Anca-Simona HROMEI
*Doctoral School of Economics and Business Administration,
Alexandru Ioan Cuza University of Iaşi, Romania*

CORPORATE GOVERNANCE SYSTEMS AND CONVERGENCE TENDENCIES

Review Article

Keywords
*Corporate governance;
Convergence;
Corporate governance systems;
Corporate social responsibility;
Market globalization*

JEL Classification
G34

Abstract

Over time, the specialized literature has very clearly delimited the two main types of corporate governance systems, namely the "outsider" and the "insider" type, starting from the analysis of various internal and external factors. However, as the economic environment and financial markets evolve, the influence of several factors changes, and certain features of a system are increasingly found in companies previously included in a distinct governance system. This paper firstly aims to delineate the characteristics specific to each governance system, and secondly to present those reasons, factors and the characteristics that lead to the possible gradual convergence of the governance systems worldwide.

CORPORATE GOVERNANCE SYSTEMS

The corporate governance system applicable to a particular country is chosen according to the characteristics of each model and the way in which they are bent on the economic, financial and legislative situation of the respective country, the principles offered by the Organization for Economic Cooperation and Development usually having an indicative role.

The corporate governance system chosen and developed in a particular country is determined by certain internal factors such as the shareholding structure, the degree of development of the respective economy, the legal framework in force, the political environment, the culture and history of the respective country, as well as by some external factors, among which can be mentioned the capital infusions from abroad, the worldwide political-economic context, the cross-border institutional transactions and investments.

The analysis of corporate governance systems is relevant in the case of large companies, where there is a clear delimitation between shareholders and directors, as opposed to the case of small companies, where the sole owner or a small number of owners participate directly in the management of the company.

Short, Keasey, Hull & Wright (1998) and Franks and Mayer (2000) classify corporate governance systems according to the "outsider/insider" model, which later became the most popular and frequently addressed classification in the works dealing with this topic.

Depending on how the corporate governance is implemented, two main models can be delimited, namely the "outsider" system and the "insider" system, the differences between the two referring especially to the capital structure of the companies (dispersed vs. concentrated property), the attitude and openness towards the external financing sources, the orientation and elaboration of strategies, and the interest towards certain stakeholders, etc. (Onofrei, 2009).

The characteristics of corporate governance models usually vary from one country to another, being influenced by the legal regulations of the respective state, by the events and transactions that characterize the economic reality of the respective area, as well as by the status of each company.

For the analysis of each model many elements are taken into consideration, such as: the model of ownership distribution and the distribution of percentages between the various shareholders, the structure and composition of the Board of Directors, the key players in the corporate environment and the interaction between them, the applicable legislative framework, the presentation requirements of the relevant information in the case of companies traded on the stock exchange, and the separation of the decisions that require the approval of the shareholders. Considering all the aspects previously mentioned, each of the two models will be described as following.

The Outsider (Anglo-Saxon) Governance System

This model is specific to companies operating in countries such as the United Kingdom, the United States of America, Canada, Australia and New Zealand.

These governance structures are characterized by the predominant participation of independent persons, respectively individual investors, not affiliated with the company, referred to in the specialized literature as external shareholders or "outsiders". Within these systems, the legal provisions clearly define the rights and obligations of managers, directors and shareholders as key decision makers in the activity of the respective companies. Another key feature of this model refers to the relationships between shareholders and the company, as well as those between the other shareholders, all being governed by simple and clear procedures (Hall & Soskice, 2001).

The key players in the Anglo-Saxon model, with influence in establishing the corporate governance framework are the shareholders, especially the institutional investors, directors and the management, but also the state institutions, stock exchanges, and large consulting companies.

The Anglo-Saxon governance system can be characterized by the following features:

- The existence of a high degree of capital dispersion;
- The financing is made mainly through the stock exchange;
- The state, through the public authorities, has a limited involvement in the economic environment;
- The information is transmitted through a transparent system;
- The accounting profession plays an important role in the elaboration of rules;
- There is a clear delimitation of tax accounting;
- The presence of a stable economic environment;
- Companies have a high degree of liquidity;
- The system of traditional law (common law) applies.

The social capital of the companies included in this system is generally owned by a large number of shareholders oriented towards obtaining fast benefits, especially as dividends. When it comes to ways of financing these companies, the capital market mechanisms are usually preferred rather than bank loans.

The Board of Directors of the companies following the Anglo-Saxon model comprises both members affiliated to the company (insiders), having either the quality of employees or business partners, as well as members from outside, who are not directly linked to the company. When speaking about the leading role of the board in this corporate governance model, the president usually holds also the position of general manager of the company. This double role contributes to the limitation of the number of people with decision-making power and access to important information, often providing the framework for suspicion of intentional misinformation or even fraud.

The name of an outsider system emphasizes the dominant role of the independent individual shareholders, who are not linked to the company through different business relationships. Organizational connections are structured into two categories, namely those established between owners (shareholders) and directors, and those between administrators and management, resulting an organizational hierarchy structured on three levels: shareholders – administrators – managers (Onofrei, 2009).

Within the outsider system, the importance of the shareholders' right to vote is emphasized, which entitles them to choose or dismiss their directors. A dispersed shareholding structure would lead to the dilution of the power of shareholders to decide on the management of the company, thus explaining the prevailing interest for the benefits that the shareholders of the companies in this model receive as dividends (Nistor & Popa, 2014). As the property is dispersed among a large number of shareholders, it is highly important that the access to information of all the shareholders should be as fast as possible in order to substantiate the decisions. This requirement has led to the development of a transparent information system, with a well-defined internal audit activity, with clear objectives, adequate internal policies and procedures being developed.

The companies belonging to this system of governance accept the external financing, the participation of the investors in the share capital being realized by the purchase of shares listed on the stock exchange market. Thus, it is possible to observe a dependence of the companies on the market resources and a rapid reaction to the signals offered by it, the price of the shares being an indicator of the performance and stability of a company. So it can be stated that the financial markets play a controlling role of the companies' performance and stability. Also, within this system, in order to achieve the objectives set by the owners, companies often use takeover mechanisms, sometimes even hostile ones.

The great corporate scandals that have occurred in the American economic environment have been associated with the limitations of this type of governance system. However, its strengths are aimed at achieving performance, increasing the dynamism of companies and a sustained upward economic trend in the US economy, a strong capital market with high financial reporting standards and transparency, which is why it is frequently recognized as a leading model in international corporate governance, as Nistor and Popa (2014) stated.

The "Insider" (Continental-European) Governance System

The insider system is a model based on human relations (relationship based system), being influenced by the cultural diversity within the European Union as well as the whole Asia-Pacific region.

In this model the ownership is concentrated among a small number of shareholders, and the owner-manager relationships are tight and stable. The owners use this approach to evaluate a series of "organizational skills" based on which future performance can be predicted. It is often claimed that the stability of ownership in companies belonging to these systems and the criteria used for performance evaluation allow managers to gradually respond to changes in market conditions, a fact that causes these companies to mainly accept the gradual restructuring (Hall & Soskice, 2001).

Therefore, the main characteristics of this system concern a concentrated structure of ownership, the shareholders usually activating within the respective corporations or having direct business relations with them. This system presents, as a distinct feature from the outsider model, the existence of a strong shareholding, with major influence on the management; the banks, the big financial investment companies as well as other entities frequently have the role of owners within these companies and control their decisions and plans. The stability of the shareholding structure determines the elaboration of long-term strategies, the interest of the owners being oriented towards the same distant time horizon. Companies in this category often resort to limiting the issuance of new shares, in order to increase the control held by certain shareholders. In this respect, those who hold a majority percentage of shares actively participate in the management of those companies, pursuing and sanctioning the non-performing management, at the same time stimulating the economic efficiency and effectiveness, as well as harmonizing the interests of all the stakeholders, including the employees (Cosneanu, Russu, Chirițescu & Badea, 2013).

The capital markets on which companies in this category operate are not as developed as those in the "outsider" system, and standards for transparency and information provision are relatively limited. As for the resort to certain sources of financing, in the "insider" system the companies prefer banking institutions and bank loans rather than the financial market instruments. Given the important role of banks in providing financing, they have a major interest in the activity of large companies, assuming even a role of monitoring their activity. The limited number of creditors and participants in the corporate capital outline a concentrated property structure. This system of governance is characterized by cross-holdings of capital, which form a shareholding network within which banks play a central role. They have a multiple role being at the same time shareholders, creditors and depositors. Thus, the strong control that the creditors have within the companies of this system is outlined.

As a positive aspect, companies from the insider model area are pursuing at the same time the satisfaction of the interests of several stakeholders, showing interest in sustainable economic activity and developing responsibility and environmental programs (Nistor & Popa, 2014).

The researchers in the field also pointed out the limits or disadvantages of this system, referring to the low degree of protection for minority shareholders and the risk of financial concentration towards a single source of capital. Moreover, the criticisms of this system of governance have addressed the following aspects (Bogdan, Farcane, Popa & Boloș, 2011):

- The companies in which the banks own shares receive easier loans, due to the fact that banks in their role of shareholders focus on increasing the performance of those companies;
- The existence of an increased risk for the banks that hold a large number of shares in these companies, their losses being major in the case of bankruptcy;
- The close connection between banks and companies imposes limitations on the level of liquidity, which restricts the involvement of the respective companies in certain new business opportunities;
- The existence of coalitions at the shareholder level might determine a non-correlation of the decision-making power with the number of shares held.

Also in the context of the weaknesses of this system, Bebchuk (1999) mentions the private benefits granted to the detriment of corporate efficiency, while La Porta, Lopes-de-Silanes & Shleifer (1999) invokes the reduced protection that minority shareholders benefit from in the context of the capital market as well as the concentrations of owners within companies that can be associated with poor corporate governance.

These ownership models and the tendency towards incremental restructuring are compatible with an industrial relations system that allows the opinions of employees to be expressed, either, for example, through statutory rights granted to them for representation on the board of directors, or through negotiation of a “social plan” that addresses the consequences of eventual restructuring at the level of employees (Edwards, 2004).

FROM DIFFERENCES TO CONVERGENCE OF CORPORATE GOVERNANCE SYSTEMS

Regarding the differences between the two systems, they primarily concern the relationships that are established between the directors, the majority (main) shareholders and the minority shareholders as well as their rights and obligations. Unlike the “insider” system, which diminishes the role of minority shareholders, the “outsider” model does not distinguish between majority and minority shareholders, thus generating greater stock exchange efficiency and increasing capital flow. In the outsider type system, the role of the majority shareholders is cancelled by the voting procedures imposed on the administrative directors who have the role of tempering the influence of the majority shareholders in the decision making. Moreover, within these systems one can observe the lack of preferences for the transactions with a high level of risk. In other words, the leader of a company in an outsider governance system is engaged in contractual terms, while one belonging to the insider system receives a social mandate from the company (Cosneanu et al., 2013).

In outsider type systems, the property is widely dispersed among a large number of shareholders, each of them owning only a small part of the total capital of the companies. The shareholders have open and distant relationships with the managers, and the current financial performance of the company is used as the main indicator of its health status. The need to convince shareholders who do not have detailed knowledge about the respective corporations regarding the fact that the market challenges are difficult but still confronted, determines the managers in this context to undertake a faster and more radical restructuring, compared to the tendency of those in the insider system. This concern for the interests of the remote or non-involved shareholders determines the companies whose governance system is in the outsider category to be reluctant to negotiate and consult the restructuring plans with the employees’ representatives, therefore these systems are very well suited to unregulated work markets, in which employees have relatively limited opportunities for decision and for expressing opinions at the company level (Hall & Soskice, 2001).

Significant changes have been identified lately in the level of governance systems, but also in the nature of industrial relations especially at the European level. Often, a tendency to manifest certain features specific to the “outsider” system within “insider” systems has been identified, the specialists considering that such a key model, based on a convergence process, would emerge along the Anglo-Saxon lines. Among the large, internationalized companies in the sectors where competition is truly globalized, there is evidence to support the existence of a certain degree of convergence along the Anglo-American lines. Edwards (2004) analysed multinational companies in Germany, the Netherlands, France and the United Kingdom, noting a trend among multinationals towards the Anglo-Saxon model. This trend can be considered as a significant proof of the evolution of the governance systems, given the role of large companies in establishing trends throughout the economy. While large and internationalized companies may have some side effects within a business system, this may also be the case for small and medium-sized companies. This is applicable even for companies in the protected sectors of globalization, which are governed and structured in different ways from those highly internationalized, a consequence of this being the increase of diversity among the national systems of corporate governance. These changes occur without an orderly convergence process; certain convergent patterns are obvious, but diversity within the respective countries remains a key feature. However, the institutional configurations become “hybridized” as they evolve, in response to external challenges and to the actions of interested actors and companies in the system.

At the moment, although the differences between the two models of corporate governance are obvious, due to some external factors, a slowly convergence tendency can be observed, features from one model being adopted and identified in companies which belong to the other model.

Such ***factors*** refer to:

- The increased competitive pressures of global commerce;
- The development and diffusion of codes of good governance and regulations (Collier & Zaman, 2005; Goergen, Martynova & Renneboog, 2005);
- The convergence of financial accounting standards and practices(Gemon & Meek, 2001);
- Increasing number of mergers and acquisitions between companies from different corporate governance systems and countries (Pagano, Röell & Zechner, 2002);
- Integration of product markets and capital markets (Nestor & Thompson, 2000; Khanna & Palepu, 2004);
- The increasing role of sustainability culture (Folke, 2007; Salvioni, Franzoni, Gennari & Cassano, 2018).

When it comes to *market and commerce globalization*, as global product market competition intensifies, corporate governance systems at the firm level also become similar, because firms decide to adopt more efficient elements of corporate governance. Moreover, when expanding product markets, companies must adapt to rules and procedures required by that particular market, this way adapting its corporate governance. When speaking about market and globalization, researchers state that in a monopolistic environment there may be less interest in promoting better corporate governance. A monopoly may be less pressured to make a profit than a competing firm and may have a greater ability to make such profit without adapting corporate strategies precisely because of its reduced competitive pressure. Therefore, monopolists will tend to keep older models of corporate governance, costs and financial structures. With openness to a competitive environment, retaining the old models of governance becomes difficult. As competition intensifies, companies realize the importance of adapting practices and policies to the characteristics of the governance system specific to the country in which they currently operate, in particular increasing the attention given to all stakeholders. High production and competitive advantages depend on the effectiveness of the decision makers to elaborate such strategies. The globalization of the product market directly influences the characteristics of corporate governance systems, diminishing the importance of certain specific suppliers. The globalization, development and diversification of the communication media allow small companies to easily and quickly locate suppliers from different corners of the world, thus reducing the need to develop close ownership or control relationships with suppliers so far in the long term (Nestor & Thompson, 2000).

As previously stated, another determinant for corporate governance convergence is the *evolution and diffusion of the governance codes*. Aguilera and Cuervo-Cazurra (2004) stated that countries with weak shareholder protection, high government liberalization and a strong presence of foreign institutional investors tend to primarily develop corporate governance codes. The weak protection of shareholder rights and the need for efficiency as a result of market pressure determines the development and dissemination of codes of good governance also in countries belonging to a different model of governance, which borrow the recommendations of codes issued by companies belonging to the stronger model, namely the outsider system.

The *evolution of the financial accounting standards and practices is* also considered to determine convergence of corporate governance models. This tendency is based on the intensification of the international business activity that has determined diversity in the accounting and financial reporting practices. Companies prepare their financial reports according to the country framework developed on the legal, political, cultural and business environment. When developing businesses outside that country, the reporting framework previously used might lack international comparability, therefore the imperious need to adapt the way information is presented according to that specific region.

When comparing the two systems of corporate governance, researchers consider that the outsider system having the American accounting standard US GAAP as basic reporting framework offers greater comparability in information. For this reason, more and more European companies draw up annual reports using the US' accounting standards (Braendle & Noll, 2006).

The evolution and fast growing *integration of stock markets* is one of the key factors determining convergence of corporate governance systems. Together with the expansion of multinational companies from countries with a corporate governance system towards countries with a different system, investors accept the idea that holding a diverse and international shares portfolio determines future higher returns and lower risks than the case of a single country portfolio. As a result, a large number of pension funds started to allocate part of their portfolios to international equities, together with specialised mutual funds created to allow participation of individuals in foreign stock investments. This phenomenon is more visible in countries with strong institutional investor communities (outsider model of corporate governance), but as these countries successfully increase institutional savings, this approach is slowly extending to companies from the insider model of corporate governance (Nestor & Thompson, 2000).

Another argument for convergence of governance models through *integration of capital markets* is the increasing number of restructuring and reorganization strategies through *cross-border mergers and acquisitions*. Listing a company on a foreign stock market can indicate that the company intends to expand through stock swaps, highlighting the appropriate circumstances for a merger or acquisition transaction. When a company from a country belonging to a certain governance model is acquiring a company from a different model, the new resulting company will usually adopt the governance characteristics of both the models. In other words, some corporate governance features of the system of the acquired or absorbed company are likely to be retained, while some practices of the acquirer's governance system will be adopted, this phenomenon conducting to convergence (Yoshikawa & Rasheed, 2009).

With the continuous fast growth of the Anglo-Saxon stock markets, a functional convergence towards the outsider system is more likely to occur especially due to companies from the "insider" system being traded on the US and UK stock markets.

Corporate governance is also considered a mean to enhance the performance of a company. The orientation of strategies towards *sustainability* and the implementation of corporate governance along the lines of *social responsibility* can be a significant convergence factor between the corporate governance systems specific to different countries. Policies and practices oriented towards social responsibility principles involve overcoming differences on choosing various performance indicators that characterize the "outsider" and the "insider" corporate governance systems. Therefore, companies that compete in global markets must adapt their strategies according to the values of long-term corporate development. The satisfaction of the shareholders and other stakeholders guarantees the success of the company regardless of the formal structural differences specific to the different models of corporate governance. Although one of the features of the "outsider" system is the orientation towards short-term profits and benefits, nowadays the tendency to apply the long-term orientation to sustainable development implementation of the "insider" model is present also in Anglo-Saxon companies (Miller & Serafeim, 2014).

According to Salvioni et al. (2018), integrating the concept of social responsibility among corporate governance features determine a change in corporate performances, contributing to modifying the orientation of the business and creating the favourable environment and framework for substantial convergence in corporate governance systems, sustainability becoming a formal business driver.

CONCLUSIONS

Debates on the supremacy of one corporate governance model or another continue, recent papers confirming that more and more companies from the "insider" model tend to orient their corporate governance practices towards the outsider system's principles, due to external factors such as increasing competition, market and product globalisation, increasing number of cross-border mergers and acquisitions transactions, diffusion of corporate governance codes and a higher attention to social responsibility and sustainability culture.

The increasing importance of sustainability and social responsibility in the board's decision-making in order to satisfy the needs of all stakeholders might bring convergence in the future, although convergence to a unique corporate governance model is unlikely to happen. We can rather expect that the two main models of corporate governance will continue to borrow characteristics from each other in order to adapt and obtain performance, but still maintain their core features.

Cultural differences amongst states can explain why convergence may be functional (adopting similar practical rules) rather than formal (similar legal system being used) as states are willing to regulate the market according to recent developments but are not ready yet to amend their economic philosophy and laws.

Acknowledgements

This work was cofinanced from the European Social Fund through Operational Programme Human Capital 2014-2020, project number POCU/380/6/13/125015" Development of entrepreneurial skills for doctoral students and postdoctoral researchers in the field of economic sciences".

REFERENCES

[1] Aguilera, R. V. & Cuervo-Cazurra, A. (2004). Codes of good governance worldwide: What is the trigger? *Organization Studies*, *25(3)*, 415–443.

[2] Bebchuk, L. (1999). A Rent-Protection Theory of Corporate Ownership and Control, *Harvard Law School Discussion Paper*, No. 260, 37.

[3] Bogdan, V., Farcane, N., Popa, D. N., & Boloș, M. I. (2011). *Raportarea financiară la nivelul grupurilor de societăți. Repere contemporane. [Financial reporting at company level. Contemporary landmarks]*, Ed. Economică.

[4] Braendle, U. & Noll, J. (2006). On the Convergence of National Corporate Governance Systems. *The Journal of Interdisciplinary Economics*, *17(1-2)*, 57-81.

[5] Collier, P. & Zaman, M. (2005). Convergence in European corporate governance: The audit committee concept, *Corporate Governance: An international Review*, *13*, 753–768.

[6] Cosneanu, S., Russu, C., Chirițescu, V. & Badea, L. (2013). Necesitatea implementării guvernanţei corporatiste în întreprinderile româneşti [The need to implement corporate governance in Romanian companies], *Economie teoretică şi aplicată.*Vol. XX, (No. 4), 58.

[7] Edwards, T. (2004). Corporate governance, industrial relations and trends in company-level restructuring in Europe: convergence towards the Anglo-American model?, *Industrial Relations Journal*, 35(6), 518-535.

[8] Folke, C. (2007). Social–ecological systems and adaptive governance of the commons. *Ecological Research*, *22(1)*, 14-15.

[9] Franks, J. R. & Mayer, C. (2000). Ownership and Control of German Corporations, available at SSRN http://dx.doi.org/10.2139/ssrn.247501

[10] Gemon, H. & Meek, G. (2001). *Accounting: an international perspective*, Irwin McGraw-Hill Boston.

[11] Goergen, M., Martynova, M. & Renneboog, L. (2005). Corporate Governance Convergence: Evidence From Takeover Regulation Reforms in Europe, *Oxford Review of Economic Policy*, *21(2)*, 243–268.

[12] Hall, P. & Soskice, D. (2001). *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage.* Oxford, Oxford University Press.

[13] Khanna, T. & Palepu, K. (2004). Globalization and convergence in corporate governance: Evidence from Infosys and the Indian software industry, *Journal of International Business Studies*, *35*, 484–507.

[14] La Porta, R., Lopes-de-Silanes, F. & Shleifer, A. (1999). Corporate Ownership around the World, *Journal of Finance*, 54, 471-517

[15] Miller, K. & Serafeim, G. (2014). Chief Sustainability Officers: Who Are They and What Do They Do? In Harvard Business School, Oxford University Press, *Leading Sustainable Change*, Chapter 8, 1-24.

[16] Nestor, S. & Thompson, J. K. (2000). Corporate Governance Patterns in OECD Economies: Is Convergence Under Way? *Organization for Economic Cooperation and Development*, available online at http://www.oecd.org/dataoecd/7/10/1931460.pdf

[17] Nistor, I. E. & Popa, A. (2014). Modelele de guvernanță corporativă și sursele de finanțare externă[Corporate governance models and external financing sources], available online at http://conferinta.academiacomerciala.ro/CD2014/articole/5/MODELELE%20DE%20GUVERNANTA%20CORPORATIVA%20SI%20SURSELE%20DE%20FINANTARE....pdf, p. 583-590.

[18] Onofrei, M. (2009). *Guvernanța financiară corporativă[Financial Corporate Governance]*, Ed. Wolters Kluwer.

[19] Pagano, M., Röell, A. A. & Zechner, J. (2002). The Geography of Equity Listing: Why Do Companies List Abroad? *The Journal of Finance, Vol. 57, No. 6*, 2651-2694.

[20] Salvioni, D., Franzoni, S., Gennari, F. & Cassano, R. (2018). Convergence in corporate governance systems and sustainability culture. *International Journal of Business Performance Management*, 19(1), 7-15.

[21] Short, H., Keasey, K., Hull, A. & Wright, M. (1998). Corporate governance, accountability, and enterprise".*Corporate Governance: An International Review, Vol. 6* (No. 3), 151-165.

[22] Yoshikawa, T. & Rasheed, A. A. (2009). Convergence of Corporate Governance: Critical Review and Future Directions, *Corporate Governance: An International Review*, *17(3)*, 388–404.