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Convergence in Corporate Governance in Light of Globalization

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I. Introduction

Dear colleagues:

In my paper and in this short presentation, I am trying to provide a theoretical framework for analyzing and explaining convergence in corporate governance and, as it is, for analyzing and explaining convergence of legal structures in general. While our colleagues from Cambridge and Edinburgh have focused on the extent and the various areas of legal convergence and have delivered hard empirical evidence for the convergence of shareholder protection over the past two decades, I am mostly concerned with making sense of this evidence and putting it into an overall framework. This framework is based upon globalization and the patterns of change fostered by it. Accordingly, I will talk about social and legal theory and some theoretical foundations of change and of comparison.

I will deal with three issues, all of which have been discussed among legal scholars in the past years, but they have not, as far as I can see, been put together to form a comprehensive framework for analysis. First, I am concerned with the concept and methodology of convergence. Second, I will talk about globalization because it is a phenomenon closely related to convergence in corporate law and because it can be conceptualized in a way that is useful for the convergence debate. And thirdly, I will talk about processes of change that foster convergence as

well as about processes of change that foster the persistence of differences.

II. The Concept and Methodology of Convergence in Law

As for the concept of convergence, I suggest that convergence be understood as a process, rather than as a status or result achieved through this process. So, there may well be convergence between two countries' corporate governance structures despite differences that persist and maybe always will. In using such a dynamic concept of convergence, the focus of the inquiry is not on whether there are enough similarities to conclude that certain legal structures have converged. Such a focus, first of all, inevitably leads into a discussion about whether the glass is half empty or half full, which is irrelevant. Second, a focus on the status or result of convergence tends to obstruct the view on tendencies and patterns of change which are noteworthy and deserve analysis. And thirdly, a static focus seems inappropriate because in many instances, it may be difficult, for a number of reasons, to measure reliably what the current status of one country's legal development is in relation to another country's development, while a tendency of convergence can be discerned nonetheless.

The second point that I wish to make concerning the concept and methodology of convergence in law is one that goes to the heart of the theory and method of comparative law. I am of the view that we should take as the units of comparison laws, or legal structures, only. Some comparative corporate governance scholars, however, tend to compare entire social institutions and arrangements, which combine legal, economic, and political elements. What is being compared is some functional unit that consists of, *e.g.*, economic structures such as the stock market and the spread of equity ownership on the one hand, and legal structures such as shareholders' rights on the other.

Such a functional definition of the unit of comparison seems in line with what comparatists tell us about the method of comparative law. My point is, however, that the underlying paradigm of a functional linkage between a legal structure and its various environments is, as a matter of legal and

social theory, not well founded. If we take into account how much the law operates according to its own logic and how much its evolution depends upon its own history, any comparative law theory that is based upon a belief in fully functional linkages between law and society and a belief that such linkages are the same everywhere and have been the same in the past might lead us into trouble. In comparative law, also, we should take the law as what it is: an autonomous social system that is predominantly concerned with reproducing itself and which, while it is open towards its various environments, is not subject to the logic or the needs and wishes of, *e.g.*, the economy. Accordingly, in comparative law, we should compare laws only.

This does not mean that the economic and political environments are irrelevant for the comparison and the evolution of the law, but it does mean that we must focus instead on the coevolutionary processes that occur between a legal structure and the respective segments of its environments and that we must look at the dynamics, or the stasis, of these processes. Accordingly, within the analytical framework that I suggest, I compare legal structures and take their environments as one source from where to take explanations for the convergence of laws or the persistence of differences between legal structures.

One last point that I would like to make concerning the concept of convergence has to do with its conception as a process. Convergence refers to how the law evolves and changes, which is one of the central issues of legal theory. The concept of legal change that lies at the heart of my theoretical framework for the analysis of convergence in law is not a teleological one. A teleological concept of change and convergence would imply that there is change and convergence towards a defined convergence point and that change is driven towards that point of convergence. So, some corporate law scholars believe that convergence in corporate governance is a convergence towards a model of shareholder value maximization or, more broadly, towards the most efficient form of corporate organization or some globally agreed-upon best practice standard. Such a theory of legal change does not seem to be supported by the evidence, especially if we look at the processes that have brought about convergence in specific instances. Rather, a framework for the

analysis of legal change and convergence should be based on an evolutionary and non-teleological model which focuses on circumstances and conditions that have caused variation in a system and on the circumstances and conditions that favored the selection of one variant over the other. With regard to convergence in corporate governance, the theoretical framework that I will present accordingly mostly deals with identifying the kinds of variation that globalization entails and the particular circumstances upon which selections depend under the condition of globalization.

III. The Globalization of the Law

Globalization means an increase, extension, and intensification of social activities, relations, and dependencies across political, geographical, and cultural borders.

What does globalization mean with respect to the law? First of all, given the lack of a fully established global political system and given the limits that globalization entails with respect to the regulatory autonomy of the nation states, globalization of the law goes along with an increase in law production outside the centers of the national political systems and, more importantly, with an increase in law production outside the political system in general. The decreased role of the political system in the production of legal structures is the basis for the multiple phenomena of transnational law, such as regulations from private transnational standard-setters and the practice of transnational business law by global accounting and law firms.

The second characteristic of what globalization means with respect to the law is that because of the lack of a fully established global political system and despite the phenomena of transnational law, the nation states still harbor the most important and sophisticated legal structures and regimes within the global legal system, and they still harbor the most powerful political structures and law producers within the global political system. It is, at first sight, an astonishing phenomenon that despite a global economy, national legal structures, in particular corporate law structures, maintain such an important role.

The third point that I would like to make concerning the globalization of the law is that there is actually a global legal system. This essentially means that there is a specialized and autonomous global discourse about law. While the legal structures within this global system differ from one sector, *i.e.*, from one state to another, they are all *legal* structures and as such, they are different from other social structures, such as economic or political structures.

IV. Convergence of Legal Structures

All these characteristics regarding the globalization of the law are the conditions under which the law evolves in the age of globalization. I am going to point out that these characteristics of the globalization of the law facilitate and foster certain patterns of change, which, in turn, foster convergence. What are these patterns of change?

The first pattern is imitation. By imitation, I refer to the concept that is better known as legal transplant and as reception. Imitation is a pattern of change facilitated by globalization because the intensified transnational communications are the basis for a „free trade in legal ideas“ and because the autonomy of the global legal system makes it possible for legal rules to travel independently from their environment.

But globalization not only facilitates imitation, it also fosters it. Why? There are a number of reasons. First, because of comparison. Globalization has made comparison easier because of the permanent availability of everything that exists out there in the world within a given social system. That is true both for politics as a law producer and for the various national sectors of the legal system.

The second reason why globalization fosters imitations are collisions, *i.e.*, collisions between various sectors of the global legal or political system. Globalization has increased the potential for such collisions because of more and more cross-border issues that the law deals with. Collisions irritate the social system within which they occur, and a system that has been put under pressure because of a collision may select to

imitate those structures or elements that are the cause of the collision in order to restabilize the system. The Sarbanes-Oxley Act and its extra-territorial effects on the EU, followed by the EU's response in the Eighth Company Law Directive, are a prominent example for an imitation engendered through a collision.

A third factor that fosters imitation is the global nature of many shocks and crises. Shocks and crises have long been recognized as key drivers of the evolution of corporate law, and often times, shocks and crises cause systems to imitate because imitation seems the fastest way to restabilize a system that has come under pressure. The imitation of many aspects of the Sarbanes-Oxley Act by the EU, after Europe got its own corporate scandals, illustrates this point.

Besides imitation, there is a second pattern of change which globalization facilitates and fosters. It is parallel innovation, which means that similar conditions in the various sectors of the law's environment or of the environment of law production provide similar impulses for changes in the law. To the extent that globalization fosters such similar conditions, it also fosters parallel innovation.

Such parallel innovation is further facilitated by the fact that the law production increasingly moves away from the center of the national political systems towards their edges and the edges of the systems and networks that the law serves, as I have pointed out before. Because the more closely the law is produced alongside the systems and networks which it serves, the more immediately the parallel impulses coming from these systems and networks will be reflected in the law through parallel innovation. Accordingly, the areas of corporate law where we can see the most similarities across nations are those areas where the evolution of the law is closely linked to the financial markets and where global institutional investors play an important role as well as in the areas dominated by the transnational practice of business law, such as M&A. In addition, in these areas, the law production is much less exposed to interventions from national politics, which again makes parallel innovations particularly likely.

The third pattern of change facilitated and fostered by globalization is coordination. By coordination, I mean most of all harmonization. The reasons for increased coordination under the conditions of globalization are more or less the same as the ones for more frequent imitation. Coordination, quite like parallel innovation, is particularly likely to occur at the edge of the systems and networks which the legal structures are designed to serve, *i.e.*, in areas where private standard-setters and the transnational practice of business law are important law producers. Here, the law production is driven by similar impulses, and interventions from national politics are less likely. Both these factors make coordination particularly easy. The most prominent example for such coordination is the convergence project between the FASB and the IASB regarding global accounting standards.

Neither imitation nor parallel innovation nor coordination necessarily leads to convergence of legal structures. There is no necessity in legal evolution anyway, and there are always forces at work which make convergence unlikely. Conversely, there are certain circumstances which foster convergence as a consequence from imitation, parallel innovations, or coordination. Without entering into detail too much, two circumstances can be mentioned which explain why there is or there is not convergence.

The first circumstance has to do with whether a legal structure is coupled rather tightly or rather loosely to its various environments, such as in particular the economic and political environments. Legal structures such as those from private standard-setters and from the transnational practice of business law are tightly coupled to the economic structures and networks which these structures serve and which they come from. Legal structures such as national corporate organizational law, however, are typically coupled relatively loosely to both the political system and the economy. Now, the chances for convergence depend upon the nature of the coupling – loose or tight – that exists between a particular legal structure and its environments. So, *e.g.*, if a legal structure has been imitated which is tightly coupled to the relevant part of the economic environment, similar economic structures and conditions will foster convergence. Think of the convergence in the area of financial disclosure. If

the coupling between a legal structure and the relevant economic environment is rather loose, differences between the sectors of the economic environment will be less of an obstacle to convergence than they would be in an instance of tight coupling.

The second circumstance that is relevant with respect to the chances for convergence is the nature of the coupling – rather tight or rather loose – that exists between a legal structure and its *legal* environment. By legal environment, I mean the particular legal context into which a legal structure is embedded, including legal doctrine, concepts, language, and culture. Convergence is less likely if the relevant legal environment does not exist or is not the same as elsewhere. And conversely, as an example, imitation of an isolated regulation concerning insider trading is more likely to lead to convergence if there are pre-existing similar doctrines and concepts of disclosure, equal treatment of investors, and fairness vis-à-vis market participants because a legal rule concerning insider regulation is tightly coupled to these concepts.

V. The Persistence of Differences Between Legal Structures

While globalization fosters the convergence of legal structures especially because of imitation, parallel innovation, and coordination, it also fosters, at the very same time, the persistence of differences between the nations' legal structures. One circumstance that fosters the persistence of differences, or, put differently, prevents convergence despite instances of imitation, parallel innovation, or coordination – one such circumstance are differences which exist between the various sectors of the environments of the law and the law production. And the tighter a legal structure is coupled to these differing environments, the less likely convergence is. So, *e.g.*, the tight coupling between labor-related aspects of corporate governance on the one hand, such as co-determination and work councils, and the political system on the other makes differences in this area persist to the extent that there are relevant differences between the various nations' political systems.

Another circumstance that prevents legal structures from converging despite instances and opportunities for imitation, parallel innovation, and

coordination is path dependence. The concept is well known and has gotten a lot of attention in recent business law scholarship. In the present context, it is sufficient to note that obviously, the question whether imitations, parallel innovations, or coordination actually foster convergence depends on what the starting point in any given sector of the legal or the political system or the economy was.

VI. Conclusion

By filling in the results of empirical comparative studies into a framework like the one that I have presented, I posit that we come to a plausible and well-founded account of what happens to corporate law under the conditions of globalization and of how the convergence in corporate governance that we can see can be explained. In particular, I posit that this framework provides a more plausible account of convergence in corporate governance than the story of the triumph of the shareholder value maximization model does. The least that this framework does is provide us with hypotheses and directions for the study of convergence and persistence in corporate governance.

To be sure, what I have presented here is just the skeleton of the framework. Beyond this skeleton, the framework, *e.g.*, also provides a basis and directions for making sense of the widely noted phenomenon of Americanization of corporate law. This phenomenon has to do with imitation and the circumstances that make a system select one pre-existing rule rather than another. Globalization certainly provides hints and insights as to what circumstances favor selecting U.S. legal rules and therefore, globalization, again, proves to be a fruitful reference point within this framework for analyzing and explaining convergence in corporate governance.

Thank you for your attention.