17 A Bundle Perspective to Comparative Corporate Governance

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INTRODUCTION

In this chapter, we seek to bring to the core of the study of comparative corporate governance analysis the idea that within countries and industries, there exist multiple configurations of firm-level characteristics and governance practices leading to effective corporate governance. In particular, we propose that configurations composed of different bundles of corporate governance practices are a useful tool to examine corporate governance models across and within countries (as well as potentially to analyze changes over time). While comparative research, identifying stylized national models of corporate governance, has been fruitful to help us think about the key institutional and shareholder rights determining governance differences and similarities across countries, we believe that given the financialization of the corporate economy, current globalization trends of investment, and rapid information technology advances, it is important to shift our conceptualization of governance models beyond the dichotomous world of common-law/outsider/shareholder-oriented system vs civil law/insider/stakeholder-oriented system. Our claim is based on the empirical observation that there exists a wide range of firms that either (1) fall in the 'wrong' corporate governance category; (2) are a hybrid of these two categories; or (3) should be placed into an entirely new category such as firms in emerging markets or state-owned firms. For example, we have firms listed on the New York Stock Exchange (NYSE) such as Nordstrom, which has a majority owner (Nordstrom family), and firms in the traditional Continental model, such as Telefónica in Spain which has dispersed ownership. This is the opposite of what the insider/outsider models would predict. To push the example further, there are firms in Japan which are concentrated, such as NTT DoMoCo, Hitachi and Nissan, and others which are dispersed, such as Sanyo Electronics or NEC Corporation. In sum, it is difficult to continue to equate firm nationality with governance model.

In addition, as Aguilera and Jackson (2003) argue, firms, regardless of their legal family constraints, their labor and product markets, and the development of the financial markets from which they can draw, have significant degrees of freedom to chose whether to implement different levels of a given corporate governance practice: i.e. firms might chose to fully endorse a practice or simply seek to comply with the minimum requirements without truly internalizing the governance practice. An illustrative example of the different degrees of internalization of governance practices is the existing variation in firms' definition of director independence or disclosure of compensation systems.

In this chapter, we first discuss the conceptual idea of configurations or bundles of corporate governance practices underscoring the concept of equifinal paths to given firm outcomes as well as the complementarity and substitution in governance practices. We then move to the practice level of analysis to show how three governance characteristics (legal systems, ownership, and boards of directors) cannot be conceptualized independently, as each of them is contingent on the strength and prevalence of other governance practices. In the last section, we illustrate how different configurations are likely to play out across industries and countries, taking as the departing practice, corporate ownership.

BUNDLES OF CORPORATE GOVERNANCE PRACTICES

Corporate governance relates to the 'structure of rights and responsibilities among the parties with a stake in the firm' (Aoki, 2001). Effective corporate governance implies mechanisms to ensure executives respect the rights and interests of company stakeholders, as well as guarantee that stakeholders act responsibly with regard to the generation, protection, and distribution of wealth invested in the firm (Aguilera, Filatotchev, Gospel & Jackson, 2008). The empirical literature on corporate governance has been mostly rooted in agency theory, assuming that by managing the principal–agency problem between shareholders and managers, firms will operate more efficiently and perform better. This stream of research identifies situations in which shareholders' and managers' interests are likely to diverge and proposes mechanisms that can mitigate managers' self-serving behavior (Shleifer & Vishny, 1997), such as the board of directors, shareholder involvement, information disclosure, auditing, the market for corporate control, executive pay, and stakeholder involvement (Filatotchev, Toms & Wright, 2006). Despite the large body of research, the empirical findings on the link between governance practices and firm outcomes (e.g., firm performance) continues to be mixed and inconclusive (Dalton, Daily, Ellstrand & Johnson 1998; Dalton, Hitt, Certo & Dalton, 2007).

Within this stream of work, the influence of board independence on firm performance has been of great interest (Dalton et al., 2007, Finkelstein & Hambrick, 1996, Johnson, Daily & Ellstrand, 1996). However, empirical research from an agency perspective is equivocal as neither Dalton et al.'s (1998) meta-analysis nor Dalton et al.'s (2007) literature review offer support for this relationship or agency prescriptions in general. Likewise, neither the joint nor separate board leadership structures have been found to universally enhance firm financial performance (Beatty & Zajac, 1994; Dalton et al., 1998, 2007) nor has support been found for the hypothesized relationship between share ownership by large blockholders and performance measures (Dalton, Daily, Certo & Roengpitya, 2003). The ambiguity regarding empirical evidence also applies to other areas of corporate governance research (Filatotchev et al., 2006), such as executive pay (Bebchuk & Fried, 2004) or the market for corporate control (Datta, Pinches & Narayanan, 1992; King, Dalton, Daily & Covin, 2004).

The weak interrelationships between 'good' corporate governance and firm performance cast doubt on several premises of agency research and suggest a need to reorient corporate governance research frameworks. Filatotchev (2008) argues that one reason for the mixed empirical results related to the effectiveness of various governance mechanisms may be the neglect of patterned variations in corporate governance contingent to the contexts of different organizational environments. Likewise, Aguilera and Jackson (2003) posit that the 'under-contextualized' approach of agency theory remains restricted to two actors (managers and shareholders) and abstracts away from other aspects of the organizational context that impact agency problems, such as diverse task environments, the life cycle of organizations, or the institutional context of corporate governance.

A growing literature has sought to develop a configurational approach to corporate governance by identifying distinct, internally consistent sets of firms and the relations to their environments, rather than one universal set of relationships that hold across all organizations, and by exploring how corporate governance mechanisms interact and substitute or complement each other as related 'bundles' of practices. The theory of complementarity provides the basis to understand how various elements of strategy, structure, and processes of an organization are interrelated (Aoki, 2001; Milgrom & Roberts, 1990, 1995). The concept of complementarity offers a rigorous explanation to the synergistic effects among activities. Two activities are complementary when the adoption of one increases the marginal returns of the other and vice versa (Cassiman & Veugelers, 2006). This configurational logic is also fairly well-devloped within the field of Human Resource Management (HRM), and in particular in efforts to predict what combinations of HRM practices lead to high work performance systems (Delery & Doty, 1996; Huselid, 1995; Lepak, Liao, Chung & Harden, 2006; MacDuffie, 1995).

Within the context of strategic and governance research, Rediker and Seth (1995) introduced the concept of a 'bundle of governance mechanisms' under the rubric of a cost–benefit analysis. They propose that firm performance is dependent on the effectiveness of the bundle of governance mechanisms rather than the effectiveness of any one mechanism. Additionally, they argue that even though the overall bundle is effective in aligning manager–shareholder interests, the impact of any one mechanism may be insufficient to achieve such alignment. For example, the effectiveness of board independence is likely to increase in the presence of other corporate governance elements such as the existence of board committees, which structure and enhance the influence of independent directors within the board. Likewise, independent directors are argued to play an important role in setting executive pay and assuring appropriate incentive alignment between executives and shareholder interests. At a broader institutional level, the factual independence of directors is enhanced by the existence of comparatively strong legal protection of shareholder rights. In short, this approach helps explain why no one best way exists to achieve effective corporate governance. Rather, corporate governance arrangements are diverse and exhibit patterned variation across firms and their environments.

In general, when one mechanism acts as a substitute for another mechanism, this refers to the direct functional replacement of the first mechanism by the second. An increase in the second mechanism directly replaces a portion of the first mechanism, while the overall functionality of the system remains constant. Rediker and Seth (1995) empirically examine the substitution effects between board monitoring, monitoring by outside shareholders, and managerial incentive alignment. If managerial incentives are aligned with shareholder interests such that acting in the best interest of shareholders is also in the best interests of the managers, then the need for the board to monitor the actions of management on behalf of shareholders is reduced and the governance mechanisms are substitutable. Similarly, if board monitoring is comprehensive and the board actively sanctions management when management is not acting in shareholder interests, then the alignment of managerial incentives to shareholder interests may be less necessary. Indeed, Zajac and Westphal (1994) find that the use of long-term incentive plans for chief executive officers (CEOs) are negatively related to the monitoring processes in place; firms that have stronger incentive alignment tended to have weaker monitoring mechanisms and vice versa. In this way, monitoring and incentive alignment act as substitutes for one another to provide a general level of governance effectiveness in controlling for agency issues. In addition, Desender et al. (2011) demonstrate that ownership concentration and board composition become substitutes when it comes to monitoring management. They uncovered that while the board of directors complements its monitoring role through the higher use of external audit services when ownership is dispersed, this is not the case when ownership is concentrated.

However, Ward et al. (2009) propose that in some circumstances, instead of acting as substitutes, monitoring and incentive alignment may act as complements to one another, where the presence or addition of one mechanism strengthens the other and leads to more effective governance in addressing agency problems. For instance, Rutherford and Buchholtz (2007) empirically examine the complementarity of board monitoring and CEO incentive systems and find that CEO stock options complemented boards that monitor through frequent, formal meetings. Independent and active boards can also be functional in prohibiting managers from repricing stock options in the face of poor performance, or modifying performance targets or metrics that trigger incentive compensation. In this way, the addition of monitoring facilitates the improvement of incentive alignment, avoiding moral hazard issues, even when the incentive structure itself does not change.

In applying complementarities to corporate governance, various works have stressed that the simultaneous operation of several corporate governance mechanisms is important in limiting managerial opportunism (Hoskisson, Hitt, Johnson & Grossman, 2002, Rediker & Seth, 1995; Walsh & Seward, 1990). For example, Anglo-American or shareholder-oriented corporate governance systems are based on broad interdependencies between performance incentives within executive remuneration, board independence, and the market for corporate control. These corporate governance mechanisms serve to align incentives within and outside the organization, and to make corporate governance more effective in environments of dispersed ownership. Yet, even these interdependent mechanisms of corporate governance would remain quite ineffective without further complementary mechanisms, such as high information disclosure to investors, which allows the market to price shares accurately, and a rigorous system of auditing to assure the quality of information disclosed (Aguilera et al., 2008).

Elements common in Anglo-American corporate governance systems often remain absent in other countries, where other corporate governance mechanisms may effectively substitute and display different sets of complementarities. Where one specific mechanism is used less, others may be used more, resulting in equally good performance (Agrawal & Knoeber, 1996; Garcia-Castro, Aguilera & Ariño, 2011). For example, in German and Japanese corporate governance, monitoring by relationship-oriented banks may effectively substitute for an active market for corporate control (Aoki, 1994). Jensen (1986) also suggests that when the market for corporate control is less efficient, the governance effects of debt holders may play a particularly important role in restraining managerial discretion. The long-term nature of bank–firm relationships may also display critical complementarities with a more active role of stakeholders, such as employees, as employees' investments in firm-specific capital are protected from 'breaches of trust' (Aoki, 2001) and employee voice helps to make managers more accountable internally by more thoroughly justifying and negotiating key strategic decisions (Streeck, 1987).

The number of potential combinations of corporate governance practices, and hence their complementarities, is extensive. These configurations remain to be systematically theorized and investigated empirically. Moreover, a particular corporate governance mechanism, such as the market for corporate control or independent board members, may have opposite effects in different institutional contexts. Whereas the market for corporate control may help exert discipline in the context of dispersed ownership and high transparency, the same may undermine the effective participation of stakeholders. At the level of institutions, corporate governance practices embodying conflicting principles may also allow for more heterogeneous combinations of corporate governance characteristics and maintain requisite flexibility for future adaptation in a population of firms (Stark, 2001).

Building on strategic governance and institutional analysis, a number of recent studies develop a conceptual framework for better understanding the influence of organization–environment interdependencies on the effectiveness of corporate governance in terms of firms' contingencies, complementarities between governance practices, and potential costs of corporate governance (e.g., Aguilera et al., 2008; Filatotchev et al., 2006).

This research proposes that effective corporate governance depends upon the alignment of interdependent organizational and environmental characteristics and helps to explain why, despite some universal principles, no 'one best way' exists. Rather, the notion of corporate governance as a system of interrelated firm elements having strategic or institutional complementarities suggests that particular practices will be effective only in certain combinations and, furthermore, they may grant different patterns of corporate governance (Aguilera et al., 2008; Garcia-Castro et al., 2011). This research sustains that corporate governance recommendations and policymaking will be more effective if they take into account the potential diversity of governance mechanisms, which deal with important firm-level contingencies.

In the next sections, we discuss how three different governance practices – legal pressures, ownership structure and board practice – are defined in the context of other governance mechanisms.

LEGAL ENVIRONMENT

Inevitably, corporate law and regulation in every country deal with different kinds of corporate governance challenges starting from the classic potential conflict of interests between the managers and shareholders, extending to the opportunism of controlling shareholders against minority shareholders, to the tensions between shareholders and managers with other corporate constituents such as employees or debt-holders (Aguilera & Jackson, 2003; Davies, Hertig & Hopt, 2004). In this regard, rather than addressing actor–actor conflicts in isolation, different configurations of bundles of corporate governance mechanisms explore the interactions among the multiple firm actors (i.e., shareholders, managers, employees, state, suppliers, etc.), their respective interests and constraints, and the associated legal tradeoffs to become effective members of the intra-firm relationships. In this section, we first discuss how different legal jurisdictions impose a diverse sort of constraints (or enablers) to reduce (or to enhance) the opportunism among the multiple constituencies of the firm. Second, we comment on the emerging issue of new governance or the existing debate between soft law and hard law.

Legal strategies and legal families

The baseline regulatory paradigm constrains corporate actors by requiring them not to take particular actions, or engage in transactions, that could harm the interests of other stakeholders. Lawmakers can establish such constraints as *rules* (*i.e., laws), which* relates to prohibiting some kind of behavior, *ex ante,* or *standards* (*i.e., soft law*)*, which* leaves the compliance determination to the courts, *ex post (i.e., jurisprudence)* (Kraakman, Davies, Hansmann et al., 2004). In most countries, corporate governance practices fall in the domain of mandatory corporate and stock exchange law, as well as a set of self-regulation initiatives (*standards*) such as codes of corporate governance (Aguilera & Cuervo-Cazurra, 2009; Hopt, 2011).

In general, the rule strategy is more common in Continental Europe, while in the United States and the United Kingdom jurisprudence is preferred to rules. Kraakman, Armour, Davies, Henriques, Hansmann, Hertig, Hopt, Kanda and Rock (2009) propose two main hypotheses to explain this sharp division. First, they draw on the traditional legal origin dichotomy between common and civil law. In civil law countries such as France or Spain, judges follow and enforce strict and clearly defined rules. Second, the implementation of *rule* strategies in corporate governance has its roots in capital markets history.

However, when it turns to corporate governance regulation, influenced by the United Kingdom, there is a convergence towards the use of codes of corporate governance in Continental European countries (Aguilera & Cuervo-Cazurra, 2004, 2009; Kabbach-Castro & Crespí-Cladera, 2011). In fact, on February 22, 2006, the European Union (EU) Corporate Governance Forum strongly endorsed the view that national corporate governance codes should be implemented under the 'comply or explain' principle as proposed by the UK Cadbury's Report (IFC 2008).

The law and finance literature focuses on the importance of law (i.e., rules and standards) and its enforcement to protect the property rights, particularly, minority shareholder rights (La Porta et al., 1998; Shleifer & Vishny, 1997). The main argument is that the protection of investors' rights, which is granted by the origin of the legal system (civil or common law), is a central determinant of investor willingness to finance firms (La Porta et al., 1998, 1999). It follows that, in countries with strong shareholder protection, investors are more willing to take minority positions rather than controlling the firm. On the contrary, where shareholder rights are not well protected, investors will compensate for this deficiency by taking controlling positions in a firm (Shleifer & Vishny, 1997). Then, the supply of finance through minority shareholders is constrained by the extent of their protection under the law or other kind of financial regulation (Milhaupt & Pistor, 2008). And, ultimately, it is argued that the quality of property rights' protection determines economic outcomes in those countries. For example, La Porta et al. (1998) claim that a 1.6-point increase in the shareholder rights measure, roughly the distance between the American common law legal origin and French civil law averages, reduces ownership concentration by five percentage points.

La Porta et al. (1998), and subsequent work, has placed research on legal families at the core of the corporate governance discussion.[1] These studies have had a large impact on public policy and scholarship and have also triggered an extensive debate on the role of law in corporate governance (Aguilera & Jackson, 2010). However, scholars are critical of their core arguments (Aguilera & Williams, 2009), in part because their assumptions are believed to be too narrow and do not hold for recently important economic success stories such as China, whose remarkable economic growth is not tied to the common law system as an 'ideal rule-of-law' (Milhaupt & Pistor, 2008). In fact, recent studies (Gilson, 2006, 2007) have raised doubts about the overwhelming focus on controlling shareholders as value-destroying actors in concentrated ownership systems of corporate governance. The argument is that some private benefits of control are necessary for inducing the controlling shareholder to exercise a monitoring function. The need to secure activism from the controlling shareholder is made particularly crucial in countries with both ineffective corporate law and weak commercial law.

In the same logic, Roe (2002: 271) concludes, '[The] quality of a country corporate law cannot be the only explanation for why diffuse Berle and Means (1932) firms grow and dominate. Perhaps, for some countries at some times, it is not even the principal one.' He argues that corporate law protective of minority shareholders cannot cover every instance of destruction of shareholder value. Even in the best-case scenario, i.e., the United Kingdom and the United States, the system of corporate law protects minority shareholders well against breach of fiduciary duties, lying, stealing (i.e., dishonest behavior). Yet, even the Anglo-American system does not protect minority shareholder against managerial mistakes (i.e., the business judgment rule). As such, shareholder value destruction can take place not only through managerial dishonest behavior but also because of managerial errors.

The puzzle for Roe (2002) is that ownership is diffused in the United States and the United Kngdom despite the fact that the law does not cover every instance of shareholder value destruction; hence, some other mechanisms must be activated in order to account for this behavior, and Roe proposes that we need to take into account *politics*[2] (Roe, 1994, 2000). In his view, for example, European social democracies pressure corporate managers to forego opportunities for profit maximization in order to maintain high employment. Therefore, concentrated ownership is a defensive reaction to these pressures. In a different way, in the United States, legislators responded to a populist agenda in the 1930s and limited the power exercised by large financial conglomerates, reducing the ownership concentration. Franks, Mayer and Rossi (2009) offer further empirical evidence for Roe's argument as they demonstrate that dispersed ownership emerged rapidly in the first half of the 20th century in the United Kingdom, even in the absence of strong investor protection.

More recently, novel research by Deakin and others (Armour et al., 2009; Deakin, Lele & Siems 2007; Siems & Deakin, 2010) sheds light into the unexplained issues of the influence of legal families on corporate governance practices and firm behavior. Siems and Deakin's (2010: 17) main conclusion is that 'legal rules are, to a significant degree, endogenous to the political economy context of the systems in which they operate.' Hence, there exist two main theories of corporate regulation. On the one hand, the public interest theory argues that a government pursuing social efficiency (i.e., social welfare) will respond to market failures by looking after the public interest through regulation (Djankov, 2009). On the other hand, the public choice theory (Peltzman, 1976; Stigler, 1971) claims that regulation is socially and economically inefficient, favoring bureaucrats to social welfare. An illustrative example is Djankov, La Porta, Lopez-de-Silanes & Shleifer's (2002) study of entry regulation across countries. They find evidence that less democratic countries are heavily regulated, and such regulation does not yield visible social benefits, supporting the public choice theory that emphasizes rent extraction by politicians.

In sum, to understand the relationship between legal differences and the patterns of bundles of corporate governance practices, we have to consider not only the legal origin of a particular environment but also political forces shaping the corporate agenda, capital markets history, and corporate law differences as an integrated framework. In this regard, one emerging debate in the comparative law and governance literature concerns the effectiveness of soft law (i.e., *standards*) versus hard law (i.e., *rules*), which still needs to be answered.

Hard law versus soft law

Since the turn of the century, corporate governance in the form of soft law in various forms has gained ground (Aguilera & Jackson, 2010; Hopt, 2011). Aguilera and Cuervo-Cazurra (2004) argue that corporate governance codes are designed to address deficiencies in corporate governance systems by recommending comprehensive set of norms on good practice to firms in regulatory environments, which are hard to change. The content of many of these codes stipulates guiding principles on board composition, ownership structure, and executive compensation schemes (Kabbach-Castro & Crespí-Cladera, 2011). And, in fact, most advanced and emerging economies have relied on codes of good governance based on the 'comply or explain' principle as an expediting mechanism to update their corporate regulation, given their often-outdated and rigid legal system.

It is interesting to observe, for example, how the United States continues to develop hard law such as the 2002 Sarbanes–Oxley Act and the 2010 Dodd–Frank Act to improve governance accountability and transparency, whereas most of the other advanced industrialized countries continue to rely mostly on voluntary codes of good governance (Aguilera & Cuervo-Cazurra, 2009; Aguilera & Jackson, 2010). Hopt (2011) claims that this dichotomy between hard law and soft law might be explained as a positive byproduct of scandals, when policymakers can see where regulation has lacunae or is not effective. However, he continues, scandal- or crisis-driven regulation often becomes too strict. For example, in Germany, instead of giving the corporate governance code commission time to revise its recommendations on directors' remuneration, in 2009, the German Parliament reacted with a mandatory reform law on this issue (Aguilera & Jackson, 2010; Hopt, 2011).

In sum, we reach the conclusion that there is neither an optimum regulation level nor a 'one size fits all' *magical* bundle of corporate governance practices that copes with different firm's realities and their industry and countries contingencies. In addition, we suggest two policy implications. First, a balance between *rules* (i.e., hard law) and *standards* (i.e., soft law) is context-dependent, and policymakers have to behave accordingly in order to avoid the risk to overthrow well-established culture, values and governance practices to new norms that not necessarily resolve immediate crisis or corporate scandals. Second, corporate governance codes introduce flexibility to the corporate governance system, allowing firms and corporate stakeholders to adapt governance's practices to their contingencies; yet a clear enforcement mechanism should be in place to guarantee the desired outcomes. Finally, it seems inevitable that we are moving towards a new territory of global governance where regulation is implemented at the industry level and enforced at a transnational level (Aguilera, 2011).

OWNERSHIP STRUCTURE

One important component of the corporate governance bundle is the ownership structure of the firm. Differences in ownership structure have two obvious consequences for corporate governance, as surveyed in Morck, Wolfenzon and Yeung (2005). On the one hand, dominant shareholders possess both the incentive and the power to discipline management. On the other hand, concentrated ownership can create conditions for a new problem (agency type II), because the interests of controlling and minority shareholders are not aligned and the controlling shareholders could expropriate the minority shareholders. Connelly, Hoskisson, Tihanyi and Certo's (2010) review suggests that shareholders with significant ownership have both incentives to monitor executives and the influence to promote strategies they feel will be beneficial.

The ownership structure is quite diverse across countries, with dispersed ownership being much more frequent in US- and UK-listed firms, compared to Continental Europe, where concentrated ownership is prevalent (La Porta et al., 1999). Faccio and Lang (2002) report in a study of 5,232 publicly traded corporations in 13 Western European countries that only 36.93 percent could be considered firms with dispersed ownership. In many transition economies (and emerging economies), family owners and other blockholders are an important governance constituency (Douma, George & Kabir, 2006).

The nature of governance problems differs greatly between publicly traded companies with and without a controlling shareholder (Bebchuk & Hamdani, 2009, La Porta et al., 1999). With controlling shareholders, the market for corporate control that plays such an important role in the analysis of companies without a controller cannot provide a source of discipline. With a controlling shareholder, the fundamental governance problem is not opportunism by executives and directors at the expense of public shareholders at large but rather opportunism by the controlling shareholder at the expense of the minority shareholders. Shareholder control is an internal governance mechanism, which can range from a sole majority owner to numerous small shareholders, and is likely to influence other elements of the corporate governance bundle. For example, Desender, Aguilera, Crespi-Cladera and Garcia-Cestona (2011) argue that there may be substitution/complementary effects between dimensions of the ownership structure (concentration/dispersion) and the board of directors in terms of monitoring management.

Several researchers, including Aguilera and Jackson (2003) and Adams et al. (2010), call for a distinction between types of controlling shareholders when studying ownership structure because different types of owners pursue different strategic objectives, and thus can be expected to exert different demands from boards and disciplinary effects on managers. We distinguish between family ownership, institutional ownership, and bank ownership.

Family control represents a distinctive class of investors in that families hold little diversified portfolios, are long-term investors, and often hold senior management positions, which places them in a unique position to influence and monitor the firm (Shleifer & Vishny, 1997). For example, Anderson and Reeb (2003) find that families that appear in both Forbes' Wealthiest Americans Survey and the Standard & Poor's 500 Index (S&P 500) have over 69 percent of their wealth invested in their firms. The incentives to directly monitor management increase with the wealth at stake. In addition, the distance from controlling shareholders to management is likely to be minimal, as very often owners will be managers themselves. Anderson and Reeb (2003) find that family members serve as CEOs in about 43 percent of the family firms in the S&P 500. Family members have both the incentives and abilities to monitor and discipline management, because of their close interaction and their incentives to protect their investment, but also because family members have excellent information about the firm, as a result of a long-term relationship with the firm (Smith & Amoako-Adu, 1999). Since the family group has often been running the company since its founding and generally has representatives within different levels of management, they are in a unique position to effectively monitor the operations of the company (Demsetz & Lehn, 1985). In addition, they can monitor the operations of the company at a much lower cost than other monitors due to their better understanding of the firm's wealth-creation processes and their better access to internal information (Raheja, 2005). Desender et al. (2011) argue that, as a consequence of substitution effects, boards in family firms are less focused on monitoring compared to boards in firms with dispersed ownership.

Institutional investors are mutual funds, pension funds, hedge funds, insurance companies, and other non-banking organizations that invest their members' capital in shares and bonds. The main goal of institutional investors is to maximize the financial gains from a portfolio of investments, which makes them more concerned about maximizing shareholder value and liquidity (Aggarwal et al., 2010, Thomsen & Pedersen, 2000). To accomplish this goal and reduce the uncertainties of their investments, institutional investors usually have an arm's-length relation with firms, where rather than spending time and resources trying to improve the performance of a company in its portfolio, they simply sell the shares of the underperforming company and walk away (Ingley & van der Walt, 2004). The presence of institutional investors is likely to have influenced other elements of the corporate governance bundle. For example, Ahmadjian and Robbins (2005) report that Japanese firms were influenced by Anglo-American institutional investors to adopt business practices more consistent with the Anglo-American shareholder-based system.

Banks often have multiple ties with the firms in which they own shares and their equity stake primarily serves to cement an often-complex set of non-shareholder relationships with the firm (Roe, 1994). Kaplan and Minton (1994) and Kang and Shivdasani (1997) point out that banks possess private information on firms, either through the past repayment records of the bank's existing borrowers or through the banks' superior knowledge of local business conditions (Triantis & Daniels, 1995). As shareholders with superior access to information and power to discipline management, it can be argued that banks are able to reduce the monitoring efforts needed, which may have an influence on other elements of the corporate governance bundle.

BOARD OF DIRECTORS

Boards are by definition the internal governing mechanism that shapes firm governance, given their direct access to the two other axes in the corporate governance triangle: managers and shareholders. The board receives its authority from stockholders of corporations and its job is to hire, fire, compensate, and advise top management on behalf of those shareholders (Jensen, 1993) as well as monitor top management teams to assure they comply with the existing regulation. This delegation occurs because stockholders generally do not have a large enough incentive to devote resources to ensure that management is acting in the stockholders' interest. It is the duty of the board of directors to manage the company's affairs in the interests of the company and all its shareholders (fiduciary duty), within the framework of the laws, regulations, and conventions under which the company operates. Boards are therefore an alternative to direct monitoring by shareholders (Bebchuk & Weisbach, 2010). Board members depend on the CEO to provide them with relevant firm-specific information. Therefore, the better the information the CEO provides, the better is the board's advice but also the better the board can perform its monitoring role. In addition, boards typically delegate some of their duties to specific board committees such as audit, remuneration, and nomination committees as additional monitoring controls.

Fama (1980) argues that the composition of the board of directors is important, as it likely to influence the monitoring efforts of the board. Observers typically divide directors into two groups: inside directors and outside directors. Generally, a director who is a full-time employee of the firm in question is deemed to be an inside director, while a director whose primary employment is not with the firm is deemed to be an outside director. In recent years, public pressure and regulatory requirements have led firms to have majority-outsider boards and there is a lot more surveillance on what constitutes independence. The characteristics of boards of large US corporations have been described in a number of studies. For example, Fich and Shivdasani (2006) find for a sample of 508 of the largest US corporations that, on average, the board contains 12 board members, of which 55 percent are outsiders, and has 7.5 meetings a year. A number of the directors served on multiple boards (i.e., interlocking directorates); the outside directors in these firms averaged over three directorships. Linck et al. (2008) present similar findings for a larger sample of 8,000 smaller firms.

Since 2002, there have been significant changes. The Sarbanes–Oxley Act contained a number of requirements that increased the workload of and the demand for outside directors (see Linck, Netter & Yang, 2008 for a description of these requirements). In addition, the scandals at Enron and WorldCom have led to substantially increased public scrutiny of corporate governance, accountability, and disclosure. Consequently, boards have become larger, more independent, have more committees, meet more often, and generally have more responsibility and risk (Linck et al., 2008). These changes both increased the demand for directors and decreased the willingness of directors to serve. As a consequence, director pay and liability insurance premiums have increased substantially.

Zahra and Pearce (1989) argue that the two main roles of the board are monitoring and advice. The monitoring role of the board is rooted in the agency theory where the primary concern of the board is to curb the self-serving behaviors of agents (the top management team) that may work against the best interests of the owners (shareholders) (Eisenhardt, 1989; Jensen & Meckling, 1976). Agency theory strongly favors outside directors, those detached from management and daily operations, as they facilitate objectivity (Kosnik, 1987), while separate CEO and chair positions provide further checks and balances (Rechner & Dalton, 1991). Several theoretical papers in the finance literature examine why boards may not monitor too intensively. Warther (1998) shows how the management's power to eject board members may result in a passive board. Similarly, Hermalin and Weisbach (1998) use a manager's power over the board selection process to show how board composition is a function of the board's monitoring intensity. However, Almazan and Suarez (2003) argue that passive (or weak) boards may be optimal because, in their framework, severance pay and weak boards are substitutes for costly incentive compensation. Empirically, the evidence with respect to the relationship between board characteristics and firm performance has been mixed (e.g., Dalton et al., 1998, 2007).

The advisory role is rooted in the resource dependence (Boyd, 1990: Daily & Dalton, 1994; Gales & Kesner, 1994; Hillman, Cannella & Paetzold, 2000; Pfeffer, 1972; Pfeffer & Salancik, 1978) and stakeholder traditions (Hillman, Keim & Luce, 2001; Johnson & Greening, 1999; Luoma & Goodstein, 1999) and suggests that boards should take a role that centers on advising management and enhancing strategy formulation. The resource dependence theory (Pfeffer & Salancik, 1978) argues that corporate boards are a mechanism for managing external dependencies (Pfeffer & Salancik, 1978), reducing environmental uncertainty (Pfeffer, 1972) and reducing the transaction costs associated with environmental interdependency (Williamson, 1984) and ultimately aid in the survival of the firm (Singh, House & Tucker, 1986). Furthermore, insiders on the board are viewed as important contributors as they are knowledgeable about firm operations. Empirical studies in the resource dependence tradition have shown a positive relationship between board capital and board effectiveness (e.g., Boyd, 1990; Dalton et al., 1999; Pfeffer, 1972). Carpenter and Westphal (2001) found that boards consisting of directors with ties to strategically related organizations, for example, were able to provide better advice and counsel, which is positively related to firm performance (Westphal, 1999). In addition, Hillman et al. (1999) found that when directors established connections to the US government, shareholder value was positively affected. They conclude that such connections held the promise for information flow, more open communication, and/or potential influence with the government, a critical source of uncertainty for many firms.

Boards are faced with an apparent paradox in that, on the one hand, they are expected to exercise control over the top management so that interests of shareholders (and other stakeholders) are protected, whereas, and zon the other hand, they need to work closely with the top management to provide valuable support in choosing corporate strategy and make informed decisions in implementing strategy (Hillman & Dalziel, 2003; Sundaramurthy & Lewis, 2003). While there is a large literature that studies the monitoring role of boards, research on the advisory role, the interaction between the board's two roles and the interaction between board roles and other elements of the corporate governance bundle has been scarce.

Desender et al. (2011) argue that the primary role of the board of directors is not independent from the context in which the company operates. The importance of the monitoring and advisory role is expected to be influenced by other elements of the corporate governance bundle, such as the legal protection of shareholders. For example, Adams (2005) find for a sample of Fortune 500 firms that, boards devote effort primarily to monitoring, rather than dealing with strategic issues or considering the interests of stakeholders. Other elements of the corporate governance bundle, such as the ownership structure or the executive compensation, could also influence the importance of one role or the other. To illustrate, firms with controlling shareholders may benefit more from putting emphasis on the advisory role of the board compared to firms without controlling shareholders.

When ownership is diffuse, the monitoring role of the board is likely to be more important because it is difficult for the dispersed shareholders to coordinate their monitoring activities and is also not worthwhile for any individual investor to monitor the company on a continuing basis (Aguilera, 2005; Davies, 2002). To resolve the alignment problem in firms with dispersed ownership, the board may prioritize the monitoring role, as collectively all shareholders benefit from the monitoring efforts by the board of directors. Shleifer and Vishny (1986) argue that large shareholders have strong incentives to monitor managers because of their significant economic stakes. Even when they cannot control the management themselves, large shareholders can facilitate third-party takeovers by splitting the large gains on their own shares with the bidder. Large shareholders might have access to private value-relevant information (Heflin & Shaw, 2000), engage with management in setting corporate policy (Bhagat et al., 2004; Davies, 2002; Denis & McConnell, 2003), have some ability to influence proxy voting, and may also receive special attention from management (Useem, 1996). Since blockholders have both the incentives and the power to hold management accountable for actions that do not promote shareholder value (Bohinc & Bainbridge, 2001), the monitoring role of the board, in such a situation, is considered to be less important (Aguilera, 2005; Desender et al., 2011; La Porta et al., 1998).

SYSTEMS OF CORPORATE GOVERNANCE

Probably, the quintessential question in comparative corporate governance is: *What describes and explains variation in corporate governance systems across countries?* To answer this question, most comparative corporate governance researchers contrast two dichotomous models of corporate governance: Anglo-American and Continental European. At the core of this distinction are the different systems of corporate ownership (Aguilera & Jackson, 2003, 2010; Ahmadjian & Robbins, 2005; Barca & Becht, 2001; Becht & Röell, 1999; Berglöf, 1991; Gedajlovic & Shapiro, 1998; Hall & Soskice, 2001; La Porta et al., 1998; Rajan & Zingales, 1998; Shleifer & Vishny, 1997). Franks and Mayer (1990, 2001) describe two types of ownership and control systems, the so-called 'insider' and 'outsider' paradigms. The insider system corresponds to an ownership structure where few or even a single shareholder has the control of a firm, which is the case in most Continental European countries (Barca & Becht, 2001). On the other hand, the outsider system is characterized by the separation between ownership and control where ownership is dispersed amongst a large number of shareholders. Both the United States and the United Kingdom are examples of outsider systems.

Together with ownership structure, the legal systems, and its related corporate law, the development and structure of capital, product, and labor markets, and the political and economic institutions define the myriad of varieties of capitalisms that, ultimately, characterize corporate governance systems (Hall & Soskice, 2001). In this regard, although the dichotomy remains a useful framework to start with, the stylized Anglo-American and Continental models only partially account for governance realities in Japan (Aoki et al., 2007; Dore, 2000; Gerlach, 1992), East Asia (Dore, 2000; Feenstra & Hamilton, 2006; Fukao, 1995; Gerlach, 1992; Hamilton et al., 2000; Lincoln et al., 1998), a wide range of European countries (Lubatkin et al., 2005; O'Sullivan, 2000; Pedersen & Thomsen, 1997; Prowse, 1995; Rhodes & van Apeldoorn, 1998; Weimer & Pape, 1999; Whittington & Mayer, 2000), and the new emerging markets (Aguilera et al., 2011, Chung & Luo, 2008; Khanna & Palepu, 2000, Singh & Gaur, 2009).

More recently, there have been efforts to more systematically account for these cross-national differences, resulting in a wide range of categorizations of corporate governance systems. We summarize what we believe are the current main four comparative corporate governance system categorizations. In Table 17.1, we outline the core governance characteristics indentified in the different corporate governance categorizations.

First, Weimer and Pape (1999), starting from the observation that the debate on corporate governance in an international setting is restricted by the lack of a clear framework, propose a revised taxonomy of corporate governance systems. They based their analysis upon eight firm characteristics: (1) the concept of the firm, (2) the system of the board of directors, (3) the main stakeholders that exert control on managerial decisions, (4) the development of the capital market, (5) the role of the market for corporate control, (6) the corporate ownership structure, (7) the executive compensation system, and finally (8) the time perspective of economic relationships. And, to allow for an international comparison of these attributes, they divided countries into 'market-oriented' systems (the Anglo-American system) and 'network-oriented' systems. Then, the latter is composed of Germanic countries (e.g., Germany and the Netherlands), Latin countries (e.g., France and Italy), and Japan. After discussing the diverse characteristics across geographic regions, Weimer and Pape conclude that the central attribute to the market-oriented systems is the market for corporate control, which serves as an external mechanism for shareholders to influence managerial decision. In the opposite side, in the network-oriented systems, oligarchic groups with different identities substantially manipulate managerial decisions by direct modes of influence.

Second, Aguilera and Jackson (2003) draw on an 'actor-centered' institutional approach to explain firm-level corporate governance practices in terms of institutional factors that shape how actors' interests and conflicts are defined ('socially constructed') and represented. In their model, they examine how labor, capital, and management interact to explain firm's governance patterns under diverse institutional settings. First, they use 'forward-looking' propositions to analyze the isolated effects of each institutional domain on each stakeholder and illustrate this mechanism around three different conflicts: (1) class conflicts, (2) insider–outsider conflicts, and (3) accountability conflicts. And then, to explain cross-national variation on corporate governance systems, they turn to 'backward-looking' propositions that capture the cumulative and interdependent effects of different institutional domains within countries.

Third, Millar et al. (2005), taking an international business orientation, classify three different systems: (a) the Anglo-Saxon (i.e., *market-based system*), (b) the Communitarian

Table 17.1 Review of country-level systems of corporate governance

Weimer and Pape 1999				
	Market-oriented		*Network-oriented*	
	Anglo-Saxon	Germanic	Latin	Japan
Countries	USA, UK, Canada, Australia	Germany, The Netherlands, Switzerland, Austria, Denmark, Norway, Finland,	France, Italy, Spain, Belgium	Japan
Concept of the firm	Instrumental, shareholder-oriented	Institutional	Institutional	Institutional
Board of directors	One-tier	Two-tier	Optional (France), general one-tier	Board of directors; office of representative directors; office of auditors; de facto one-tier
Main stakeholder	Shareholders	Industrial banks (Germany), employees, in general oligarchic group	Financial holdings, the government, families, in general oligarchic group	City banks, other financial institutions, employees, in general oligarchic group
Capital markets	High	Moderate/High	Moderate	High
Market for corporate control	Active	Inactive	Inactive	Inactive
Ownership concentration	Low	Moderate/ High	High	Low/ Moderate
Executive compensation, performance-dependent	High	Low	Moderate	Low
Time horizon	Short term	Long term	Long term	Long term
Millar et al. 2005				
	Market-based system		*Relationship-based system*	
	Anglo-Saxon	Communitarian	Emerging Market	Developing Countries
Countries	USA, UK, Canada	Continental European countries	East European countries, Asian countries such as some provinces of China (e.g. Shanghai, Guangzhou, and Shenzhen); Malaysia; Thailand; Indonesia; the Philippines and some of the Latin American countries such as Mexico, Chile, and Brazil	In Asia: Burma, Laos, Cambodia, India and some provinces of China
Shareholder rights	High	High	Low/Moderate	Low
Control function	Market	Market/Governments	Governments	Governments

Main stakeholder	Shareholders	Industrial banks (Germany), industrial firms, families, in general oligarchic group	Financial holdings, the government, families, in general oligarchic group	Financial holdings, the government, families, in general oligarchic group
Capital markets	High	Moderate/High	Low/Moderate	Low
Market for corporate control	Active	Inactive	Inactive	Inactive
Ownership concentration	Low	Moderate/High	High	High
Time horizon	Short term	Long term	Long term	Long term
Institution transparency	High	High	Low/Moderate	Low
Gilson 2006				
	Efficient controlling shareholder system	*Inefficient controlling shareholder system*		
Countries	USA, Sweden, Canada	Italy, Mexico, South East Asian countries		
Ownership concentration	Low/High	Moderate/High		
Shareholder rights	High	Moderate		
Quality of law	High	Low		
Management monitoring	Market/Majority shareholders	Majority shareholders		
Private benefits of control	Non-pecuniary	Pecuniary		
Capital markets	High	Low/Moderate/High		
Market for corporate control	Inactive	Inactive		
Institution transparency	High	Low		

system, which includes Continental European countries (i.e., *stakeholder-based system*), and (c) the Emerging Market system that comprises the East European countries, Asian countries such as China, Malaysia, Thailand, Indonesia, the Philippines, and some of the Latin American countries such as Mexico, Chile, and Brazil. Taking into account the reality of the local, non-economic forces that influence firm capabilities and behaviors, they conclude that business systems have a strong influence on corporate governance practices, particularly information disclosure and corporate transparency. They show that the institutional arrangements representative of a certain type of business system affect information disclosure, among which is the effectiveness of legal institutions that set boundaries between mandatory and voluntary information disclosure.

Finally, from the legal perspective, Gilson (2006: 1643) states that, 'the familiar dichotomy is simply coarse as to be wrong.' He proposes to respond to its deficiencies by looking more closely at two central features of a more complex taxonomy: (1) the concepts of controlling shareholders, and (2) of private benefits of control. In the first place, Gilson defines two patterns of ownership concentration, *inefficient* and *efficient* controlling shareholders. Countries where 'bad' law allows the cost of private benefit extractions to outweigh the benefits of monitoring are characterized as *inefficient* systems. By contrast, the ownership pattern may reflect a structure of *efficient* controlling shareholders, in which good law helps the benefits of more focused monitoring to be greater than the costs of private benefit extraction. Secondly, he turns to the nature of the private benefits of control to distinguish between *pecuniary* and *non-pecuniary* private benefits. The first is *pecuniary* private benefits of control: i.e. the non-proportional flows of resources from the firm to the controlling shareholder. The second is *non-pecuniary* private benefits of control: i.e. forms of emotional and other benefits that do not involve transfer of 'real' resources. After characterizing the controlling shareholder taxonomy, Gilson discusses how prior distinct countries such as the United States and Sweden can be similar in terms of 'real' outcomes in protecting the minority shareholders and, ultimately, the financial investors. And he concludes that 'to better understand the macroeconomic impact of efficient controlling shareholder systems, we need to better understand the micro-level dynamics of this ownership structure. As the focus of corporate governance scholarship shifts to controlling shareholder systems, we need to think small' (Gilson, 2006: 1678).

DISCUSSION

The growing integration of financial markets is a key factor of convergence of corporate governance systems. Investors in most countries increasingly accept the proposition that holding an international equity portfolio leads to higher returns and lower risk than a purely domestic portfolio. As a result, many pension funds now allocate a certain portion of their portfolios to international equities, while a large number of specialized mutual funds have been developed to allow individuals to participate in foreign equity investment. At the same time, non-financial companies realize that broadening the investor base will lower their cost of capital and may also lessen volatility in the price of the company's stock.

The growing wish of both investors and issuers to operate in the international capital market requires some degree of acceptance of common values and standards. Institutional shareholders have brought with them expectations about shareholder value and are increasingly requiring firms to establish profit targets and to produce competitive returns on equity. Institutional investors also insist that companies respect international norms of governance, particularly concerning the fiduciary duties of management and obligation of controlling shareholders to respect demands of minority investors concerning transparency and the procedures for exercising corporate control, especially at the shareholders' meeting. Thus, in addition to the legal and institutional changes, which are occurring in their home countries, companies are forced to adapt their behavior in order to be able to tap global capital markets.

Since the mid-1990s, there has been much talk of the convergence of corporate governance systems to Anglo-American standards, and several trends have pointed in this direction (e.g., Coffee, 1999, 2002; Denis & McConnell, 2003). However, Thomsen (2003) argues in favor of *mutual convergence*, i.e. that not only has European corporate governance converged to US standards but also US corporate governance has effectively converged to European standards through the concentration of ownership and increasing levels of insider ownership (Holderness et al., 1998; Meyer, 1998), the separation of management and control in more independent boards (Monks & Minnow, 2001), the deregulation of the banking system (Financial Services Modernization Act, 1999; *The Economist*, 1999), and the increasing importance of stakeholder concerns (Agle et al., 1999; Jawahar & McLaughlin, 2001; Jones & Wicks, 1999). These shifts indicate that it is increasingly more relevant to look at the configuration of governance practices at the firm level.

Moreover, the fact that there are firms that fit within the different corporate governance models within countries is indicative of the current hybrid trends away from stylized arrangements. An illustrative case is the rapidly changing configurations in emerging markets as they get strong influences from abroad. The case of Brazilian Stock Exchange (BSE) segmented listing is worth discussing. The Brazilian capital market faced a dramatic decrease in the number of listed firms and the trade volume during the last decade of twentieth century, going from 551 firms in 1996 to 428 firms in 2001, and from 112 billion to 65 billion dollars over the same time period (WDI, 2011). In December 2000, the Brazilian Stock Exchange – BM&FBovespa – issued new listing rules, the 'Novo Mercado.' The aim of this regulation was to increase investors' confidence in the BSE market and to raise the level of management and majority shareholders' accountability through good corporate governance practices and greater transparency, and, as a consequence, to reduce the cost of capital. The Novo Mercado listing rules establish that public share offerings have to use mechanisms to favor capital dispersion and broader retail access such as the 'one-share-one-vote' principle. Additionally, among other requirements, firms have to maintain a minimum free float, equivalent to 25 percent of the capital, to disclose financial information according to the US GAAP or IFRS accounting standards, and to have at least five members on the board of directors and 20 percent of independent directors.[3] These governance requirements are indeed very much in line with NYSE requirements.

The interesting dimension of the BSE market regulation is that recognizing that some existing listed firms would find it difficult to adopt the new rules, which were quite restrictive compared to the traditional market rules and the corporate law, the BM&FBovespa proposed two differentiated levels of corporate governance practices, level 1 and level 2 (Carvalho, 2003). Altogether, there were four listing types: (1) traditional market, (2) level 1, (3) level 2, and (4) Novo Mercado.[4] In March 2011, BM&FBovespa has 422 listed firms, of which 17 are on the level 2 trading list, 38 on the level 1 trading list, and 117 on the Novo Mercado; the remaining 250 are on the traditional market. This is very interesting because within a given stock market there are several degrees of compliance with governance rules which in a way equate to different models of corporate governance within a given country. The Brazilian example also supports the argument that firms do have choices within a given legal jurisdiction and a given country to adopt certain practices over others.

In sum, assembling corporate governance practices into bundles according to country institutional characteristics needs to be reconsidered, given the increase of the heterogeneity of corporate governance practices adopted by firms within countries as a result of internationalization and information advances. Therefore, we believe the discussion of corporate governance bundles is more fruitful at the firm level than at the country level and comparative corporate governance research may want to explore the heterogeneity of bundles within countries in addition to comparing across countries. Some scholars are currently developing empirical papers using set-theoretic methods (QCA/Fuzzy sets) to uncover different configurations of corporate governance practices across countries leading to high firm performance (García-Castro et al., 2011; Misangyi & Holehonnur, 2010) or to high IPO performance (Bell et al., 2010).

In following sections, we exemplify how different configurations of corporate governance practices could play out across countries, taking as the departing practice, corporate ownership. We distinguish between family ownership, bank ownership, institutional ownership, state ownership and firms with dispersed ownership.

Family ownership

Family control represents a distinctive class of investors in that they hold little diversified portfolios, are long-term investors, and often hold senior management positions, which places them in a unique position to influence and monitor the firm (Shleifer & Vishny, 1997). Obviously, the higher the stake in the firm, the higher the alignment between the family owners and other shareholders will be. In an extreme case scenario, where the family owners are also actively involved in management and have an ownership stake above 50 percent (examples include Oracle Corp., Reebok Int. Ltd in the US market, BMW and Inditex in Continental Europe or Samsung Group in Korea), the role of the board of directors is unlikely to strongly focus on monitoring. Second, the executive compensation package often intended to enforce alignment is of little relevance if managers hold an important stake of their wealth in the company. Third, disclosure is likely to be lower for family-controlled firms, as a consequence of their lower need for financing through the capital market. Finally, other elements of the corporate governance bundle are also likely to be influenced by the presence of family owners. While family firms are typically more associated with the insider system, for the United States, Anderson and Reeb (2003) show that one-third of S&P 500 firms can be classified as family-controlled firms. We believe that corporate governance dynamics for family-controlled firms are likely to be similar, independent of the country in which they are incorporated. Perhaps, the better protection of minority shareholders allows family firms to rely more on the capital market for financing than on bank debt in countries with strong legal shareholder protection; however, banks could perform an important monitoring role to reduce expropriation risks in countries where shareholders are less protected and firms rely for external financing on bank debt. Therefore, we argue that, on average, family firms at least across the advanced industrialized and emerging market world, are likely to rely on a similar corporate governance bundles.

Bank ownership

Studies on comparative corporate governance have associated insider systems of corporate governance with a high dependence of firms upon banks and high debt/equity ratios. Instead of arm's-length lenders, banks tend to have more complex and longer-term relationships with corporate clients. Exmples of firms controlled by banks include Compagnie des Alpes in France, Banesto in Spain, and NEC in Japan. Firms with a strong bank relationship often rely on confidentiality, as information is shared between the bank and its corporate clients. In addition to holding considerable equity portfolios themselves, banks name representatives to the company boards and are seen as exercising a leadership role in non-financial companies or among groups of companies. Banks are often seen as representing all shareholders: their power extends beyond direct share ownership, as they hold and vote shares for individual investors. As a shareholder with superior access to information and power to discipline management, banks are likely to influence the priorities of the board of directors, other monitoring mechanisms, and the design of executive incentives plans. Insider knowledge of the business allows the banks to serve a critical monitoring function, at a lower cost than what would be possible for other shareholders. In addition, as an important provider of financing to the firm, the bank is likely to offer much stronger incentives to executives in order to promote long-term profit maximization. Therefore, bank ownership affects the corporate governance bundle in a number of ways. First, we believe that the role of the board is likely to be less focused on monitoring and more focused on the provision of resources. Second, the bank's high monitoring is likely to reduce the importance of executive incentives to achieve alignment of their interests. Third, disclosure to outside investors is typically linked to the need of external financing. In this sense, firms with a strong bank relationship are more likely to depend less on financing through the stock market and have lower disclosure needs. Other elements of the corporate governance bundle, such as the reliance on the market for corporate control or importance of external auditing, are also likely to be influenced by the presence of a bank as controlling shareholder.

Institutional ownership

The main goal of institutional investors is to maximize the financial gains from a portfolio of investments, which make them more concerned about maximizing shareholder value and liquidity (Aggarwal, Isil, Miguel & Matos, 2010; Thomsen & Pedersen, 2000). Examples of firms controlled by institutional owners include Kaufman & Broad and Rexel in France and Vedanta Resources in the United Kingdom. Prior research finds that a small number of institutional investors take an active role in the governance of their portfolio firms by waging public and private campaigns, sponsoring shareholder proposals, and voting against management attempts to entrench (Gillan & Starks, 2003). For example, the mutual fund industry is generally far less committed to activism than the pension fund industry. This partly reflects the fact that the mutual funds must differentiate their products by applying their skills in assembling portfolios that are different from those of competitors and must demonstrate their portfolio management skills; thus, they do not emulate but try to beat indexes. On balance, this sector is more likely to continue to pursue 'buy and sell strategies.' To accomplish this goal and reduce the uncertainties of their investments, institutional investors usually have an arm's-length relation with firms – where rather than spending time and resources trying to improve the performance of a company in its portfolio, they sell the shares of the under-performing company and walk away (Ingley & van der Walt, 2004). Bushee et al. (2008) find that large, low-turnover institutions with preferences for growth and small-cap firms tend to prefer firms with existing preferred governance mechanisms and that these institutions are associated with future improvements in shareholder rights.

The degree of the involvement of institutional owners is likely to affect the corporate governance bundle. Improvements in disclosure, board independence, and a focus of executive compensation on long-term value creation are more likely in firms with high levels of institutional investors' involvements. Besides, institutional investors have both the incentives and ability to operate as an effective monitor and they have acquired important experience regarding the effectiveness of corporate governance by their presence in other firms. The extent to which they may pursue direct monitoring instead of monitoring by the board or alignment through incentives is likely to depend on their total investment portfolio and limitations in terms of personnel. Institutional investors following a short-term investment strategy are much less likely to operate as active monitor or to instigate significant changes in the corporate governance dynamics of the firms in which they invest.

State ownership

In several countries, state ownership is a salient feature in some industries. State companies have received less attention in the international corporate governance debate. Examples of state-owned firms include NTT in Japan, Électricité de France in France, PetroChina in China, and Lloyds Banking Group in the United Kingdom. The state is generally said to be a passive owner, with a general tendency to be an owner with a long-term perspective, emphasizing value creation over time. A common argument in favor of state ownership is that there is a need to secure social welfare and protect certain national strategic sectors, and that such welfare and strategic concerns may not be addressed by firms which are run according to the principle of profit maximization. The alleged weaknesses of state companies are explained by their deviation from the principle that the control of a company should be vested in the hands of its owners. While, in theory, the tax-paying public owns state companies, they are controlled by bureaucrats. Hence, the companies are run according to the goals of bureaucrats, which in Shleifer and Vishny's (1997) opinion are neither social welfare nor maximizing profits. Bureaucrats are first of all inclined to pursue their own political interests, such as securing votes by catering for the interests of special interest groups such as public employee trade unions. Several challenges relate to how state ownership should be organized and administered, as it needs to balance political and economic goals, on the one hand, and the state's parallel functions as owner and regulator, on the other hand.

In terms of corporate governance, state ownership is more likely to strongly focus on a stakeholder approach to corporate governance than a shareholder approach. In terms of the board composition, this means the inclusion of politicians and employee representatives. This is likely to reduce the monitoring role of the board and to enforce their advisory role. Furthermore, state-owned firms are likely to have other objectives beyond financial performance, such as long-term growth, which are likely to influence the sensitivity of the executive compensation to financial performance. In addition, disclosure is unlikely to be higher than in firms without state ownership, given their access to private information and reduced need to rely on the capital market. Finally, the risk of hostile takeovers is minimal, as it depends on the willingness of the controlling owner to sell.

Ownership dispersion

Grossman and Hart (1980) argue that the free-rider problem makes it cost-ineffective for small shareholders to act as monitors of management. Firms without controlling owners therefore are more likely to assign a strong monitoring role to the board of directors, emphasizing board independence. Examples include Japan Airways and Honda in Japan, BAE System and British American Tobacco in the United Kingdom, and Total and Air Liquide in France. In addition, executive compensation is another mechanism that could help reduce the possible divergence of interests between shareholders and managers. In terms of disclosure, one could expect firms with dispersed ownership to provide more information to their shareholders, as these firms tend to rely on the capital market for financing. Furthermore, the market for corporate control moderates the divergence of interests, because shareholders acquiring control can discipline managers who fail to create shareholder value. This discipline can take the form of a takeover, closer shareholder monitoring, or dismissing management (Jensen, 1988; Shleifer & Vishny, 1986). To the extent that shareholder monitoring is less present when ownership is dispersed, or the board is dominated by management, reliance on the market for corporate takeover is going to be more important to align management interest with those of shareholders.

The above examples demonstrate that there is a wide range of combinations of corporate governance practices that firms can adopt which might be partly limited by the environment but are also constrained or enabled by the set of governance practices available. To conclude, we urge future research in comparative corporate governance to adopt a more holistic view of the firm–environment relationship and to examine the firm interdependencies among corporate governance practices. In other words, we encourage corporate governance scholars to move beyond the country-level models of corporate governance and study the degrees of freedom that firms have to embrace governance practices. Future research should also (1) study the increasing governance shifts towards a hybrid or mutual convergence system with multiple effective configurations of corporate governance practices, (2) explore existing industry pressures to comply or deviate towards certain practices, (3) expand the configurational framework to firms in emerging markets as these firms vary tremendoustly, and (4) rely on research methods that nicely capture this configurational approach. There is much exciting work to be done ahead of us!

NOTES

1 La Porta et al. (1998) focus on four legal origin families: English common law, French civil law, German civil law and Scandinavian civil law. On the other hand, Zweigert and Kotz (1998) distinguish among five legal families: namely, Romanistic (France), Germanic (Germany and Switzerland), Anglo-American (United States and United Kingdom), Nordic, and East Asian (Japan and China).

2 We would like to thank Michael Goyer to point out this important dimension.

3 For further details, see http://www.bmfbovespa.com.br/

4 In addition to these four categories of corporate governance practices, the BM&FBovespa also includes a corporate governance differentiation for the over-the-counter market where only those publicly traded companies duly registered with CVM (Securities and Exchange Commission of Brazil) can be listed, called BovespaMais.

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