

Corporate governance convergence and sustainability

[Daniela M. Salvioni, Simona Franzoni, Francesca Gennari]

Abstract— The globalization of markets and information has determined the search for convergence between the systems of corporate governance, especially with reference to listed companies. Particularly, the growing integration of financial markets seems to be a key factor of convergence of corporate governance systems. In the last quarter century, the convergence has been promoted by regulatory and self-regulatory actions directed to the spread of best practices of corporate governance. A host of regulation, standards, recommendations, programmes and much more have emerged; from OECD Principles of Corporate Governance (1999, 2004, 2015) to the UN Guidance on Good Practices in Corporate Governance Disclosure. These initiatives are undoubtedly necessary and useful, but they seem to promote a so-called ‘de jure’ convergence rather than a substantial or ‘de facto’ convergence. Governance practices vary not only across countries but also across firms and their spirit of governance. The main question we want to answer in this paper is if sustainability and the broader concept of social responsibility imply a change in the spirit of governance, which promotes de facto convergence between the different systems of corporate governance existing all over the world. In fact, this spirit is inextricably linked to the culture and performance of organisations, and it implies a focus on the principles and values that dominate internal and external relations, internal processes of behavioural orientation, enhancement of transparency requirements and multidimensionality of responsibilities, objectives and results.

Keywords — Corporate governance, Sustainability, Convergence

I. Corporate governance systems: between differences and convergence trend

One of the most striking differences between countries' corporate governance systems is the difference in the firms' ownership and control existing across countries (OECD, 1999). According to this fact, corporate governance systems can be divided into outsider systems, characterised by wide dispersed ownership, and insider systems, characterised by concentrated ownership.

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The Anglo-Saxon countries can be defined as typical case of outsider or market-oriented systems, where there are big corporations, characterized by a high openness towards risk capitals market, clear separation between ownership and management, one-tier corporate governance systems and control functions exercised by markets. The risk connected to this type of corporate governance system is mainly referable to the excessive orientation to the short-term (OECD, 1999).

Vice versa, the insider systems are typical of countries characterised by less developed financial markets. In this situation the company's ownership is frequently concentrated and stable, with the majority shareholders involved in the management and able to influence corporate governance decisions in order to maximise the value creation in the long-term.

The different characteristics of ownership structure (Morck et al., 1988; McConnell and Servaes, 1990) referred to outsider and insider systems tend to determine factors of divergence for companies working in the two systems. In fact, the different time orientation influences the business strategy and, consequently, the key performance indicators.

The globalisation and the growing integration of financial markets in the world are considered the prior factors of convergence of corporate governance rules and, consequently, corporate governance systems (Nestor and Thompson, 2000; Khanna and Palepu, 2004). This phenomenon is known as in form or de jure convergence (La Porta et al., 2000; Gilson, 2004; Khanna et al., 2006; Yoshikawa and Rasheed, 2009; Lazarides and Drimpetas, 2010): national systems are encouraged to the production of rules inspired by high-quality corporate governance standards and principles (e.g. OECD Principles on Corporate Governance, UN Global Compact principles, UE Papers) to favour a common competitive ground for global companies which intend to attract foreign investors. These standards about good governance condition not only national legislators but also the governance practices voluntarily adopted by companies to adequately compete on global markets.

So, the presence of globally recognised high standard of corporate governance favour a stepwise convergence between outsider and insider systems. Nevertheless, the production of rules with international value can represent a factor of formal convergence without qualifying a guarantee of operational or substantial convergence. Convergence in function or de facto refers to the adoption of corporate behaviours abstract from corporate governance systems' characteristics and rules.

The latest arise of new concepts referring to sustainable development and stakeholder relation management (Steurer, Langer, Konrad and Martinuzzi, 2005; Cadbury, 2006; Elkington, 2006) redefines the role of companies in society. A wide vision of responsibility based on appreciation of links between long-lasting company's success and fair

settlement of stakeholders' expectations is established, with consequent changes in terms of spirit of governance. The acceptance of CSR and sustainability as important business performance indicators emphasises the interdependence among stakeholder relation management, economic and socio-environmental responsibility, economic and not economic results, capability to obtain consents and resources in the long-term. Further, the relation between corporate governance and corporate social responsibility has been risen great attention since the 1960s (Jo and Harjoto, 2012).

Basing on the previous considerations the question is if a corporate culture inspired by sustainability can be considered as a factor of substantial convergence between different corporate governance systems, with regard to goals in terms of creation of sustainable value (Salvioni and Gennari, 2014).

II. Sustainability and convergence in corporate governance system

The emphasis on CSR and sustainability principles requires a significant change in the long-term direction of the entire organisation to fairly meet stakeholders' expectations. In fact, a corporate approach inspired by sustainability requires good corporate governance that is a governance grounded on stakeholder engagement, fairness, transparency and accountability. In this way, companies can nurture over time their corporate value, which is a 'sustainable value' because of realized on the links between long-lasting company's success and fair settlement of stakeholders' expectations.

The most sustainable companies in the world are fitted in the Global 100 Index¹ on the base of a cluster of variables referred to different aspects of corporate global responsibility (economic, social and environmental dimensions). In April 2015 we carried on a qualitative analysis of the 20 companies included in the Global 100 Index for all 5 years from 2011 to 2015.

In particular, we have analyzed all the companies' reports available on companies' web site (corporate governance report, sustainability report, integrated report, etc.) searching for information about the corporate engagement in a long-term value creation. The long-term perspective means that the ultimate goal of an organization is sustainability (Schaefer, 2004, Porter and Kramer, 2006; Mostovicz et al, 2009) and, consequently, this impacts on company's objectives and strategies promoting the gradual diffusion of sustainability culture in all organizational levels.

Of 20 companies, 11 belong to insider systems (Adidas, City Developments, H&M, Kesko, Koninklijke Philips Electronics, Natura Cosmetics, Neste Oil, Novo Nordisk, Statoil, Storebrand, Vivendi), and 9 to outsider systems (Agilent Technologies, BG Group, Centrica, Enbridge,

Prologis, Sun Life Financial, Suncor Energy, Unilever, Westpac Banking).

We noticed that, irrespective of corporate governance systems, companies that systematically include sustainability matters in their goals and strategies are characterized by a long-term business orientation; this refers to the crossing of divergence in time orientation about economic results with the aim to permanently create value satisfying equally ample stakeholders groups. Furthermore, these companies emphasize the systematic commitment of the board in sustainability goals also by means of specific committees and chief officers, believing that a sustainability-oriented board can be a change agent (Maritz et al., 2011) able to maintain a constant dialogue with stakeholders and to ensure the CSR matters are integrated into corporate objectives and business operations.

The effective board's commitment in CSR matters represents the prerequisite for the strategies realization in organizational levels and the consequent obtainment of coherent economic and socio-environmental performance. In fact, the translation of sustainability values into actual results requires coherent internal control's tools and processes (Salvioni and Astori, 2013). These mechanisms, favouring the transfer of sustainability concepts in business behaviours at all organizational levels, promote substantial convergence in corporate governance by means of the exploitation of opportunities and the economic and social risks' management with which the companies should compete.

The implementation of fully responsible behaviours requires referral to varied objectives, addressed to: an appropriate valorisation of the entire network of internal and external relations, the optimisation of behaviours with respect to stakeholders' expectations, information exchange and dissemination of conditions of ethical behaviour (Salvioni, 2010). In this context, a correct orientation and equitable behaviour are of paramount importance for those who continuously develop decisions and actions, from which the actual ability to create sustainable value derives.

The actual awareness of goals to be achieved makes the assignment of responsibilities to the organisation possible, according to a structured development aimed at reuniting expectations and actual results through management. The pursuit of strategic objectives determines the emergence of specific responsibilities, closely related to the aims (variously expressed in terms of quality and quantity and implying a different degree of corporate risk), as well as the need for appropriate impact evaluations on economic, competitive, social and environmental success and sustainable future.

The large emphasis placed on the need to identify and manage critical elements connected to the lasting survival of company underlines the focus on the development of internal control systems that can monitor a wide range of risks and disseminate a positive approach about risks' managing and reporting in the organisation. Internal control systems ensure the maintenance of a competitive advantage in an increasingly open, dynamic and uncertain environment when they are designed to take advantage of opportunities, promptly signalling the uncertainty of the defined phenomena, acting and reacting to threats, ensuring a coordinated and systematic approach to risk. Therefore, the

¹ The Global 100 Index expresses the "Most Sustainable Corporations in the World" and it is managed by "Corporate Knights Capital", which builds indexing solutions and market-beating portfolios for institutional clients. See www.corporateknights.com.

structural and operational characteristics of processes of internal control must ensure the continuous monitoring of critical factors for company's success and the proper recognition of significant variables, complying with the optimisation of economic and social/environmental performance.

So, the effectiveness of internal control systems requires a careful analysis of dominant critical factors and it is primarily affected by the spread of the culture of sustainability and social responsibility at all levels of the organisation. In fact, failures in transferring the core values of sustainability and social responsibility in different management tasks can disrupt the correct implementation of corporate governance decisions (Franzoni, 2013). In this respect, codes of ethics and code of conduct are designed to clearly summarise the principles, values and responsibilities that corporate bodies and organisation must share, internalise and respect. The effective management of differences in organization's values can also find support in the adoption of a plan to build a corporate ethical culture, eventually supported by the appointment of ethics officers and/or the establishment of ethics committees (Salvioni, 2003).

In conclusion, we can affirm that the characteristics of internal control systems (which ensure the dissemination of company's goals and values in all organizational levels) are not so affected by the rules and behaviours typical of different corporate governance systems but by the orientation of the directors towards sustainability matters. In fact, the identification of critical factors for company's success and their translation into objectives to be pursued by the organization (thanks to internal control mechanisms) depend firstly by the board's priorities for creation of sustainable corporate value.

III. Conclusions

The spread of sustainability principles and a wide concept of responsibility foster a change in relevant corporate performances, modifying business orientation and creating prerequisites for substantial convergence in corporate governance systems. This is possible when sustainability values nurture the essence of governance being part of corporate culture. It is clear that the recognition of sustainability principles as corporate cultural factors is differently fulfilled according to company's characteristics and external ties. In fact, corporate governance systems are the result of cumulative processes (Djelic, 1998; Bebchuk and Roe, 1999; Vogel, 2003; Puchniak, 2007; Davies and Schiltzer, 2008) based on rules and on the necessity to regulate companies' behaviours. Companies' voluntary conducts can pre-empt formal best practices, inciting mutual phenomena of formal and substantial convergence towards the overcoming of traditional corporate governance systems' limits.

In this sense, sustainability becomes a formal business driver. Hence, irrespective of characteristics of corporate governance systems, concerning financial markets and ownership concentration, companies which effectively exercise sustainability modify their corporate policy, giving importance to the creation of sustainable value as a condition for their growth and development in the long-term. So, one of the most important elements of divergence

between insider and outsider corporate governance systems, related to the different time tendency to results, tends to decrease influencing company's strategies and decision making processes.

It should however be emphasized that the numerous and frequent scandals, which often involve companies, show how far the companies are from a situation where sustainable tasks transform into management behaviours. Most of scandals are related to the clear privilege of economic performance, highlighting the persistence of differences between sustainability objectives declared and corporate conduct.

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