Corporate governance & convergence

in cross-border mergers and acquisitions

P.J.A. Goorhuis Msc

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Supervisors
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MANAGEMENT SUMMARY

The purpose of this research is to investigate whether there are actual signs of corporate governance convergence through cross-border mergers and acquisitions. This study used a qualitative method of case studies to investigate this question. In total, four cross-border case studies were executed.

The search for an answer on this question has been guided by a combination of three indicators of corporate governance: accounting and disclosure standards, shareholder rights and board structure and functioning. Furthermore, it was tried to determine what form of convergence was applicable by using a convergence typology created by Gilsson (2001): functional convergence, when existing governance institutions are flexible enough to respond to the demands of changed circumstances without altering the institutions' formal characteristics; formal convergence, when an effective response requires legislative action to alter the basic structure of existing governance institutions; and contractual convergence, where the response takes the form of contract because existing governance institutions lack the flexibility to respond without formal change, and political barriers restrict the capacity for formal institutional change.

This research suggests that cross-border mergers are a way to contractually transfer corporate governance systems. There are also signs of formal convergence. It is quite common in a cross-border merger for the target to adopt the accounting standards, disclosure practices and governance structures of the acquirer. However, there are also hybrid possibilities in which the most protective corporate governance arrangements of both companies are incorporated.

Especially in the case of Chile’s institutional environment it became apparent that quite some legislative action was undertaken to create an institutional setting that would create a valuable foreign investment climate. From the results of the case studies it can be learned that these changes are highly valued and that Chile is regarded as a country with a very stable institutional background.

This research has indicated that there exists a diverse array of research studies that explore the scale and direction of the phenomenon of corporate governance convergence across as well as within individual countries. Combining the results of this research study gives the opportunity to generalize about this process. First, extant literature indicates that market integration leads to a demand for greater efficiency. On its turn, this tends to fuel convergence or adoption of Anglo-American governance practices, quite regularly in adapted forms. Another generalization lies in the fact that capital market integration asks for a greater legitimacy in regard of institutional investors and international organizations, which also tends to drive convergence. Finally, the specific political and historical circumstances appear to impede convergence or create the need for corporations to adapt new corporate governance practices.

Research on the evolution of corporate governance has shown that there is no clear answer on the question whether there is one ultimate corporate governance system to which all corporate governance systems converge. This is due to the fact that each model has strengths and weaknesses that only become clear in different environments or circumstances.

CONTENTS

List of Figures

LIST OF TABLES

ABBREVATIONS

ADR: American Repository Receipt

AFP: Administradora de Fondos de Pensiones (Pension Fund)

CAPEX : Capital Expenditures

CME: Coordinated Market Economy

DAX: Deutscher Aktien Index

FDI: Foreign Direct Investment

IAS: International Accounting Standards

IFRS: International Financial Reporting Standards

GAAP: Generally Accepted Accounting Principles

GDP: Gross Domestic Product

LME: Liberal Market Economy

M&A: Merger and Acquisition

OECD: Organisation for Economic Co-operation and Development

SEP: Sistema de Empresas (Public Enterprise System)

SOE: State Owned Enterprises

SPL: Sociedad Punta de Lobos

SVS: Superintendencia de Valores y Seguros (Superintendency of Securities and Insurance)

Preface

After an excruciating 14 hour journey in a leg-torturing 80s airplane with accompanying original coloured interior design – hence 'Iberia nooit meer weria' – the time had come to speak the famous words:

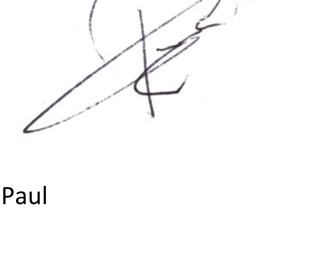
*"Eso es un pequeño paso para un hombre; un salto gigantesco para la humanidad"**

Reality was a bit less dramatic however and 'hola, taxi, cerveza and cuanta cuesta' probably were the only Spanish words spoken after setting foot on the Latin American continent.

Let me explain how this journey started. Since my master Business Administration neared its end, it was time to start thinking about a proper master thesis project for my master track international management, preferably abroad. There were some rough ideas on this matter but the project really started shaping up after some constructive consultations with my college teacher dr. Huub Ruel. He soon became my first supervisor and helped establishing contacts with possible companies at which I could perform my master thesis. Initially, contacts were established with a brewery in Peru but after some positive emails, nothing was ever heard again. Luckily, dr. Ruel had a couple of other possibilities pending. One of those was PricewaterhouseCoopers in Santiago de Chile which immediately responded and in a very positive way indeed.

A couple of months later I saw the Andes mountain range laying beneath, coloured by the rising sun, framed by the window of an airliner. Not long thereafter I landed in Santiago, Chile's capital city. I especially want to notice that I had a great time at the Tandem Santiago language school which helped create a basic knowledge of Spanish within two weeks. After these two weeks my internship at PricewaterhouseCoopers started. It was the start of a fantastic period with lots of new experiences and friends. I especially want to thank my supervisor Ivan Cortés, department director Mattieu Bruno Vallart and policy advisor Pablo Necochea for their support and care; at work but even more so in leisure time. All in all, my stay and internship in Santiago de Chile was probably the best decision I made during my college period.

I would like to thank my parents for their support during my second master period and stay in Chile. Finally I would like to thank my supervisor Dr. H.J.M. Ruel for the coordination of my research project and the constructive lessons and advice that contributed to the successful completion of my master thesis. Also the useful comments of M.R. Stienstra Msc have been a great help in finalizing this thesis.



Paul

* That's one small step for a man, one giant leap for mankind (Neil Armstrong, 1969)

1. INTRODUCTION

1.1 BACKGROUND OF RESEARCH

More and more companies are looking abroad for acquisition targets or merger partners to help them meet their growth aspirations. While transnational deals are not uniquely prone to disaster, they do offer a different mix of opportunities and risks, which need to be understood and managed if the deals are to be successful. An important factor in mergers and acquisitions (M&As) is corporate governance.

According to Shleifer and Vishny (1997), “corporate governance deals with the ways in which suppliers of finance to corporations assure themselves return on their investment”. A more general definition is given by the OECD which describes corporate governance as “a set of relationships between a company’s board, its shareholders and other stakeholders” (OECD, 1999). According to O’Sullivan (2001), corporate governance “is concerned with the institutions that influence how business corporations allocate resources and returns. Specifically, a system of corporate governance determines who makes investment decisions in corporations, what types of investments they make, and how returns from investments are distributed”. In financial economics, theoretical research applies a narrow definition of corporate governance, allegedly because it can be better modelled. However, exploration of scientific articles on the subject of corporate governance learns that it is important to use a broad perspective of corporate governance. A reason for this is that national corporate governance systems differ dramatically along a series of dimensions. A rough distinction can be made by dividing corporate governance systems in stock market-centered capital markets and bank-centered capital markets; the United States and Anglo Saxon countries versus systems featured in countries like Germany and Japan. Some systems characterize themselves by large groupings of related corporations, as in Japanese keiretsu, Korean chaebol, or European holding company structures (Gilson, 2001).

The diversity of practices around the world nearly rejects a common definition. Internationalization has sparked policy debates over the transportability of best practices and has fueled academic studies on the prospects of international convergence (Guillen, 2000). Not only products were the playing field of competition, but also governance systems. Aoki (2000) argued that the lean production system that characterized Japanese industries was linked to the Japanese governance system in which managers and workers were shielded from shareholder demands, but still monitored by banks in case of poor performance. This vertical keiretsu structure allowed executives to manage with a long-term orientation whereas the U.S. managers focused more on short-term because of shareholder pressures regarding quarterly earnings growth. On the other hand, the U.S. system was praised for its transparency through a stock market-centered capital market which made it possible to react quickly upon changes in the economic environment (Gilson, 2001).

In the end, the debate on corporate governance focused on ties between particular national governance institutions and competitiveness. This is where convergence of corporate governance systems is introduced since it was argued that competitive forces would direct national systems to one single efficient form. Interestingly, predictions about the specific form of convergence were quite dependent on what national system performed most successfully at the time of such predictions. There was a period that a bank-monitored system as in Japan and Germany was regarded as the best choice since it allowed for lean manufacturing; then regarded as the spearhead of efficient production. However, the Japanese economy came to a halt and American economy rose with sustained growth, low unemployment rates and low inflation. The American corporate governance system gained popularity and even became an ultimate standard of corporate governance.

After a couple of corporate malfeasance scandals in the U.S. (ENRON, WorldCom) their governance model lost its appeal as well. Since then, scholars recognized that national governance systems turned out to be more adaptive in function, and therefore more persistent in form. For instance, U.S. manufacturing companies were able to adopt the Japanese lean production system but adapted it to their own corporate governance model, thus leaving the institutional form largely intact. The debate on convergence of corporate governance therefore remains.

This research tries to give insight in convergence process by investigating whether cross-border M&As show signs of developments towards a common standard of corporate governance or just remain different.

1.2 Research questions and objectives

As described above, Hall and Soskice (2001) divide systems of national corporate governance into two categories. Within these systems there are corporate governance arrangements that are typical for each of these categories. The goal of this research is to study how M&A's contractually transfer corporate governance systems and to see whether they evolve towards one common standard, or in other words: do corporate governance systems converge through M&As?

This focus can be translated into an assumption, which can be regarded as the basis of this research.

Assumption: Differing corporate governance systems have a tendency to converge towards each other through M&As.

Existing corporate governance literature shows a tendency that countries with a common law system offer better protection to investors than countries that operate under civil law. Better protection often means more valuable firms (La Porta et al., 2008), and better developed financial markets (Martynova and Renneboog, 2008). The question that follows from this establishment is how countries converge towards a better corporate governance system. It would be interesting to see whether cross-border mergers and acquisitions are influential in this process. Consequently, this results in the central research question:

To what extent do corporate governance systems converge through mergers and acquisitions?

The most important elements of this central question are defined below.

TABLE 1: DEFINITIONS OF ELEMENTS IN MAIN RESEARCH QUESTION

Core elements	Definition
Cross-border mergers and acquisitions	A cross-border M&A is a merger or acquisition transaction that involves two companies from two different countries (Pablo, 2009)
Corporate governance systems	The structure of rights and responsibilities among the parties with a stake in the firm (Aguilera and Jackson, 2003)
Convergence	Convergence – in case of corporate governance – refers to increasing isomorphism in the governance practices of public corporations from different countries (Gilson, 2001)

As can be seen, this research focuses mainly on country regulation rather than firm-level regulation. There are several reasons for doing so. First, there is empirical evidence that reveals a high correlation between corporate governance at the firm-level and at the country level. Second, it is virtually impossible to study the content of corporate charters, the amendments and all shareholder decisions. An analysis has been made of the variation in a cross-section of firm-level corporate governance indices and it is concluded that most of the variation finds its reason in country characteristics (Martynova and Renneboog, 2008). This basically means that corporate governance at the firm-level is to a great extent determined by the legislation and jurisdiction of the country in which the firm operates. In the same research it is argued that countries matter so much because “they influence the costs that firms incur to bond themselves to good governance and the benefits they receive from doing so” (Martynova and Renneboog, 2008).

The goal of this research is to formulate an answer on the main research question, as formulated and defined above. To do so, this central question is decomposed into sub-questions:

1) What are cross-border mergers and acquisitions?
2) What is corporate governance?
3) What is convergence?

To answer these questions and the central question, a few methods will be used. The method to create the theoretical framework will be discussed in this chapter. The methods that are used to answer the research questions and those necessary to analyze the date are discussed in chapter 3. These methods were based on the work of Babbie (2001), King et al (1994), Kvale (1996), Saunders et al (2009) and Yin (2003).

1.3 RESEARCH APPROACH

The research has been performed in phases. The first phase consist of a description of the problem and methodology, which on its turn results leads to the second step of creating a theoretical framework. The third phase will encompass a couple of case studies to find support for the theoretical elaborations and hypotheses. Eventually, the aforementioned steps build up to phase 4 in which the research questions will be answered using the gathered data from the preceding steps.

1.3.1 THEORETICAL FRAMEWORK

It is important to give the research direction and structure, which will be done through the creation of a theoretical framework. For this literature study, a number of databases and key words were used of which an overview is enclosed in the appendices.

Although recent literature was preferred, it became obvious that on some subjects older articles still had a benchmark function for newer research and therefore some less-recent literature was also used in this research. A key criterion for determining the significance of a certain article was to determine the frequency of citation of it in other publications. Since databases offer the opportunity to sort on the number of times an article has been cited, it was well worth the effort to do so with articles that have been around for at least 2 years. There is a reason for these two years; recent work is not cited as often as literature that has been circulating longer, so newer articles were judged by their abstracts and subject relevance.

When an article was useful, the reference list was also explored to see if there were any relevant articles that might have been overlooked. This is a method called ‘snowball sampling’ of which ‘snowball’ refers to the process of accumulation as each located subject suggests other subjects (Babbie, 2001). Since the names of the journals were known through the reference list, the articles from these journals were retrieved by means of the ‘e-journal’-function of the UT library website. Reverting to this facility finds its ground in the experience that when articles could not be found with help of other databases, this function often proved successful.

2. THEORETICAL FRAMEWORK

2.1 INTRODUCTION

The globalization of business over the past decades has fueled a worldwide search for competitive advantage. Companies have followed their customers – who are going global themselves – as they respond to the pressures of obtaining scale in a rapidly consolidating global economy. In combination with other trends, such as increased deregulation, privatization, and corporate restructuring, globalization has fueled a growth in cross-border merger and acquisition (M&A) activity as never seen before. Nevertheless, it is obvious that cross-border M&A's have become a fundamental phenomenon in the world wide business landscape.

2.2 CROSS-BORDER MERGERS AND ACQUISITIONS

A cross-border M&A is a merger or acquisition transaction that involves two companies from two different countries (Pablo, 2009). However, it is important to note that "M&As of companies with their headquarters in the same country, although normally classified as domestic, often have cross-border issues of concern when they integrate operations located in different countries" (Child et al., 2001, pp. 7–8). Compared to foreign direct investments or strategic alliances, acquiring a company in a different country than the acquirer's, may provide the buyer a fast alternative to expand internationally. Acquisitions of firms headquartered in other countries present an especially good opportunity for the acquiring firm to learn new knowledge and acquire new capabilities (Shimizu, 2004). In other words the objective of an acquisition is to create value (Colman, 2010). However, these benefits have their downsides because usually, the acquirer pays a premium in order to get control of the target. This target may also profit from valued opportunities brought by the M&A, such as technological improvements, enhanced risk management and corporate governance policies, to name a few (Pablo, 2009 and Root, 1998).

It is only quite recently that researchers have altered their focus more and more towards cross-border M&A's. This is not surprising since the number of cross-border deals has seen a dramatic increase over most of the past decade. According to Very and Schweiger (2001) the value of cross-border M&A transactions was 274 billion in 1996, rose to 672 billion USD in 1998 and reached 1.7 trillion USD in 2006 (Hyun and Kim, 2009; OECD investment news, dec. 2009). However, due to the financial crisis which started in 2007, the size and number of M&A deals completed in 2008 and 2009 were considerably lower than in the years before 2007. The year 2009 even shows a 56% decline in M&A transactions compared to 2008 (OECD investment news, dec. 2009).

Imagining a world without financial and economical crisis, there are several factors responsible for fueling the growth of cross-border M&As. Among these factors are the worldwide phenomenon of 1) industry consolidation and privatization, 2) free trade among countries and decrease of restrictions on foreign investments and 3) deregulation of services (Chen and Findlay, 2003).

The dynamics of cross-border M&As are largely similar to those of domestic M&As. There are however some unique features since countries have distinct cultural, economic and institutional structures (Pheng and Yuquan, 2002 and House et al., 2002). Cross-border M&As are a way of entering new and lucrative markets, as well as a method of expanding the market for a firm's current goods. It is quite common that suppliers often follow the international expansion of the related buyers. The reason behind this is to ensure that the transplanted buyer does not switch to an alternate foreign supplier, which could cause a threat for the current supplier in its own domestic market. Thus, it seems that international M&As can have two goals: to take advantage of a new opportunity or to avoid a possible future threat (Shimizu, 2004).

Firms persuading cross-border M&As face some challenges. When they engage in cross-border M&As they are faced with unique risks such as ‘liability of foreignness’ (Petersen and Pedersen, 2002) and ‘double-layered acculturation’ (Slangen & Hennart, 2002). The liability of foreignness is the problem of being an outsider and being blocked in access to resources that are crucial (Petersen and Pedersen, 2002). Double-layered acculturation means that “M&As require the investing firm to interact with both a variety of local stakeholders embedded in the host-country environment and a local firm” (Slangen & Hennart, 2002). There are quite a few potentially hindering factors for a firm to fully realize their strategic objectives: differences in national culture, business practices, customer preferences and institutional circumstances such as government regulations (Root, 1998). There is an amount of uncertainty and information asymmetry in foreign markets which cause difficulties for firms to find the right fit with both the target firm and the local market (Root, 1998; Shimizu, 2004). It is clear that the liability of foreignness and double-layered acculturation pose a few barriers to learning new knowledge and capabilities in a cross-border M&A.

The pursuit of cross-border M&As demands that the firm considers a various array of conditions, including country-, industry-, and firm-level factors, which all have their ties with the acquiring and the target firm. Looking at the national and industry levels, factors such as capital, labor, and natural resource endowments, together with institutional variables such as the legal, political, and cultural environment, are of great importance. Zooming in on the firm level, it is important that organizations which pursue an internationalization strategy first need to explore, identify and evaluate potential targets to acquire in the host countries (Shimizu, 2004).

In the past, economic perspectives such as transaction cost economics (TCE) and ownership-location-internalization framework (OLI) were the prevailing theoretical principles on which cross-border M&A research was based (Shimizu, 2004). This can be explained by the fact that cross-border M&As were often studied from an FDI perspective, emphasizing entry mode decisions and the resulting gains from these decisions. These research studies focused mainly on the different national cultures and their institutional settings and emphasized the minimization of the risks and inefficiencies in entering the foreign markets in which transaction costs played a key role.

When looking at existing research on cross-border M&As, it becomes clear that the European and Asian Pacific region have been extensively researched. Zademach and Rodriguez-Pose (2009) consider cross-border M&A events in countries that are part of the (at the time of research) EU25 and European Free Trade Association. Chen and Findlay (2003) focus their research in the Asian Pacific region. The Latin-American region however, appears to be rather overlooked in M&A research and therefore also seems to lack detail research studies of M&A events in that region. Rossi and Volpin (2004) focus on the determinants of cross-border M&A activity, in particular on the differences in the legal system and on the level of regulations among 49 countries, some of which belong to the Latin American region. Elaborating on their research it is shown, that there is more cross-border M&A activity in those countries that have good accounting standards and are protective of foreign investment. According to Rossi and Volpin (2004), investor protection affects the cross-border M&A activity in a given country according to the level of frictions and inefficiencies facing the target company. When analyzing M&A transactions in Latin America, most of the countries in the region—with few exceptions mainly in the Caribbean— are civil-law countries. Therefore, less variability in the legal code exists (Pablo, 2008).

Civil law

Civil law may be defined as that legal tradition which has its origin in Roman law, as codified in the Corpus Juris Civilis of Justinian, and as subsequently developed in Continental Europe and around the world. Civil law eventually divided into two streams: the codified Roman law (as seen in the French Civil Code of 1804 and its progeny and imitators - continental Europe, Québec and Louisiana being examples); and uncodified Roman law (as seen in Scotland and South Africa). Civil law is highly systematized and structured and relies on declarations of broad, general principles, often ignoring the details.

Common law

Common law is the legal tradition which evolved in England from the 11th century onwards. Its principles appear for the most part in reported judgments, usually of the higher courts, in relation to specific fact situations arising in disputes which courts have adjudicated. The common law is usually much more detailed in its prescriptions than the civil law. Common law is the foundation of private law, not only for England, Wales and Ireland, but also in forty-nine U.S. states, nine Canadian provinces and most countries which first received that law as colonies of the British Empire and which, in many case, have preserved it as independent States of the British Commonwealth.

More recently, research leaned towards the value of international expansion and cross-border M&As from the resource-based and organizational learning perspectives (Shimizu, 2004). Identifying a target and actually taking it over, however, are just the beginning of a process of reorganization that can take a few months or even years. An important factor in this process is the structure of rights and responsibilities among the parties with a stake in the firm: corporate governance (Aguilera, 2003).

2.3 Corporate Governance

There is a considerable diversity between practices around the world which makes it difficult to compose a common definition. The process of internationalization has initiated policy debates regarding the adaptation of best practices across borders and academic studies on the prospects of international convergence (Guillen, 2000; Gilson, 2004). What the national differences in corporate governance are and how they should best be conceptualized remain intensively debated.

In essence, corporate governance concerns methods of how suppliers of finance to corporations assure themselves of getting a return on their investment (Shleifer, Vishny, 1997). More specific: the allocation of rights and obligations among the firm's stakeholders, including shareholders, managers, workers and others with a stake in the corporation (Aquilera and Jackson, 2008). The extent to which these rights and obligations are defined and enforced is dependent on the institutions of corporate governance present in a given country. These institutions include formal laws and regulations, codes of good governance, taken-for-granted assumptions about the appropriate role of the various stakeholders, and other informal behavioral norms sanctioned by tradition or practice (Aguilera and Jackson, 2003). Institutions of corporate governance are a crucial factor in a country's long-term development. The main objectives of these institutions are: stimulating the corporate performance through a business environment that motivates productivity and to ensure corporate conformance between the interests of investors and society (Aguilera, 2008). Research has indicated a positive relationship between effective national corporate governance systems and firm performance in emerging economies (Klapper and Love, 2002).

Regulative institutions have two different faces: besides their constraining influence they also support and empower actors (Schneper and Guillen, 2004). This can easily be illustrated by taking a closer look at the German system of corporate and labor laws. At companies above a certain size half of the seats on the board of directors are reserved for workers and their representatives. As can be imagined, cross-border M&A's will most likely exert their influence on corporate governance systems.

Therefore, this research will be laid out around cross-border M&A's and how is dealt with different corporate governance systems. Various influences like history and power balance contribute to the fact that corporate governance institutions differ across countries, with certain important implications for the degree of influence of shareholders and workers (La Porta et al, 1999; Aguilera and Jackson, 2003; Agosin and Pasten, 2003).

National corporate governance systems are quite in a league of their own, being deeply rooted and relatively resistant to change (Shleifer and Vishny, 1997). This persistence finds its reason in the underlying ideology about how to govern the corporation. Countries can roughly be divided into two major types of economies: liberal-market economies (LME) and coordinated-market economies (CME) (Hall and Soskice, 2001). Liberal-market economies are characterized by competitive market arrangements, in which organizational decisions are significantly influenced by the forces of supply and demand. Furthermore, shareholder rights are highly protected and labor relations are characterized by open-market relationships, with firms having the freedom to hire and fire employees almost at will (Hall and Soskice, 2001). Examples of countries belonging in this category are the UK, the US, Australia, Canada, New Zealand and Ireland. Coordinated-market economies are distinguished by a high degree of organization and coordination of interest groups in which multiple stakeholders are represented. In this institutional setting it is possible for employees, suppliers, customers and financial institutions to influence a firm's policy and decisions. Examples of CME-countries are Germany, Switzerland and the Scandinavian countries.

Concluding from these types of economies one could say that basically two types of governance can be distinguished: 1) an economic view of maximizing shareholder value and 2) a more social approach of serving the interests of multiple stakeholders. Elaborating on this phenomenon it is useful to examine the key aspects of the shareholder-oriented model found in LME's. In this model it is argued that the interests of shareholder-principals receive the best protection from "unrestricted competition for stewardship of corporate assets using a takeover market" (Hall, Soskice, 2001).

A considerable share of the corporate governance literature on the acquisition process concentrates mostly on shareholder rights and neglects the role of other stakeholders (Siems, 2010). For instance, employment relations are treated as if they were determined by labor markets like in the LME-model (Hall and Soskice, 2001; Aguilera and Jackson, 2003). However, their interests are often the opposite of the acquirer's shareholders and employees may fear breaches of trust concerning their firm-specific investments (Aguilera and Jackson, 2003).

2.4 Corporate governance convergence

In the context of corporate governance, convergence refers to increasing isomorphism in the governance practices of corporations from different countries (Aguilera and Jackson, 2003). This is quite a general definition and total isomorphism is not likely, even among firms in the same country. Therefore more operationally clearer definitions of corporate governance are needed. In extant research on this matter a number of different definitions with different starting points exist. Scholars have made a distinction between convergence in form and convergence in function (Gilson, 2004). The first perspective relates to increasing similarity in terms of legal framework and institutions. Functional convergence on the other hand implies performing the same functions within a possibly differing legal and institutional framework; for instance: ensuring fair disclosure or accountability by managers. La Porta et al (2000) define functional convergence as "decentralized, market-driven changes at the firm level". Apparently, functional convergence of corporate governance practices occurs with greater regularity.

Another distinction of convergence is given by Khanna et al (2006), who define *de jure* convergence and *de facto* convergence. In essence, de jure convergence occurs when two countries adopt similar corporate governance laws. On the other hand, when practices converge there is de facto convergence. It is quite easily illustrated by the existence of similar rules in different countries – *de jure* convergence – but nevertheless it is common that these rules are differently enforced; no *de facto* convergence.

Gilson (2004) identifies three kinds of corporate governance convergence. First there is functional convergence, which occurs when institutions are flexible enough to respond to demands by market participants and no formal change in the rules is necessary. Then there is formal convergence, which means an adoption of best practices forced by a change in the law. Finally contractual convergence, which defines the process of firms changing their own corporate governance practices by committing to a better regime, possibly because the legal system lacks flexibility or laws cannot be changed.

Whilst discussing the concept of convergence it is necessary that one is able to specify in what direction entities in a given group are converging towards. Describing that German and French corporate governance are converging does not give any specific information about the direction of this convergence. For instance: does one system move towards the other or vice versa, or maybe they both converge towards a midpoint. Another option is that both systems are moving to a new governance framework that is quite different from both current systems.

As can be seen in Hall and Soskice (2001) it is also quite common in existing research to examine convergence in terms of zones: the Anglo-American and outside the Anglo-American. In previous research corporate governance was often linked to key elements of the Anglo-American model: various outsider- or market-oriented practices such as independent directors, greater corporate information disclosure or stock-based executive compensation (Starks and Wei, 2004).

An important question is: what exactly is converging? The focus of research studies can be pointed at convergence in systems, rules, processes and practices. This implies that comparative analysis of different studies is often problematic since they mostly are not alike. Therefore an analytic scheme is quite useful to be able to see directly which factors and processes are incorporated in a certain research study.

Basically, two different forces that have influence on governance practices can be distinguished: forces that push countries towards convergence and forces that defy convergence or might even fuel divergence. In essence, the interplay between these two forces determines the existence, speed and degree of convergence. It is possible that these drivers and impediments affect convergence at both the country and firm level (Bris e.a. 2008).

2.5 STRUCTURED LITERATURE REVIEW

Since convergence has become a topic of interesting academic debate, there have been efforts to empirically examine this phenomenon in relation to corporate governance practices. Combined with the fact that this research study revolves around convergence and corporate governance, it seemed opportune to make an inventory of empirical papers on convergence, to see whether some generalizable conclusions can be drawn.

Empirical papers on convergence have appeared in journals that cover diverse areas, such as economics, management, finance, organization theory and social studies. In this structured literature review, major journals in these fields were searched systematically using key word searches, citation trails etc. It was tried to use articles published in respectable journals and over a period of the past 10 years (2001-2011). Some articles that are presented in this literature review were not included in these journals. This is due to the fact that some of them are working papers and even though they might not be published in one of the respectable journal, the pioneering and important character of these articles could not be ignored.

The search for relevant articles was performed through 'Web of Science', a scientific searching machine facilitated by Twente University's library website. The search was further structured by looking for a number of relevant key words: corporate governance and convergence. The reason these search words were chosen is due to the fact that they form the essential elements of this research. Furthermore, expanding the search with terms like 'mergers and acquisitions', 'divergence' and 'cross-border' resulted in double finds and articles in which corporate governance was not featured.

In total 137 results were found, and after examining the results it appeared that roughly 25 articles were directly applicable to the purpose of this research. Other papers addressed the issue of convergence as well but indirectly or not in a usable context. Moreover, some of these articles were overlapping with other papers thus defeating the purpose of using them. The articles are summarized in table 2 in which information on sample, type of study, variables and hypotheses and conclusions is presented.

TABLE 2: STRUCTURED LITERATURE REVIEW ARTICLES ON CORPORATE GOVERNANCE AND CONVERGENCE

Authors and year of publication	**Time period**	**Sample**	**Variables**	**Research questions and findings**
General level				
Clarke, D.C., 2011 (American Journal of Comparative Law, 59 (1), 75-110	n/a	n/a		Review on past and future of comparative corporate governance. Calls to enlarge the scope of comparative corporate governance
Country level				
Gilson, 2001 (*The American Journal of*	n/a	n/a	Historical analysis	Investigates the interplay of functional adaptivity on the one hand, and institutional persistence or path dependency on the

Comparative Law, 49 (2), 329-357)				other, and that will influence whether such corporate governance convergence as we observe will be formal or functional. No specific form of convergence found.
Aguilera and Cuervo-Cazurra, 2004 (*Organization Studies*, 25: 415–43)	1978-1999	49 countries	DV: whether a country developed a governance code; number of codes developed IV: country's legal system; anti-director rights; economic integration; government liberalization; foreign institutional ownership; domestic capital market	Examines the mechanisms underlying the worldwide diffusion of organizational practices. Concludes that codes were developed in response to both endogenous and exogenous factors. It is argued that efficiency needs and legitimation pressures led to the adoption.
Schneper and Guillén, 2004 (*Administrative Science Quarterly*, 49 (2), 263-295)	1988-1998	37 countries	DV: announced hostile takeovers IV: shareholder rights; labor rights; bank rights	Investigates the differing levels of hostile takeover activity across countries by adopting a "stakeholder power" perspective on corporate governance and considering differences among stakeholders in their legally protected power to defend their interests against stakeholders with opposing interests. Finds that shareholders', workers', and banks' rights affected the adoption. Announced hostile takeovers increased with greater shareholders' rights and decreased with greater workers' and banks' rights.
Toms and Wright, 2005 (*Business History*, 47: 267–95)	1950-2000	US and UK	Historical analysis of changes in corporate governance systems	Examines why American and British firms adopted diversification strategies and multi-divisional structures in the middle of the twentieth century and why this strategy and structure was reversed towards the end. Finds that monitoring by shareholders increased in both countries.
Goergen, Martynova and Renneboog, 2005 (Tilburg University working paper)	1990-2004	30 European countries	Takeover regulation reforms	Investigates whether the recent reforms of takeover regulation in Europe are leading to a harmonization of the national legislations. Finds that there is convergence in regulations.
Collier and Zaman, 2005 (*Corporate Governance: An*		20 countries		Investigates through analysis of recent corporate governance codes whether corp. governance systems in Europe show signs of convergence. Finds that there has been a degree of convergence towards an Anglo-

international Review, 13: 753–68)				Saxon model of corporate governance
Khanna, Kogan and Palepu, 2006 (*The Review of Economics and Statistics*, 88: 69–90)	1998	49 developed and developing countries	DV: legal protection of shareholders and creditor protection IV: degree of capital market, product market, and labor market integration between pairs of countries	Examines the similarity and convergence of corporate governance practices between economically interdependent countries. Concludes that globalization may have induced the adoption of some common corporate governance standards but these standards may not have been implemented.
Aguilera and Cuervo-Cazurra, 2009 (Corporate Governance, an international review)	1978-2008	64 Countries	DV: whether a country developed a governance code; number of codes developed IV: country's legal system; anti-director rights; economic integration; government liberalization; foreign institutional ownership; domestic capital market	This article is a sequel to their 2004 article on Codes of Corporate Governance. Hence propositions are similar and in addition to their first article, they note that despite the criticism that the codes' voluntary nature limits their ability to improve governance practices, codes of good governance appear to have generally improved the governance of countries that have adopted them, although there is need for additional reforms
Martynova and Renneboog, 2010 (Tilburg University working paper)	1990-2005	30 European countries and US	Key elements: Soft law, comprising: (i) (hard) corporate law; (ii) stock exchange regulations (listing requirements); (iii) codes of good practice provided there is a legal basis for these codes (the law refers to a code of good practice which is itself not incorporated in the law); and	It proposes a methodology to create detailed corporate governance indices which capture the major features of capital market laws in the analysed countries. Finds that countries of English legal origin still provide the highest quality of shareholder protection. In the mean time, many Continental European countries have improved their legal system up to the standard set by the English legal system.

			(iv) corporate practice.	
Firm level research				
Tuschke and Sanders, 2003 (*Strategic Management Journal*, 24: 631–49)	1996-1999	76 listed German firms	DV: adoption of stock-based incentive plan; adoption of transparent accounting standards (GAAP or IAS) IV: ownership concentration	Investigates the effect of ownership on the adoption of stock option pay and transparent accounting practices of German firms. There is an inverse U-shaped relationship between ownership concentration and these governance reform measures.
Aguilera and Jackson, 2003 (*The Academy of Management Review*, 28(3), pp. 447-465)	n/a	n/a	DV: 1) role of capital, 2) role of labour, 3) role of management IV: 1) property rights, financial system, interfirm networks. 2) Representation rights, Union organization, skill formation. 3) Management ideology, career patterns.	Investigates how to develop a theoretical model to describe and explain variation in corporate governance among advanced capitalist economies, identifying the social relations and institutional arrangements that determine who controls corporations, what interests corporations serve, and the allocation of rights and responsibilities among corporate stakeholders. Concludes that while nations presently retain distinct "profiles" of corporate governance, the range of internal variation among firms is growing, particularly between large internationalized corporations and protected domestically oriented or private corporations.
Khanna and Palepu, 2004 (*Journal of International Business Studies*, 35: 484–507)	1981-2001	Infosys, Indian software company	Qualitative study	Investigates manner in which Infosys has attempted to shape corporate governance practices in India more generally, and why these attempts have had limited effects thus far. Finds the firm adopted US corporate governance practices to attract talent, not because of global capital market pressure.
Khanna, Palepu, Srinivasan, 2004 (*Journal of Accounting Research*, 42: 475–508)	2002	794 firms in 24 countries in Asia-Pacific and Europe	DV: information disclosure (overall and financial transparency) IV: interactions with US financial (listing, equity investment, FDI), product (export, operations) and labor (business	Analysis of disclosure practices of companies as a function of their interaction with U.S. markets. Results are broadly consistent with the hypothesis that cross-border economic interactions are associated with similarities in disclosure and governance practices

			travel) markets	
Buck and Shahrim, 2005 (*Journal of International Business Studies*, 36: 42–61)	2000/2001	7 matched UK and German firms	DV: coverage of executive stock options (ESO), performance conditions of ESO	Comparison of 7 German and UK firms in regard of coverage of ESO and performance conditions attached to ESO. Finds that US-style ESO have found their way into German firms but with very distinctive un-American features.
Khanna, Kogan and Palepu, 2006 (*The Review of Economics and Statistics*, 88: 69–90) *	2001	495 firms in 25 emerging economies	DV: *de facto* similarity to US corporate governance standards (CLSA index) IV: exposure to global capital markets, global product markets, and global labor markets	Investigates whether there is evidence that globalization is correlated with similarity in corporate governance. Concludes that globalization may have induced the adoption of some common corporate governance standards but that there is little evidence that these standards have been implemented
Wojcik, D., 2006 (Journal of Economic Geography, 6:5, 639-660)	2000-2004	300 Largest publicly traded European firms from 17 countries	IV: Shareholder rights & duties, takeover defences, disclosure, board structure and functioning DV: Corporate governance rating	Analyzes the dynamics of corporate governance between 2000 and 2004 focusing on convergence. Finds that Continental companies have narrowed the gap in relation to the UK and Ireland, and there is evidence of convergence within individual countries and industries. Nevertheless, the European corporate governance landscape is still diverse, with differences between countries overwhelming differences between industries.
Claessens and Schmukler, 2007 (Journal of International Money and Finance, 26:5, 788-813)	1989-2000	39,517 firms from 111 countries	IV: country and firm characteristics DV: participation of firms in major capital markets	Studies international financial integration. Finds that firms more likely to internationalize are from larger and more open economies, with higher income, and better macroeconomic environments. These firms tend to be larger, grow faster, and have higher returns and more foreign sales. International financial integration will likely remain constrained by country and firm characteristics.
Sanders and Tuschke, 2007 (*Academy of Management Journal*, 50: 33–56)	1996-2000	89 listed German firms	DV: adoption of stock option plans IV: associations with US markets (US stock listing and sales); executives' business education; adoption of transparent	Investigates the impact of exposure to US markets of German firms on the adoption of stock option plans and finds that the adopters were likely to have greater degree of associations with US markets and had experience of adopting other "institutionally contested" practices.

			accounting standards (GAAP or IAS); board interlocks; industry adoption	
Yoshikawa, Tsui-Auch and McGuire, 2007 (*Organization Science*, 18: 973–88)	1990-2005	Sony	Multiple case, multiple level study. Qualitative	Analyzes the diffusion of governance innovation in Japan. It is argued that Japanese systems of corporate governance neither fully converge to, nor completely diverge from, the Anglo-American model. Finds that the spread of innovation across firms and institutional levels is far from linear and straightforward, and that other well-regarded firms raised strong opposition to the institutionalization of corporate governance reforms
Markarian, Parbonetti and Previts, 2007 (*Corporate Governance: An International Review*, 15: 294–310)	1995 and 2002	75 large firms	Comparison of governance and disclosure practices between 1995 and 2002	Examines the changes in governance practices such as CEO/Chair duality, the percentage of independent directors, and board size as well as the degree of governance-related disclosure of large global firms. Finds that in regard to governance-related disclosure practices, for both Anglo-Saxon and non-Anglo-Saxon groups, disclosure practices have been evolving and converging towards more disclosures regarding governance matters.
Bozec, 2007 (*Corporate Governance: An International Review*, 15: 535–45)	2002	230 Canadian firms	DV: board composition; executive compensation; shareholder rights; information disclosure IV: US cross-listing; US operations	Examines whether US market interaction is related to the US governance practices among Canadian firms and finds that greater US market interaction is associated with US governance practices.
Bris and Cabolis, 2007 (Yale University)	1999	Rhone Poulenc (French) and Hoechst (German)	Case study	Analyzes the role of cross-border mergers in the process of corporate governance convergence. It shows that, despite the nationality of the firm, the corporate governance structure of Aventis is a combination of the corporate governance systems of Hoechst and Rhone-Poulenc, where the newly merged firm adopted the most protective provisions of the two merging firms
Bris, Brisley and Cabolis, 2008 (*Journal of Corporate Finance* 14,	1990-2001	39 industries in 41 countries	IV: Shareholder protection difference, accounting standards	Analysis of the effects of changes in corporate governance on firm value, and on an industry as a whole. Finds that firms that can adopt better practices willingly do so, and the market assigns more value to better

224–240)			difference DV: Value of cross-border mergers	protection.
Martynova and Renneboog, 2008 (*Journal of Corporate Finance*, 14, 200–223)	1993-2001	29 European countries	IV: corporate governance indices, measures of corporate governance spill-over effects DV: the bidder and target announcement returns	When the bidder is from a country with a strong shareholder orientation (relative to the target), part of the total synergy value of the takeover may result from the improvement in the governance of the target assets. In full takeovers, the corporate governance regulation of the bidder is imposed on the target (the positive spill-over by law hypothesis). In partial takeovers, the improvement in the target corporate governance may occur on voluntary basis (the spill-over by control hypothesis). Empirical analysis confirms both spill-over effects.

*Same article, both at country and firm level, hence twice mentioned.

2.5.1 COUNTRY LEVEL STUDIES

Focusing on country level, Gilson (2001) investigates the interplay of functional adaptivity on the one hand, and institutional persistence or path dependency on the other. The question is if this will influence whether such corporate governance convergence as observed will be formal or functional. Khanna *et al.* (2006) aimed their study at examining the similarity and convergence of corporate governance practices between countries that are economically interdependent. Their conclusion was that there were indeed similarities between them. Goergen *et al.* (2005) concentrated on the reforms of takeover regulations in Europe and found that convergence towards the Anglo-American system has taken place. Another study which focuses on takeovers is performed by Schneper and Guillén (2004) and concerns the spread of hostile takeovers in 37 countries. It was shown that the frequency of hostile takeovers is affected by the extent of shareholder right protection and the extent to which workers' and banks' rights are protected. Basically this study indicates that new practices will diffuse in a country only when powerful actors agree with them.

This is where Aguilera and Cuervo-Cazurra (2004) provided some more insights because their research has shown that various country level factors, such as legal tradition and global economic integration are positively related to the adoption of new codes of corporate governance. A further addition to research on adoption of corporate governance was made by Zattoni and Cuomo (2008). They compared the adoption of corporate governance codes between civil law and common law countries and found that codes in civil law countries existed more for legitimating reasons than the determination to improve the governance practices of national companies. However, Aguilera and Cuervo-Cazurra (2009) state that codes of good governance appear to have generally improved the governance of countries that have adopted them, although there is need for additional reforms.

So far it is shown that although new codes of corporate governance may be implemented, convergence does not necessarily occur in a substantial sense but only in form (Khanna et al, 2006). Thus, if the state does not in any way enforce codes of good governance, firms might be able to non-comply despite adoption of these codes. This suggests that country level convergence and firm level convergence are different constructs and need to be analyzed separately.

Martynova and Renneboog (2010) may well be the first authors that do not use the US governance model as a benchmark to compare the corporate governance models of other countries with. Moreover, it is mentioned that this method of corporate governance comparison is a flaw in other previous research studies. Instead, they create a new index that does incorporate the regulatory principles that prevail in other countries.

After reading research that is performed on country level, some conclusions can be made. First, it seems that research studies suggest convergence in many different ways but when it comes to evidence on this matter, there is only very little that suggests that convergence is actually occurring. Second, much of the convergence that is found in research studies is merely formal and not actual or substantial. Third, convergence of corporate governance codes cannot be seen as a subject on itself because it is dependent of other factors such as economic interdependence and political backgrounds. Following from this ascertainment is that an investigation into these factors can provide more insights than just trying to find evidence of convergence.

So far it has become apparent that country level analysis is not sufficient enough to examine the processes that lead to the adoption of corporate governance codes. Little is known about the interaction of various factors at macro, institutional and firm level. Therefore further inquiry into firm level processes and factors is necessary. Also, in paragraph 2.4.3, a deeper analysis is executed concerning the factors that fuel convergence and the factors that form impediments to convergence.

2.5.2 Firm level studies

A couple of studies have used the US corporate governance system as a standpoint of view to depart from and judge other corporate governance systems along this line. Khanna et al. (2004) analyze the disclosure practices of companies as a function of their interaction with U.S. markets. They revealed a positive association between disclosure scores and a variety of market interaction measures, including U.S. listing, U.S. investment flows, exports to, and operations in tire United States. Trade with the United States at the country level, however, has an insignificant relationship with the disclosure scores. Interestingly, Khanna and Palepu (2004) show in a case study that the Indian IT-company Infosys adopted US governance practices but did not do so because of global capital market pressure but only to attract talent which is needed to compete in global markets.

Khanna et al. (2006) performed another research on the relationship between global market exposure and adoption of US governance practices. Since some scholars have argued that globalization should pressure firms to adopt the most efficient form of corporate governance, Khanna et al. (2006) performed research on this topic and concluded that there is no relationship between global market exposure and adoption of US governance practices.

Markarian et al. (2007) focused on changes in governance and disclosure practices of 75 large multinational firms in various countries. Results indicate that non-Anglo-Saxon firms have developed their governance practices towards promoting an independent mechanism of control, namely a mechanism that is more similar to an Anglo-Saxon governance regime. As this independency is regarded as a key element of the Anglo-American system, it is concluded that convergence towards that system took place.

Tuschke and Sanders (2003) and Sanders and Tuschke (2007) investigated the transnational diffusion of organizational practices from institutional environments in which they are legitimate to environments in which key institutional actors contest them. They contrast processes facilitating pioneering adoptions of contested practices with processes that diffuse the contested practices. Ownership concentration and exposure to US markets indeed affect the adoption of stock option pay and transparent accounting standards. These studies show that exposure to US markets and powerful shareholders prompts German firms to adopt US governance practices. This appears to be the case as well for Canadian firms (Bozec, 2007).

These firm-level studies mostly concentrated on the adoption of some elements of the US governance and accounting practices. Yoshikawa et al. (2007) on the other hand, argue that Japanese systems of corporate governance neither fully converge to, nor completely diverge from, the Anglo-American model. Rather, Sony – the pioneer of corporate governance reforms – and its followers selectively adopted features from this model, decoupled them from the original context, and tailored them to fit to their own situations to generate governance innovation. Moreover, their research has shown that although firms in Japan adopted some elements of US corporate governance practices, they implemented them in a different manner. This could indicate that convergence occurs mostly in a formal way at the firm level and that actual practices show very little of these changes in corporate governance.

Another interesting case study in this retrospect was performed by Bris and Cabolis (2004). By analyzing a cross-border merger of a German and French company they tried to establish how two differing corporate governance systems become one. Interestingly, the most protective arrangements from both systems were exported to the corporate governance system of the newly formed corporation, thus not suggesting that some sort of US benchmark corporate governance system was used as a base model.

Wojcik (2006) also focuses on European level and concludes that within the structure of corporate governance, shareholders' rights and duties and takeover defenses have changed little while ratings for board structure and functioning, and particularly for disclosure, have risen in every country and industry. In comparison with the UK and Ireland, continental companies have come closer to their standard and there is evidence of convergence within individual countries and industries. Nevertheless, the European corporate governance landscape is still diverse, with differences between countries overwhelming differences between industries.

Since firms make changes in their corporate governance structure, one can imagine that these changes have consequences for firm value. Focusing on this subject, Bris, Brisley and Cabolis (2008) found that more market value is assigned to better protection of shareholders and accounting standards. Martynova and Renneboog (2008) concentrated on takeover returns and corporate governance in acquisitions. It was found that when the bidder is from a country with a strong shareholder orientation (relative to the target), part of the total synergy value of the takeover may result from the improvement in the governance of the target assets.

From these firm level studies three key conclusions can be drawn. First, empirical evidence suggests that product market and labour market integration are drivers of convergence that are as important as financial market integration. Second, not much research has been performed on the relationship between capital market integration and convergence at the firm level. Third, convergence might be an individual choice by firms instead of a trend that affects firms country or industry wide. So far, only an overview of extant literature has been given but since it is important to understand what drives and impedes convergence, a further analysis on these subjects has been executed in the paragraphs below.

2.5.3 Drivers of convergence

In general, the pro-convergence group argues that globalization accelerates competition over 'best practices', and firms that are subject to global markets are 'forced' to adopt the Anglo-American model because it is regarded as a de facto global standard (Bris and Cabolis, 2002). On the other side there is institutional theory that states that organizational fields tend to become more isomorphic over time because of mimetic, normative and coercive forces (DiMaggio and Powell, 1983). In cases of corporate governance these pressures can also be present. For instance, when a firm accesses capital markets abroad, it has to conform to the regulatory framework of that market, which acts as a coercive force. Likewise, when firms adopt best governance practices from another country, it is a mimetic process.

What is more, the demands for protection of minority shareholders, better disclosure, stock-base compensation, etc. have become a sort of spearhead of corporate reforms across a large number of industrialized nations. For example, convergence is stimulated through international harmonization of disclosure and accounting (OECD, 2010).

Following on this section is an elaboration on the more important drivers of corporate governance convergence. Although they are discussed separately, it should be mentioned that these drivers can be interwoven. Integration of financial markets and diffusion of codes of good governance can very well have influences on each other. In a same way, integration of product markets and financial markets may be interrelated because when a firm globalizes its operations it might need to seek foreign capital.

A primary driver of convergence of corporate governance practices is the integration of financial markets (Claessens and Schmukler, 2007). In the last two decades, financial markets which operated in relative isolation have become more integrated. This process has its implications for corporate governance. Financial market integration comes in different shapes: listing by firms from one country in the stock exchanges of other countries (Aguilera, 2008), increasing foreign portfolio investment in both developed and developing countries (Agosin and Pasten, 2003), cross-border mergers and acquisitions, and free capital flows across countries. What these factors have in common is that they all cause a fundamental transformation in the ownership structure of corporations. A typical development of the last years is the number of firms that list their shares in multiple exchanges across the world (Bell et al, 2008).

One would expect that firms would only be interested in listing in countries that have very low regulatory requirements because it would be easier to adapt to. Interestingly, the exact opposite is true. This can be explained by the fact that firms which decide to list in a foreign market with higher disclosure standards, essentially engage in a bonding mechanism, signaling to investors that they are prepared to comply to higher standards than required in their own country. It was found that bonding increases a firm’s share value (Bris et al, 2008). However, it should be noted that there are exceptions to this mechanism because some countries – Singapore for instance – are still developing their corporate governance system whilst being a very popular location for foreign investments nevertheless.

Another path of convergence lies in the attraction of foreign institutional investors. The resulting demand for the stock can fuel price raises and increase firm value. In order to attract those foreign investors though, it is crucial to adapt to their expectations of good governance in regard of disclosure and respect of rights of minority shareholders (Schneper and Guillén, 2004).

Cross-border mergers and acquisitions also are a way of how capital market integration can potentially lead to convergence. It could be that the previously mentioned listing in a foreign exchange is an indication of a firm’s aspirations to engage in cross-border acquisitions. It is quite likely that the new corporate governance system after an acquisition will be composed of governance characteristics of both countries. This then results in convergence, since some elements are retained, but some are adopted from the acquired firm’s country.

A second driver for convergence is product market integration. There still is discussion about whether product market integration can have an effect on governance similar to financial market integration. There is a technological view that sees corporate governance as a technology or a new innovation, and in a globalized world of competition firms really need to comply with the most innovative practice (Khanna and Palepu, 2004). Nations and firms that stick to less optimal governance systems will fall behind and have to adopt the more efficient system, resulting in convergence.

Another more institutional view is that there is a competition between governments to attract firms to locate their operations in their countries (Witt, 2004). Each government tries to come up with attractive regulations including those on corporate governance. Moreover, firms themselves adopt the most efficient elements of corporate governance systems because of an intensifying global product market competition.

The last driver to be mentioned is the development and diffusion of codes of good governance (Aguilera and Cuervo-Cazurra, 2004). Furthermore the harmonization of accounting rules across countries is a factor of concern (Coffee, 1999). Diffusion of corporate governance codes is given by the development that countries with weak shareholder protection, high government liberalization and a strong presence of foreign institutional investors tend to develop these codes (Aguilera and Cuervo-Cazurra, 2004). In summary, their research suggests that pressures from both market and institutions influence the diffusion of codes.
Capital flows across countries are not well-served with different accounting standards. The International Accounting Standards Committee is therefore addressing this issue by the creation of a common standard of international accounting (IFRS.org). This development towards uniformity can be supportive to the process of convergence.

2.5.4 Obstructions to convergence

Although all sorts of forces push firms in different nations towards convergence in corporate governance, it has not been a race (Aguilera and Jackson, 2003). Developments in a certain direction mostly seem to be caused by factors within a country instead of global factors (Hermes et al, 2006). This implies that there are forces that hinder convergence. To create a complete image of convergence and national corporate governance systems, these hindrances need to be examined as well. Obstructions of convergence are: complementarities among existing institutions and rules, structure- and rule-driven path dependence, complementarities, rent-seeking by interest groups, prevalence of multiple optima, economic differences and differences in social norms, differences in property right regimes, and lack of consensus on an ideal.

In research of Aguilera et al (2008) it is shown that independent directors, executive pay incentives, information disclosure, and takeover markets form a set of complementary elements that are the fundaments of the Anglo-American corporate governance system. Looking at the Japanese system in a same way, the core elements are high reliance on debt, monitoring by debt holders, absence of a market for corporate control, cross-shareholding by firms within a business group, and long-term employment practice which stimulates investment in firm-specific skills (Gilson, 2001). In the German system also exist complementary items such as the important role of the workforce and major banks in corporate governance (Hall and Soskice, 2001).
Summarizing, all these elements and their role in governance practices cannot be seen as isolated items but a complementary to each other.

Another impediment to convergence is path dependence. This refers to a situation where the current state of a system is determined not only by its initial conditions but also by the path it took. Initial conditions, determined by historical events or the design of politics, can set an economy down a particular path. For example, the weakness of American financial intermediaries, and important characteristics of Japanese corporate governance including lifetime employment and main bank relationships, find their origins not in considerations of efficiency, but in the interplay of populism and federalism in the case of the United States, and in the World War II and immediate post-war experience in the case of Japan (Gilson, 2001).

A third obstruction to convergence are rent-seeking interest groups. This factor could be illustrated by the example of Germany's corporate governance system. In Germany there are some powerful groups of investors and also employees that are embodied in labor unions and banks. These parties can resist change because it would reduce their private benefits of control while the efficiency gains from change would be shared by several actors (Hall and Soskice, 2001). Moreover there are laws that allow unequal voting rights instead of the one share-one vote norm, in order to protect family control. Control would be lost when converging towards a US-model. Only groups with ties to political power could have some altering power in this situation.

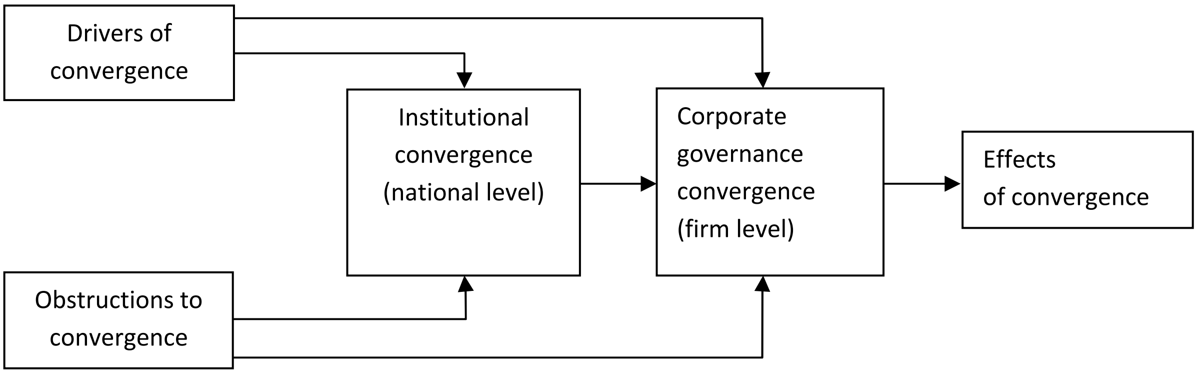
There is a view that in this era of globalization many nations would try to emphasize their national differences and identity. The consequence of the integration of financial markets is that foreigners buy assets of a country through both foreign portfolio investments as well as through cross-border acquisitions. It is these investors that quite often demand reforms of corporate governance. This could cause a contra reaction against foreign investors by making it more difficult for them to gain control.

Social and commercial norms can be hindering as well for shaping a common corporate governance standard. The different governance systems in Germany and the US/UK say something about the social backgrounds in those countries. In Germany, social obligations are far more important than the interests of shareholders and although there are initiatives to harmonize regulations at European Union level, it could well be that the situation remains the same because of a clash of economies, now seen in the financial crisis that concerns many countries.

Although governments recognize the importance of property rights, the arrangement of those can differ considerably across countries. It is argued that governments play an important role in the allocation of control rights and its legal enforcement. A weaker property rights regime mostly means smaller firms and concentrated family ownership. In these regimes, companies organize themselves and invest in political capital, for instance: Keiretsu in Japan or Chaebols in Korea. These arrangements are quite long-term oriented and feature a strong incentive to maintain this situation (Milhaupt, 2004).

Basically it comes down to the existence of a number of options for the optimal corporate governance structure. Nations can choose different packages of practices that eventually create the same sort of corporate governance (Khanna et al, 2006). Moreover, each empirical study on corporate governance convergence produced inconsistent and unclear results. On the other hand it could be argued that these different optimal configurations are just harmless mutations and that a common standard will eventually eliminate all instances of divergence (Hansmann and Kraakman, 2001). As can be seen, both convergence and hindrances to convergence co-exist in a field of tensions.

FIGURE 1: CONVERGENCE IN CORPORATE GOVERNANCE; ANALYTICAL FRAMEWORK



2.6 NO IDEAL CORPORATE GOVERNANCE SYSTEM

Research on corporate governance has shown that there is no clear answer on the question which corporate governance system is best and will eventually rise up to be the system of the future. This is due to the fact that each model has strengths and weaknesses that only become clear in different environments or circumstances. For instance: in the 1980s and early 1990s, the Japanese model as considered as optimal (Porter, 1992) but after a while the US model was highly regarded. After a couple of corporate malfeasance scandals (ENRON and Worldcom) the US model lost its luster as well. Clarke (2011) therefore suggests that because the very meaning of convergence is so uncertain, as well as the failure over so many years to come to any consensus as to whether it is occurring, perhaps it is time to abandon the 'future speculations approach' to comparative corporate governance studies. One could ask what purpose is really served by trying to figure out if convergence is inevitable or not. However, there is value in determining which features of which system perform well or less optimal.

3. METHODOLOGY

3.1 INTRODUCTION

The purpose of this chapter is to enlighten the methodology of the used research approach; specifically concerning the steps necessary to answer the central research question. Since the central research question and its sub questions have been discussed in chapter 1, there will be no further elaboration on that subject. This chapter will concentrate on the empirical part of the research, consisting of the case studies and the analysis.

3.2 PURPOSE OF RESEARCH

This research can be characterized as descriptive-exploratory since its purpose is to find out what is happening, to seek new insights, ask questions and assess phenomena in a new light (Saunders et al, 2009). Exploratory research also means that the focus is initially broad and becomes progressively narrower as the research progresses and case studies are being performed.

The goal of this research is to find out whether there are signs of convergence of corporate governance and in which form these occur.

3.3 CASE STUDIES

Case studies focus "on one or a few instances of some social phenomenon, such as a village, a family or a juvenile gang" (Babbie, 2001). Another definition of a case study is "a strategy for doing research which involves an empirical investigation of particular contemporary phenomenon within its real life context using multiple sources of evidence" (Saunders et al, 2009). Yin (2003) adds that within a case study, the boundaries between the phenomenon being studied and the environment in which it is being studied are not clearly evident. There is also little consensus on what may constitute a 'case' and the term is used broadly.

Case studies are performed for a number of reasons. They may be descriptive but can also be explanatory with the goal of trying to understand certain social processes and structures. In this research case studies are used to create an understanding to what extent different corporate governance systems can converge. Hence, the character of these case studies is merely descriptive. Other reasons for employing case studies are that they may also give the researchers an idiographic understanding of the particular case under examination or can even be the basis for development of "more general, nomothetic theories" (Babbie, 2001) .

The reason why case studies are chosen as the research method in this research is because they are useful in giving answers on 'how' and 'why' questions about a contemporary set of events over which the researcher has little or no control (Yin, 2003). An insightful description of complex events is no trivial task. Descriptive work can be very important because there can be a great deal which is still unknown or because our explanatory abilities are weak, and because good description is partly dependent on good explanation. An often overlooked advantage of in-depth case studies is “that the development of good causal hypotheses is complementary to good description rather than competitive with it” (King et al, 1994).

Quantitative studies can average out typical details and nuances, thus neglecting the ‘exceptions to the rule’, whereas qualitative research – i.e. case studies – pays attention to the specific circumstances in which the subject of the case study is situated and maybe influenced.

The case studies that will be used in this research are a type of formal study in which data are gathered through interviews. To give a good description of the dynamics of cross-border mergers and acquisitions in relation to a possible convergence of corporate governance, an in-depth examination is required. The use of case studies facilitates the answering of the ‘how’ question and gives some inside information about the underlying processes that govern cross-border M&As and corporate governance convergence.

The case studies will be performed as qualitative field research. This kind of research enables researchers to observe social life in its natural habitat: to go where the action is and watch (or ask questions). There are several elements appropriate to field research. To name a few: practices, roles, relationships and organizations. As can be imagined, these topics more or less appear in this research. Practices of the target company could well be different than those of the acquirer company, not in the last place because of different regulatory backgrounds. Roles differ too, since companies with varying corporate governance systems have different management structures and therefore different competences and tasks. Relationships between for instance employees and employer are influenced by use of a certain corporate governance system. The same applies to the organizations.

3.4 Selection of case studies

The case studies in this research were chosen according to a few criteria. The focus of this thesis is on the development of differing corporate governance systems and whether this occurs in a converging direction. Different governance arrangements in countries – regarding the protection of shareholder rights and employees in target and acquirer country – form the basis of the hypotheses. It is therefore necessary that the case studies are set up in a way that these assumptions can be tested.

Since corporate governance still differs across countries and thus involves different arrangements for protection of employees and shareholder rights, these different corporate governance systems were the basis for selecting case studies. Moreover, each acquisition in a case study encompasses companies that feature different systems of corporate governance, as to be able to study the consequences of acquiring a company with a different system of corporate governance than the acquirer itself.

Furthermore, stock listed companies were selected because of the necessity of presence of shareholders. Another reason for using these companies is the larger scale and greater impact of a merger or acquisition on stakeholders and company structure. This offers better opportunities to study corporate governance changes.

In total, 4 mergers and acquisitions were chosen for executing the case studies. The acquiring companies each had a total revenue of more than 5 billion and employed more than 10,000 people. Since type of industry or product does not have consequences for the arrangements of corporate governance, these factors were not regarded as relevant in the selection of the companies.

3.4.1 Operationalization

To determine the type of corporate governance convergence, three forms of corporate governance convergence were studied. These types of convergence were: functional convergence, when existing governance institutions are flexible enough to respond to the demands of changed circumstances without altering the institutions' formal characteristics; formal convergence, when an effective response requires legislative action to alter the basic structure of existing governance institutions; and contractual convergence, where the response takes the form of contract because existing governance institutions lack the flexibility to respond without formal change, and political barriers restrict the capacity for formal institutional change.

To establish which form of convergence – if present – would be applicable three elements of corporate governance were studied: shareholder rights, accounting and disclosure standards and board structure and functioning. An operationalization of these terms is given in the table below. The indicators for shareholder rights were adapted from Bris and Cabolis (2004), the accounting and disclosure indicators were adopted from Nam (2004) and the board composition and functioning indicators from Leal and Carvalhal da Silva (2005).

TABLE 3: OPERATIONALIZATION OF CORPORATE GOVERNANCE ELEMENTS

Dimension	Operationalization	Indicators
Corporate governance	Accounting & disclosure standards	- Disclosure semi-annual reports - Disclosure quarterly financial statements - Website with corporate information - Accounting and audit standards compared to international standards (for example IAS/ISA)
	Shareholder rights	- One share one vote - Proxy by mail allowed - Shares not blocked before meeting - Cumulative voting/proportional representation - Oppressed minority - Preemptive rights to new issues - % of share capital needed to call an extraordinary shareholder meeting - Mandatory dividend
	Board composition and functioning	- Chairman and CEO independent - Separate audit, appointment and remuneration committees - Board made up of outside and independent directors - Board size between 5 and 9 members - Board members’ terms of service

3.5 Case study data collection

When executing case studies, there are basically six sources of evidence according to Yin (2003): documentation, archival records, interviews, direct observation, participant observation and physical artifacts. The sources of evidence used in this research consist of documentation and interviews with members of the management of the companies as described above. Not all data in these case studies were gathered through interviews but also with help of scientific and newspaper articles on the acquisitions.

3.6 Interviews

As mentioned before, one source of evidence are interviews with the relevant actors of the concerning case study. According to Babbie (2001), “A qualitative interview is an interaction between an interviewer and a respondent in which the interviewer has a general plan of inquiry but not a specific set of questions that must be asked with particular words and in a particular order”. At the same time though, the qualitative interviewer obviously needs to be familiar with the questions to be asked, which allows for a smooth and naturally proceeding interview. Therefore, a qualitative interview is in essence “a conversation in which the interviewer establishes a general direction for the conversation and pursues specific topics raised by the respondent” (Babbie, 2001). As Yin (2003) states, the interviewer has two jobs: “(a) follow your own line of inquiry, as reflected by your case study protocol, and (b) ask your actual (conversational) questions in an unbiased manner that also serves the needs of your line of inquiry”.

According to Kvale (1996), two different metaphors for interviewing can be distinguished: the interviewer as a ‘miner’ or as a ‘traveler’, all dependent on the specificity of the information that the interviewer wants to extract from the subject. Elaborating on these metaphors, the role of the interviewer in this research could be characterized as a ‘miner’, trying to find specific information about aforementioned subjects and processes.

The key to a good interview is to construct good questions in which bias is avoided. Besides that, there is also a risk of respondent bias when the interviewee gives answers that the interviewer likes to hear. In this case study, the interviews are semi-structured, which means that there is a list of themes and questions to be covered (Saunders et al, 2009). The order of questions might vary depending on what the respondent answers and how the conversation develops. From Saunders et al (2009), we also learn that interviews can be distinguished by the function of the interviewees, namely as respondents or as informants. When looking at this interview typology, this research probably consists of both worlds since the interviewer directs the interview but at the same time it could be possible that the participant can suggest other persons to be interviewed as well as other sources of evidence. This way the respondent also plays the role of an ‘informant’ (Saunders et al, 2009; Yin, 2003).

The sequence of the interviews consists of three sections. Firstly, a set of introduction questions has been composed with the purpose to gather some background information on previous acquisition experience. This is followed by a set of in depth questions regarding the most recent acquisition and covers the subjects of research named in the central research question: the corporate governance regulations and whether there are any signs of convergence or maybe divergence.

Preferably the interviews are taken face to face, on location, which assures that the interviewees are as comfortable as possible. Unfortunately, due to time restrictions and difficulties regarding scheduling of interviews with interviewees, the number of case studies was limited. This meant data had to be acquired by researching other acquisition through use of newspaper articles and scientific publications on specific mergers and acquisitions.

The guarantee of confidentiality regarding the outcomes meant the interviewees could speak freely. Before each interview the protocol was explained and interviewees were asked if they had any objections against taping the interview. The length of the interview varied between 30 to 45 minutes and afterwards the interview was transcribed. A good reason for recording and transcribing is to provide an accurate rendition of an interview (Yin, 2003). The transcription has been done literally to stay close to the original interview as possible.

In the first Chilean case study, Mr. Matthias Mohr, at Sociedad Punta de Lobos was interviewed. Since the acquisition of Chilean SPL by German K+S in 2006 he is the general manager of the Chilean salt mining company. In the other Chilean case study interview questions were addressed at Mr. Gustavo Zang, director M&A's at PricewaterhouseCoopers in Santiago de Chile, who was previously involved in an English-Chilean acquisition.

3.7 Description of case studies

3.7.1 K+S & Sociedad Punta de Lobos

The acquisition of the Chilean salt producer Sociedad Punta de Lobos (SPL) by K+S Aktiengesellschaft – a German company - was concluded on 29 June 2006. K+S bought 99.3% of the company for just under € 385 million; after deducting the debts taken over by K+S, the purchase price comes to about € 365 million. The business was being taken over retroactively with effect from 1 May 2006.

SPL is South America's biggest salt producer. It obtains salt very cost-effectively from an open-cast mine in the Atacama Desert and also produces sea salt from its own facility in Brazil. In addition, with Empremar S.A., SPL operates its own shipping company in Chile and it owns the distribution company ISCO in the United States. SPL's headquarters are in Santiago de Chile. The chief sales markets are South America and the east coast of North America. Almost 850 people are employed in the production plants, sales organisation and logistical units.

In this transaction, K+S, Europe's leading salt producer in the shape of ESCO – European Salt Company, was advised by the Investmentbank AssetChile, the law firm Freshfields Bruckhaus Deringer, and the auditing firm Price Waterhouse Coopers. The purchase price was financed by the Deutsche Bank in the form of a syndicated loan.

3.7.2 Biwater U.K. & Cascal

The Biwater Group is a leading water and wastewater business which develops and delivers solutions and services to a wide client base across the world. The main UK business streams are Construction and Consultancy. Established in 1968, Biwater has grown from its construction and manufacturing foundations in the UK to encompass the full spectrum of water and wastewater services in over 30 countries including: water and wastewater treatment; membrane technology and desalination, water infrastructure investment and operation; water asset management and consultancy and water leisure facilities design and construction.

Cascal is a specialist investor and operator of water and wastewater systems. It was formed in April 2000, and nowadays is a subsidiary of Sembcorp Utilities, a leading energy, water and marine group listed on the main board of the Singapore Exchange. Cascal has an extensive knowledge of the international water market and invests in and operates water and wastewater facilities worldwide. The company is currently working in eight countries across four continents.

In 2006, Biwater acquired Cascal for 100%.

3.7.3 Vodafone & Mannesmann

In 2000, Vodafone AirTouch succeeded in taking control of Mannesmann after last-minute concessions overcame the objections of the German group's board. The acquisition is the largest corporate in history with a £112bn ($183bn) all-share deal. The new company – back then with around 42 million customers – is run from Vodafone's Newbury headquarters, although Mannesmann continues to have a head office in Düsseldorf.

The offer Vodafone's made and was agreed upon gives Mannesmann shareholders a 49.5% stake in the new business. This is just short of the majority control that Mannesman chairman Klaus Esser had sought earlier. Mannesmann shareholders were given 58.964 Vodafone shares for each stock they held in the German group, a £5bn increase on the original offer of 53.7 shares.

3.7.4 Rhône-Poulenc & Hoechst

The Company was founded in 1928 through the merger of Société des Usines Chimiques du Rhône (Society of Rhône Chemical Factories) from Lyon and Établissements Poulenc Frères (Poulenc Brothers Company) from Paris founded by Étienne Poulenc, a 19th century Parisian apothecary and brought to prominence by his second and third sons Emile and Camille Poulenc (1864–1942). In 1950, the company synthesized chlorpromazine which it sold to Smith, Kline & French (today part of GlaxoSmithKline) who marketed the drug as Thorazine. In January 1999, Rhône-Poulenc merged with Hoechst AG to form Aventis. In 2004, Aventis went on to merge with Sanofi-Synthélabo forming Sanofi-Aventis, the third largest pharmaceutical company in the world.

In 1997, the chemicals division of Rhône-Poulenc was spun off into a separate company named Rhodia. The agricultural chemicals division of Rhône-Poulenc, known as Aventis CropScience after the merger with Hoechst, was sold to the German chemical and pharmaceutical company Bayer in 2002.

4 - Results

4.1 Introduction

In this section the results of the case studies are presented. Two of these case studies were executed in Chile and it became obvious that gathered information on ‘accounting standards’ and ‘shareholder protection’ were the same in both Chilean cases. This is the reason why it was found to be redundant to discuss these indicators separately in each Chilean case study. Therefore, these indicators are discussed as a separate section above both Chilean case studies.

4.2 Accounting and disclosure standards

Chile has taken significant steps over the last several years to strengthen the quality of its financial and non-financial disclosure, notably in adopting and implementing International Financial Reporting Standards (IFRS). Its new Corporate Governance law achieves significant additional improvements by strengthening auditor independence requirements, requiring them to attend shareholder meetings to respond to questions raised by shareholders, strengthening Superintendency of Securities and Insurance (SVS: the government entity in charge of capital market regulation) oversight of the auditing profession, refining the definition of related party transactions in accordance with IFRS standards and enhancing the role and independence of Directors’ Committees in reviewing such transactions.

Another key actor in Chile’s corporate governance framework is the Public Enterprise System (SEP). This is the main state institution responsible for exercising the state’s ownership function for most State Owned Enterprises (SOEs) (23 out of 32), However, separate legal and institutional arrangements are in place for many of the larger or more prominent SOEs. It is in this area that Chile has been taking important steps to make these supervisory arrangements more uniform by establishing a new SEP Code of Conduct and new procedures for appointing independent directors in the 23 SOEs under its supervision. Similarly, the SOE corporate governance legislative proposal to expand the number of SOEs subject to SEP and SVS supervision would extend the application of international accounting and audit standards to nearly all SOEs.

One of the issues that Chile has considered during the review period is the recommendations of the 2004 Accounting and Auditing Report on Observance of Standards and Codes (ROSC) carried out by the World Bank. Chile has taken action on several of these recommendations. Questions were raised during the review concerning the clarity of the division of responsibilities between Chile’s Institute of Auditors, which self-regulates the implementation of auditing technical standards consistent with international norms, and the role of SVS, which in turn ensures that minimum standards are respected. However, the Chilean authorities maintained that SVS should continue to play an active role, which would be strengthened further by the new corporate governance law, in light of the fact that Chile’s Institute of Auditors has only recently begun playing a more active role and that regulatory safeguards are needed to ensure that both play their roles as required.

Review of disclosure, auditing and accounting provisions applying to SOEs show that Chile is making an effort to harmonize standards applying to most SOEs, with further progress achieved in April 2009 through the enactment of the Transparency Act, requiring all SOEs to disclose the same information as corporations are required to provide to the SVS. There may be scope to clarify the division of responsibilities between different auditing functions for SOEs in Chile, with a view towards reducing the degree of overlapping external auditing responsibilities between external auditors, the Controller, and in exceptional cases such as in the mining sector, specialized review bodies.

4.3 Shareholder rights

Identical to other Latin American countries, the Chilean legal system stems from a French origin. Over the years however it started to evolve towards a surprisingly high degree of investor protection, mostly through the pressure of institutional investors. The kinds of variables that determine the extent to which the system of corporate governance protects outsider (and, especially, minority) interests, and which are characteristic of the English system include the following (La Porta e.a. 1998, see also Appendix B):

(1) the one share-one vote principle,
(2) proxy vote by mail allowed,
(3) shares not blocked before a shareholders' meeting,
(4) cumulative voting with proportional representation, oppressed minority rights,
(5) preemptive rights to new share issues that can be waved only in writing, and
(6) low percentage of share capital needed to call an extraordinary shareholders' meeting.

Although the principle of one share-one-vote is protected by law in Chile, it can be evaded through the issue of different classes of shares. Proxy votes by mail are not allowed which makes it more costly for small shareholders to exercise their rights. In addition, before a new law on corporate governance was introduced by Congress in 2000, the rights of American Depository Receipt (ADR) holders were vested on and exercised by the president of the board of directors. Regarding the fact that several large Chilean corporations have been issuing new shares on the New York Exchange for almost twenty years, this provision caused an even greater concentration of power in the hands of controllers. Furthermore, it reduced the incentive of foreign investors to hold Chilean shares through the ADR mechanism.

Shares need to be registered five days before a shareholders' meeting to be allowed to vote on the principle of one share-one-vote, taking into account the exceptions noted above. To call an extraordinary shareholders' meeting, five percent of share capital is required. This percentage is relatively low compared to international average and therefore seems to be positive for the protection of shareholders' rights. In Chilean corporate law there are provisions present that concern the oppressed minority.

As far as information access for shareholders is concerned, current legislation features quite limiting provisions. For instance, management of a firm can withhold certain information from shareholders if an action is still under negotiation to prevent prejudice by making such information public. To impose such a ‘reserved’ status on information it must be approved by at least 75 percent of the votes of the Board of Directors. Moreover, this information must be communicated to the SVS under confidentiality, the day after the vote. This provision can limit transparency because controllers of a company could opt to hide information from minority shareholders and from the public in order to use it for their own benefit.

Until approval of a new law on takeover bids, it was possible to exclude some shareholders from a takeover offer. Old legislation only vaguely mentioned an obligation to inform the public of a party’s intention to make a tender offer. Nothing was mentioned on aspects such as non-discrimination, right to revoke a bid and the role of the leadership of a company during such tender offers. In essence this meant that small shareholders and holders of ADRs could be surpassed and had to bear the consequences in the form of lower share prices. The new law tries to provide a regulatory framework regarding share prices during takeover bids and rent extraction from controllers.

Elaborating on the new law on tender takeover offers, it tries to minimize the manager-shareholder agency problem by setting up auditing committees and requiring independent directors. Moreover, it also regulates dealings between related parties in order to ensure that controllers do not extract rents from non-controlling shareholders. When the board of directors is not able to reach agreement, the audit committee must designate independent evaluators. Shareholders that represent at least 5 percent of shares can also try to resolve such matters by requesting an extraordinary shareholders’ meeting.

4.4 BiWater & Cascal

4.4.1 Institutional environment and corporate arrangements

The situation in Chile is different than for instance Argentina. Countries like Argentina experience lots of influence from political sources and unions. Chile created a very solid regulator capability and the regulator already existed when the privatization process took place. At BiWater this was seen as an advantage and besides that, Chile has a good track record from an investment point of view.

In the UK the water companies were regulated. This meant they got into a situation where they had enough money to keep growing but they could not expand in the UK. Hence the only way to get into unregulated income is to go abroad. At that stage, the former state owned company had been privatized but yet deployed the same people. Privatization was accomplished by selling of shares of the company into the public. So actually the ownership of the company was completely split.

Cross-holdings are not allowed and indirect control structures are very common in Chile; however non-voting shares are unusual. Chilean economic groups control 70 percent of listed companies and 90 percent of their assets and control concentration is also very high in Chile. The five largest shareholders control 57 percent indirectly in Chile.

Corporate ownership was highly concentrated with the main owner being often a group with interests in a large number of companies and in several sectors of the economy. In these circumstances, a conflict arises between the controllers (or "blockholders") and non-group shareholders. There have been attempts at rent extraction on the part of blockholders, which have shown that such actions are possible and that company controllers have the incentives to engage in them. This may be acting to discourage potential small shareholders from entering the market.

There were two types of shareholders: the shareholders that used to be state companies and 'normal' investors. The former state companies were quite keen on keeping their former influence regarding control of the company whereas normal investors had their focus on returns-on-investment. The reflexes of the former state companies show that Chile's corporate governance system has been developing towards a certain standard of legal system that is more in line with typical corporate governance provisions in economies like the US or Europe.

Board structure and functioning were not in line with international standards. The chairman of the board and the CEO were the same person which is quite an impediment to independency and transparency. Besides that, it reduces firm value. The board at Cascal did not use committees, was not made up of a majority of outside directors, directors did not serve consecutive one-year terms, and did not have a minority shareholder mandated fiscal board.

An interesting feature of Chilean corporate balance sheets is that debt-equity ratios are extremely low. This is in itself quite surprising, since in "insider" systems like Chile's, managers will prefer to finance projects with debt rather than with new share issues, which decrease their ownership and control. Agency theory also tells us that bond markets prefer to lend to companies with highly concentrated ownership, since the agency problem between owners and managers tends to be much less intense in such companies than in those with widely disperse ownership patterns. The cause for such low levels of indebtedness in Chilean companies is partly related to the somewhat undeveloped nature of the Chilean capital market. Though some large Chilean companies issue bonds domestically, the organized bond market is still quite shallow, with very few daily transactions. The big purchasers of bonds are the AFPs (the Administradoras de Fondos de Pensiones: Pension Funds) and insurance companies, which tend to hold them to maturity. AFPs are restricted to a maximum of 20 per cent of any single bond offering. Since there are only eight AFPs, the same AFPs appear as purchasers of practically all new bond issues.

In the case of BiWater & Cascal the protection of shareholders in Chile was on certain points valued as high as in the U.K. In Chile there is no squeeze-out mechanism which means that all shareholders are more or less equal and will be treated as such.

TABLE 4: ANTIDIRECTOR RIGHTS INDEX (MEASURE OF SHAREHOLDER PROTECTION BY LA PORTA E.A., 1998) BIWATER AND CASCAL (SEE APPENDIX FOR EXPLANATION COMPONENTS)

	BiWater	Cascal
The one share-one vote principle	1	1
Proxy vote by mail allowed	1	0
Shares not blocked before a shareholders' meeting	1	1
Cumulative voting with proportional representation	0	0
Oppressed minority rights	1	1
Preemptive rights to new share issues that can be waved only in writing	1	1
Percentage of share capital needed to call an extraordinary shareholders' meeting	1 (10%)	1 (5%)
Antidirectors rights index	6	5

4.4.2 Corporate governance and employees

In Chile there are quite a few unions present, but are mostly active in the mining industry. In the BiWater/Cascal deal they were not very strong and involved. It was noted that at the very initial stage there were some technical criteria. If a company wanted to acquire an asset in the water sector you needed to prove that you were capable of managing an asset in the water sector.

A specific feature of Chilean capital markets not found elsewhere in emerging markets is the existence of well-developed institutional investors. These are the private pension managers that arose from the pension reform of 1981. The reform replaced a pay-as-you-go system run by the state which had defined benefits by an individual-capitalization system with defined contributions and run by heavily regulated private firms (the Administradoras de Fondos de Pensiones, AFPs). All Chilean workers are obligated to choose an AFP, to which they must contribute 10 per cent of their monthly incomes (plus an administration fee). At retirement, they can opt between a lump sum that must be converted into an annuity and a programme of monthly withdrawals. The AFPs now manage assets that are worth about one half of the country's GDP. In spite of the limitations imposed upon the AFPs in the kinds of investments they can make, they have been responsible for a significant deepening of the stock market.

4.5 K+S & Sociedad Punta de Lobos

4.5.1 Institutional environment and corporate arrangements

When a company acquires abroad and the market is not fully open there are capital inflow restrictions for example. There are certain regulations how a company can invest in Chile: certain forms need to be filed, which does not exist in Europe. Also there may exist certain restrictions for certain operations that can only be done by Chilean nationals. This means that foreign acquirers need to take care of those restrictions. For example, Empremar (maritime business) has a Chilean manager because there are certain codes that say: a maritime company needs a Chilean manager.

Regarding the government, Mr. Mohr experienced it to be relatively efficient; not the crazy scenes of Argentina and Brazil. One cannot establish a trustful position/relation with the state in those countries. With a change of government, it is quite likely that there will be a change of the law (and interpretation) a company has to fight against. In Chile there is a stable regulatory background that allows for big investments which is appreciated by K+S. At K+S lots of questions were received: “Do we have to fear for our money when we invest 500 millions there? What happens next year when there is a change in government?”. The answer was that nothing serious would happen because of this thorough regulatory background. Chile has a stable democracy, whether it is center left or center right government. There may be different accents in certain politics but not structurally different so there is no fear of someone taking the company away or impose strange regulations that make a company’s work impossible.

Corporate ownership of SPL was concentrated. The board – the owners were five persons – also had one speaker, who was the main shareholder. This was 70% of the controlling stake, 30% Citibank. They together own the company and sat in the board. They also instructed the general manager that was here before and respectively told the other managers to do what they wanted them to do. In the smaller companies in Chile exists hierarchical and direct leadership: The board dictates and the general manager executes. Cultural change is important and it needs to be done carefully to be more European style and to allow for more discussion. In many parts the general manager does not know what the right solution is, so he needs experts. As Mr. Mohr put it: “Sometimes it is not good that the general manager says: this is what we do. And the experts say: oh my god”. They tended to follow hierarchical distance. Therefore it is better to change the system, especially today with high levels of responsibility. Moreover, with the CAPEX it is necessary to allow for talking and another more open-minded structure.

Also necessary in regard of strategic decisions is to expand to another country. The arguments for this expansion need to be put carefully and the topic needs to be developed slowly. Friction is to be avoided. After the acquisition, the way decisions were made remained basically the same. Formerly there existed a Chilean board, which was very direct. Today there is a remote board from Germany, some other experts – 5 to 10 depending on the topic – and lots of reporting issues. But apart from that, the internal structure of decision making is more or less the same.

Control used to be very high in the Chilean company but today reporting standards are more in line with international governance standards, which gives K+S/SPL more freedom to think because they “know who to turn to”. Certainly from a corporate governance perspective there is a lot of additional regulation from a stock listed company in comparison to the old structure, but that is somehow embedded into the reporting schedule.

The adoption of banking supervision practices limit the power of controllers to misuse bank lending for their own benefit and to the detriment of non-controlling shareholders, depositors, and tax payers. The Chilean story shows that, in developing country settings, there are enormous synergies between improved corporate governance and improved banking supervision. This situation is quite comparable to that of Germany.
In Chile there exists an own human resource area, own purchase area and administration. In countries like the Netherlands and France, this does not exist because corporate headquarters are so close. In the past there was a board, where financial investors were present: “like it or not, they said yes or no”.

Nowadays the management has to go to Germany to ask K+S for approval for a project. This is a type of corporate governance which is typical for DAX company, and is under lot of scrutiny. There are people being paid just to control that everything is running fine in the process of approval. These kind of issues: a company has a long standing relationship with bank X, the company takes money from bank X for 3%. This may be a perfect deal for SPL but seen from a group perspective there is a long standing relation with X Y Z. The group prefers Z, so we take Z.

Investment opportunities have been improved. Normally there is a center of control which offers limited freedom to come up with projects. Today, the planning process is more intensive; there is not the board anymore but a German commission that approves. When K+S acquired the company, they only brought two persons: Mr. Mohr and Mr. Miehlke, with the latter being president of the board, and external in the holding shell. Mr. Mohr as well sits in the shell, but as a sort of manager inside the company to monitor processes. There is only one man at the top.

As far as shareholder protection is concerned, SPL is a shared company, but it’s a closed one. In the distant past one could buy shares. Shareholder protection is not as bad as one might think. There still is no squeeze-out mechanism. The essence of that can be interpreted that even small shareholders have their rights. Maybe this is not good for the financial market but from a shareholder perspective it is good because no one can force someone else to sell. In all European states there are squeeze-out mechanisms but they are not as severe as in the US where a company can throw everyone out; maybe Europe is in between.

K+S tried to make use of the situation by paying a price that was seen as high from a Chilean perspective. Just five years before, the company was acquired by a group of investors with Citibank as an institutional investor on their side, for approximately 110 million dollars. K+S acquired it for 480 million. The owners that had it before made a huge bargain. They had a focus on the business that one can only have and execute when one is a private investor. No public company like K+S that has shares on the stock exchange could go to the supervisory board and say: “listen I have a company that is doing that and that, worth 1 million, but we offer 500 million”. No one would be able to sell this, it would be rejected.

TABLE 5: ANTIDIRECTOR RIGHTS K+S AND SPL

	K+S	SPL
The one share-one vote principle	1	1
Proxy vote by mail allowed	1	0
Shares not blocked before a shareholders' meeting	0	1
Cumulative voting with proportional representation	0	0
Oppressed minority rights	0	1
Preemptive rights to new share issues that can be waved only in writing	0	1
Percentage of share capital needed to call an extraordinary shareholders' meeting	1 (5%)	1 (5%)
Antidirectors rights index	3	5

4.5.2 Corporate governance and employee right protection

The union issue is country specific: there were huge issues with the Esco-deal since France has a strong position. Germany is strong as well, but perhaps a little more reasonable than France. In Chile, there are strong unions in mining business (where there’s lots of money: in copper and metal mining). In case of SPL the union counts 50 people, and it functions really more in the old sense of the word: they try to get collective bargaining (wages), so they try to speak with one voice versus the company. Not like Germany where the trade union sits in the supervisory board and asking questions about the acquisition and gives the vote. The union is not that present in decision making in Chile, which is perceived as good for the company.

In the acquisition, there were no troubles with trade unions because they were happy that an international company took over their business. In the past years Chilean companies were owned by the same people for a long time, who were trying to get the highest prices. Therefore conditions were harsh whereas a European company brings in a flavour: it will be fine. There is nothing to give away for free, but certainly the trade unions relations are well-kept.

The US are different with lay-offs; very easy and brutal at erasing people. The labor market is very flexible and one might doubt whether it is good or bad. In Europe there is very high employee protection, with high barriers to re-enter. An employer fires a person, who then receives compensation. The employer will think five times to let a new worker come in to fill in this place. “In Chile, an employer has two weeks. There is a meeting: “I don’t like to work at SPL anymore, I go to X, you will have to find a replacement, ciao””. This worker is gone in two weeks, and the employer needs to replace him. The labor market is very free.

There is however a high formality on closing work contracts: employers have to go to the public notary for every new work contract and also for the end of the work contract. All remaining payments need to be laid out, and both parties declare that with this payment everything is solved. Thus, formality is high and the flexibility of Chilean labor market is also high. It is easy to lay-off employees, but from know-how perspective it is obviously not always a good thing. “K+S policy is that companies will not execute harsh cuts, so people that are sent off are given a nice package so that they do not fall on the sidewalk so to say.”

4.6 Rhône-Poulenc acquires Hoechst to form Aventis

4.6.1 Institutional environment and corporate arrangements

Both merging companies come from countries with similar institutional characteristics, economic development, and financial markets. Besides this, both Germany and France are members of the European Union and the European Monetary System. This implicates that some aspects of the deal that are usually relevant in other cross-border mergers are not an issue here. These aspects are: combination of different markets, exchange rate considerations, and the domicile of the newly created firm.

Rhône-Poulenc, being established in France, operated under the predominant unitary system, which is comparable to the structure in place in the US. It features a Board of Directors or *Counseil d'Administration* whose members are elected at the general meeting of shareholders and a Chairman of the Board ("New Global Leader," n.d.). As a German company, Hoechst was established under the two-tiered system which consists mainly of a Board of Supervisors and a Board of Management. Finally, Aventis, even though incorporated in France, was structured as Hoechst, with a two-tier system allowed in France since the legislation reform in 1966. The companies agreed that Aventis should have a two-tiered German-style corporate governance structure. The main reason for doing so was because of familiarity with this model of former Hoechst shareholders and Aventis management, which consists of former Hoechst executives (Analysis Merger Plan, 1999).

Rhône-Poulenc did not have a Management Board. For Hoechst and Aventis, the Management Board bears the responsibility to manage the Corporation. The term for members of the Management Board at Hoechst was five years and that term has been maintained in Aventis. The number of members of the Management Board was set by the Supervisory board at Hoechst, but it is fixed at seven in the by-laws of Aventis. The Management Board is responsible to call shareholders' meetings in both cases (Hoechst and Aventis) (Gregoriou and Renneboog, 2007).

On the one hand, the German law stated that members of the Management Board at Hoechst could not be removed arbitrarily but only for a material cause. On the other hand, Aventis' by-laws state that such members can be revoked at any time by the Supervisory Board in accordance with the provisions of the French Commercial law (Gregoriou and Renneboog, 2007). Decisions of the Management Board are passed by the simple majority rule and, while at Hoechst the Chairman had casting vote in case of equality of votes, this power has been removed from the Aventis' Chairman. Moreover, at Hoechst there did not exist any limitations regarding decisions made by the Management Board. The French law that is present at Aventis however, requires that some decisions are to be approved by the Supervisory Board, as well as any major strategic decision.

TABLE 6: ANTIDIRECTOR RIGHTS RHÔNE-POULENC AND HOECHST

	Rhône-Poulenc	Hoechst	Aventis
The one share-one vote principle	0	1	1
Proxy vote by mail allowed	1	1	1
Shares not blocked before a shareholders' meeting	0	0	0
Cumulative voting with proportional representation	0	0	0
Oppressed minority rights	0	0	0
Preemptive rights to new share issues that can be waved only in writing	1	0	1
Percentage of share capital needed to call an extraordinary shareholders' meeting	1 (10%)	1 (5%)	1 (10%)
Antidirectors rights index	3	3	4

With respect to the functioning of the shareholder meetings, we find that both Rhône-Poulenc and Hoechst were very similar prior to the merger. Aventis, however, rather than combining the two structures, introduced improved provisions that were not present in the merging companies (Bris and Cabolis, 2004). This is a case of corporate governance convergence through a cross-border merger where the resulting entity is more protective of shareholders than the two original firms, and where the new entity improves the default legal system prescribed in the national Corporate Code. Interestingly, Hoechst had already adopted the one-share-one-vote principle and proxy vote by mail, which is not necessary in German corporate law (Hoechst, 2000).

4.6.2 Corporate governance and employees

In Germany, the Co-determination Act—introduced after the World War II and expanded in the 1970s—states that companies with fewer than 2,000 employees should have 2/3 of the Supervisory Board elected by shareholders and 1/3 elected by the employees. In companies with more than 2,000 employees the ratio is 1/2 elected by the shareholders and 1/2 by the employees. The general rule in Germany states that the Supervisory Board shall consist of three members. Exceptions allow the Board of Supervisors to have as many as 21 members. For companies with more than 20,000 employees the Board of Supervisors consists of 20 members equally equally representing the shareholders and the employees. (“Codetermination,” n.d.).

The Board of Directors from Rhône-Poulenc had a minimum of twelve members and a maximum of eighteen, three of whom were employee representatives. The Supervisory Board from Hoechst had 20 members, half of whom were employee representatives. Aventis has a Supervisory Board of 16 members, four of whom are employee representatives. All non-employee representatives were/are elected at the general meeting of shareholders. According to this, Hoechst's employees have lower representation in the Supervisory Board, while Rhône-Poulenc's employee representation has, in the worst case, remained the same and, in the best case, increased by 8.3% (Bris and Cabolis, 2004).

The German law states that in complying with its principal function, the Management Board should take into account not only the interests and wellbeing of the company and its shareholders, but also those of the employees and the larger surrounding community.

Both French and German unions said that "the success of the merger will depend to a large extent on its ability to motivate and involve the men and women employed in the firm." The two unions therefore came up with the following goals:

- Rejection of redundancies and any deterioration of working conditions;
- Upgrading equipment and staff in production, research, development and sales; and
- to maintain the co-determination system for the new company's German workers and to improve the industrial relations arrangements for French workers in this direction.

This declaration was distributed in both French and German (one side of the document in German and the other in French) in all of the two companies' plants on both sides of the Rhine (Bilous, 1998). Especially the last goal is interesting with relation to this research since it indicates the unique hybrid corporate governance provisions that were made for the new corporate entity: a new system with the most protective elements of both governance systems.

Since Germany is very employee oriented, the most remarkable differences lie in that area. The trade union sits in the supervisory board and is actively involved with issues regarding the acquisition.

4.7 Vodafone acquires Mannesmann

4.7.1 Institutional environment and corporate arrangements

In Germany, due to the density of intercorporate networks and high concentration of ownership, mergers are in general negotiated on a friendly basis among large block holders. Public tender offers, including hostile bids, therefore scarcely occur.

Looking at the existing German "model" of corporate governance there are a couple of features which are particularly relevant. One of them is that capital has a strong financial commitment to particular enterprises, which is reflected in a stable ownership, a strong role for banks, and the absence of a market for corporate control (Hall and Soskice, 2001). The level of corporate concentration in Germany is, on average, higher than in Britain or the United States. The largest owners are usually non-financial corporations and banks. These groups often pursue strategic interests related to organizational strategy and long-term relational incentives, since ownership strongly overlaps with a variety other commercial relations. These factors make owners more long-term oriented and bound to the welfare of the firm than is typical in liberal countries. There, institutional investors retain a greater capacity to exit and pursue solely financial returns on their shares.

Under new management though, a tendency towards shareholder orientation could be seen, especially at focusing on increased information for shareholders. In the old situation, the Supervisory Board had to go to much trouble to gather information.

As far as ownership structure is concerned, Mannesmann featured quite an internationally oriented structure compared to other German firms, with over 60 percent of its shares in the hands of foreign investors and 40 percent by U.S. and British investors. Initially, before Mannesmann took over Orange, there were no large shareholders and shares were fragmented. Due to ownership fragmentation voting participation at shareholder meetings was very low: 37 percent of capital was represented and 90 percent of these votes were cast through proxy rights of banks (Baums and Fraune, 1995).

A crucial issue in the takeover battle was the support of various institutional investors holding dispersed stakes. Shareholders lacked stakes large enough to execute some coordinated control and they did not have any strategic incentives for holding shares. The vulnerability of Mannesmann was that it lacked a committed ownership structure: Its shares were highly fragmented among institutional and foreign investors which were holding less than 1 percent of the share capital. While large blockholders in Germany may be effective monitors, high ownership concentration has other disadvantages: lack of capital liquidity, lack of risk diversification, costs for small shareholders unable to share the private benefits of control accruing to large blockholders, etc (Jackson and Höpner, 2001).

Although Mannesmann received very good ratings for investor relations, its value for shareholders was not likewise. There are a couple of reasons for this fact. First, its accounting practices lacked transparency; it had not yet adopted IAS or U.S.-GAAP standards, nor had it sought after a listing on the New York Stock Exchange. Second, managerial compensation was not stringently coupled to share prices. Third, the operational level lacked implemented shareholder-value-oriented performance criteria, such as discounted cash flow (UN, 2001). All in all this indicates a management that is less capital market oriented than would be imagined regarding the size of the company, international orientation, level of diversification and ownership structure.

At the moment of the takeover, German accounting and disclosure rules were often considered to lack transparency. Traditionally, German accounting has stressed very conservative prudence rules (Vorsichtsprinzip), creditor protection and long-term business conservatism. Both international standards (IAS) and US rules (GAAP) are more investor oriented: aiming for greater disclosure, valuation based on current market prices and stricter definition of profits. However, international accounting has arrived among large German firms. By 2002, 43 of the 100 largest German companies published balance sheets in accordance with US-GAAP or IAS (now: IFRS) accounting rules. Among them are 21 of the 22 companies with more than 50% of dispersed ownership (Monopolkommission, n.d.).

There were some issues regarding a lack of disclosure of ownership stakes. This might give bidders the advantage of being able to gather substantial stakes unnoticed. On the other hand, this lack of transparency may have a discouraging effect on potential bidders, since it is unclear to them what the power of minority blockholders acting as white knights (takeover defence strategy by acting as a third party for takeover) is. Lack of disclosure therefore makes takeover battles uncertain and full of risks (Dignam and Galanis, 2009).

In the absence of active resistance from stakeholders, the various regulatory factors (accounting rules, corporate law, competition law, and other defensive actions) were insufficient to ward off a hostile bid or to construct an adequate defense. German accounting rules did not discourage the takeover bid. In addition, past caps on voting rights in the Mannesmann corporate statutes were voided by the *Gesetz zur Kontrolle und Transparenz im Unternehmensbereich* (Act on Control and Transparency in the Corporate Domain, KontraG), passed in 1998, and went into effect mid-2000.

As far as board composition and functioning is concerned, the situation at Mannesmann was not quite perfect. Although Mannesmann featured an independent CEO and Chairman, the German two-tier board system showed it weaknesses in a sloppy supervisory board that gave high bonuses that had no relation to past performance. The appointment process of supervisory board members was not transparent in Mannesmann's case and because of that, independency was not guaranteed.

The case of Mannesmann can be seen as illustrative for the development of German corporate governance. Ownership is quite fragmented and other institutional factors that discourage takeovers do not provide enough effective resistance. German banks for instance, once played an important governance role but nowadays they do not offer takeover protection. This is because banks have shifted their orientation to investment banking with which relationship banking stands in conflict.

Germany has now adopted a new corporate law, with a stronger regulation of takeovers. The major points are the following:

- shareholders of the same class must be treated equally
- the shareholders of the target company must have enough time and must be provided with enough information to decide if they want to accept the takeover bid
- it is forbidden to create false markets by the trading in shares of bidder and target
- the bidder must have enough funding available at the time of the announcement of the bidding and
- a takeover bid must not restrict a target company in its ordinary business activities for more than a reasonable period of time.

The future will show if it works to make future takeovers more predictable and less vicious than the Vodafone – Mannesmann one ("Vodafone and German takeover law," n.d.).

Germany can no longer be described as having a bank-oriented, insider or stakeholder model of corporate governance. It can be concluded that complete international convergence is not the case, but Germany develops some sort of hybrid model of governance characterized by institutionalized employee involvement on one hand and an increasingly open capital market on the other hand.

TABLE 7: ANTIDIRECTOR RIGHTS VODAFONE AND MANNESMANN

	Vodafone	Mannesmann
The one share-one vote principle	0	1
Proxy vote by mail allowed	1	1
Shares not blocked before a shareholders' meeting	1	0
Cumulative voting with proportional representation	1	0
Oppressed minority rights	1	0
Preemptive rights to new share issues that can be waved only in writing	0	0
Percentage of share capital needed to call an extraordinary shareholders' meeting	1	1 (5%)
Antidirectors rights index	5	3

4.7.2 Corporate governance and employees

In Germany workforce has always been very organized in labor unions and have a distinct role even in political debates regarding Germany's economical development and future. Employees at Mannesmann were also members of *Industriegewerkschaft Metall*, (Industrial Union of Metalworkers), a very dominant metalworkers' union in Germany .

Employees constitute an important force in German corporate governance through the legal institution of codetermination. Codetermination refers to the rights of information, consultation, and codetermination in the decision-making structure of companies through both works councils and the employee representation on the Supervisory Board of German companies. This means that German management has to deal with voice from both capital and labor. The consequences are that management operates under a duality principle of both long-term profit maximization and employee utility (Hall and Soskice, 2001). In German corporations, a higher share of value-added goes to employees and a lower share to capital than in Britain.

The new Management Board structure at the target initiated conflicts with the labor representatives of the Supervisory Board. Past labor director Sigmar Sattler left Mannesmann, but remained labor director of Atecs AG (automotive and engineering division at Mannesmann, which was sold in the restructuring phase) (Schulten, 1999). Unexpectedly, Vodafone rejected the idea that employees should approve the appointment of a labor director to the Management Board, the traditional procedure at Mannesmann. As a result, labor representatives boycotted the shareholders' meeting and abstained from voting during the appointment of Julian Horn-Smith as spokesman of the Mannesmann Management Board. The consequence of this was that one of the Management Board members – originally from Mannesmann – was given additional functions as a labor director (Jackson and Höpner, 2001).

The rights of employees can have a negative effect on takeover activity. First, employee representation on the Supervisory Board lessens the direct influence of shareholders. Employee representatives are likely to support defensive actions taken by management in the event of takeover battles. Codetermination can be particularly decisive if the shareholder side of the Supervisory Board is divided among competing factions. Second, the institutional protection of employment and consensus in corporate restructuring reduces the capacity of hostile raiders to engage in *ex post* redistribution of wealth following takeovers.

5. CONCLUSION

This research presents results about the development of corporate governance, more specific: whether there are any signs of convergence in this area. Three indicators of corporate governance are considered: accounting standards, shareholder rights and board structure and functioning. To determine the type of corporate governance convergence, three forms of corporate governance convergence were studied. These types of convergence were: functional convergence, when existing governance institutions are flexible enough to respond to the demands of changed circumstances without altering the institutions' formal characteristics; formal convergence, when an effective response requires legislative action to alter the basic structure of existing governance institutions; and contractual convergence, where the response takes the form of contract because existing governance institutions lack the flexibility to respond without formal change, and political barriers restrict the capacity for formal institutional change.

This research suggests that cross-border mergers are a way to contractually transfer corporate governance systems. There are also signs of formal convergence. It is quite common in a cross-border merger for the target to adopt the accounting standards, disclosure practices and governance structures of the acquirer. Chilean salt mining company SPL adopted the German accounting system of K+S. However, the example of Hoechst and Rhône-Poulenc shows that there are also hybrid possibilities in which the most protective corporate governance arrangements of both companies are incorporated.

Especially in the case of Chile’s institutional environment it became apparent that quite some legislative action was undertaken to create an institutional setting that would create a valuable foreign investment climate. From the results of the case studies it can be learned that these changes are highly valued and that Chile is regarded as a country with a very stable institutional background.

5.1 DISCUSSION AND LIMITATIONS

This research has indicated that there exists a diverse array of research studies that explore the scale and direction of the phenomenon of corporate governance convergence across as well as within individual countries. Combining the results of this research study gives the opportunity to generalize about this process. First, extant literature indicates that market integration leads to a demand for greater efficiency. On its turn, this tends to fuel convergence or adoption of Anglo-American governance practices, quite regularly in adapted forms. Another generalization lies in the fact that capital market integration asks for a greater legitimacy in regard of institutional investors and international organizations, which also tends to drive convergence. Finally, the specific political and historical circumstances appear to impede convergence or create the need for corporations to adapt new corporate governance practices.

Whilst examining existing literature on corporate cross-border mergers and acquisitions and corporate governance convergence, it seemed there were some blank spots regarding this subject. Little is known about the effect of the acquirer's country governance structure on the governance practices of the target firm and whether the nationality of the acquirer has any influence on this matter. The insights of previous empirical studies should be used to determine the direction of future research. Some possible directions that came up during this research are discussed below.

5.1.1 Hybrid corporate governance practices

As could be seen, some authors are convinced that the outsider model of US and UK firms is the emerging global standard. However, there are country specific corporate governance regulations that still remain intact. This fact suggests that continuity and change in institutional environments often exist next to each other and form frameworks of two backgrounds: hybrid systems. What this means is that firms do not shift from one set of practices to another but choose options in between; i.e. options that combine local practices with new systems that are often imported from other institutional environments.

It is often quite complex to make changes in a certain institutional framework a company operates in. Corporations and countries cannot simply switch from the old model to a new practice, especially not those imported from a different institutional context. There are various forces from outside and inside the corporations or countries that can cause actors to respond by determining a strategic path. It is not unlikely that they defend their situation or look for compromises, all depending on the institutional setting and the circumstances they operate in.

Sometimes foreign practices are modified to fit the specific institutional and cultural context and hybrid systems are created. Some scholars suggested that for instance the Japanese practices will be a combination – a hybrid – of Anglo-American and Japanese systems and that there even are more options of hybrids that the Japanese system can adopt. In the case study of Hoechst and Rhône-Poulenc it was found that as firms in these countries try to find a balance between the external pressures for more market-oriented perspective and local rules and norms, the option of a hybrid system is often not far away. These then not only differ from the traditional arrangements in their countries but also from those of the Anglo-American context. This is a strategic choice that firms make to deal with the multiple and often competing interests and goals of their most important stakeholders.

Hybrid practices give an insight in the question whether convergence is likely or not. It would be necessary to compare countries because each country has a different environment that can generate different types of hybrid governance practices. Moreover, even on firm or industry level there can be differences that influence the characteristics of a hybrid form. Small firms for instance, may not be so willing to adopt new practices, whereas larger firms do. It is also possible that the optimal corporate governance structure is industry specific or even firm specific. In Chile there are firms that have better corporate governance indicators than others. This could be due to the fact that their global exposure is greater and that they face more global competition, which may lead them to lean towards a more US-oriented model instead of domestic. Case studies that focus on specific industries or firms within these industries can therefore give additional insights that would be lost in country-level research.

5.1.2 Institutional change

A common trend in corporate governance research is to see institutions as unchanging and national factors. It could well be that this view comes at its end since the globalization with its economic integration fuels the birth of a new type of institutions. Looking at the European Union, quite some new institutions have been developed that exert their influence on economic activities in its member states. For this reason it is important to incorporate these supra national institutions and their implications in research about institutional environments. There could well be an entire new level of interactions between institutions on national level and those at supranational level which on its turn could lead to corporate governance changes in both directions: a country influencing the supranational, but also the supranational influencing the country.

5.1.3 From concentrated to open ownership

Since part of this research was performed during an internship at PwC in Santiago de Chile, it is interesting to look at how Chile's corporate governance developed itself. It seems that it is often assumed that governance systems are divided into two categories: the US/UK-shareholder-oriented model and the stakeholder-oriented model found in countries as Germany and Japan (Hall and Soskice, 2001). As can be imagined after what has been shown in this research, it would be too simple to divide all governance systems in these two categories. In Chile there has been a distinct development from family-owned highly centralized firms to public firms controlled by professional managers. In between lay different nuances of corporate governance and degrees of corporate change, for instance: publicly listed firms that are owned by a founding family. Ownership and management are strongly interwoven in which means that findings in much research papers on governance, which assume a separate management and ownership, are not applicable to these. In emerging economies like Russia and China public corporations and institutions are created simultaneously, therefore providing enough new material for researchers to be studied. Would this be just a corporate governance development in compressed time or will something completely new occur? Since these countries do not really start from a certain corporate governance system, it will be interesting to see what role firm-level characteristics will play in their development or adaptation of new corporate governance practices.

5.1.4 Power distribution and corporate governance change

In Hall and Soskice (2001), it is suggested that a system of governance is a reflection of the distribution of power within a society. In Germany, labour unions have always had unparalleled power and are illustrative of relatively high stakeholder importance in Germany. In the US, power of stakeholders is far less and shareholders are more influential. Seen from this perspective, it could be hard to imagine that convergence will happen, especially considering the fact that different nations have chosen their own paths to an optimal distribution of power. An examination of the evolution of power structures and governance practices could therefore give an interesting view on convergence across countries as well as reasons for divergence or remaining equally different.

5.2 Limitations and suggestions for future research

Although empirical studies appear to have focused on a process of increasing cross-border similarity, it is not operationally clear what would constitute convergence. It is therefore necessary to be as specific as possible about the degree and form of converging or diverging governance systems.
A second issue is that comparability across research studies is difficult because different levels of analysis have been used. Multilevel analysis would probably give a wider usable insight into the process of corporate governance convergence.

With the limited number of performed case studies it is actually impossible to draw any definitive conclusions on the influence of cross-border mergers and acquisitions on corporate governance changes. Furthermore, since this thesis was performed as part of an internship at PricewaterhouseCoopers, the number of companies in Chile that could be approached in name of PwC for the case studies was quite limited because only the M&A customers of PwC could be approached through PwC itself.

Last but not least, to be able to give a representative demonstration of convergence, longitudinal qualitative studies are vital. Apart from fast-developing countries (and governance systems) such as China, convergence mostly is a slow process and needs more time to be studied appropriately. Normally a cross-sectional study identifies similarities but it does not answer the question whether there is or has been a movement between these similarities. Only through studies over a longer period it can be enlightened that a prior state has been left to evolve towards a new situation.

Quantitative large sample studies on convergence give an idea about trends but often generalize too much to provide insights in the specifics of a complex process like corporate governance convergence. Especially the interactions between important actors in the process of corporate governance change are a subject of qualitative research. Furthermore, corporate governance changes are often touched by the influence of multiple factors on different levels. Qualitative research on corporate governance mostly seems to limit itself to a single country. Therefore it would be a welcome addition to current research that future research on this matter would be performed from a cross-border case study approach.

Since there are many circumstances that have an influence on developments in corporate governance, it is not possible to make a general prediction of the path that convergence of national corporate governance institutions may follow. Since there will not only be variations between countries but also within these countries – because specific conditions can ask for particular responses – the range of predictions will be limited to the variation across and within national systems.

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APPENDICES

Appendix A: Interview script / Checklist

Subject: Corporate governance and convergence

Date:

Introduction

i. Word of appreciation for fulfilling request for interview
ii. Short description of personal background of interviewer
iii. Explanation purpose of research
iv. Inform the interviewee about use of data obtained from the interview
v. Agreement of confidence and nothing said in this conversation can be traced back to the interviewee or the organization. Interviewee may stop interview upon request
vi. Ask for approval for recording the interview for transcription

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START INTERVIEW
*voice recorder on

Part 1: Accounting and disclosure standards

1. Does the company's annual report, website or publicly disclosure include information about potential conflicts of interest such as related party transactions?
2. Does the company specify in its charter, annual reports or other means sanctions against management in the case of violations of its desired corporate governance practices?
3. Does the company use an international accounting standard (IASB, US GAAP, IFRS)?
4. Does the company use one of the leading global auditing firms?
5. Does the company disclose in its website or annual report compensation information for the CEO and board members?

Part 2: Shareholder rights

6. Does the company charter or verifiable actions facilitate the process of voting to all shareholders beyond what is legally required?
7. Does the company charter grant additional voting rights beyond what is legally required?
8. Does the company grant tag along rights beyond what is legally required?
9. Are pyramid structures that decrease control concentration present?
10. Do shareholder agreements that decrease control concentration exist?

Part 3: Board composition and functioning

11. Are the Chairman of the Board and the CEO different persons?
12. Does the company have monitoring committees such as a compensation and/or nominations and/or audit committee?
13. Is the board clearly made up of outside and possibly independent directors?
14. Is the board size between 5 and 9 members, as recommended by the IBGC Code of Best Practices?
15. Do board members serve consecutive one-year terms, as recommended by the IBGC Code of Best Practices?
16. Is there a permanent Fiscal Board?

17. Close interview
18. Thank participant for cooperating
19. Ask if the participant wants to receive a final summary of the study

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END INTERVIEW

Appendix B: Antidirector rights index explained

- *The one share-one vote principle*: Equals one if the company law or commercial code of the country requires that ordinary shares carry one vote per share, and zero otherwise. Equivalently, this variable equals one when the law prohibits the existence of both multiple-voting and nonvoting ordinary shares and does not allow firms to set a maximum number of votes per shareholder irrespective of the number of shares owned, and zero otherwise.

- *Proxy vote by mail allowed*: Equals one if the company law or commercial code allows shareholders to mail their proxy vote to the firm, and zero otherwise.

- *Shares not blocked before a shareholders' meeting*: Equals one if the company law or commercial code does not allow firms to require that shareholders deposit their shares prior to a general shareholders meeting, thus preventing them from selling those shares for a number of days, and zero otherwise.

- *Cumulative voting with proportional representation*: Equals one if the company law or commercial code allows shareholders to cast all their votes for one candidate standing for election to the board of directors (cumulative voting) or if the company law or commercial code allows a mechanism of proportional representation in the board by which minority interests may name a proportional number of directors to the board, and zero otherwise.

- *Oppressed minority rights*: Equals one if the company law or commercial code grants minority shareholders either a judicial venue to challenge the decisions of management or of the assembly or the right to step out of the company by requiring the company to purchase their shares when they object to certain fundamental changes, such as mergers, asset dispositions, and changes in the articles of incorporation. The variable equals zero otherwise. Minority shareholders are defined as those shareholders who own 10% of share capital or less.

- *Preemptive rights to new share issues that can be waved only in writing*: Equals one when the company law or commercial code grants shareholders the first opportunity to buy new issues of stock, and this right can be waived only by a shareholders' vote; equals zero otherwise.

- *Percentage of share capital needed to call an extraordinary shareholders' meeting*: The minimum percentage of ownership of share capital that entitles a shareholder to call for an extraordinary shareholders' meeting.