THE GLOBALIZATION OF CORPORATE GOVERNANCE
by Ron Dore

Level playing fields

Anti-globalization is, of course, a nonsense. Nothing short of a civilization-destroying nuclear winter will stop the multiply ramifying effects of the innovation process which makes transport and communications ever easier and cheaper. Nevertheless, the combination of trade union protectionists, passionate environmentalists, third world sympathizers, and miscellaneous antinomian activists for whom "globalization" has replaced "capitalism" and "the multinationals" as the central focus of indignation and hatred, may prove not to be a force to be dismissed lightly. Well before they were joined by the MacDonalds-trashers on the streets of Seattle, an internet-mobilized coalition of thoughtful, rich-world campaigners had played a not inconsiderable part in mobilizing developing country opposition to the OECD's proposed Multilateral Investment Agreement.1 And there was obvious justice in their argument – that "national treatment" for foreign investors may seem like an enlightened application of the "level playing field" principle of fairness and mutuality, but, as in rugby, it is also a recipe for making sure that the heavyweights win. They win, of course, because they are the best team, but "best" only in the single dimension of point-scoring capacity. The losers may be more beautiful or have superior morals. They may be happier at home than on the pitch; they may be more artistically creative, more sensitive in personal relations, more loyal, more altruistic.

The thing about the global economy – or rather about the combination of free capital flows and the elevation to categorical imperative of the principle of free competition in the global economy – is that it is not like a game of rugby. In three respects. First, it is very hard to opt out of playing it, or to argue that golf, with its handicapping system, would be a better game to play; the heavyweights can apply formidable sanctions against anyone who tries to drop out. Secondly, the act of playing it may do something to all those other moral, aesthetic and social characteristics, which you cherish and which you think favorably distinguishes you from the heavyweights. And thirdly, the rules are in constant evolution, and the heavyweights have the greatest say in evolving them, and the most intimidating influence on the umpire's interpretation of them

Translated into less allegorical terms: (1) trade dependency is real dependency. To keep its access to American markets, for instance, China had to agree to American terms for its admission to the WTO. And the strength of the American farm lobby was such that those terms had to include the blunting of an important mechanism by which Europe, Japan and Korea had secured greater equality of income distribution in their period of rapid industrialization, namely subsidizing agricultural prices. (2) Economic systems are embedded in societies with distinctive values to which their citizens may be attached. The equality just mentioned is a case in point. Different societies have different views of the liberty vs. equality trade-off – of how much inequality of income and life chances can be tolerated to achieve greater economic freedom and economic efficiency. The general consensual view on that score is rather different in Scandinavia, and Japan, from what it is in America.

And as for the point about the umpire, its translation is obvious. In the shaping of an emerging world culture, in the creation of the global public good of a world order – i.e., the formation and running of international regulatory institutions -- the rich countries in general and America in particular have preponderant, and sometimes overwhelming, influence.

Several questions arise from this. The first is economic impoverishment. Does the international trade and finance regime actually make poor people absolutely poorer? Or relatively poorer? Even if "the rising tide lifts all boats", is globalization like the national-territorialisation of Italy over the last century, producing a polarizing gap between North and South – i.e., not actually an

increase in poverty but an increase in inequality?. That is not my question here, but for a lively debate on that issue see the Wade-Wolf exchange in a forthcoming issue of *Prospect*.

The second issue is cultural impoverishment. The French and the Chinese are perhaps the most determined resisters to what in the 1950s we called the CocaColonisation, nowadays more often the MacDonaldisation of the world. In Europe it is doubtful if quotas on American TV soaps will make any difference in the long run. Asia may turn out to be very different. Japanese soaps rival the American in Southeast Asian markets.

International institutions, international power

But there is a third issue which is the one I want to say something about here – the issue of the impoverishment/dilution of national economic cultures, as the heavyweights succeed in forcing increasingly interdependent economies into one-size-fits-all international regimes. Increasingly, banks which want to be international banks, corporations which want to be international corporations have to be certain kinds of banks and corporations. And the sort of banks and corporations they are have important implications for the distributions of power and wealth and income in their societies which may not at all accord with their hitherto accepted sense of justice.

As one percipient observer of international financial regulation says, "the closed nature of policy communities and the growing dependence of regulators and supervisors on private market interests, has meant that regulatory standards are increasingly aligned to the preferences of the largest global market players."2 He illustrates that with the story of the Basle Committee and its capital adequacy rules for banks. The American acceptance of the Basle Committee's scheme in the 1980s (a prerequisite for its adoption) was as much prompted by the "level playing field" concern to defend American banks against competition from foreign banks with less rigorous requirements, as by the public goods concern with prudential regulations as a means of ensuring stability of the system.3

It is the power of the US government, working in harmony with US financial institutions, to dominate the rule-making processes of creating an international order -- in the World Bank and the IMF as well as in the BIS -- which provides far greater justification than the ubiquitous presence of Hollywood or MacDonalds for asserting that globalization means, in effect, Americanization.

Which is not to say that cultural influences do not count. In the aftermath of the Afghan War we are most conscious of the awesome weight of America's military power – a defense budget equal to the world's next nine biggest spenders if you believe Paul Kennedy (*Financial Times*, 2 Feb 2002), the next fifteen biggest if you believe Thomas Friedman (*International Herald Tribun*e, 4 Feb 2002). The economic power – by which America won over Pakistan's cooperation, for instance – is impressive too. But, to use Joseph Nye's terms,4 there is both hard power -- the ability to coerce others to give you what you want by military and economic pressures, and soft power -- cultural and ideological influence; the ability to make others want the same things as yourself. The two intimately interact. Fear and admiration go together in that "prestige" is being the object of either or both.

The feedback effect of the greatest importance is through the world-wide diffusion of liberal free-market ideology -- the belief that free market competition and consumer sovereignty constitute the only recipe for economic efficiency and progress, the belief that markets allocate resources more efficiently than can government and that allocation of resources by government (apart from minimal social security safety nets) should be resorted to only in the case of obvious market failure (e.g., roads and defense), that corporations should be managed in such a way as to maximize shareholder value, and that the use of the stock market as a means of buying and selling corporate control is an essential guarantor of efficiency. The diffusion has been greatly aided by the fact that -- thanks to the prestige which accompanies American power, and thanks to generous scholarship funding out of American wealth -- American graduate schools in

economics, law and political science have trained large numbers of the world's elite opinion leaders. At the same time and for the same reasons, the graduate schools of economics in Europe and Japan, which train those who do not go to the United States, use American textbooks, accept the same axioms, absorb the same ideology. And that ideology, promoting "level playing field" market competition throughout the world, gives advantages to the teams with the strongest competitors. It allows them increasingly to absorb (buy out) their competitors, and thus further reinforces the power, prestige and wealth which gave the United States its cultural hegemony in the first place.

Countries with different social systems, different cultures and ideologies, different ideas of an appropriate equality-efficiency trade-off are, consequently, under continuous pressure to see their own as "deviant" forms of capitalism and to become "normal countries", by adopting American models and patterns. I say "American" because America has the hard power which backs the process of missionary diffusion. But the similarity of the co-evolving institutions of the other Anglophone countries – Britain, Australia, New Zealand, Canada – has made "Anglo-Saxon" the standard term in the "types of capitalism" literature which takes as its starting point Michel Albert’s provocative *Capitalism vs. capitalism.*5

The "deviants" and the "normals"

The main features of the "deviant" countries like Japan and to varying degrees the countries of continental Europe, are that, while recognizing the virtues of market competition in many spheres they (a) accept that labor market flexibility should be sacrificed to both worker protection and the fostering of organizational loyalties, (b) expect organizational loyalties to preclude the buying and selling of companies through the stock exchange, (c) expect managers to have a broader range of responsibilities -- to employees and other stakeholders -- than a mere obligation to maximize shareholder returns, and (d) retain, as a token of citizen solidarity and mutual responsibility, a large public sector for health, education and collective social insurance whose universal equal-rights nature is expected to minimize the need for means-tested safety nets.

The first three are the core of these "deviancies". Firms are seen not as a matrix of enforceable, limited-term contracts between principals and agents which delimit individual responsibilities, but as entities which have some real existence, to which people make commitments over and beyond what can be spelt out in formal contracts. They are seen, almost, as communities of the people who work in them, and – to the most completely institutionalized extent in Japan -- run by managers who have worked their way up inside the firm along predictable career tracks through bureaucratic structures. Their managerial organizations, in other words, resemble nothing so much as an army or a police force in Europe, and certainly have precious little in common with the way in which top managers, head-hunted from the executive labor market, bargain their lavish pay, stock option and pension packages with a British or American Board’s compensation committee.

One of the means by which the societies which have created this kind of corporate institutions come to see them as "deviant", hence anomalous and hence destined to give way to more normal American-style patterns is through international chatter – business forum chatter, Davos chatter, OECD chatter, chatter predominantly in the English language and predominantly reflecting the Anglo-Saxon view of normality. Google will take you to 225,000 web sites which discuss "Corporate governance".

A global consensus?

The OECD first got into the act in 1996 when it set up a Business Sector Advisory Group on Corporate Governance which produced its report in April 1998 under the title, "*Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets".* Known generally as the Millstein Commission after its chairman, an American businessman/professor of commercial law, the six-man group included Adrian Cadbury, author of a famous report on the

governance of British corporations, the chairman of Salomon Inc. a Japanese businessman, a German commercial lawyer, and Michel Albert, author of the book cited earlier in which he had claimed that the German and Japanese corporate system which gave employees a powerful voice in the running of companies was both morally superior and probably more efficient than the American system, but went on to deplore the fact that, paradoxically, it was the American system which was, even in those countries, increasingly admired and imitated.

The Millstein report reflected this diversity of backgrounds at least in its opening fanfare statements. "Generating long-term economic gain to enhance shareholder (or investor) value is necessary to attract equity investment capital and is, therefore, the corporation's central mission. *At the same time however, corporations must function in the larger society. To varying degrees, different national systems and individual corporations may temper the economic objective of the corporation to address non-economic objectives."* (My italics) But the overwhelming consideration was "the global competition for capital" which required that corporations be transparent both about "their economic and non-economic objectives".

There are two things to note about this statement of the diversity issue. First, the universal validity of the principle of shareholder value objectives is rooted in "the global competition for capital". This ignores (a) the fact that even in AngloSaxon countries, most investment funds of corporations are internally generated, (b) the still continuing "home bias" of investors, particularly as sustained by exchange rate volatility – see the recent review of the issue by Asso6, (c) all the doubts expressed since the Asian crisis even by people hitherto at the heart of the Washington consensus about the opening of national capital accounts – the precondition for a global capital market.

The second curious thing about this formulation is the use of the terms "economic" and "non-economic". Maximizing the returns to capital is "economic", manipulating the distribution of income, maximizing employment or the returns to labor, is somehow "non-economic".

Before taking this further, let me pause to note that the Millstein report went to the OECD's Council of Ministers which produced an "authoritative" document much more single-mindedly reflective of the American clout within the organization: *OECD Principles of Corporate Governance, 1999*. No "let 100 flowers bloom" fanfare declarations here. All trace of "larger society" considerations, of tolerance of diversity disappears. The document begins with "The rights of shareholders" and goes on to specify them in detail. To give an example, at the heart of current German disputes about their new law regulating takeovers (which those seeking to preserve Germany diversity actually seem to have won), "Anti-take-over devices should not be used to shield management from accountability."

National differences, Value differences

To return to "economic" and "non-economic", the fact is that the diversity of views as to what should be the "mission" of the corporation is not just "national". It is also ideological, a diversity of values. Deng Hsiao Ping is famous for the line: I don't care whether the cat is black or white, provided it catches the mice. But in fact there is no such simple criterion as mice-catching to measure the performance of corporations. Neo-liberals would thoroughly agree with the OECD's emphasis on accounting profit or enhancement of shareholder value; neo-mercantilists might in addition be concerned with corporate contributions to national competitiveness (taking account, for example, of external economies generated through employee training or environmental improvement); social democrats might look for the maximization of value added per unit of given resources, but consider also the way in which the distribution of value added, as between returns to labor and returns to capital, affects the overall societal income distribution.

The dominance of the underlying neo-liberal view gets hidden in much of the discussion about the actual nitty-gritty mechanisms of corporate governance. None of the views of the mission of the corporation which I have just enumerated condones the type of corporate buccaneering daily

being revealed in the Enron stories or described in great detail a propos RJR Nabisco in *Barbariansat the Gate7* Nor would anyone want to see perpetuated the sort of incompetence which has recently ruined Marconi in Britain. But the remedies considered in the corporate governance literature are almost exclusively *external* -- accounting transparency to improve the accuracy of stock market valuations, regulatory pursuit of fraud, the role of the shareholders' general meeting, "disciplinary" take-overs to oust inefficient management, legal requirements for the appointment of "external" directors with no executive function, dominance of those external directors on audit and compensation committees, and so on. In these external mechanisms, as usually prescribed, the role of the stock market is crucial. Transparent accounting allows shareholders to judge when they should desert a company. When things look bad, the share price goes down. A wake-up call to managers. If they do not respond and get people buying their shares again, a depressed share price, one possibly that puts the stock market valuation below the real value of the assets, makes the company ripe for take-over. An alternative management which convinces the shareholders that they are better able to give them value comes in and throws the incompetents out.

There is first the question of how far that story corresponds to the Anglo-Saxon reality. In turns out that in fact "disciplinary" take-overs are far outnumbered by "strategic" take-overs, and subsequent records fail to show that taken-over companies produce better profits8. The second question is: how relevant are these mechanisms for countries with undeveloped stock markets and/or cultural resistance to hostile take-overs? Whether they can be made so, whether, that is to say, market institutions can be rapidly improved to optimalise equity-owner discipline is a major point of discussion in the Asian country where the open debate is most vigorous, namely China. And the overwhelming consensus of the advice China gets from international commentators is that the development of the stock market, its widening and deepening, the control of fraud and insider trading, is an essential prerequisite for making Chinese corporations, efficient.

Market and Organization: External disciplines, internal disciplines

In the meanwhile, as a substitute for equity-owner discipline. There is a good deal of discussion of another form of external discipline – creditor discipline, a monitoring role for the banks. What tends always to get neglected is the fact that, in countries which have community-like corporations, the effective mechanisms which impose discipline on those who manage corporations are not external at all, but *internal*.

Some of these internal controls will be national-formal -- the legally sanctioned role of unions or employee representatives in German co-determination or the Staff and Workers Councils of the Chinese SOEs and COEs -- or local-formal, as in the case of Japanese management-union arrangements "constitutionalised" in management-union contracts. Some will be entirely informal -- personal pressures of subordinates and peers on decision-takers.

At a recent seminar in Japan, a corporate lawyer with a good deal of experience of dealing with cases of bankruptcy and enterprise reconstruction remarked that in nearly every case he has known in which an incompetent or dishonest CEO was sacked, the beginning of his downfall was a loss of confidence among the middle managers. Yet, in spite of the fact that the Japanese business journals are full of talk of the need for external directors and other mechanisms for curing "insiderism", there is very little discussion and analysis of the internal controls which actually work.

A word or two about *how* they work. First, one has to rid oneself of the simple notion that the typical organizational "organigram" with vertical lines which show who has authority over whom, who "answers" to whom, tells the whole story. Subordinates sometimes "suggest" as well as answer – much more, and more effectively in some cultures than in others. There are, if you like, "capillary controls" over their immediate superiors of younger enthusiastic junior managers who have to do the detailed work of preparing the papers for important decisions their superiors have to take. (Do not forget that Japan has a lifetime employment system: the junior managers are

tomorrow's senior managers and are in – muted -- competition for faster-than-average promotion to senior positions.) Sometimes there have been more formal and collective forms of this otherwise "capillary" control, when junior managers set up their own informal study groups and write memoranda for senior management remonstrating against what they consider to be strategic mistakes.

Then there are the "insider" boards (up to 50 members in large firms) made up of senior executives. As far as actual decision-taking is concerned, these boards merely apply a rubber-stamp, the real discussions of business strategy take place in informal groups of top managers. But the boards also play an important role in reflecting morale within the firm, the "public opinion" of employees, to which top executives are usually quite sensitive.

Then, thirdly, there is the control exercised by a firm's labor union. In the typical large Japanese firm, the union is autonomous and confined to the enterprise. Everyone who is not defined in the 1946 Trade Union Law as "an agent of the employer" belongs to it, which means in practice that junior managers are also members until they reach positions of line authority, usually when they are in their early to mid-thirties. The way the union exercises constraint on the authority of managers is predominantly through Union-Management Joint Consultative Committees which meet regularly and have an agenda consisting of (a) items for report (of decisions managers have already taken), (b) items for joint consultation before decisions are taken, and (c) items for joint decision. What kind of decision comes in what category, is established, not by law as in the German co-determination system, but by a union-management contract within the firm, which acts as a kind of "constitution".

The Anglo-Saxon system of *external* controls works to keep managers honest and efficient by threatening punishment – punishment through take-over as a result of the impersonal workings of the stock market, or punishment through dismissal by a Board of Directors, dominated by External Directors whose job is explicitly defined as representing the interests of capital-providing owners. The Japanese system of *internal* controls works – through face-to-face, not impersonal, arm's length relationships – by exerting moral pressure on managers' consciences.

Clearly the crucial thing is the sensitivity of those consciences. What determines that?

Cultural traditions cannot be ignored, but clearly of the greatest importance are employment patterns and the way they structure life chances. Japanese top managers, after a lifetime of work in their firm tend to be closely identified with it. There is no external labor market offering them an alternative job, hopefully with better pay and stock options. The threat that their negligence or dishonesty might damage the reputation of their firm -- or lead it into bankruptcy if it failed to conform to the "hard budget constraints" which economic reality imposes on it -- can make those consciences sensitive indeed.

Why it matters for China – and the rest of us

For no country are these issues more important than for China as it seeks to elaborate the future patterns for its reformed State-owned enterprises,. For no country is it more necessary to resist the pressures of American-led OECD "Principles" and think hard about the relative importance of stock-market-derived *external* controls and own-organization-derived *internal* controls on the way corporations are run. In two important ways the example of Japan is relevant. China shares with Japan – indeed gave to Japan – an ethical tradition of dutifulness. The ethical vocabulary of responsibility, guilt and shame, derived from Mencian and Sung Confucianism is a shared one. They may pronounce the words differently but they write them with the same characters; they have a similar resonance. And secondly, the lifetime employment patterns of the "iron rice-bowl" community-like Chinese state-owned enterprises still remain, in spite of the new fluidity introduced by foreign firms and joint ventures and the entrepreneurial opportunities of China's rapid growth, very much like that of the typical Japanese corporation. And, as the earlier

discussion suggested, there is an intimate connection between the power of internal controls and the pattern of "career employment" rather than "job employment".

And what happens in China will have crucial importance for the shape of our globalize world and the chances of OECD "Principles" gaining truly universal acceptance. Paul Kennedy, in his gob-smacked review of Americanmilitary might,9 wrote of China (not Europe) as having the only chance of challenging America's hard power in the 21st century. Likewise the probable weight of the Chinese economy in the world economy will give it clout in the soft dimension of setting institutional and cultural standards. To revert to my earlier point about the correlation of national and ideological differences, that prospect will be alarming to neo-liberals: less so to social democrats.

----

1 Kobrin, S.J. (1998) "The MAI and the clash of globalizations", *Foreign Policy*, Fall, 97-109
2 Underhill, G.R.D., ed. *The new world order in international finance*, London, Macmillan,1997 p. 43
3 *Ibid. p. 29*
4 Nye, J.S.Jr., (1990) "The changing nature of world power", *Political Science Quarterly*,105, 101-2
5 *Capitalisme contre capitalisme*, Paris, Editions Seuil, 1991, Trans, *Capitalism against Capitalism,* London, Whurr, 1993
6 Pier Francesco Asso, "The 'home bias' approach in the history of economic thought: Issues on financial globalization from Adam Smith to John Maynard Keynes", in Jochen Lorentzen and Marcello de Cecco, eds., *Markets and Authorities: Global Finance and Human Choice*, Cheltenham,Edward Elgar, forthcoming, 2002
7 Bryan Burroughs, New York, Harper and Row, 1990
8 See,e.g. Mary O'Sullivan*, Corporate governance, innovation and economic performance in the EU, Summary Report,* mimeo INSEAD, 2001
9 *Financial Times, 2 Feb 2002*