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Discussion Paper Series nr: 05-08

Corporate Governance Reforms around the World

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CORPORATE GOVERNANCE REFORMS AROUND THE WORLD

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March 2005

Abstract
Contemporary contributions to the comparative corporate governance literature are often couched in simple, dichotomous terms. Corporate governance systems are typically described as "insider" versus "outsider" systems, as "shareholder" versus "stakeholder" capitalism, or as involving "equity-financed" versus "debt-financed" firms. We are suspicious of greater variety than allowed by these dichotomous models, and report an explorative study on corporate governance reforms around the world in search of heterogeneity. The study involves a 38-country comparative study of corporate governance reform codes, and uses content- and exploratory factor analyses to demonstrate that they reference not two but no less than five independent but mutually complementary corporate governance mechanisms (CGMs).

Keywords: Institutional influences, diffusion of governance mechanisms, comparative corporate governance

Acknowledgements
A previous version of this paper was presented at the 15th Annual Meeting of the International Association for Business and Society in March 2004. We thank our session participants for their comments. Rob Alessie, Maarten Bosker, Oana Branzei, Michael Carney, Wolter Hassink, Reggie Hooghiemstra, Rob Phillips, Joppe de Ree, Hans Schenk, and Hans van Oosterhout provided useful comments on previous drafts. A special word of thanks goes out to Monique Niven and Merel van Keulen for invaluable research assistance. All errors remain our own.

OVERVIEW OF THE ISSUES

Comparative corporate governance scholars have long tried to capture corporate governance reforms – and the phenomenon of corporate governance more generally – in simple, dichotomous distinctions (Aguilera & Jackson, 2003; Gedajlovic & Shapiro, 1998). Specifically, researchers have long tried to typify corporate governance practices around the world either as resembling the Anglo-American model of governance or as gravitating towards the Continental European governance models (Becht & Roël, 1999; Fukao, 1995; La Porta *et al*., 1998; Shleifer & Vishny, 1997). The former system is normally characterized in terms of: (a) equity-based financing, (b) a strong influence of executive directors on corporate boards, (c) dispersed ownership, (d) relatively timid private shareholders, and (e) active markets for corporate control. The latter system is subsequently sketched in terms of opposing characteristics: (a) debt financing, (b) corporate boards that are more independent of executives, (c) concentrated ownership, (d) active institutional shareholders, and (e) weakly developed markets for corporate control. It is often noted, however, that many real-life corporate governance arrangements in regions like Asia (Dore, 2000), Eastern Europe (Filatotchev, Buck, & Zhukov, 2000), and Latin America (Guillén & Tschoegl, 2000) are more stubbornly diverse in that they do not always fit this compelling but oversimplified dichotomous classification.

In the present paper we seek to go beyond these bipolar distinctions by seeking to inductively uncover a more fine-grained taxonomy of CGMs. In the exploratory empirical study reported here, we use content- and exploratory factor analyses to study the content of 38 CGR codes. To the best of our knowledge, this represents a unique effort in that it involves the first study ever to explore the actual content of a large sample of such codes by means of qualitative data analysis. The results of this analysis showed that CGRs around the world do not just reference two, but no less than five complementary CGMs: (1) *organizational design*, referring to a structural conception of managerial control that draws heavily on intra-organizational checks and balances; (2) *ownership concentration*, a control model in which large shareholders form the primary check on potential managerial opportunism; (3) *dispersed ownership*, a model drawing heavily on the legal protection of (minority) shareholders; (4) *managerial empowerment*, an alternative conception of "control" that is rooted in the idea that managers often act as benevolent stewards rather than as potentially opportunistic agents; and (5) *esteem responsiveness*, a model in which managers are kept in check by controlling the flows of blame and praise they receive.

SCOPE AND OBJECT OF THE STUDY

Theoretical Background

Suppliers of external finance – dispersed shareholders, blockholders, families, or the state – have a need for professional managers who can run the firms they own for them, because many financiers lack the expertise and often also the incentive to do the job themselves (Shleifer & Vishny, 1997).[i] Hiring a professional manager can be costly in myriad ways, however, because the interests of corporate financiers and hired professional managers need not always coincide (Alchian & Demsetz, 1972; Jensen & Meckling, 1976). Given a divergence between the interests of the financiers and the managers of a given firm, we only have to assume: (a) that the manager is somehow concerned with increasing his or her own utility, (b) that the amount of decision-making authority delegated by the owner is nontrivial, and (c) that the actions and intentions of the manager are imperfectly observable to the financier (and neither of these assumptions seems too far-fetched in corporate settings) to envisage a situation in which the interests of the financiers are likely to suffer at the hands of their self-appointed agents.

The corporate governance literature has identified two general ways in which professional managers can exploit the confidence bestowed on them (Gedajlovic & Shapiro, 1998). The first of these is generally known as on-the-job consumption (Williamson, 1964), and involves managerial efforts to enhance their nonsalary income. Generally, this type of managerial consumption drives up costs by charging the corporation for assorted non-negotiated perks. A second form of managerial abuse manifests itself when managers seek satisfaction of their needs for power and prestige (Baumol, 1959) by making decisions that favor corporate size and growth rather than the maximization of value for the financiers. Essentially, managers then seek to enhance the perceived external prestige of their job by overdiversifying (Amihud & Lev, 1981) or by pursuing mergers and acquisitions that are status enhancing but at best profit-neutral and often profit-lessening (Schenk, 2005). Under these conditions, the ability of corporate financiers to reach favorable outcomes like profitability, innovativeness, and market share depends at least in part on their ability to effectively control and monitor managers (Gedajlovic & Shapiro, 1998; Walsh & Seward, 1990).

Definition of Core Concepts

A defining characteristic of virtually all studies on corporate governance is that they more or less follow an agency theory-inspired setup like the one sketched above.

Under this conception, corporate financiers always have a need for one or several *corporate governance mechanisms* (CGMs), which may defined as arrangements by which the suppliers of external finance to corporations assure themselves of getting a return on their investment (Shleifer & Vishny, 1997). Corporate governance studies differ rather sharply, however, in terms of the explanatory role they allow these CGMs to play.

Many *orthodox* studies of corporate governance follow a predictable roadmap in the sense that they typically see CGMs as *independent variables*: the CGM is seen as an empirically estimable factor that can explain a portion of the observable variance in given social phenomena. More specifically, such studies focus on the effect of adopting or endorsing CGMs on what we will call corporate governance outcome variables (see Figure 1). In the present paper, we will define such *corporate governance outcome variables* (CGOV) as all financial and organizational indicators that are influenced by choices pertaining to the design and implementation of CGMs.

Insert Figure 1 about here

One exemplary combination in this respect involves the assessment of the influence of appointing outside directors (CGM) on firm performance (CGOV) (Dalton *et al*., 1998; Peng, 2004). Other examples of a sheer endless list of empirically explored CGM – CGOV combinations are: investor protection and size and breadth of the equity market (La Porta *et al*., 1997); executive pay and firm performance (Bebchuk & Fried, 2003; Jensen & Murphy, 1990; Tosi *et al*., 2000);

long-term incentive plans and stock market returns (Westphal & Zajac, 1998); and minority shareholder rights and dividend payments (La Porta *et al*., 2000).

In sharp contrast, most *comparative* studies on corporate governance tend to treat CGMs as *dependent* variables only: the CGM is seen as a significant social phenomenon in and of itself, which' variable manifestations are worthy of being explained by tracing them to empirically estimable antecedent factors (e.g., see: Gedajlovic & Shapiro, 1998; La Porta *et al*., 1997, 1998, 1999; Pedersen & Thomsen, 1997). More specifically, such studies focus on the effect of a given set of corporate governance antecedent variables on CGM adoption and endorsement (see Figure 1). In the present paper, we will define such *corporate governance antecedent variables* as all indicators that influence choices pertaining to the design and implementation of CGMs.

Comparative corporate governance scholars tend to be rather precise and self-restrictive when it comes to hypothesizing the origin of CGAVs. According to at least three rivaling camps, the most significant CGAVs derive either from the legal environment (La Porta *et al*., 1997, 1998, 1999), the political environment (Roe, 1994, 2003), or the societal environment (Dyck & Zingales, 2002; McGuire & Gomez, 2003; Rajan & Zingales, 2003) of the firm. The literature on comparative corporate governance thus tends to be somewhat different in focus than the "orthodox" approach to corporate governance (see Figure 1). Whereas the latter focus on the effect of CGMs on CGOVs, the former are more likely to pay attention to the effect CGAVs on CGMs.

Contributions of the Paper

Perhaps somewhat surprisingly, however, both the orthodox and the comparative literatures on corporate governance tend to rely on rather crude distinctions when it comes identifying relevant CGMs. We have at least two conceptual concerns with the present literature, which we will briefly elaborate upon below. More importantly, we will also explain how the present paper can contribute to the literature on corporate governance by elucidating upon these limitations.

A first conceptual concern is that few studies fail to make a distinction between the overarching CGMs on the one hand and more mundane corporate governance sub-mechanisms on the other. Such *corporate governance sub-mechanisms* (CGSMs) are similar to CGMs in one important sense: they consist of managerial monitoring and control devices that serve to "tame" managers in the wake of problems related to managerial agency like the ones sketched in the theoretical background section of the present paper. The name CGSM is appropriate because neither of these devices is *in and of itself* capable of guaranteeing the suppliers of external finance to corporations some degree of getting a return on their investment – a definitional characteristic we deem central to the higher-order CGMs. Rather, each of these CGSMs must be combined with one or several others to form an effective CGM. Hence, we see a CGM as a stand-alone monitoring and control device, which consists of two or more CGSMs. With the present paper, we thus hope to make a first contribution to the literature on corporate governance by (a) making a conceptual distinction between CGMs and CGSMs, and (b) tentatively supporting this conceptual distinction by means of an exploratory empirical study.

A second conceptual concern is that to the extent that corporate governance contributors do distinguish between CGMs and CGSMs, they typically tend to assume that the relevant CGSMs will mesh into no more than two dichotomous CGMs at the aggregate level (Gedajlovic & Shapiro, 1998; Seward & Walsh, 1990). More specifically, the contradistinction is typically sought between the continental European system of corporate governance (also called the "Rhineland" model) and the Anglo-American tradition of governance (Aguilera & Jackson, 2003). The former CGM is then characterized by means of CGSMs like two-tier board systems, active institutional shareholders, and concentrated ownership. The latter CGM is suggested to draw on CGSMs like well-developed markets for corporate control, strong legally founded investor protections, and well-developed managerial labor markets. Interestingly, if a certain national corporate governance tradition in, say, Asia (Dore, 2000), Eastern Europe (Filatotchev, Buck, & Zhukov, 2000), or Latin America (Guillén & Tschoegl, 2000) does not cohere well with such straightforward dichotomous typifications, a common knee-jerk is to argue that such corporate governance traditions are "hybrids" between the former two systems rather than idiosyncratic, stand-alone systems of corporate governance. In contrast to the homogenizing tendencies so often evidenced in the corporate governance literature, we suspect corporate governance systems around the world to evidence a greater degree of diversity. With the present paper, we thus hope to make a second contribution to the literature on corporate governance by (a) hypothesizing that different configurations of CGSMs will mesh into at least three and possibly more stand-alone CGMs, and (b) tentatively supporting this conjecture by means of an empirical investigation into the subject matter.

Empirical Object: Corporate Governance Reforms

Corporate governance reforms (CGR) may be defined as deliberate interventions in a given country's ongoing corporate governance traditions by the state, the local securities and exchange commission, the stock exchange, or other parties, usually with the objective of harmonizing them with both international pressures for institutional change *and* endogenous (national) institutional evolution (cf. Whitley, 1999; Whittington & Mayer, 2000). Almost invariably, these CGRs are pitched in the form of a so-called *CGR code*: a set of codified corporate governance norms pertaining to such issues as the role and composition of the board of directors; the installment of board subcommittees (like audit, remuneration, and nomination committees); the appointment and rules of operation applying to external auditors; the distribution of rights and powers over professional managers, various groups of shareholders, and other stakeholders; the role of the media in information dispersion; and the protection of employees who "blow the whistle" (Aguilera & Cuervo-Cazurra, 2004).

CGR codes are now a ubiquitous phenomenon in the corporate landscape, but they are by all means a relatively novel innovation. Figure 2 reports the historical patterning and spread of CGR codes. The figure shows that their diffusion across and adoption by nation states did by no means follow a linear path. The "grandmother" of all corporate governance codes is the 1992 *Cadbury Committee Report*, the first corporate governance guideline that challenged the effectiveness of British corporate governance practices in the face of a deep recession and a number of inignorable corporate failures. The report became a "flagship guideline" (Stiles & Taylor, 1993) that urged many other countries in the British Commonwealth and beyond to critically evaluate their own corporate governance practices. A second impetus for CGR code initiation came early in the new millennium, in the form of a large number of corporate scandals (accounting mishaps as well as unnecessary bankruptcies), of which especially the Enron fiasco shook investor confidence and brought many stock exchanges and securities and exchange committees on the verge of despair. The effect of this worldwide "jolt to the system" also shows up in Figure 2: several nation states feverishly began to update their existing CGR codes, and many states that did not have a CGR code yet adopted one fast. At the end of 2004, no less than 49 countries, amongst which all but two of the nations joined in the OECD, had codified their ongoing corporate governance traditions in the form of a CGR code.

Insert Figure 2 about here

It would be a mistake, however, to believe that all 49 countries that have adopted a code of good governance have thereby (re)designed their corporate governance systems "from scratch." To a large extent, codes of good governance contain very little new content at all, but really in fact *codify* the extant business model of the country in which they were developed. To the extent that new provisions are adopted, it is certainly not the case that these are necessarily derived from some type of "global" corporate governance model centered on, say, the prescriptions of agency theory or the Berle and Means corporation. Myriad studies show that global convergence to agency theory-based governance is *not* the worldwide trend (Hollingsworth & Boyer, 1997; Orrú, Biggart, & Hamilton, 1997; Whitley, 1999), and that the Berle and Means (1932) image of dispersed ownership of large corporations only fits a very limited range of rich, common law countries (Gedajlovic & Shapiro, 1998; La Porta *et al*., 1999). CGRs thus mend and improve upon the *existing* institutional infrastructure of a given country, rather than that they "transplant" novel institutions in their entirety from abroad. A fitting metaphor in this respect is that of "rebuilding the ship at sea" (Elster *et al*., 1998): since corporate governance traditions are a sticky, ongoing affair, it is far easier to make amendments and "patch" existing institutions than to design entirely new ones. A good example in this respect is the UK, which has issues no less than 13 CGR codes since the publication of the 1992 Cadbury Committee Report, which all build on and accept as institutional legacy the accomplishments of this earlier Committee. The upshot of this rather incremental perspective on CGRs is that even a study of governance *reforms* (rather than extant governance *systems*) is not likely to find evidence of global convergence, but rather a persistence of and entrenchment in what are fundamentally national institutions.

The fact that these national norms and institutions are now for the first time codified in the form of comprehensive, authoritative, and mutually comparable CGR codes does have one obvious advantage, however: the content of these norms can now for the first time be studied integrally and directly. For the study reported here, we will use the formal analytical technique of content analysis to delve deeper into the CGR codes of no less than 38 countries worldwide (content analysis being the appropriate analytical technique for the discovery of the underlying meaning of rich and voluminous narrative sources; Carney, 1972; Holsti, 1969). To the best of our knowledge, our effort is the first ever to produce a large-scale comparative study of the actual content of CGR codes since their emergence in the global corporate landscape in the early 1990s.[ii]

METHODS

Sampling

We explored the structure of CGMs worldwide on textual data derived from national CGR codes. We used these codes as our object of empirical interest because they allow for unique, detailed, and mutually comparable views on the codified corporate governance traditions of many nation states. In total, we were able to draw on a pool of no less than 131 corporate governance codes derived from 49 countries. We reduced this pool to a final sample using the following cumulative criteria.

First, we decided to limit our analysis to *only one* corporate governance code per country, such that our final sample would in any case not be greater than 49 CGR codes. Second, we sampled for *comprehensiveness* in the sense that we only allowed codes commenting on a given country's entire corporate governance traditions into our final sample. Partial codifications, such as memo's commenting strictly on executive compensation or on the role of independent directors on corporate boards, were discarded as being non-representative of a country's extant corporate governance practices. Third, for countries with more than one comprehensive CGR code, we sampled for *authoritativeness* by focusing only on documents that were officially commissioned, either by the state, the local Securities and Exchange Commission, or the stock exchange. In most cases, the commission in charge of codifying a nation's corporate governance traditions represented a broad coalition of well-informed insiders, usually chaired by a retired senior executive and consisting of active executives, non-executive directors, and a number of respected academics specializing in corporate governance. Fourth, and finally, in the case that more than one comprehensive and authoritative CGR code could be identified (such as in the UK or the US, for example), we consistently opted for the *most recent* document.

In conjunction, these four sampling criteria resulted in a final sample of 38 nation states with a corresponding number of CGR codes (see Table 1). The sample was theoretically balanced in that it represented OECD countries (26) as well as non-OECD members (12), EU member (20) and non-member (18) states, and Commonwealth members (8) as well as non-members (30).

Insert Table 1 about here

Data Coding, and Data Analysis

We used content analysis (Carney, 1972; Holsti, 1969) to systematically code the messages communicated in these initial text data. Content analysis commences with a set of concepts in relation to which relevant messages can be classified. The concepts we used to explore the contents of these CGR codes consisted of 17 CGSMs, which were inductively arrived at after a first thorough reading of all 38 CGR codes in our sample (see Table 2). The inter-coder reliability for this task averaged on 89 percent between the two principal coders, which we considered satisfactory given the relative complexity of the task at hand.[iii] We used NVivo, a qualitative data analysis software package, for managing our 38 sampled documents and for converting the coded text into numerical measures for subsequent use in statistical analysis procedures. We expressed the number of characters coded for each CGSM as a percentage of the total length of a given code in order to adjust our measures for any a priori size differences between the codes (the average length of the codes was 75,520 characters; standard deviation: 56,449 characters; range: 20,038 – 246,918 characters). On average, we were able to code 57% of a given code with the help of our 17-item measurement instrument (standard deviation: 17%; range: 15% – 93%).

We subsequently converted the aforementioned data in a 38 stimuli (observations/CGR codes) X 17 traits (variables/CGSMs) matrix, usable for in subsequent statistical analyses. Table 3 reports descriptive statistics and Pearson correlations for the variables in our data matrix. Next, we subjected our data matrix to a principal components analysis. Visual inspection of the Scree plot showed that a five-component solution was desirable. In a second round of principal component analyses, five components were extracted. Each component had an Eigenvalue > 1.0, and the five components jointly explained 67% of the variance. We subsequently subjected the components to a Varimax rotation (with Kaiser normalization) to increase the interpretability of our findings. Table 4 displays the results of this exploratory factor analysis, and reports the significant factor loading(s) for each variable.

Insert Tables 3 & 4 about here

The results in Table 4 show a clean and readily interpretable factorial solution: all variables have a clear and consistently high loading on a primary factor (all primary loadings are > 0.5, average 0.74); relatively few variables have significant loadings on secondary factors (6 out of 17, average 0.38); and each factor consists of at least a pair of variables with negligible loadings on other factors (cf. Thurstone, 1947). Remember that the objective of this study was to dimensionalize corporate governance reforms by exploring how CGSMs mesh into CGMs around the world. In this sense, we thus find five clear CGMs (i.e., our five factors), each comprising two or more CGSMs (cf. Tables 1 & 4). In the following section, we will briefly put forward plausible interpretations of these five factors.

RESULTS

Five Corporate Governance Mechanisms

Organizational Design. Our first factor references a structural conception of managerial control we will label *Organizational Design* (e.g., see Dalton *et al*., 1998). The philosophy behind this CGM is that the best way to keep managers in check is to make sure that they operate in an environment in which all structural checks and balances are firmly in place. In principle, the most powerful of these structural mechanisms emanate from the Board of Directors, and are deliberately designed and exercised on behalf of shareholders (Gedajlovic and Shapiro, 1998). Table 4 shows that our first CGM references three of these Board of Directors-related CGSMs: (1) *Nominating Committee*, a CGSM that ensures that the selection of new board members is fair and balanced, and that these new members are appropriately equipped before they take on the job; (2) *Audit Committee*, a CGSM guaranteeing the availability and verification of crucial financial and operational information; and (3)

Remuneration Committee, a CGSM that guarantees an equitable pay policy for upper management, such that the company is able to hire and retain capable leaders without overpaying them. A final CGSM incorporated into this first CGM is (4) *Whistleblower Protection*, a mechanism ensuring that employees who desire to question the (mis)conduct of the organization that employs them can openly do so without fear of managerial retaliation. In brief, the organizational design CGM keeps managers in check by means of a coherent set of internally designed CGSMs that define the organizational boundaries of managerial discretion (Michael & Pearce, 2004). We expect this first CGM to be in heavy use in many nation states around the world, because it represents a strictly *internal* CGM that should be less costly to operate than strictly *external* (e.g., the market for corporate control and the managerial labor market) or "mixed" (combining internal and external CGSMs) CGMs (Walsh & Seward, 1990).

Ownership Concentration. Our second factor represents a dominant CGM, which we will name *Ownership Concentration* (e.g., see Shleifer & Vishny, 1986). The logic behind this CGM is that the best way to keep managers in check is to reduce the degree of separation between ownership and control by concentrating the ownership of the corporation in the hands of one or a few powerful investors (Berle & Means, 1932). Due to the concentration of ownership, these investors will then both have the means and the motive to monitor and control managers (Shleifer & Vishny, 1997): the incentive to monitor is high because the controlling shareholder is the ultimate residual claimant (Alchian & Demsetz, 1972), whereas the ability to monitor is high because the controlling shareholder can often control the corporate board (Fama & Jensen, 1983; Tosi & Gomez-Mejia, 1989). Table 4 shows that our second CGM references four CGSMs that are commonly associated with ownership concentration: (1) *Institutional Investors*, a CGSM that provides large investors with additional rights (such as the right to call shareholder meetings and the right of privileged access to top management) and responsibilities (such as the duty to take an active role in the governance of the corporation, especially by means of casting votes at the annual shareholders' meeting); (2) *Stakeholder Equity*, a CGSM that ensures the non-financial stakeholders of the company an equitable treatment (this mechanism coheres well with concentrated ownership, since: (a) the most important stakeholder group mentioned in codes of corporate governance are by far the employees of the firm, and (b) many countries with concentrated ownership traditions grant employees special privileges such as co-determination and lifetime employment; Roe, 2003); (3) *Bonus*, a CGSM that controls managerial self-interest seeking behaviors by strictly regulating the amount of cash bonuses and other pecuniary short-term incentives managers can grant themselves (as managerial compensation and especially cash bonuses tend to be significantly lower in firms with concentrated ownership than in their more dispersedly owned counterparts); and (4) *Media Information Rights*, a CGSM that controls the number of media channels through which firms ought to inform interested outsiders (a mechanism that is known to be correlated with the ability of controlling shareholders to divert corporate resources to their sole advantage; Dyck & Zingales, 2002). In brief, the ownership concentration CGM limits managerial discretion by means of a coherent set of CGSMs that jointly reduce the chasm that separates ownership from control (Berle & Means, 1932). Prior studies have shown that ownership concentration is a preferred CGM in many nations across the globe, as it seems to serve as a sort of "second-best" solution to the "first-best" solution of strong legal protection of minority shareholders (La Porta *et al*., 1999; but see Roe (2003) for a competing explanation rooted in political CGAVs).

Dispersed Ownership. The third factor we uncovered represents another ownership-oriented conception of managerial control, which we will refer to as *dispersed ownership* (e.g., see Grossman & Hart, 1980). The philosophy behind this CGM is that the best way to solve the agency problem is to render the separation between ownership and control more or less harmless by making sure that the rights of all shareholders (and not just those of blockholders) are explicated and legally enforceable (Jensen & Meckling, 1976). Table 4 shows that this CGM draws on four CGSMs: (1) *Shareholder Voting*, a CGSM that explicates all issues on which shareholders may vote during the annual shareholders meeting; (2) *Shareholder Rights*, a CGSM listing all ancillary rights bestowed on shareholders (including the right to call shareholder meetings and the right to receive information on the performance of the firm and any intended changes to its corporate strategy); (3) *Auditor Rules of Operation*, a CGSM that ensures that shareholders not only receive information on the corporation's policy and finances, but that this information is also checked for veracity; and (4) *Equal Treatment of Parties*, a CGSM that makes sure that blockholders are not privileged over minority shareholders (for example, by not allowing shareholders to obtain control rights in excess of their cash-flow rights; Grossman & Hart, 1988). In sum, the dispersed ownership CGM keeps managers in check by means of a coherent set of CGSMs that make them more accountable to all parties with an equity stake in the firm – regardless of the size of that stake. We expect this third CGM to be a popular means of managerial control in many countries worldwide, as prior research has shown that strong (legal) protection of minority shareholders is likely to contribute to more efficient investment allocation, better developed financial markets, higher-valued publicly listed firms, and even higher economic growth in general (Beck, Levine, & Loayza, 2000; La Porta *et al*., 2002; Rajan & Zingales, 1998).

Managerial Empowerment. The fourth factor that emerged from our data analysis is different from all other factors in that it reflects an alternative conception of managerial "control," which we will label *managerial empowerment* (e.g., see Davis *et al*., 1997). The guiding idea behind this CGM is that real-life managers are far from the self-interested sharks that agency theory (and the Neo-Hobbesian tradition in organizational economics more generally; cf. Bowles, 1985) holds them to be, and that many managers are in fact benevolent stewards whose interests are naturally aligned with those of their principals because both parties take pride in and wish to contribute to the greater social system in which they are embedded (Lee & O'Neill, 2003). The best way to ensure that such benevolent beings contribute as much as possible to goals and objectives of their masters is to make their mandate as broad as possible, and thus "stewardship theorists focus on structures that facilitate and empower rather than those that monitor and control" (Davis *et al*., 1997: 26). Table 4 shows that this fourth CGM draws positively on two CG<u>S</u>Ms that empower rather than constrain managers: (1) *Employee Ownership*, a CG<u>S</u>M that empowers managers by giving them control rights in excess of their negotiated managerial mandate; and (2) *Option*, a CG<u>S</u>M ensuring that managers are (in the long run) rewarded for all the good deeds that they do. But the fourth factor is bipolar in that it also evidences a strong negative loading on (3) *Board*, a CG<u>S</u>M that normally acts as an internal mechanism for monitoring managers, but that apparently has no place in a CGM that operates by placing confidence and trust in organizational leadership. In brief, the managerial empowerment CGM stimulates managers to contribute to the greater good of the corporation by means of a coherent set of CG<u>S</u>Ms that reward good deeds rather than crowd-out good intentions by monitoring behavior or punishing mistakes (Frey, 1998). The mechanism seems especially appropriate for nation-states with strong collectivist cultures like Korea or Japan (Lee & O'Neill, 2003), but a note of caution is appropriate. Simply empowering managers without providing additional safeguards can be costly, and a recent study by Tosi and his colleagues (2003) demonstrates that if control mechanisms are absent, managers are less likely to engage in courses of action that maximize shareholder value than when at least some controls are in place.

Esteem Responsiveness. The fifth and final factor emerging from our data entails a conception of managerial control that we will label esteem responsiveness (e.g., see Brennan & Petit, 2004). The philosophy on which this CGM rests is that managers can best be kept in check by controlling the flows of blame and praise they receive. The controlling effect of esteem has intrinsic and extrinsic components. The intrinsic component consists of the fact that all individuals are to some extent "hardwired" to desire the esteem of others (Fodor, 1983). Thus, one would expect that corporate executives try to lead their organizations into excellence, as this would buy entitle them to praise from outside audiences. The extrinsic attraction of esteem to corporate executives lies in what it can potentially buy them (cf. Ellickson, 2001). Under this conception, managers would seek a reputation for having exceptional abilities because this would entitle them to higher pecuniary compensation (Milbourn, 2003). Table 4 shows that the esteem responsiveness CGM derives from two complementary CGSMs: (1) *Auditor Appointment*, a CGSM that regulates the amount of praise and blame corporate executives receive by making the financial and operational results of the firm they lead known to a wider audience; and (2) *Social Reporting*, a CGSM that influences the amount of esteem and disesteem bestowed upon managers by informing outside parties about the nonmarket performance of the firm in which they take an interest. In short, the esteem responsiveness CGM reduces the problem of separated ownership and control by means of a coherent set of CGSMs that make managerial conduct more transparent and interpretable to outside observers. More specifically, managers are expected to be responsive towards the ebb and flow of esteem, in the sense that they will work towards goals bringing them esteem and avoid results causing them to accumulate disesteem because of the intrinsic and extrinsic rewards esteem harbors. We expect this final CGM to be quite popular in many countries around the world, as its self-enforcing and self-policing qualities make it a relatively quick and inexpensive mechanism for ensuring that managers keep the promises they make (Elster, 1989a).

CONCLUSION

The contemporary literature on corporate governance – orthodox as well as comparative – is characterized by two salient shortcomings. In the first place, many corporate governance scholars fail to make a conceptual distinction between CGMs and CGSMs. The former overarching control and monitoring devices can single-handedly guarantee the suppliers of external finance that the managers they appoint to run the firm will operate in their best interest. In sharp contrast, the latter devices *help* to control and monitor managers, but they must be used in conjunction with other devices to ensure effective control over managerial conduct. The exploratory study reported in this paper supports the conceptual distinction between CGMs and CGSMs, as it has demonstrated that the latter exist in stable configurations around the world, thereby comprising the former.

A second, even more salient shortcoming of the received literature on corporate governance is that it usually only recognizes two clearly distinct CGMs (namely: the Rhineland and Anglo-American traditions of governance), and denotes all other known corporate governance traditions as hybrid systems that eclectically combine selected aspects of these governance archetypes. The present paper has contributed to this literature in that it has moved beyond the dichotomous tradition and has identified no less than *five* distinct CGMs.

The CGMS identified are: (1) a structural conception of managerial control we labeled *organizational design* (e.g., see Dalton *et al*., 1998); (2) a control model in which the primary check on potential managerial opportunism is *ownership concentration* (e.g., see Shleifer & Vishny, 1986); (3) a model oriented towards the protection of (minority) shareholders we labeled *dispersed ownership* (e.g., see Grossman & Hart, 1980); (4) an alternative conception of "control", rooted in the idea that managers often act as benevolent stewards rather than as potentially opportunistic agents, which we dubbed *managerial empowerment* (e.g., see Davis, Schoorman, & Donaldson, 1997); and (5) a model in which managers are kept in check by controlling the flows of blame and praise they receive, which we labeled *esteem responsiveness* (e.g., see Brennan & Pettit, 2004).

Of course, the present study is limited in several ways. First, like all comparative studies at the level of nation states, it suffers from a considerable small-sample bias. A second, related limitation is that our small sample size necessarily limits our scope of feasibly applicable statistical techniques, implying most pressingly that we could not corroborate the five factors we identified with confirmatory factor analyses on data derived from a larger, independent sample. Third, our focus on corporate governance reforms rather than extant corporate governance systems does to a certain degree mix fact with aspiration. Fourth, and finally, the work reported in the present paper is qualitative and exploratory in kind, and only future, les exploratory studies can reveal whether the taxonomy of CGMs here has any value as a classificatory instrument or whether any of the five CGMs by themselves has any demonstrable potential as a predictor of CGOVs. Nevertheless, even after we discount for all these obvious shortcomings, we believe that the present study as brought us a little closer to appreciating the true and unique variation of the myriad idiosyncratic corporate governance traditions that exist around the world.

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FIGURE 1

Differential Focus of Corporate Governance Studies

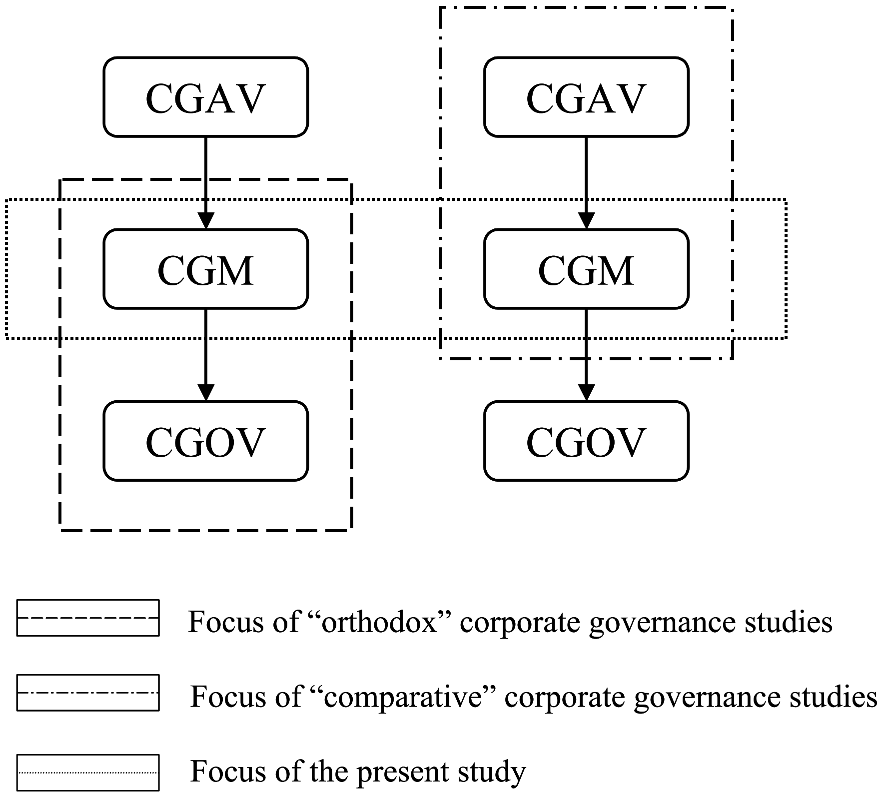
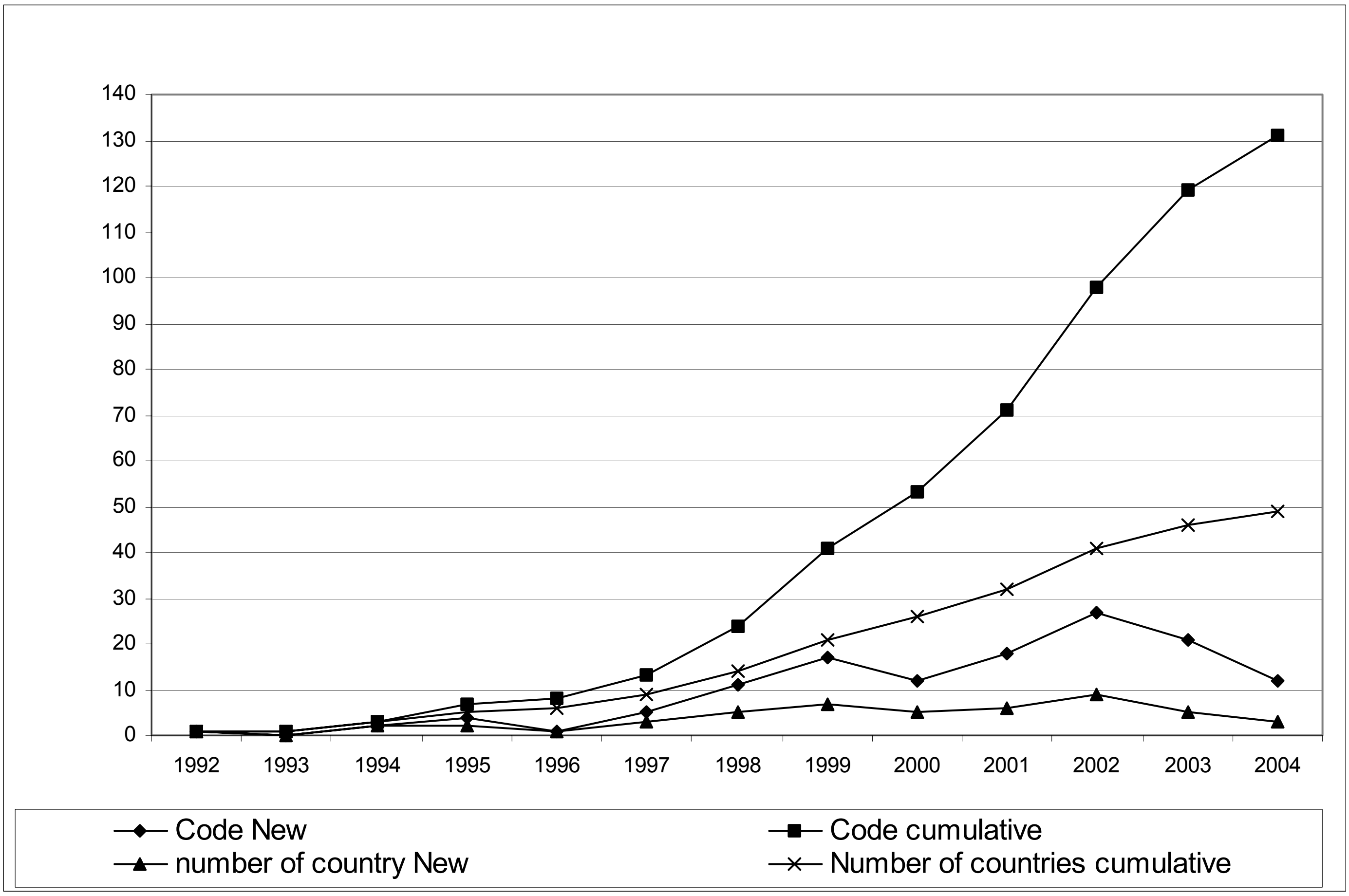


FIGURE 2

Corporate Governance Reform Codes Issued around the World, 1992-2004



Source: Chart compiled from data supplied by the European Corporate Governance Institute (www.ecgi.org).

TABLE 1

Sample and Control Variables

Country	OECD member state	EU member state	Common-wealth member state	Code issued before Enron (10-16-2001)
Australia	Yes	No	Yes	No
Austria	Yes	Yes	No	No
Belgium	Yes	Yes	No	No
Brazil	No	No	No	Yes
Canada	Yes	No	Yes	No
Cyprus	No	Yes	Yes	No
Czech Republic	Yes	Yes	No	Yes
Denmark	Yes	Yes	No	No
Finland	Yes	Yes	No	No
France	Yes	Yes	No	No
Germany	Yes	Yes	No	No
Greece	Yes	Yes	No	Yes
Hong-Kong	No	No	No	Yes
Iceland	Yes	No	No	No
Ireland	Yes	Yes	No	Yes
Italy	Yes	Yes	No	No
Japan	Yes	No	No	No
Kenya	No	No	Yes	No
Lithuania	No	Yes	No	No
Macedonia	No	No	No	No
Malta	No	Yes	Yes	Yes
Mexico	Yes	No	No	Yes
Netherlands	Yes	Yes	No	No
Norway	Yes	No	No	No
Pakistan	No	No	Yes	No
Peru	No	No	No	No
Poland	Yes	Yes	No	No
Portugal	Yes	Yes	No	Yes
Romania	No	No	No	Yes
Russia	No	No	No	No
Slovakia	Yes	Yes	No	No
South-Africa	No	No	Yes	No
Spain	Yes	Yes	No	No
Sweden	Yes	Yes	No	No
Switzerland	Yes	No	No	No
Turkey	Yes	No	No	No
United Kingdom	Yes	Yes	Yes	No
United States	Yes	No	No	No

TABLE 2

Variables: Corporate Governance Sub-Mechanisms

Variable	**Description**
Bonus	% of CGR code text devoted to executive compensation in the form of cash bonuses and other forms of short-term incentive pay
Option	% of CGR code text devoted to executive compensation in the form of stock options and other forms of long-term incentive pay
Board	% of CGR code text devoted to the appointment, composition, and rules of operation of a company's board of directors (BOD)
Nominating Committee	% of CGR code text devoted to the appointment, composition, and rules of operation of the BOD's subcommittee involved with the selection and training of new BOD members
Audit Committee	% of CGR code text devoted to the appointment, composition, and rules of operation of the BOD's subcommittee involved with overseeing the company's principal information flows and selecting an external auditor to verify the content of that information
Remuneration Committee	% of CGR code text devoted to the appointment, composition, and rules of operation of the BOD's subcommittee involved with determining the company's overall executive pay policy as well as the specific amount of monetary incentives to

	be paid out to executives in a given year
Shareholder Voting	% of CGR code text devoted to a description of all issues on which shareholders are allowed to vote during the shareholder's meeting, as well as the rules of operation pertaining to that meeting in general and the voting process in particular
Shareholder Rights	% of CGR code text devoted to a description of all ancillary rights granted to shareholders, including the right to call shareholder meetings, the right to be informed about important corporate decisions, and the right of interpellation
Auditor Appointment	% of CGR code text devoted to the selection and appointment of the external auditor
Auditor Rules of Operation	% of CGR code text devoted to the rules of operation to be followed by the company in terms of facilitating the external auditor's job as well the rules of operation to be followed by the auditor him- or herself
Institutional Investors	% of CGR code text devoted to a description of institutional investors as a separate category of investors, usually in contradistinction with dispersed shareholders, with distinct rights and obligations such as the right to engage in a direct dialogue with executives and the obligation to actively monitor them on behalf of all shareholders
Social Reporting	% of CGR code text devoted to a description of all social, health, and environmental issues about which firms are expected to report, either integrated with or separated from their report of key financial indicators and results
Equal Treatment of Parties	% of CGR code text devoted to a description of all rules of operation firms must follow in order to ensure the equitable treatment of all parties with a financial or competitive stake in the company (including minority shareholders)

Stakeholder Equity	% of CGR code text devoted to a description of all rules of operation firms must follow in order to ensure the equitable treatment of all parties with a social or political stake in the company (other than shareholders)
Employee Ownership	% of CGR code text devoted to a description of all rules of operation firms must follow in order to provide managerial and other salaried employees with the opportunity to become co-owners of the firm
Whistleblower Protection	% of CGR code text devoted to a description of all rules of operation firms must follow in order to ensure the protection and economic independence of employees that seek to publicly address corporate wrongdoings
Media Information Rights	% of CGR code text devoted to a description of all media channels firms ought to utilize to inform shareholders and other stakeholders of important corporate decisions and results

TABLE 3

Means, Standard Deviations, and Correlations Dependent Variables[a]

Variable	Mean	s.d.	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16
1. Bonus	0.19	0.01																
2. Option	3.59	0.13	-.059															
3. Board	32.23	0.14	.023	-.464**														
4. Nom. Comm.	1.46	0.02	.298	-.042	-.063													
5. Aud. Comm.	4.94	0.06	.081	-.170	.082	.572**												
6. Rem. Comm.	1.88	0.03	.094	.085	.105	.379*	.562**											
7. Share Vote	1.74	0.03	-.209	-.109	-.080	-.271	-.215	-.301										
8. Share Right	2.59	0.03	-.272	-.023	-.197	.014	-.299	-.258	.231									
9. Aud. App.	0.67	0.01	-.162	-.122	.259	-.148	.069	-.215	-.080	-.231								
10. Aud. Rules	1.33	0.02	-.199	-.116	.058	-.028	.138	-.350*	.084	.238	.186							
11. Inst. Invest.	0.65	0.01	.387*	.123	-.010	-.151	.002	.201	-.010	.016	-.092	-.088						
12. Soc. Report.	1.61	0.02	-.206	-.056	.309	-.326*	-.024	-.231	-.076	-.168	.416**	.142	.172					
13. Equal Treat.	1.32	0.02	.174	-.049	-.085	.016	-.032	.012	.426**	.528**	-.143	.262	.454**	.034				
14. Stake. Equi.	0.23	0.01	.552**	-.062	-.027	.013	.002	-.068	.237	.058	-.133	.112	.401*	-.069	.381*			
15. Empl. Own	1.06	0.04	-.002	.596**	-.425**	.022	-.156	-.011	-.086	.192	-.109	-.171	.049	-.079	-.033	-.003		
16. Whistleblw.	0.08	0.00	-.042	-.073	-.166	.517**	.668**	.390*	-.192	-.123	-.008	.107	-.078	-.216	-.104	-.045	-.075	
17. Media Info.	1.45	0.01	.314	-.074	-.079	.053	-.210	-.213	.216	.215	-.048	.103	.322*	.162	.361*	.522**	.217	-.080

[a] * $p < .05$

** $p < .01$

TABLE 4

Exploratory Factor Analysis[a]

	Factor 1	**Factor 2**	**Factor 3**	**Factor 4**	**Factor 5**
Description	Organi-zational design	Ownership concentra-tion	Dispersed ownership	Managerial empower-ment	Esteem responsive-ness
Eigenvalue	3,126	2,627	2,260	1,896	1,409
% Var. Expl.	18,39	15,45	13,30	11,15	8,29
% Cum. Var. Expl.	18,39	33,84	47,14	58,29	66,58
1. Nom. Comm.	**0,754**				
2. Aud. Comm.	**0,891**				
3. Rem. Comm.	**0,638**		-0,341		
4. Whistleblw.	**0,833**				
5. Bonus		**0,688**	-0,461		
6. Inst. Invest		**0,759**			
7. Stake. Equi.		**0,808**			
8. Media Info.		**0,696**			
9. Share Vote	-0,348		**0,544**		
10. Share Right			**0,735**		
11. Aud. Rules			**0,606**		0,384
12. Equal. Treat		0,430	**0,733**		
13. Option				**0,854**	
14. Board				**-0,681**	0,309
15. Empl. Own.				**0,842**	
16. Aud. App.					**0,742**
17. Soc. Report					**0,830**

[a] Extraction method: Principal Component Analysis; rotation method: Varimax rotation with Kaiser normalization; rotation converged in 6 iterations; only significant factor loadings (> 0.3) are reported; highest factor loadings for each variable are printed in bold.

ENDNOTES

[i] For firms with dominant owners, the main problem is one of capability. Many entrepreneurial businesses face succession crises at one stage of their existence or another. Furthermore, and especially in family-run businesses, it is obvious that second- or later-generation owners need not have inherited the business skills of their parents and grandparents. For firms with dispersed ownership, the problem is also one of incentives. Optimal portfolio theory (Fama, 1980) suggests that shareholders must diversify their investments over many firms, which proportionately lessens their interest in running one of these themselves.

[ii] A few other studies of GCR codes exist, but here the actual content of the codes is neglected. Instead, the adoption of a code of corporate governance is treated as a binary event (either a country adopts a code or not) and the study is then designed to explain the adoption decision. Such studies must of course make the rather strong assumption that "the content of codes [only] varies slightly across countries" (Aguilera & Cuervo-Cazurra, 2004: 420).

[iii] In order to keep the coding task cognitively manageable, we coded the CGR codes in two rounds. In a first round of data coding we strictly coded for a first set of nine CGSMs. In a second round, we coded for the remaining eight CGSMs. This sequential coding procedure helped us secure the reliability and validity of our coding efforts by making it easier to identify and discriminate between relevant chunks of textual data.