Tightening corporate governance

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Abstract

Tightening corporate governance in multinational corporations (MNCs) is difficult because of confusion over the proper conception of governance, competing pressures on and complex attributes of MNCs, and the fact that many prescriptions are untested. This article documents multiple pressures on MNCs and recommends how management should cope with those pressures. Tightening governance directly concerns pressures from investors, exchanges, and regulators for adoption of recommended standards and practices to increase financial transparency and fiduciary accountability. MNCs also face pressures for corporate social responsibility (CSR). Short-term financial performance and longer-term financial viability may conflict with one another and also with the social and environmental components of triple bottom line performance. MNCs are organizationally complex to manage. Geographical diversity peculiarly means great variance in legal systems, other non-market institutions, and MNC governance and CSR approaches across country units. International standards for governance and reporting are not well established; and enforcement occurs largely by stock exchanges and national jurisdictions.

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1. Introduction

This article documents multiple pressures on top managements and governing boards of multinational corporations (MNCs) and recommends how they should cope with those pressures. The article clarifies tightening corporate governance, explains what we know and what we do not know in terms of general theories and evidence available in relevant bodies of literature bearing on this managerial challenge, assesses the MNC implications of cross-national variations in governance approaches, and explains the historical context and possible futures of emerging international corporate governance and reporting standards. The article suggests needed research, teaching, and practice to deal with the challenge of tightening corporate governance.

1.1. Definition of tightening

MNCs face investor, exchange, and regulator pressures for increased financial transparency, fiduciary accountability, short-term financial performance, and long-term strategic viability. Tightening corporate governance means explicitly increased MNC compliance with specific standards and practices recommended in national and international governance codes and guidelines. Tightening involves reducing entrenchment and discretion of top managements and governing boards, and increasing both formal and willing compliance of executives and directors with internal and external governance codes and guidelines. Complying with best governance prescriptions should be a source of competitive advantage such that no MNC can afford to fall too far behind in the adoption of best governance prescriptions.

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1.2. Complicating factors

The managerial challenge of tightening corporate governance in MNCs is complicated by circumstances that make the agency conflict view of managing the public company too simplistic for the real world of competition and regulation.

- Definition and conceptualization of corporate governance remains a matter of confusion and controversy. There are two competing perspectives on governance. One perspective emphasizes shareholder wealth maximization. The Berle and Means thesis of separation of ownership and control argued in *The Modern Corporation and Private Property* (1932) underlies agency theory in economics and finance. Newer academic literature emphasizes that proper conceptualization of governance is broadening from this agency conflict to a complex mix of ethics, accountability, transparency, and disclosure (Gill, 2008).
- Recommended standards and practices have not been well demonstrated to be implementable or effective and often are not well studied in academic literature (Finegold et al., 2007). Tightening prescriptions have been precipitated by a series of company scandals and industry or financial crises. The essential foundation of effective corporate governance remains the personal integrity and business acumen of executives and directors (Cadbury, 2006: 25).
- MNCs face pressures—from governments, international institutions, and nongovernmental organizations (NGOs)—for CSR defined as improved business ethics, multiple-stakeholder responsiveness, and environmental sustainability.
- International standards for governance and reporting (financial or non-financial) are not yet fully established; and enforcement occurs largely by stock exchanges and national jurisdictions.

1.3. MNC traits

The 500 largest MNCs account for over 90% of foreign direct investment (FDI) stock and about half of world foreign trade (Rugman and Verbeke, 2004). That MNCs tend to be regional rather than truly global businesses may dampen what otherwise could become, in the absence of strong international governance guidelines, globally “footloose” firms looking for weak governance and responsibility conditions.

MNCs are organizationally complex to manage. The more global a firm, the more organizationally complex it is to manage. Such globally complex firms involve peculiar difficulties in coordination (Alpay et al., 2005).

Multinationals operate across at least two national borders and legal systems; tradeoffs and reporting may be partly country specific. Peculiarly MNCs operate across various types of economies and legal systems involving different approaches to corporate governance and CSR and also varying levels of governmental corruption. MNC traits include distance, exposure to different cultures, organizational complexity, need to decentralize to local conditions, dispersed activities, marked variations between host and home countries, and the liability of foreignness in host countries (Zaheer, 1995).

Geographical diversity means significant variance in legal systems and other non-market institutions. A firm’s governance structures and practices may thus vary greatly across country subsidiaries. Many MNCs are organized as a set of subsidiaries that are legal entities in host countries (Kiel et al., 2006). While the parent legal entity in a home country is subject to that country’s corporate governance laws and codes, MNCs operate as a collection of subsidiaries and often joint ventures. Each of such affiliates of the MNC is typically a legal entity in the host country. MNCs may be structured legally in some instances around essentially parent and local tax considerations. Some foreign affiliates are wholly owned; others are not. Subsidiaries may have local boards; joint ventures may have separate boards of managers.

1.4. Two competing definitions of corporate governance

Two different, although related, definitions of corporate governance have been advanced (Mallin, 2006: 3). Partly competing definitions signal confusion and controversy affecting in turn how to define and conceptualize tightening of governance.

The 1992 Cadbury Report, the key set of tightening proposals, characterized governance as “the system by which companies are directed and controlled” (Cadbury, 1992: 15). The underlying agency conception stresses that “Corporate governance deals with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment” (Shleifer and Vishny, 1997: 737). Governance can be defined more broadly (Weil and Manges, 2002: 1). The OECD revised principles (2004: 11) treat governance as a set of stakeholder responsibility relationships in addition to the structure for “setting, achieving, and monitoring corporate objectives and performance” (Mallin, 2006: 3).

The overlap between the two definitions concerns organizational structure for direction and control of the firm, focusing on top managers and governing boards. The difference between the two definitions concerns the role of non-financial stakeholders. The agency view restricts governance structure narrowly to financial stakeholders. The OECD view broadens governance considerations to other stakeholders. The European Union (EU) seeks both to tighten governance and to increase CSR. A U.K. study suggests shift from solely financial accountability toward a more stakeholder-based approach (Money and Schepers, 2007).

2. Corporate governance in MNCs

Increased pressures toward tightening governance arise from various sources, as noted in practitioner and academic literatures (Kaplan, 2008: 5; Brick and Chidambaram, 2008). CEOs (Bielak et al., 2007) and directors (Maly and Anderson, 2008; Rappeport,
2007; Taub, 2006) report such pressures. Increased pressures on MNCs and their CEOs have been cited (Birkinshaw et al., 2007; Walker, 2006).

2.1. External pressures on MNCs

One set of pressures concern financial stakeholders. Shareholders are becoming increasingly active, as illustrated by turmoil at Telstra in Australia (Washington, 2007). Executives and directors should understand increased investor concern. Short-term earnings manipulations, influenced by stock-based managerial incentives, are unlikely to constitute sound long-term strategy (Zhang et al., 2008).

Increasing regulatory pressures are driven by the series of company scandals and industry and financial crises since the 1980s. In the wake of recent corporate scandals (Harris, 2008) in various countries, U.S. stock exchanges strengthened listing requirements. Scandals destroyed the reputation capital of the corporate sector (Fombrun, 2006), and precipitated the Sarbanes–Oxley Act of 2002 (SOX). The EU nations have experienced since the 1990s strong pressures for more effective governance along U.S. and U.K. lines (Perry and Rehman, 2006). MNCs must practice full compliance with strengthening regulations in home and host countries.

Some pressure is governmental. The U.S. response to a global corruption scandal was the Foreign Corrupt Practices Act of 1977 (FCPA), which increased internal control and recordkeeping requirements for domestic as well as multinational firms. Active debate continues in the U.S. over benefits and costs of SOX (Brick and Chidambaran, 2008). From late 2008, various countries have increased dramatically market interventions. MNCs will have to be sensitive to significant cross-national variations in governmental concerns (Boddewyn, 2007).

These pressures aim at various aspects of MNC management. There is heightened scrutiny of the strategic direction of the firm, CEO compensation and incentives, management misconduct, transparency and disclosure, and CEO replacement and succession planning. Illustrations and documentation of each key concern are provided below. A survey of 1400 directors at public, private, and non-profit corporations considered successions, leadership, strategic planning, and corporate performance as the top forces (Taub, 2006). Top management should expect to focus on these concerns in working with governing boards, and expect heightened scrutiny from external sources.

Surveys of directors indicate increasing board interest in strategy formulation, operational planning, and plan execution (Maly and Anderson, 2008). This interest inserts the board into business management as distinct from corporate governance. Management should expect to support this closer interaction for sound strategy and operations.

CEO compensation and incentives are controversial. U.S. Congress approval, in the face of public outrage, of the administration’s $700 billion mortgage bailout proposal depended on safeguards concerning such compensation. A survey of directors and CEOs reported that 2/3’s of respondents believed CEO compensation either “somewhat high” or “too high” and only about 1/3 “just right” (Rappeport, 2007). Respondents cited lack of real performance objectives and evaluation (58.8%), lack of relationship of compensation to future corporate performance (47.8%), and “undue CEO domination of the [pay-setting] process” (39.6%). Top management will have to more sensitive conditions affecting compensation setting (Sapp, 2008). Under new U.S. Security and Exchange Commission (SEC) guidelines, beginning with 2007 filings, U.S. companies must include a Compensation Disclosure and Analysis (CD&A) section (Dalton and Dalton, 2008). Compensation has become more oriented toward stock options—stimulating a backdating scandal and debate over expensing policy and over executive compensation (e.g., Gabbaix and Landsier, 2008; Kaplan, 2008). While the CEO has arguably captured the pay-setting process, better governed firms likely pay less for luck and thus more in line with market forces (Bertrand and Mullainathan, 2001).

The UN Convention against Corruption (adopted October 2003 and in force December 2005) and the OECD Convention on Combating Bribery of Foreign Public Officials in International Business Transactions (signed December 1997 and in force February 1999), to which Germany adheres, prohibit business corruption of foreign officials. In 2006–08, a major corruption scandal at Siemens led to resignation of both chairman and CEO and then to criminal indictments and large fines to the U.S. and Germany. Siemens investigators uncovered some $2.1 billion in suspicious payments. In 2008, Siemens first warned of a projected major drop in earnings; and then announced cuts of about 4% of its work force. Executives and directors must emphasize business ethics and anti-corruption efforts.

Transparency and disclosure are key improvements sought by reformers. U.S. Secretary of the Treasury Henry Paulson called on sovereign wealth funds, such as those of China and the United Arab Emirates (UAE), to provide more openness. Transparency International (TI), an anti-corruption non-governmental organization (NGO), has reported transparency information for oil and gas companies, listing Shell and StatoilHydro among the “most transparent” (Swann, 2008). Rankings may be a competitive advantage.

Top managements should expect increased transparency and disclosure of financial, social, and environmental information. Only about half of boards have a succession plan in place (Taub, 2006). A survey of directors and CEOs reported that 56.3% of respondents said the board has a formal CEO succession plan (Rappeport, 2007). However, such plans are not widely disclosed. About half of 1400 board members surveyed (at public, private, and non-profit corporations) reported that they regard themselves as less than effective in CEO succession (Taub, 2006). Top managements should expect to prepare and disclose succession policies and plans.

Executives and directors should respond to governance and responsibility pressures with stronger ethics, greater transparency and disclosure, better governance practices, and greater sensitivity to CSR considerations. Without personal integrity and business acumen of officers and directors, governance and responsibility standards are little more than hortatory (Khanna et al., 2006). Executives and directors have less desirable options for how to react or anticipate. There has been reported movement toward foreign firm exit from U.S. exchanges, private equity, and international IPO listings, partly to escape SOX requirements and audit
fees (Litvak, 2007). While empirical evidence on these options is debated, one study suggests that, while SOX induced small firms to exit through private acquirers or go to non-U.S. exchanges, there was no immediate effect on large firms (Piotroski and Srinivasan, 2008). Possibly, departing firms had simply faced higher costs of capital due to poorer performance. The SEC proposes permitting public companies to use international financial reporting standards (IFRS) starting in 2010 and perhaps requiring them to do so in 2014. A chief argument for the proposal is the concern that U.S. exchanges might be losing market share. In 1986, Delaware permitted corporations to limit or eliminate the personal liability of directors. That approach spread to virtually all 50 states.

International standards for corporate governance and reporting (financial or non-financial) are not yet fully established; and enforcement occurs largely by stock exchanges and national jurisdictions. Nonexistence or weakness of governance mechanisms and transparency in many developing and transition countries (Millar et al., 2005; Shleifer and Vishny, 1997: 738) and significant variation in governance mechanisms across advanced economies has enormous implications for MNCs. Italy had, until the 2003 corporation law (Ghezzi and Malberti, 2008), weak corporate governance mechanisms (Shleifer and Vishny, 1997: 738). Implementation of best practices is the test of management integrity.

2.2. Conceptualizing corporate governance

“Corporate governance is distinct from—and should not be confused with —the topics of business management and corporate responsibility, although they are related” (Weil and Manges, 2002: 1). This agency view is misleading for corporate governance research, teaching, and practice concerning MNCs for two reasons. First, governance mechanisms are everywhere simply economic and legal institutions subject to political processes (Shleifer and Vishny, 1997: 738)—as re-emphasized by recent governmental interventions. Precisely because governance and responsibility are increasingly related, it is difficult to disentangle financial and non-financial pressures on MNCs. Two, an “inconvenient truth” for agency theory is that the final goal of corporation law, even in the U.S., is social prosperity broadly defined rather than company profitability (Lipton and Rowe, 2007). Tightening governance affects non-financial stakeholders and in various ways that may activate public debates and political processes.

There are heightened public expectations concerning sound business management, ethics, and CSR. Talisman, a Canadian firm, was pressured by human rights activists into selling its Sudan investment (McCarthy, 2008). Shareholder and stakeholder activism concerning CSR initiatives is another set of pressures on management (Logsdon and Van Buren, 2008). UN Secretary-General Kofi Annan organized the UN Global Compact, which promotes ten principles concerning human rights, labor rights, environmental responsibility, and anti-corruption accepted voluntarily by adhering companies. The EU has been promoting voluntary CSR—defined in terms of stakeholder responsiveness, environmental responsibility, and sustainable development (Elkington, 2006)—since 2000. ISO 26000, scheduled for publication in 2010, will provide guidance (not certification) concerning CSR. The likely result will be greater disclosure of information rather than definition of specific global standards.

About 1000 organizations in some 60 countries reportedly adhere to the revised Global Reporting Initiative (GRI) guidelines. GRI was formed in 1997 by the Coalition for Environmentally Responsible Economies (CERES) and the Tellus Institute, with support of the United Nations Environmental Programme (UNEP). Companies listing on the Johannesburg Stock Exchange must comply with the King Report (I—1994, II—2002). King II requires compliance with GRI reporting standards. The King II Integrated Sustainability concept integrates corporate governance, ethics management, and triple bottom line reporting (Painter-Morland, 2006). This example signals that corporate governance and corporate social responsibility will not be automatically separate dimensions for MNCs operating globally.

To summarize this article’s perspective, in either definition explained earlier, corporate governance is basically some system of checks and balances on choices made by top management. Checks and balances may range from virtually nothing effective (i.e., general freedom of action for the CEO) to strongly defined and stringently enforced by government (e.g., the basic intention of SOX). One may think of governance as including the following four dimensions of a company: (a) defining its purpose and values; (b) key board and management practices; (c) top management, especially CEO, selection, compensation, and incentives; and (d) company performance measured in terms of multiple outcomes. Governance concerns what kind of board will be more likely to select the right CEO for sustainable company performance in the context of industry and home and host countries. This governance process is thus more complex for MNCs operating across multiple governance, CSR, and corruption conditions.

The OECD guidelines for multinationals, first issued in 1976 and again revised in 2000, state that firms should “support and uphold good corporate governance principles and develop and apply good corporate governance practices” (OECD, 2000: 19). The guidelines encourage firms to communicate social, ethical, and environmental policies, codes of conduct, and material information concerning governance structure and policies and employee and stakeholder relations (OECD, 2000: 5, 20).

A key development has been inquiries into corporate governance standards and practices in a significant number of countries (Erakovic, 2007). The London Stock Exchange (LSE) formed the Cadbury Committee in the wake of major British corporate scandals. The 1992 Cadbury report made 19 recommendations in a voluntary Code of Best Practice for improving financial performance developed by study of companies then generally accepted as well governed (Cadbury, 2006: 21–22). These recommendations remain the core prescriptions for corporate governance principles and practices. The LSE required simply annual disclosure of the degree of compliance and statement of reasons for areas of noncompliance (Cadbury, 2006: 23). Since various prescriptions proved controversial or insufficient, there followed in the U.K. a series of inquiries (including the Greenbury Report, 1995; Hampel Report, 1998) and a Combined Code (Jones and Pollitt, 2004). Inquiries included directors’ remuneration; broad internal control beyond financial controls; board supervision of risk management; non-executive directors; and guidance for board chairs.
Inquiries in other countries tended to emphasize similar governance improvements while also stressing the need to maintain stakeholder responsiveness simultaneously (e.g., Dey Report, 1994, Toronto stock exchange; Peters Report, 1997, Amsterdam stock exchange). The Viénot Reports (1995, 1999) have had considerable influence outside France in continental Europe and French-speaking countries. In May 2000, the European Association of Securities Dealers (EASD) issued Corporate Governance Principles and Recommendations based on a comparative study of national and international best practices.

3. Relevant literatures

Corporate governance falls at the intersection of several relevant bodies of literature: economics and finance, corporate governance law, management theory, and business and society studies. Key findings from those literatures are as follows. These large and expanding academic literatures are not unified or consistent in viewpoint, predictions, or prescriptions. Real firms face contradictory pressures from uneven country regulation and uneven competition conditions. Multiple theories of governance may explain these contradictory pressures better (Udayasankar et al., 2008). The study just cited combines, for example, agency, stakeholder, institutional, and resource-dependence theories.

The agency perspective dominates economics and finance literatures. These literatures address governance from the perspective of investor return under conditions that separate ownership and control in public companies. This agency approach, positing self-interest of economically rational actors, focuses on how large numbers of shareholders can align the interests of hired executives with their own through incentive and monitoring devices when those executives possess asymmetric information. The agency approach is opposed to stakeholder participation devices and non-financial considerations such as CSR. Such devices and considerations are acceptable in the agency approach only to the degree they serve to advance investor interests. Strengthened fiduciary accountability was a marked theme of corporate governance reports in the 1990s. Corporate scandals and industry and financial crises suggest that such fiduciary accountability is difficult to institutionalize.

Corporate governance law (Millstein, 2006) separates into the two broad approaches of common law in countries (especially the British Commonwealth) that follow the Anglo-American model and civil law in countries that follow the continental European model. Both approaches should be understood as families of diverse governance models, since there are great variations. The U.K. is today arguably an independent evolution (Davies and Rickford, 2008; Tylecote and Ramirez, 2006) lying somewhere between U.S. and European approaches (Deakin and Hobbs, 2007; Toms and Wright, 2005). While awkward to classify, Canada, Australia, and New Zealand are somewhere between U.S. and U.K. approaches. Most other countries generally follow the European civil law tradition.

Nevertheless, the dividing line is effectively between rules (roughly the Anglo-American common law approach) and principles (roughly the European civil law approach). The likely impact on top management and governing boards is awkward to predict. Rules are more specific and thus more easily evaded by management; principles are more general and thus more broadly interpreted by regulators.

Common law systems permit judges to apply constitutional, statutory, and precedent rules to particular cases. (Precedents are not, strictly speaking, absolutely binding.) The Anglo-American approach historically has emphasized fiduciary accountability for investor return. But social prosperity rather than profit maximization is the ultimate goal of corporation laws (Lipton and Rowe, 2007). In common law systems, firms are thus not strictly bound at law to maximize profits. Other considerations are admissible under the business judgment rule and also so-called corporate constituency (or stakeholder) statutes adopted in more than half the U.S. states.

Civil law systems nationally codify corporate governance principles and practices, which are typically even less restrictive with respect to profit maximization—as in the EU which has recently emphasized greater CSR. International codes and guidelines for corporate governance reflect the civil law tradition.

MNCs operate across national boundaries and legal systems. MNCs may have a parent legal entity in a common law or civil law country and subsidiaries in the other form of legal system. A firm’s governance structures and practices may vary greatly across country subsidiaries. Variance in corporate governance law across countries has important implications for tightening, in the absence of strong international codes and guidance.

The academic literature has tried to grapple with this crude distinction in legal systems. LaPorta et al. (2002) argued that common law systems of corporate governance outperform civil law systems of corporate governance. As illustration, U.S. and U.K. firms typically should outperform German firms. The posited reason is greater protection of investor rights: legal protection is superior to type of financial system (capital market finance in outsider economies in common law countries versus banking finance in insider economies in civil law countries). The validity of this finding is increasingly challenged. The basic criticism is that the LaPorta proposed index of investor protection is a simplistic, inaccurate statement of differences among legal systems. The polar distinction is overly simplistic. For example, the U.K. arguably has evolved to lie between U.S. and civil law approaches. There is also little systematic relationship between corporate governance measures and corporate performance measures. Findings are likely highly dependent on context and firm-specific circumstances. The differences in effective investor protection may be nil between the U.S. and Germany. Moreover, governance is an evolving situation such that the U.K. may have leapfrogged past the U.S., while India is just beginning to improve (Lele and Siems, 2007). Some common law country firms may have stronger governance attributes than comparable U.S. firms.

Management theory is a broad rubric encompassing several related fields of study such as leadership, organizational theory and behavior, and strategy. Most relevant to the MNC are the institutional and resource-dependence theories of organizations. MNCs, which can be differentiated network organizations (Rugman and Verbeke, 2003), are involved with complicated strategic and
geographic dispersion of investments and operations. The core theory of the multinational firm has tended to divide into the two, partly conflicting, foci of (a) institutionalism reflecting complex organizational structure understood sometimes as a function of transaction cost economics and sometimes as a more eclectic empirical phenomenon, and (b) resource-dependency reflecting complex strategic management understood as highly variable deployment of resources across multiple countries. MNC decision-making is a complicated socio-political strategic management process (Bower and Doz, 1979: 165).

Business and society is, like management theory, a broad rubric encompassing a number of closely related fields of study. The ones most relevant to corporate governance are business ethics, corporate social responsibility and responsiveness (or corporate citizenship), and stakeholder management theory. As foreign entities in host countries, multinationals may face increasing incentives and pressures for citizenship behavior. Since host country conditions are highly variable, and in many emerging and transition countries politically corrupt as well, CSR strategy and stakeholder management are likely to prove more complicated for MNCs (Driver and Thompson, 2002). Tata Motors had planned to produce the world’s cheapest car at a new plant in West Bengal, India, where various suppliers wish to locate. The result was a dispute with local farmers over what land conversion and also what price land sale should command. In part, the problem is that the government may be obtaining land for lower price than farmers might (hypothetically) get directly from firms wishing to purchase land. In Kerala, India, Coca-Cola has faced a dispute over groundwater use and pollution at bottling facilities. These conflicts of interest are difficult to diagnose and resolve. It is difficult to order corporate priorities, although the Johnson & Johnson Credo (first issued in 1943) does so. An MNC may need to shift production location from one country (or region) to another. In doing so, to obtain lower labor costs or favorable tax treatment, it abandons one community and local employees in favor of investment in another community and hiring of other local employees. Corporate governance reports of the 1990s simply advised attempting to balance shareowner and other stakeholder interests. These reports did not provide concrete guidance concerning how to do so.

There is a dividing line between adherents of narrowly oriented shareowner value maximization and adherents of broader triple bottom line performance. The division is partly ideological (what one believes about markets versus governments) and partly theoretical (what one thinks is the purpose and contribution of the business enterprise). The agency perspective dominates economics and finance literature; stakeholder management, corporate social responsibility, and sustainable development dominate business and society literature. Both perspectives can be found competing in corporation law. Management theory focuses on complexity of MNCs and the related internalization of external conditions as basis for competitive advantage. MNC complexity varies on a country basis and thus approaches business and society issues. MNCs cannot maximize shareowner wealth while ignoring broader legal and political environments varying by country and region. Organizational integrity, in the form of strong core values and ethics, may be the minimum-cost solution to legal compliance (Paine, 1994).

4. Cross-national variations

MNC governance principles and practices remain a matter of largely voluntary adoption by companies within largely national codes and guidance. Examination of how to tighten governance in MNCs remains difficult, because “Even in advanced market economies, there is a great deal of disagreement on how good or bad the existing governance mechanisms are” (Shleifer and Vishny, 1997: 737). One empirical study of 15 countries and 483 firms concluded that regulation enhances within-country convergence in practices while competition enhances cross-country convergence in practices (Udayasankar et al., 2008). In many less developed economies and some transition economies (illustrated by Venezuela and Russia), “corporate governance mechanisms are practically nonexistent” (Shleifer and Vishny, 1997: 738). Characterizing cross-national variation in corporate governance approaches and practices for research, teaching, and practice purposes thus is not simple (Aguilera and Jackson, 2002).

Even within the OECD countries, there are several different approaches. National political processes may opt, in different countries, at varying combinations of shareholder return, stakeholder satisfaction, and corporate social responsibility. The EU is weighing how to harmonize corporate governance approaches and what to do with co-determination. Key models are explained here.

The Anglo-American, or common law, approach emphasizes fiduciary accountability of directors and the agency problem of how investors can monitor and control executives. The U.S. and U.K. are outsider economies with relatively diffused public company ownership. The common law approach does not strictly enjoin profit maximization; the business judgment rule, legal precedents approving corporate philanthropy, and in about half of the states so-called constituency statutes afford broader discretion to boards. A typical feature of the Anglo-American approaches is a single-tier board. The Italian 2003 corporate governance law affords companies’ choices among the three options of the traditional Italian system, the German two-tier system, and the Anglo-American single board system (Ghezzi and Malberti, 2008).

Features of the German approach, an instance of a civil law system, are a dual or two-tier board (supervisory and management) and labor co-determination, which are not common across EU systems (Jungmann, 2006). The supervisory board appoints the management board and is entitled to certain information. The German approach, an instance of a civil law system, emphasizes dual company responsibilities to two classes of stakeholders (i.e., investors and employees). The involvement of labor and trade unions varies by ownership and number of employees. By a 1972 law, each establishment with five or more permanent, voting employees has a works council. The EU has created a European-level registration (Societas Europea or SE) with a single board (on the Anglo-American pattern) but involving the issue of works councils. Where this SE is created in Germany, German co-determination law applies. Cross-border mergers create issues concerning co-determination and works councils.

There is some evidence bearing on where German governance (Government Commission, 2002) may be headed in relationship to employee relations. Höpner (2001) constructed a shareholder value index for the 40 largest listed German companies. External
market exposure interacts with internal factors (such as increasing executive compensation and reduced monitoring by banks and corporate networks) to increase emphasis on shareholder value. The study thus found changing coalitions among shareowners, managers, and employees. Although the changes did not result in opting out of collective agreements or endanger co-determination, industrial relations became more market driven.

The Japanese approach is a blend in which there is a single board and largely company (rather than trade) unions, and until recently assured lifetime employment. Banks have traditionally been more important than investors; and firms are often members of extended “family” networks (keiretsu). The Japanese governance reform process (Japan Corporate Governance Forum, 2001) may therefore result in a distinct evolution that increases flexibility in decision-making while retaining core aspects of the conventional Japanese company (Buchanan and Deakin, 2007). One study finds for Japan that an investment portfolio of well-governed firms (defined using an index of several attributes thought to be associated with firm profitability and market value) significantly underperforms an investment portfolio of poorly-governed firms (Aman and Nguyen, 2008). The empirical relationship between governance and performance is complex.

Governance developments outside the OECD countries are much more diverse (Oman, 2006). Some evidence suggests progress in corporate governance outside the developed countries. The Securities and Exchange Board of India (SEBI) has guidelines for listing companies. Tata Group, of India, seeks to improve shareowner and stakeholder values through the Tata Code of Conduct, Tata Business Excellence Model, Global Reporting Initiative (GRI), and group core values (Waknis, 2007). In voluntary adoption of IFRS, in more developed countries firm-specific factors dominate country-level institutional factors, and in less developed countries the exact reverse seems true (Francis et al., 2008). In more developed countries, benefits likely exceed costs of better governance choices, while less developed countries need better institutions.

MNCs are headquartered and operate in very different countries. Empirical research has focused on testing three very simplified distinctions that are too simplistic and inaccurate for MNC prescriptions.

1. The LaPorta testing of common law versus civil law systems, assessed in the previous section, does suggest that investor protections matter (Desai and Moel, 2008).
2. Public companies, typical of the U.S. and U.K. outsider economies, are not the only common organizational form. France, Germany, and Japan are more insider economies (Tylcot and Ramirez, 2006). Research distinguishes between diffused investor ownership (dominated by institutional investors) in outsider economies and managerial or controlling-interest domination in insider economies. Insiders enjoy stronger private control benefits concealed from other stakeholders (Holthausen, 2003). Family-owned/controlled firms are important in much of East Asia and noted for lack of transparency.
3. Style of management (Culpan and Kucukemiroglu, 1993) distinguishes collective leadership in Japan from strong CEO in the U.S. Style of management may interact with national culture (Witt and Redding, 2008). Interviews with ten leading players in Malaysia’s corporate governance development after the 1997–98 Asian financial crisis suggest that the majority placed greater emphasis on the social aspect of corporate governance relative to strengthened formal duties of shareowner accountability. Changes in corporate culture (i.e., attitudes and values) are likely antecedent to effective accountability reform (Liew, 2007).

5. Basic history of corporate governance

Cross-national variations discussed in the previous section reflect different historical traditions that may affect possible futures for MNCs. Modern governance theories and practices reflect numerous developments over several centuries commencing with the introduction of the MNC joint stock ownership corporation illustrated by the English Honourable East India Company (HEIC), 1600–1874, and the Dutch East India Company (VOC), 1602–1800. The 1720 South Sea bubble was an early financial scandal (Cadbury, 2006: 15). Adam Smith, The Wealth of Nations (1776), commented adversely on the governance problems of HEIC and its monopoly rule in India. The U.K. passed a Joint Stock Companies Act in 1844 and introduced limited liability in 1862 (Cadbury, 2006: 16). Bismarck introduced mandatory supervisory boards (i.e., the German two-tier board system of today) in 1870 (Cadbury, 2006: 16).

The basic division in corporate governance reform is typically portrayed as between Anglo-American (or common law) and European (or civil law) approaches. European corporate governance legislation was national in origin. In the U.S., corporate governance legislation was largely state by state, with Delaware being most important (Bradley and Wallenstein, 2006). In common law countries, court cases strongly shaped corporate governance practices. Dodge v. Ford Motor Co. (Michigan Supreme Court, 1919, 204 Mich. 459, 170 N.W. 668), which articulated the business judgment rule, endorsed shareowner wealth maximization as the primary but not necessarily the sole purpose of the corporation. The Great Depression generated the Berle-Dodd debate concerning shareowner wealth maximization versus broader stakeholder considerations. Collapse of the Samuell Insull electricity holding company in the Great Depression led directly to the Public Utility Holding Company Act of 1935. The Securities And Exchange Acts of 1933 and 1934 created the U.S. Securities and Exchange Commission (SEC) and prohibited insider trading. Major developments in the U.S. since 1932 have increased importance of institutional investors and widened diffusion of stock ownership through pension funds. These devices are not as well developed elsewhere.

Since the 1992 Cadbury Report, many national codes of best governance practice and various international guidelines have appeared (Cadbury, 2006: 26; OECD, 1998, 1999, 2000, 2004; Pierce and Waring, 2004). Codes and guidelines are typically voluntary. They emphasize disclosure or transparency, checks and balances, and a proportion or number of independent directors (Cadbury, 2006: 27).
The relationship of several key dependent variables to governance prescriptions is not strongly established by empirical research.

- Studies of U.K. companies after the 1992 Cadbury Report find some evidence over time of increased compliance with recommended standards and practices. There is some evidence of reduction in board and management entrenchment (Dedman, 2000; Tsipouri and Xanthakis, 2004).
- Entrenchment devices do appear to reduce firm value and stockholder returns (Bebchuk et al., 2009). But firm-level governance attributes are complementary to and not substitutes for country-level investor protection rights.
- Compliance may affect capital market perceptions expressed by fund managers and analysts (Cheung and Jang, 2008).
- Good governance leads to less earnings management in normal conditions but is financially significant mostly when a firm is in financial difficulty or facing a major threat (Rose, 2005; Shen and Chih, 2007).
- During the 1990s, U.S. firms with stronger shareholder rights exhibited higher valuation, profits, and sales growth; these firms had lower capital spending and made fewer acquisitions (Gompers et al., 2003). Similar results have been found in some other countries (Black et al., 2006; Chen et al., 2007; Cheung et al., 2007). However, announcement of compliance with the German Corporate Governance Code did not show any short-term event study effect on firm value. Higher levels of code compliance or improvements in governance quality did not have any long-term positive effect on stock price performance. Independent monitoring and legal enforcement may be required (Nowak et al., 2006).
- International Financial Reporting Standards (IFRS) may increase quantity and quality of disclosures. One study across 34 countries concludes that full IFRS adopters had a significantly lower cost of equity capital relative to non-adopters (Kim and Shi, 2007). Reduction in cost of equity capital is greater for adopters from countries with weak institutional infrastructures.

6. Three possible futures for MNCs

Three possible scenarios for evolution of international corporate governance and reporting standards impact MNC management very differently.

A scenario of voluntary company efforts at best practices would continue the pre-2008 situation. This alternative is the most flexible from a business perspective; but also likely to be the least reliable and trustworthy. This approach depends on purely market sorting of winners and losers through competition. Best practices should tend to disappear in competitive conditions. Early movers might gain competitive advantage. But whether markets are sufficiently competitive is not well established empirically. Compensation systems tend to work against best governance practices. Dramatically increased government intervention in markets following September 2008 undermines the scenario. Scandals and crises tend to erode investor and public confidence and to threaten the foundations of the market system. Failures of integrity tend to provoke increased government regulation. Voluntary CSR might be evaluated not as succumbing to social pressures but as a cushion against reputational effects of weak performance.

The second scenario is the “hard law” of government regulation. FCPA and SOX are instances of reaction to scandals and crises. Evidence on whether earnings management has become more conservative post-SOX is divided and disputed (Lobo and Zhou, 2006). Evidence on whether SOX has tended to move companies to non-U.S. exchanges seems mixed: it has had no clear effect on large companies but may have had an effect on small companies. This alternative is the least flexible from a business perspective; but also likely now to work popular with politicians and public sentiment. This approach tends over time to increased detail and rigidity (Hopt and Leyens, 2005). Companies must expect to comply regardless of immediate cost. There are more independent directors and wider practiced separation of the Chair and CEO positions. Internal control and the strategic role of the supervisory board are improving. A strategic issue is making use of hard law for competitive advantage.

Between company voluntarism and hard law lies “soft law.” The term covers national and international codes that involve voluntary adherence but are promulgated by bodies such as stock exchanges, securities dealers associations, NGOs, and intergovernmental institutions such as the OECD. IFRS voluntary adoption is of this character. Soft law retains flexibility of company voluntarism while benefitting from the external legitimacy and pressure of supra-company promulgation. MNCs can adhere but not implement in some instances (as illustrated by joining the UN Global Club but doing little to implement its principles); or look for operating locations with weaker standards. Management should set a strong standard of adopting best practices, bearing in mind the difficulty to date of establishing reliable empirical relationships with performance measures of various types. The Japanese governance system, in relying on strong company cultures, is arguably superior to the U.S. governance system measured by performance rather than governance outcomes (Yoshimori, 2005). The problem in the U.S. system is pressure for earnings management. It is possible to meet the letter of the law by appointing worthless individuals and adopting useless prescriptions (Cadbury, 2006: 26). Enron had excellent corporate governance practices and excellent codes of conduct that proved to be worthless. Enron suffered from poor governance culture rather than recommended practices and this culture ignored bad business judgment concerning risks inherent in its business model (Deakin and Konzelmann, 2004; Stewart, 2006).

7. Needed research, teaching, and practice

The future of tightening turns on whether there will be global convergence across countries (and if so, on what particular model of governance, in light of the three scenarios) or continuation of significant national variations (Garrett, 2004; Gregory, 2006). Convergence focuses on protection of investor rights in emerging and transition countries where governments are corrupt and...
legal institutions weak. Pace of convergence will depend on speed and effectiveness of economic globalization. FDI has tended to exit from Russia due to that country’s efforts to re-nationalize energy industries.

Research needs to establish whether, in addition to trends concerning convergence versus continued divergence, there are any reasonably reliable relationships between various corporate governance principles and practices and corporate performance measures (both financial and non-financial in a triple bottom line framework). Our knowledge base about governance prescriptions is in reality quite weak. Most SOX-instituted practices and related NYSE or NASDAQ regulations had not been studied in the prior academic literature (Finegold et al., 2007). While stronger corporate governance firms tend to have better financial performance, the relationship is not particularly strong and is subject to considerable criticism. A financial relationship does not necessarily determine what will happen in triple bottom line performance. Public expectations concerning CSR have been heightened by scandals and crises.

Teaching should focus on the need for flexibility and pragmatism, in the absence of conclusive research findings, and on the vital roles of personal integrity and business acumen. Dodge v. Ford (1919) not the dominating legal standard of Anglo-American corporate governance. A significant number of states have adopted so-called constituency statutes modifying that standard. Corporate governance will likely evolve as a balancing of considerations. There must be a balance between flexibility and compliance, between shareowner wealth and stakeholder responsiveness, between financial performance and other responsibilities, and so forth. Enron and similar instances illustrate what happens when balance is lost or ignored. There may be an inherent conflict between national and global codes of corporate governance practice. There may also be a tendency for codes to become more detailed and rule oriented over time, reducing corporate flexibility. While both competitive market forces and statutory regulation are required, it may not prove feasible to reduce voluntary codes of best practice “to legally enforceable rules” (Cadbury, 2006: 25). The essential consideration in directorship and management is qualitative: individuals must be independent and of high moral integrity and sound business judgment (Cadbury, 2006: 25). The difficulty is to define independence in practice (Cadbury, 2006: 27).

Companies should identify and implement best governance practices, independently of convergence or divergence. The key dimensions of best practices are careful selection of directors and executives, succession planning, and disclosure and transparency. Design of compensation systems that will promote strategic sustainability and personal integrity is important, as illustrated at Enron.

In practice, the executives and directors of MNCs must appreciate cross-national variations in corporate governance and rising importance of both international guidelines and triple bottom line performance expectations. Best practices must emphasize management integrity and strategic flexibility for balancing of multiple considerations. Differences in investor protections due to national variations will likely persist. International pressure may work. A U.S. investor, 99% owner in a Czech media company, recouped through the use of international agreements and tribunals about $355 million from the Czech Republic over marked failure of domestic protections (Desai and Moel, 2008). Protection of investor rights and promotion of business integrity are the proper foci of international norms and national laws.

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