DOI:
10.1111/corg.12067

National Governance Bundles Perspective: Understanding the Diversity of Corporate Governance Practices at the Firm and Country Levels

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Introduction

Corporate Governance: An International Review was founded in 1992, and its mission is to develop a rigorous and relevant global theory of comparative corporate governance. Over the past twenty years (or twenty-two years), this journal has grown in reach and reputation. To commemorate its 20th Anniversary and by the initiative of its former editor William Q. Judge, the journal held a special conference in Cambridge, England in September, 2012. The co-sponsors of this conference were the Judge Business School (University of Cambridge) and the publisher of CGIR, Wiley Publications.

The theme of the 20th CGIR Anniversary Conference was National Governance Bundles (NGB) and this special issue publishes the best articles presented at the conference, as well as commentaries by two distinguished keynote speakers of the conference. In all, 137 abstracts were submitted to the conference. Of these, 70 were accepted for presentation at the two-day conference in Cambridge. Of the conference presenters, 24 were invited to submit their articles to a blind review for publication in CGIR. This issue features the five articles accepted for this special issue. In line with the journal's mission, the aim of the conference and this special issue is to advance our understanding of the interplay between firm- and national-level governance mechanisms, and its effects on firm outcomes. We named it National Governance Bundles (NGB) Perspective as it combines insights from the literature on firm-level governance bundles with insights from the national governance systems literature.

Defining National Governance Bundles

Although the idea of complementarity and substitutability among control mechanisms can be traced back to the work by Milgrom and Roberts (1990, 1995), the concept of "bundle of governance mechanism" was introduced in the governance literature by Rediker and Seth (1995). Complementarity

implies synergetic effects among activities and provides the basis to understand how various elements of the organizational architecture (e.g., strategy, structure, processes, information, and control systems) are interrelated and interdependent (Milgrom and Roberts, 1990). Accordingly, two governance mechanisms are complementary when the adoption of one increase the marginal returns of the other and vice versa. In contrast, the substitutability effect refers to the direct functional replacement of one mechanism by the other, while the overall functionality of the system remains unaffected (Aguilera, Desender and Castro Kabbach, 2011).

The complementarity and substitution perspectives among governance mechanisms has provided the theoretical basis for the configurational approach in comparative governance research (Aoki and Jackson, 2008; Aguilera, Filatotchev, Gospel and Jackson, 2008). This approach has motivated most of previous studies about firm-level governance bundles, which provide relevant insights about why different configurations of governance practices at firm-level may lead to similar firm outcomes (Rediker and Seth, 1995; Hoskisson, Castleton and Withers, 2009; Ward, Brown & Rodriguez, 2009; Garcia-Castro, Aguilera and Arino, 2013). These studies, however, have mainly examined firm-level complementarities and substitutions among internal corporate governance mechanisms (firm-level governance bundles) with limited consideration of the national context.

Filatotchev, Jackson and Nakajima (2013) outline an emergent stream of research which argues that understanding how corporate governance differs around the world requires a more rich and comparative view of institutions. In particular, they argue that the nature of governance conflicts, and the effectiveness of well-known corporate governance practices, differs across countries due to broader sets of complementarities among institutions within the particular social and political environment. In developing these arguments, they illustrate how performance effects of corporate boards, ownership concentration and executive incentives may differ according to the legal system and institutional characteristics in a specific country. Institutions may also affect the extent of complementarity or substitution among different firm-level governance practices. Their discussion suggests that researchers need to develop a more holistic and institutionally embedded theoretical understanding of corporate governance to analyze the organizational outcomes of various governance practices. The contribution of this perspective is to go beyond more universalistic approaches, which apply models such as agency theory in the same universal manner in different institutional settings.

Bell, Filatotchev and Aguilera (2014) suggest a "nested model" of corporate governance within which the process of legitimization through governance may be "nested" within a broader context of investors' perceptions of the legitimacy of institutions associated with the firm's home country. The nesting of firm-level governance with country-level institutions and the associated complexity it creates represent an important boundary condition that affects the firm's process of legitimization through firm-level governance in the eyes of investors. Although some recent studies emphasize this "nested" nature of cognitive and regulatory institutional factors (Greenwood, Diaz, Li, & Lorente, 2010), there is scarce research on their intersection in the context of corporate governance and capital markets. Bell et al. (2014) extend further research of neo-institutional theorists who argue that regulatory institutional logics hold a preeminent place in shaping organizational legitimation (Deephouse & Suchman, 2008), chiefly in the realm of corporate governance. In a similar vein, Moore, Bell, Filatotchev and Rasheed (2012) explore legitimacy aspects of a "fit" between firm-level bundles of corporate governance and national formal and informal institutions in their study of foreign initial public offerings (IPOs) in the US and UK. They advance a comparative institutional perspective to explain capital market choice by firms making an IPO in a foreign market and find that internal governance characteristics and external network characteristics are significant predictors of foreign capital market choice by foreign IPO firms. The authors' results suggest foreign IPO firms select a host market where the firms' governance characteristics and third party affiliations fit the host market's institutional environment.

According to North's (1990) well known framework, country's combination of informal and formal institutions guides individuals and organizations in dealing with uncertainty, decoding the environment, and taking appropriate actions. From a country's perspective, therefore, corporate governance systems are seen as the means by which a nation channels corporate power for the good of society so that wealth is created efficiently and distributed fairly within a national economy (Judge, Douglas and Kutam, 2009). This perspective has motivated cross-national governance research, which has also incorporated the logic of configuration at the national level. This research, however, has attempted to explain firm outcomes focusing on national-level complementarities among governance forces external to the firm (e.g., Millar, Eldomaty, Choi & Hilton, 2005; Weimar & Pape, 1999) with limited consideration of its interaction with firm-level governance mechanisms.

We believe that these promising streams of governance research have yet to converge and inform each other (Judge, 2009; Judge, Filatotchev, and Aguilera, 2010), which is the main objective of this special issue. The National Governance Bundles perspective finds support on Aoki and Jackson's (2008: 2) framework to understand diversity of corporate governance, which suggests that "*there are various patterns of linkage between CG (corporate governance) mechanisms (institutions) and organizational architecture (OA) as non-market information system, the workings implication of which cannot be adequately understood only in terms of the standard framework.*"[1] Thus, in elaborating this special issue we view corporate governance systems as comprising bundles of interrelated or even intertwined external (country-level) and internal (firm-level) forces, which provide structures and processes of the relationship between firm's management and stakeholders, most commonly owners. The historical path dependence among such mechanisms has resulted to a variety of country and organization type specific governance solutions which fit well within the context they evolved (i.e. current legislation, national culture and ownership structure of the organization) and both complement and substitute each other (Roe, 2005). Therefore, these combinations can be seen as National Governance Bundles (NGB), which means configurations of governance mechanisms that simultaneously operate at the firm- and national-levels to govern firms within an overall economy or collection of economies. It is worth noting that we see national governance bundles as distinct from firm-level governance bundles (e.g., Aguilera et al. 2011) and national governance systems (or country-level systems of corporate governance) (e.g., Millar, Eldomiaty, Choi and Hilton, 2005), while the former comprises only complementarities and substitution among firm-level governance choices, the last focus on exclusively on country-level governance systems.

National Governance Bundle Perspective and Firm Outcomes

Understanding how national and firm-level governance mechanisms interact to influence firm outcomes has implications for governance theory and practice for several reasons. Across the globe, the trend towards increased country-level governance legislation and more elaborate firm-level governance codes continues in response to corporate scandals, the global financial crisis and the opening of markets in

[1] It is worth noting that by "standard," Aoki and Jackson (2008) referred to the traditional economic and micro-level agency perspective where CG is viewed as simply dealing with the ways in which suppliers of finance to corporation assure themselves of getting a return on their investment.

developing economies. Advocates of these reforms often view increased corporate governance regulation as good by definition and able to halt risk, corporate malfeasance, excessive executive compensation, and earnings management by its mere implementation. Clearly, formal governance regulations and informal codes play a valuable role, but trade-offs among national and firm-level governance mechanisms exist.

More intriguing, the current wave of such governance reforms seems to follow similar pattern across countries and continents. They tend to equally promote the fiduciary duty of the board of directors, the level of mandatory disclosure of financial information and executive compensation, the say-on-pay by minority shareholders, or the respect of one-share-one vote rule. Nevertheless, the nature of agency costs differs across national systems of corporate governance and within firms operating under the same national governance system (e.g., Garcia-Castro, Aguilera and Arino, 2013). The implications are that governance reforms that work well in one context might not be as effective in another context. Firms' ownership structure and the value-relevance of financial information for monitoring purposes are good examples. These firm-level governance attributes vary across firms within the same national systems, resulting that a national legislation increasing the level of mandatory financial disclosure may not provide the same level of constrain on managerial discretion across firms. Likewise, enhance board effectiveness or the fiduciary duties of directors in countries where employees are well represented in the board and the corporate law requires split between management and supervisory boards, may require a different approach than the traditional Anglo-Saxon context. Accordingly, under the national governance bundle perspective the effectiveness of corporate governance configurations is assumed to be contingent upon a fit between national- and firm-level mechanisms. Hence, the construction of national- and firm-level governance bundles and the understanding of how such bundles affect firm outcomes is a promising research field.

It is from this perspective that the five articles and two commentaries published in this special issue help us to better understand how firm outcomes are contingent to the fit between firm- and national-level governance mechanisms. Each of the articles investigates a specific set of firm- and country-level governance mechanisms and demonstrates that they combine into bundles either to address different agency problems or to compensate for weak national environments. They also demonstrate that the bundles perspective is a promising approach to better understand firm governance outcomes. These

articles give a good overview of the state of research on national governance bundles and also illustrate avenues for future research and development. In the next paragraphs we summarize each of the articles included in this special issue.

Vanacker, Heughebaert, and Manigart (**Institutional Frameworks, Venture Capital and the Financing of European New Technology-based Firms)** examine how shareholder protection and personal bankruptcy laws on the national level affect financing choices of new technology-based firm (NTBFs) and interact with venture capital funding on the firm level. In an analysis of 6,813 NTBFs in 6 European countries, the authors find that better shareholder protection are associated with increased equity financing and less forgiving personal bankruptcy laws with decreased debt financing. They further find that venture capital funding on the firm level strengthens these relationships, interacting with the national system in a complementary way. Venture capitalists, they argue, are effective monitors and also bring good corporate governance practices to a firm, but are only able to play this role in a national environment of strong shareholder protection and entrepreneur-friendly bankruptcy laws. By showing that firms access to capital is affected by a national governance bundle, combining legal systems at the national level and venture capital at the firm level, they bring new insights to research on entrepreneurial finance, and to corporate governance in private companies.

Driffield, Mickiewicz and Temouri (**Institutions and equity structure of Foreign Affiliates)** examine how national- and firm- level factors affect the division of equity stakes between foreign majority and local minority owners in multinational enterprises, using a large sample of foreign affiliates in 16 Central and Eastern European countries. They argue that a minority ownership stake provides a local partner with appropriate incentives when local national institutions fail to protect foreign majority investors and when firm specific firm attributes, such as a high ratio of intangible assets, increase information asymmetry between shareholders and management. They show that foreign majority owner consciously selects the ownership structure, using a minority stake as a governance mechanism that substitutes for effective governance systems at the national level, and addresses the agency problems stemming from intangible assets. National- and firm- level factors have independent effects on the incentive effect of minority ownership stakes, and that consequently, there will be variation in ownership structure of foreign affiliates both within and between countries.

Aslan and Kumar (**National Governance Bundles and Corporate Agency Costs: A cross-Country Analysis)** point out that a bundles approach can also be used to simplify and tighten analysis of the national governance environment and its effect on firm level governance configurations. They use a unique firm-level and longitudinal dataset of international syndicated bank loans and ownership structures from twenty-two major European and Asian countries. They develop a theoretical model which features a Corporate Information Quality (CIQ) bundle composed by national governance mechanisms that impact the information asymmetries between insiders and outsiders, and a Creditors Rights and Debt Enforcement (CRDE) comprising national governance mechanisms that constrain large shareholders moral hazard. Their results suggest that the strength of CIQ and CRDE bundles have direct effects on firm's cost of debt but also indirectly through constrains on controlling shareholders' discretion. This study further supports the view that firm outcomes depend on the potential substitution effects between national- and firm-level governance mechanisms. Precisely, Aslan and Kumar show that these bundles impact dominant shareholders' choice between greater equity control and the level of external monitoring by debt holders

Yoshikawa, Zhu, and Wang (**National Governance System, Corporate Ownership, and Roles of Outside Directors: A Corporate Governance Bundle Approach)** develop a conceptual model of NGBs that combine national governance institutions with ownership structure on the firm level, and posit theoretical mechanisms that link these to a firm's choice of board structure. They identify three types of corporate ownership: dispersed ownership, concentrated family ownership and concentrated state ownership, which interact with under-developed and well-developed national governance systems, to determine the role of the board of directors. Yoshikawa, Zhu and Wang combine agency theory and resource dependence theory, noting that boards serve not only as monitors but also as resource providers, and show how NGBs that combine national governance environment with ownership structure determine the predominant role the board of directors plays within the firm. The model emphasizes the divergence in interests between different stakeholders, and in particular, a substitution effect between the external monitoring of independent outside board members and the internal monitoring by majority shareholders. A key insight from this article is the importance of understanding power on the part of the majority shareholder, and the degree to which national institutions may constrain majority shareholder discretion.

Kim and Ozdemir (**Structuring Corporate Boards for Wealth-Protection and/or Wealth-Creation: The Effects of National Institutional Characteristics)** similar to Yoshikawa et al. also base their analysis on the insight that boards of directors have both monitoring and resource provision functions, which they conceptualize as wealth protection and wealth creation. In an empirical study of boards of 5963 firms in 23 countries, they find evidence that national governance systems affect board function as wealth protectors or wealth creators. They argue that institutional characteristics at a national level affect the cost and benefits of different functions of the board, and theorize on how board composition is a substitute or a complement to features of national institutions that constrain or enable managerial and majority shareholders discretion. They find, for example, that investor protection and wealth-protecting boards are complements, while rule of law and wealth protecting boards are substitutes. Open markets complement both wealth-protecting and wealth-creating boards. The strength of this approach is its careful consideration of the conditions under which national institutions and firm level governance structures are substitutes or complements.

Current state and future directions in NGB research

These five articles highlight the interaction between national institutions and firm-level governance practices, and show the benefits of a NGB perspective. They show how firms choose governance structures in the context of national governance institutions, to either substitute for weak institutions, or to complement strong ones, and that firm outcomes, such as cost of capital, are affected by these interactions. They illustrate how variation in firm characteristics, such as ownership or nature of assets, interact with national institutions, and lead not only to cross-national differences, but also to within country variation in governance choices. These articles also highlight the challenges in conducting NGB research, illustrating the wide range of firm-level and national-level features that must be considered, and highlighting the theoretical difficulty of specifying the mechanisms by which national and firm level features substitute for or complement each other. These articles suggest that while the NGB approach is extremely promising, we are just at the beginning and there is much more to do empirically and theoretically. We believe that these articles point to several directions in which the NGB perspective can be further developed.

One area in which the NGB perspective can be further developed is to take further into account informal institutions. The articles included in this special issue tend to conceptualize national institutions of governance in similar terms: investor protections, for example, or rule of law. Missing are informal institutions, such as voluntary codes, social norms, relationships and networks. There is good reason for this—specifying and theorizing about interactions between firm and national level attributes is challenging and difficulties for measuring and conceptualize the monitoring forces of informal institutions make things even more difficult. Future NGB research can also explore attention to formal institutions, that are usually not considered in an agency theory based approach to comparative corporate governance, such as mandated employee representation on boards or management and directors labor market.

Given that corporate governance research relies primarily on the divergence of interests between the principal and the agent, another possible vein for future research on NGB is to further develop the theoretical grounds for the interplay between firm- and country-level governance mechanisms and how this affects choice of firm level governance practice and firm outcomes. Along this line, the work by Hambrick and Finkelstein (1987) suggesting that managers' degree of discretion, or latitude of managerial actions, emanates from three loci: the individual (e.g., political acumen), organization (e.g., board of directors), and the environment (e.g., industry regulation) can be a starting point. Further, the conceptual study by Crossland and Hambrick (2007) extends this previous work and demonstrate that managerial discretion also differs among countries due to the disciplinary forces of national formal and informal institutions. In other words, firms are embedded in a system of social norms, practices, and relationships—or national governance system—that impose both constraints and enablers on managerial and large shareholders discretion. Hence, the effectiveness of specific governance mechanisms or firm-level governance bundles needs to be examined within the intended level of constraint on managerial discretion.

Another issue that needs to be further developed is the conditions that enhance the relationship between the national and firm level mechanisms. The articles in this special issue show a wide range of different ways in which the two can be related but does not cover all potential interactions. The studies by Driffield et al. and Aslan and Kumar look at how national systems affect the discretion of shareholders to choose different levels of equity and debt and the governance forces inherent in these choices.

Yoshikawa et al. suggest that national systems affect who makes the decisions—the discretion of controlling shareholders versus other stakeholders or shareholders—and how this power distribution affects the composition and role of board of directors, while Kim and Ozdemir look at how national systems and board role are linked as complements or substitutes. Vanacker et al. examine how national systems affect firm's choice in terms of financing and the governance shortcomings of venture capitalists. More research needs to be done on these interactions but also in the interactions with firm-level attributes that warrant the governance effect of these mechanisms. For example, the assumed monitoring forces of independent outside directors, debt holders or even external equity holders relies on the level of firm's transparency and quality of its financial information.

In the same line, underrepresented in our sample of articles for the conference and this special issue is work that brings in an additional variable of variation across firms—how differences in firm level factors, such as voluntary disclosure, performance contingent compensation, or board expertise will lead to different bundles—enabling us to see variance within and across countries. Exceptions include Vanacker et al. which consider this with the presence of venture capitalist and Driffield et al. with firm's level of intangible assets, for example. Yet, we see less of this—perhaps because of its difficulty to reliably observe this extra variable or measure it in terms of firm specific differences in a cross national setting. It is also difficult empirically to tease out causality and relationships when, for example, national systems are found to be related to variation in ownership and ownership in turn interacts with national system to lead to different outcomes.

Filatotchev et al. (2013) argue that a comparative approach must go beyond a thin view of institutions as simply increasing or decreasing agency costs. Rather, a thicker understanding of institutions is needed to identify the salient dimensions along which institutions vary and how these mediate the effectiveness of corporate governance practices. While many single country case studies have generated substantial insights into locally diverse institutions, a large gap remains in systematizing this knowledge and developing a more theoretically informed comparative understanding of institutions. For example, future studies may compare the governance role of executive compensation in different contexts of emerging economies, such as family controlled firms in India or state-controlled Chinese and Russian companies. Similarly, it is important to understand what factors underpin board effectiveness in various institutional contexts. For example, do independent directors perform significant governance roles in

family controlled firms in South-East Asia and India or in state-controlled but publicly listed companies in Russia and China?

Finally, also absent from the articles in this special issue and relevant avenue for future research is the association between NGB and firm performance. Understanding whether and how different national governance bundles lead to higher firm performance or—like Ward et al. (2009)—whether firm performance act as a mediator of how monitoring forces of national and firm-level mechanisms interact, can be a fruitful areas for future research on the topic of NGB. However, an integration of institutional theory and corporate governance studies when exploring organizational performance requires new research methodologies. The main bulk of corporate governance literature uses published data from company accounts, or relies on surveys of companies or investors. Much of this research attempts to link the presence of particular corporate governance practices (e.g. board structural characteristics, ownership patterns, etc.) with the economic performance of companies (e.g. share price performance or profitability). One extension to this approach would involve drawing on new innovations in social science, such as set theoretical methods and configurational approaches to organization to examine how corporate governance factors combine and produce different outcomes in different institutional contexts.

For example, by using Fuzzy Set Qualitative Comparative Analysis (fs/QCA) Bell at al. (2014) make a methodological contribution which, in turn, helps our theoretical understanding of the legitimization process associated with different firm-level governance factors in diverse institutional environments. The authors utilize fs/QCA because its intent is not to isolate the net, independent effects of single variables on a particular outcome but rather to identify the combinations of variables that bring about the particular outcome in question. By leveraging fs/QCA's configurational approach, they have been able to relax some of the assumptions normally associated with the quantitative techniques inherent to most empirical governance research, such as permanent causality, additivity, and causal symmetry. Another extension is the need to examine how regulatory and informal institutions impact the processes of corporate governance itself. Such process-oriented research would incorporate a more qualitative understanding of governance outcomes and take greater account of the actual behavior of key participants.

An important correlate to more comparative and institutional views of corporate governance is the necessity to collect and triangulate data from a variety of sources – such as combining statistical studies based on surveys and published information with follow-up of semi-structured interviewing about processes and case studies that look at how these processes interact. While the search for comparative qualitative data about corporate governance poses many new research challenges, we submit that this future research agenda will lead to better answers to many research questions and help provide a more realistic and policy relevant understanding about what makes corporate governance effective.

Conclusion

The NGB perspective on comparative corporate governance remains in its infancy. The articles and commentaries included in this special issue demonstrate the promise of NGBs, and also hint at how much empirical and theoretical work remains to be done. Taken as a whole, they show how attention to the interplay between firm- and national-level governance mechanisms enriches our understanding of comparative corporate governance and helps to identify how and why governance practices vary both across and within national systems. We hope that this special issue will encourage other researchers to adopt, and further develop the NGB perspective in their own work, and that the articles presented here will inspire new ideas, approaches, and debates.

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