises four steps. The first step or criterion (that he calls 'transplant as label') is rather superficial: the transplant of some international rule is successful if it can be found on the law books of the receiving country. A more substantive second step ('transplant as content') considers the degree to which the content of the formal rule is adapted to the local context, while the third step ('transplant as practice') captures the extent to which that content produces actual effects on local actors. Only then can the social outcomes produced in the source and the receiving countries be meaningfully compared ('transplant as outcome'). Applying these ideas to the Swedish Corporate Governance Code, which came into force in 2005, having been elaborated on the basis of the

UK Corporate Governance Code, Larsson-Olaison shows how the key features of independent directors, nomination committees and the ‘comply-or-explain’ approach fit into the staircase model. Overall, he concludes, there is more or less convergence, depending on the feature examined and the criterion used.

Sweden is just one of many countries around the world that have adopted a UK-style corporate governance code. Not surprisingly, the proliferation of codes has often been presented as a key convergence vector (e.g. Aguilera & Cuervo-Cazurra, 2004). Codes of best practice are ‘soft law’ or self-regulation tools that are meant to empower shareholders vis-à-vis otherwise entrenched managers by ensuring that independent directors are in a position to monitor managers thanks to robust disclosure procedures. This focus is sensible in the UK, where shareholding is dispersed, institutional investors actively monitor compliance based on the ‘comply-or-explain’ approach, and courts can be relied upon to protect shareholders rights. While the UK Corporate Governance Code may achieve its objective, the same cannot be said of most of the emerging and developing countries that have followed suit. In these countries, as Umakanth Varottil (2020) argues, concentrated ownership is the norm. Codes that are meant to empower shareholders only strengthen dominant shareholder control and enhance their private benefits to the detriment of minority investors, who are unable to rely on robust court systems to defend their rights. Measures specifically designed to ensure that directors act in the interests of minority shareholders are needed.

In this respect, Varottil explains, reliance on codes alone is insufficient, not least because remedies available to shareholders but also matters of director appointment and removal, all of which are essential in the prevention of self-dealing, related party transactions and other abuses, are normally dealt with in mandatory or ‘hard’ corporate law. But corporate law tends to reflect the political power of various interest groups, as Peter

Gourevich and James Shinn (2005) have argued, with the implication that blockholders in family- or state-controlled companies are able to successfully resist the sorts of legal changes required to protect minority shareholders. The enthusiastic adoption of international standards of corporate governance is a legitimacy-signalling exercise designed to attract foreign investments, with little changing under the surface. One way to tackle this problem, Varottil suggests, is to promote the adoption of codes specifically tailored to the governance problems arising in family-controlled and state-controlled companies. To date, very few of these codes have been adopted. The extent to which they may be beneficial, however, remains an empirical question that needs to be addressed, particularly in developing and emerging countries.

The comparative corporate governance literature often identifies instances of ‘decoupling’ between *de jure* convergence and *de facto* divergence (e.g. Rasheed & Yoshikawa, 2012). This pattern, as Olivier Butzbach and Gennaro Rotondo (2020) argue, does not fit the banking industry. Contrary to how banks are portrayed by Eugene Fama (1980) and other financial economists, banks are not just special kinds of firms. They are financial institutions that generate money claims on the economy which have public good features, and whose operation relies on high levels of personal and societal trust. They are more leveraged and more exposed to capital markets than other firms and must deal with a wider variety of agency problems (e.g. depositors and not just shareholders are principals). They are also more regulated and historically have adopted a variety of alternative organizational forms. In principle, these features reduce the likelihood of convergence in banking, but three decades of privatization and liberalization of banking around the world may have pushed banks, along with other corporations, toward a shareholder-oriented governance model. Surprisingly few studies have focused on this question to date.

Butzbach and Rotondo address this lacuna by considering the Italian case. For the most part of the 20th century, equity in most of the legal forms Italian credit institutions could take was held by public entities, whose boards were appointed by central, regional or local government. In the early 1990s, most banks were transformed into joint-stock companies and their capital was gradually privatized. By the end of the decade, a corporate governance code for listed companies was adopted. Today, contrary to many other Italian firms which remain family-controlled, the largest banking groups look very much like their Anglo-American counterparts, with diffused ownership and a few minority institutional investors. Yet obstacles to convergence persist. In line with European regulations designed to insulate banks from potentially destabilizing shareholder behaviour, there are legal limits on shareholder rights as regards the acquisition and sale of equity stakes, as well as limitations on the exercise of voting rights. Contrary to the political economy literature associated with Mark Roe (2003) and others, this state of affairs is not due to the resistance to change by powerful interest groups but rather to tensions within the law itself.

Competition & Change: uniquely placed to advance the conversation

Taken together, the contributors to this Special Issue invite us to shed simplistic framings and intuitions about the convergence debate. The processes underpinning the observed trajectories of convergence and divergence are complex and multi-faceted. Many (although by no means all) of the kinds of functional analyses employed in economics and finance assume straightforward causalities, ignore the constitutive powers of narratives, downplay the role of contingency and more generally miss many of the relevant political economy considerations. More specifically, they underplay the subordination of corporate governance reform to the prioritization of capital market efficiency and liquidity; and this priority is

represented in terms of Panglossian benefits to adopters rather than to owners and lenders of capital, with may impact growing inequality both nationally and internationally. This does not mean that the standard economic approach should be dismissed – it contains a ‘grain of truth’, but simply not ‘the whole truth and nothing but the truth’. An important question that institutional and political economy approaches can shed a light on is how and why this grain of truth is mobilized by sophisticated actors in the complex process of convergence (or institutional change more generally), and to what effect.

Competition & Change has long been devoted to advancing this agenda. In the past two decades, the journal has carried some excellent papers on corporate governance (e.g. Lane, 2003; Pendleton, 2005; Vliegthart & Horn, 2007; Aglietta, 2008; Rahim, 2012; Maisenbacher, 2018). We hope that this Special Issue will stimulate further research and help cement the journal’s reputation as an interdisciplinary outlet for critical perspectives on the causes and consequences of competition and institutional change with respect to globalization, financialization, corporate governance, and broader conceptualizations of capitalist relations.

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