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Global strategy faces local constraints

Variations in national corporate governance systems and the degree to which groups of stakeholders influence strategy decisions can have a substantial impact on a company's efforts to look beyond its borders



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Corporate governance systems vary across countries, and these differences directly affect both the process for developing global strategies and the kinds of strategies that can be adopted. In this article, we examine how different corporate governance systems might influence decisions about company globalisation and, in particular, decisions to take operations abroad.

Global strategy decisions pose a very tough test for the effectiveness of corporate governance systems in that they seek to maximise profits and global competitiveness, often at the expense, at least in the short term, of some corporate governance players. By definition, a global strategy means taking a global, rather than a single-country, view of strategy, and this can be hard for those players with strong ties to the company's home country. Second, some aspects of global strategy, particularly the overseas relocation of jobs, mean real sacrifices for some, especially employees.

◆ Players in corporate governance

We identify five critical stakeholder players that most affect the company's decisions about global strategy:

Employees and their collective organisations, such as unions and work councils, have various legislated, statutory, contractual or negotiated rights, such as employment conditions, that must be considered.

The *board of directors* is the ultimate governing body of an organisation and, as such, it must approve all company strategies, including global ones.

The *top management team* is charged with day-to-day responsibility for strategy and operations.

Shareholders exercise their voice through their shareholder rights, such as cumulative voting or proxy voting, but they can also exit the company by selling their shares if they do not agree with globalisation strategies or other decisions.

Finally, *governments* set and enforce the overall rules of national corporate governance; they design specific norms about international business, such as trade policies; and they can selectively intervene in individual globalisation decisions, such as moving operations abroad, or subsidising a given company because of its national strategic relevance. Supranational governments, such as the European Union, also play a role in regulating corporate governance, the consultation rights of workers, bankruptcy procedures and the like. We exclude other stakeholders, such as customers, suppliers and competitors, because they tend to be less involved with corporate governance.

◆ Cross-national differences

Corporate governance systems vary by country, as do the roles and power of the five corporate governance players. Figure 1 summarises these differences for some major countries and types of corporate governance systems: the "Anglo-American" systems of the US and UK, the "Continental" systems of Germany, France and Italy, and the "Extended" system of Japan.

In the rest of this article, we briefly describe the main characteristics of these corporate players across countries and their potential influence on global decision-making.

◆ Employees

Two main variables differentiate employees, as a collective group, across countries. First, the country's labour market will influence the flexibility and mobility of employees. Countries such as the US that have employment at will, whereby a contract can be terminated at any time, are likely to have flexible labour markets and short-term labour commitment. Generally, the consequence is that labour training is done outside the company and employees have general and portable skills.

In more rigid labour markets, such as Germany and Japan, companies invest a great deal in bespoke, in-house training, which tends to result in more highly skilled labour forces and company-specific skills. These, in turn, are less transferable from one company to another.



Second, the strength of labour unions and unionisation rates varies from one country to another. For instance in France, where union rights are extended to all employees regardless of union affiliation, unionisation will have a much greater influence on corporate decision-making than in the US or UK, where only union members benefit from collective bargaining agreements. Japanese companies tend to have enterprise unionism, which leads to collective bargaining at the company level and grants a strong voice to employees.

We consider that employees who are less mobile and who have a

stronger voice within the company will get more involved in global strategy decisions. Generally speaking, these employees will seek to keep their jobs domestically as opposed to moving them around the globe.

In 2004 for example, employee opposition to job losses prevented the restructuring, via a merger with a foreign partner, of France's financially troubled Alstom, a major producer of ships and trains. In the same year Volkswagen, despite suffering from very high labour costs, had to promise its western German employees job security until 2011 in exchange for a wage freeze until 2007 and more flexible working hours. The company's workers wield considerable power, partly through co-determination rights, which require employees to be consulted on corporate decisions.

◆ Top management teams

Cross-national variation in top management teams is mostly reflected in their functional background and their international experience, as well as the patterns of managerial career mobility. Managers in the US and UK tend to have professional backgrounds (often with formal business school education) and strong functional backgrounds in finance or marketing. This is not the case in Germany, where managers are more technically oriented. In France, managers often share a common *grandes écoles* background and ideology, frequently linking them back to government positions that they have previously held.

There is also variation in the international experience and background of managers, with US managers having the most foreign-born individuals in their management teams and France, Italy and Japan the least. Managerial career mobility tends to be very fluid in the US and UK due to open labour markets whereas, in Japan and France, managers tend to remain with a company for a long period of time.

The presence of foreign nationals and managers with prior international experience, combined with open labour markets, means that teams will be more likely to push global

strategies. In the US, more and more companies have foreign-born CEOs, including Charles Bell of McDonald's, who is Australian, E. Neville Isdell of Coca-Cola, who is Irish, and Carlos Gutierrez of Kellogg's, who was born in Cuba. There is also wide acceptance of leaders from across borders in the UK – consider Americans Marjorie Scardino at Pearson, Arun Sarin at Vodafone and Rose Marie Bravo at Burberry, and French-born Jean-Pierre Garnier at GlaxoSmithKline.

Conversely, management teams dominated by closed labour markets and ties to government, or founding or controlling family, will be more reluctant to engage in global strategies, mostly due to their preference for keeping control domestically. For example, Germany's Bertelsmann, one of the world's largest media companies, is controlled by the Mohn family. In 2002, the company fired its chief executive, Thomas Middelhoff, for pursuing global expansion strategies too vigorously and for what was perceived as an abrasive US-style approach to management. Middelhoff was replaced by Gunter Thielen, who had long-term ties to the Mohn family.

◆ Shareholders

Countries vary in their mix of types of shareholders. At one extreme, the US and UK have mostly arms-length, neutral shareholders, who are focused on shareholder value maximisation. Although many UK shareholders are large institutions, such as pension funds, these generally play passive roles, compared with the shareholder activism that arose in the US among institutional investors such as Calpers. Japan has plenty of institutional shareholders, but these tend not to be neutral and often act as part of a network, or *keiretsu*, that supports the role of the company and, hence, incumbent management. Germany's main trait is that banks play a leading role in influencing corporate policy at many companies, both as lenders and shareholders.

Employee shareholders typically use their ownership to block the global relocation of jobs. This applies even in the US where United Airlines provides a rare example of a large public company with majority ownership by its employees (55 per cent owned by an employee stock ownership plan). This employee stake and, hence, control have greatly constrained the ability of the airline to relocate jobs overseas. For example, United Airlines' flight attendants' union has been able to block plans to staff more flights from its lower-cost Taiwan base.

◆ Boards of directors

The composition of boards of directors also shows strong contrasts across countries. For instance, Japanese companies are renowned for having very large and inefficient boards, sometimes with more than 50 members. Japanese boards also have very few outsiders to monitor managers and the strategic direction of the company.

Italian and French boards are considered medium-sized, although still quite inefficient due to the lack of outsiders. Germany is unusual because it tends to have a wide variety of stake-

Figure 1 Main characteristics of corporate governance players in six selected countries

	United States	United Kingdom	Germany	France	Italy	Japan
EMPLOYEES	<ul style="list-style-type: none"> Flexible labour Low unionisation Employment at will 	<ul style="list-style-type: none"> Flexible labour market 	<ul style="list-style-type: none"> Work councils Co-determination High skills Non-flexible labour market 	<ul style="list-style-type: none"> Work councils Low unionisation Short-term contracts 	<ul style="list-style-type: none"> Long-term contracts Rigid labour market Medium skills 	<ul style="list-style-type: none"> Enterprise union Life-time employment Medium skills
SHAREHOLDERS	<ul style="list-style-type: none"> Institutional investors and individuals Dispersed 	<ul style="list-style-type: none"> Institutional investors Dispersed 	<ul style="list-style-type: none"> Other non-financial firms Banks 	<ul style="list-style-type: none"> Foreign investors State 	<ul style="list-style-type: none"> State Families 	<ul style="list-style-type: none"> Other non-financial firms Banks
GOVERNMENT	<ul style="list-style-type: none"> Liberal policies Arms-length Weak takeover barriers 	<ul style="list-style-type: none"> Liberal policies Arms-length Weak takeover 	<ul style="list-style-type: none"> Protectionist policies Medium takeover barriers 	<ul style="list-style-type: none"> Protectionist policies Interventionist Medium takeover barriers 	<ul style="list-style-type: none"> Protectionist policies Interventionist Strong takeover barriers 	<ul style="list-style-type: none"> Protectionist policies Strong takeover barriers
BOARDS OF DIRECTORS	<ul style="list-style-type: none"> High activism High % of outsiders due to investor pressure 	<ul style="list-style-type: none"> High activism High % of outsiders determined by law 	<ul style="list-style-type: none"> Moderate activism Stakeholders as a significant minority Medium size 	<ul style="list-style-type: none"> Moderate activism Minority outsiders Medium size 	<ul style="list-style-type: none"> Low activism Large % of insiders Medium size 	<ul style="list-style-type: none"> Low activism Large % of insiders Large size
TOP MANAGEMENT TEAM	<ul style="list-style-type: none"> Professional (Finance/MBA) background Some foreign-born management Open labour markets 	<ul style="list-style-type: none"> Semi-professional background Some foreign-born management Open labour markets 	<ul style="list-style-type: none"> Technical background Few foreign-born managers Closed labour markets (long term) 	<ul style="list-style-type: none"> Common educational backgrounds State links Few foreign-born managers Closed labour markets (long term) 	<ul style="list-style-type: none"> Non-professional No foreign-born management Closed labour markets (long term) 	<ul style="list-style-type: none"> Common educational backgrounds No foreign-born management Closed labour markets (long-term)

holders represented in the upper (supervisory) board, such as employees, industrial banks and suppliers. In November 2004, a commission convened by the BDA, the German employers association and BDI, the industry federation, concluded that the German co-determination system had become a hindrance to German companies operating internationally and a barrier to inward investment. It recommended changes to the laws, which were last revised in 1976. Under this proposal, individual companies would be free to choose a system of employee representation, taken from three options, ranging from retention of the current system to a looser consultation system separate from the supervisory board.

France Telecom provides an example of how board representation can be distorted by national interests. Although privatised in 1997, France Telecom still has significant intervention by the French government. Out of 15 members of the board of directors, only seven are elected by the shareholders meeting, while three represent employees and five members represent the French government.

The most active boards are in the UK and US, in part due to the enforcement of corporate law. In the UK, the Cadbury Report and subsequent codes of good governance have had a great deal of influence in designing efficient boards. In the US, the Sarbanes-Oxley Act of 2002 has also introduced pressure for a higher percentage of outsiders on boards.

◆ Government

Finally, countries also differ in terms of the degree of government intervention in their economies and protectionism of their markets. Government intervention is usually in the form of market regulation. A representative measure for government intervention in the economy is regulation around takeovers. The US and, to a lesser degree, the UK have weak takeover barriers and it is mostly up to individual companies to design anti-takeover measures. Conversely, in countries such as France, Germany, Italy, and Japan, government intervention often provides strong takeover barriers, such as golden shares, which bestow on the holder veto power over changes to the company's charter.

The various hindrances to hostile

takeovers in many continental European countries continue to make it difficult for foreign companies to make acquisitions across borders in Europe. In 2001, plans for a European takeover code, which would guarantee the right of shareholders to be consulted during bids, were shelved following objections from the German government. The previous year Vodafone, the UK telecoms company, made a successful hostile bid for Mannesmann, a German telecoms company, and the German government was worried that other local companies might fall into foreign hands. For example, Volkswagen is protected from takeover by special law and the European code threatened to undermine this protection. Nevertheless, individual countries, including Germany, are now making gradual changes to make takeovers easier.

Sweden, which falls in the Continental governance model, is one of a number of countries that use multiple voting rights to help prevent its corporate empires from becoming vulnerable to takeover. The Wallenberg family, for instance, owns only 7 per cent of Ericsson, the telecoms firm, yet controls the company, because it owns a class of shares that carries 1,000 times the rights of ordinary shares.

France is also particularly active in preserving national ownership of major companies. In 2004, the French government brokered the takeover of Aventis, a French-German pharmaceutical company, by France's Sanofi-Synthelabo, while blocking a bid from Switzerland's Novartis. Similarly, France blocked Germany's Siemens from bidding for Alstom's railway operations, which manufacture the high-speed TGV trains.

◆ How managers can use their corporate governance systems

Top managers need to recognise that they are not in sole charge. Global (and other) strategy is an equilibrium game among corporate governance players. Managers need to work on building coalitions and aligning interests behind a common approach.

Assuming that you want to improve your use of global strategy, then how can you do this from the various countries? If you are a manager in an Anglo-American system, then you are generally in luck. Your country's corporate governance sys-

tem is a source of competitive advantage. A manager in a Continental system faces many constraints, especially from the legal involvement of employees. But, committed employees can also be a major source of global competitive advantage.

In the Continental system, managers have to align, trade off and meet other stakeholders' interests halfway. They have to craft their language and rhetoric to meet the other players' expectations. The watchwords here are consensus and social cohesion.

In the Extended (Japanese) system, companies have generally capitalised on their export-oriented model and high innovation driven by employee loyalty. But because of the rigidity of their corporate governance system, they have not exploited as much as

“Managers need to build coalitions and align interests behind a common approach”

they could the different dimensions of global strategy. We would recommend that the system becomes more open in terms of the diversity of the top management team and more flexible in their governance by introducing leaner boards as well as allowing greater levels of shareholder activism.

In sum, if governments care to sustain national competitiveness and to help their companies to globalise, then they should assess the degree to which the players in their corporate governance system are aligned with each other and with their intended global strategies. For example, France might need to upgrade its compensation policies to recruit and retain world-class talent in the top management teams of its global companies.

Government policies should also become less inimical to foreign owners and use such capital to provide the much-needed global knowledge. This can only be accomplished if the right mechanisms are in place to give a voice to these foreign owners. We think that governments have the responsibility as well as the policy tools to gear the country's corporate governance system so that it enhances national competitiveness.