

The Globalization of Corporate Codes of Governance.

Over the past few years, a number of high profile cases worldwide have focused the attention of policymakers and the public alike on issues related to corporate governance. The cases of energy trader Enron and their accounting firm Arthur Andersen in the U.S and media conglomerate Vivendi in France are but two examples. Over the past 30 years in the US and over the past two decades around the world, various entities have sought to improve the quality of corporate governance (mostly with respect to the rights of minority shareholders). Assistant Professor Ruth Aguilera and her colleague Alvaro Cuervo-Cazurra of the University of Minnesota have examined the forces that influence the adoption of codes of good governance in countries around the world.

Two parallel processes have increased the perceived need for more effective monitoring mechanisms and appropriate incentive plans to strengthen corporate governance systems. The first is globalization, which includes the liberalization of government policies and the internationalization of economies, modernization in telecommunications, and the integration of capital markets. The second process is transformation in the structure of firm ownership due to the growth of institutional investors, privatization, and rising shareholder activism. It has been argued that pressures for change lead to the convergence of various practices of corporate governance and to the consequent call for action by agencies and actors in individual countries.

In a paper entitled "The Spread of Codes of Good Governance Worldwide: What's the Trigger?" (*Organization Studies*, 2003 25:415-443), Aguilera and Cuervo-Cazurra considered codes as practices adopted to improve national systems of corporate governance. They proposed that codes are developed in response to a combination of pressures from inside the firm and from the firm's own and other countries. Pressures from within the firm tend to aim at increasing efficiency in the organization, and external pressures tend to promote action to establish or shore up legitimacy, that is, to improve the image of the company as well-run and not corrupt.

The two researchers described the diffusion of codes of good governance worldwide and analyzed the complementary internal and external forces that influence adoption of such codes. They found that for a sample of 49 countries, codes of good governance are more likely to occur when a country lacks strong shareholders' protection rights. That is, codes tend to be developed in countries where the legal system has fewer protections for shareholder rights against misconduct by the board of directors. They also demonstrated that external pressures on countries and firms influence the development of codes. Specifically, codes of good governance are more likely to be issued in countries where there is considerable government liberalization and a strong presence in the economy of foreign institutional investors.

A surprising finding made by Aguilera and Cuervo-Cazurra is that countries with more effective governance systems in terms of the overall legal system, that is common-law legal systems, are more prone to continue improving their systems and to develop codes. Aguilera suggests that this fact may illustrate that the efforts of some countries to protect shareholder rights and improve corporate governance is not static, but rather a dynamic process in which corporate governance practices are revised and enhanced to keep up with new corporate realities.

These unpredicted results indicate that corporate governance is a system of practices. Importing a practice to solve limitations in the overall system is an improvement over the earlier situation, but there still remains a need for modifications to fit in with the existing system. In the case of corporate governance, codes tend to be adapted to the country's economic environment and to address the countries' most serious governance problems. For instance, codes developed by the Hong Kong Stock Exchange deal with the existence of family-owned groups, while an Italian report on that country's corporate governance speaks of the need to bring more accountability to Italian pyramid business groups. However, despite differences between and among countries, codes tend to make similar recommendations regarding the behavior of the board, protecting the rights of shareholders by tackling, primarily, the transparency and accountability of board practices through encouraging an increase in the number of directors not part of the company's management and the creation of sub-committees of boards.

Although the study revealed a tendency for the same features to appear in the codes of various countries (generally emulating the British pioneer model), it appears that countries do have a say in the codes they decide to adopt and in who instigates the development of the codes. Aguilera and Cuervo-Cazurra show that the impact that the codes have on business practices is related to the ability of the issuer to enforce the changes in corporate governance. On one hand, codes developed by governments and stock markets, and to some extent investors, have the strongest enforceability, since they can be established as a norm of operation (a condition of doing business) and, thus, might have a greater impact on promoting good governance. On the other hand, codes developed by professional associations, director associations, and management associations have lower enforceability since many such codes are voluntary and, consequently, are less likely to be able to improve deficiencies in corporate governance.