european corporate governance institute

Convergence and Persistence in Corporate Law and Governance

Law Working Paper N°. 370/2017
September 2017

Jeffrey N. Gordon
Columbia Law School, Millstein Center for Global Markets and Corporate Ownership, Richman Center for Business, Law, and Public Policy and ECGI

© Jeffrey N. Gordon 2017. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

This paper can be downloaded without charge from:
http://ssrn.com/abstract_id=3038742

www.ecgi.org/wp

european corporate governance institute

ECGI Working Paper Series in Law

Convergence and Persistence in Corporate Law and Governance

Working Paper N°. 370/2017
September 2017

Jeffrey N. Gordon

© Jeffrey N. Gordon 2017. All rights reserved. Short sections of text, not to exceed two paragraphs, may be quoted without explicit permission provided that full credit, including © notice, is given to the source.

Abstract

This paper, which will be the basis for a chapter in the forthcoming OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (Jeffrey Gordon and Georg Ringe, eds.), surveys the extent of convergence in corporate law and governance over the past 15 years. The paper assesses the efforts to measure convergence through the coding of national legal regimes and other comparative measures, finding "divergence in convergence." Among its conclusions: The decline in cross-listings on US stock markets reflects a "leveling up" of corporate governance standards in emerging market economies and financial globalization's development of credible substitutes for the US's disclosure regime. Much of convergence has resulted from the work of global governance institutions reacting to an assessment that poor corporate governance played a major role in the East Asian Financial Crisis and is otherwise implicated in financial stability. The relative lack of convergence within the EU is less because of the efficiencies of local regimes and more because of the desire of Member States to throw sand-in-the-gears of economic and political integration by impeding the growth of trans-EU firms. Finally, the latest turn in the "End of History" debate is less about the primacy of "shareholder value" and more about "which shareholders." The combination of long-standing family ownership and the reconcentration of public equity ownership in institutional investors has created a significant shareholder constituency that includes "stability" in its maximizing function, not just "efficiency."

Keywords: corporate governance; financial globalization; convergence; financial stability; East Asian financial crisis

JEL Classifications: F55, F60, G15, G28, G38, K22, N20, 038

Jeffrey N. Gordon*
Richard Paul Richman Professor of Law
Columbia Law School
435 West 116th Street
New York, NY 10027, United States
phone: +1 212 854 231 6
e-mail: jgordon@law.columbia.edu

*Corresponding Author

Convergence and Persistence in Corporate Law and Governance

Jeffrey N. Gordon*

Columbia Law School, ECGI
This draft: Sept. 25, 2017

This paper, which will be the basis for a chapter in the forthcoming OXFORD HANDBOOK OF CORPORATE LAW AND GOVERNANCE (Jeffrey Gordon and Georg Ringe, eds.), surveys the extent of convergence in corporate law and governance over the past 15 years. The paper assesses the efforts to measure convergence through the coding of national legal regimes and other comparative measures, finding "divergence in convergence." Among its conclusions: The decline in cross-listings on US stock markets reflects a "leveling up" of corporate governance standards in emerging market economies and financial globalization's development of credible substitutes for the US's disclosure regime. Much of convergence has resulted from the work of global governance institutions reacting to an assessment that poor corporate governance played a major role in the East Asian Financial Crisis and is otherwise implicated in financial stability. The relative lack of convergence within the EU is less because of the efficiencies of local regimes and more because of the desire of Member States to throw sand-in-the-gears of economic and political integration by impeding the growth of trans-EU firms. Finally, the latest turn in the "End of History" debate is less about the primacy of "shareholder value" and more about "which shareholders." The combination of long-standing family ownership and the reconcentration of public equity ownership in institutional investors has created a significant shareholder constituency that includes "stability" in its maximizing function, not just "efficiency."

Keywords: corporate governance; financial globalization; convergence; financial stability; East Asian financial crisis

JEL: F55, F60, G15, G28, G38, K22, N20, 038

* Richard Paul Richman Professor of Law, Columbia Law School; ECGI; Co-Director, Millstein Center for Global Markets and Corporate Ownership; Co-Director, Richman Center for Business, Law, and Public Policy. jgordon@law.columbia.edu.

Draft of Sept. 25, 2017

Convergence and Persistence in Corporate Law and Governance

Jeffrey N. Gordon
Columbia Law School, ECGI

Almost 15 years ago Jeff Gordon and Mark Roe co-edited a book, **Convergence and Persistence in Corporate Governance**[1]. In their introductory essay, Gordon and Roe ("G & R") linked the convergence-persistence question to globalization, in two distinct senses. The first is whether corporate governance is an element of comparative advantage in global *product* markets, which would imply that the corporate governance norms that tend toward efficient production would disseminate widely. The second sense is whether corporate governance is an element of comparative advantage in global *capital* markets, either because (i) acquirers in cross-border mergers and acquisitions would want to use a standardized "currency" or (ii) equity capital suppliers such as institutional investors would push for a standardized corporate governance model. This source of comparative advantage would suggest a convergence toward an international standard of corporate governance because of its appeal to international capital markets and, generally, a lower cost of equity capital.

G&R also observed that a key feature of corporate governance is its embeddedness in national legal systems and in particular in patterns of ownership, control, and monitoring that have national origin. In consequence, notwithstanding the impact of globalization, the rate and extent of convergence will be constrained by the forces of path-dependency, along two distinct dimensions. First, from an efficiency perspective, a particular national system might well be linked to set of complementary institutions, so that a governance change to conform to the "international" model might well reduce the value of the firm and, indeed, its global competitiveness. For example, imagine a governance regime dominated by blockholders that included "affiliated" directors placed by the large bank that provided debt finance and the lead underwriters of the company's public equity. These affiliated directors would have institutional backing for their efforts to check private benefit extraction and the misrepresentation of performance. Adoption of the convergent governance standard in favor of "independent" directors rather than affiliated directors would likely undercut the monitoring capacity of the particular national system. Independent directors would be an efficient substitute only if the domestic court system became robust enough to control private benefit extraction and the domestic securities regulation system became robust enough to protect against fraud. Substitution of the convergent standard without regard for these institutional complements could result in companies that are less efficient and compete less well in global markets.[2] In consequence, national elites may defend the domestic corporate governance regime.

Second, an existing governance set-up will inevitably create rents that incumbents will fight to preserve. Controllers in a blockholder regime may well resist a move toward

[1] Cambridge University Press (2004)
[2] See, e.g., Carola Frydman & Eric Hilt, Investment Banks as Corporate Monitors in the Early Twentieth Century United States, 107 American Economic Review 1938 (2017) (removal of investment bank designees from railroad boards increased their cost of external capital).

convergent governance institutions that could impede various sorts of "tunneling"[3] (as from genuinely independent directors) or that could facilitate the growth of public capital markets that could finance rivals (as from an increase in minority shareholder protection). Unions may resist convergent measures that "empower" shareholders because of the concern that shareholder pressure could increase the likelihood of employee layoffs. The point is that even if corporate governance convergence was "efficient" in a macro-sense, important local actors might be disadvantaged and use their political tools to resist convergent legal and institutional change.

G&R also conjectured that globalization could also affect the pace of convergence through its effect on complementarities. For example, if global competitive pressure forced banks away from a relationship model towards a transactional model, the mutual gains from "delegated monitoring" might well disappear. Alternately, global capital markets might give rise to large institutional investors that pursued a monitoring strategy that exploited different complementarities.

One convergent trend noted by G&R was the decline of state ownership, in light of the privatization waves of the 1990s and 1980s. These privatizations often catalyzed the strengthening of investor protection measures, in service of the state's goal of maximizing the proceeds on the privatization.[4] But the consequence was to strengthen public stock markets more generally.

The question is, what is the state of convergence vs. persistence as of 2017? The not particularly informative answer is, there has been considerable convergence yet also considerable persistence. There has been convergence in many of the formal governance rules yet local applications reveal considerable divergence. Substantial differences in ownership structure persist. Even with improvements in minority shareholder protection, the Anglo-American model of the diffusely owned firm does not predominate. Instead we see a proliferation of forms of ownership concentration, including family ownership, foundation ownership, and entrepreneur ownership. The rise of China in the post-2000 period has brought prominence to a new form of concentrated ownership, the State-Owned Enterprise, which has now taken on pyramidal form.[5] The success of this organizational form in spear-heading China's rapid economic growth has provided counter-evidence to the privatization trend.

G&R, writing in 2003, emphasized the role of global competition in promoting convergence. In the 2017, it would also be right to add the role of "global governance," the effort to set standards flowing from supra-national public institutions. This has been propelled through three separate channels. First is the World Bank's insistence on corporate governance reform as a condition for receipt of financial assistance, particularly following the East Asian

[3] See Vladimir Atanasov, Bernard Black, & Conrad Ciccotello, Unbundling and Measuring Tunneling, 2014 Univ of Illinois L. Rev. 1697 (2014).
[4] Jeffrey Gordon, Deutsche Telekom, German Corporate Governance, and the Transition Costs of Capitalism, 1998 Colum. Bus. L. Rev. 185.
[5] See, e.g., Keun Lee and Young-Sam Kang, Business Groups in China, in Aslim Colpan, Takashi Hikino, James R. Lincoln, eds., The Oxford Handbook of Business Groups (2010); Curtis Milhaupt, The Governance Ecology of China's State-Owned Enterprises (2017), in Jeffrey Gordon & Georg Ringe, eds., Oxford Handbook of Corporate Law and Governance (Oxford UP 2017 forthcoming) [hereinafter "Gordon and Ringe"].

financial crisis but also part of its "development" agenda. Second is the formulation by the OECD of governance "principles" first in 1999 and then in subsequent versions, most recently in 2015 (helpfully available on the OECD website in 10 languages). This in turn has led to the adoption of governance codes by dozens of countries. Third is the push for governance reforms as part of the post-financial crisis agenda of the G-20 group of leading countries, with the Financial Stability Board both shaping the agenda and also providing for follow-up auditing of national adoption of appropriate measures.

From another perspective, it has become hard to separate out the convergence/persistence question from "financial globalization" – the development of worldwide capital markets and a set of complementary actors that make it possible for firms from countries with persistently weak governance institutions to opt into higher governance regimes.[6] Firms can issue stock in a "global" offering: cross-listing on an exchange with higher governance standards; submitting to a more rigorous, better policed disclosure system of the "borrowed" jurisdiction; making use of an international network of credible investment intermediaries, such as underwriters and accounting firms (applying globally-accepted International Accounting Standards)[7]; enlisting high-reputation foreigners as independent directors,[8] and selling into the portfolios of global asset managers who will bring a certain level of monitoring.[9] More specifically, careful examination of "what matters" in corporate governance suggests that the quality of the national disclosure regime is a critical variable.[10] High quality disclosure facilitates better monitoring internally and externally. Yet this is also the governance feature that is most readily borrowed through a global offering. The US disclosure pattern sets the general template, because of the desire to include US institutional investors as offerees. The reputations of global intermediaries as well as legal enforcement play a role in making the disclosure credible.[11]

Local complementarities may have eroded as cross-holdings unwind (for example, in Germany[12] and Japan[13]), but global complementarities have become stronger. The pace of

---

[6] Craig Doidge, G. Andrew Karolyi, Rene Stulz, The U.S. Left Behind? Financial Globalization and the Rise of IPOs Outside the U.S., 110 J. Financial Economics 546 (2013).
[7] See, e.g., V.W. Fang, M. Matett, & B. Zhang, Foreign Institutional Ownership and the Global Convergence of Financial Reporting Practices, 53 J. of Accounting Research 593 (12015).
[8] Mihail Miletkov, Annette Poulsen, M. Banajide Wintoki, Foreign Independent Directors and the Quality of Legal Institutions, 48(2) Journal of International Business Studies 267 (2017).
[9] Reena Aggarwal, Isil Erel, Miguel Ferreira, Pedros Matos, Does Governance Travel Around the World? Evidence from Institutional Investor, 100 J. of Financial Economics 154 (2011) (foreign institution investors from countries with strong shareholder protection improve governance of firm in weak-governance jurisdictions); Miguel A. Ferreira and Pedro Matos, The Colors of Investors' Money: The role of Institutional Investors Around the World, 88 Journal of Financial Economics 499 (2008).
[10] Bernard Black, Antonio Gledson De Carvalho, Vikramaditya Khanna, Woochan Kim, and B. Burcin Yurtoglu, Which Aspects of Corporate Governance Matter in Emerging Markets: Evidence from Brazil, India, Korea, and Turkey (May 2015), available at http://ssrn.com/abstract=2601107.
[11] See generally Alan Dignam and Michael Galanis, The Globalization of Corporate Governance (Farnham: Ashgate 2009).
[12] See, e.g., Wolf-Georg Ringe, Changing Law and Ownership Patterns in Germany: Corporate Governance and the Erosion of Deutschland AG, 63 American Journal of Comparative Law 493 (2015).
[13] Ronald J. Gilson, Reflections in a Distant Mirror: Japanese Corporate Governance Through American Eyes, 1998 Columbia Business Law Review 203 (1998).

strictly national convergence may be slowed by the ability of local issuers to opt in the global governance system.

The "convergence" question also operates on what might be thought of as the teleological level. Have governance systems converged on "shareholder control" and "shareholder value" to the exclusion of stakeholder concerns? The assertion that we had reached the "End of History" in favor of shareholders[14] produced an intense debate. Where are we now?

A final introductory thought: When the G&R book was put together, the questions about "Convergence and Persistence" related principally to developed market economies. Attention was focused on differences among developed countries: The two-board/co-determination structure of Germany and the main bank/keiretsu structure of Japan were signature pre-occupations. More generally the main difference was framed as between "outsider" and "insider" forms of corporate governance. Were these differences political, relating to the relative power of employees vs. shareholders[15]; functional, optimizing for certain forms of production, investment, and adaptability to changing condition;[16] or rather the result of strong path dependencies?[17]

The corporate governance convergence debate today focuses much more on emerging market economies. There are three reasons. First, the East Asian financial crisis of 1997-98 was taken as showing that the corporate governance failures in such countries could produce financial instability with sharply negative consequences for developed economies. The global externalities of poor corporate governance meant that countries could not be left to internalize costs and benefits. Thus corporate governance reform immediately rose to the top of the global governance agenda through the concerted efforts of the IMF and World Bank. Indeed, a 2016 IMF report reaffirms the financial stability connection, developing the case that emerging market economies with better corporate governance were better positioned to bear the financial shocks of the Global Financial Crisis of 2007-08.[18]

Second, a group of scholars became convinced that better corporate governance would accelerate financial market development and that this in turn would produce faster economic

[14] Henry Hansmann and Reinier Kraakman, The End of History for Corporate Law, 89 Georgetown Law Journal 439 (2001), reprinted in Jeffrey Gordon and Mark Roe, eds., Convergence and Persistence in Corporate Governance (2004) [hereinafter "Gordon and Roe"]; --, Reflections on the End of History for Corporate Law, Abdul Rasheed and Toru Yoshikawa, eds., Convergence of Corporate Governance: Promise and Prospects (Palgrave-MacMillan 2012), available at http://ssrn.com/abstract=2095419.
[15] E.g., Mark J. Roe, Political Preconditions To Separating Ownership from Corporate Control, 53 Stan. L. Rev. 1463 (2000).
[16] Peter Hall & David Soskice, eds., Varieties of Capitalism: The Institutional Foundations of Comparative Advantage (Oxford UP 2001); Ronald J. Gilson, Globalizing Corporate Governance: Convergence of Form and Function, 49 American Journal of Comparative Law 329 (2001), reprinted in Gordon and Roe; Ronald Gilson and Mark J. Roe, Understanding Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization, 102 Yale L. Rev. 871 (1993).
[17] Mark J. Roe and Lucian Bebchuk, A Theory of Path Dependence in Corporate Ownership and Governance, 52 Stanford Law Review 127 (1999), reprinted in Gordon & Roe.
[18] IMF, Global Financial Stability Report: Fostering Stability in a Low Growth, Low-Rate Era (Oct. 2016) (Ch. 3, Corporate Governance, Investor Protection, and Financial Stability in Emerging Markets, at 93-102.

development in emerging market economies.[19] So improved corporate governance became part of the development agenda, also promoted by the World Bank. Third, institutional investors came to believe in both the portfolio value of international diversification and the possibilities in emerging market economies of a higher growth rate than in OECD countries. Corporate governance reform would facilitate pricing, cabin the risks of sudden losses because of insider opportunism, and thus produce superior risk-adjusted returns. Institutional investors became advocates for corporate governance reform,[20] operating through private organizations like the International Corporate Governance Network and important quasi-official bodies like the OECD.

The debate about convergence within developed countries is still interesting. For example, given the robust governance of the European Union, why is it that the corporate governance regimes of the EU Member States still exhibit significant divergence? Why isn't there a fully harmonized company law after more than 20 years of trying?

This chapter will explore the "convergence or persistence" question as follows: Part I will explore the efforts to measure convergence directly by observing the evolution of law-on-the-books governance provisions. Part II will look at convergence through some capital market indicators: (i) the reduced incidence of "cross-listings" onto US stock exchanges by firms from jurisdictions with weaker investor protection; (ii) the increase in IPOs on emerging market stock markets; and (iii) an increase in cross-border mergers involving a US party in which the survivor is not a US corporation, a so-called "inversion."

Part III will look at evidence of divergence, particularly "divergence within convergence," which seems to describe the general state of play. In this regard, a 2017 compilation by the OECD of various national corporate governance provisions, the OECD Corporate Governance Factbook, is a valuable resource. One element that has driven measures of convergence over the past 20 years has been the increasing employment of independent directors across many countries. This part looks at divergent practices regarding the role and selection of the independents. It also looks at the divergent take-up of a governance innovation, shareholder votes on remuneration, "Say on Pay Policy" and "Say on Pay." Metering convergence/divergence is methodologically challenging. Without detailed country analyses, we may be a risk of assuming "convergence" on the basis of formal similarities that mask important functional differences. In this spirit, a recent set of case studies on independent directors in Asia argues for "varieties" of independent directors rather than a unitary institution.[21] Do we emphasize the divergences, which may fade over time as the convergent features assert themselves, or will the divergences attain their own functional legitimacy?

Part IV will discuss the role of global governance in corporate governance convergence, focusing particularly on the role, post-East Asian financial crisis, of the IMF, World Bank, and OECD, and the additional impact of the global financial crisis in enlisting the G-20 world leaders

[19] See infra notes 23-25 (work of La Porta el al). Ross Levine, Financial Development and Economic Growth: Views and Agenda, 65 J. Economic Literature 688 (1997).
[20] Reena Aggarwal, supra note 10; Stuart Gillian & Laura Starks, Corporate Governance, Corporate Ownership, and the Role of Institutional Investors: A Global Perspective, 13 J. Applied Finance 4 (2003).
[21] Dan W. Puchniak, Harold Baums, Luke Nottage, eds., Independent Directors in Asia: A Historical, Contextual and Comparative Approach (Cambridge UP forthcoming 2017).

and the Financial Stability Board in promoting corporate governance convergence. One conclusion is that the convergence push through global governance is motivated by financial stability concerns perhaps at least as much as by efficiency and productivity.

Part V will ask why the EU, a supra-national body empowered with governance authority, has not produced more convergent corporate governance. The asserted answer is not so much the efficiencies of local adaptations and institutions but the desire of the Member States to throw sand-in-the-gears of economic and political integration. Divergence makes it harder to accomplish cross-border merger and acquisition activity, which otherwise would produce much tighter integration.

Part VI will briefly address the "End of History" debate: whether corporate governance indeed has converged on a "shareholder value" model. The terms of the debate have shifted, however. It's not shareholders vs. stakeholder in a straightforward sense. We may all be shareholder value proponents now. The current question is, *which* shareholders, the ones who will pursue "efficiency only" or others who may include "stability" within their maximizing function? Stakeholders may fare differently depending on which shareholder objective function is predominant. Family shareholding groups that need political buy-in to protect their economic stakes are like to see value in stability; large institutional investors that are subject to government regulation, or see themselves as permanent investors locked into the systemic risk of instability, may well have a similar perspective. Global governance institutions, which are accountable to governments, are also likely to have "stability" objective. One important piece of evidence is the growing movement for "Stewardship Codes" and the concerted campaign against the purported "short termism" of hedge funds, all designed to add stability to the shareholder maximizing function. The chapter concludes by asking about whether "stability" will become a general objective of corporate governance convergence.

Part I: The Effort to Measure Convergence Directly

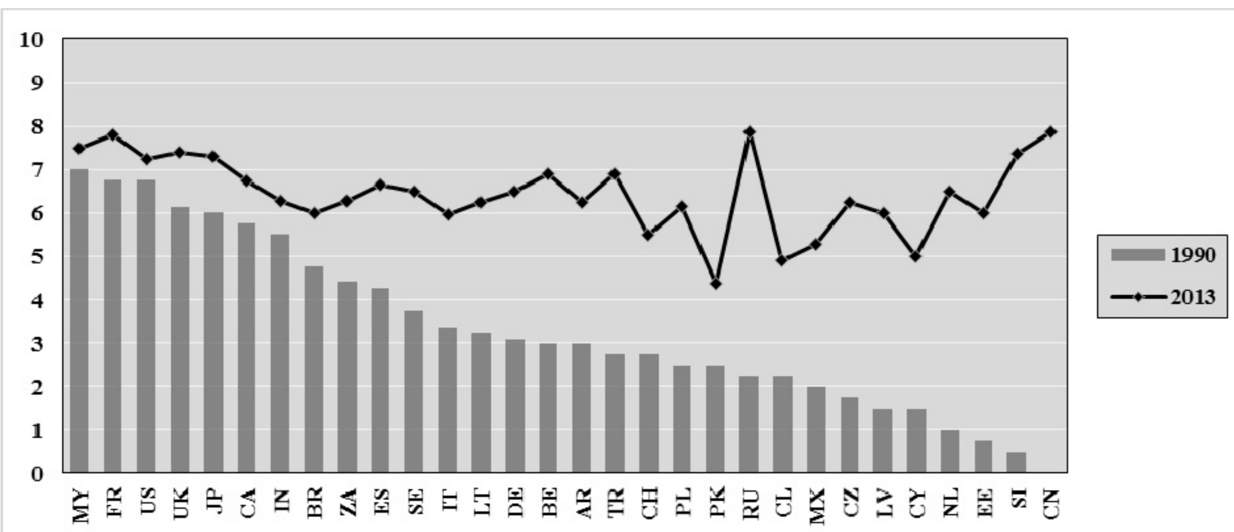
How do we know if corporate governance systems are in fact converging? Can we break a corporate governance regime into discreet elements and measure them, and then sum them up in a reliable way?[22] The first effort to do this is associated with the decade-long series of "legal origins" papers of Rafael La Porta et al, which devised various measures of investor protection that were in turn presented as explanatory elements of different ownership patterns and levels of financial development. The project initially focused on an "anti-director rights" index,[23] which was effectively dismantled as a flawed coding exercise by Holger Spamann,[24] but then reclaimed through a more accurately coded "self-dealing" index.[25] The project was at its core "anti-

[22] For the intellectual history with detailed citations, see David Cabrelli & Mathias Siems, Convergence, Legal Origins, and Transplants in Comparative Corporate Law: A Case-Based and Quantitative Analysis, 63 American Journal of Comparative Law 109, 117-124 (2015).
[23] La Porta, Rafael, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny, Legal Determinants of External Finance, 52(3) J. Finance1131–50 (1997); -----, Law and Finance, 106(6) J. Political Economy 1113–55 (1998).
[24] Holger Spamann, The "Antidirector Rights Index" Revisited, 23 Review Financial Studies (2010).
[25] Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, The Law and Economics of Self-Dealing, 88 J. Financial Economics 430 (2008).

convergence," since it was heavily invested in the thesis of trans-national "families" of corporate law, locked into their paths through their "legal origins." But the data that fueled this argument was cross-sectional, not time series, so actually the "Legal Origins" project was not sufficiently powered to test its most interesting conjecture.

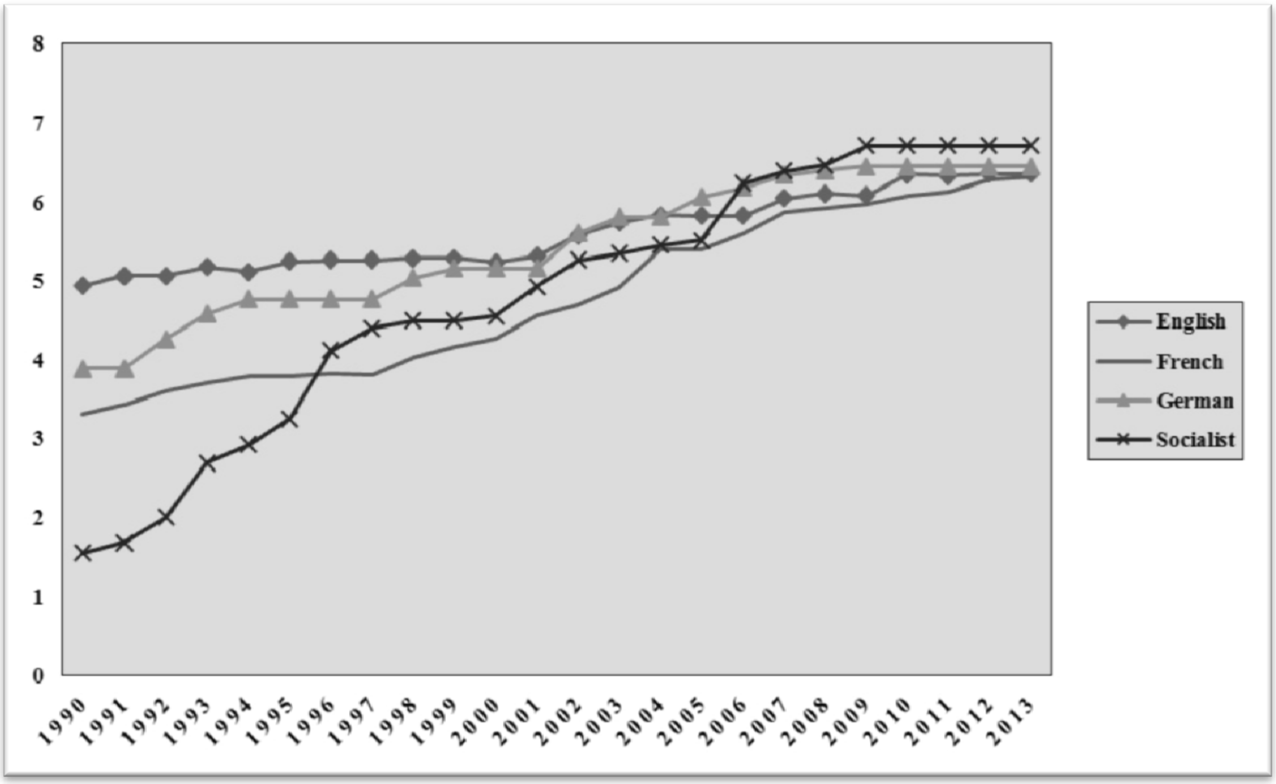
An alternative way to measure a critical dimension of corporate law and governance, "shareholder protection," has been devised by a group of scholars associated with Mathias Siems, developing "leximetric" measures and evidence.[26] The most recent entry states its punchline in the title: "Disappearing Paradigms in Shareholder Protection, 1990-2013."[27] The general strategy is similar to the La Porta et al approach, devising an "shareholder protection" index with somewhat different set of variables focused on shareholder powers only. Subjectivity and some arbitrariness are inevitable, as they acknowledge. Coding requires quantification and an index requires summing, for which there is only questionable theoretical justification.[28] With these inevitable caveats, the special contribution of Katelouzou and Siems is the coverage: 10 elements, 30 countries, and 24 years of data; and the use of network analysis to assess country clusters. The authors also divide the variables into "enabling" – those that empower shareholders to take self-protective action; and "paternalistic" – mandatory features.[29]

Their results come through in a couple of charts:



[26] The most recent entry is Dionysia Katelouzou and Mathias Siems, Disappearing Paradigms in Shareholder Protection: Leximetric Evidence for 30 Countries, 1990-2013, 15 Journal of Corporate Law Studies 127 (2015). The article contains a history of the project including citations. For a useful theoretical discussion of corporate governance indices and empirical results that link changes in shareholder protection to securities markets development, see Simon Deakin. Prabirjit Sarkar, and Mathias Siems, Is There a Relationship Between Shareholder Protection and Stock Market Development? (forthcoming J. of Law, Finance and Accounting 2018). See also Mathias Siems, Taxonomies and Leximetrics (2017), in Gordon and Ringe.
[27] Id.
[28] See Michael Klausner, Empirical Studies in Corporate Law and Governance (2017), in Gordon and Ringe.
[29] For an early effort at this distinction see Jeffrey N Gordon, The Mandatory Structure of Corporate Law, 89 Columbia Law Review 1549 (1989).

Katelouzou and Siems, p. 133, Fig 1.



Katelouzou and Siems, p. 148, Fig. 7

Figure 1 shows significant convergence across the 30 countries over the period. The average level of shareholder protection as measured by their index advances in every country from the beginning of the period (1990) to the end (2013), and the countries that were lowest and the beginning of the period have made the biggest changes. Further analysis shows that the convergence occurs over roughly the same elements of shareholder protection, consistent with the idea of the evolution of a normative model of corporate governance that has international acceptance.[30] Figure 7 puts paid to the La Porta et al idea that "origins" are "destiny," by showing great convergence in shareholder protection among the purportedly distinct legal families. More controversially, Katelouzou and Siems seem to think that their results disprove the emergence of a paradigm based on the "American" model, because many of the convergent protections are mandatory rather than enabling.[31] But the US has adopted many mandatory corporate governance elements over the time period. Indeed, adjustments in mandatory legal rules to reset the accountability of managers and shareholders has been an essential part of the American model.[32]

There are three important limitations on such direct convergence measures. First, they are based on "law on the books" coding. Explicit and implicit enforcement mechanisms can vary significantly. For example, the value of the right to bring a shareholder derivative suit for a breach of directors' fiduciary duties will importantly depend upon the functional capacity of the local judicial system.

Second, nominally similar governance elements measures may function quite differently across national regimes, depending on ownership patterns and other complementary institutions. For example, director "independence" in jurisdictions characterized by family and blockholder ownership ought to be defined differently than in the case of jurisdictions characterized principally by diffuse share ownership, in light of the different agency problems to be solved.[33] Directors who are "independent" from management may help constrain managerial agency costs for the typical American firm, but independence from the controlling shareholders is crucial most elsewhere for "good governance." Moreover, correctly framed definitions of "independence" from controllers may be inadequate without public minority shareholders selection (or veto) rights. To take another example, government ownership presents distinct challenges to the value of "independence." China's state-owned enterprises are populated with "independent directors,"

---

[30] Id. at p. 155.

[31] Id. at pp. 151-153.

[32] For example, the mandatory director independence rules found in Sarbanes-Oxley and the stock exchange listing rules, the limits on loans to insiders in Sarbanes Oxley, and "Say on Pay" in the Dodd-Frank Act. A similar effort to code and quantify shareholder protections is found in Mauro F. Guillen & Laurence Capron, State Capacity, Minority Shareholder Protections, and Stock Market Development, 61(1) Administrative Science Quarterly 125 (2016). The Guillen & Capron index, which covers 78 countries over the 1970-2011 period, shows a similar pattern of convergence, both generally across countries and across legal "families." The IMF has done similar work in creating coded measures of corporate governance change, focusing on emerging market economies. This work also shows convergence. See IMF, Global Financial Stability Report, Ch. 3, Corporate Governance, Investor Protection, and Financial Stability in Emerging Markets (2016), at 88-93. For further work focusing on emerging markets, see Stijn Claessens and B. Burcin Yurtogly, Corporate Governance in Emerging Markets: A Survey, 15(C) Emerging Markets Review 1 (2013).

[33] This point is forcefully argued in Dan W. Puchniak and Kon Sik Kim, Varities of Independent Directors in Asia: A Taxonomy, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2930785.

but their role presumably is advance rather than constrain the state's employment of ownership prerogatives. Thus some would argue that "coding" is inadequate and even misleading in its capturing of governance features, arguing instead for thick accounts of local governance evolution.[34] The convergence picture becomes much more complex through this lens.

Third, direct convergence measures are often incomplete as a measure of a country's corporate governance system. As is explained below, the separate elements of mandatory disclosure found in securities regulation may play a crucial governance role. This can vary widely across countries, independent of formal shareholder protection. More generally, even if particular elements of governance are concededly important, such as board structure and disclosure, constructing a valid measure of these governance element may vary across countries.[35]

Part II: Capital Market Evidence on Convergence

One important measure of the extent of corporate governance convergence is the behavior of firms seeking to raise equity capital in a globally-competitive capital market. Evidence of convergence comes in (i) the decline of cross-listings by firms from purportedly lower investor protection jurisdictions onto US stock exchanges; (ii) the increasing capacity of firms in emerging market economies to raise equity capital through IPOs; and (iii) an increase in "inversion" transactions in which issuers switch their domicile from the US to a foreign jurisdiction. None of these developments suggest that investor protection is less robust in the US than previously, rather, that the gap between the highest and lowest investor protector regimes has diminished so that countervailing factors might dominate the listing or domicile choice. This is consistent with the convergence pattern reflected in the Katelouzou and Siems study.

(i) The decline in cross-listings. A substantial literature documents the existence of a valuation premium for foreign firms that cross-list on US stock markets, and the effect is strongest for firms whose primary listing is in a jurisdiction with weaker investor protection.[36] One component of valuation creation is how the listing "bonds" the foreign issuer to the higher quality US regime, in particular the disclosure requirements of the federal securities laws, as enforced by public and private litigation, and the stock exchange listing rules.[37] This bonding

[34] Dan W. Puchniak, Harold Baum, and Luke Nottage, Independent Directors in Asia: A Historical, Contextual and Comparative Approach (Cambridge UP forthcoming 2017).
[35] See Bernard Black, Antonio Gledson De Carvalho, Vikramaditya Khanna, Woochan Kim, Corporate Governance Indices and Construct Validity, Corporate Governance: An International Review (forthcoming 2017); --- and B. Burcin Yurtoglu, Methods for Multicountry Studies of Corporate Governance (and Evidence from the BRIKIT Countries), 183 Journal of Econometrics 230 (2014).
[36] See Nicholas C. Howson and Vikramaditya S. Khanna, Reverse Cross-Listings – the Coming Race to List in Emerging Markets and an Enhanced Understanding of Classical Bonding, 47 Cornell Int'l L. J. 607, 611-614 (2015). A more detailed literature survey is found in G. Andrew Karolyi, Corporate Governance, Agency Problems and International Cross-Listings: A Defense of the Bonding Hypothesis, 13 Emerging Markets Rev. 516 (2012). Additional literature discussion is found in Chinmoy Ghosh & Fan He, The Diminishing Effect of U.S. Cross-Listing: Economic Consequences of SEC Rule 12h-6, 52 J. Financial and Quantitative Analysis 1143 (2017).
[37] John C. Coffee, Jr., Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance, 102 Columbia Law Review 1757 (2002).

effect shows the limits of efforts to measure governance convergence through coding corporate law, since a national regime of investor protection can be improved by opting into a more credible disclosure regime.[38] The number of cross-listings began to decline in the mid-2000s, and various US business and political leaders claimed that the toughening US regulatory regime, reflected in the Sarbanes-Oxley law that followed the post-Enron/WorldCom scandals, had undercut the value proposition.[39] In consequence the SEC liberalized the "delisting" rules in the hope that easier exit would encourage more firms to cross-list. [40] Recent papers suggest that the consequence was to reduce the cross-listing premium, especially for firms with weaker corporate governance, because the new rule undercut the credibility of the cross-listing bond.[41] This would reduce the appeal of the US as a "bonding" regime.

But what accounts for the previous decline in cross-listings? It's not that the US regime is so onerous; rather, the need for bonding has declined. As shown in the prior discussion of "convergence," corporate governance has leveled up in many jurisdictions. Imperfect coding may still reflect an underlying phenomenon. Firms can also credibly engage in governance self-help through adoption of strong internal governance arrangements (such as credibly independent directors[42]) and through measures that make disclosure robust and reliable, such as reporting on international accounting standards and retention of high-reputation external accountants. Firms can also hire internationally-reputed underwriters in their IPO. Cross-listing may still be valuable for weakly governed firms (even if diminished by the easier US exit), but the decline in cross-listings reflects reduced demand because of reduced need. The willingness of foreign issuers to go public on foreign exchanges rather than the US suggests that the governance-quality advantage of the US has dissipated. Leveling up means that issuers obtain an insufficient cost-of-capital discount for bonding the firm to the US governance regime, given the costs.[43]

[38] The importance of disclosure in assessing a corporate governance regime is demonstrated in Bernard Black, Antonio Gledson De Carvalho, Vikramaditya Khanna, Woochan Kim, and B. Burcin Yurtoglu, Which Aspects of Corporate Governance Matter in Emerging Markets: Evidence from Brazil, India, Korea, and Turkey (May 2015), available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2601107.
[39] *See, e.g.*, Interim Report of the Committee on Capital Markets Regulation, (2006), available at http://capmktsreg.org/app/uploads/2014/08/Committees-November-2006-Interim-Report.pdf; Michael R. Bloomberg and Charles Schumer , Sustaining New York's and the US' Global Financial Services Leadership (2007); Craig Doidge, G. Andrew Karolyi; and Rene Stulz. Why Do Foreign Firms Leave U.S. Equity Markets? 65(10) J. Finance 1507–1553 (2010).
[40] This was through the SEC's adoption of Rule 12h-6 under the 1934 Securities and Exchange Act.
[41] E.g, Chinmoy Ghosh and Fan He, The Diminishing Effect of U.S. Cross-Listing: Economic Consequences of SEC Rule 12h-6, 52 J. Financial and Quantitative Analysis 1143 (2017).
[42] See Jay Dahya, Orlin Dimitrov, John J. McConnell, Dominant Shareholders, Corporate Boards, and Corporate Value: A Cross-Country Analysis, 87 J. Financial Economics 73 (2008) (independent boards create value in countries with weak investor protection); Miguel A. Ferreira, Pedro Matos, The Color of Investors' Money: The Role of Institutional Investors Around the World, 88 J. of Financial Economics 499 (2008).
[43] For recent contrasting empirical claims on the current value of the US "bond," *compare* Louis Gagnon and G. Andrew Karolyi, The Economic Consequences of the U.S. Supreme Court's *Morrison v. National Australia Bank* Decision for Foreign Stocks Cross-Listed in US Markets https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1961178 (as An Unexpected Test of the Bonding Hypothesis) *with* Amir N. Licht, Chris Poloiquin, & Jordan Siegel, What Makes the Bonding Stick? A Natural Experiment Involving the U.S. Supreme Court and Cross-Listed Firms 29–32 (Harvard Bus. Sch., Working Paper No. 11-072, 2013), available at http://ssrn.com/abstract=1744905 (forthcoming, Journal of Financial Economics).

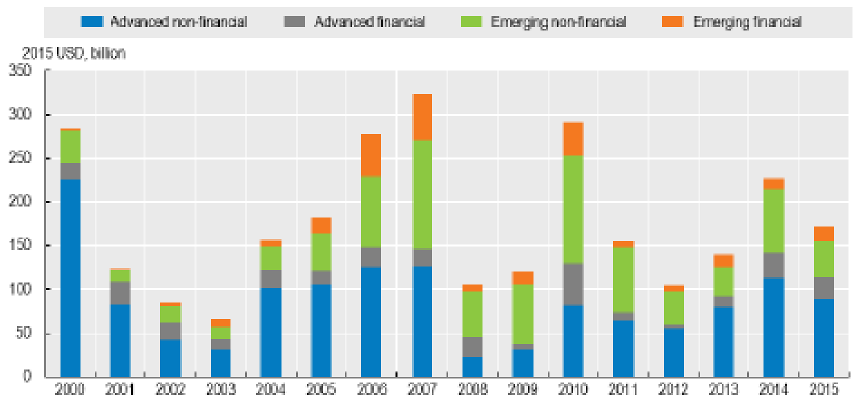
(ii) *Increased emerging market IPOs.* Another indication of "convergence" is provided by the ability of firms in emerging market economies to access capital markets through IPOs, whether on local exchanges or through cross-listing on an exchange at a global financial center. The OECD Business and Finance 2016 Scoreboard has a graphic, reproduced below, that shows this, covering the 2000-2015 period. Firms in emerging markets are able to raise an increasing amount of equity capital over the period, in dollar amount (correcting for the immediate run-up prior to the crisis) and as a percentage of the total amount raised. As shown by the graphic from OECD researchers Mats Isaakson and Serdar Celik, "advanced economies" dominated the IPO market early in the period; more recently the split with emerging economies has been 50-50.[44] Moreover, most equity-raising by non-OECD firms occurs in non-OECD capital markets. To a significant extent, of course, these changes reflect the economic rise of China, but such changes do carry evidentiary weight on the governance set-up, since public shareholders are directly exposed to frailties in governance.

[44] See also Mats Isaksson and Serdar Celik, Who Cares? Corporate Governance in Today's Equity Markets, OECD Corporate Governance W.P. No. 8 (2013) (fig. 2.3), http://www.oecd-ilibrary.org/governance/who-cares-corporate-governance-in-today-s-equitymarkets_5k47zw5kdnmp-en.

An increase in emerging market use of public equity markets

Companies tap public equity markets for funding for the first time by making an initial public offering (IPO). During the early 2000s, global IPO activity was dominated by companies from advanced economies. However, in the last ten years, companies from emerging markets account for almost half of the money raised through IPOs.

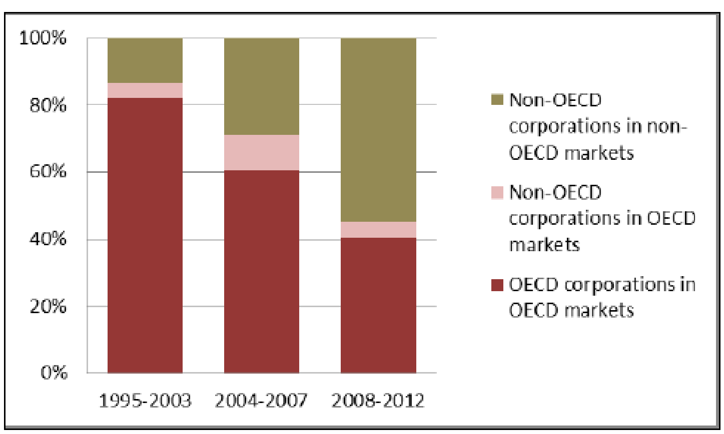
Figure 6. Initial public offerings (IPOs), 2000–2015



From OECD Business and Finance Scorecard (2016) (fig. 6)

Figure 2.3. Global shift in equity markets

Relative share of equity raised through initial public offerings by OECD and non-OECD corporations and its distribution between OECD and non-OECD equity markets



Note: OECD corporations' fundraising in non-OECD markets throughout the period was insignificant and is not included in the figure.

Source: based on data from Thomson Reuters New Issues Database, Datastream, stock exchanges' and companies' websites.

From Mats Isaksson and Serdar Celik, Who Cares? Corporate Governance in Today's Equity Markets, OECD Corporate Governance W.P. No. 8 (2013) (fig. 2.3) *(iii) "Inversions"*. An "inversion" is a merger in which the target is the formal corporate survivor of the transaction, which is so structured to shift the corporate domicile of the on-going enterprise. Often this is to take advantage of the more desirable governance regime of the new domicile. In the current mergers and acquisition environment, the term most particularly refers to transactions in which a US issuer, typically organized in Delaware, merges into a foreign target, choosing a non-US domicile for the on-going enterprise. The motivation is tax minimization: US-domiciled firms are subject to US corporate income tax on their worldwide earnings; non-US-domiciliaries are subject to US tax only on their US activities.[45] Favorite destinations have been Ireland, the Netherland, and the UK, but Bermuda, Switzerland, and Canada have been chosen as well. The firms retain their US stock exchange listings and thus remain subject to the US federal securities laws. There are two messages relevant to the convergence debate. First, even though the governance regimes of these particular jurisdictions differ, at least formally, in most respects they are convergent. Or rather: if there is a decrement to governance quality, it is swamped by the immediate tax savings. Second, in considering what "counts" as corporate governance, the content of securities regulation and the exchange's listing rules also must be included. The "inverted" firms were in the same position as any other cross-listed firm. Their US listing bonded themselves to the disclosure and other regulatory elements of the US federal securities laws and to the exchanges' own rules, including the implicit and explicit enforcement mechanisms.

Part III: Evidence of Non-Convergence Or Divergence-Within-Convergence

Notwithstanding indications of some convergence, there is also ample evidence of significant divergence. Indeed, the continuing (if reduced) cross-listing premium indicates this. Surveys of institutional investors indicate wariness about foreign firms in countries with relatively weak corporate governance, especially for firms whose ownership structure (such as family control) and internal governance indicates vulnerability.[46] Empirical evidence on institutional investor investment behavior bears out the reliability of the surveys.[47]

Divergence takes two forms: The first is a non-following of the convergent norm – for example, not requiring independent directors. The second, far more common, is divergence within the convergent norm: "divergent convergence." Evidence of both forms is divergence is found in the OECD Corporate Governance Factbook (2017), a readily-accessible current guide to world-wide corporate law and governance.

For example, on board structure, the OECD describes a divergent practice on board structure: One tier boards are most common (19 jurisdictions), two tier boards are also common (10 jurisdictions) but that the optional choice between one-tier or two-tier boards is growing (12

[45] See Eric L. Talley, Corporate Inversions and the Unbundling of Regulatory Competition, 101 Va. L. Rev. 1649 (2015). Tax-minimizing inversions became particularly popular 2010-2014 but were slowed by the adoption of US Treasury regulations that narrowed the qualifications. See generally Anton Babkin, Brent Glover, Oliver Levine., Are corporate inversions good for shareholders? Journal of Financial Economics (forthcoming 2017), http://dx.doi.org/10.1016/j.jfineco.2017.07.004.
[46] E.g., McKinsey & Co., Global Investor Opinion Survey (July 2002).
[47] E.g., Christian Leuz, Karl V. Lins, Francis E. Warnock, Do Foreigners Invest Less in Poorly Governed Firms?, 22 Review of Financial Studies 3245 (2009) (Effect is most pronounced in countries with weak disclosure and poor shareholder protection).

jurisdictions, given the development of the Societas Europaea (SE) in the EU. And there are still other variants in three important jurisdictions, Italy, Japan, and Portugal.[48] The maximum terms for board members varies from one year to indefinite terms, though the most common maximum term is three years.[49]

There is a convergent practice on the presence of independent directors on the board, whether in a two-tier board structure (for the supervisory board) or a one tier structure.[50] Yet the number of independent directors diverge: most common is two or three by law and 50 percent by voluntary measures (via a "comply or explain" Code). Jurisdictions vary on the numbers and ratios. Moreover, "national approaches on the definition of independence for independent directors vary considerably, particularly with regard to maximum tenure and independence from a significant shareholder."[51] These differences would predictably result in divergence on the independence-in-fact of nominally "independent" directors and indeed, their putative function.

Similarly, there is convergence on "independent" audit committees, formally required for listed companies by 89 percent of jurisdictions; covered by Code in the rest.[52] Yet there is divergence on whether this means "majority" independent directors or 100 percent.[53] And there appears to be no convergent practice on the relationship between the audit committee and the external auditors.

One fundamental divergence relates to the function of independent directors, deriving from the divergent patterns of ownership.[54] The stylized division is between diffuse ownership (or ownership that is reconcentrated in institutional owners that represent diffuse beneficial owners) and family or blockholder ownership. Independent directors of diffusely owned firms are called to protect the interests of shareholders vis-à-vis the management teams. In family-dominated firms, the controllers monitor management; independent directors are called to protect minority shareholders. This means to monitor insider dealings of various types. On a count-the-countries basis, family ownership dominates throughout the world.[55]

Yet: In a substantial fraction of jurisdictions (19 jurisdictions of 46), board approval is not required for approval of important related party transactions, and where required, independent directors review is not necessarily required (13 jurisdictions), nor is an opinion from an outside specialist (9 jurisdictions).[56] Moreover, only seven of 46 jurisdictions have special

---

[48] OECD Corporate Governance Factbook, at 93, 101-105
[49] Id at 94, 106-07.
[50] Id. at 95-96
[51] Id. at 98-100. 108-111
[52] Id. at 114
[53] Id. at 115, 117-119.
[54] For a current analysis of such ownership patterns, see Gur Aminadav and Elias Papaioannou, Corporate Control Around the World, NBER WP 23101 (Dec. 2016) (figs. 4a, 4b: Type of Control in 2012, 2007 [approx. 26,000 Companies; Market Cap approx. $4 trillion]available at www.nber.org/papers/w23010; Julian Franks and Colin Mayer, Evolution of Ownership and Control Around the World: The Changing Face of Capitalism, ECGI WP 503/207 (April 2017), available at http://ssrn.com/abstract_id=2954589.
[55] See sources in preceding note.
[56] OECD Corporate Governance Factbook, at 67-69. For further discussion of cross-country

arrangements designed to facilitate minority representation on the board.[57] And within this group of seven, only Israel gives the public minority the right to veto the reelection of independent directors. How genuinely convergent is the practice of director independence if (1) independent directors will not necessarily review important related party transactions and (2) formally independent directors are elected by the controllers whose potential self-dealing they are supposed to monitor?[58]

Do these divergent elements within a convergent practice matter? The evidence is "yes, they should." First, the particulars of a reform can determine whether it is "high impact" or not. In the case of the move to independent directors, for example, whether the fraction of independent directors is relatively high or low and whether they are given key governance roles predictably should affect investor protection. The importance of these variations are borne out in a recent (2017) detailed cross-country analysis of board reforms.[59] The study finds that "high impact" measures that markedly change the fraction of independent directors, particularly if implemented quickly, will markedly increase the value of the firm (measured by Tobin's *q*), as will measures that assure audit committee and auditor independence.[60]

Second, governance elements commonly have country-specific effects, because of country-specific positive and negative complementarities, as well as substitution effects. For example, the level of enforcement resources available to a market regulator will affect the quality of disclosure. The efficiency of a court system will affect the impact of legal rules on investor protection. Independent boards staffed by high quality directors may substitute for weaknesses in the formal legal system.[61] The importance of country-specific analysis of "good corporate governance" is argued most forcefully in Bernard Black et al, which builds country-specific corporate governance indices for four emerging market economies covering critical governance variables such as board structure and disclosure.[62] The index elements that measure "good disclosure" or "better board structure," for example, vary within each country; the divergences matter.

---

differences in the treatment of related party transactions, see Anatasia Kossov and Dimitri Lovyrev, Related Party Transactions: International Experience and Russian Challenges, OECD Russian Corporate Governance Roundtable (2014), at 3-16, available at http://www.oecd.org/daf/ca/RPTsInternationalExperienceandRussianChallenges.pdf.

[57] Id. at 123, 126

[58] See María Gutiérrez Urtiag and Maribel Sáez, Deconstructing Independent Directors, 13 J. Corp. L. Stud. 63 (2013); see also Donald C. Clarke, The Independent Director in Chinese Corporate Governance, 31 Del. J. Corp. L. 125, 170-71 (2006). See generally Guido Ferrarini and Marilena Filippelli, Independent Directors and Controlling Shareholders Around the World, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2443786, published in Randall Thomas and Jennifer Hill, eds., Research Handbook on Shareholder Power (Edward Elgar 2015).

[59] See Larry Fauver, Mingyi Hung, Xi Li, Alvaro Taboada, Board Reforms and Firm Value: Worldwide Evidence, 125 J. of Financial Economics 120 (2017).

[60] Id. at 133-138.

[61] Dominic Barton and Simon C.Y. Wong, Improving Board Performance in Emerging Markets, 2006(1) McKinsey Quarterly 36 (2006).

[62] Bernard Black, Antonio Gledson De Carvalho, Vikramaditya Khanna, Woochan Kim, and B. Burcin Yurtoglu, Which Aspects of Corporate Governance Matter in Emerging Markets: Evidence from Brazil, India, Korea, and Turkey (May 2015), http://ssrn.com/abstract=2601107.

A good example of partial convergence and divergence-within-convergence is the experience with "Say on Pay," a shareholder vote on the company's remuneration practices. The concept has had remarkably quick take-up as an element of global governance best practice since its legislative adoption in the UK in 2002.[63] Rapid diffusion shows convergence, yet the convergence has been partial. First, jurisdictions have divided on whether to require (or recommend) shareholder votes on remuneration *policy*, a general ex ante view on the company's pay strategy. As of the OECD's 2017 survey, 29 of 46 countries (63%) had adopted such "Say on Pay *Policy*."[64] Obviously a significant fraction of countries (which may not even disclose individualized pay) do not empower shareholders in this way. The division is even sharper on shareholder votes on the level/amount of remuneration, "Say on Pay." Only 24 countries (52%) require (or recommend) such a shareholder vote. Is the vote binding or advisory? For Say on Pay *Policy*, 19 countries (41%) adopt the "binding approval" variant, making that the most widespread. For Say on Pay, 17 countries (37%) adopt the binding approval variant (vs. seven, advisory only). Take-up of shareholder voting on remuneration policy and practices appears to be far more widespread in the OECD countries, especially the US and the EU member states, than emerging market economies. The EU, for example, promoted shareholder voting on remuneration in the 2017 Shareholder Rights Directive.[65] As an innovation on a core corporate governance question, there is more general convergence on the thesis than convergence on the implementation.

A more radical version of "divergence within convergence" is advanced in a recent volume on independent directors in Asia,[66] which argues both that (i) independent directors are "ubiquitous" in Asia, found in higher proportion across more firms than in the "West," *and* (ii) functionally, there are "varieties" of independent directors in Asia, differing substantially from the US variant and differing even within Asia.[67] Adoption of a transplant, particularly under pressure of foreign investors or global governance institutions, does not determine how the new institution will function. That emerges over time, as the transplant is contextualized within the local ecology, and can lead to significant divergence in practice.

Part IV: Global Governance As Promoting Convergence

Origins. Reform of corporate governance has been on the global development agenda for nearly 25 years. Nearly every country seeking access to external finance has undertaken major reform, as documented by Katelouzou and Siems (30 countries) and also by Fauver et al (40

---

[63] For a distillation of the UK legislative history, see Jeffrey N. Gordon, "Say on Pay": Cautionary Notes on the U.K. Experience and the Case for Shareholder Opt-In, 46 Harvard Journal on Legislation 323, 341-42 (2009). For discussion on differences among national take-ups, see, e.g., Guido Ferrarini and Maria Cristina Ungureanu, Executive Remumeration, Ch. -- herein; Randall Thomas and Christoph Van Der Elst, Say on Pay Around the World, 92 Washington Univ. Law Review 653 (2015).
[64] OECD 2017 Corporate Governance Factbook, at 131-138.
[65] Directive (EU) 2017/828 (May 17, 2017).
[66] Dan W. Puchniak, Harold Baums, Luke Nottage, eds., Independent Directors in Asia: A Historical, Contextual and Comparative Approach (Cambridge UP forthcoming 2017).
[67] Dan W. Puchniak and Kon Sik Kim, Varieties of Independent Directors in Asia: Diversity Revealed, in id., (Chapter 3).

countries).[68] This wave of activity is not simply from the independent action of different countries responding to the imperatives of the global capital market or acceding to a letter-writing campaign from institutional investors. Rather this widespread adoption of corporate governance reforms has been stimulated through what might be thought of as global governance, in which the main actors have been the IMF, the World Bank and the Organization for Economic Development (OECD). In the aftermath of the global financial crisis of 2007-09, the G-20 group of national leaders and the Financial Stability Board have joined into the project.

Probably the origin of the global corporate governance reform movement was the Cadbury Committee Report issued in 1992.[69] Although aimed at the governance of UK firms, particularly the "control and reporting functions of boards, and on the role of auditors," the Report became internationally influential both for the substance of its recommendations and for the form that they took: a "Code of Best Practice" enforced on the "comply or explain" model. The recommendations were not mandatory, but as a condition of listing on the London Stock Exchange, firms were required to state whether they "complied" with a recommendation, and if not, to "explain" why not. Codes of corporate governance best practice are now a common feature of stock exchange listing rules or national corporate law, generally following the "comply or explain" pattern and have provided a channel for convergence.[70]

East Asian crisis. The East Asian financial crisis of 1997-98 propelled corporate governance to the realm of global governance. The Asian "Tigers" flourished in the 1990s, which led to a massive influx of Western finance, generally in the form of dollar-denominated credit to private companies whose earnings were principally in local currencies. This mismatch left these firms seriously exposed to exchange rate risk; depreciation in the value of the local currency would undercut the firms' ability to repay foreign creditors. Insofar as the entanglement of these firms with the government gave rise to an implicit government credit guarantee, sovereign creditworthiness was also at risk. A devaluation of the Thai baht triggered competitive currency devaluations across many countries in the region and a "run on the bank" by western lenders who anticipated default. The crisis exploded, threatening the economic stability of many countries and the region as a whole. Indeed, except for the Great Depression, it was "the crisis of the century." The IMF stepped in with multi-billion dollar rescue packages.

The IMF imposed many conditions on countries accepting aid ("conditionality"), including corporate governance reform. Financial crises are generally assumed to arise principally from macroeconomic considerations and policy mistakes and have been ubiquitous

---

[68] Larry Fauver, Mingyi Hung, Xi Li, Alvaro Taboada, Board Reforms and Firm Value: Worldwide Evidence, 125 J. of Financial Economics 120 (2017); E. Han Kim, Yao Lu, Corporate Governance Reforms Around the World And Cross-Border Acquisitions, 22 J. of Corporate Finance 236 (2013) (26 countries).

[69] More formally styled, "Report of the Committee on the Financial Aspects of Corporate Governance." The chair was Sir Adrian Cadbury, scion of the Cadbury-Schweppes confectionary firm. The report may be found at http://www.ecgi.org/codes/documents/cadbury.pdf.

[70] On the adoption and spread of corporate governance codes, which generally operate on the Cadbury-inspired "comply or explain model," see, e.g., Ruth Aguilera and Alvaro Cuervo-Cazurra, Codes of Good Governance Worldwide: What Is the Trigger?, 25(3) Organization Studies 415 (2004); __ Codes of Good Governance, 17 Corporate Governance: An International Review 376 (2009). The European Corporate Governance Institute maintains a database of codes. See http://www.ecgi.org/codes/all_codes.php.

over time.[71] The structure of many East Asian enterprises raised problematic governance concerns, however. Family groups owned vast business enterprises through control mechanisms that separated cash flows from control rights, and commonly received preferred access to credit in coordination with the economic growth plans of government elites. This set up provided many opportunities for private benefit extraction at the expense of public shareholders and external creditors. An influential article by Simon Johnson, later the chief economist of the IMF, described the importance of the corporate governance channel as follows:

> "The theoretical explanation is simple and quite complementary to the usual macroeconomic arguments. If expropriation by managers increases when the expected rate of return on investment falls, then an adverse shock to investor confidence will lead to increased expropriation as well as lower capital inflow and greater attempted capital outflow for a country. These, in turn, will translate into lower stock prices and a depreciated exchange rate. In the case of the Asian crisis, we find that corporate governance provides at least as convincing an explanation for the extent of exchange rate depreciation and stock market decline as any or all of the usual macroeconomic arguments."[72]

Without sufficient protections for public shareholders and creditors,

> "[M]anagement [in firms that failed] was able to transfer cash and other assets out of company with outside investors, perhaps to pay management's personal debts, to shore up another company with different shareholders, or to go straight into a foreign bank account. The fact that management is most emerging markets is also the controlling shareholder makes these transfers easier to achieve. The downturns in these countries have been associated with significantly more expropriation of cash and tangible assets by managers." [73]

To elaborate some on the channel: Poor corporate governance enhanced the risks of private benefit extraction. One safeguard was for external credit providers to insist on short maturities. This increased the run risk (from non-rollovers) as creditors would anticipate an increased likelihood of default from (i) the exchange rate mismatch and (ii) extra extractions by controllers to protect their positions.

In its report on the crisis, the World Bank concluded that:

---

[71] See Carmen M. Reinhart and Kenneth S. Rogoff, This Time Is Different: Eight Centuries of Financial Folly (Princeton UP 2009)

[72] Simon Johnson, Peter Boone, Alasdair Breach, Eric Friedman, Corporate Governance in the Asian Financial Crisis, 58 J. Financial Economics 141 142 (2000). To elaborate some: the poor corporate governance enhanced the risks of private benefit extraction. One safeguard was for external credit providers to insist on short maturities. This increased the run risk (from non-rollovers) as creditors would anticipate an increased likelihood of default from (i) the exchange rate mismatch and (ii) extra extractions by controllers to protect their positions.

[73] Id. The connection between good institutions and local financial stability received a full exposition in Daron Acemoglu, Simon Johnson, James Robinson, Yunyong Thaicharoen, Institutional Causes, Macroeconomic Symptoms: Volatility, Crises and Growth, 50 J. Monetary Economics 49 (2003).

"The poor system of corporate governance has contributed to the present financial crisis by shielding banks, financial companies, and corporations from market discipline. Rather than insuring internal oversight and allowing external monitoring, corporate governance has been characterized by ineffective boards of directors, weak internal control, unreliable financial reporting, lack of adequate disclosure, lax enforcement to ensure compliance and poor audit."[74]

Hence significant corporate governance reform became part of the IMF's conditionality program and then, subsequently, associated with lending and more general development activity by the World Bank. Not to demean the development motives, but the impetus for this insistence on corporate governance came from "first world" concerns: In a regime of robust cross-border capital mobility, weak corporate governance in emerging market economies was a threat to global financial stability. A country's corporate governance set-up that internalized *local* economic and political costs and benefits could nevertheless produce *global* externalities. Thus corporate governance reform had a new imperative.

OECD Principles. But what "reforms" exactly? The Asian crisis prompted a call for the OECD to develop "a set of corporate governance standards and guidelines,"[75] which resulted in the OECD Principles of Corporate Governance, issued in 1999.[76] The Principles heavily relied upon the work of the business and legal community in the US that had been focusing corporate governance matters since the 1970s, including the American Law Institute project on corporate governance, as well as the insights and further discussion stirred by the Cadbury Committee Report.[77] The OECD Principles identified five specific elements: shareholder rights, equitable treatment of shareholders, the role of stakeholders, disclosure and transparency, and the responsibilities of the board. The Principles were somewhat elaborated, both in the text, and in a set of "annotations." The investor protection thesis was supported by the work of economists pursuing the "law and finance" research program,[78] but the Principles had both broader and more specific reach.

Promoting Governance Reforms. After the East Asian crisis, the World Bank and the IMF established the "Financial Sector Assessment Program," which entailed a country-specific assessment of the soundness of the financial system, the "infrastructure, institutions and markets" needed for development, and the country's adherence to "selected financial sector standards and codes."[79] The OECD Principles were immediately wrapped into this global governance project of the World Bank and the IMF. The Principles "underpin the corporate governance component of the World Bank/IMF Reports on the Observance of Standards and Codes" (ROSC) and were designated by the Financial Stability Forum (established in 1999, in the crisis aftermath) as "one

[74] The World Bank, East Asia: The Road to Recovery (1998) at 67, http://documents.worldbank.org/curated/en/364021468770639382/East-Asia-the-road-to-recovery.
[75] OECD Principles of Corporate Governance (1999) (frontspiece)
[76] Id.
[77] For alternative accounts of the intellectual history of the OECD Principles, see Mathias Siems and Oscar Alvarexz-Macotela, The G20/OECD Principles of Corporate Governance 2015: A Critical Assessment of the Their Operation and Impact, 2017 Journal of Business 310, 312.
[78] See the papers cited supra, notes 23-25.
[79] http://www.worldbank.org/en/programs/financial-sector-assessment-program.

of the 12 key standards for sound financial systems."[80] The "Principles" were meant to serve as a "reference point," but between the Principles and the Annotations, there was significant basis for a prescriptive agenda of corporate governance reform and comparative evaluation.

As part of its ROSC program, the World Bank prepares country "assessments" that highlight changes and "improvements," make policy recommendations, and "provide investors with a benchmark against which to measure corporate governance" in the studied country. In the case of non-OECD countries, the recommendations can be rather detailed.[81] The corporation governance indicators also became important in the World Bank's "Doing Business" measures of country-specific business-relevant factors. These indicators, presented in index form, are presumably relevant for foreign director investment and portfolio investment, which becomes the reason that governments may pursue reform. The World Bank also prepares thematic reports arguing for particular "Doing Business" improvements in corporate governance, for example, enhancing investor protection.[82]

In the aftermath of the Asian financial crisis, the World Bank, in cooperation with the Asian Development Bank and OECD, embarked on a campaign to proselytize for higher corporate governance standards in Asian economies.[83] Among the tools were "roundtables" of business, government, and academic elites.[84] Most notable has been the OECD-Asian Roundtable on Corporate Governance, hosting its 18th meeting, October 2017 in Tokyo. Convergence onto an international standard was plainly the agenda. The 2003 Roundtable produced agreement on an "action plan for improving corporate governance," viz., "The White Paper on Corporate Governance in Asia" (published in English, Chinese, and Japanese). The 2011 Roundtable updated the White Paper with specific reform recommendations; it included an overview of corporate governance frameworks in 13 Asian countries. The OECD Principles were used as the benchmark for developing the ASEAN Corporate Governance Scorecard in 2012, which ranks the top listed companies in 6 countries.

---

[80] OECD Principles, 2d version (2004), at 3. Corporate governance assessments under the ROSC initiative are at the invitation of country authorities and in general have been requested only by emerging market economies, not developed economies.

[81] See, e.g., World Bank, Report on the Observance of Standards and Codes, Corporate Governance Country Assessment: Vietnam (2013).

[82] World Bank, Doing Business: Protecting Minority Investors – Achieving Sound Corporate Governance (2017) (tracking countries that adopt measures that strengthen minority investor protection).

[83] The IMF has recently used evidence from the global financial crisis of 2007-09 to reemphasize the connection between corporate governance and financial stability, especially in emerging market economies, presenting evidence that "stronger corporate governance and investor protection frameworks enhance the resilience of emerging market economies to global financial shocks." Corporate governance improvements "foster deeper and more liquid capital markets, allowing them to absorb shocks better" and more efficient stock markets, less prone to crashes; better corporate governance and investor protection is associated with stronger corporate balance sheets, less reliant on short term (runnable) funding. These findings, argues the IMF, should lead to further, deeper corporate governance reform, especially on the dimensions of minority shareholder protection and disclosure. See IMF, Global Financial Stability Report: Fostering Stability in a Low Growth, Low-Rate Era (Oct. 2016) (Ch. 3, Corporate Governance, Investor Protection, and Financial Stability in Emerging Markets, at 93-102).

[84] http://www.oecd.org/daf/ca/oecd-asianroundtableoncorporategovernance.htm

More generally, the OECD has recently (2017) produced a new OECD Corporate Governance Factbook, a comparative report on 47 jurisdictions "hosting 95% of all publicly traded corporations in the world as measured by market value," which is presented as "a unique source for monitoring the implementation" of the latest OECD Principles.[85] The goal of this OECD venture is to promote through the "soft law" of global governance[86] a movement toward a convergent best practice.[87]

Global Financial Crisis: the focus on financial firms. The global financial crisis of 2007-2009 produced another crisis in corporate governance, in particular the corporate governance of financial institutions. The prevailing governance model was found to encourage excessive risk-taking. The deficiencies included misaligned compensation schemes, insufficient board monitoring of the risk-taking by the firm, and overly complex organizational structures that made it difficult to manage (or monitor) the business and that greatly complicated resolution planning. This led to revision of the convergent corporate governance prescription for banks, undertaken by the Basel Committee on Banking Supervision. In "Principles for Enhancing Corporation Governance" in 2010 (revised in 2014), the Basel Committee's additions focused on risk-monitoring, including the necessary internal controls; compensation, and complexity.

With greater confidence in pursuing a distinctive governance agenda, the Basel Committee revisited bank governance in 2015, with "*Guidelines*: Corporate Governance Principles for Banks." (emphasis added.) These "Guidelines/ Principles" give considerable specificity to the board's role in a banking institution, especially the board's role in risk-monitoring and assuring adequate internal controls. Moreover, the board is tasked with additional attention to compliance monitoring in light of other issues that emerged about bank behavior before and after the crisis. The "Guidelines/Principles were not meant to be regulatory, but to guide supervisors in assessing corporate governance regimes; nevertheless, the degree of specificity is much greater than in the OECD Principles.

The G-20 and the FSB. The most important post-crisis global financial governance vehicle was a series of G-20 Leader Summits which brought together presidents and prime ministers of a self-organized group of 20 leading countries to deal with the crisis and its aftermath across a broad range of economic and regulatory items. In turn the G-20 empowered a recharged "Financial Stability Board," which was tasked with charting out a common regulatory agenda to guard against a crisis recurrence.[88] Obviously neither the G-20 nor the FSB has compulsory authority, but the relevant international organizations have pursued a compliance strategy of "peer assessment" of whether particular countries were pursuing agreed-upon reforms.

Corporate governance made its way to the G-20 agenda in 2015. The OECD examined its Principles in wake of the financial crisis and decided that the application rather than the

[85] OECD Corporate Governance Factbook (2017), at 5.
[86] See Chris Brummer, Soft Law and Global Financial System Cambridge UP 2012).
[87] Another important source of "principles" designed to guide governance choices and expectations has been produced by International Corporate Governance Network, "an investor led group of governance professionals." The 4th edition is found at http://icgn.flpbks.com/icgn_global_governance_principles/#p=5.
[88] For more detail see John Armour, Dan Awrey, Paul Davies, Luca Enriques, Jeffrey Gordon, Colin Mayer, Jennifer Payne, Principles of Financial Regulation (Oxford UP 2016), at 623-625.

Principles themselves were the flaw in the governance of financial firms.[89] The ongoing second revision of the Principles focused mostly on the expanding significance of institutional investor ownership. The 2015 version of the Principles was submitted to the G-20 Leaders Summit in November 2015 and adopted there. They are now known as the G20/OECD Principles of Corporate Governance. In addition to the additional weight they carry because of the G-20 imprimatur, country-specific compliance with the Principles will now become part of the FSB's peer assessment process.[90] This is important because it will permit the FSB to focus on the country-specific implementation of appropriate governance norms for financial firms.

Basel Committee and the FSB. Thus it appears that the corporate governance of financial firms will be subject to scrutiny through two elements of the global financial regulatory system: the board focus of the Basel Committee, as transmitted through national supervisors, and the broader governance elements that emanate from the national governance set-up, per the FSB's scrutiny. Yes, the "Guidelines/Principles" of the Basel Committee admit of diversity, as do the G20/OECD principles, but convergence pressure seems likely.

The general point is this: to an extent that might surprise academics focused on the political economy of races to the top or bottom driven by local political economy, convergence on a common set of corporate governance principles and practices has been driven by various forms of global governance. One conclusion is that the convergence push through global governance is motivated by financial stability concerns at least as much as by efficiency and productivity. The global governance push has particularly affected less developed countries – "emerging market economies" – that are more sensitive to the certification of the World Bank and other development organizations. But it has also affected OECD countries as well, as reflected in the quite common adoption of corporate governance "codes" as well as various elements of prescriptive reform.[91] Moreover, after the financial crisis of 2007-09 the corporate governance of large banking organizations has become a particular global governance target.

---

[89] OECD Steering Group on Corporate Governance, Corporate Governance and the Financial Crisis (February 2010).

[90] See FSB, Thematic Peer Review on Corporate Governance – Summary Terms of Reference (Aug. 2016): "The overarching objective of the review is to take stock of how FSB member jurisdictions have applied the Principles to publicly listed, regulated financial institutions, identifying effective practices and areas where good progress has been made while noting gaps and areas of weakness. It will also inform work that is underway to revise the OECD's Assessment Methodology that is used by the World Bank as the basis for country assessments undertaken as part of its Corporate Governance Report of Standards and Codes initiative and will provide input to governance-related aspects of the FSB's broader work on conduct for financial institutions."

[91] On the adoption and spread of corporate governance codes, see sources cited surpa in note --. Although the "codes" movement seems principally driven by global governance actors, investors have played a significant role as well. For example, the International Corporate Governance Network, founded in 1995, which claims affiliation of major institutional investors and asset managers holding over $20 trillion in assets, has been a major promoter of codes, most recently Stewardship Codes. See https://www.icgn.org//global-stewardship-codes-network.

Part V: Supra-National Governance – the EU

When the G&R book was put together in 2002, the most salient questions of "convergence and persistence" related to the EU countries, Japan, and the United States. The main EU-specific questions were (1) the durability of co-determination in Germany and elsewhere in the EU and (2) the appeal of bank and blockholder monitoring, both elements in opposition to the movement toward the diffuse shareholder-centric model associated with the UK and the United States. As noted in the introduction to this chapter, the debate focused, structurally, on "outsider" vs. "insider" governance, and whether the governance differences resulted from political stories, functional sorting, or simply strong path dependencies that had perhaps an internal efficiency dimension even if not global efficiency. In any event, the divergent EU countries were Member States in a transnational federation with legislative and executive authority, which on many dimensions sought to "harmonize" local regimes. Company law and corporate governance practices seemed a natural target.

So what happened? A recent analysis by Martin Gelter, which reviews the relevant history in some detail, reports that "[T] here is no uniform assessment of company law harmonization in the European Union; views vary between characterizing company law as a "success story of European efforts to regulate" and the claim that EU Company law is 'trivial.'"[92] From one perspective, the countries of the EU have converged on a high level of minority shareholder protection and robust disclosure, even if the particulars of such protections are not "harmonized." Within that convergence, law-making on company law in the EU generally has provided significant latitude for national variations, with the rare exception of some prescriptive post-financial crisis limits on executive compensation in banking organizations, which were linked to other financial stability regulation.[93]

An EU path to greater convergence seems stalled for three fundamental reasons. First, "top down" harmonization applying to all firms in all Member States would produce significant inefficiencies because of diverse initial conditions, particularly diverse ownership patterns that produce different core agency problems. Provisions for shareholder empowerment that that may be desirable where ownership is diffuse would have negative consequences for minority public shareholders where ownership is concentrated. Moreover, the complex EU politics of law-making would also conduce to significant inefficiencies in a top down approach.[94]

Second, "bottom up" harmonization in which *companies* could choose the corporate governance model most suited to their objectives would upset national decisions about the

---

[92] Martin Gelter, EU Company Law Harmonization between Convergence and Varieties of Capitalism, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2977500, forthcoming in Harwell Wells, ed., Research Handbook on the History of Corporate Law, 2018). When it comes to 'the board,' that critical governance institution, the judgment of two experienced corporate analysts is unequivocally equivocal: "The overall result is an unstable balance between convergence and divergence, shareholder and stakeholder influence, as well as European v. national rulemaking." Paul L. Davies and Klaus J. Hopt, Boards in Europe: Accountability and Convergence, 61 American J. of Comparative Law 301 (2013).

[93] See the Capital Requirements Directive IV (CRD IV), 2013/36/EU, Article 94(1)g), and the implementing Capital Requirements Regulation (CRR), 575/2013.

[94] See European Company Law Experts, Response to the European Commission's Consultation on the Future of European Company Law (May 2012).

balance of power between shareholders and employees. For example, "regulatory competition" on the US model could permit a German firm to shuck co-determination and its two-tiered board via a simple merger with a UK shell set up for purpose of the merger (assuming approval of such a transaction is for shareholders). There is also general concern among EU parties that permitting firms freely to move their "seats" to pursue the optimal company would lead to a "race to the bottom," though of course some would claim that Delaware, the winner of the US race, has produced a package of corporate law and judicial machinery that has many positive attributes.

The third factor that has produced corporate governance divergence in the EU is the profound ambivalence about the project of transnational economic and political integration that a convergent system would facilitate. The place where this is clearest is the discord over the 13th Company Law Directive, the Takeover Directive, a debate that raged in the late 1990s and early 2000s.[95] A key sticking point was the "level playing field": the need to avoid protectionist national company law that heightened defensive barriers for local firms while permitting acquisition of foreign targets. Firms needed to be mutually contestable to guard against mercantilist behavior.

In the effort to break a deadlock, a representative group of "High Level Company Law Experts" was convened in 2001. The Experts called for a "board neutrality" rule in the face of a hostile bid, a "breakthrough" rule that would permit the holder of at least 75 percent of the cash flow interest in a target to succeed in the bid, and an overcoming of "Golden Share" vetoes by governments in privatized former state-owned enterprises. The goal of the Experts was to foster the EU's project of transnational economic integration, which they understood to be advanced by cross-border mergers to create companies of EU-wide scale:

> An important goal of the European Union is to create an integrated capital market in the Union by 2005. The regulation of takeover bids is a key element of such an integrated market.
> ***
> Many European companies will need to grow to an optimal scale to make effective use of the integrating internal market. The same is true for companies which compete on global markets. Takeover bids are a means to achieve this for those engaged in the business of both bidder and target.
> ***
> In many parts of Europe on the other hand, takeover barriers existing in various Member States more often tend to result in control over listed companies being incontestable. In the view of the Group, this is undesirable in the European context, as an integrated capital market has to be build up in order for business to fully benefit from and make effective use of the integrating internal market in Europe.[96]

---

[95] See generally Jeffrey Gordon, The International Relations Wedge in the Corporate Convergence Debate in Gordon & Roe, at 202-208, available at https://papers.ssrn.com/sol3/papers.cfm?abstract_id=374620.

[96] Report of the High Level Group of Company Law Experts on Issues Related to Takeover Bids, Jan 10, 2002, available at www.ecgi.org/publications/winter.htm.

There were various technical objections to the Experts' proposal and the proposed follow-on directive from the European Commission, but the rejection came from a deeper source. Strong form convergence, which truly would have brought about free mobility of capital, people, and products – genuine transnational economic integration -- was actually not what the Member States wanted, at least the relevant business and political elites. Too much autonomy and national identity would be sacrificed. The barrier to adoption of the proposed Takeover Directive was not so much the efficiencies of local adaptations and institutions but the desire of the Member States to throw sand-in-the-gears of economic and political integration. Divergence makes it harder to accomplish cross-border merger and acquisition activity, which otherwise would produce much tighter integration. The strength of national identity and the comparative weakness of European identity is the ultimate hindrance to corporate law convergence in the EU.

Part VI: Convergence on "Shareholder Value," But Which Shareholders?

Twenty years (1997) ago Henry Hansmann and Reinier Kraakman wrote an essay for a Columbia Law School conference to address the question, "Are Corporate Systems Converging?" Their answer, The End of History for Corporate Law,[97] identified a particular governance modality for large economic enterprise, the "standard shareholder oriented model," organized on these principles:

> [First, T]he ultimate control over the corporation should rest with the shareholder class; the managers of the corporation should be charged with the obligation to manage the corporation in the interests of its shareholders; [second] other corporate constituencies, such as creditors, employees, suppliers, and customers, should have their interests protected by contractual and regulatory means rather than through participation in corporate governance; [third] noncontrolling shareholders should receive strong protection from exploitation at the hands of controlling shareholders; and [fourth] the market value of the publicly-traded corporation's shares is the principal measure of its shareholders' interests.[98]

They claimed that this model was superior to a state-oriented model, a labor- (or stakeholder-) oriented model, or a manager-oriented model. Subsequently, they would claim superiority to a model oriented around a powerful family tied to the state and largely free of regulation. The measures for superiority were all of: ideological (normative) appeal; comparative efficiency, and dominance as an empirical matter. The essay spawned a literature with many interesting objections,[99] some seeing the essay as a polemic and responding in kind.

[97] Henry Hansmann and Reinier Kraakman, The End of History for Corporate Law, 89 Georgetown Law Journal 439 (2001), reprinted in Gordon and Roe. For the sequel, see -----, Reflections on the End of History for Corporate Law, Abdul Rasheed and Toru Yoshikawa, eds., Convergence of Corporate Governance: Promise and Prospects (Palgrave-MacMillan 2012), available at http://ssrn.com/abstract=2095419.
[98] End of History, 89 Georgetown Law Journal at 440-441.
[99] See, e.g., Adam Winkler, Corporate Law or the Law of Business?: Stakeholder and Corporate Governance at the End of History, 67 Law and Contemporary Problems 109 (2004); Cynthia Williams and John M. Conley, An Emerging Third Way? The Erosion of the Anglo-American Shareholder Value Construct, 38 Cornell International Law Journal 493 (2005); Franklin A. Gevurtz, The Globalization of Corporate Law: The End of History or a Never-Ending Story? 86 Washington Law Review 475 (2011).

It seems to me that the current deep question of corporate governance teleology is not, "shall the firm be run for the interest of shareholders?", but: "which shareholders?" And the end pursued by many shareholders as well as global governance actors (including many governments) is not just "efficiency" but "stability."

Around the same time as the Hansmann and Kraakman essay, Gordon argued that the linked regimes of trade liberalization, capital market liberalization, and a newly flexible labor market constituted a "new economic order," and the interaction would produce an unprecedented level of economic adjustment costs.[100] In particular the interaction between globalized trade, which heightens product market competition, and liberalized capital markets, which provides additional ways for shareholder insurgents to pressure managements to cut costs, improve margins, and become more efficient, was likely to increase layoffs and flatten wage growth. Finding a new job is costly and for a meaningful fraction of employees, wage loss after re-employment will be significant.

If adjustment costs are large, widespread, and persistent, social and political stability may be put at risk. "Which shareholders" will affect adjustment costs in important ways. Let us posit that there will be two types of shareholders, overlapping in most respects, but one type that is purely efficiency-minded, and the other, stability-minded as well. First, efficiency-only shareholders may push firms to respond quickly to a changed competitive environment, unheeding of adjustment cost issues (to the extent not required by law). A rapid response by one firm in a competitive environment will evoke rapid responses from its competitors, leading to a change in the rate of economic change, an increase in the second derivative, which will much increase the realization rate of adjustment costs. Thus change driven by efficiency-only shareholders will have a redoubling effect on adjustment costs and thereby heighten stability concerns.

Governments are certainly likely to see strong reasons to be concerned to maintain stability, if only because of electoral consequences. But some shareholders will be stability-minded as well, because their interests require attending to stability-preserving objectives. Family shareholding groups that need political buy-in to protect their economic stakes are like to see value in social and political stability. Large institutional investors may well have a similar perspective. First, they are subject to the regulation of stability-preferring governments. But further: a large institutional investor that is diversified across the economy and is a permanent investor will have stability concerns irrespective of implicit government pressure. An efficiency-only investor can opt-out of instability by holding cash or gold. A large institutional investor cannot and must internalize instability costs. Global governance institutions, which are accountable to governments, are also likely to have stability objectives. This is demonstrated by the growing global governance movement for "Stewardship Codes" and the concerted campaign against the purported "short-termism" of hedge funds.

The irony, of course, in the "which shareholder" question, is that stakeholder concerns enter through the side door. Worrying about downsizing and depressed wages thus reframed

[100] Jeffrey N. Gordon, Employees, Pensions, and the New Economic Order, 97 Columbia Law Review 1519 (1997).

through the stability channel is still about maximizing shareholder value, but for "which shareholder?" To say that we are at "the end of history" only begins the analysis.

Conclusion: Convergence and Stability

Corporate governance "convergence" first entered the agenda as a growth and development question. At a time of worry about performance of the US corporate governance model, would "strong monitors" of insider systems prove superior to "weak owners"? The East Asian financial crisis injected corporate governance into the machinery of global financial stability as well as economic development. Perhaps the reconcentration of weak owners in outsider systems into institutional investors will produce another sort of convergence: special attention to the interests of stability-minded shareholders, including the social implications of corporate governance. Stability concerns already exists where family-ownership is high. Will stability be added as a first order element in corporate governance convergence?

# # #

european corporate governance institute

about ECGI

The European Corporate Governance Institute has been established to improve *corporate governance through fostering independent scientific research and related activities.*

The ECGI will produce and disseminate high quality research while remaining close to the concerns and interests of corporate, financial and public policy makers. It will draw on the expertise of scholars from numerous countries and bring together a critical mass of expertise and interest to bear on this important subject.

The views expressed in this working paper are those of the authors, not those of the ECGI or its members.

www.ecgi.org

european corporate governance institute

ECGI Working Paper Series in Law

Editorial Board

Editor	Luca Enriques, Allen & Overy Professor of Corporate Law, Faculty of Law, University of Oxford
Consulting Editors	John Coates, John F. Cogan, Jr. Professor of Law and Economics, Harvard Law School
	Paul Davies, Senior Research Fellow, Centre for Commercial Law, Harris Manchester College, University of Oxford
	Horst Eidenmüller, Freshfields Professor of Commercial Law, University of Oxford
	Amir Licht, Professor of Law, Radzyner Law School, Interdisciplinary Center Herzliya
	Roberta Romano, Sterling Professor of Law and Director, Yale Law School Center for the Study of Corporate Law, Yale Law School
Editorial Assistants	Tamas Barko , University of Mannheim Julia Keith, University of Mannheim Kai Lion, University of Mannheim

www.ecgi.org\wp

european corporate governance institute

Electronic Access to the Working Paper Series

The full set of ECGI working papers can be accessed through the Institute's Web-site (www.ecgi.org/wp) or SSRN:

Finance Paper Series	http://www.ssrn.com/link/ECGI-Fin.html
Law Paper Series	http://www.ssrn.com/link/ECGI-Law.html