CONVERGENCE OF CORPORATE GOVERNANCE SYSTEMS: GOOD OR BAD?

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• Abstract:

The progress achieved by the field called Corporate governance is tremendous. In the past few decades, reforms in corporate governance reforms have emerged as an important center of corporate law in countries across the globe. With the recent developing trends of globalization, it has been presumed by many scholars that these corporate laws will ‘merge’ or ‘converge’ gradually. Though theoretically it all sounds good that it will create a free flow of capital but the practically, implementation of such convergence will not be possible and ideal. Why will any nation state want to adopt a single set of corporate governance rules by keeping aside its own diversity and unique way of cultures and values? Different nations have different economic stability and interests according to which a corporation is set up. Now there are different models (outsider and insider) which have come up like Anglo-USA, Japanese and German model which we can broadly study under few important heads. The idea of having a perfect model itself is good or bad for all jurisdictions is the question. The researcher intends to analyse whether convergence of corporate governance will be good or bad. The paper also tries to connect the concept of convergence with the neo-liberal school of thought and then examine whether it will be useful or not. The researcher is more inclined against the concept of convergence, for which exhaustive arguments are also being given. Also, the ideas of various scholars and their proposals will also be taken into consideration.

Keywords—Corporate Governance, Convergence, Globalization, Neo-liberal, Model, Economic stability.

• Introduction:

India today has seen a revolutionary change in field of corporate governance with the constant growing of corporations. The recent developing trends of globalization, it has been presumed by many scholars that these corporate laws will ‘converge’ gradually. This was deeply thought and analyzed by various scholars and among them some of them agreed but few disagreed. The main contention of supporters of this convergence is that, it will lead to development of a commodity market to permit free flow of economic resources from one use to another across national economic

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boarders. Also that freeing of capital flow will lead to the more efficient allocation of capital by improving savers access to investment opportunities.

Henry Hansmann and Reinier Kraakman were the people who came up with this idea of convergence first from their article “The end of history for corporate governance” in 2000. But very few actually thought about what will be the repercussions and consequences of the convergence. Will it be helpful for few countries or most of them? Can there be a ‘single best corporate governance’ model which can be adopted by everyone? If so, will international competition, force all countries to adopt this type of systems? Few of the scholars are of the view that convergence has already started happening because of the globalization, decreasing in proximity of resources and capital flow, legal mechanisms but it cannot be argued with a conclusive proof. This paper tries to understand whether such convergence is possible or not and what will be the effects of it on domestic markets and governance. Also the paper goes by understanding the basic concepts and models of corporate governance first, then in part 5 it will give arguments against convergence of corporate governance.

Aims & objectives:

The researcher intends to find an answer for whether the idea of convergence of corporate governance systems proves good or bad? And can there be any ‘best model’ for governance which can be adopted?

- Methodology:

Methodology used is from doctrinal and secondary sources. Various scholarly articles, books and web sources are being used to make a brief study on the given project title.

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• **Observations:**

If we have to refute the convergence idea, we should continue with our primary hypothesis that, since every nation state have their own cultures, laws, working circumstances and governance structure it will become difficult to choose any similar model which will be accepted and easy to adopt by all. Convergence is a concept which is very difficult to fulfill because of the differences of thoughts, ideologies and traditions. It is immaterial that which model we follow. It can be either an existing one, or combination of various models or entirely a new model. But as previously said, consensus on such guidelines is difficult to follow.

• **Important Concepts Involved:**

Following are few concepts which are important to understand before proceeding with the main arguments:

- **Corporate Governance:** This broadly refers to the systems by which a corporation is directed and controlled by its shareholders, directors, creditors, promoters and officers. All these members are expected to work in the best interest of the corporation. This also specifies the rights and responsibilities of different participants in the corporation. Corporate governance is concerned with the institutions that influence how business corporations allocate resources and returns3.

- **Convergence:** According to Oxford Dictionary, ‘Converge’ means to come together or towards same point4. In the current context, it is equivalent to merging of merit points of all the kinds of corporate governance systems across the globe and makes an ‘ideal best model’ which will be adopted by all the states. Convergence will lead to merging of all the governance systems of nations in one model which will have all the special characteristics.

- **Neo-Liberalismview:** It is one among the three schools of thought (Realism, Liberalism and Constructivists) of International Relations jurisprudence which elaborates about integration of nation states for a common motive and collective security which is being adopted in order to have a collective decision making and peaceful coexistence. In the present scenario, this school has relevance as convergence of corporate governance systems is similar to coming together of nations states with a common intention and understanding5. The scholars supporting this ideology foster the idea of collective security and decision making by making an ideal model which will be adopted by majority of states.

- **Globalization:** It involves buying, selling and exchange of goods and services from all the markets in world at the same time which involves import/ export and also exchanging of

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5Dag EniarThorsen and Amund Lie, *What is Neo-Liberalism?*, *Department of Political Science*, University of Oslo.
cultures and traditions. Since every state has a different perspective about law and customs, globalization helps in mixing of traditions and ideologies all over the world. But it seems totally hypothetical when it comes to actual merging of these traditions. In the current perspective, the concepts of convergence and globalization are almost synonymous.

- **Models of Corporate Governance:**

For deciding on to a best corporate governance model, one needs to categorize them broadly into *insider-oriented model* and *outsider-oriented model* so as to understand their merits and credibility. The distinction between these two corporate governance systems relates to the different structures of ownership which is reflected in the corporate governance structure by envisaging different models of shareholding.

- **Insider-oriented model:** This model is characterized by cohesive groups of “insider” who have a closer and more *long-term relationship with the corporation*. A concentrated ownership model is portrayed by controlling shareholders, powerless securities markets and divulgence norms. Moreover, share ownership is concentrated and the real partners are straightforwardly spoken to on the board. This is particularly true of Asian countries such India and China, which are “marked with concentrated stock ownership and a preponderance of family-controlled businesses while state controlled businesses form an important segment of the corporate sector in many of these countries.

- **Outsider-oriented model:** It displays dispersed share ownership with large institutional shareholdings. This framework is by and large described by scattered possession, an unmistakable partition of possession and control and liquid securities markets. As far as responsibility for organizations, this model is portrayed by high fracture of ownership, where single shareholders can barely ever independently influence the administration of the corporation. The model is referred to as outsider because shareholders typically have no interest in managing the corporation and retain no relationship with the corporation except for their financial investments, the separation of ownership and control is at its best.

In this paper, three kinds of models are considered as standard: (i) Anglo-Saxon model (ii) German model (iii) Japanese model. They are nowhere mentioned to be as the only best models available

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7 Brian Ikol Adungo, *An Analysis of the view that the corporate governance systems worldwide are inevitable converging towards a model based on shareholder primacy and dispersed ownership structure*, Available at: http://SSRN-id2049764.pdf (last seen-16th March 2016).

8 Supra note 7.


11 Supra note 9.
across the globe but they have gained at least significant reputation to be called so. Let us examine each of these models and find out whether ‘Best Model’ theory can be fulfilled or not.

1. **Anglo-Saxon Model:**
This model is adopted by USA and UK prominently. It includes both insiders and outsiders. The key players in this model include management, directors and shareholders (*Corporate governance triangle*). It is characterized by share ownership of individual, and increasingly institutional, investors not affiliated with the corporation (known as outside shareholders or ‘outsiders’). Here, the shareholders are responsible for selecting the directors and in turn, the directors appoint the managers of the corporation which maintains the separation between ownership and control. Members of management hold seats on the boards, but each board is required to have some directors who are not members of management\(^{12}\). The board usually consists of executive directors and few independent directors. The board often has limited ownership stakes in the corporation but is required to act in a fiduciary manner for shareholder’s interest by overseeing management on behalf of shareholders\(^{13}\).

2. **German Model:**
This model consists of two tier board consisting of a **Supervisory board** (consisting of labour/employee and shareholder’s representatives) and **Management board** (consisting insiders i.e. executives of the corporation)\(^{14}\). Banks hold a long term stakes in German corporations. Even the corporations prefer banking finance more than equity finance. The board of directors is responsible for day to day activities of the corporation. There are 3 salient features of this model which makes it different from others:
   i. **Board Composition** (2 tier board)
   ii. **Shareholder's rights** (set by law not by shareholders)
   iii. **Voting rights restricted** (limit a shareholder to vote till certain percentage, regardless of his share in the corporation).

3. **Japanese Model:**
Japan has single board similar to that of in UK and USA models. The corporation is dominated by members by members of management covering over 3/4\(^{th}\) of board members which are mainly managers\(^{15}\). The system’s key players consist of bank, Keiretsu\(^{16}\), management and the government. Both main bank and Keiretsu have two different functions, yet overlapping and complementary. The main bank provides its clients with loans and other facilities. Similar to that of German model, banks are generally the majority shareholders in the corporation.

The main merit points of these models are being discussed as above (not exhaustive but explanatory). Proponents of the convergence theory generally argue that corporate governance laws

\(^{12}\)Supra note 9.


\(^{14}\)ibid

\(^{15}\)ibid

\(^{16}\)A conglomeration of businesses linked together by cross-shareholdings to form a robust corporate structure (in Japan).
are converging on similar models like that of the Anglo-Saxon model (as seen above) partially because they view this model as most efficient\(^\text{17}\). But the researcher is of the opinion that there cannot be any single best model because even Anglo-Saxon model has witnessed scams and major structural failures like Enron\(^\text{18}\) and WorldCom\(^\text{19}\) Corporations. Since, different situations of economic stability and culture have been observed in different states they have adopted corporate governance model according to their own convenience. Then returning back to the question that, why will any state adopt a model which is equal for everyone? Will not that lead to conflicts in cultures and believes? 

- Analysis:

  I. *Reasons and arguments given by supporters of convergence:*

There has been an ongoing debate on the convergence of corporate governance systems. Some scholars standing in support of this concept give some valid reasons to substantiate why the convergence will lead to better governance. Some of the scholars should be appreciated for their efforts in this direction because, today we are living in that era where states consider their sovereignty and pride above all due to which bringing them all together under one umbrella becomes a tough job.

  1. ‘BEST MODEL’ Theory:

As of now, the definition of ‘best model’ is not defined in any statute, book or article, but we can get an apprehension of it and accordingly a definition can be framed. It has been an ongoing debate among scholars globally regarding this. Since now, we have already become familiar with the neo-liberal school of thought, where nation states come together and form groups with their own governing laws. *Organization for Economic Cooperation and Development* (OECD) is one such international economic organization formed in 1948 with 34 states as its member determined towards their democracy and market economy. This organization creates a nexus between neo-liberal school of thought and common place for all corporate governance models. OECD is a good platform where states compare their policy experiences, seek answers to common problems, identify good practices and coordinate domestic and international policies of its members\(^\text{20}\). After this organization, it gives a ray of hope to scholars who stand on the side of convergence of corporate models. Among various models around the world, Anglo-American model of corporate governance generates

\(^{17}\) Supra note 1.


pressure or a kind of upper hand on. Therefore, in order to avoid such clashes the scholars are pretending to make an idealistic model by combining merit points from different corporate governance systems.

2. Global Integration (Globalization):

The growing integration of financial markets all over the world is a key factor of convergence of corporate governance systems. Businessmen travel from one nation state to another looking for a better opportunity which results in hormonal relations among them. By making globalization as a tool, we can easily make them united and act for a similar cause. Then after that even if the laws governing them gets same, they will not oppose it. Investors in most countries increasingly accept this proposition because; in this the holdings will be in international equity portfolio which leads to higher returns and lower risk than a purely domestic portfolio.

3. Legal Convergence:

Legal infrastructure and its dynamics 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. Some of the readers will ask, how is law seems to converging with one another? The valid answer to that will be that the convergence is the result of an increasing tendency of large firms to ‘choose’ their regulatory environment. Firms today are free to reside and transact from any jurisdiction and follow the law of that land. For instance, in order to list their shares in New York Stock Exchange, large companies from a growing number of jurisdictions become subject to US securities rules and accounting norms. In such ways corporations come together create a market of their own in international seas.

II. Arguments against convergence:

Different scholars across the globe have different perspectives on convergence and as student of corporate governance it is important for us to learn and understand their ideas also. Let us now examine few arguments of the researcher which will try to prove that convergence is not possible after seeing the current scenario:

1. Shareholder Centered laws:

According to the pioneers of the present concept, Henry Hansmann and ReinierKraakman, a principal reason for convergence is a widespread normative consensus that corporate managers should act exclusively in the economic interests of shareholders, including non-controlling shareholders. The main argument of the supporters of convergence focuses upon the welfare of

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21 ibid

22 See generally: Article by Stilpon Nestor and John K. Thompson on Corporate Governance patterns in OECD economics: Is convergence under way?, Directorate for Financial, Fiscal and Enterprise Affairs, OECD.

23 ibid

24 Supra note 1.
shareholders worldwide. Now, corporate governance is not only about supporting or looking after the welfare of few classes of any corporation, rather it should be for the welfare of maximum number of people involved with the working of the corporation. Therefore, this argument is arbitrary and biased to a specific class and can be challenged at any point of time because it’s not just the shareholders but there are various other members who contribute in growth of corporation.

2. **Flip side of ‘Globalization’:**

Supporters also blame the impact of *Globalization* (as seen in the previous section) among the corporates a prominent reason for convergence. Firms that are truly global in strategic outlook, with world-wide production, service provision, added value chain, markets and customers, which call on international sources of finance, whose investors are located around the world, are located around the world, are moving towards common governance practices. Also with globalization, free flow of economic goods and resources can be done which will lead to more efficient allocation of capital by improving saver’s access to investment opportunities & company’s access to finance.

Suppose convergence happens, no doubt companies will lead towards improved access to goods and services outside state but will lead to numeral conflicts as the cost of production and manufacturing will differ which cannot be solved if the laws applicable are similar in those two nation states. Now, to this counter argument the supporters will ask that application of laws is being observed in a domestic scenario as well. We don’t see any conflict arising there. To this, there is a simple answer that, at an international level, the nation states do not surrender their sovereignty that easily even if they become signatory to a set of rules. That is the fundamental rule of International law that the laws agreed by the states are not mandatory to be binding on them because sovereigns were regarded as being equal and not subject to a common superior. Also, if there is conflict between international and domestic law, the latter one will prevail always. It is upto the states to decide what proportionate sanctions can be imposed. Therefore, if a single model is being adopted, states will not surrender their sovereignty that easily. Even they have to survive in the world federation.

Corporations have different kinds of setups, working environments, capital structures and profit & loss statements. ‘Competition’ among these corporations determines its efficiency and goodwill. It is equivalent to a force created in the market which urges them to perform their best. It is vehemently submitted, that after convergence all the governance systems will come to a constant or static position because there will be no state which could even think to become the market king. For instance, as soon as he starts his monopoly, there will be other states to pull him down to that same

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26 Supra note 9.
27 J. Craig Barker, *Mechanisms to create and support Conventions, Treaties and other responses*, University of Reading, UK, Available at: http://www.eolss.net/eolsssamplechapters/c14/e1-44-01/E1-44-01-TXT.aspx#3. The Binding Nature of International Law (last seen- 5th June 2016).
level. It will kill the basic crux of ‘market’. This statement doesn’t mean that the company should be allowed to do whatever it feels like but the restrictions should at least be reasonable.

3. **Differentiation of Cultures and Traditions:**

Corporate governance is the field linked with all welfare of employees, board of directors and managers of the corporation. Removing the conflict of interests among the people is the main aim of this governance system. The idea of convergence as discussed in previous sections is an idea given by scholars but they forgot to see the differentiations in cultures, laws, traditions and society. Therefore, it becomes difficult to predict that whether convergence can be possible or not.

4. **State of confusion and baseless assumptions:**

The assumptions which the supporters propose are totally baseless because they have examined only few aspects of corporate governance for calculation. They don’t have access to full information. Scholars of economics look only to the economic part of convergence, legal scholars look only into the sanctioning power of the states. There is lack of deeper studies in this field. Hence, their arguments become baseless and mere assumptions. According to me, we might be moving towards convergence but full convergence is never possible because of the never ending aspects which are difficult to know and study. Also since different states behave differently in different situations, all we can do is assume!

5. **Differentiation in economies:**

Growth of economies is different in different states. The convergence policies or schemes will compel them to come together, give up their identity and come into contact with some other state. The law regulating economies are different so equal laws regarding corporate governance will be difficult to impose. For instance, after convergence a conflict arises between USA and Zimbabwe, and according to the facts it is observed by the appropriate court or tribunal that Zimbabwe is at major fault. Now, the sanction as mentioned in ‘Corporate Governance Code of the World’ (hypothetical) is unreasonably high which Zimbabwe cannot afford because the economy of that country doesn’t allow them to bear such heavy monetary sanction. The fine imposition should be proportionate enough. That doesn’t give a defence to the defaulter and encourage them to commit crime as big as possible but law should not be isolated with morality. Therefore, convergence of corporate governance systems will lead to weakening of the base of all the economies of the world at a very large level.

6. **Complex Mechanism involved:**

A famous adage says “Rome was not built in a day” which means things which involve huge thought processes cannot be done in one day, it takes appropriate time. The idea of converging is also a very long and cumbersome process. It cannot be accomplished in one night. There has to be a lot of technicalities and methods involved so that all the check boxes are filled and taken into due consideration. While merging the thoughts of each and every state should be taken into consideration. There might be a situation where one state is unhappy to have lost the identity but the other state is not. A proper committee should be setup for having a clearer thoughts and
approaches. That committee should make sure that equal representation is been given by all the states.

- **Conclusion:**
We have seen from the above discussions that convergence of laws is indeed taking place due to some strong. It can be interpreted in other words that, convergence is an inevitable phenomenon which will happen in near future. The researcher concludes and flashes light on the point that it will not be an ideal scenario if this happens. We should leave the states to their own state of governance because that is there because of a lot of research and after observing differences. We should accept the differences which have been created by the almighty. By merging we are only creating a state of confusion and chaos. A better mechanism to regulate the corporate governance all over the world can be thought of similar to OECD. It is an international law issue as it involves disputes between nation states and their members hence it will require a lot of pondering and discussions.

Apart from discussing the ideas of converging and making a best model for the governance, it will be better to repair the domestic governance systems so that the current shortcomings can be looked after with proper care. Given the importance of corporate resource allocation to economic and social outcomes, it is crucial that we develop a more sophisticated analysis of national and international developments that determines who makes investment decisions in corporations, what types of investments they make, and how returns from investments are distributed. Therefore, it is now understood that convergence of corporate governance systems is as of now, a distant dream and very difficult to happen because of the above mentioned arguments and reasons of its failure. The idea of it should be totally struck down.

- **References:**


13. Article by Stilpon Nestor and John K. Thompson on *Corporate Governance patterns in OECD economics: Is convergence under way?,* Directorate for Financial, Fiscal and Enterprise Affairs, OECD.

