Have Corporate Governance Systems in the World Converged in Recent Years?

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Abstract

This paper surveys prevailing corporate governance systems and examine whether there is a convergence of corporate governance systems throughout the world. Even though there have been many studies arguing for convergence and showing evidence of convergence, there are also equal amount of studies arguing against convergence and offering evidence against convergence. Since reforms of corporate governance in most countries were recently done or are still in progress, it may take several more years to observe and evaluate how economies have responded to global pressure of transparency and disclosure of information.

Keywords: corporate governance, convergence

I. Introduction

There is a wide variety of corporate governance systems in the world, and there has been an interest in determining the best corporate governance system. The market-based model adopted by the US and the UK has been praised as the best mechanism to contain corporate misconduct. In recent years corporate governance all over the world is under reform. The Sarbanes-Oxley Act, enacted recently in the US, made a significant change in the US approach to corporate governance and federalized some legal relationships governing the internal structures of US corporations. The OECD endorsed the Principles of Corporate Governance for its member countries in 1999 and made a revision in 2004. Both Japanese and Korean governments have implemented reforms on corporate governance in recent years.

With recent reforms in corporate governance all over the world, there have been many studies to examine whether cross-national patterns of governance are converging. As interest in the economic role and effect of corporate governance has increased markedly, the academic discussion about global corporate governance convergence has also increased. The global reality is that corporate governance convergence is happening. In Korea, the government carried out reforms on corporate governance after the Asian financial crisis of 1997-1998. These reforms include improving financial structure of companies by reducing debts, removing cross debt guarantee among affiliated companies, reducing circuitous equity ownership and unfair transactions among affiliated companies, enhancing accountability of controlling shareholders and management, enhancing transparency of transactions and disclosures, requiring representation of outsider directors on the board of directors by more than 25%, and closing loopholes in gift and inheritance tax provisions.

Corporate governance is about the control of the resources in firms. A system of corporate governance determines who makes investment decisions in corporations, what types of investments are made and how returns from investments are distributed. Some researchers (e.g. Groenewegen, 2004) approach this issue by asking who should control the firm and how this can be done efficiently from the perspective of institutional economics. Corporate governance is an important issue not only because it determines who control the firm, but also because corporate values are determined by corporate governance. There have been many studies showing that corporate governance affects firms' market values (Thomsen, 2004; Black, 2005).

In this paper, we survey prevailing corporate governance systems and examine whether there is a convergence of corporate governance systems. The next section presents different corporate governance systems with country-specific idiosyncrasies. Section 3 shows diversity in corporate governance system in the world and the reasons for diversity. Section 4 examines several factors contributing to convergence in corporate governance system in recent years. Section 5 surveys literature on convergence of corporate governance systems with a focus on empirical evidence from the U.S. Europe and Japan. In the last section we draw conclusions.

II. Corporate Governance Systems

Even though there are a wide variety of corporate governance systems in the world, successful market economies in the world have one of two distinctly different systems. They are the market-based system and group-based system. The market-based and the group-based corporate governance systems are the appropriate responses to different political and institutional arrangements. The market-based system is found in the US and the UK, thus called the Anglo-Saxon model, while the group-based system is found in the Continental Europe and Asia.

Market-based System (Shareholder Capitalism)

Market-based system of corporate governance is characterized by the separation of ownership and management, the existence of a widely diffused ownership structure, a strong emphasis on the protection of minority investors in securities law and regulation, liquid stock markets, a low level of inter-corporate cross holdings, and relatively strong requirements for disclosures. In this system, markets play a crucial role. Firms are diffusely held with no single owner owning a considerable majority of shares to exercise control over the firms. Companies are run by professional managers. Institutional investors are either the largest or dominant owners of equity and have a large monitoring role to play as can been seen from CalPERs. They tend to operate on the principle of portfolio diversification so that they have no intention to run the corporation. This system is called "market-based" because it relies heavily on the capital market. It is also identified as "shareholder capitalism."

Patterns of corporate financing in the market-based system show high dependence on equity financing with low level of debt financing. The capital market is not only the source of securing finance for the firms, but also the means for shareholders to discipline management. This market-based system is marked by the existence of markets for corporate control and readily available professional managers. These features of the system act as "checks and balances" on the expropriating interests of the managers.

The corporate ownership in the US is the best example of fractionated shareholding. Dispersion of share ownership is very wide compared to other countries. The largest category of corporate shareholders is institutional investors, particularly mutual funds and pension funds. US capital markets are well-known for their efficiency and liquidity. Legal provisions support the right of shareholders to control the corporation and make management accountable to the shareholders (La Porta, et al., 1997). Regulation has been structured to provide relatively complete information to investors. An independent regulatory agency, the Securities and Exchange Commission (SEC), ensures that equity is not accumulated by any one shareholding group by any unfair means like making premium payments to acquire firm shares. So, ownership is not concentrated in the hands of a few in the US corporate structure like in Europe and Asia.

The UK model of corporate governance is based on the principles of individualism, competition and a strong belief in market-oriented capitalism. Therefore ownership is highly fragmented with more equity being held by the institutions such as insurance companies and pension funds. However, no single institution owns a dominant share of equity in any corporation. As in the US, which follows the Anglo-Saxon corporate governance model, the UK has strong legal and regulatory provisions in place to protect the dispersed interests of shareholders.

Group-based System (Stakeholder Capitalism)

Unlike the market-based system, the group-based system is marked by concentration of ownership, highly concentrated voting powers, high level of inter-corporate crossholdings (Maher and Anderson, 2000). The ownership and control are relatively closely held by identifiable and cohesive groups of insiders who have long-term stable relationships with the company (La Porta, et al., 1999). Other features of this system include pyramidal ownership structures, bank-dominated relationships and familial control of the company. Capital markets are not as active as in the Anglo-Saxon model and they do not provide the means to discipline the management. Institutional investors are not dominant and sometimes face legal or regulatory restrictions on their investment in equity. In this system, interests of all stakeholders of the company are considered in major business decision-makings. Thus, this system is called "group-based" system or stakeholder capitalism. Banks play a very important role in the group-based system. In contrast to arm's length relationships with the corporations under the market-based system, banks under the group-based system tend to have long term relationships with corporations and exercise some control on corporate clients. Instead of public disclosure of complete information, this system relies on confidential sharing of information among insiders. Regulation has focused on prohibition of illegal or speculative activities instead of enforcing strong public disclosure.

A company may be controlled by owning majority of voting shares or by owning a significant minority holding assisted with some control-augmenting devices. These include cross-shareholdings, pyramid structures, and shareholder agreement. One device can be used in combination with other devices. For example cross-shareholdings can be used in combination with shareholder agreement or cross-guarantees. Cross-shareholdings are used to form substantial shareholder cores to diminish the influence of other shareholders on company policy. Parent company or those with dominant positions in the parent company can exercise control while possessing only a small share of equity through pyramid structures. Shareholders who hold relatively small shares of equity can have shareholder agreements to act in convert so that they can constitute an effective majority. These agreements oblige those in the agreement to vote as a block.

The corporate governance system of Germany is a bank-centered, group-based system. Banks control more of the corporate activities instead of shareholders, though ownership is shared by different groups of investors - banks, investment institutions, companies, government, and others. German capital markets are relatively small and less developed. Bank dominance and weak capital markets further compels the German companies to resort to borrowings from banks, giving much leeway for bank control. Each company has a house bank or main bank which takes care of most financial transactions of the company. While Germany exhibits the classic bank-centered, group-based system, several other European countries, including the Scandinavian countries, Switzerland, Austria and Netherlands, show very similar features as Germany's.

In France, the corporate governance system is characterized by interlocking share ownership among groups of financial and non-financial companies and the absence of a diverse investment community. The controlling interests in the French governance structure are held by the state, the banks and the corporate management - the state being the predominant player. The French business model has developed a complex network of cross-shareholding known as "verrouillage" in order to protect itself from strong competitors and hostile takeovers. Through the "verrouillage" net work, most of the shares are held by friendly companies. The French government exercises control over French companies directly through the ownership of company shares and indirectly through its control over banks which lend capital to companies. This control of French business by the French government is called "dirigisme."

The Japanese system is similar to the European group-based system with heavy reliance on trust and relationship. In Japan, cross-shareholdings and interlocking directorates has been through Keiretsu structure. In Keiretsu, groups of industrial and financial companies are brought together with suppliers, and banks play a central role. The dominant shareholder in Keiretsu is the main bank with a considerable amount of ownership shares. Instead of making short-term gains, banks fund firms to build strong long-term relationships and to make long-term gains. Unlike in other countries where banks recall the loan amount as soon as they sense that the firm is going out of business or becoming bankrupt, Japanese banks support their client firms by pumping in more capital at critical times. This system works out very well during the normal or booming economic conditions. However, when recession hits the entire economy, banks end up with enormous amounts of non-performing loans. This was the reason why Japanese banks had financial difficulties during the 1990s.

The Korean corporate governance system is very similar to the Japanese system. Like Japanese keiretsu, Korea has conglomerates called "chaebol." The building of these conglomerates was the result of strategic industrial policy that took much from the Japanese example, along with the specific political economy features of South Korea. Systematic state intervention, especially in credit allocation, and crucial protection of domestic markets in the initial growth phase, were important elements of that strategy. Korean chaebol is distinguished from Japanese keiretsu in two aspects. While there is a single family controlling each keiretsu, each chaebol in Korea is under familial control. A bank is at the center of keiretsu structure in Japan, but Korean conglomerates were not allowed to own a bank until recently.

III. Diversity in Corporate Governance

Many explanations have been provided for the reason why there exist divergent corporate governance systems across different countries in the world. However, we will limit our discussion to three major factors. They are the theories of path dependency, rent-seeking and politics.

Theory of Path Dependence

Bebchuk and Roe (1999) propose the theory of path dependence in explaining corporate ownership and governance.

This theory provides the reasons why, despite international pressures to converge, some economies vary in their corporate governance processes. They argue that this is typical of a path dependent phenomenon that is driven either by structure or rule dependent mechanisms governing a country. By structure driven path dependency, they mean that the subsequent ownership structures in any given economy largely develop out of the initial ownership structures that the economy had while it started. Rule driven path dependency relates to the impact that the initial ownership structures have on the subsequent ownership structures through their effect on the nation's corporate laws.

With the passage of time their corporate rules may converge, but it does not necessarily mean that the control structures have also converged. The difference in ownership structures still persist due to factors like sunk costs, complementarities, network externalities, endowment effects and multiple optima that have affected the initial ownership structures. Also, reasons like persistence by the managers to extract rents from diffused ownership groups, and the persistence of the controlling owners to extract private rents, contribute towards non-convergence of ownership structures, which will be discussed later.

While the initial corporate structures are established, the role of interest group politics to push the governments for mandating rules either in or against favor of their interests has a big impact on the emergence of subsequent corporate structures and rules governing these structures. The power that these existing patterns of ownership structures can exert, on the policymakers at later stages to maintain the status quo or to change the rules in ways conducive to their rent extraction benefits, affects the path dependence of a rule-driven governance structure.

Theory of Rent Seeking

Though reforms would bring a more efficient corporate governance system, it may not be in the interests of all groups in the society to carry out the reform. Political coalitions may have an interest in keeping existing rules, even if they are inefficient. Coffee (1999) points out that the recent inability of Japan to adopt needed banking reforms and of Russia to stabilize its economy – each in the face of a world-wide consensus that reforms were needed – seem to illustrate the blocking power of entrenched groups that, even at the cost of national paralysis, are able to stall reforms that would adversely affect them. According to Bhasa (2004), the rent-seeking behavior of the controlling owners, who actively bolster their maximization of private benefits, would thwart all efforts in rationalizing legal systems that would call for and encourage the emergence of financial institutions to accumulate and hold large blocks of shares. When the private benefits of control are large, large blockholders would resist all means to garner extra capital from the markets because that would leave them with lesser control over the corporations they hold. However, he argues that although this behavior of controlling shareholders is reflected at contingent levels, the roots to it are laid in the initial ownership structures that started with the economy.

Theory of Politics

In social democracies there are strong legal systems that protect employee interests whereas there are strong investor protection mechanisms in individualistic capitalism. This divergence in the legal systems among countries thus leads to the divergence in corporate governance practices. The countries with the group-based system are motivated by the social welfare motives. According to Roe (2000), managers are compelled by the social democracies to forego some profit maximizing goals for public welfare, to ensure employment stabilization and to use capital to keep the business going at a stable rate instead of downsizing at times when the markets are not aligned to the firm's production capabilities.

Communitarian capitalism or social democracy calls for the protection of employee interests whenever there is a conflict between the employees and the shareholders. This leads to an increase in agency costs which are far from being controlled by the market forces. Given the differences in the political perspectives of nations it is difficult for any nation to quickly adapt to foreign best practices. Some economies are in better positions to agglomerate capital due to their political presence internationally and also because of their internal structures of governance that are so well defined that spreading risk becomes easier for them. Countries like Germany, Japan and Korea, though they do not have well developed capital markets and are troubled with union problems, have corporate governance practices which are comparably among the best in the world. While the US and the UK are performing well with their market-centric models, Japan, Germany and France are performing equally well with their insider models of governance.

V. Convergence in Corporate Governance Systems

With increasing degree of globalization in the world, it is inevitable that companies in the world and their governments seek some common sets for most efficient corporate governance practices. Gilson (2000) identifies three kinds of corporate governance convergence: functional convergence, formal convergence and contractual convergence. Functional convergence occurs when institutions are flexible enough to respond to demands by market participants. In this case, no formal change in the rules is necessary. Formal or legal convergence occurs when a change in the law forces the adoption of best practices as experienced in Korea recently. Contractual convergence occurs when firms change their own corporate governance by committing to a better regime. A trend towards convergence of corporate governance in all three areas has been developing in recent years. The following three factors have contributed to convergence of corporate governance practices mostly.

Functional Convergence through Globalization

Increasing globalization of financial markets is a main contributing factor of convergence of corporate governance systems. In recent years, holding an international equity portfolio leads to higher returns and lower risk than a purely domestic portfolio. Consequently managers of institutional investors now allocate a certain portion of their portfolios to international equities while a large number of specialized mutual funds have been developed to allow individuals to participate in foreign equity investment. Furthermore, many non-financial companies realize that broadening the investor base will lower their cost of capital and may also lessen volatility in the price of the company's stock. Many companies now seek to be listed in overseas markets. The functional convergence is evidenced by creation of many new exchanges in Europe. The Euro new markets have been established in Netherlands, Belgium, France, Italy and Germany. In response, London also established the investment market of the London Stock Exchange.

The interests of both investors and issuers to operate in the international capital market require functional convergence of corporate governance in regard to 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 behavior in order to be able to tap global capital markets.

Globalization of product markets preceded globalization of financial market. In a monopolistic environment there is less of an incentive to promote better corporate governance because a monopolist can have greater capability to attain profit without improving corporate governance and strategy due to relatively weak competitive pressures. However, as globalization of product markets progresses, domestic markets are open to foreign competitors and competition intensifies. Domestic companies soon realize that there should be a better corporate governance structure in order to become more efficient.

One impact of globalization of product markets on corporate governance structure is less reliance on firm-specific suppliers. With drastic improvements in communications, companies can easily locate suppliers anywhere in the world. This reduces the need to develop close ownership relations or control of long-term suppliers. Many companies began to divest their interests in suppliers. The OECD Principles of Corporate Governance is the result of market-driven or functional convergence. The principles have no intention to make a systematic convergence of legal systems. It is just a reference for policy makers to formulate their own legal framework and for market participants to develop their own practices.

Formal Convergence through Laws and Regulations

Considerable differences in corporate law and securities regulation have been attributed as the reason why divergence in corporate governance systems exists among countries. There is a distinction between common law and civil law and many have analyzed the impact of the two different systems on corporate 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.

Corporate laws are also different. The concept of limited liability is treated differently in different jurisdictions. In some countries, the "firewall" between a corporation and its shareholders is impenetrable, all but for the worst kind of abuse. Others take a less austere view. For example, in Germany, group legislation allows for piercing the company veil in situations where one firm in practice assumes decision-making functions of another. In the continental tradition, the company has an independent will and it can make decisions without control or supervision of its shareholders. On the other hand, in the Anglo-Saxon tradition, the corporate concept is based on a fiduciary relationship between shareholders and the managers. These differences affect shareholder rights and the role of statutory capital and the responsibility of the board differently.

It seems that legislation related to corporate governance has been converging over the past few years. New legislation include the Sarbanes-Oxley Act in the U.S., renewal on initiative of Derek Higgs in the UK, Loi de Securite Financiere in France and the Cromme Code in Germany and the Tabaksblat Code in the Netherlands. The Sarbanes-Oxley Act in the US formalized certain legal relationships governing the internal structure of the US corporations. The US Securities and Exchange Commission is becoming more tolerant of relationship investors and is more and more willing to grant so-called safe harbors for consultations between them and company management.

At the same time, 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 regarding consolidation; it has also made important steps in facilitating take-over. In France, the 1997 Marini Report on company law reform recognized the need for a "contractualization" 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 most of the countries, share buy-backs were allowed, in recognition to the fact that companies need more flexible tools to return money to their shareholders.

Contractual Convergence

Contractual convergence occurs as many large firms choose their regulatory environment of another country. Dual listing of securities in the US is a means for foreign issuers to commit to better corporate governance (Coffee, 1999). This, of course, is not due to legal eclecticism but rather to the need to tap the most liquid 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. Miller (1999) finds a positive and significant effect of the announcement of an American Depository Receipt. Furthermore, Lins, et al. (2001) and Lins, et al. (2005) indicate that this announcement not only has a positive and significant effect, but also has a larger effect for firms from countries with weaker investor protection. Contractual convergence to better corporate governance of a firm seems to create the market value for the firm.

Contractual convergence can also occur through cross-border mergers. Target firms change their corporate governance systems when acquired by foreign companies. So, cross-border mergers imply a complete transfer of the corporate governance mechanisms from one legal regime to another. Bris and Cabolis (2002) shows that acquisitions of firms in countries with less protective regimes – French and German origin – have a negative impact on the acquirer's value while target industries conversely benefit from acquisitions by firms from countries with better corporate governance – English and Scandinavian legal origin. Another example is the General Principles issued by CalPERs as a precondition for investing in foreign securities.

V. Survey of Literature on Convergence and Diversity

Until very recently there has not been much debate on convergence of corporate governance systems. For example, when Shleifer and Vishny (1997) compared various corporate governance systems, they focused on the differences of the market-based system and the group-based system rather than convergence of them. They argue that each system is rooted in an appropriate combination of legal protection of investors and some form of concentrated equity ownership. They find that the U.S. and U.K. systems depend somewhat more heavily on stronger legal protection and less concentrated equity ownership. On the other hand, the German and Japanese systems are characterized by more concentrated equity ownership but weaker legal protection. They report that it is not necessary to debate which system is a better corporate governance system because all four countries seem to have good corporate governance systems suitable to their political and economic circumstances.

They also report that other countries than the big four lack the necessary legal protection to develop good corporate governance systems. While there is some room for variation in legal protection, there is a base level of legal protection that is required if an economy is to have an effective corporate governance system and this base level is not met in many of the world's economies. La Porta, et al. (1997) reported that civil law, with its more rigid statutory rights, is perceived as less flexible in terms of economic decision making while udder common law, the firm can contract out of most legal norms.

Even though an evolution towards stronger legal protection for investors would lead to improved corporate governance systems in many countries and greater economic growth, it is not clear whether such a development would actually occur. Some earlier studies are skeptical about legal convergence of corporate governance systems. Many changes in laws that are needed to bring about legal convergence are very likely to be difficult politically. For example, Coffee (1999) hypothesized that corporate evolution is likely to follow the path of least resistance and that evolution in corporate laws faces too many obstacles to be predicted.

Bebchuk and Roe (1999) and La Porta, et al. (1999) speculated that the controlling shareholders in the world will fight to protect the private benefits of control that accompany their concentrated equity ownership. Because attempts to improve laws protecting minority shareholders clearly threaten those private benefits of control, they will exert concerted efforts to block any attempt to improve laws. To the extent that controlling shareholders are influential people within economies, convergence to legal systems that are more protective of minority investor rights will be difficult.

Recently there are several studies supporting convergence of corporate governance, including legal convergence. Hansmann and Kraakman (2001) argued that there is a strong likelihood of convergence toward a single governance model. They assert that the basic corporate form has already achieved a great deal of uniformity because economies are approaching a world-wide consensus that managers should act in the interests of shareholders and that this should include all shareholders, whether controlling or non-controlling. They believe that there are three main factors to move economies toward consensus. These are the competitive pressures of global commerce, the failure of alternative models, and the shift of interest group influence in favor of an emerging shareholder class. They admit that convergence in corporate law proceeds more slowly than convergence in governance practices. However, they expect that the pressure for convergence in law will be strong and ultimately successful.

Perotti and von Thadden (2003) went further to argue that convergence is towards the market-based system or Anglo-Saxon model. They believe that increases in market competition in the world and global financial are likely to increase the returns to information collection and analysis, thus generating greater information revelation. Ultimately, this process will lead to reduced influence by banks and a convergence toward market-based corporate governance system.

Instead of legal convergence of corporate governance systems, Coffee (1999) and La Porta, et al. (1999) predicted the path to convergence is through functional convergence. As discussed above, functional convergence occurs when individual corporations adjust their practices in ways that create stronger governance, in spite of a lack of appropriate legal structure. Investors can opt to invest their money in companies that are domiciled in more investor-friendly regimes. Firms in less protective regimes can bond themselves to practice better corporate governance by listing on exchanges in more protective regimes or by being acquired by firms in more protective regimes. Many foreign firms list in the US for functional convergence (e.g., Israel in Coffee, 1999).

In recent years, there are several studies showing that firms experiencing functional convergence perform better. Doidge, et al. (2001) and Doidge, et al. (2004) examined performance of firms and find that foreign companies listed in the U.S. have greater Tobin's Q ratios than do firms from the same countries that are not listed in the U.S. Reese and Weisbach (2002) reported that foreign firms that list in the U.S. do so to protect shareholder rights. They hypothesize that the firms that list in the U.S. are better able to take advantage of growth opportunities and that their controlling shareholders cannot extract as many private benefits of control. On the basis of a sample of 9,277 industry-country-year observations, Bris and Cabolis (2002) presented that the Tobin's Q of an industry typically increases when firms in that industry are acquired by firms domiciled in countries that have stronger corporate governance systems. Black, et al. (2003) reported that corporate governance is an important factor in explaining the market value of Korean public companies.

They find that good corporate governance measured by the corporate governance index has statistically strong and robust effect on the market value of firms measured by Tobin's Q.

There are a few studies on the effect of globalization. Khanna, et al. (2002) analyzed 37 countries to determine whether globalization is leading firms to adopt a common set of most efficient governance practices. They find de jure convergence at the country level. Rather than converging toward any single system, however, they find convergence between various pairs of economically interdependent countries. They find no evidence of de facto convergence. They conclude that globalization has induced adoption of some common corporate governance recommendations but that these recommendations are not being widely implemented. In a similar study with a data set on governance in 24 developing countries, Palepu, et al. (2002) found that globalization is correlated with similarity in corporate governance. As in Khanna, they find that de jure similarity in governance is not driven by convergence to U.S. standards, but rather to pairs of economically interdependent countries. They find virtually no evidence of de facto similarity in corporate governance.

While viewing ownership and control arrangements are still a part of a society's core characteristics and will remain to a considerable degree idiosyncratic, Nestor and Thompson (2004) reported that convergence is indeed taking place for reasons related to the globalization of financial and product markets, an increasing proximity of legal and institutional norms, and a more open circulation of and attitude towards foreign ideas and they emphasize that the growing integration of financial markets is a key factor of convergence of corporate governance systems. According to Loulmet and Morin (2000), the pattern of privatization, high equity issuance and loosening of traditional inter-corporate ties had led to some remarkable changes in the equity ownership in many European countries. Carati and Rad (2000) confirmed that the market-based corporate governance system as well as the group-based corporate governance system has converged to their theoretical convergence model with the key distinguishing feature of the coexistence of an active market for corporate control and direct monitoring by large shareholders.

Many studies are done on convergence in corporate governance structure or mechanisms such as board structure and ownership structure. Some studies, including Shleifer and Vishny (1997), Coffee (1999) and Hansmann and Kraakman (2001), reported that governance systems in the US, Germany, and Japan indicate signs of convergence toward each other. Board structure in Germany and Japan is moving more toward the U.S. model of a single-tier board that is relatively small and has both insiders and a meaningful number of outsiders. On the other hand, large shareholders are on the increase in U.S. firms.

Wojcik (2001) examined changes in ownership structure in German firms and reports that the level of ownership concentration fell significantly over the 1997-2001 period, that financial sector institutions declined in importance as blockholders, and that cross-holdings began to dissolve. He concludes that the significant international incidence of privatizations represents a move toward the private ownership and that German firms are moving toward the Anglo-Saxon system. In a more recent and extended study, Wojcik (2004) defines the principal building blocks of corporate governance as shareholders' rights and duties, take-over defenses, disclosure, and board structure and functioning. Using a data set on corporate governance ratings of 300 largest European companies from 17 countries, he finds that there has been little change between 2000 and 2003 in the area of shareholders' rights and duties and take-over defenses. On the other hand, the increase in ratings for boards and particularly disclosure was spectacular. Companies from the European Continent had been closing the gap in relation to the UK and there is also evidence of convergence within the Continent itself, as well as within individual countries and industries. Nevertheless, he states that diversity has not disappeared from the European corporate governance landscape.

Other studies on board structure also indicate convergence toward an Anglo-Saxon governance structure. Dahya and McConnell (2002) and Dahya, et al. (2002) reported evidence of significant changes in board structure in the U.K. following adoption of Code of Best Practice. However, evidence from some other countries is less favorable. De Jong, et al. (2002), after examining firms in the Netherlands following a private sector initiative to promote change in the balance of power between management and investors, reported that there is no substantive effect of this change on corporate governance characteristics. Bianchi and Enriques (1999) reported that attempts by the Italian government to increase protection of minority shareholders by fostering greater activism by institutional investors have not been successful.

Allen and Gale (2003) discussed that good corporate governance in Anglo-Saxon countries involves firms pursuing the interests of shareholders while, in other countries like Japan, Germany and France, it involves pursuing the interests of all stakeholders. They further argue that stakeholder capitalism can often be superior when markets are not perfect and complete as in Japan and point out that Toyota, which should be a poorly run firm according to the Anglo-Saxon standards and should have produced low returns for shareholders, has performed better for shareholders in the long run than Ford, GM and even the S&P 500. In a study on the relation of investment and leverage in Japan during the 1990s, Arikawa, et al. (2003) found that changing characteristics of corporate governance does not matter. Steane (2001) argued that divergence rather than convergence is manifested in non-profit governance boards in Australia.

VI. Conclusions

Is there convergence of corporate governance systems in the world? Even though there have been many studies arguing for convergence and showing evidence of convergence, there are also equal amount of studies arguing against convergence and offering evidence against convergence. Guillen (1999) argued against convergence because the variety of economic, social and political actors involved in corporate governance across countries makes it hard to envision convergence as the result of global pressure. He also presents longitudinal evidence drawn from both advanced and newly industrialized countries showing little convergence over the last twenty years. Bhasa (2004) argued that given the cultural settings of different nations, it would never be possible for corporate laws to converge universally.

Jacoby, et al. (2004) from comparison of corporate organizations in Japan and the US found mixed evidence of convergence. The longitudinal data show some Japanese companies becoming more like those in the United States and the structural equation modeling results show a Japanese style model emerging in some U.S. companies. However, there is also evidence from the survey data and from the structural equation modeling results of continuing differences in corporate governance, employment, and executive-decision making in two countries. Wojcik (2004) who finds convergence in corporate governance in Europe from the empirical evidence of 300 largest European firms from 17 countries, admited that as of 2003 the differences between countries were still sharp and they seemed to overwhelm the differences between the industries.

So, Denis and McConnell (2003) stated that even though convergence in other aspects of corporate governance such as board composition and ownership structure are evident in some places, broad convergence may be hampered by the fact that there is not yet agreement on the factors that determine the optimal structures for individual firms. Presumably, market forces will affect the extent to which convergence occurs; however, market forces are not allowed to operate unimpeded throughout the world. In this respect, Greene and Boury (2003) contended that the elements of convergence contained in the Sarbanes-Oxley Act are unlikely to result in full transatlantic harmonization of corporate governance rules. Instead, the best way forward for the European Union and the US lies in the mutual recognition of each other's corporate governance regimes.

Convergence in corporate governance principle and diversity of corporate governance practice may not be inconsistent. Corporate governance practices evolve to meet changing conditions and are expected to continue to evolve. Corporate and regulatory practices vary significantly across nations and cultures. Since reforms of corporate governance in most countries were recently done or are still in progress, it may take several more years to observe and evaluate how economies have responded to global pressure of transparency and disclosure of information.

In Korea there have been many debates on corporate governance since the Asian financial crisis. Some reformists argue for the Anglo-Saxon governance system blaming the crisis on insider model of governance system while businessmen, particularly Chaebol, resist a sudden change in the governance system. Many regulations are made to improve corporate governance and transparency. As stated in the introduction, corporate governance is about power and responsibility. Therefore, corporate governance systems reflect public policy choices. Three elements of politics – interests, institution, and political conflict – are in play all over the world. As long as there are political differences among countries, diversity will persist, even though each system will adopt good practices of another.

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