

Decoupling as a Sustainable Firm Response to Pressures for Convergence and Divergence in Corporate Governance: The Case of Codes of Good Corporate Governance

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Whether corporate governance systems, policies, and practices are converging to the Anglo-American model is an intensely debated issue. This article addresses the convergence-divergence debate in corporate governance in the context of the diffusion of codes of good governance. Rather than joining the “either-or” debate, a model is being presented in which drivers of convergence and impediments to convergence are simultaneously considered as determinants of the depth of convergence outcomes. The notion of sustainable strategic decoupling is introduced to address these dynamics at the firm level of analysis and to highlight that firms can actively respond to conflicting institutional pressures for change and continuity by making strategic choices.

INTRODUCTION

Codes of good corporate governance have become an increasingly visible phenomenon over the past decades. The U.S. in 1978, and the U.K. in 1992, were the first major economies that have issued codes of good governance. By 2008, codes of good governance have been created in more than 90 countries around the world. A variety of transnational organizations like the World Bank, the IMF (International Monetary Fund), the EC (European Commission), and the OECD (Organization of Economic Coordination and Development), among others, have spurred this development and have actively promoted the development of these codes (Aguilera & Cuervo-Cazurra, 2009; Monks & Minow, 2004). These organizations have often been directly influenced by the U.S. and the U.K. which hold traditionally dominant positions within these forums.

Especially during its economic resurgence in the 1990s, the U.S. has attempted to establish its own domestic regulatory corporate governance framework as international best practice. At the same time the U.S. and the U.K. have also become benchmarks for best practices in corporate governance for other economies that perceived Anglo-American governance models as drivers for economic growth (Walter, 2008). As a result, current governance codes contain a wide variety of traditional Anglo-American best practice provisions regarding board composition, director and auditor independence, treatment of shareholders, executive compensation schemes, transparency in financial reporting and disclosure, among many other topics. Many of these provisions build upon agency theory logic (Fama & Jensen, 1983; Jensen & Meckling, 1976), which is the central and dominant tenet of the Anglo-American style of corporate governance. The specific content of every code varies across business systems, but ultimately, codes of good governance attempt to improve the quality of companies' board governance and to increase

the accountability of companies to shareholders while maximizing shareholder or stakeholder value (Aguilera & Cuervo-Cazurra, 2004).

The worldwide proliferation of these codes raises the question, are corporate governance systems and governance policies and practices converging to the Anglo-American model? In searching for an answer to this question, several studies, on different levels of analysis (i.e., cross-country, country, firm-level), have focused on examining whether the phenomenon of convergence exists or not and have, in the context of codes of good governance presented moderately strong evidence of a convergence trend in their nature and content (see Aguilera, Cuervo-Cazurra, and Kim (2009), Guillen (2000) and Yoshikawa and Rasheed (2009) for reviews of this literature).

One line of reasoning in this stream of research is that through competitive pressures of global capital, product, and labor markets, governance systems and corporate governance policies and practices inevitably converge towards the Anglo-American shareholder value maximization model (Coffee, 1999; Hansmann & Kraakman, 2001; Khanna, Palepu, & Srinivasan, 2004). A contrasting perspective in this literature is that path dependence and the embeddedness of corporate governance in a nation's institutional context place strong limits on convergence (Bebchuk & Roe, 1999; North, 1990; Whitley, 1992). Others go beyond this convergence-divergence dichotomy and argue that governance systems neither fully converge to, nor fully diverge from, the Anglo-American model. Instead, the argument is that there are various degrees of decoupling from the Anglo-American model and firms actively influence, manipulate, and customize their institutional environment to fit governance policies to their own situations (Yoshikawa, Tsui-Auch, & McGuire, 2007). This approach in the analysis of convergence appears to be very useful because it not only directs attention to firm level governance choice and response within an institutional framework, but also simultaneously considers the drivers and impediments of convergence and the institutional pressures for continuity and change.

Although supranational (e.g., OECD, World Bank, IMF), regional (e.g., EU) and national regulatory agencies (e.g., governments, stock exchanges, manager-, director-, professional-, and investor associations) are able to enact pressure to adopt good governance codes at the transnational, national and firm level, firms – the ultimate targets of regulatory action – remain embedded in their specific business system and local institutional context. Drivers of convergence and change (e.g., global financial, product, and labor market integration, harmonization of accounting standards) and impediments to convergence (e.g., differences in property rights, rent seeking by interest groups, complementarities and multiple optima in business systems) simultaneously determine the nature and depth of convergence.

In response to simultaneous pressures for continuity and change, firms can make strategic choices, ranging from passive conformity to proactive manipulation (Oliver, 1991). Allowing for strategic choices at the firm level of analysis, the question regarding convergence becomes more complex. The issue of firm level convergence is now not only “either or”, but requires addressing the form of convergence and the firm strategy in the choice of convergence, culminating in the question, how deep does convergence go? In line with this reasoning, several firm level studies have found high levels of compliance with good corporate governance codes (Bozec, 2007; Collier & Zaman, 2005; Nowak, Rott, & Mahr, 2005; v.Werder, Talaulicar, & Kolat, 2005). However, there are also several descriptive studies that show that compliance with codes at the firm level may largely be in form rather than in substance (Ananchotikul, Kouwenberg, & Phunnarungsi, 2009; Buck & Shahrin, 2005; Romano, 2007; v.Werder et al., 2005). Despite this contradictory discrepancy, very few studies have sought to explain why some firms that have formally adopted a code of good governance, decouple this policy from actual use and why convergence may be in form rather than in substance (v.Ees & v.Witteloostuijn, 2007).

In this article, following Meyer and Rowan (1977), Oliver (1991), and Westphal and Zajac (1994), the notion of decoupling will be used as an operational definition for addressing the issue of convergence at the firm level. Decoupling is defined as the combination of outward appearance of compliance with codes of good governance together with hidden behavioral divergence, or in terms of Oliver's (1991) typology of strategic responses to institutional processes as “...disguising nonconformity behind a façade of acquiescence” (p. 154).

I will show that addressing the convergence issue in the context of good governance codes with the notion of decoupling has three important implications for current research. First, research on codes of good governance may have underestimated that there are large gaps between formal rules and institutions, on the one hand, and actual firm policy and firm behavior, on the other hand. Second, it is important to allow for active firm behavior in response to institutional pressures. Firms can actively manage compliance and convergence pressures with a variety of strategies and have leeway for divergence through decoupling. Third, consistent with the varieties of capitalism argument that there is no single best model in governance (Hall & Soskice, 2001), pressures for continuity from domestic and local institutions continue to be of great influence on firm behavior, despite global capital, product, and labor market pressures for convergence and change. Based upon these arguments, I develop a model to explain and to predict under what circumstances compliance with codes of good governance at the firm level will be largely superficial, rather than substantive in nature. I argue that a decoupling strategy in the compliance with good corporate governance codes will be more attractive to firms, and also be more sustainable under the following conditions: (a) firms' compliance costs are relatively high, (b) firms' costs of outright and visible non-compliance are relatively high, and (c) outsiders' compliance monitoring costs are relatively high. It can be expected that various firm level characteristics such as ownership structure, management orientation, firm strategy, global market pressure, as well as, institutional-level factors, affect firms' choice to decouple policy from practice in the use of codes of good governance.

The remainder of the article is organized as follows. Section 2 of the article depicts the nature of codes of good governance and the functional assumptions underlying the "comply or explain" principle. Section 3 analyses the fundamental assumptions of codes of good governance in the context of different business systems. Section 4 links the phenomenon of decoupling to the convergence-divergence debate in corporate governance. Section 5 formulates a firm-level model of sustainable strategic decoupling in the compliance with codes of good governance. Section 6 closes the article with a conclusion.

THE NATURE OF CODES OF GOOD GOVERNANCE

A code of good governance can be considered a tool that includes a set of best practices designed to address deficiencies in corporate governance systems and to improve the quality of a firm's corporate governance overall. Most codes have some recommendations on the following seven practices: (1) a strong, involved board of directors; (2) a balance of executive and non-executive directors, including independent non-executive directors; (3) clear division of responsibilities between the chairman and the chief executive; (4) timely, quality information for the board; (5) formal, transparent procedures for the appointment of new directors; (6) balanced and understandable financial reporting; and (7) maintenance of a sound system of internal control (O'Shea, 2005; OECD, 2004).

Aguilera and Cuervo-Cazurra (2004) found that in many business systems stock markets or the overseer of stock exchanges (i.e., securities and exchange commissions), associations of managers, and associations of directors played an active role in developing the initial corporate governance codes. Investors' associations and governments played a secondary role in developing initial national codes of good governance.

The implementation of codes can be pursued through legislation (e.g., Sarbanes-Oxley Act of 2002) or through a voluntary "comply or explain" approach. Codes that are based upon the "comply or explain" principle, require companies to disclose a report including (1) a declaration of conformity that states how they have applied the principles in the code, and (2) in the cases that companies have not complied with the provisions, then they need to explain the reasons for any non-compliance (O'Shea, 2005). There are two important underlying assumptions of the "comply or explain" principle (OECD, 2004). First, the principle "comply or explain" assumes that it is not possible to adopt a "one-best-way" approach to corporate governance for all firms. Firms differ in a variety of organizational characteristics, and the principle allows self-regulation and the possibility of non-compliance with best practice provisions. The second assumption, related to the first one, is that an efficient capital market (including financial press, rating agencies, analysts, institutional investors, and stock exchanges) will monitor the compliance with a

code and penalize unjustified non-compliance with lowering share prices or accept justified non-compliance (Brunsson & Jacobsson, 2000; Cuervo, 2002; MacNeil & Li, 2006; Nowak et al., 2005). Besides these two assumptions, an implicit consideration that appears to underlie the focus of most codes is the concern with principal-agent issues (Fama & Jensen, 1983; Jensen & Meckling, 1976), reflected in the emphasis on board structure and composition, as well as, on improving companies' accountability to shareholders.

These are strong assumptions and the questions that arise are how these widely diffused codes fit into different business systems with diverse institutional characteristics, and what kinds of business systems would most effectively support the codes' intended functioning. The next section of the article seeks to answer this question by placing the fundamental assumptions of codes of good governance in the context of the characteristics of generic categories of business systems.

CODES OF GOOD GOVERNANCE AND THEIR INSTITUTIONAL ENVIRONMENTS

In finance and economics, a distinction is generally made between two systems of corporate governance: Bank-based systems and market-based systems (Edwards & Fischer, 1994; Shleifer & Vishny, 1997), although substructures can be identified between and within these systems (Gugler, Mueller, & Yurtoglu, 2004; Levine, 2002).

In bank-based systems, only small percentages of the total stock of large firms are in free float, trading volumes are relatively low (i.e., stock markets are relatively small in relation to the national economy), and information disclosure for outsiders is weak. Ownership is concentrated. Banks, companies, and families are large shareholders and exert control over firms. Boards are controlled by internal directors or external directors linked to large shareholders. Dual-boards are common and include labor representatives. Bank-based systems are prevalent in continental Europe and Asia (Cuervo, 2002; Juergens, 2000; Shleifer & Vishny, 1997).

In market-based systems, a high proportion of a firms' stock is in free float, stringent accounting rules promote open information disclosure, financial markets are liquid (i.e., stock markets are relatively large in relation to the national economy), minority shareholders are well protected, ownership of corporations is relatively disperse, and markets for corporate control (e.g., takeovers) are active. Single board structures are most common and exist to represent the interests of shareholders and do not include labor representatives. Market-based systems predominate in Anglo-Saxon countries (Cuervo, 2002; Juergens, 2000; Shleifer & Vishny, 1997).

This distinction between market-based and bank-based system captures, of course, not all features of institutions in business systems. However, it takes into account many proximate and background social institutions related to the key institutional domains relevant for explaining the functioning of codes of good governance (Whitley, 1992).

Considering the differences along the market-based/bank-based dimension of governance systems, the "comply or explain" principle appears to function most effectively in capital market-based financial systems. While disclosure of compliance with a governance code is often a mandated legal requirement, monitoring and enforcement is expected to occur through self-regulation in conjunction with the capital market (Nowak et al., 2005). What is assumed is that a declaration of conformity with the code by a listed company would serve as a signal to national and international investors about firm-specific governance, and investors would take this information into account when they evaluate firms and make their investment decisions. It is generally assumed by code developers and issuers that cases of non-compliance will be monitored and sanctioned by an efficiently working capital market, or as the chairman of the German corporate governance code commission phrased it: "Those who dare not to comply with the code shall be punished by the capital market (FAZ, 2001, p. 13)."

Besides the assumption of efficient capital markets another unarticulated consideration in the formulation of codes of good governance is the concern with principal-agent issues (Fama & Jensen, 1983; Jensen & Meckling, 1976). Principal-agent conflicts are of concern in business systems characterized by dispersed shareholders and professional managers. Agency theory, which addresses this

conflict, is by far the dominant theory in corporate governance research and the principal-agent conflict is the primary conflict around which most of the U.S. corporate governance research has revolved (Chhaochharia & Laeven, 2008; Daily, Dalton, & Canella, 2003; Morrison, 2004). Agency theory informs most mechanisms and regulations of good corporate governance provisions in codes. For example, code recommendations regarding adoption of audit committees, age limits for members of the management board, disclosure of individualized executive compensation figures, performance oriented compensation for auditors, or director and officer liability are practices that come directly from principal-agent reasoning and are conceptualized to deter detrimental effects of self-interested top managers. However, in contrast to principal-agent conflicts, principal-principal conflicts arise between controlling shareholders and minority shareholders and result from concentrated ownership and control, family ownership, business group structures, pyramiding, and weak legal protection of minority shareholders. Principal-principal conflicts are prevalent and the basic governance issue in many developed and developing economies around the world (Almeida & Wolfenzon, 2006; Claessens, Djankov, & Lang, 2000; Denis & McConnell, 2003; LaPorta, Lopez-de-Silanes, & Shleifer, 1999; LaPorta, Lopez-de-Silanes, Shleifer, & Vishny, 1998). Clearly, resolving principal-principal conflicts requires different solutions from those offered by the mainstream agency perspective.

Taking into consideration the key assumptions underlying the functioning of the “comply or explain” mechanism in particular, and the subject matter of codes of good governance in general, it can be argued that codes may find a supportive institutional environment primarily in business systems characterized with strong investor rights, dispersed ownership structure (i.e., mainly principal-agent conflicts), and efficient capital markets.

Interestingly, as quoted above, the Chairman of the German governance code commission assumes in his statement in the year 2001 that the institutional environment of Germany’s bank-centered business system would support the functioning of the German code that strongly builds upon Anglo-American ideas of corporate governance. Very recent research, however, casts doubt on the effectiveness of the German code (Andres & Theissen, 2008; Nowak et al., 2005). Besides the concern that codes may not function as intended in bank-based systems, codes that draw heavily from the principal-agent perspective in agency theory – and de facto ignore institutional differences in business systems – may even prove counterproductive (e.g., promoting ownership concentration – a common agency theory prescription - in systems characterized by principal-principal conflicts) in many economies (Young, Peng, Ahlstrom, Bruton, & Jiang, 2008). Nevertheless, recent research shows that codes of good governance based upon the “comply or explain” principle have diffused widely around the world, and have been implemented and adopted by firms in bank-based, as well as, market-based business systems. By the end of 2005, 95 countries had issued codes of good governance, whereas only 13 countries had issued codes before 1998 (Aguilera et al., 2009; Zattoni & Cuomo, 2008).

This observation raises the question if this codification activity can be seen as evidence of a convergence trend of business systems towards the Anglo-American capital-market based model. Indeed, the chairman of the Baum commission, responsible for the development of the German code, argued that transferring typical Anglo-American corporate governance principles into the German business system would be a reasonable undertaking, because future convergence of investor protection standards in Germany and other continental European countries into the direction of Anglo-American company law can be expected (Nowak et al., 2005). However, there is a heated academic debate on the validity of this convergence hypothesis. The next section of the article will address this convergence-divergence debate and show that the observation of decoupling at the firm level can offer a way to visualize convergence processes.

DECOUPLING POLICY AND PRACTICE IN CORPORATE GOVERNANCE REFORM

Proponents of the convergence hypothesis, often found in the field of financial economics, typically argue that globalization in capital, product, and labor markets, the harmonization of accounting rules,

crosslistings, and a growing shareholder culture and ideology will inevitably lead to convergence towards the Anglo-American model (Coffee, 1999; Hansmann & Kraakman, 2001; Khanna et al., 2004).

Opponents of the convergence hypothesis, often scholars in the fields of sociology, political science, or law, put forward path dependence arguments and that as a necessary condition for convergence to occur, the potential benefits of the shift from one regime to another have to outweigh the actual benefits of control enjoyed by controlling shareholders (Bebchuk & Roe, 1999). Also, the embeddedness of corporate governance in a nation's institutional context (e.g., differences in property rights, level of economic nationalism, and differences in social norms) is argued to place strong limits on convergence (North, 1990; Whitley, 1992).

In the light of this divergence-convergence debate, Zattoni and Cuomo (2008), drawing from the law and finance literature (LaPorta et al., 1999; LaPorta, Lopez-de-Silanes, Shleifer, & Vishny, 1997; LaPorta et al., 1998), attempt to explain why codes of good governance are adopted in different business systems. The observation they make is that in contrast to countries with a common law system (i.e., proxy for strong investors' rights, dispersed ownership structure, and active capital market), civil law countries (i.e., proxy for weak investors' rights, concentrated ownership, and illiquid capital market) adopt codes later, issue a lower number of codes, and state more ambiguous and lenient recommendations. They arrive at the conclusion that the issuance of codes in civil law countries is driven more by legitimation or symbolic reasons than by efficiency reasons or intentions to substantively improve governance practices. This conclusion is supported by research on the politics of international standard setting in international relations and international political economy (Brown & Woods, 2007; Walter, 2008) that finds the adoption of corporate governance best practices issued by the OECD, the IMF, and the World Bank, organizations dominated by Anglo-American countries, to be frequently in form rather than in substance in many non Anglo-American countries. Especially after or during financial crises, the political and corporate elite in a country, national stock exchanges, and national financial authorities, concerned about the effectiveness and legitimacy of the national governance model, may import models of codes of good corporate governance from more successful business systems. However, firms within the domestic business system may either totally accept, fully reject, or as well modify these codes to fit them to their own situation in the local institutional context (Gordon & Roe, 2004; Walter, 2008). This implies that a focus on the divergence-convergence dichotomy at the country-level, and the research question of whether the phenomenon of convergence exists or not, falls short in taking into account the existing dynamics and underlying processes of simultaneous institutional pressures for change from external forces (e.g., global market integration or regulating authorities) and pressure for continuity from different corporate actors embedded in the local business systems (e.g., controlling owners, managers, influential shareholders and stakeholders). Only recently, a very limited literature has begun to address these simultaneous dynamics (Jackson & Moerke, 2005; Juergens, Naumann, & Rupp, 2000; Yeung, 2006; Yoshikawa et al., 2007). In the context of this article, it is important to recognize that the simultaneous and conflicting institutional pressures for change and continuity provide firms with some leeway in their strategic choice of compliance with codes of good governance. Supporting this argument, several firm level studies have found high levels of compliance with good corporate governance codes (Bozec, 2007; Collier & Zaman, 2005; Nowak et al., 2005; v.Werder et al., 2005), but other research also has found that firm compliance with codes may be merely in form rather than in substance (Ananchotikul et al., 2009; Buck & Shahrim, 2005; Romano, 2007; v.Werder et al., 2005). For example, Romano (2007) finds that 92 % of listed Italian companies adopt the corporate governance code of the Italian stock market and issue a declaration of conformity, in accordance with the "comply or explain" principle. However, after investigating the single provisions of the code, he finds that although firms formally follow the code by, for example, establishing audit committees, remuneration committees, and issuing a declaration to appoint independent directors, at the same time, in around 20 % of listed companies these committees did not hold any meetings and did not install independent directors. Similarly, Ananchotikul et al. (2009) characterize 12 % of listed firms on the Thailand stock exchange (SET) as "talk-only" firms regarding the compliance with codes of good governance. The authors define "talk-only" firms as firms that issue a declaration regarding their voluntary compliance with the SET code, based on the "comply or explain"

principle, but do not follow through in the adoption of policies related to shareholder rights and board independence. A similar observation could potentially be made for the German code of good governance. Although the German Ministry of Justice and the chairman of the code commission see evidence for the success of the code in its very high acceptance rate (i.e., declaration of conformity issued by well over 90 % of listed firms) (Nowak et al., 2005), several researchers are more skeptical and speculate that in the German case "...it cannot be entirely excluded that companies declare to comply with a certain standard, although their practice is actual different" (v.Werder et al., 2005, p. 185).

Despite these discrepancies, there is a lack of studies that go beyond merely descriptive analyses and seek to explain why some firms that have formally adopted a code of good governance decouple this policy from actual use (v.Ees & v.Witteloostuijn, 2007). Developing a theory to address this question is very timely because it "... directs the convergence-divergence debate not only to the formal institutional arrangements, but also to firm-level governance choice and response within the formal framework" (Yoshikawa et al., 2007, p. 983). As argued above, individual firms have some discretion in making strategic choices in response to institutional pressures for change and continuity. As the descriptive research depicted above shows, in the compliance with codes of good governance, some firms pursue a strategy in which they disguise nonconformity with codes of good governance behind a façade of acquiescence (Oliver, 1991).

The role of this behavior in corporate governance has been established by recent research (Fiss & Zajac, 2006; Fiss & Zajac, 2004; Wade, Porac, & Pollock, 1997; Westphal & Zajac, 1994, 1998, 2001; Zajac & Westphal, 1995). For example, Westphal and Zajac (1994) found that a large number of U.S. corporations adopt long-term incentive plans in CEO compensation but did not actually use them. Westphal and Zajac (2001) showed that in the U.S. decoupling is a common and a predictable occurrence in the domain of stock buyback programs. Fiss and Zajac (2004) found that firms in Germany proclaimed to support a shareholder value orientation but did not in fact do so. In this literature, decoupling is explained as an outcome of conflicting micro-political and macro-institutional processes.

This literature on decoupling provides an interesting perspective for the convergence-divergence debate and for the adoption behavior of codes of good governance on the firm level of analysis. Studying decoupling behavior on the firm level would also move the research focus from the binary convergence-divergence dichotomy at the country level to intracountry variation regarding substantial versus superficial convergence. The following section of the article will seek to identify and explain the antecedents of decoupling in the use of codes of good governance and to develop a model to predict under what circumstances firms are likely to pursue this strategy.

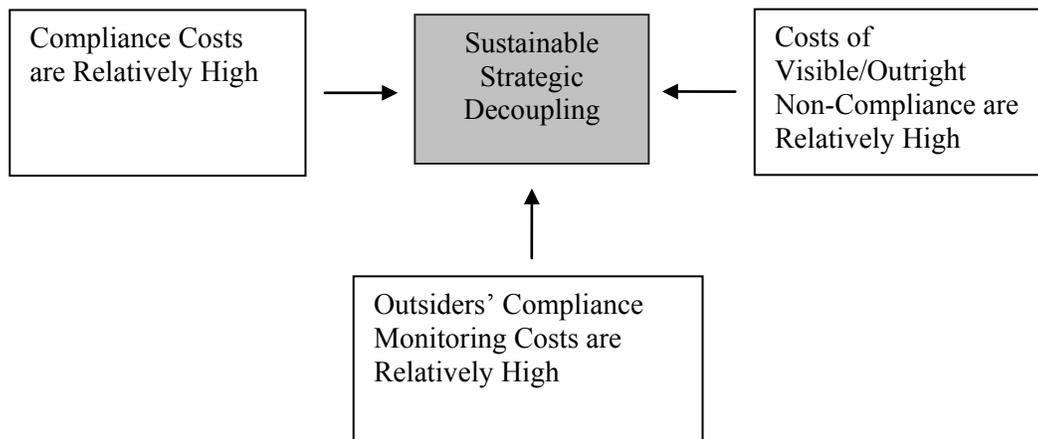
STRATEGIC DECOUPLING AS A RESPONSE TO CODES OF GOOD GOVERNANCE

A firm's adoption and implementation of a code of good governance can be explained by two main approaches: rationalist or efficiency and constructivist or legitimacy. Reasons of efficiency and legitimacy both compete with and also complement each other (Scott, 2001). Efficiency explanations of compliance with codes of good governance point to cost/benefit calculations by corporate actors. Legitimacy explanations suggest that codes of good governance are adopted because of their taken-for-grantedness, which makes adoption socially expected. These two explanations are not necessarily incompatible with each other because firms adopt practices for different reasons. There is evidence suggesting that both rationalist and constructivist reasons explain the adoption of organizational practices in corporate governance (Tolbert & Zucker, 1983; Westphal & Zajac, 1994). Tolbert and Zucker (1983), for example, note that efficiency appears to dominate the early adoption of practices, and legitimation, the late adoption. In the short to medium term it can be expected that cost/benefit calculations by corporate actors will drive the compliance behavior with codes of good governance. In the long term, it can be expected that shared norms among corporate actors and legitimacy reasons are the primary drivers of compliance with codes of good governance. This dichotomy between the efficiency rationale and the institutional rationale does, however, not mean that firms have no choice but to choose one or the other alternative. The notion of sustainable strategic decoupling introduces the potential for active firm agency

and recognizes that firms have discretion in making strategic choices in the compliance with codes. In taking into consideration the previously outlined functional assumptions and the subject matter of codes, the model presented below depicts under what circumstances firms may pursue a sustainable decoupling strategy in response to conflicting pressures in their institutional environment. I argue that firms formally adopt a code of good governance but decouple it from actual use when:

- (a) firms' compliance costs are relatively high,
- (b) firms' costs of outright and visible non-compliance are relatively high, and
- (c) outsiders' compliance monitoring costs are relatively high.

FIGURE 1
THEORETICAL MODEL OF SUSTAINABLE STRATEGIC DECOUPLING



The following paragraphs will describe and explain the elements of the proposed model.

Sustainable Strategic Decoupling

Strategic decoupling is defined here, following Meyer and Rowan (1977), Oliver (1991), and Westphal and Zajac (1994) as the combination of outward appearance of compliance with codes of good governance (i.e., issuing of a declaration of conformity) together with hidden behavioral divergence (i.e., not following through with recommendations). This strategy may be pursued by firms who seek to concurrently avoid the costs associated with outright and visible non-compliance with codes and the costs of substantive compliance with codes. External sources of pressure to adopt codes (e.g., global market pressure, official pressure, normative pressures) can make it very costly for firms and corporate actors to openly oppose compliance. At the same time compliance with codes can be very costly for firms and corporate actors (e.g., recommendations may restrict owners' control rights or influence managers' discretion or private gains). Firms caught between these contradictory pressures are likely to pursue a decoupling strategy. Strategic decoupling that is *sustainable* and viable over long periods of time places the strongest obstacles to deep and substantive convergence. Decoupling strategies are more sustainable when it is very costly for outsiders and market actors to monitor the quality of compliance and to use this information to discipline firms to follow through with the codes' recommendations. This argument stresses that convergence in corporate governance codes may be far from a straightforward linear process and that the resilience of different varieties of capitalism may be significant. The following paragraphs will focus the antecedents of sustainable strategic decoupling.

Firms' Compliance Costs

The substantive compliance with codes can entail significant costs for firms (Aguilera, Filatotchev, Gospel, & Jackson, 2008). Code compliance, however, is a multidimensional concept as codes contain

many different best practice provisions. Therefore, studying compliance costs at the aggregate level of the code would lead to mixed results. Instead, a more informative approach would be to separate costly and non-costly code provisions for firms. The costs of code provisions for firms can be examined regarding two characteristics: (a) direct systemic costs (i.e., out-of-pocket expenses associated with routine compliance with codes that demand human, physical, and financial resources including, for example, publication and dissemination of a declaration of conformity, webcasting meetings, hiring internal auditors) and (b) indirect opportunity costs that impact the strategic priorities, political influence, and discretionary decision making power of corporate actors (i.e., managers, directors, and controlling owners/shareholders).

Direct systemic costs may be relatively higher and more difficult to absorb for small firms with a small resource base and firms that face pressure to reduce operating costs compared to large firms and firms that perform well. However, for other provisions, costs may largely be dependent on the extent to which the provisions affect the controlling shareholders', managers' and directors' political and discretionary decision making powers and mental models.

Substantive compliance with codes may be highly costly for those owners whose control over cash-flow rights exceeds their control over share ownership. The dominant form of corporate ownership outside the U.S. and the U.K. is family-controlled firms (Morck, Wolfenzon, & Yeung, 2005). Related to this, the literature on corporate finance shows that, non-financial firms and banks often are part of the same larger family-controlled groups (LaPorta et al., 1999). High ownership concentration may provide the controlling owner with the incentives and means to entrench himself and/or to exploit minority shareholders by diverting assets and profits (i.e., the principal-principal conflict). Insiders may find it very costly to substantively adopt code provisions that demand transparency and expose such exploitation. However, corporate law can promote the continuance of a business system's corporate ownership pattern and codes may stand in open contradiction to hard law (Bebchuk & Roe, 1999). For example, the Austrian Code of corporate governance includes and restates the country's "Squeeze-out of Shareholders Act" that, as research has demonstrated, clearly puts minority shareholders at a disadvantage ("Austrian Code of Corporate Governance," 2007; Gugler, 2001).

In examining ownership patterns it is important to take into account the identity of the owners (e.g., institutional investors, banks, families, other (non)financial companies, governments, foreign investors) as this can have implications for their assessment of costs regarding substantive code compliance (Thomsen & Pedersen, 2000; Wahl, 2006). For example, while perhaps the most important economic benefit of complying with codes of good governance is access to capital markets on better conditions, bank-owned firms have (at least partly) internalized their banking relationships and have privileged access to capital. These firms may perceive compliance as relatively costly if it does not significantly reduce the firm's cost of funds.

Substantive compliance may also be highly costly to powerful executives (i.e., managers and directors) when provisions affect their political or discretionary decision making power. Van Ees and Van Witteloostuijn (2007) differentiate between managerially accepted provisions (e.g., supervisory board self-evaluation), managerially debated provisions (e.g., director independence), and managerially contested provisions (e.g., disclosure of individual executive remuneration or regulation of the length of top management team (TMT) contracts). Each category of provisions can be conceptualized in terms of costs that executives would perceive to incur when following them. Managerially contested provisions directly and negatively affect the executive and would be perceived as being costly.

However, it is important to recognize that the assessment of compliance costs has a subjective and cognitive underpinning (Fiss & Zajac, 2004; MacNeil & Li, 2006). The cognitive aspect of the assessment of costs related to the adoption of codes and the move towards shareholder value orientation may be reflected in corporate actors' mental models of the corporation. The literature offers support for the importance and the persistency of mental models in influencing an actor's assessment of novel governance models (Daft & Weick, 1984; Fiss & Zajac, 2004; Sanders & Tuschke, 2007). For example, top managers in Germany, Korea, Japan, or Taiwan who are socialized into firms through a highly developed system of vocational education and training may have formed a productionist, company-

centered management identity and value orientation. Those actors are likely to perceive code provisions that, for example, aim at increasing outsiders on boards as very costly and inefficient. Their mental models may favor reliance and trust in insiders with experience and information about the firm.

In sum, code provisions do not only represent direct systemic costs related to the amount of resources firms have to spend to comply with a code. Code provisions also represent costs related to the discretionary decision making power and political influence and to the mental models of powerful corporate actors. Clearly, path dependencies and forces of institutional continuity influence the perceived and the real costs of compliance with codes of good governance for firms and corporate actors.

The question that arises here is that when compliance with codes can be costly for corporate actors, why and under what circumstances could high compliance rates with codes nonetheless be observed? An answer to that could be that firms adopt codes in form rather than in substance, if the perceived or the real costs of visible and outright non-compliance are relatively high.

The Costs of Visible and Outright Non-Compliance

Several studies have reported high levels of code compliance (i.e., dissemination of a declaration of conformity) by firms within different stock indices across a variety of business systems and have rarely presented examples of firms that adopt explicit strategies of non-compliance with codes (Bozec, 2007; Collier & Zaman, 2005; Nowak et al., 2005; v.Werder et al., 2005). Although it may be difficult to exactly quantify the costs of outright and visible non-compliance, it appears that firms generally perceive these costs to be high. Two of these cost sources that stem from pressures for compliance with codes are highlighted in this section of the article: (a) costs that stem from international market pressures for compliance and (b) costs related to domestic normative pressures for compliance.

Various researchers have argued that international market pressures push firms towards compliance with established Anglo-American international corporate governance practices (Coffee, 1999; Hansmann & Kraakman, 2001; Khanna et al., 2004). Compliance pressures can work through different mechanisms related to capital, product, and labor markets.

The roles of the U.S. and U.K. capital markets are often emphasized. Firms can raise capital in these highly liquid markets by directly issuing equity or by cross-listing their shares via different types of American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs). By listing in any of these countries' stock markets, firms come under pressure to follow the markets' SEC requirements and to comply with internationally recognized corporate governance codes to signal investors their creditworthiness and their intentions to pursue good corporate governance practices. Outright and visible non-compliance with codes would signal the exact opposite and would be costly in terms of failing to invoke investor confidence and to raise capital. Capital market pressures for compliance also arise when financial institutional investors from these markets are directly investing in foreign. These investors may pressure firms to comply with codes with which they are familiar. Outright and visible non-compliance with codes can also in this case be highly costly for firms if it deters investors to provide capital.

The roles of international product and labor markets as sources of pressure towards convergence are less emphasized (Khanna et al., 2004). If firms attempt to integrate themselves into a marketplace in which Anglo-American governance practices prevail, the cost of doing business would be greater if firms do not conform to these governance practices. Customers and suppliers may positively assess the creditworthiness of a firm if it declares compliance with a code of good governance that reflects domestic governance practices. Similarly, firms that seek to attract workers from business systems like the U.S. or the U.K. may provide code compliance declarations as a signal to prospective employees that the firm is governed in a manner with which they are familiar. Outright and visible non-compliance with codes may be very costly for firms that are engaged in cross-border product or labor market interaction with business systems close to the Anglo-American style.

Besides international market pressures, firms also can face and incur costs related to domestic normative pressures for compliance with codes. Once a code is issued it becomes a source of normative pressure in a business system and firms and corporate actors may incur costs by outright and visible deviation from the norm. Managers are inclined to comply with codes because they want their firm to

have a positive reputation and adhere to institutionalized organizational practices to maintain support from the environment (Meyer & Rowan, 1977; Pfeffer & Salancik, 1978). The declaration of conformity with a code is usually published in a firm's annual report, which is a highly visible document. Stakeholders' perception of a firm's reputation is strongly influenced by this presentation (Laan, 2009) and creditors, shareholders, customers, employees, governments and others may support or not support the organization upon their perceptions. Outward and visible non-compliance with a code may lead a firm to a reputation of being not well-governed and consequently to lose stakeholder support that can negatively materialize. Also, if non-compliance with codes causes a conflict with a powerful stakeholder, this stakeholder can be expected to call for more hard law and costly and potentially intrusive mandatory legislation on the issue.

In sum, firms that explicitly resist compliance pressures for code adoption can incur substantial costs of non-compliance in a variety of ways. Clearly, forces of institutional convergence influence the costs of non-compliance with codes of good governance for firms and corporate actors. Although these compliance pressures might push firms to formally comply with codes, at the same time, compliance with codes can be very costly. Firms and corporate actors that are caught between these pressures may judge that they can avoid both the costs of substantive compliance and of outright and visible non-compliance by adopting a decoupling strategy. If, under such circumstances decoupling strategies are attractive, the question becomes: When will decoupling strategies be sustainable? This is a central question to be addressed in the convergence-divergence debate as it relates to the path and form of the convergence process and to the question of whether deep convergence is only a matter of time.

Asymmetries in Compliance Monitoring and Difficulties in Enforcement

Decoupling strategies will be more attractive and more sustainable when outsiders and market actors find it very difficult or costly (a) to monitor and observe the true quality of compliance and (b) to use this information to punish non-compliance behavior. While the disclosure of compliance is often a legal requirement, a fundamental functional assumption of codes is that monitoring and enforcement will occur through an efficient capital market (Nowak et al., 2005). As argued above, code acceptance may not necessarily be a proxy for actual compliance with provisions. It may merely be a costless box-checking exercise for firms if market actors find it difficult or incur high costs in monitoring actual compliance behavior (e.g., appointing independent auditors and convincing firms to let them do the audit). Given that firms may have strong incentives to conceal the real quality of compliance and to minimize both internal, as well as, external inspection and evaluation, observing actual compliance, is far from easy, even for relatively sophisticated market players (Walter, 2008).

As codes of good governance become instilled with value (i.e., why would codes of *good* governance be bad) and become taken-for-granted by the firms' stakeholders (incl. capital market actors) in the institutional environment, their collective action will be governed by a "logic of confidence and good faith," (Meyer & Rowan, 1977, p. 357) whereby they accept on faith that firms are behaving in accordance with the legitimate goals of the code. In such an environment, firms tend to avoid inspection and evaluation of code compliance because it could uncover deviations that undermine legitimacy. But also stakeholders who may themselves be actors in the same institutional environment avoid inspection and evaluation of code compliance because it would violate the assumption of the "logic of confidence and good faith" (Meyer & Rowan, 1977). There is evidence that investors "overlook" to evaluate the true quality of code compliance, if breaking with the prevailing institutional logic makes this attempt difficult and costly to pursue (Walter, 2008).

Even if non-compliance is observed by outsiders or market participants there are several factors that can impede the enforcement of the codes: For example, the type of jurisdiction within in a business system can limit the efficiency in the application of codes of good governance (LaPorta et al., 1998). In civil law countries, as opposed to common law countries, judges cannot enforce the application of the codes with the force of regulation. In civil law systems laws and practices can only be developed and codified in parliaments (Cuervo, 2002). Related to that, recent research shows that the U.S. SEC has rarely been able and willing to enforce U.S. securities laws against any U.S. cross-listed foreign firm

because of numerous legal and institutional obstacles (Siegel, 2005). This finding weakens the predictive strength of the functional convergence hypothesis (Coffee, 1999) and shows that firms have potential leeway for strategic and sustainable decoupling.

The implications of the arguments in this section are clear. When outsiders' monitoring costs are high and code compliance cannot be enforced, decoupling in the compliance with codes of good governance can be a sustainable and viable strategy over time. This also implies that convergence in corporate governance codes is far from a straightforward linear process, and deep convergence may be not only a matter of time.

CONCLUSION

The question of convergence of corporate governance systems, policies, and practices has attracted much research attention and caused heated academic debates. This article suggests that an instructive approach to address this question, and to move the debate forward, would be to simultaneously consider the drivers of convergence and the impediments to convergence in theoretical models. In doing so, research will be moved away from an overly simple "either or" debate (Bebchuk & Roe, 1999; Coffee, 1999), to the more challenging question as to how to interpret firms' balancing acts of continuity and change. Ultimately, to fully understand convergence processes in corporate governance it is important to address this issue at the firm level of analysis. The rapid diffusion of codes of good corporate governance offers researchers an opportunity to study convergence processes at the firm level. The notion of sustainable strategic decoupling - as a viable firm strategy in managing simultaneous pressures for continuity and change - suggests that convergence in regard to codes of good governance may in many instances merely be in form rather than in substance. The presented model seeks to explain this strategic choice in the compliance with codes and shows that compliance is not just an economic issue or an issue that is largely driven by macro-level (institutional) factors, but also shows that the issue touches on internal organizational dynamics. Further research building upon this framework will lead to a more differentiated and more skeptical view on convergence processes and will aid in preventing to mistake formal actions with substantive and deep changes in corporate governance.

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