The Evolutionary Mechanisms of Hybridization in The Current Global Environments of Corporate Governance: Potential Stabilities of Hybrid Structures

Presented
By

Hideki Takei

To
The Department of International Business and
The School of Business
In partial fulfillment of the requirements for
The Degree of Doctor of Business Administration
In the Subject of
International Business

Southern New Hampshire University
Manchester, New Hampshire
U.S.A.

August 10, 2004

Committee Approval:

Philip Vos Fellman, Ph.D. (Chairman) Professor of International Business Strategies	Signature	8/10/04 Date
Mahboubul Hassan, D.B.A. Professor of Finance and Economics	Signature	8/10/04 Date
Massood V. Samii, Ph.D. Professor of International Business and Strategies	Signature	8/10/04 Date
Nicholas Nugent, Ph.D. Professor of International Business Marketing	Signature	8/10/04 Date

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Acknowledgements

Masao Takei (1912-2001), my grandfather and mentor, who game me unconditional trust, love, and support. He still watches me from Heaven, for which I give thanks. He was the first person who respected and protected my dignity.

My family members, who have always shown me kindness and tolerance all my life.

Dr. Philip Vos Fellman, chairperson of my committee, who has been my mentor and colleague during our five-year relationship as friends and research partners.

Dr. Massood V. Samii, who has respected and protected my dignity and nurtured my scholarly growth. He has been a great department chairman and my completion of this degree is in large part due to his leadership in the Southern New Hampshire University Department of International Business.

Dr. Nicholas Nugent, who has encouraged me along every step towards the completion of my doctoral studies.

Dr. Mahboubul Hassan, who has aided me in my research design and significantly contributed to my dissertation.

Professor Izumi Nokana, who has supported me since my bachelor studies in Josai University.

There are many additional persons to whom I would like to express my gratitude, both at S.N.H.U. and at other institutions and societies, including the Academy of International Business, the Academic Association for Organizational Science, and the Association for Global Business. Without their generous assistance and recognition of my work, I could never have successfully completed my doctoral dissertation.

The Evolutionary Mechanisms of Hybridization in The Current Global Environments of Corporate Governance: Potential Stabilities of Hybrid Structures[1]

Hideki Takei

1-1: Introduction

Corporate governance is an important dimension of management. Appropriate governance practices lead companies to continuously improving prosperity by guiding them through environmental uncertainties and the risks of operations, especially operations in unfamiliar overseas environments. In this regard, effective corporate governance structures have been critical to the success of multinational enterprises (MNEs) that tend to face higher levels of uncertainty and risk than domestic corporations.

In addition to the serious uncertainty and risk in international business environments, MNEs have had to deal with varying and often unfamiliar requests and values on the part of local investors and regulatory authorities. These groups frequently define their interests and the objectives of their investments on the basis of their own cultural and historical background. As financial markets have globalized, they have also been made more complex as a result of encouraging international investors to participate in several indigenous and multinational securities markets.

These various requests, values and demands on the part of international investors or local regulatory authorities have often been a drag on the overseas performance of MNEs.[2] While indigenous governance structures might be quite well suited to local values and regulatory demands, they are unable to deal with the requests and values of home country corporations and their investors. This provides a serious challenge to multinational

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[2] A typical example is the case of Eli Lilly in Japan. Lilly originally attempted to penetrate the Japanese pharmaceutical market through a joint venture with Japanese manufacturer Shionogi Ltd. The difference in approach to meeting customer and Ministry of Health requirements was so intense that Lilly was eventually forced to dissolve the partnership at a considerable loss. Lilly's organizational approach and the approach of local companies were so incompatible that no middle ground could be found (Yoshino and Malnight, 1990).

corporations operating in a global sourcing, manufacturing, marketing and financial environment.

There have been several studies to on the emergence of new corporate governance structure in MNEs. The purpose of these studies has primarily been to attempt to determine what would be more effective for multinational corporate governance than the existing indigenous structures. In this regard, one of the latest findings is that more effective governance structures may come about through the emergence of hybrid governance. Hybrid governance is the result of a process whereby indigenous corporate governance structures are modified to accommodate international requirements, but without sacrificing deeply rooted historical and cultural values. In this regard, it is more accurate to speak of "hybridization", or a *transformation* of governance structure and a change in the overall *governance paradigm*, rather than a simple process of modification. A hybrid governance structure is, fundamentally, a new structure which while sensitive to local values, nonetheless meets a reasonable international standard of *due diligence.* Interestingly, some recent studies on hybrid corporate governance (Aoki, 2000) argue that the highest level of corporate performance in MNE's may come not from local governance structures, nor from overseas governance structures of the developed countries but rather from a hybridized governance system.

While the superior potential performance of hybrid structures has been previously argued (Aoki, 2000), there have not been confirmatory studies of actual corporate performance to date. One reason for this is that the structure of emergent hybrid governance has not been clearly differentiated from that of more traditional concepts of corporate governance.

In earlier studies, hybrid models were described as having "semistrong" governance attributes from different types of indigenous corporate and social structures (Williamson, 1996). By semi-strong, earlier authors, particularly Williamson, actually mean a system where external values are rather arbitrarily grafted onto local governance structures. In theory, this kind of structure draws upon relatively equal amounts from the overseas company's governance environment and the local governance environment. In terms of models, this kind of hybridization is relatively primitive. While these models attempt to mix local and international values, they do so in an unintegrated or additive fashion. In other words, while they may add governance provisions and requirements in relatively equal measure from both the local system and the international system, there is no attempt to integrate these two elements.

In this case, the principal attributes of semistrong governance models are the result of an unstable hybrid model. The model is unstable because the process lacks any integrative function. An additional complication in the literature has been that hybrid corporate governance models have been traditionally addressed as a *transitional* phase of governance which is, on the whole, assumed to be following a pattern of global convergence (Bradley et al, 1998). The problem here is that convergence is *assumed* rather than demonstrated and this then results in a mischaracterization of the process of hybridization, and often in the definition of a model where the various elements of hybridization are inherently unstable (i.e., they are temporary, transitional mechanisms) (Williamson, 1996).

One consequence of this mischaracterization is that by assuming hybridization is merely an intermediate step on the way to global convergence the hybrid model is seen as a merely temporary, intermediate process. Williamson (1996) sees hybrid structures as the "mid-point" on the path to convergence and he envisions a process where, after this mid-point, hybrid attributes start disappearing, in order to be replaced by rather unspecified "convergent" elements. Clarifying this process does not, unfortunately, lead to any better description of the process of evolution and adaptation in corporate governance structure. Where the point of governance has been most clearly articulated (Bradley et al, 1998; Logue and Seward, 1999) it turns out that the so-called "point of convergence" is simply the Anglo-American, purely contractarian system. Far from being a point of convergence, this would simply be the imposition of one local system across global markets. To date, recent historical evidence suggests that not only is such an outcome improbable (Kester, 1991; Roe, 1999; Aoki, 2000; Gilson, 2001; Licht 2002) but also that the "transaction cost proof" of the universality of shareholder value is, at best, a delusion and at worst a pointless triviality (Fellman and Takei, 2003).[3]

1-2: A Different Type of Hybrid Structure

The stability of the hybrid structure is quite important to ensure the potential effectiveness of the structure because the semistrong attributes as explained by Williamson (Williamson,1996) would be strengthened gradually by both forces arising from historical path dependences and from cultural values once the hybrid structure is stabilized, and after it holds all semistrong attributes (Liebowitz and Margolis, 2002). In other words, if the hybrid structure behaves in a stable fashion, the governance structure may be more effective than indigenous structures, providing that the hybrid structure holds all the required governance attributes (for the international capital market) because all of the required investor attributes would be gradually strengthened, without imposing impossible constraints on local governance structures.

While the stability of such hybrid structures is important, there have not been sufficient empirical studies on the stability of hybrid governance structures. Instead, scholars have focused on studying the ways in which the transformation of indigenous corporate governance structures take place when MNEs set up local operations as a result of

[3] Bradley et al (1998) begin their argument in a relatively straightforward way, by invoking traditional transaction cost economics to explain how transaction costs limit the boundaries of the corporation. In this sense, they place transaction costs at the center of the structure of the multinational corporate environment. Nothing, in this context, is more important in determining the activities and the profitability of a corporation than transaction costs. Having established this as the baseline, they then turn to shareholder value as the principal driver of corporate activity. This is, to say the least, a bit puzzling, given the fact that different societies, different legal structures, and different historical and institutional structures are well known to place different values on shareholder democracy, and shareholder and stakeholder returns (Kester, 1991). A very simple example would be the Japanese security market, where there are virtually no shareholder dividends and shareholder democracy is not merely unheard of, but actively suppressed (Kester, 1991). At the core of this flawed argument is the assumption that "pursuing the market value rule ensures that the values of all stakeholders' claims are maximized" (Bradley et al, 1998). Unfortunately the authors fail to take into account the fact that in the real world, markets are not perfect, side payments are generally constrained by both transaction costs and institutional norms, and with imperfect information, local equilibria can never reach Pareto-optimal equilibria (Aoki, 2000). In short, they argue that in a world with no transaction costs, maximizing shareholder value would maximize all stakeholder positions. Unfortunately, this contradicts the most basic assumption, which is that transaction costs govern the activities and scope of the corporation.

market globalization (Fukao, 1999). This kind of study has typically reported the characteristics of various transformations and hybridizations of various indigenous governance structures without empirically describing the stability of those hybrid structures.

In addition to this difference of focus, students of international corporate governance and control face a number of difficulties in undertaking comparative studies of the transformation of local governance structures. While such comparative studies are definitely needed, little work has been undertaken in this regard. Nonetheless, such studies are necessary in order either to substantiate or reject existing theories of hybridization, since current theory makes strong claims regarding the utility and durability of hybridization as a mode of transformation of indigenous governance structures (Williamson, 1996).

Consequently, if we are to believe in the potential stability of hybrid governance structures, we must determine whether there is a hybrid governance structure that holds all required attributes for global markets which transforms the two indigenous governance structures which we refer to as polar opposites (i.e. market structures vs. hierarchical structures). Without such comparative studies between these two polar governance structures, it would be difficult clarify differences between the traditional way in which hybrid corporate governance structures are described and the more fully articulated stable hybrid governance structures which are the subject of this study.

While the distinction between stable and transitional corporate governance systems is central to the current study, it is important to understand that in earlier studies, particularly those dating from the 1990's, it may have been difficult to make this distinction since at that time there were not many examples of these two polar governance structures which now make up the empirical core of the present comparative study. In other words, part of the issue is theoretical, but part of the issue relates to the fact that in the twenty-first century globalization has pushed U.S., Japanese, and German governance systems to move towards some kind of stable hybrid structure.

Fortunately, we now know that current hybrid governance structures are an output of the hybridization which has taken place between market-driven governance structures (such as the U.S. governance structure[4]) and relational governance structures (such as the Japanese and German corporate governance structures[5] (Guillen, 2000; McDonnell, 2002). While there are many countries belonging to a *cluster* centered one or another of these two indigenous structures, the hybridization of corporate governance structures in large MNEs in U.S.A., Japan, and Germany due to globalization is the central concern of this writing.

While OECD reports have not discussed the stability of hybrid structures, they have argued that MNEs with a U.S. style governance structure have nonetheless attempted in recent years to acquire some of the values of Japanese and German governance structures. In the same vein while MNEs with Japanese and German structures have aggressively tried to adopt the governance values of the U.S., such efforts have been less than entirely successful (Bradley et al, 1998). These general observations regarding hybrid governance structure suggest that a hybrid structure might be a more stable middle point for Japanese and German corporate governance structures.

This dissertation aims at clarifying the stability of current and emerging corporate governance structures in MNE's with special attention to large corporations in the U.S.A., Japan, and Germany. Since the existence, and indeed the desirability of hybrid structures appears to have been generally accepted, this dissertation will focuses particularly on the potential stability of hybrid corporate governance forms.

I begin with a description of the current environment and changes brought about through globalization on indigenous governance structures of MNEs. In these descriptions, I narrow the discussion to the three most important specific indigenous governance structures (i.e., those of the U.S, Japan and Germany). The U.S. governance structure is

[4] U.S. governance structure is also called as the Anglo-American governance model. Sometimes, the Anglo-American governance model is called as the contractarian governance model.
[5] The relational governance model is also called as the communitarian governance model.

classified as the contractarian mode and the Japanese and German governance structures are classified as the communitarian mode. Consequently, at the end of this description, we will treat with two polar governance structures (i.e. contractarian and communitarian; or market-oriented vs. hierarchy and relational oriented) that we would be observing as hybridized during the current round of globalization of product and capital markets.

Then, I start discussing the general trends of globalizations of the indigenous governance structures. These discussions include both theoretical discussions and empirical arguments. The theoretical discussions are mainly traditional theories relating to hybridization and the hybrid structures of corporate governance. Such theories include four ways of describing globalization, (1) convergence theories, (2) non-convergence arguments, (3) path dependence theory, and (4) hybrid governance theory. The empirical discussion which follows primarily relates to the OECD governance model that has been typically considered appropriate for modeling the emerging hybrid governance structures which contain both the communitarian and contractarian structures (Guillen, 2000).

Following this discussion, I compare the OECD governance model to Oliver Williamson's governance model in order to make some fundamental distinctions between the theoretical description of hybrid governance structures and the actual emerging hybrid structures. Following this, I begin the discussion regarding the potential stability of the OECD governance model as a result of the path dependence. Then, I introduce Masahiko Aoki's A-J-P statistical model of comparative corporate governance and his use of the Pareto-optimum equilibrium.

At the end of the discussion, I build a new hybrid integrated governance model (HIG) as a stable OECD governance model. Consequently, the HIG model is an empirical form of the OECD governance model. HIG represents both an advance in the theory of comparative corporate governance and control as well as being supported by a wide range of empirical observations. The empirical data on the HIG model is then used for the confirmation of the stability of the OECD governance model in this modified form (HIG) through field study with MNEs from the U.S., Japan, and Germany.

After discussing the results of the field study, I explain the nature and importance of stability to HIG. As the theory leads us to believe, HIG is indeed a stable form of the more general model initially proposed by the OECD.

1-3: Goals of this Dissertation with respect to the Field of International Business

Explaining HIG as a stable version of the OECD governance model is the main goal of both my empirical study and my theoretical research to develop new explanations of the current hybrid governance structure. The theoretical elaboration of HIG as a more complete model of the OECD hybrid governance structure is an important addition to the comparative study of corporate governance. Empirical confirmation gives us the confidence that HIG does, in fact, better explain the current processes of hybridization better than existing models (i.e. the Williamson governance model).

One of the most important elements of system transformations is the search for greater competitive fitness by transforming systems. In most cases, it is generally understood that the new systems will be functional only if the systems have both the fundamental capacity for satisfying requirements in the market place as well as the specific capability for dealing with indigenous requirements in different markets (www.insead.fr, 2004). Hence the stability of the new system is a central issue with respect to competitive fitness because the new system cannot utilize the more efficient properties arising from the process of globalization unless the system is stable.

Two of the most difficult issues regarding stabilizations are historical dependence and the persistence of cultural values because these values are so strongly held that they are locked-in such a way that they become major obstacles for obtaining or holding new values from different systems. Consequently, knowing the level of persistence for traditional values and understanding the barriers which need to be overcome in order to gain acceptances for the new values by indigenous systems is critical for success.

There have been numerous arguments about the hybridization of various indigenous values in corporate governance (Williamson, 1996; Subramani et al, 1999; Sheard, 2002). The school of thought following Licht, Gilson etc, which is based upon the theory of path dependence, examines the stability of hybrid structure. Building on the work of Arthur (1989, 1990, and 1994) and then Aoki (2000 and 2003) I use the results of my empirical study to explain the strong competitive fitness of stable hybrid structures, which typically occur after the initial hybridization.

2: Market Globalization

Recent market globalization has influenced the practices and the performance of indigenous corporate governance systems. Cross-border relationships among various corporations from different regions have profoundly affected these markets. Because of the scope and pace of recent globalization, these systems tend to face a number of serious difficulties in satisfying the different requests and values which emanate from outside participants in cross-border business relations. This conflict is especially intense because the fundamental values and goals of indigenous governance structures are generally based upon very different historical dependencies, cultural values, and institutional structures than those of global organizations (MNEs). In comparison to modern global organizations, these indigenous systems are generally quite ineffective for good operational decisions and for financing corporate activities through international financial markets.

While the indigenous structures would be still effective in international markets if the indigenous structure could maintain the original values and successfully interact with the global environment. However, this is not observed in practice because of historical persistence (i.e. path dependent lock-in of institutions) and barriers to the acquisition of the different global values. Consequently, indigenous governance structures have had to try to find ways to interact with global markets possessing different values. Most commonly, this results in either a "structural" failure or else a fragmented economy in which a small sector of corporations hybridize and compete globally while t he bulk of the economy stagnates locally.

In this chapter, I describe the process of the globalization of markets in order to understand how it has influenced indigenous corporate management practices and indigenous structure for corporate governance and control.

2-1: The Globalization of Markets in the Developed Countries

The globalization of corporate governance typically occurs in companies that have to control operational and financial decisions in cross-border business relations. If we look at the current round of restructuring in indigenous systems, we find change most commonly tends to occur in MNEs with headquarters in developed countries. This is generally believed to be the result of the greater intensity of global competition in developed countries.

For example, in 1999, foreign direct investment (FDI) inflows to developed countries reached at \$636 billion. This is \$156 billion more than the FDI numbers for 1998 and approximately 75% of the world's total FDI. FDI outflows from developed countries maintained relatively high levels, but the growth of outflows declined as the result of negative economic developments in Asia such as the Asian currency crisis of 1997 (UN, 2000).

While the globalization of the markets appears to have been steadily advancing, there have only been a few critical players contributing to the actual growth of FDI. Generally speaking, the U.S.A., the UK, France, Germany, and Japan have been responsible for the bulk of FDI activities.[6]

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[6] The U.S.A. and the UK had been the leaders in FDI. Total FDI inflows between the U.S. and the EU dramatically increased in 1999 even though the inflows doubled from 1998. The EU also played major role

Japan became a popular region for FDI inflows following liberalization and deregulation of the financial sector. For example, FDI inflows to Japan reached $13 billion in 1999 as compare to only $3 billion in 1998 (UN, 2000).

In examing the effects of globalization on developed countries, I choose the U.S.A., Germany, and Japan because these three countries are not only the leaders but also because they have been the subjects of comparative studies in corporate governance and control (Bradley et al, 1998). In the following sections, I describe the details of market globalization in these three countries.

2-2: A General Descriptions of Product Market Globalizations in the U.S., Japan, and Germany

According to the United Nations (2000), there were nine major industries for the top 100 MNEs in 1998. These nine industries are: (1) electronics/electrical equipment/computers, (2) motor vehicle and parts, (3) petroleum exploration/refining/distribution and mining, (4) food/beverages/tobacco, (5) chemicals, (6) pharmaceuticals, (7) diversified, (8) telecommunications, and (9) trading. These industries can be characterized as capital and knowledge intensive with sensitive financial requirements as well as the need to raise large working capital in global markets.

In global product markets, 55 firms out of the world's 100 largest MNEs in 1998 were from the U.S., Germany, and Japan. Their shares in the total value of foreign assets for the top 100 MNEs reached at 60% in 1998.

U.S. corporations have dominated the world's 100 largest MNEs. For example, there were 28 U.S. firms in 1990, 27 U.S. firms in 1997, 26 U.S. firms in 1998. General Electric in electronics/electrical equipment/computers industries and General Motors in

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in global FDI. For example, FDI inflows to the EU were approximately $305 billion; this was a 23% increase over 1998. Among EU members, France and Germany led the other members (UN, 2000).

motor vehicle and parts industries were respectively number one and number two in the 100 MNEs in 1998. In addition, there were another 24 U.S. firms on the same list. Industries in which these firms are active include electronics, motor vehicles, retailing, petroleum, chemicals, and utilities (UN, 2000).

In addition to the U.S. dominating global markets, the growth of total foreign assets for U.S. firms has constantly increased. For example, the total foreign assets of U.S. firms in the top 100 MNEs was 31.5% in 1990, 32.4% in 1997, and 32.9% in 1998. While the growth rate between 1990 and 1998 was only 1.4%, U.S. firms have constantly added foreign assets to already substantial foreign asset base (UN, 2000).

German firms also frequently appear in the world's 100 largest MNEs (UN, 2000). For example, there were 9 German MNEs in 1990, 11 German MNEs in 1997, and 12 German MNEs in 1998. Particularly noteworthy were DaimlerChrysler (9^{th}) and the Volkswagen Group (11^{th}), two of the largest German MNEs. Major industries in which German MNEs are active include motor vehicles, pharmaceuticals/chemicals, and electronics.

The growth of the total foreign assets of German MNEs has likewise been constantly increasing. For example, the total of foreign assets of German MNEs in the top 100 was 8.9% in 1990, 12.7% in 1997, and 12.6% in 1998 (UN, 2000). German MNEs have often occupied critical leadership segments in global markets.

There are 17 Japanese companies among the world's 100 largest MNEs in 1998 (UN, 2000). The number of Japanese firms in the world's 100 largest MNEs has grown from 12 firms in 1990 to 17 firms in 1997 and 1998. The 17 firms include Toyota (6^{th}) and Honda (18^{th}). The major industries in which large Japanese MNEs are key players are motor vehicles, electronics, and trading.

Japanese MNEs have maintained their portions in the total of foreign assets of the top 100 MNEs since 1990. For example, the total Japanese portion was 12% in 1990, 15.7%

in 1997, and 14.5% in 1998 (UN, 2000). Japanese MNEs have also taken strong leadership positions in global markets.

2-3: Globalization of Equity Markets in the U.S., Japan, and Germany through Cross-Border Mergers and Acquisitions

Large MNEs have generally preferred mergers and acquisitions to "organic growth" (UN, 2000). One reason that cross-border mergers and acquisitions are preferred is because MNEs expect both faster business growth and more rapid increase in proprietary assets through the cross-border mergers and acquisitions (UN, 2000). Such proprietary assets include research and development, technical know-how, patents, goodwill, local licenses, and distribution networks. Such assets would otherwise require MNEs to spend a long time and great effort in developing by themselves.

While above mentioned benefits have driven much of the MNE preference for cross-border mergers and acquisitions, these preferences have been further enhanced by better conditions for cross-border mergers and acquisitions. This is primarily the result of two factors: (1) the liberalization and deregulations of capital markets and (2) the emergences of advanced information technologies allowing connectivity between different local capital markets through global information networks (UN, 2000).

Nationally based or nationally headquartered MNE's face a new problem with the globalization of capital markets and that is the introduction of overseas equity holders. With the presence of overseas equity holders, the board must either learn to accommodate the values of those equity holders or otherwise face a challenge to management's control of the firms' assets. The United Nations (2000) summarized this process as follows.

> It appears also that the increasing globalization of capital markets is contributing to a certain convergence of different systems of corporate governance and financing patterns. One identification of this is the increased acceptance of mergers and acquisitions around the world. As noted earlier, the United States and the United Kingdom remain the most active countries with regard to mergers and acquisitions, but the incidence

> of takeovers has also increased in both continental Europe and Japan. The frequency of mergers and acquisitions also raises questions related to corporate governance, including as regards the protection of minority shareholders and the role of other stakeholders (UN, 2000).

This statement of UN implies "certain convergence" towards more market-driven governance systems and away from the communitarian governance practices with their emphasis on stakeholder value. However, it is important to notice that these convergence arrangements do not necessarily mean complete convergence to a market-driven governance structure. The UN report made an effort to clearly point out the importance of the fair treatment of both minority shareholders and stakeholders.

In same ways the UN's statement is simply reflective of the power balances between U.S., German, and Japanese MNEs in cross-border mergers and acquisitions. In other words, they anticipate a general tendency for governance transitions towards market-driven systems primarily because the U.S. MNEs who maintain market-driven governance structures have been the dominant players in cross-border mergers and acquisitions. As a result, Japanese and German MNEs have to some degree had to acquire market-driven values even in their indigenous governance structures in order to profitably interact with U.S. MNEs. However, since Japanese and German MNEs are also powerful players in the global M&A market, the relational values of corporate governance (i.e. stakeholder values, relational financing, etc.) have been also observed in the international M&A market.

These arguments are supported by a list detailing the origins of the MNEs who have participated in recent large cross-border M&A deals. For example, the 19 MNEs that participated in the largest 50 cross-border deals which were completed during 1987-1999 were primarily from the U.S.A., Japan, and Germany. Deals by 19 of these firms accounted for 38% of total of the largest 50 cross-border M&A deals. Additionally, 23 companies acquired in the top 50 cross-border M&A deals (1987-1999) were also from these three nations. This activity accounts for approximately half of the total of the 50 largest cross-border M&A deals (UN, 2000).

U.S. MNEs led cross-border M&A deals during this period. There were 10 U.S. acquirers participating in the top 50 cross-border M&A deals (1987-1999) and 19 U.S. acquired firms in the same deals (UN, 2000).

German MNEs have also participated actively in the top 50 cross-border M&A deals (1987-1999). There were 7 German acquirers in cross-border mergers and acquisitions and 2 German acquired firms in the same deals. Among German participants, there were 5 firms which appeared in the 20 largest MNEs with active cross-border mergers and acquisitions (UN, 2000).

While Japanese securities markets have generally been regarded as inefficient for cross-border mergers and acquisitions, there were, nonetheless, 2 Japanese acquires and 2 Japanese acquired firms in the top 50 cross-border M&A deals (1987-1999). While there are only 2 acquired Japanese corporations, Japanese companies have been increasingly viewed as attractive targets for cross-border mergers and acquisitions because of the increased liquidity of Japanese securities markets brought about by a series of deregulations and liberalization of the market. For example, by the year 1999, Japan becomes the 9th largest target for cross-border mergers and acquisitions (UN, 2000). A good example of this is the acquisition of Japan's Long Term Credit Bank by U.S. led investor group.

The UN report (2000) also described some interesting characteristics of Japanese participation in cross-border mergers and acquisitions. According to the US report, the number of Japanese firms acquired by foreign MNEs has exceeded those purchased by Japanese MNEs since 1997. This trend in Japanese cross-border mergers and acquisition activities has primarily been caused by the Japanese long-term economic recession.

3: A General Description of Recent Changes in the Corporate Governance of MNEs

3-1: A General Description of the Current Changes in Corporate Governance of MNEs in Developed Countries

As described previously, the current process of globalization in both product and financial markets has facilitated a kind of convergence towards market-driven corporate governance structures (Guillen, 2000). Fukao (1999) argues that such movements have emerged as the result of the ways in which the globalization of markets has seriously limited the performance of indigenous firms. In a more general sense, this is a product of the fact that local firms which cannot globalize are characterized by governance structure that reflect their traditional values, a result of historical path dependence. These firms then have a low fitness level when competing against globalized MNEs.

Again, while the general tendency of transitions in governance systems have been towards market-driven governance practices (Guillen, 2000), there is also considerable evidence of non-convergence (Licht, 2001; Gilson, 2001). Hirata (2003) explains the reasons for this situation by citing three influences of globalization on MNEs' corporate governance systems.

First, he argued that the current high intensity of globalization in both product and financial markets has brought different management values and strategic objectives to the governance of indigenous corporations. Such changes, which he described as *value migrations*, are caused by the globalization of the board of directors (Esser, 2001). Globalizing the board reflects the fact that approximately 15% of investment portfolios and institutional investments have gone to the cross-border investments. Naturally, these global investment activities have globalized not only the shareholder composition but also director composition because large foreign investors have a built in incentive to place their representatives on corporate boards in order to protect their investments. Consequently, appearances of the foreign directors in MNEs have gradually increased.

> Companies with three or more foreign directors increased from 11 percent in 1993 to over 23 percent in 1998. The globalization of the board is truly underway. .... Europe and North America lead the trend toward global boards. Most of the companies seek directors outside their regions, with very different cultural and business backgrounds. (Esser, 2001).

However, t he globalization of the board is not unproblematic. In a number of cases, the difference in corporate values and historical perspectives can damage existing corporate governance structures because consensus building, strategic planning and decision-making in general may become quite difficult. The introduction of foreign directors may cause serious internal conflicts between native and foreign directors if their original values and culture are significantly different.

For example, Krug and Nigh (1998) noted that:

> ...greater cultural distance leads to greater number of executive departures ... cultural differences undermine communications and the level of cooperation between merging top management teams. The negative effect of culture is, however, significantly reduced when the foreign multinational has international experience (Krug and Nigh, 1998).

Another area of potential value conflict comes from the globalization of information. Advanced information technologies have supported international investors' activism by allowing them to reach new information for investment decisions and planning (Hirata, 2003). Such informed international investors are not only able to make appropriate decisions and timely transactions in capital markets (Monks and Minow, 2000; Torre and Moxon, 2001) but they become increasingly able to pressure board decisions by rapidly dumping stock whenever they find board decisions not to be in their best interests as investors (disclosure effects).

Disclosure effects are especially important for international investors who undertake transactions in highly liquid equity markets because the availability of information makes equity transactions in such markets faster and more complex but also more transparent due to universal connectivity (Evans and Wurster, 1997).

The appearance and influence of such international investors has continued to increase as Monks and Minow (2000) describe below.

> By 1994, foreign investors accounted for more than one percent of total world stock market capitalization. This figure has not since been exceeded, although the flow of funds across national borders has shown a consistent rise (Monks and Minow, 2000).

International investors who have efficient information networks and sufficient financial powers to influence multinational equity markets and transactions have further polarized global MNE's from firms run with indigenous governance systems driven by local, path dependent, institutional and cultural values.

Put simply local firms which are bound by path dependent lock-in are generally both unwilling and unable to hybridize their governance and hence their operations. This means that even without formally restricted access to international capital markets they remain unable to tap international capital markets. This has a doubly dampening effect on the firms performance.

First, they are limited to local capital markets, which are generally unable to supply equity capital in either the volume or at rates competitive with international markets. This means that capital-rationing effects will profoundly inhibit the growth of indigenous firms as compared to MNEs.

Secondly, because they operate in an environment constrained by indigenous values and institutions, they are unable to earn a competitive returns when compare to MNEs engaging in commerce in the same substantive areas. This means that wherever a country is partially globalized, the MNEs will ultimately drive the purely indigenous firms out of business.

The influence of international investors has motivated both institutions and corporations to adopt new modes of governance in order to tap global product and capital markets. In many cases, the principles of corporate governance elaborated by the OECD have been the guiding examples for changes in the governance models of various countries possessing well capitalized MNC's. However, unlike the view put forth by convergence advocates, who argue that these changes are merely the intermediate stage of a process which must ultimately converge to Anglo-American norms, these new governance structures have instead tended to follow a pattern whose endpoint is typically not convergence, but rather, hybridization.

In other words, instead of taking the Anglo-American contractarian system of corporate governance to be a one-size-fits-all model, the guiding principles have been recognized more nearly as guidelines for MNE's with respect to the parts of their operations which can be changed to match those of the headquarters (Eli Lilly). While they are not necessarily evidence of global, or even regional convergence, the OECD guiding principles are generally quite carefully considering as important benchmarks by companies who must move away from various indigenous values in order to satisfy international investors (Monks and Minnow, 2000).

For example, according to the OECD principles, MNE's should demonstrate a respect for shareholder value. In particular, the corporate board should be the ombudsman for the protection of shareholders, shareholder property rights, and should actively work to improve the disclosure and transparency, and accountabilities of the board (Guillen, 2000).

Similar to the OECD principles, the International Corporate Governance Network (ICGN) emphasizes five shareholders' rights: informed judgments, voting rights, disclosure and transparency, one-share-one-vote principle, and a fiduciary obligation for voting institutional investors (Monks and Minnow, 2000; ICGN, 2003).

In addition to these guiding principles, several professionals have suggested additional governance elements for MNE's. For example, Choe (1998) suggested that MNE's' governance practices should maintain board independence, an adequate set of internal controls, and organizational and financial transparency. Tateishi (2001) stated that higher levels of transparency, accountability, information disclosure, and business ethics were the universal elements of MNE's governance.

McRitchie (2002) built five universal elements based upon democracy at the workplace as basis of governance in global markets. These elements are (1) shareholder participation and proportional representation; (2) an emphasis on voting rights; (3) effective communication; (4) an emphasis on relational shareholders, and (5) strong board independence based on an independent power resource for directors.

In sum, four critical, or "universal" elements can be used to characterize globalized governance principles. These elements reflect both contractarian and communitarian values. First, from the contractarian point of view, it is important to respect shareholders' property rights and voting rights. Second, disclosure and transparency must be maintained at high level. Third, board accountabilities must be ensured by high levels of board independence and a strong respect for the director's fiduciary duties. Finally, information and relational efficiencies must be maintained through efficient information flows, interaction, and communications.

Third, powerful relational investors have actually facilitated the value migrations in MNE's' corporate governance structures. Sine relational investors hold large portions of equities for long-term and monitor and supervise operations and governance of the corporation in which they invest (Bhagat et al, 2002), relational investors mix the values of market-driven systems and relational systems (Hirata, 2003). In general, since there have not been generally accepted principles of governance which incorporate both contractarian and communitarian values of governances, large relational investors each establish their own corporate governance principles with respect to equity investments (Guillen, 2000; CalPERS, 2003).

Relational investors have influenced governance practices in U.S. and European nations as Bhagat et al (2002) described below.

> In the last decade, a substantial academic and popular literature has argued that American corporations focus too much on near-term profitability, and that their long-term performance might improve if they had long-term investors ["relational investors"]. ... A recent report to the European Commission concludes that 'strong block-holders' are a major impediment to good corporate governance of European companies (Bhagat et al, 2002).

Generally speaking, since powerful relational investors primarily come from the U.S. market, relational investors tend to reflect the market-driven values. As a result, their requests for long-term relationships and long-term returns from their investments reflect the market-driven values of shareholder welfare protection (Bhagat et al, 2002). For example, relational investors may intentionally invest in under-performing long-term projects if they expect that such projects would increase short-term profitability.

However, relational investors have undertaken very similar actions to selective intervention in communitarian governance systems. Generally, the appear to consider these interventions as a substitute for mergers and acquisition activities because they establish long-term financial relationships with MNE's in order to gain continuous profitable returns on investment through participation in the business operations of the MNE's. Such intervention is designed to improve the MNE's overall financial performance (Kester, 1991; Milhaupt, 1996; Bhagat et al, 2002).

3-2: A General Description of the Current Influences on U.S. Corporate Governance

According to Esser (2001), US firms have had to finance large amount of working capital in global equity markets as they have globalized. Since investors tend to vary from country to country in global equity markets, the globalization of U.S. boards has also increased. For example, currently, more than 23 percent of US corporations have three or more foreign directors on their boards (Esser, 2001).

Since foreign directors and investors have a variety of different interests and values, their presence on the board often influences U.S. management and g[illegible]nce practices. In particular, directors from large foreign institutional investors h[illegible]ed the U.S. corporations to reflect their own values and interests as a result of their large financial powers. At the same time, U.S. corporations have begun to recognize the importance of adopting new values in order to attract foreign investors and more generally to reduce the cost of capital in global markets (Lightfoot and Kester, 1991; Salmon, 1993; Hamilton, 2000; Esser, 2001).

Relational investors who have long-term perspectives and who participate in the governance of the firms in which they invest in order to protect their interests have forced U.S. firms to respect not only short-term profits but also long-term profits and to place a greater emphasis on long-term strategic planning (Hamilton, 2000; Bhagat et al, 2002; Sheard, 2002).

The emergence of relational investors has also forced U.S. corporations to change some of their business decision criteria. Generally speaking, U.S. firms tend to make decisions primarily to maximize shareholder value. Relational investors, however, have forced management to consider stakeholder welfare as well, particularly when those relational investors are stakeholders for the U.S. firms. In such situations, the pension funds and other relational equity investors try to protect both returns on their investments and the returns for the equity holders of the pension funds so that the pension funds can protect both long-term returns and financial stability (Bradley et al, 1998). [7]

Since relational investors try to monitor and supervise governance practices and strategic plans as insiders (Bhagat et al, 2002), U.S. corporations have had to include long-term relational practices in their governance policies. This means that U.S. firms must not only

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[7] This is commonly known as the fiducially duties of the pension fund.

have efficient disclosure to outsiders but also high levels of transparency and information sharing for internal monitors.

3-3: Recent Changes in the U.S. Corporate Governance System

As previously discussed, U.S. corporate governance has had to attempt to satisfy a variety of investor requests and relational values that contractarian governance values on their own cannot satisfy. While U.S. companies have tried to change their governance structures to satisfy these different values, they face four obstacles in doing so, these are: (1) incomplete contracts, (2) externalities, (3) the complexity of cross-border transactions, and (4) difficulties with social welfare maximization (Bradley et al, 1998). If we follow the structuralist explanation of contractarian governance as elucidated by Bradley et al (1998), we can easily see the difficulties which a purely contractarian system has in ordering with the interests of stakeholders and other residual claimants.

First, since U.S. corporations are viewed as bundles of contracts of all participants, U.S. governance practices are inherently restricted within the terms of these contracts (Monks and Minow, 2000). Generally speaking, since equity investors are the most important residual claimants, they have had the greater bargaining power with respect to this bundle of contracts. Hence, U.S. corporations have primarily tried to maximize shareholder welfare and it is this interest which tends to dominate both their operations and their corporate governance practices.

While U.S. firms may respect the contractual nexus, they cannot fully satisfy all shareholder interests because there is no complete contract describing every possible situation. Additional constraints on the efficiency and completeness of the contractarian approach may also arise as the result of bounded rationality and information asymmetry.

In addition, such contract-based business operations and governance practices are not acceptable in regions where mutual relationships and long-term collaborations have been emphasized. For example, in such communitarian regions, general agreements are made before contracts are sighed. This is done to ensure long-term business relations and continuous collaboration within the framework of a general agreement. General agreements are typically more flexible and more tolerant of unexpected business situations and unusual events in business operations.

Bradley et al (1998) also describe the limitations of contractarian governance systems from the practical point of view. They argue that complete contracts cannot be constructed not only because of bounded rationality but also because of language problems and the lack of universally accepted criteria for evaluating the contracts.

The incompleteness of contracts is one basic limitation of U.S. corporate governance. Also in different regions with various other cultures and histories, relational investors have seriously concerns about the agency problems in contractarian systems which occur between investors (principals) and management (agents).

In an effort to solve these agency problems, large overseas shareholders elect some number of directors to serve as their representatives. The board is expected to solve information asymmetry and self-dealing problems by gaining corporate information directly from management. While the directors are expected to function as a bridge between the shareholders and the managers in order to solve agency problems, such problems will not be completely solved unless the directors can go beyond mere contracts and collections of corporate information freely (Monks and Minow, 2000).

As I described, while the directors are expected to monitor and supervise the management to ensure shareholder welfare and interest within the terms of contracts, they are not effective monitors for situations that are not written in the contracts. In addition, there will not be complete contracts to describe such unexpected conditions. Consequently, such incomplete contracts tend to give some rooms for the self-dealings and the opportunisms of the agents when there are unexpected or unwritten situations are happening.

Second, the externality makes the society's resource allocation inefficient when mutually beneficial contracts for all stakeholders are not made. When some parties cannot receive benefits, the parties become externalities to damage all contracts. This externality problem is more serious when a corporation does not have mechanism to solve the problem. Efficient corporate governance mechanism can reduce the externality by interest alignments among the stakeholders.

This becomes serious problem when foreign investors and foreign directors participate into the U.S. governance systems because they may not be tolerant for such unbalanced distributions of interests and resources. Especially, the relational investors are not tolerant to the unfairness because their traditional governance values emphasis on fairness and equalities.

The relational investors are also fiduciaries who are responsible for their investors and employees. Generally speaking, while there are two different types of the pension funds, the private pension funds are the largest group of institutional investors (Monks and Minow, 2000).[8] The private pension funds are governed by laws called as ERISA (http://www.benefitslink.com/erisa, 2003). ERISA is to encourage private firms to create pension plans for their employees and to protect their investments in the plans. ERISA allows the trustees of the private pension funds to be the non-neutral fiduciaries who will have conflicts in interesting because settlers and beneficiaries are both employees and employers (Monks and Minow, 2000).

Consequently, the trustees are serious about total returns on their investments since fiduciary duties to the pension plan participants are set to high levels. For example, incompetent trustees may pay a fine for the poor performances, be eternally prohibited from managing pension funds, or even go to prisons (Monks and Minow, 2000).

In addition, SEC reformed proxy-voting system based upon more communitarian information sharing and interactions. SEC's reforms of the proxy voting systems in 1992

[8] These are public pension funds and private pension funds.

aimed at improvements in the voting effectiveness through better communication and information flows between the management and the shareholders who have no intentions to control the firms. Such SEC's reforms minimize the agency problems and ensure balanced distribution of resources and interests through information sharing and consensus (Choi, 2000).

Third, cross-border transactions in various markets with different traditions and cultures make the U.S. governance system for less effective than it might be for purely domestic US. corporations. As the UN (2000) report states, while U.S. firms lead FDI inflows and outflows in global markets, the U.S. governance system which is based on market-driven values tends to create obstacles for the cross-border transactions, especially in more communitarian markets. This means that not only are there conflicts in governance practices when U.S. corporations enter foreign markets but different local regulatory environments and government intervention which is for more common in communitarian systems also lead to conflicts.

Finally, there are significant differences in the meaning of economic efficiency between the contractarian values and the communitarian values. Naturally, such differences are reflected to the ways of improvements of the efficiency. Generally speaking, contractarian governance practices try to maximize economic efficiency by improving the market efficiency because the efficiency of the market is the most important economic principle of the contractarian system. However, communitarian systems will try to maximize economic efficiency through the maximization of social welfare because in a communitarian system maximizing aggregate social welfare through the economy is the primary goal (Bradley et al, 1989). Consequently, even if U.S. corporate governance practices are doing their best to improve economic efficiencies, these governance practices will not be seen as improving economic efficiency when they are applied in communitarian economic systems. In fact, what may appear to be a highly efficient mechanism of governance to a U.S. corporation may appear entirely arbitrary and capricious to companies, investors, and government regulators in countries other than the US. and Great Britain (Licht, 2001).

3-4: The Flat Management Structure of Chrysler

In recent years some U.S. corporations have tried to adopt more relational and long-term perspectives in their governance systems. These include long-term planning, flat management structure, quality circle type labor collaboration, and harmonizing labor and management relations. These movements towards a more transparent system have been rather widely discussed (Bussman, 1998).

Chrysler, for example, introduced a new flat organization structure in the early 1990s. Chrysler changed its corporate structure from a "chimney system" to a "platform system" in order to improve teamwork and collaboration in the workplace (Bussman, 1998). Platform structure and flat management have generally been the norms in more communitarian societies such as Japan and Germany. In the same way this kind of system facilitates information sharing and consensus building among employees and management.

> The current method adapted from Japanese manufacturers and since imitated by others, is to assemble representatives from each of the key functions into platform teams. [A platform is a basic chassis from which several vehicles may be made.] Team members from the different functions work simultaneously and communicate frequently to assure, for instance, that the shape of a particular body part will accommodate adjacent components. In addition, a manufacturing representative may suggest that a minor change in the design of a component will facilitate more error-free assembly, or a supplier may suggest that a change will not only increase the reliability of a component but also save cost. Under the old, chimney-style way of producing vehicles, most of these suggestions would have virtually no chance of being adopted. With platform teams, most of them become reality. The result is a reduction of the time it takes to bring a new vehicle to market from about five years to less than half that in many instances. Commensurate savings are achieved in costs, and defects average about one per vehicle currently (Bussman, 1998).

In addition to this transformation, Chrysler also empowered its employees in the production processes so that their suggestions could feed directly into Chrysler's design, manufacturing and marketing systems and facilitate continuous quality improvement practices throughout the entire Chrysler system (Bussman, 1998). As a result, Chrysler was able to achieve not only higher quality in their products but also dramatic improvements in production processes and labor relations.

3-5: A General Description of Current influences on Japanese Corporate Governance

As the globalization of Japanese markets has continued, the growth of international investors has also become more significant. For the first time in Japanese history, Japanese boards and governance practices have included both overseas nationals and foreign values. This change is due to more than just cross-border mergers and acquisitions by Japanese corporations. It is the result of participation in the Japanese equity markets, a phenomenon which has been increasing since 1990. For example, the portion of foreign investors in the total equity holdings of Japanese corporations was 13.4% in 1998 as compared to only 4% in 1990 (Ootsuka, 1999). According to the latest report by Kanda et al (2003), the portion of foreign investors in Japanese equities was 13.2% in 2000. Table 1 is a list of the recent large investments in Japanese markets by the foreign investors (Ogawa, 2000).

Table 1: Large Investments in Japan in Recent Years by Foreign-owned Corporations

Month/Years	Foreign Investor	Japanese firm	Type of investment
Dec/1998	GM	Isuzu Motors	Additional investment of 14 billion yen
Jan/1999	GE Capital	Nippon Lease	Bought out for 786.5 billion yen
Mar/1999	Renault	Nissan Motor and Nissan Diesel Motor	Capital participation of 605 billion yen
Sept/1999	BT and AT&T	Nippon Telecom	Capital participation of 220 billion yen
Sept/1999	Artemis	Aoba Life Insurance	Acquired for 15 billion yen

Source: Ogawa (2000)

Since these new foreign shareholders have looked for higher short term returns from their investments than Japanese investors typically require, Japanese firms have had to consider the shareholder welfare for more seriously. This, in turn, has forced a number of changes in their corporate governance practices. In addition to general shareholder welfare, Japanese corporations have been forced to focus on quarterly profits, higher dividends, capital gains, more timely disclosures, greater transparency, more efficient monitoring, and better communications in order to meet the requirements of foreign equity investors (Ootsuka, 1999).

> When Japanese firms see the foreign institutional investors as shareholders, their influences to Japanese corporate governance and management might not be so significant. However, it is quite important for the Japanese firms to notice meanings of strong demands for disclosures in the foreign institutional investors (Ootsuka, 1999).
>
> Japanese firms would not be able to maintain stable shareholders and levels of stock prices if they do not introduce 'efficient operations' reflecting Western types of corporate governance that aim at maximization of shareholder returns (Ootsuka, 1999).

The volume of equity trades in the Japanese market also shows a continuous progression in the globalization of the market. Since the end of the bubble economy in 1990, the major players in equity trades have been foreign investors (Ootsuka, 1999). While foreign investors occupied only minor portions of the overall traded value in the Nikkei in 1989, this portion rose to 29.1% in 1997, a 20.3% increase. As the portion of Japanese equities held by foreign investors increased, foreign investors also began to appear on and influence Japanese corporate boards (Ootsuka, 1999).

The deregulation of equity trading and liberalizations of the Japanese equity markets have been also responsible for the current situations of the Japanese markets (McKinsey & Company, Nov 10 2001). Such deregulations started in 1990 to make the Japanese securities market more liquid through encouraging equity trades in the markets. For example, Japanese government deregulated bond issues and stock listing criteria for Tokyo Stock Exchange from 1990 to 1991. In addition to these deregulations, Japanese government stared improving transparencies of the markets by introducing the mandatory disclosure to the large equity holders. These governance actions became the bases of the Japanese big bang in November 1996. The big bang is a comprehensive reorganizations and reformations of the Japanese financial and banking industries (Ootsuka, 1999).

Japanese government has also built new legal environments to support the big bang. For example, Japanese government implemented the new commercial acts to promote equity barter in the markets (McKinsey & Company, Jan 1st 2002). While such equity barter is expected initially to encourage mergers and acquisitions in the Japanese markets, active equity barters are also expected to improve both transparency of the Japanese corporate governance practices and financial information disclosures with the market enforcements.

To let Japanese managers feel the market reactions and forces, the new commercial acts enhanced flexibilities of the sock options in the Japanese markets. Fundamentally, this aims at giving Japanese executives both senses of the market-driven senses such as ROI, capital gains, and the market reactions to their operations (McKinsey & Company, Jan 1st 2002). Actually, Japanese executives who notice large capital gains from executions of the stock options have started making decisions and strategic plans to improve their stock performances and returns from the equity holdings.

These deregulations, the big bang, and the new commercial acts also changed the traditional relationships between Japanese firms and the main banks by letting the securities market monitor corporate governance practices and corporate performances of the Japanese firms. Since the main banks had held their strong appearances not only by their financial powers but also their monitoring and intervention functions, the traditional relationships would be more business orientation after the securities markets took over the financing and the monitoring functions (Charkham, 1994; Fukao and Morita, 1994; Aoki, 2000; Gilson, 2001; McDonnell, 2002).[9]

[9] Especially after Japanese government passed new act to limit amounts of shareholdings of commercial banks on November 2001, such relationships have been clearly changed (Mizuho Research Institute, 2002).

According to McDonnell (2002), main bank is defined as "the bank with which a Japanese firm has a special long-term relationship." The main banks maintain such long-term relationships through loans to and equity holdings of Japanese corporations (McDonnell, 2002). Charkham (1994) stated that the main bank system was the most convenient method for the Japanese companies to finance working capitals in where sufficient capitals were not available in the equity markets during the post-WWII economic redevelopment. The main bank system was also effective tool for the Japanese government to allocate scarce financial resources efficiently to rebuild the Japanese economies (Aoki, 2000).

One of the most important tools for the main banks to maintain the long-term business relationships is called as the selective intervention (Aoki, 2000). It has been the most effective safeguard in Japanese companies because the Japanese corporations can expect operational and managerial supports from their main banks when the firms face financial and operational troubles (Kester, 1991; Lightfoot and Kester, 1991; Fukao, 1999).

Generally speaking, the main banks take leading positions during the selective interventions due to their strong positions as critical financial sources and participants of governance practices (Lightfoot and Kester, 1991). With their financial powers and information resources, the main banks can suggest effective remedial actions and support implementations of the remedial actions during the selective interventions. Naturally, the main banks will monitor and supervise the corporate governance practices to ensure timely approvals and implementations of the remedial actions.

While the main banks do the selective interventions to save their clients, the main banks will also gain benefits from the successful selective interventions. These benefits have been explained as the economic motivation and the relational motivation (Fukao, 1999). From the economic standpoint, the banks take the selective interventions to protect their loans that generate cash inflows to the banks as interests. Consequently, the banks must make sure their clients are financially and operational healthy enough to pay the interests to the banks and to maintain the capital principals (Fukao, 1999).

As I mentioned, the economic relationships between Japanese firms and the main banks have changed by the diffusions of the equity financings of Japanese corporations and the liquidations of the Japanese equity markets through deregulations and new commercial laws (Yoshimitsu, 1999). Since the main banks will do the selective interventions and monitoring only if they loan sufficient capitals to companies, the main banks will not keep the interventions and the monitoring if corporations finance their working capitals in the securities markets. In addition, the companies will not ask for the selective interventions and the monitoring to the main banks if the Japanese securities markets are efficient enough to monitor and supervise their business operations and governance practices through stock prices and market reactions (Yoshimitsu, 1999).

Such changing relationships between the main banks and the Japanese companies have been clearly observed. According to MITI (2003), 86% of Japanese firms thought the relationships with the main banks would change. Instead of functional contributions to the Japanese governances and operations, the main banks have started acting as financial service institutions that support Japanese corporations' global business operations, global financings, and global investments. In addition, Japanese firms try to use the former main banks as financial consultants that have accumulated experiences and sufficient industry information (Latham, 1999). For example, 32.7% of Japanese firms pointed out that the main banks were critical information resources for their operations (MITI, 2003).

As I described, deregulations, new commercial acts, diffusions of the equity financing, and changing relationships with the main banks have changed the traditional Japanese governance practices. More precisely, the Japanese governance practices have acquired more market-oriented values of governance.

In addition to the influences form the domestic markets, the globalizations of businesses and financings of the Japanese companies have changed the traditional Japanese governance practices to more market-driven governance practices. Mainly, the globalizations of the Japanese governance practices aim at making Japanese firms more attractive to the foreign investors (Latham, 1999). One of the obvious changes of the traditional Japanese governance practices is to allow the foreign investors to participate into the governance practices (Kanda, 1999; MITI, 2003).

Under these new environments for the Japanese governance practices, the Federation of Economic Organization of Japan (Keidanren) encouraged Japanese companies acquiring necessity values and functions of corporate governance that the new environments ask for (Keidanren, 1997). To support the acquisitions, Keidanren issued the Urgent Recommendation Concerning Corporate Governance that is suggesting the Japanese firms to introduce global standards in auditing, director responsibilities, functions of the board, shareholder protections, and disclosures.

> In order to maintain and strengthen their international competitiveness into the twenty-first century in the context of an age of mega-competition, Japanese businesses must realize a form of corporate governance that meets global standards. Corporations are working on a regular basis to improve their management efficiency and to implement policies giving greater priority to stockholders interests, but in addition they are now expected to achieve corporate governance that is effective in firmly establishing corporate ethics and ensuring sound management. This requires consideration of such matters as the proper shape of corporate organs, the way in which they exercise restraint on each other, and the arrangements for checks on management. (Keidanren, 1997).

The corporate governance committee of corporate governance forum of Japan issued the Japanese Revised Corporate Governance Principles as the guiding principles of the Japanese corporate governance practices in the global markets. The principles were built based upon global governance principles such as the OECD principle (ECGI, 2003).

These principles suggest more market-oriented governance practices to the Japanese companies even if the principles still respect the communitarian values of governance. For example, while directors are responsible for monitoring, supervisions, and strategic decisions, the directors should still respect good relationships with the CEO during the directors' services (Principle 1 and 2-1). On the other hand, the principles suggest high levels of the director independences by including the independent outside directors in the boards (Principle 3-2 and 4). Similar to the other principles, the Japanese principles also suggest timely disclosures of corporate information, accurate financial statements and audits, and maintenances of transparencies of the governance practices (Principle 11 and 12).

3-6: A General Description of Current Influences on German Corporate Governance

After the integration of West Germany and East Germany, German securities markets experienced stock trade booms that brought senses of shareholders welfares into German investors in 1990s. Such investors increased German market capitalization significantly as well as equity values in the German markets.

For example, total market capitalization in German equity market of 1999 increased by approximately 800% in compare to the capitalization of 1987 (Kumagai, 2002). In addition, these significant increases in the market capitalization had been accelerated through a series of privatizations such as Deutsch Telecom. While domestic equity trades of 1991 were only 17.8 billion DM, these trades rose to 107.3 billion DM in 1998.

Similarly, foreign equity trades of 1998 became 199.6 billion DM while the trades of 1991 were only 24.6 billion DM. Especially, the foreign equity trades in the German equity markets occupied approximately 65% of total equity trades in 1998 (Japan Ministry of Finance, 2003).

Such globalizations in the German equity markets have been supported by advanced global information networks that allow the foreign investors not only to access detail corporate and market information but also to make equity trades. Especially, such advanced global information networks facilitate the cross-border mergers and acquisitions in the German equity markets (Kumagai, 2002).

Since the IT revolutions dramatically improved information and decision environments for equity investments in the German securities market, German companies have had to develop more effective governance structures in order to allow them to make more timely decisions and to implement more rapid changes in order to respond to more efficient global information networks.

While there are several obstacles in the traditional German governance structures to make such timely actions with the advanced information technologies, the cross-capitalization with commercial banks and other business allies has been one of the most serious obstacles. The cross-capitalization will make speeds of the decisions and implementations slow because consensus building and interest alignments among participations of the cross-shareholdings take time. Even if they have a final decision, implementation of the decision would take time because the implementation has to be progressed gradually to ensure the consensus in the implementation process (Kumagai, 2002).

To support the restructurings of the traditional German governance structures through the dissolutions of the cross-shareholdings, the German government eliminated tax burden on capital gains from the dissolution of the reciprocal shareholdings in 2002 (Logue and Seward, 1999; Kumagai, 2002). German corporations welcome the deregulations and tax removals with great appreciations. For example, when government announcement of the tax elimination was released on December 23 in 1999, German stock index increased by approximately 4% and recorded the highest point. Eventually, several large corporations and commercial banks announced their liquidations of the cross-shareholdings (Kumagai, 2002; Mizuho Research Institute, 2002; Ministry of Finance of Japan, 2003). As a result, the tax eliminations increased levels of not only the German market capitalization and equity trades but also the effectiveness of the German governance structures significantly (Logue and Seward, 1999; Kumagai, 2002).

German companies have also tried to reform their traditional German corporate governance systems. For example, GPC Biotech AG has created guiding governance principles for better performances of their governance practices. The principles are built based on the Code of Best Practice of the German Panel on Corporate Governance which is actually already following OECD governance principles (GPC, 2002).

Fundamentally, both the GPC principles and the Code of Best Practice aim at appropriate protections of shareholder rights (GPC, 2002; www.rid.ru, 2003). For example, the responsibilities and duties of the management board and the supervisory board have been redefined based on shareholder value. The management board has been given the responsibility for efficient operational management and managerial decisions in order to maximize corporate values and profitability. The supervisory board has been structured both to maintain a high degree of independence from management (in order to obtain better monitoring and control), to protect shareholder welfare and to contribute to increase corporate values and shareholder welfare.

This statement of principles also recommends timely and efficient disclosure as well as timely communication and information exchange among the various corporate constituencies in order to improve the corporation's overall governance. To satisfy these recommendations, the GPC principles recommend that the management board establish and maintain effective information flows and communication between the management board and the supervisory board (GPC, 2002; www.rid.ru, 2003).

3-7: Recent Changes in the Japanese and German Corporate Governance Systems

As previously described, as a result of globalization, the previously traditional Japanese and German corporate governance systems have been moving towards a more market-driven orientation. In generally, the Anglo-American corporate governance system has been characterized as having five indigenous governance values. These are (Charkham, 1994; Monks and Minow, 2000; Sheard, 2003):

1. Market orientation
2. Contractual structure
3. Board of directors independence
4. Shareholder wealth maximization
5. A short-term financial and strategic perspective (Charkham, 1994; Monks and Minow, 2000; Sheard, 2003).

In contrast, Japanese and German corporate governance have been characterized and described by five different indigenous values of the communitarian system. These five values are (Charkham, 1994; Monks and Minow, 2000; Sheard, 2003):

1. An insider orientation
2. Relational management and financing
3. Assured participation in major decision-making by all stakeholders
4. A total welfare orientation
5. A long-term perspective

Insider orientation typically reflects a policy of internal promotions, placing employee representatives on the board/boards of directors, employee-oriented corporate governance practices, and corporate-group oriented financial and strategic practices such as those practiced by the Japanese Keiretsu in their special relationships with their lead banks. Basically, an insider oriented corporate governance system aims to protect all stakeholders in the organization (Lightfoot and Kester, 1991; Charkham, 1994; Monks and Minow, 2000).

In German corporate governance, the supervisory board consists of the representatives from major shareholders, labor union, and employees to protect these stakeholders' interests. However, the supervisory board has had social obligations to bring benefits to their communities. The management board is organized by professional management to ensure good business decisions and operational performances (Charkham, 1994).[10]

Based on the current survey and reports, the insider-orientation has been still preferred by German and Japanese firms. For example, according to a field research in Japan, only 25% of 690 large Japanese corporations have tried to change insider directorships and internal promotion systems. This indicates that Japanese firms have still strongly maintained insider oriented corporate governance with powerful inside directors and executives (The Corporate management and HRM special committee, 1997). As another example, MITI's report (2003) discussed that Japanese firms would maintain the insider orientation under strong pressures towards more market (outsider) orientation. According to MITI (2003), this is not a rejection to the outsider orientation because the Japanese companies have introduced outside directorships actively. Mainly, Japanese firms have used the outside directors as symbols of better disclosures in global markets. Basically, Japanese firms have still thought that insiders perform better supervisions and decision-makings due to more knowledge and experiences in their businesses.

German insider orientation in corporate governance has created and strengthened in German histories and cultural values. Consequently, the insider orientation with such dependences will not be completely and easily eliminated under the current globalizations and pressures from the international investors (Suzuki, 1999). In addition, such inside oriented governance system will be still maintained since the German corporate law has mandated the employee-oriented compositions of the two-tier board structures (GPC, 2002).

> The purpose of Corporate Governance is to achieve a responsible, value-oriented management and control of companies. Corporate Governance Rules promote and reinforce the confidence of current and future

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[10] See, the Co-determination Act of May 1976. Charkham (1994). Pp.14, 17-18, 22-24. For the protection of shareholder's rights, see the German Stock Corporation Act or Aktiengeseta AktG: Section 12 for full voting right for each ordinary share, Section 67 for no impediments with regard to ownership or registration, Section 68 for transferability of share at ay time, Section 134 for participation, proxy and exercise of voting rights at general meeting, Section 101 for election of members of the supervisory board, and Section 58 for participation in company profits. For more detail, see GPC Biotech AG (Nov 2001).

shareholders, lenders, employees, business partners and the general public in national and international markets (GPC, 2002).

Generally speaking, both Japanese and German governance structures have tried to acquire the market orientations. Especially, active equity trades and the cross-border mergers and acquisitions in their equity markets have forced the indigenous structures to obtain the market-oriented governance values. In addition, domestic investors have been familiar with concepts of the shareholder welfare protections. As a result, Japanese and German governance structures have to obtain a series of the market-oriented values such as the shareholder protections, market-based decisions, and stock price consciousness.

In Japan, the market-orientation values that the traditional Japanese structure should obtain have been characterized with better disclosure, active external financing, better investor relations, stock performances, and the stock options. Especially, the disclosure has been quite important issue for the Japanese corporate governance since the main banks have not been able to monitor and supervise Japanese corporate performances and governance practices due to drastic shifts to the equity financings (Kester, 1991; Milhaupt, 1996). Consequently, Japanese companies have had to rely strongly on market reactions, evaluations, and stock performances for the monitoring and supervision (The Corporate management and HRM special committee, 1997).

In addition, better disclosures and governance transparency have been critical issues for Japanese companies that have tried to raise working capitals in the foreign equity markets (The Corporate management and HRM special committee, 1997). For example, several Japanese companies have started trying to improve qualities of their disclosures to reduce costs of capital in the global equity markets by eliminating the Japan premium (Fukao, 1999).

Japanese corporations have tried to improve the market and operational performances by improving decision-making processes and qualities of directors. For example, 80.9% of large 690 Japanese firms have tried to accelerate speed of decision-makings through downsizing of the board. In addition, 65.7% of the Japanese firms have tried to change performance measurements from sales volumes to profits such as net profit or gross profit (The Corporate management and HRM special committee, 1997).

In Germany, the stock booms of 1990s introduced the market orientation in the German equity markets. As I described already, these booms made the size of the German equity market eight times as large as it used to be. During the booming, German investors have been getting familiar with ideas of the shareholder value maximization. This market orientation has been expected to be accelerated after the German government eliminated taxes on capital gains from dissolving the reciprocal shareholdings (Kumagai, 2002; Japan Ministry of Finance, 2003).

Relational aspects and long-term orientation have been considered as explicit characteristics of the communitarian governance practices. It is well known that Japanese corporate governance practices are characterized by long-term relationships and mutual trusts (Sheard, 2003). Lightfoot and Kester (1991) described these relational values in the Japanese automobile industries.

> In the automobile industry, for example, a business relationship between two companies will formally begin with the signing of a 'basic agreement,' usually a long-term contract subject to annual renewal. Rather than addressing a specific transaction, basic agreements are expressions of intent to engage in mutually beneficial business transactions, to establish and maintain an atmosphere of mutual trust in business dealings, and to respect each other's autonomy. .... Basic agreements receive much of senior management's time, for considerable due diligence is done before entering into a close, long-term relationship (Lightfoot and Kester, 1991).

In Germany, the relational values can be expressed by the three core functions of the supervisory board: interlocking function, monitoring function, and strategic decision making and ratification function (Charkham, 1994). The interlocking function of the supervisory board is to establish efficient interaction flows based upon mutual trusts and interdependence in corporations to make good business decisions and executions

(Charkham, 1994). The German corporate acts still support the core functions of the supervisory board.

While the relational values are still supported by the German laws and the two-tier board structures, it is important to see how the business relationships between commercial banks and German corporations have changed. German commercial banks have taken powerful positions in German industry as suppliers of working capitals and business information. The origin of such special relationship between the banks and German corporations can be found in the early stages of German industrialization. At the time, the German corporations had nothing but the banks for their financial resources because domestic capital markets were seriously underdeveloped and capitals in the markets were not sufficient enough to support the corporate financing (Lightfoot and Kester, 1991; Charkham, 1994).[11] German corporations have received comprehensive and wide ranging services such as depository services, loans, investment advice, free foreign exchange transactions, free consulting, advising, extensive monitoring, and information resources (Charkham, 1994).

According to the current empirical studies, Japanese and German firms have still maintained the relational values. For example, majority of the 690 large Japanese corporations considered the long-term relationships with stable shareholders would be still very valuable and appropriate (The Corporate management and HRM special committee, 1997). Table 2 shows this tendency (Shimotani, 2003).

[11] The German capital markets have been still inefficient in compare to the Anglo-American or Anglo-Saxon capital markets because German corporations have been financing from the banks. As a result, German industry's market capitalization has been still low in compare to other Western counterparts. At the same time, debt financing has been quite high level in compare to the counterparts. The German corporations have called these banks as *Universalbanken* referring to banks that offer comprehensive and wide range of services such as deposit, lending, investment, foreign exchange, consulting, advising, monitoring, and information resources.

Table 2: Stockholders Structure (%)

Year	Banks	Corporations	Individuals	Foreign Investors
1985	21.6	24.1	25.2	5.7
1990	16.4	25.2	23.1	4.2
1995	15.4	23.6	23.6	9.4
1996	15.1	23.8	23.6	9.8
1997	14.6	24.1	24.6	9.8
1998	14.0	24.1	25.4	10.0
1999	12.8	23.7	26.4	12.4
2000	11.5	22.3	26.3	13.2

Source: Shimotani, (2003)

However, even if Japanese companies have tried to maintain long-term business relationships with the main banks, the relationships have been still changed from long-term financial relationships to long-term business partnerships. The business partnership uses the main banks as advisors and consultants for their business operations (Mizuho Research Institute, 2002).

This concept of the new long-term relationship with the main bank has been also applied to the relationships with keiretsu members and other business alliances as the relationship-based alliances and collaborations (MITI, 2003). The relationship-based alliances and collaborations are long-term relationships based upon not the cross-shareholdings but the pure business collaborations. The shift to the new relationship has been observed with the dissolutions of the cross-shareholdings. For example, 43.8% of 690 Japanese companies thought that inefficient cross shareholdings must be liquidated (The Corporate management and HRM special committee, 1997).

In the German governance system, the relational aspects will be maintained by the two-tier board structures required by the law. The two-tier systems respect long-term stable relationships with stakeholders such as employees, unions, and banks (Suzuki, 1999; GPC, 2002; Mizuho Research Institute, 2002).

However, even if the traditional long-term relationships would be kept, German firms have changed the natures of the long-term business relationships. For example, German cross shareholdings have been dissolved greatly because they have started emphasizing on assets efficiency and returns from equities that have held through the maintaining cross shareholdings while German firms will still maintain the cross shareholdings for business relationships (Kumagai, 2002).

Naturally, these actions have influenced traditional relationships with commercial banks because the banks were the largest players of the cross-shareholdings. Since the German companies have changed attitudes to the cross-shareholdings, the banks have also started changing their attitudes. For example, the banks have started acting as pure equity investors in the German corporations who expect for higher returns from their investments (Kanamori et al, 1993; Federal Ministry of Justice, 2003).

Similar to the German firms, the commercial banks have started dissolving the cross-shareholdings for better asset utilizations and returns from their investments. For example, in 2000, D.B. Investor[12] stated, "At the latest, by the year 2007, we will liquidate all equities of more than 20 large German firms including Daimler-Chrysler in markets." (Kumagai, 2002). According to Kumagai (2002), the Deutsch Bank planed to use capital gains from the liquidations to invest in their core businesses and non-listing high-tech firms for better returns.

Participation and stakeholder wealth orientation have been considered as important characteristics of the communitarian governances. Mostly, participations are observed in cross business activities and monitoring because these activities are collaborative among business allies. Such participations are also described as the selective interventions, cross-directorships, employee transfers, and director transfers.

In Japanese industries, when several firms hold shares each other, total returns from the investments tend to be greater due to overall business growth and expansions through collaborative and coordinated business activities. In addition, the reciprocal ownerships allow each Japanese company to conduct businesses at lower level of asset ownership

[12] This company has managed equities held by the Deutsch Bank.

since assets are held by other firms where the company holds their equities as the cross shareholdings (Kester, 1991).

Once Japanese companies establish such business relationships, active information sharing through both formal and informal communications begins among the members. Such information sharing can be even extended to the management transfers or the cross directorship to create group-wide information networks and business interactions (Kester, 1991; Lightfoot and Kester, 1991).

The German laws have mandated participations and collaborations of all stakeholders. For example, the German stock corporation act defined the two-tired board system as a basic structure of the German corporate governance (Monks and Minow, 2000). This system facilitates stakeholder participation in operational decisions and in governance practices since the supervisory board consists of representatives from unions, employees, and shareholders.

In addition to the two-tier structure, the co-determination act of May 1976 has still asked management to make business decisions to ensure both corporate welfares and stakeholder welfares (Charkham, 1994). Especially, this act facilitates German companies aiming at the total welfare maximizations because of the stakeholder participations into the business decisions and operations at the board levels.

According the current empirical studies, while the fundamental mechanisms to support the participations have been highly destabilized in the current globalizations, Japanese firms have still respected the basic values of participations and collaborations. Namely, while Japanese companies have considered shareholders as important stakeholders, they have still considered their employees as more important stakeholders than the shareholders (The Corporate management and HRM special committee, 1997; Hirata, 2003).

The executive officer system in Japanese corporate governances has been a good example to see how Japanese companies have tried to acquire the market-driven values while they still keep the basic Japanese governance values. The executive officer system or *Shikko Yakuin Seido* has been a dominant governance system in large Japanese companies since Sony's first introduction of the system in 1997.[13] The executive officer system was made based upon the officer system of the U.S. corporate governance system. Consequently, this system is neither the Japanese traditional corporate governance system nor a governance system under the Japanese commercial law (Sony, 1997; Ueda, 1999).

Japanese corporations have introduced the executive officer system to gain effectiveness of the U.S. governance practices even if they maintain the long-term relationships and collaborations among the insiders (Ueda, 1999). According to Ueda (1999), 87.3% of 100 large and leading Japanese corporations had already introduced the executive officer system in order to shorten the corporate decision-making process. 65.1% of the companies answered that the introduction of the system was also intended to revitalize corporate board meetings. Other reasons reported for adopting an executive officer system were to (1) reduce the number of directors, (2) to strengthen the monitoring of board functions, and (3) to allow directors to focus on a higher level of decision-making.

According to the Sony's executive officer system, the board of Sony headquarters includes seven inside directors, two outside directors, and four auditors. The two outside directors satisfy SEC's requirements for securities market listings (Sony, 1997; Ueda, 1999). While the outside directors have been getting more importance in the board, their contributions to the governance practices are quite limited since they cannot be members of the management committees where are actual places for final decisions and supervisions. Instead of the two outside directors, all seven inside directors can attend both the board meetings and the management committees since they are also executive officers. Consequently, the board independence might not be assured quite well (Ueda, 1999).

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[13] In 1997, Sony introduced the executive officer system that was approved at the 80th regular shareholder meeting.

Generally speaking, there are many arguments saying that the executive officer system might not improve the Japanese governance practices. For example, Japanese companies have introduced the system not for the improvements of the governance performances but for the symbols of corporate efforts to improve the governance performances (Ueda, 1999). According to Ueda (1999), the executive officer system would be only the symbolic actions to impress the equity markets temporarily by showing the corporate efforts to satisfy several market requests such as better disclosures or fast decision-makings. Rather, the actual benefits from the executive officer system are restructurings of the boards by reducing the sizes of the boards. For example, Sony reduced 25 directors and Toshiba reduced approximately 20 directors after their introductions of the system (Ueda, 1999).

The German corporations will still respect the participations and the collaborations because of the two-tier board structure and other laws that ensure the stakeholders' participations into corporate governance practices. Even if the current situations are not quite appropriate for the participations, the German companies will still maintain the values of the participations as long as the German laws mandate the two-tier structure and the co-determination principle (Jackson, 2002).

However, as I described, it is true that the German firms have tried to change the traditional governance structures to be more market-oriented structures after the removals of the taxation on capital gains from dissolutions of the cross shareholdings on January 1st, 2002 (Kumagai, 2002). These have changed the values of the participations greatly because the participations and the collaborations have been based upon tightly connected long-term business relationships through the cross-shareholdings (Mizuho Research Institute, 2002).

4: Discussion of the Globalization of Indigenous Corporate Governance Systems

4-1: Theoretical Discussion of the Processes of Globalization and their Action upon Indigenous Corporate Governance Systems

While there are discussions about changed in various governance structures in the current global markets, there have been discussions about the globalizations of the indigenous governance structures before the current globalizations. According to Hirata (2003), there are two common ways of the globalizations of the indigenous governance structures and practices. The first way is to modify the indigenous governance systems to satisfy the new values and goals emerging from the globalizations. While such modifications could satisfy these new environments temporarily, the modifications would not be the best solutions because the modified indigenous governance structures would loose their temporary effectiveness in the new environments when the new global environments demand for new values that exceed the fundamental capacities of the indigenous structures.

Esser (2001) pointed out two required conditions of the modified governance models. These two points also imply the limitations of performances of the modified indigenous governance structures in the new environments. First, the modifications must build appropriate functions and structures in the indigenous structures so that the modified structures could be effective in the complicated global markets where various regulations, business patterns, customers, employees, and shareholders exist.

Second, the modifications must give the universal governance elements to the indigenous structures. For example, the modified structures must be universal enough to allow the various investors in the global markets to have satisfactions form the governance practices (Esser, 2001). These two points have been also supported by Monks and Minow (2000) as the global citizenship responsibilities of MNEs in the global markets.

While Esser (2001) did not state the universal elements of the modified structures, Monks and Minow (2000) stated six universal requirements to increase the international investors' confidence levels that the modified indigenous structures should satisfy. First of all, the modifications should give the international investors several tools to monitor and supervise entire governance procedures and practices to protect their interests. Second, the modified structures should allow the international investors to send their representatives to the board of directors to monitor the governance practices and decisions. Third, the modifications should encourage the managers ensuring high levels of accuracies and honesties of the financial information through strict auditing mechanisms. Fourth, the modifications should establish efficient voting systems for the international investors so that they could appeal their opinions and requests through the votes. Fifth, the modifications should build various disclosure mechanisms to improve the disclosures. Basically, the managers in the modified structures must disclose critical events and information timely to all investors. Finally, the investors should be able to use their ownership transfer rights in the modified structures.

The second way of the modifications is to replace their indigenous governance structures with new and more effective governance structures. This approach is not easy in compare to the first one because there would be conflicts in organizations dues to both traditional and cultural differences between the indigenous structures and the new structures (Hirata, 2003). However, this approach might build truly effective governance systems with long-term stability if the replacements are done appropriately by considering the various differences in the governance values.

While these two ways have been generally supported in the globalizations of the indigenous governance structures, MNEs have preferred the modifications of their traditional governance systems to the replacements with the new systems based upon my previous arguments about the general tendencies of the globalizations of MNEs' indigenous corporate governance systems. Emergences of the hybrid structures of various indigenous governances are good examples of such preferences and general trends of the globalizations of the MNEs' corporate governance structures.

From the theoretical points of view, there are two theoretical concepts underneath the discussions of the two typical ways of the governance globalizations. The two theoretical concepts are the convergences of the governance structures and the non-convergences of the structures due the path dependences of various indigenous governance values.

4-2: Convergence Arguments

The convergence arguments have been quite popular for the explanations the future directions of the transformations of indigenous governance structures (Hirata, 2003). Since the convergence concepts were originally developed based upon the U.S. industrial developments and dominances (Guillen, 2000), the convergence arguments assume that all corporations in the world would adopt the U.S. corporate governance structures as the best governance model as their industrializations progress. These convergence assumptions were highly supported in 1960s because scholars believed that the strong U.S. dominances in the world economies were achieved by higher effectiveness of the U.S. governance structures and practices than any other indigenous governance structures.

Based upon the assumptions, the convergence arguments have predicted future directions of system developments (Bratton and McCahery, 1999). For example, in the global products markets, proponents of the convergences argued that there were homogeneous elements and structures making the absolute superiorities of corporations. The homogeneous elements include not only he structural differences but also environmental elements such as type of regulations, laws, and economic policies as Rowley and Benson (2002) stated.

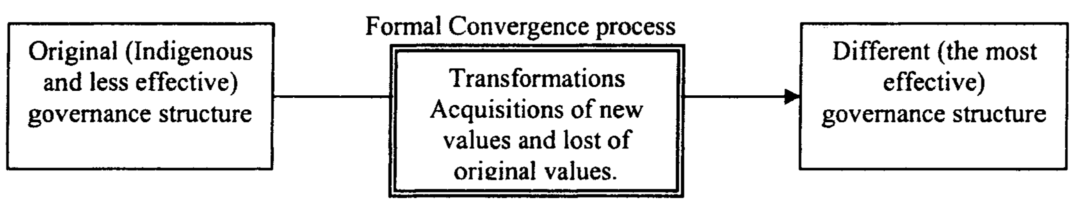
> Early convergence theorists, such as Harbison and Myers and Kerr et al., assumed that the process of industrialization and the spread of advanced technology would move all countries towards political and economic systems similar to that of the United States. … there is 'one best way' of managing (Rowley and Benson, 2002).

While the convergence concepts have the conceptual backgrounds as the assumptions, the convergence has been classified into two different types based upon the ways of convergence. One of the types is called as the formal convergence while the other is called as the functional convergence (McDonnell, 2002).

> Nothing else in the literature is quite so sweeping as Hangman and Karaka, but a number of other scholars seem to accept the basic point. John Coffee and Ronald Gilson distinguish formal and functional convergence (McDonnell, 2002).

The formal convergence is a transformation of a certain indigenous structure to be a different indigenous structure as figure 1 shows.

Figure 1: Formal Convergence



The formal convergence refers a complete convergence to a system that is absolutely superior to the other systems. Especially, when the convergence concepts emerged, the formal convergence refers complete transformations of indigenous political and economic systems to the U.S. systems (Harbison and Myers, 1959; Kerr et al, 1960; Guillen, 2000). This idea was used to explain some globalizations of various indigenous governance structures. For example, Hangman and Karaka attributed the formal convergence to the absolute effectiveness of the U.S. governance structure and its environments (McDonnell, 2002).

> However, for the broadest and boldest statement of the view that currently dominates American legal academia, one should peruse The End of History for Corporate Law by Henry Hangman and Reinier Karaka. Hangman and Karaka believe they have spotted a growing consensus in academia, business and government in favor of a shareholder and market-oriented model of corporate governance along American lines. … Capital markets and institutional investors prefer the American model and are helping to export it elsewhere because it has proved its superiority in

> practice. Thus, they think the world is converging to the American way, and that is a good thing (McDonnell, 2002).

As I mentioned, the formal convergence was generally and widely supported in the 1960s. However, it was severely criticized later for the oversimplified view of indoctrination processes and the overemphasis on the technological impacts (Rowley and Benson, 2002). In addition to these theoretical inferiorities, there are two more reasons for the severe criticisms. First, there has been virtually no clear observation of the formal convergences (Gilson, 2001). The lacking of the observations has been considered as serious deficiency of supports to the formal convergence concept (McDonnell, 2002).

> They [Hangman and Karaka] consider various alternative models and find them wanting – based on very little evidence, it must be said. They also point to some limited evidence of movement towards the American model in Europe and Japan as proof of their thesis (McDonnell, 2002).

Second, it would be almost impossible to see a certain governance structure in the same complementarities because there aren't the complete integrations of the various indigenous governance structures and the different complementarities such as laws and institutions for the indigenous governance practices. In addition, such complete integrations are not expected at all because persistence of the indigenous values would prevent the integration with their path dependences of the indigenous values (Heinrich, 1999; Khanna et al, 2001).

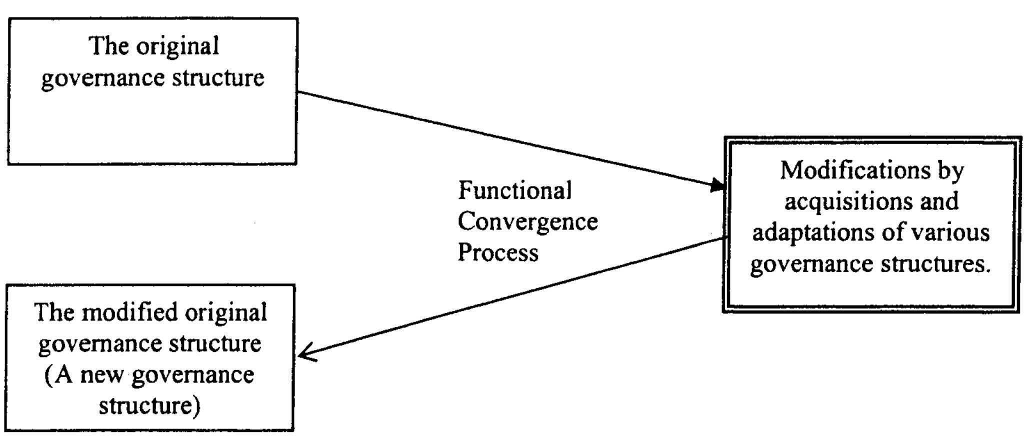
Guillen (2000) proved the impossibility of the formal convergence and stated that differences in legal, institutional, and political structures and systems were strong enough to prevent the formal convergence to a certain structure in the globalizations of indigenous governance systems. Rather, the globalizations are offering chances to the indigenous governance structures to be more effective through acquisitions and adaptations of various indigenous values that the current global markets request.

> The three arguments against convergence in corporate governance – legal, institutional, political – provide enough reason to cast serious doubt on the idea that there is convergence in corporate governance, whether on the

> shareholder-centered model or a hybrid. Globalization seems to encourage countries and firms to be different, to look for a distinctive way to make a dent in international competition rather than to converge on a best model. In a global context, corporate governance must support what a country and its firms can do best in the global economy. Globalization seems not to be about convergence to best practice, but rather about leveraging difference in an increasingly borderless world (Guillen, 2000).

The functional convergence refers modifications of their own governance structures through adaptations of different governance functions of various governance systems (Khanna et al, 2001). A main difference between the formal convergence and the functional convergence is directions of the convergence processes. As figure 2 shows, the functional convergence is a convergence to a new indigenous model based on the original indigenous model. In other words, the original model transform to a new indigenous model by modifying itself with new values and functions of other governance structures. Consequently, the functional convergences have been considered as contingent movements or modifications of indigenous governance structures (Gilson, 2001).

Figure 2: Functional Convergence



Generally speaking, the functional convergence tends to be short-term lived since an output of functional convergence is only a modified system that still has weak competitive fitness and efficiency (Bratton and McCahery, 1999; Gilson, 2001).

While the functional convergence has been clearly observed as the first step of reactions to the market globalizations, there are confusions between the functional convergence and the hybridizations even if the hybridizations do not mean the modifications of the indigenous structures but the introductions of new governance structures that hold all required values of governance practices (Gilson, 2001).

This misunderstanding emerged when Japanese companies started introducing the executive officer system (Hirata, 2003). The executive officer system is not a hybrid structure but a modified traditional Japanese structure because the executive officer system is simple adaptations of the market-driven governance structures to the traditional Japanese structures. Consequently, the executive officer system has not been the truly effective structure that reflects optimum balances of the market-driven values and the relational values (Ueda, 1999).

4-3: Non-convergence Arguments and Path Dependence

The convergence arguments have been criticized for the over simplifications of globalizations of various indigenous systems (Rowley and Benson, 2002). In addition to the criticisms, opponents of the convergence arguments have even created the non-convergence discussions based upon the path dependences of institutions, traditions, historical events, and cultures in indigenous corporate governance systems and practices (Guillen, 2000).

> There are at least three arguments in the extant literature that provide a rationale against the prediction that corporate governance practices are converging or will converge across countries. First, corporate governance systems are tightly coupled with path-dependent regulatory traditions in the areas of banking, labor, tax and competition law that are unlikely to be modified in the near future. (Guillen, 2000).

The path dependence is defined as "the tendency of corporate governance systems to preserve conditions that existed in the past due to economic or political reasons or simply due to historical accident" (Licht, 2001). Such historical accident includes both initial conditions and historical events (Liebowitz and Margolis, 2002; Yoda, 2003).

The path dependence theory states that specific structures will not converge toward a certain single structure because a series of various historical events lock in values generated in the historical events as the bases of the structures (Arthur, 1989 and 1990). Since the dependences fixed indigenous governance values so tightly, it is impossible to break the strong persistence of the historical dependences. Consequently, the historical dependences will protect the original values from invasions of new values continuously (www.rikkyo.ne.jp, 2003).

Since the path dependence is generated from the historical events, the dependence is highly sensitive to the initial conditions where every historical event begun (Liebowitz and Margolis, 2002).[14] Consequently, the historical path dependences reflect the initial conditions because the historical events also reflect the initial conditions.

> According to the path dependence perspective, initial historical conditions matter in determining the corporate governance structures that are prevalent today. Central to the idea of path dependence are complementarities, also called indivisibilities (Khanna et al, 2001).

The historical path dependences can be observed and explained based upon the initial conditions and a series of the historical events as core influences for the formations of the dependences. However, the historical path dependences cannot be predicted prior to the events due to our knowledge limitations and information inefficiency (Gilson, 2001).

This nature of the historical path dependences has been characterized as the multiple optima and the unpredictability of outputs throughout the entire histories called as the stochastic process (Arthur, 1990). This unpredictability of the historical dependences makes the transformations of various indigenous governance structures more complex

[14] Liebowitz and Margolis discussed that the path dependence is observed even in markets characterized through utility maximization and voluntary decisions by an individual because the path dependence is highly sensitive to the initial conditions.

because we cannot predict future historical influences to the indigenous governance structures during the transformations (Modis, 1989; Liebowitz and Margolis, 2002).

While the historical events create strong historical persistence of the indigenous governance values, Licht (2001) discussed that the historical persistence is not the only path dependences of the indigenous governance values. In addition the historical persistence, Licht (2001) pointed out the cultural dependences of the indigenous values.[15] According to his arguments, the cultural values would be the strongest impact on the persistence of the indigenous values that even created "a chain of causality" of a nation's political system. This means that a nation's complementarities of the corporate governance would be significantly influenced in a series of the historical events by the cultural values that are locked in the indigenous governance structures. This argument has been supported especially by the institutional investors such as CalPERS that has suggested their own cultural value sensitive principles of corporate governance for corporations that CalPERS invests (Licht, 2001).

Licht (2001) used the cultural dependences to reject the formal convergence towards a single model in international corporate governance.

> Adopting features of the German corporate governance system would be much smoother than adopting the American system if Greeks shared more cultural values with Germans. If some American features still look attractive, more effort and resources would need to be invested in order to implement them in Greece. In the extreme, a corporate law reform that ignores cultural differences can fail miserably, as the recent Russian experience proves (Licht, 2001).

While there are three sources of the strong persistence of governance values, the cultural values have been considered as the most powerful influences than the initial conditions and the historical events. This is because the cultural values are built in the historical processes and shared by members in a certain region. Therefore, the cultural values have

[15] Licht explained value as "constructs, commonplace in every society. They reflect each society's preferences and priorities as to fundamental issues such as interactions between its individual members and the interrelations between society and the rest of the world."

stronger influences than the historical events and the initial conditions that could be shared and interpreted differently in the region. To express the strong influences of the cultural values, Licht (2001) called the cultural values as "the mother of all path dependencies."

> A nation's culture can be perceived as the mother of all path dependencies. Figuratively, it means that a nation's culture might be more persistent than other factors believed to induce path dependence (Licht, 2001).

To make the path dependence arguments more specified in the fields of corporate governance, Bebchuk and Roe (1999) described two sources of the path dependences in corporate governance systems: the structure driven dependences and the rule driven dependences. According to their arguments, structures include both corporate structure and ownership structure that are highly depending on the initial economic and ownership structures. Consequently, since these structures are fundamentals of the indigenous governance structures, they stated that all indigenous governance structures are different because the current corporate and ownership structures are locked in by various initial conditions.

Rules mean the corporate rules that influence and define the ownership structure of corporations. Since the ownership structure depends on the initial ownership conditions in the beginning of their economies, the corporate rules also reflect these initial conditions (Bebchuk and Roe, 1999). As a result, corporate governance systems, which are highly controlled by the rules, also reflect such initial conditions (Bebchuk and Roe, 1999; Heinrich, 1999).

These arguments of the two sources of path dependences of corporate governance systems weaken the formal convergence arguments because both the structures and the rules are not changed and integrated to form a single mode without changing historical events that we cannot change anyway (Heinrich, 1999; Khanna et al, 2001). At the end of their discussions, Bebchuk and Roe (1999) pointed out that the strong persistence of the two sources prevented the formal convergence of the indigenous corporate governance structures.

> Our analysis shed a light on why the advanced economies differ in their patterns of corporate ownership and governance. It can explain why, notwithstanding the powerful forces of globalization and efficiency, some key differences have thus far persisted. It can also provide a basis for predicting that important differences night persist in the future. Path dependence is an important force – one that students of comparative corporate governance and ownership around the world (Bebchuk and Roe, 1999).

I have discussed the fact that the path dependent nature of indigenous governance systems (and so, correspondingly the values of each particular system) is quite strong and cannot be changed or eliminated easily. In this context, there are two types of path dependence which are relevant. The first type is the result of historical path dependence formed as a result of initial conditions (sensitive dependence on initial conditions). The second type is the result of cultural values in various regions. These two different, yet related sources of path-dependent lock-in occurring in various governance systems can be characterized as either structure driven path dependence or rule driven path dependence. It still remains, however, to describe the different strengths and the fixity of embeddedness of these different kinds of path dependence.

The discussions of the power differences are quite important for the system transformations because there are evidences of the system transformations of indigenous governance structures even if the indigenous values are locked in by the strong path dependences that are considered as almost unchangeable. Consequently, there should be differences in the power levels of the path dependences so that we could assume that the observed transformations are outputs of transformations of the indigenous values that are locked in by the relatively weak forms of the path dependences. This assumption is supported by the remediability of the path dependences based upon the typologies of the dependences, as I will describe later.

According to Liebowitz and Margolis (2002), the path dependences are generally classified into the three types based upon characteristics of an outcome of the stochastic process, sensitivity to the initial conditions and institutionalized historical events, strength of persistence and lock-in effects, and sensitivity to information conditions. The three types are called as the first-degree path dependence, the second-degree path dependence, and the third-degree path dependence respectively (Arthur, 1989 and 1990; Liebowitz and Margolis, 2002).

> … we identify three distinct forms of path dependence. Two of these forms – which we define as first- and second-degree path dependence – are commonplace, and they offer little in the way of an objection to the neoclassical paradigm. Only the third and strongest form of path dependence significantly challenges the neoclassical paradigm, and as this paper shows, the theoretical arguments for this form require important restrictions on prices, institutions, or foresight (Liebowitz and Margolis, 2002).

The values locked in by the first-degree path dependence are quite similar to the outputs in the efficient markets because the values will be always optimum or, at least, given in the markets (Liebowitz and Margolis, 2002). Consequently, systems with such values locked in by the first-degree path dependences are not subjects for reforms and transformations in the current global environments since the systems with the first-degree path dependences will be always optimum and changing continuously and automatically as environments change. In other words, levels of persistence and locked-in effects of the first-degree path dependence can be ignored for the system transformations. Instead, the values with the first-degree path dependences will be described the given environments or new environments of governance systems and practices.

The second-degree path dependence emerges and locked in governance values if governance systems emerge as sub-optimum outputs as a result of information inefficiencies of markets. The second-degree path dependence is very sensitive to the initial conditions and the historical events; however, indigenous values are locked in by the second-degree path dependences to be irrational to the historical events and the initial conditions because the values do not go through appropriate historical paths due to the limitations of knowledge in the information inefficient markets (Liebowitz and Margolis, 2002).[16]

The second-degree path dependences have higher levels of persistence and lock-in effects than the first-degree path dependences because the information inefficiency will not be easily improved enough to fix the sub-optimum outcomes. In addition, the modifications of the sub-optimum values are costly in markets due to costs of information and switching costs. According to Liebowitz and Margolis (2002), a system with the second-degree path dependence is "regrettable" and its persistence is strong enough to require sufficient costs and pains to change to an optimum system. In addition, such painful correction will be only possible if the limitations of knowledge are removed with better information conditions in markets (Aoki 2000; Aoki and Okuno, 2003).[17]

The values are locked in by the third-degree path dependence the values are quite irrational outcome as a result of the serious information inefficiency and the limitations of knowledge in markets (Liebowitz and Margolis, 2002).[18] In compare to the second-degree path dependence, values locked in by the third-degree path dependences are more difficult to change so that the third-degree path dependences are frequently described unchangeable dependences. This is because situations of the information inefficiencies are worse than those of the second-degree path dependences. Consequently, improvements in such serious information inefficiencies and the limitations of knowledge take more time and costs even if the improvements are not feasible under the current conditions.

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[16] The limitation of knowledge is also called as the bounded rationality.

[17] Aoki's discussion implies important point here (Aoki, 2000). When A or J equilibrium changes to P-equilibrium, there should be an abrupt change enough to bring P-equilibrium or sub-P-equilibrium. Such abrupt changes generate the Hysteresis effects in the P-equilibrium and, therefore, make the P-equilibrium steady. Such abrupt changes will change the third-degree path dependence to the second-degree path dependence. In addition, the abrupt changes and the Hysteresis effects can remove knowledge limitation and other complementarities because such changes and P-equilibrium improve information efficiency and, therefore, modify community members new information and environments. These create conditions for a system with the new second-degree path dependence to change to the optimum system. Naturally, such change will be costly and painful. However, one can expect such costs and pains will be reduced by simultaneous changes of complementarities in better information conditions.

[18] The irrational outputs are also called as the inefficient outcomes.

While the third-degree path dependence creates such strong persistence and lock-in effects enough to impossibly changed, Liebowitz and Margolis (2002) pointed out that probabilities of the changes of values licked in by the third-degree path dependences. They use "remediability" of the third-degree path dependence to argue the probabilities.

According to Liebowitz and Margolis (2002), the remediability is supported by the basic characteristics of the third-degree path dependence. Since the values as inefficient outputs were chosen even if such outcomes should have been avoided because of the serious limitations of knowledge in markets (Aoki, 2000; Aoki and Okuno, 2003; Hayashi, 2003). Consequently, even if the values locked in by the third-degree path dependences are not changed immediately by the improvements of the knowledge limitations, the continuous improvements of the information inefficiencies could change persistent of the third-degree path dependences to weaker persistent enough to be the second-degree path dependence that can be changed (Aoki, 2000).

4-4: Hybrid Governance Theory

In the studies of system transformations, hybridizations of various systems have been discussed quite intensively (McDonnell, 2002). According to the hybridization arguments, the hybridizations of various systems with different historical dependences and cultural values could emerge in the inter-related values among the systems. This means that the hybridizations could be more feasible if there are sufficient the inter-related values in the various systems enough to be integrated to a certain system after the hybridizations.

For example, U.S. corporations have adapted Japanese production system such as the just in time production quite well because the just in time production system has the inter-related factors between the U.S. firms and the Japanese firms. The U.S. firms understood the zero-defects and the zero-inventory policies quite well because these are inter-related factors that have been shared as the basic values of the production efficiencies by any companies. On the other hand, the U.S. firms did not adopt the keiretsu system because the values of the keiretsu system were not the inter-related factors. Consequently, even if the U.S. firms successfully introduce the just in time system, the just in time system in the U.S. firms is not a convergence model but a new production model as a result of hybridizations between the Japanese management values and the U.S. management values. In the U.S. just in time system, there are still indigenous values of the U.S. management even if there are hybridized Japanese values (McDonnell, 2002).

In the fields of the international corporate governance, such hybridization arguments have been made and supported. One of the most representative hybridization arguments was Williamson's theoretical explanations and models based upon the convergence assumptions (Williamson, 1996).

As figure 3 shows, Williamson (1996) described a hybrid structure as a transition structure emerging in a middle point between the market structure and the hierarchical structure. Since the hybrid structure is a transition structure, the hybrid structure tends to have all elements of the two polar structures while the elements do not have regular effectiveness.

> Summarizing, the hybrid mode is characterized by semistrong incentives, an intermediate degree of administrative apparatus, displays semistrong adaptations of both kinds, and works out of a semi-legalistic contract law regime (Williamson, 1996).

According to Williamson (1996), a certain polar structure could be destabilized enough to start moving towards another polar structure. This movement is called as a convergence process that the original structure transforms itself to another polar structure by loosing the indigenous attributes and acquiring new values from another polar structure at the same time. Once the original structure lost 50% of the indigenous values and gained 50% of the new values, the hybrid structure emerges on the middle point of the convergence. Consequently, the hybrid structure has all attributes in the forms of semistrong modes.

Once the hybrid structure emerges, the hybrid structure lost its equilibrium due to continuous convergence process. Therefore, this unstable hybrid structure is eventually changed to another polar structure by loosing the semistrong original values and gaining more new values spontaneously. Then, the convergence process ends when the original structure lost all of the original values and gained all of the new values.

Figure 3: Williamson's hybrid governance model (The Williamson governance model)

	Market	Hybrid	Hierarchy
Attributes			
Instruments			
Incentive intensity	++	+	0
Administrative Controls	0	+	++
Performance attributes			
Adaptation A	++	+	0
Adaptation C	0	+	++
Contract Law	++	+	0

Source: Williamson (1996), Table 4.1, Pp.105.

While the instability of the Williamson governance model was clearly indicated by the hybridization process based on the convergence assumptions, Williamson also explained the instability in detail based upon distributions of the disturbance frequency and the asset specificity to a hybrid structure.

> Although the efficacy of all forms of governance may deteriorate in the face of more frequent disturbances, the hybrid mode is arguable the most susceptible. That is because hybrid adaptations cannot be made unilaterally (as with market governance) or by fiat (as with hierarchy) but require mutual consent. Consent, however, takes time. … The hybrid mode could well become nonviable when the frequency of disturbances reaches high levels (Williamson, 1996).

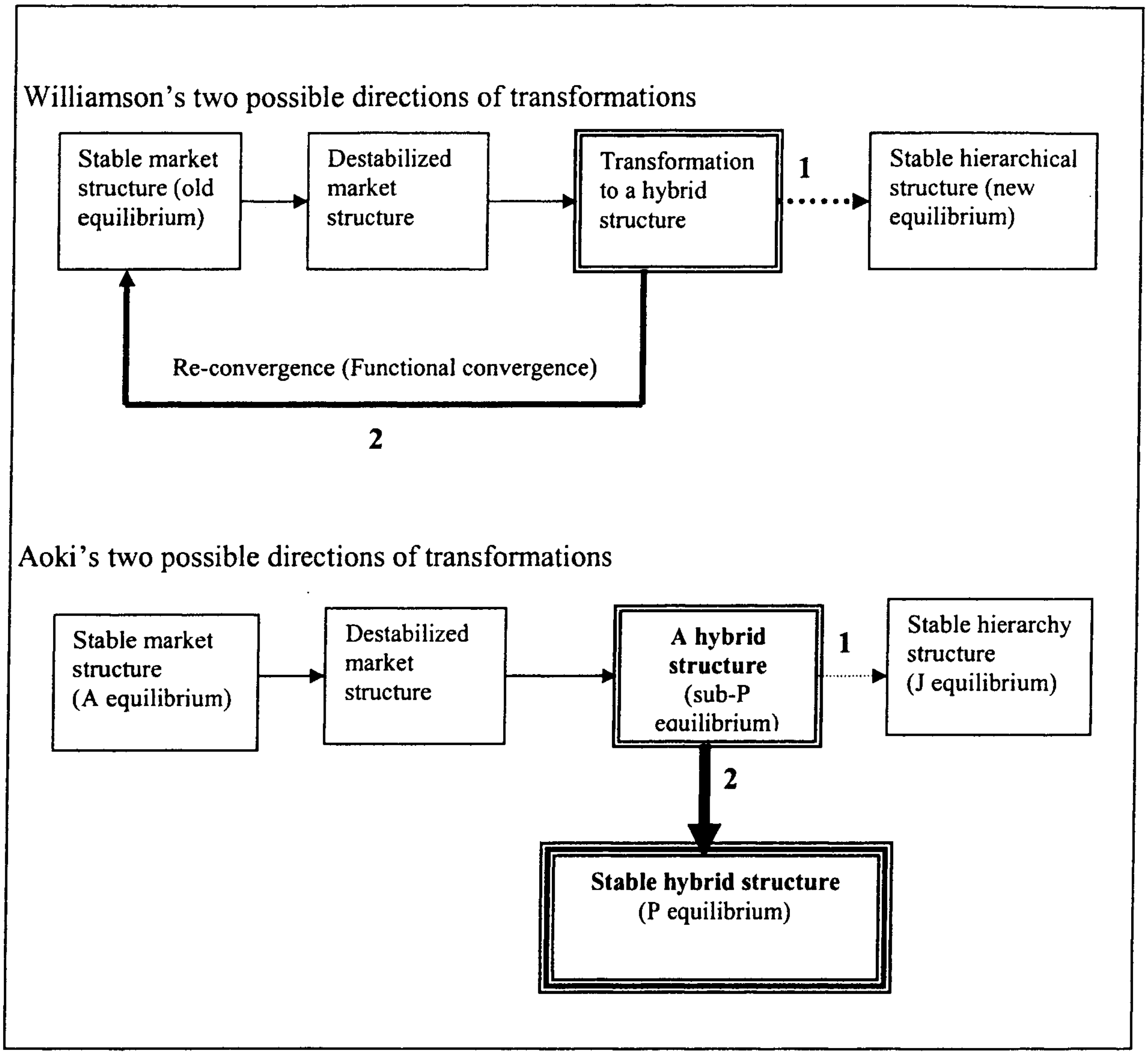
Williamson's hybridization concepts have been widely accepted in the field of the international corporate governance. For example, OECD characterized an emerging hybrid governance structure as an intermediate system between the shareholder-oriented system and the stakeholder-oriented system (OECD, 1995). McDonnell defined the hybrid model as a middle point of the communitarian system and the contractarian system (McDonnell, 2002). Fleming described the hybrid structure as a mixture of semistrong values of the shareholder-oriented governance systems and the stakeholder-oriented systems (Fleming, 1998).

However, the Williamson's concepts are criticized currently by scholars such as Aoki (2000) and Okuno (Aoki and Okuno, 2003) who pointed out some possibility of a stable hybrid structure as an abnormal output in the convergence process. Especially, Aoki (2000) and Aoki and Okuno (2003) gave a certain probability of the stabilizations of the Williamson governance model based on their models of destabilizations of the indigenous structures, hybridizations of the two different structures, and stabilizations of the hybrid structures.

Aoki (2000) explained the hybridizations between two polar equilibria called as A and J equilibria. The A equilibrium is similar to the market structure and the J equilibrium is similar to the hierarchy structure of the Williamson's arguments. There is an intermediary structure between A and J equilibria. This intermediary structure is called as the sub-P equilibrium that is considered as a hybrid structure of the Williamson's discussions. In addition the three equilibria, there is one more structure called as the P equilibrium that is considered as a stable hybrid structure, which Williamson did not consider in his discussions. Figure 4 shows transformation processes of both the Williamson governance model and the Aoki's model.

> As readers have surely surmised from the use of the terms "J-equilibrium" and "A-equilibrium," Darwinian dynamics can be used as a theoretical device for explaining some aspects of the formation of different prevailing organizational modes in Japan and the US. From this perspective, the differences in prevailing organizational modes in these two countries may be regarded as a result of different "evolutionary equilibria" evolving out of unique historical circumstances (Aoki, 2000).

Figure 4: Comparisons of directions of transformations



As figure 4 shows, what makes the Aoki's hybridization argument different from the Williamson's arguments is an assumption of a long-term stable hybrid structure called as the P-equilibrium that emerges after stabilization of the sub-P equilibrium

> Under Darwinian dynamics that involve strategic complementarity, it may be possible, depending on historical conditions, for there to be a development whereby economies converge toward a stable sub-Pareto-optimal equilibrium (Aoki, 2000).

In addition to the arguments about the stable hybrid structure, Aoki and Okuno (2003) argued the mechanisms of transformations to the stable hybrid structure. According the their arguments, a certain stable structure such as A equilibrium or J equilibrium could be destabilized enough to transform itself to a hybrid structure such as the sub-P-equilibrium if there were significant environmental changes and confusions called as the abrupt changes. The abrupt changes could destabilize the current equilibrium if the changes are caused by emergences of both new information conditions and new generations with different values and backgrounds.

> Efficient P-equilibrium exists as one of stable equilibria. Consequently, there is a concern if non-Pareto equilibria such as A-equilibrium and J-equilibrium can shift to P-equilibrium under certain conditions. .... Based upon social structures, abrupt changes can be interpreted as confusions caused by new generations with non-traditional values or people with different traditions in the current equilibrium. If such probable confusions are introduced, in the long run, P-equilibrium will be the most likely in the current equilibrium (Aoki and Okuno, 2003: translated by the author).

For example, the market structure can be highly destabilized by the IT revolutions and the international investors who have various historical backgrounds and cultural values. Since the IT revolution keeps equally increasing levels of knowledge and information about corporations and industries of investors, the informed investors as new generations lead to a unique hybrid structure.

While there are two hybrid conditions called as the sub-P-equilibrium and the P-equilibrium in the Aoki's arguments, it is important to point out that the sub-P-equilibrium is a temporarily stable hybrid structure to be the initial condition of the more stable hybrid structure called as the P-equilibrium. According to Aoki, the P-equilibrium will be quite stable since several historical events and new cultural values will be locked-in by the path dependences generated in the stabilization process from the sub-P-equilibrium.

4-5: General Trends of Globalization and their Effect Upon Indigenous Governance Systems

I have discussed theories relating to the globalizations of the indigenous governance structures so far. In this section, I describe the general trends of the globalizations of the indigenous structures based upon several empirical studies.

Generally speaking, MNEs are seeking for more effective governance structures that could satisfy various demands from different investors in the global (Pound, 1995; Bradley et al, 1998). According to OECD reports, a hybrid governance structure has been considered as potentially effective governance structures for the MNEs (Guillen, 2000).

The OECD reports described the current trends towards the hybrid governance structures in the large MNEs. Generally speaking, the hybrid systems tend to acquire values and attributes of both the market-driven structures and the relationship-driven structures (Guillen, 2000). For example, OECD reported that the corporate governance systems have not converged to the Anglo-American system but shifted to an intermediate structure between the shareholder-oriented systems and the stakeholder-oriented systems (Guillen, 2000). McDonnell (2002) reported the similar characteristics of the current hybridizations. His report said that the hybrid structures emerged on the middle point of the communitarian governance systems and the contractarian governance systems. Fleming (1998) reported that the hybrid mode acquires mixed characteristics of the shareholder-oriented governance modes and the stakeholder-oriented modes.

OECD analyzed such trend and concluded that active cross-border mergers and acquisitions in international equity markets have created conditions that hybridizations of various indigenous governance structures are made. Since general trends of deregulations and liberalizations of securities markets have given the universal values to various securities markets that all indigenous governance structures have to consider, OECD considered the hybrid governance structures as reasonable for MNEs that aggressively finance their working capitals in the global securities markets.

> The OECD's report on corporate governance – written by six prominent managers or directors from the U.S., France, Britain, Germany and Japan states that 'as regulatory barriers between national economies fall and global competition for capital increases, investment capital will follow the path to those corporations that have adopted efficient governance standards… Philosophical differences about the corporation's mission continue, although views appear to be converging.' … the experts assembled by the OECD point out that convergence is not towards the U.S. approach but towards a middle ground between the shareholder and stakeholder-centered models (Guillen, 2000).

Subramani and Henderson (1999) and Nohria (1992) also argued potential effectiveness of the hybrid corporate governance structures in the MNEs. They expected that the hybrid structures would improve organizational networks, information sharing, operational flexibility, and interactions among all constituencies of corporate governances.

> Our understanding of hybrid governance is largely drawn from a substantial body of qualitative research providing descriptive accounts of contexts of hybrid governance. The picture of hybrid governance that emerges is one of firms working together closely, each providing unique capabilities and resources and jointly deriving advantages that neither party could derive on their own (Subramani and Henderson, 1999).

On the other hand, several scholars have doubts in the potential effectiveness of the hybrid structures. For example, according to Bratton and McCahery (1999), the hybrid structures may not be able to acquire best practices of various indigenous governance systems because institutionalized differences among the indigenous systems cannot be eliminated completely and hybridized immediately. In addition, since several components of traditional governance models are tightly and complexly connected, each component may not be effective in the hybrid structures if the connection is cut and reorganized during hybridizations.

While Bratton and McCahery (1999) doubted the potential effectiveness of the hybrid governance structures, they pointed out that the stabilities of the hybrid structures would make the hybrid structure quite effective in the global markets. According to their arguments, the hybrid structures would be truly effective in the long-term if the structures could hold the best practices of various indigenous systems that were acquired in the hybridization processes. McDonnell (2002) pointed out the importance of the stability of the hybrid structures. According to McDonnell (2002), the hybrid structures must be able to hold the acquired best governance values from the various indigenous governance structures to be truly effective in the current global markets.

5: The OECD Governance Model

5-1: The OECD governance model: Emergence of a new governance structure

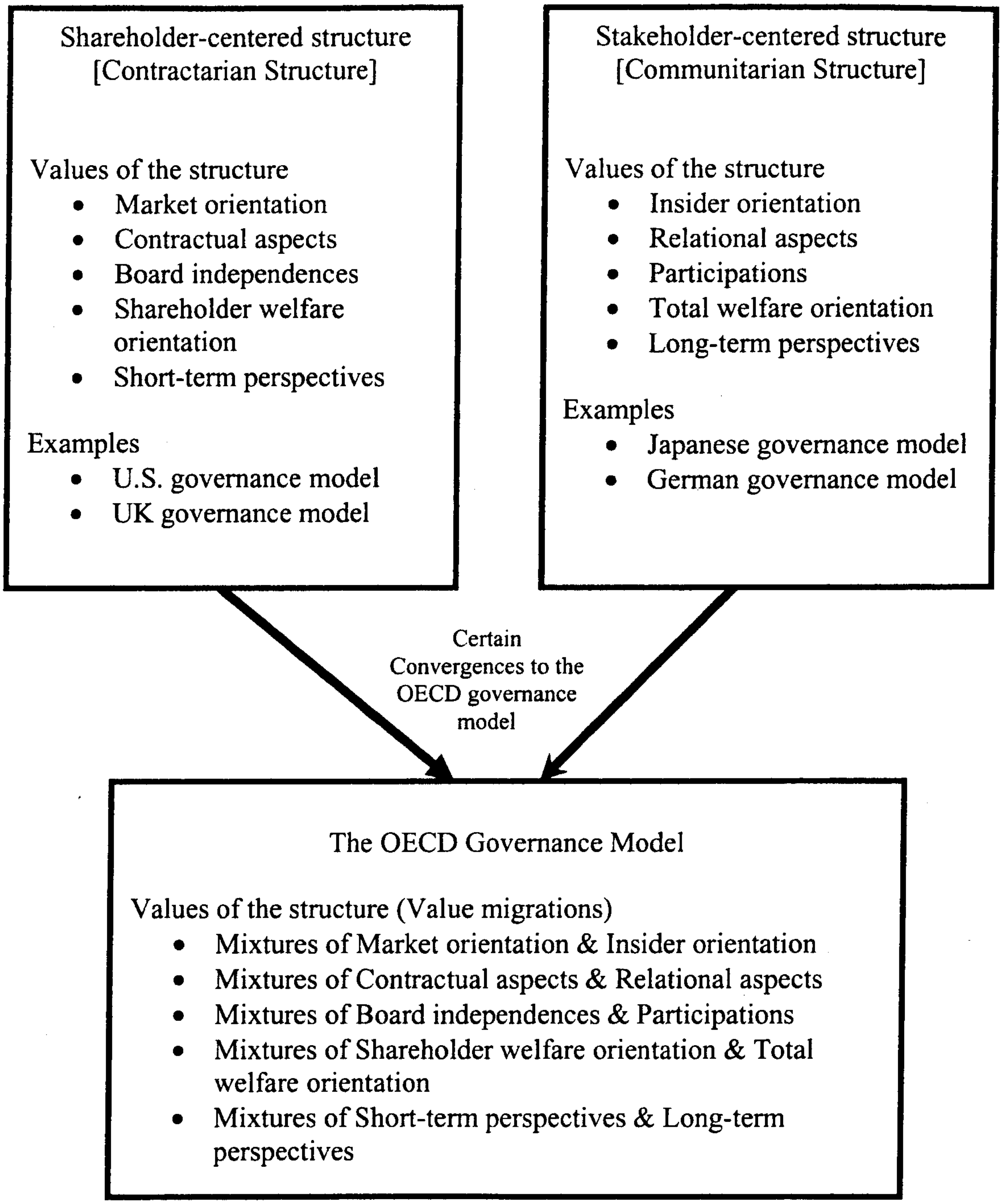
As I have discussed so far, the corporate governance structures have been undergoing changes with the globalizations of equity markets. While there have been several reports of such changes of corporate governance structures, a hybrid governance structure is considered as potentially the most effective governance structures in the current global markets.

Such hybrid governance structure was described by OECD in 1999 (Guillen, 2000). According to the OECD descriptions, the OECD governance model tends to acquire values or "philosophical differences" of both the market-driven governance structure and the relationship-driven governance structure (Guillen, 2000).

Such acquisitions of the philosophical differences let OECD conclude that the OECD governance model was a result of certain convergence movements from both the market-driven governance structure such as U.S. governance structure and the relationship-driven governance structure such as Japanese and German structures (Guillen, 2000). The OECD governance model was shown by figure 5. As the figure 5 indicates, the OECD governance model is an output of two convergence processes from the two different governance structures.

> Philosophical differences about the corporation's mission continue, although views appear to be converging.' ... the experts assembled by the OECD point out that convergence is not towards the U.S. approach but towards a middle ground between the shareholder and stakeholder-centered structures (Guillen, 2000).

Figure 5: The OECD governance model



The OECD governance model assumes that both shareholder-centered governance structure and stakeholder-centered governance structure move towards the OECD governance model. During the movements, indigenous values of each local structure are also converged and migrated to create new values in the OECD governance model.[19] The

[19] OECD called this as a certain convergence.

new values are maintained as hybrid values in the OECD governance model (Guillen, 2000).

While the OECD governance model assumes such value migrations, OECD did not clearly describe balances of different indigenous values in the model. As OECD stated that the OECD governance model was a middle point between the contractarian structures and the communitarian structures, the OECD governance model assumes that the indigenous values would be balanced through the value migrations (Guillen, 2000).

Stabilities of the OECD governance model have not been described at all. Several scholars have pointed out the lack of the descriptions of the stabilities. For example, Bratton and McCahery (1999) gave questions about the stability of the model. They argued that the OECD governance model would not be considered as stable unless we confirm levels of both optimum values migrations and utilization of the hybridized values.

While the optimum value migrations have been partially confirmed by Fleming (1998) who found coexistences of various governance values of both the shareholder-oriented governance structures and the stakeholder-oriented structures. However, Fleming still pointed out that the OECD governance model would not be considered as stable without clear observations of value utilizations in the OECD governance model to satisfy the current markets requirements.

Subramani and Henderson (1999), Nohria (1992), and McDonnell (2002) argued that the OECD governance model would not be effective in compare to other governance structures if the model would not hold well balanced mixtures of the indigenous values. In addition, they pointed out that such optimum balances would be achieved if the OECD governance model acquires and holds required governance values from the various indigenous structures for better utilizations of the hybrid values to outperform the other governance structures in the global markets.

While these questions to the stabilities of OECD governance model are basically coming from uncertainties of optimum values migrations and utilizations of the values to outperform the other governance structures, the questions are also due to lacking of theoretical arguments which could differentiate the OECD governance model from the Williamson governance model.

Such differentiations are very important to explain the stability of the OECD governance model because the Williamson governance model has been explained as unstable based upon assumptions of the convergence concepts. Williamson described that the Williamson governance model would be unstable because the model emerged temporary as a transitions model on the middle point of the convergence process to a certain governance structure. Consequently, as long as the OECD governance model is explained based upon the Williamson governance model, the OECD governance model would not be explained as stable even if the OECD governance model could be actually stable in the real world. I will differentiate the OECD governance model from the Williamson governance model by rejecting the convergence assumptions in this dissertation.

Once the convergence assumptions are removed, I will describe the balances of indigenous values in the OECD governance models. Such descriptions include the optimum balances of the indigenous values and potential utilizations of the values. The optimum balances of indigenous values mean that the OECD governance model includes only necessity indigenous values for the current environments. The potential utilizations mean that the OECD governance model can utilize the hybrid values to deal with the current environments.

In the following sections, I describe the Williamson governance model to compare to the OECD governance model. Then, I discuss the non-convergence arguments and the special balances of indigenous values to differentiate the OECD governance model from the Williamson governance model. Based upon these discussions, I build hypothetical hybrid models called as HIGs, which are stable OECD governance models.

5-2: The Williamson Governance Model: Unstable Hybrid Structure

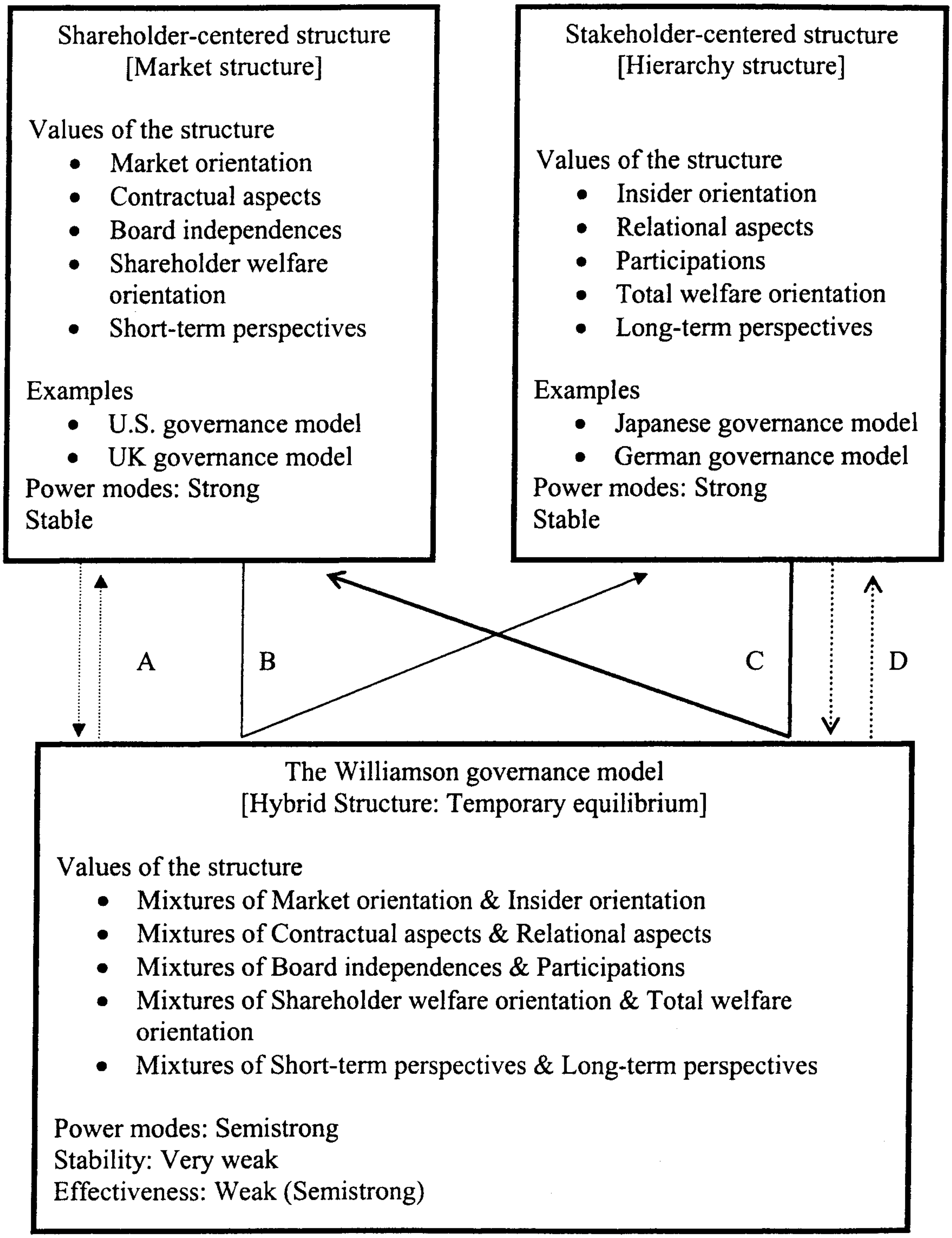
As figure 6 shows, the Williamson governance model is a transition structure in a middle of convergence processes and it will eventually move towards certain governance structures (Williamson, 1996). Consequently, the Williamson governance model is neither stable nor truly effective to hold and utilize various indigenous governance values. Rather, the model is considered as a temporary equilibrium where mutually exclusive indigenous values could coexist in the semistrong modes. In addition, such a temporary equilibrium would not allow the mutually exclusive indigenous values to coexist continuously once the Williamson governance model starts moving towards a certain structure. The Williamson governance model is, consequently, an output of a convergence process that a certain indigenous structure transforms itself to a different structure by losing its own values and gaining new values from the different structure simultaneously and continuously.

To explain these points, assume that the shareholder-centered structure is going to converge to the stakeholder-centered structure. The stable shareholder-centered structure starts moving towards the stakeholder-centered structure by losing powers of its own traditional values. Once the shareholder-centered structure lost 50% of the original powers, the structure has obtained new values from the stakeholder-centered structure by 50% of their original powers. In this condition, there is a temporary equilibrium where all indigenous values coexist in the semistrong modes. In the temporary equilibrium, the Williamson governance model exists as a hybrid model.

After this point of the temporary equilibrium, there are two possible directions of the convergence movement. One direction is to the stakeholder-centered structure and the other is to the shareholder-centered structure. The first direction means formal convergence shown as line B while the second direction means functional convergence shown as line A.

When the Williamson governance model moves towards the stakeholder-centered structure, the Williamson governance model will lose all powers of the original values and acquire full powers of values of the stakeholder-centered structure. On the other hand, the Williamson governance model moves back to the shareholder-centered structure by regaining original powers of its own values. The new shareholder-centered structure is a modified shareholder-centered structure.

Figure 6: The Williamson governance model



While Williamson (1996) did not assume stability of the Williamson governance model, he gave implications for the stability of the model. According to his explanations, the Williamson governance model could be stable only when the model could effectively hold appropriate value mixtures in the middle point. The appropriate values mixtures basically mean optimum mixtures of only necessity values from indigenous governance structures.

Williamson described that the Williamson governance model would achieve the optimum mixtures when all values of the model could be utilized to satisfy all requirements from four different institutional environments of corporate governance (Williamson, 1996). Williamson (1996) described the institutional environments as follows.

> The *institutional environment* is the set of fundamental political, social and legal ground rules that established the basis for production, exchange and distribution. Rules governing elections, property rights, and the right of contract are examples… (Williamson, 1996)

In addition, Williamson (1996) pointed out that the Williamson governance model would be more stable if the model could use such unique values to create organizational coordination and cooperation to take actions to satisfy the requirements in the institutional environments.

> An *institutional arrangement* is an arrangement between economic units... [can] provide a structure within which its members can cooperate … or rights (Williamson, 1996).

The organizational coordination and cooperation will be discussed later as the two-dimensional model of organization form and actions that figure 7 shows.

While there are several examples of the institutional environments, Williamson used property rights, contract law, reputation effects, and uncertainty. Property rights include (1) the right to use the asset, (2) the right to appropriate returns from the asset, and (3) the right to change the asset's form and/or substance (Williamson, 1996). The indigenous values have differentiated the property rights based upon their own perspectives.

The Williamson governance model faces high level of difficulty to make organizational arrangements and cooperation to satisfy the property rights in different meanings because it is a transition structure having mixed indigenous values of the property rights. To satisfy different meanings of the property rights, the Williamson governance model must have optimum mixtures of indigenous values of the property rights to make prompt arrangements and cooperation in organizations to satisfy multi-meaningful property rights.

> Most discussions of property rights focus on definitional issues. As is generally conceded, property rights can be costly to define and enforce and hence arise only when the expected benefits exceed the expected costs (Williamson, 1996).

Especially, satisfying such multi-meaningful property rights are quite important because the current globalizations of equity markets have changed indigenous senses of property rights to more multi-meaningful property rights. For example, U.S. structure has looked not only for shareholder protections but also for stakeholder protections while Japanese and German structures have had opposite situations.

Contract law means the doctrine of a contract law regime. The doctrine is a base for regal actions and government reactions in markets. Generally speaking, indigenous governance structures reflect such doctrine so that corporate actions are always lawful in the markets. However, the Williamson governance model might not be able to fully reflect indigenous doctrine because the model maintains different doctrines of two indigenous governance structures.

This implies that the Williamson governance model could be stable if the model could make appropriate corporate actions to satisfy different doctrines through optimum mixtures and utilizations of various indigenous values. Especially, this is important since the current legal environments of the global equity markets have been very similar due to several deregulations and liberalizations to achieve higher equity market efficiencies.

Different types of reputations such as market reputations and organizational reputations influence indigenous governance structures. The shareholder-centered structure is mainly influenced by the market reputations. For example, management who seeks for higher market reputations might take shortsighted actions to maximize short-term stock performances by sacrificing long-term returns on equities.

On the other hand, the stakeholder-centered structure considers internal reputations more than external reputations due to insider orientations in corporate governance practices. For example, managers who seek for better internal reputations in inter-firm trade might ignore stock performances in markets to strengthen long-term business relations.

Williamson discussed that satisfying these two different types of reputations is not possible through the Williamson governance model. However, he pointed out that the Williamson governance model would be able to consider such different reputations when the model is used in "ethnic communities" where external reputations will directly influence internal reputations through efficient communications and interactions in the communities (Williamson, 1996).

> Ethnic communities that display solidarity often enjoy advantages of a hybrid contracting kind. Reputations spread quickly within such communities and added sanctions are available to the membership [Light, 1972] (Williamson, 1996).

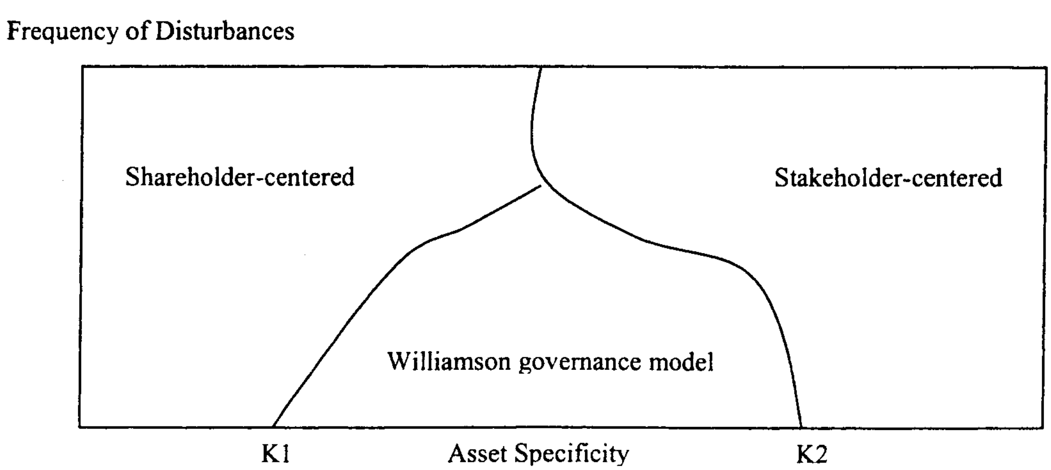
This point is important because the ethnic communities have emerged in the global equity markets. In the markets, the international investors and the relational investors have built the ethnic communities by various traditional values creating different senses of the reputations. In addition, such the ethnic communities have been expanded through advanced information networks that connect the investors tightly.

Uncertainties in business operations of MNEs and the global markets force MNEs taking appropriate governance practices. Such practices will be truly appropriate and effective only if the practices are well coordinated through organizational consensus. Even if various governance structures have had quite similar types of uncertainties due to the current market globalizations, keeping the optimum governance practices are still challenging for the indigenous governance structures because the various indigenous values in different organizations would be obstacles for the basic organizational consensus.

The Williamson governance model is not appropriate for making the organizational coordination and consensus to maintain appropriate governance practices. This is because the Williamson governance model cannot specify types of the coordination and consensus to take appropriate governance actions because the semistrong values are not utilized enough to form the coordination and consensus. Even if the Williamson governance model could make the coordination and consensus, these are not stable to be bottom lines of the future governance practices because the Williamson governance model is a temporary model. However, in the current global equity markets, MNEs have tried to take multiple actions based upon various types of the organizational coordination and consensus. These various types are quite similar to the coordination and consensus based on the semistrong values.

Williamson (1996) explained the organizational coordination and consensus with the two-dimensional model of organization form and actions that figure 8 shows.

Figure 8: Organization form responses to changes in frequency



Source: Williamson (1996). Pp.117. Figure 4.3. Modified by the author.

According to this model, the organizational coordination and consensus are depending on frequency of disturbances and asset specificity. The frequency of disturbances means levels of environmental volatilities to corporate governance. If the environmental volatilities become very high, governance structures need prompt coordination and responses.

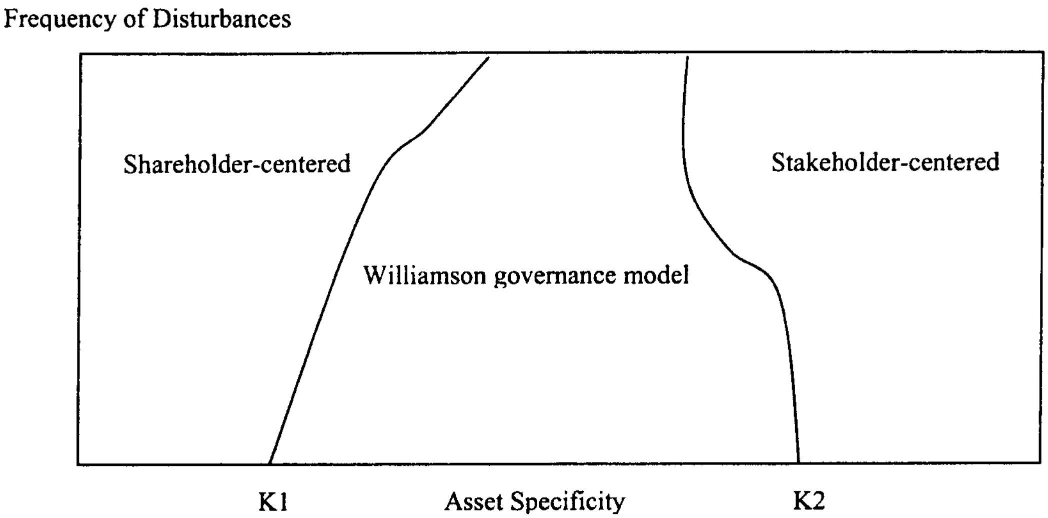
There are three types of governance structures in the model: the shareholder-centered model, the Williamson governance model, and the stakeholder-centered model. Each model has different values of corporate governance. Consequently, if the shareholder-centered types of disturbances occur frequently, the shareholder-centered model will make the best coordination and consensus to deal with the disturbances.

However, as figure 8 shows, the Williamson governance model is not viable if the frequency of disturbances are quite high. This means that the Williamson governance model can only exist if the frequency of disturbances is low level.

In addition, Williamson assumed that hybrid types of disturbances did not frequently occur. This assumption is not appropriate in the current global equity markets where hybrid types of values and requests exist. If we assume the existence of the hybrid types of disturbances, the Williamson governance model will be more stable as figure 8-2 shows.

While current disturbances are more hybrid types and such disturbances occurs constantly in the current global equity markets, there is another element for organizations to make appropriate coordination and consensus. Williamson called the element as asset specificity.

Figure 8-2: Organization form responses to changes in frequency (Implication of stability)



Source: Williamson (1996). Pp.117. Figure 4.3. Modified by the author.

The asset specificity means levels of frequencies of uses of assets that organizations use for the coordination and consensus to deal with disturbances (Williamson, 1984 and 1996). High asset specificity means higher frequency of use of a certain asset. If governance structures have assets with high asset specificities, the structures tend to have more effectiveness for the organizational coordination and consensus.

For example, even if the shareholder-centered governance structures are appropriate to deal with the shareholder-centered types of disturbances, governance structures with the most appropriate values for the disturbances would be the most appropriate for organizational coordination and consensus to deal with.

Consequently, if the Williamson governance model has hybrid values that are quite appropriate in the current global equity markets, the Williamson governance model would be more stable due to higher levels of the asset specificities of the values. Basically, to improve the asset specificity, it is critical for Williamson governance model to have frequently utilized governance values in the disturbance.

In sum, Williamson implied that Williamson governance model would be stable (1) when environments of corporate governance look for more hybrid types of values and (2) if Williamson governance model has necessity governance values to deal with the environments. When one of these is not satisfied, stabilities of Williamson governance model will not be assured.

5-3: The Potential Stability of the OECD Governance Model

As I already pointed out, stability of the OECD governance model has not been confirmed. This is because of not only lack of empirical studies but also inappropriate assumptions to the explanations of the OECD governance model. Especially, as I described, the OECD governance model is still discussed based upon the convergence assumptions that the Williamson governance model uses. Once we could release the explanations of the OECD governance model from the convergence assumptions, the OECD governance model would be considered as stable, at least, theoretically stable.

The non-convergence in transformations of governance structures has been generally accepted through extensive empirical studies. As I discussed in the literature reviews, the formal convergences have been criticized for over simplifications of the globalizations of indigenous structures (Rowley and Benson, 2002). Such criticisms are mainly based upon the path dependences of institutions, traditions, historical events, and cultures in indigenous governance structures and practices (Guillen, 2000).

The path dependence arguments have been used to reason the non-convergences and potentials of hybridizations of indigenous governance structures. According to the path dependence arguments, the path dependences could explain the non-convergence through historical persistence and cultural persistence that strongly lock the indigenous values into certain conditions. Such strong preservations of indigenous values in local structures would prevent convergence to different structures.

Based upon these generally accepted arguments and empirical results, it is quite reasonable to state that the OECD governance model is not a certain convergence model but most likely a potentially stable hybrid structure.

However, other issues to clarify the stability of the OECD governance model have not been still unclear. To clarify the stability, we still have to confirm both the optimum balances of indigenous values and the potential utilizations of the indigenous values.

These issues will be explained quite well once we have explanations of how the OECD governance models obtain and stabilize different indigenous values that the current environments require. Mechanisms of value acquisitions and maintenances based upon typologies of path dependences would explain the issues.

The typologies of the path dependences by Arthur (1989 and 1990) and Liebowitz and Margolis (2002) argued potential modifications of locked-in values of indigenous structures. According to Liebowitz and Margolis (2002), local values with the second-degree path dependence would be modified and transformed to new values. In addition, such values with the third-degree path dependence would be modified to the second-degree path dependence so that the values could be actually transformed to new values.

Such "remediability" of path dependences has explained potential stabilities of hybrid structures (Liebowitz and Margolis, 1999). The remediability allows locked-in values in the indigenous governance structures to change to new values and to accept various indigenous values from different governance structures.

Aoki (2000) and Aoki and Okuno (2003) discussed possible conditions that the locked-in values could be changed to new values and accept different indigenous values. After the changes and the acceptances, new values mixtures would be stabilized in the possible conditions. They argued that values could be hybridized when there are abrupt changes and following confusions by new information conditions and new generations with various values and/or familiarities to different cultures. After the value hybridizations by the remediability, these changes and confusions would possibly create certain semi-equilibria where mutually exclusive indigenous values could coexist as hybrid values for a long period of time. They called the semi-equilibrium as sub-P-equilibrium. The sub-P-equilibrium would be continuously stabilized by new path dependences of the hybrid values to be more stable P-equilibrium. In the P-equilibrium, the hybrid values would be held because the values are tightly locked-in the hybrid structures.

These arguments are quite theoretical. However, the current market globalizations have brought such new generations into indigenous markets. These new generations have shaken the indigenous governance structures by asking the indigenous governance practices different requests, perspectives, values, and cultural senses enough to cause the abrupt changes and confusions. In addition, the IT revolutions support the generations through efficient information networks and advanced information technologies. Consequently, conditions of Aoki (2000) and Aoki and Okuno (2003) for stabilizations of hybrid structures have actually occurred.

While conditions for the value migrations have been quite satisfied, there are still two issues to be clarified to ensure the potential stability of the OECD governance model. One is the remediability of the path dependences of indigenous governance values. The other is equilibration of the remedial values with better asset specificity at the end of hybridizations. To clarify these issues theoretically, I built hypothetical models of the remediability and the equilibrations of the indigenous values with different path dependences. Table 3 shows the hypothetical model.

The hypothetical models reflect fundamental characteristics of the remediability and the equilibrations that have been discussed by the typologies of path dependences. Consequently, the model describes the remediability and the equilibration of each one of three types of path dependences.

The first-degree path dependence is named as normal equilibrium. Indigenous values with the first-degree path dependences will be continuously changing as environments change. While the values keep changing, new values will be equilibrated in optimum conditions because such changes are given environments that have strong forces to be optimum. No matter what conditions of information efficiency are, the new values would be always optimum as long as the changes follow such strong environmental changes (Liebowitz and Margolis, 1999 and 2002).

Consequently, the hypothetical model assumes that indigenous values with the first-degree path dependences will be normally and easily equilibrated as strong forces of new external environments lead the remedial processes of the indigenous values. Such strong external environments are the market globalizations, deregulations, and the IT revolutions.

The second-degree path dependence is named as partial equilibrium. The partial equilibrium means that indigenous values with the second-degree path dependences can be changed to new values while such changes might not be complete. Such partial remediability of the indigenous values is based upon fundamental natures of the second-degree path dependences.

Under inefficient information conditions, equilibria tend to be sub-optimum. Such situations create the second-degree path dependences. While the second-degree path dependences are sub-optimum, the dependences tend to have strong lock-in effects to indigenous values as long as such sub-optimum equilibria are kept.

However, once information inefficiencies are remedied via the incorporation of new information technologies and the available of knowledge which those technologies provide, the possibility then exists that such sub-optimum equilibria can be avoided in favor of more optimal equilibria. Once the new information technology is incorporated, change can begin as a transformational process at the outset of the introduction of the technology (i.e., while it may take some time for the corporation to reach new equilibria, performance should begin soon after the technology is introduced).

These discussions well reflect the partial equilibria for the following two reasons. One is that the existing indigenous values with the second-degree path dependences are not completely changed due to strong historical dependences. No matter what external environments are appropriate for the changes of the second-degree path dependences, no one can completely change the historical dependences. The other is that new equilibria would be still sub-optimum even if better information efficiencies and knowledge exist to remedy the second-degree path dependences. This is because of the assumptions of the information inefficiencies in the real world.

Currently, advanced information technologies and worldwide information networks have improved information inefficiencies in the global markets. Such better information conditions have also expanded levels of knowledge of the international investors. As a result, in the global markets, such informed international investors started demanding MNEs their own interests and requests based upon their own values. When the international investors have sufficient financial powers, they have even forced MNEs to change the MNEs' governance values to satisfy their demands.

The third-degree path dependence is named as non-equilibrium. The non-equilibrium reflects the fundamental nature of the third-degree path dependence that the indigenous governance values with the third-degree path dependences would not be changed because the third-degree path dependences are considered as non-remedial (Liebowitz and Margolis, 1999 and 2002).

The indigenous governance values are locked-in by the third-degree path dependences if the values were generated by historical events and cultural preferences. Different from the values with the second-degree path dependences, companies will maintain these indigenous values no matter what the external environments are changing because the values have been the core values of their business conducts and governance practices.

For example, the relational values would be maintained in both Japanese and German corporations because the relational values are fundamentals for companies.

Consequently, corporate governances in the two nations tend to consider the contractarian values as additional values to the relational values. In other words, Japanese and German firms try to extend the relational values enough to acquire the contractarian values.

Such extensions are sometimes considered as the remediability of the third-degree path dependence.[20] However, since there have not been established and generally accepted arguments about the remediability of the third-degree path dependence, I consider the extensions of the third-degree path dependences are different from the remediability.

Table 3: Three equilibriums in the hypothetical model of the remediability and equilibrations

Normal Equilibrium (1st degree path dependence)	Partial-equilibrium (2nd degree path dependence)	Non-equilibrium (3rd degree path dependence)
• Given conditions (normally optimum) • Easy to change • Examples: Environmental changes around indigenous structures such as market globalizations, deregulations, IT revolutions.	• Remedial conditions • Difficult to change • Examples: New values and requests in and for indigenous structures.	• Non-remedial conditions • Impossible to change • Examples: Historical events and cultures in indigenous structures.

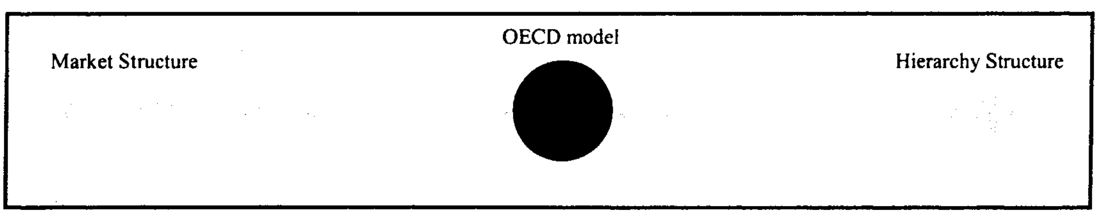
Three hypothetical equilibria in the model of posited remediability are visualized in figures 9, 10, and 11. These drawings of hypothetical paths to equilibration have been constructed within the framework of Williamson's model, primarily because the current OECD governance model drew its foundation from Williamson's framework.

[20] Forgetting curve concepts are potentially effective tools to explain the remediability of the third-degree path dependences.

The normal equilibrium is shown in figure 9. The normal equilibrium is conceptualized as a complete transition from indigenous values to the values of the OECD governance model. Here, two polar governance structures are considered.

As I have previously hypothesized, indigenous values with the first-degree path dependence are equilibrated naturally and completely in the OECD governance model. For example, globalization, deregulation, and the liberalization of equity markets have created quite new and unfamiliar market conditions. To deal with such conditions, both the market structure and the structure of corporate hierarchies need to acquire and keep a number of new governance values which typify these new markets. As a result of this kind of process, the new corporate values are identical for both indigenous governance structures because these values do not exist in either case until globalization creates the unavoidable need for their adoption. Consequently, if the new values which are acquired are retained in the two indigenous structures and if they occur solely as the result of globalization, the new corporate values would be identical to the initial conditions of the OECD governance model.

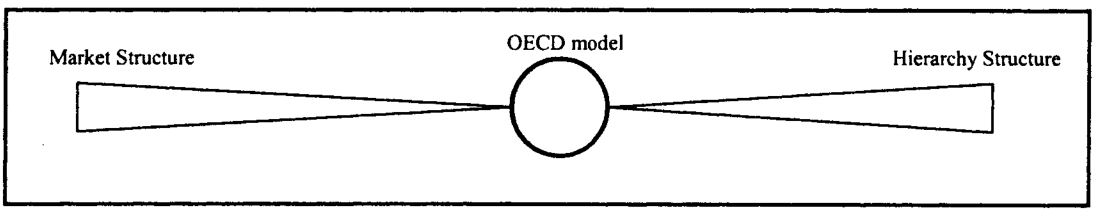
Figure 9: Hypothetical conceptualizations of equilibrations: Normal equilibrium



The hypothesized concept of a *partial equilibrium* is shown in figure 10. The partial equilibrium is conceptualized as a transition from indigenous values to the values of the OECD governance model where equilibration is incomplete. Such partial transitions still involve the modification of indigenous values. However, the partial equilibrations are not the same as the modifications described in figure 9, because partial equilibration locks in the partially equilibrated values as new values rather than the full transformed values of the fully developed OECD governance model. These partial equilibrations will lead to new corporate governance forms, however the new values will be limited by both second-degree and third-degree path dependencies. Because the indigenous values which are locked-in by second and third degree path dependence are combined with the new (OECD) values which are generated during the partial equilibration process, a greater measure of original, indigenous values would retained in the new values than are retained in the OECD governance model. This is illustrated by the two different colors used in figure 10.

As an approximation of the process of partial equilibration, half of the OECD governance model has been filled-in with a gray color, indicating the stronger influence of market values (along the lines of those in the OECD governance model) in the local corporate governance structures after the equilibration has taken place. The other half is filled-in with a white color indicating the retention of stronger hierarchical values in the local governance structure than those predicted by the OECD. A similar structure obtains with respect to hierarchical values.

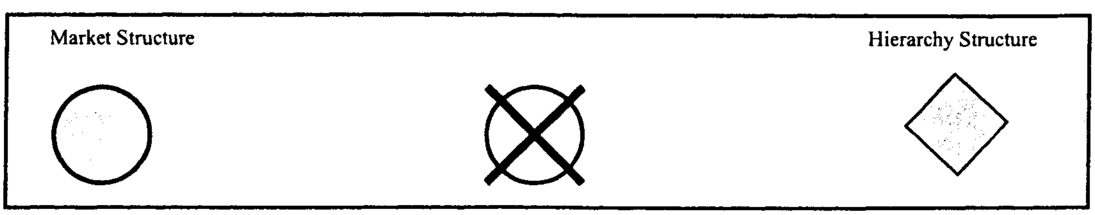
Figure 10: Hypothetical conceptualizations of equilibrations: Partial equilibrium



The failure to reach a new equilibrium is shown in figure 11. These non-equilibrium solutions (or in the language of Stuart Kauffman, the "sticking points" on Brian Arthur's "multiple sub-optimal equilibria") are conceptualized as failures of the transition of indigenous values to the OECD governance model. In general this failure is anticipated as the result of indigenous values being tightly locked-in by third-degree path dependences. As an interesting aside, while I have been looking at the formal, organized corporate sector, it is also possible that there will be a variety of situations which might give rise to a dual governance structure. That is, the formal, corporate sector might equilibrate to either a complete (OECD) set of new, market values or to a partial equilibrium such as that shown in figure 5, while other sectors of the economy (i.e., small business, grey-market or other traditional segments of the economy) might be locked into existing, inefficient indigenous values. While such a discussion is beyond the scope of the present analysis, it could provide a fruitful area of study in the future.

To return to figure 11, one example of path dependent lock-in would be where the relational values in the hierarchy structure continue to be held no matter how the environment changes, because these values are third-degree path-dependent. In this case we might think of what would happen in two different countries where both the Hierarchy structure and the Market structure are locked in by third degree path dependence. Such strong dependencies would lock-in relational values even where the hierarchy structure has acquired and kept some values from the market structure. The difference between this kind of situation and the partial equilibration discussed above is that in the situation of partial equilibration there is some change among previously existing values. Under conditions of third degree path dependence, existing values cannot be chanced at all. Some new values, largely peripheral, might be capable of being introduced to the system, but the established values will not change at all as a result of such introductions. For example, a system with deeply locked in relational values might add a beneficial ownership disclosure clause to prospectuses for corporate equity offerings. However, the equity offering might still be limited entirely to relational partners who are already established in a cross-shareholding arrangement. Thus, while there might be some symbolic progress towards the OECD governance model, the actual arrangements between shareholder and stakeholder would not change at all. The non-convergence of this model is shown below in figure 11.

Figure 11: Hypothetical conceptualizations of equilibrations: Non-equilibrium



Based upon these hypothetical models of remediability and the three kinds equilibration discussed here, in the next section, I will discuss the potential stability of the OECD governance model following the adoption and completion of the various possible hybridizations of indigenous values and explain how this relates to the proposed HIGs.

5-4: The HIG as the Stable OECD Governance Model

Based upon several hypothetical models that I showed in the previous sections, I pointed out that there should be two different OECD governance models for the two polar structures. To explain the current hybridizations forming the OECD governance model more detail, I developed two hypothetical hybrid governance models called as HIGs. The HIGs are also stable OECD governance models that consider both the remediability and the three equilibrations of indigenous values of two polar structures of corporate governance. Since the OECD governance model has been generally described as a hybrid model between the contractarian governance structure and the communitarian governance structure (Guillen, 2000), the HIGs use U.S. governance structure as the contractarian structure and Japanese and German governance structures as the communitarian structures. [21]

As table 4 indicates, the HIGs have identical normally equilibrated elements as the initial conditions. These conditions are liquid securities market, market globalizations, and information networks through advanced information technologies. These identical conditions have been widely and generally observed in the current market globalizations.

[21] Japanese and German structures have been considered as communitarian models based upon fundamental values such as relational values and stakeholder orientations while U.S. structure has been considered as contractarian model based upon market values and shareholder welfare orientations (Bradley et al, 1998).

Table 4: Basic structure of the hypothetical model of remediability and equilibrations of indigenous values of U.S., Japanese, and German structures

	HIG for U.S.A	HIG for Japan/Germany
Normal equilibrium	Liquid market, market globalizations, Networks through IT.	Liquid market, market globalizations, Networks through IT.
Partial equilibrium	Relational Values such as long-term planning, long-term business relations, and continuous collaborations with allies (stockholders).	Market Values such as shareholder protections, shareholder wealth maximizations, and quarterly profit maximization.
No equilibrium	Market Values such as shareholder protections, shareholder wealth maximizations, and quarterly profit maximization.	Relational Values such as long-term planning, long-term business relations, and continuous collaborations with allies (stockholders).

However, each HIG has different partially equilibrated values and non-equilibrated values because of different conditions of the remediability and the equilibrations of the path dependences of indigenous values in each indigenous governance structure. Basically, in the HIGs, I specified such values fitting to each category based upon current empirical studies in the three countries.

Emergences of the relational investors and the market globalizations have influenced U.S. structure significantly because the relational investors, from the market-driven point of view, force long-term perspectives in planning and participations to the U.S. structure (Bhagat et al, 2002).

> In the last decade, a substantial academic and popular literature has argued that American corporations focus too much on near-term profitability, and that their long-term performance might improve if they had long-term investors ("relational investors"). … One potential advantage of a governance structure in which more firms have relational investors derives from concerns that managers and shareholders may focus excessively on short-term profitability, with a resulting cost in long-term performance. … Relational investing could also serve as a substitute for, or complement to, the market for corporate control. … Relational investors could both provide monitoring in normal times (when a firm is not performing badly enough to warrant a hostile takeover bid), and act as a counterweight to

management's incentives to block value-enhancing control changes (Bhagat et al, 2002).

The market globalizations have also facilitated the board globalizations of U.S. corporations because the firms have had foreign investors as a result of their aggressive financings in the global equity markets and operations in the global product markets. For example, currently, more than 23 percent of the U.S. corporations have had three or more foreign directors (Esser, 2001). He argued that the board globalizations are advantageous to reduce costs of capital and improve strategic actions in the global markets only if the U.S. governance structure can be tolerant for different values and opinions from the foreign directors.

Japanese corporations have maintained the insider orientations in their directorships and promotions even if pressures towards the market orientation have become much stronger in the globalizations (The corporate management and HRM special committee, 1997). Japanese firms will keep the insider orientations by treating the outsiders in very symbolic way such as corporate spokespersons or images of good organizational restructurings when Japanese companies invite the outsiders to satisfy the values of the market orientations (MITI, 2003).

German structure maintains the insider orientations because legal enforcements such as the German corporate acts will support the employee-oriented board compositions, board structures, and corporate-wide decisions in the German governance structure (Suzuki, 1999; GPC, 2002).

Majority of Japanese firms have still valued the stable business relationships with allies (The Corporate management and HRM special committee, 1997). For example, Japanese corporations maintain continuous business relationships with the main banks by changing their long-term relationships from financial relationships to pure business relationships. For example, several main banks have begun business consulting for Japanese corporations with their experiences and information pools (Mizuho Research Institute, 2002).[22] Japanese corporations have reformed the long term relationships with keiretsu members by establishing more business oriented transactions and collaborations (MITI, 2003).

German structure maintains the relational values since the German laws will support the two-tier board structure (Suzuki, 1999; GPC, 2002; Mizuho Research Institute, 2002). In Germany, while commercial banks have not been prime financial resources for the German firms, the banks are still supporting their clients as investment banks by offering information and consulting based on their experiences and information pools (Kumagai, 2002).

Continuous participation and collaboration will be kept in Japanese structure since Japanese corporations still strongly value the insider orientations and the company communities. Especially, large Japanese corporations believe that they should maintain the continuous participation and collaborations in their organizations (Hirata, 2003).

In German structure, participation will be maintained as long as the two-tier board structure is mandated by the German corporate acts (Jackson, 2002; ECGI, 2003).

Shareholder welfare orientation has been clearly observed in Japan and Germany. For example, large Japanese corporations have changed the main management performance indexes to more profits and return based indexes (Fukao, 1999; The Corporate management and HRM special committee, 1997). However, traditional stakeholder welfare orientation has been still maintained in Japanese corporations. For example, Japanese corporations have introduced stock options to maximize total welfare. This attitude to the stock option is also advised by major business consulting firms such as McKinsey (Honda, 2000 and 2002).

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[22] Such relationships are based on return consciousnesses of the firms and the banks. (Kanamori et al, 1993; Federal Ministry of Justice, 2003)

German structure maintains the stakeholder welfare orientation even if German shareholders have asked for more stockholder welfares. Mainly, this is because of the German corporate laws that respect the stakeholder welfare orientations by several regulations to governance systems and practices (Kumagai, 2002; Jackson, 2002; ECGI, 2003; Federal Ministry of Justice, 2003).

Market orientation in Japanese structure has been facilitated through motivations to better disclosure, active external financing, better investor relations, and effective stock options (The Corporate management and HRM special committee, 1997; Fukao, 1999).

In Germany, the market orientation began in the early 1990s. During the stock market booming in the 90s, German investors were getting familiar with concepts and values of the shareholder value maximization (Kumagai, 2002; Ministry of Finance of Japan, 2003).

Current deregulations in Japanese markets have made the markets potentially efficient enough to expect market enforcements to the Japanese governance practices. The market efficiencies have been continuously strengthened because Japanese companies start liquidating equities held by the cross shareholdings to maintain assets turnovers and utilizations (The corporate management and HRM special committee, 1997).

German corporations have also started emphasizing on assets utilities and equity liquidity. While Japanese and German corporations have actively dissolved the cross shareholdings, they have also tried to make indissoluble cross shareholdings more profitable through new business relationships and governance practices (Kumagai, 2002).

Based upon the previous discussions, I summarize governance values of the HIGs into ten specific values as table 5 shows. These ten values are made by five values based on the market orientations and another five values based on relationship orientations.

Table 5: 10 indigenous governance values of the HIGs

Values	Regions
Insider orientation	Germany and Japan
Market orientation	USA
Relational aspects	Germany and Japan
Contractual aspects	USA
Participation	Germany and Japan
Board independence	USA
Total welfare orientation	Germany and Japan
Shareholder welfare orientation	USA
Long-term perspectives	Germany and Japan
Short-term perspectives	USA

Based upon these ten values, I show basic structures of the hypothetical models of the remediability and the equilibrations of the indigenous values of U.S., Japanese, and German governance structures in table 6. Table 6 is made not only for the specifications but also for the field study. Each specified value will be checked through questionnaires.

The normally equilibrated values are the current conditions that both U.S. governance structure and Japanese and German structures have faced. In the HIG for U.S.A., the partially equilibrated values are reflecting the relational values that U.S. structure does not have originally. Consequently, these values could be acquired and adapted through hybridizations to the HIG. The non-equilibrated values are reflecting indigenous values of the U.S. governance structure. These are maintained strongly throughout the transition to the hybrid structure.

In the HIG for Japan/Germany, the partially equilibrated values are reflecting the contractarian values that Japanese and German structures do not have originally. Consequently, these values are acquired and adapted in hybridization process to the HIG. The non-equilibrated values are reflecting original communitarian values of Japanese and German structures. These are maintained throughout the hybridization to the HIG.

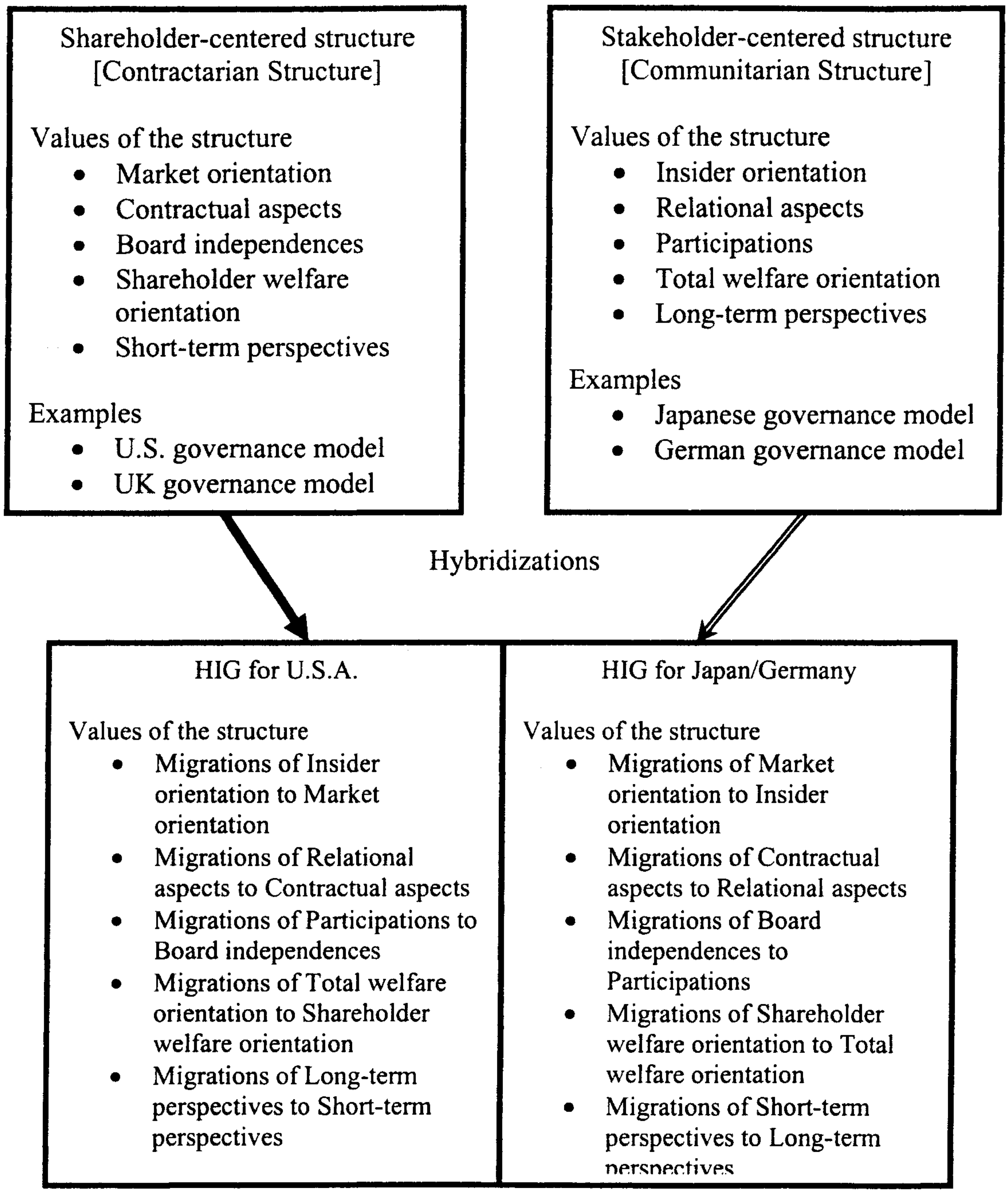
Table 6: Basic structure of the hypothetical model of the remediability and the equilibrations of specified indigenous values of U.S., Japanese, and German structures

	HIG for U.S. A	HIG for Japan/Germany
Normal equilibrium	Liquid market, market globalizations, Networks through IT.	Liquid market, market globalizations, Networks through IT.
Partial equilibrium	Insider orientation Relational aspects Participation Total welfare orientation Long-term perspectives	Market orientation Contractual aspects Board independence Shareholder welfare orientation Short-term perspectives
Non equilibrium	Market orientation Contractual aspects Board independence Shareholder welfare orientation Short-term perspectives	Insider orientation Relational aspects Participation Total welfare orientation Long-term perspectives

To show differences between the OECD governance model and the HIGs, I draw the HIGs in figure 12. While the HIG is the stable OECD governance model, what make the HIG different from the OECD governance model are levels of stabilities after the equilibrations of indigenous values. While the OECD governance model assumes mixtures of indigenous values, the HIGs assume the optimum migrations of various indigenous values through different equilibrations of the indigenous values for appropriate values utilizations of the HIG. Such optimum migrations are quite important for stabilities of the HIGs because the optimum conditions directly mean both the optimum balances of indigenous values and the better utilizations of the values.

From the Williamson's point of view (Williamson, 1996), the optimum balances of indigenous values and the better utilizations of the values ensure the stabilities of the HIGs because the model could have higher assets specificities with frequently utilized governance values in the current global markets where types of the disturbances have converged to some kind of hybrid types.

Figure 12: HIGs



6: Field Research

6-1: Hypothesis and Judgments

As I have discussed, a main goal of this dissertation is to confirm stability of the OECD governance model. Discussions of the stabilities have done throughout this dissertation and there are three required conditions for the stabilities: non-convergence, optimum balances of indigenous values at the end of the hybridizations, and potential utilizations of the hybrid values.

I have supported the non-convergence through both empirical studies and non-convergence arguments. However, the optimum balances of indigenous values and potential utilizations of the indigenous values have not been clarified through field researches while these have been theoretically explained. Consequently, the goal of my field research is to confirm the two issues.

For this field research, one of the most difficult issues is a model building for the testing. For the testing, I built the HIGs as stable OECD governance models for U.S. and Japanese and German MNEs. The HIGs are different from other indigenous governance structures because of the appropriate initial selections of indigenous values and the optimum value mixtures of the required indigenous values.

However, showing the HIGs might give prejudges and biases to samples. Consequently, instead of showing the HIGs, I simply asked the samples to select values of the HIGs based upon their own evaluations. The samples were asked to select both indigenous values to be kept and new values to be acquired for their corporate governance structures.

After the samples selected these values, the samples were asked to choose values that would be utilized through advanced information technologies and networks. To explain such information technologies, I gave descriptions of the information technologies and networks to the samples in advance.

The descriptions are basically explanations of the vertically-horizontally-integrated information and interactions flows through advanced information technologies and networks in governance structures. The integrated flows have been accepted and described as an example of efficient information and interaction systems in a hybrid governance structure for MNEs.[23]

Therefore, once samples form optimum balances of indigenous values as the HIGs initially assumed, HIGs could satisfy the optimum value mixtures in the current environments. Such value mixtures differentiate the HIGs from other indigenous governance structures thorough such unique values that no single indigenous structure can produce.

In addition, when the selected values and the potentially utilized values are quite similar, the HIGs would satisfy the institutional environments through better organizational coordination and consensus. This is because of better asset specificities of the HIGs. Once these two issues are confirmed, I consider the HIGs as stable models. Then, I consider the OECD governance models as also stable non-convergence models.

6-2: Research Method

This research used self-administered questionnaires that were distributed to CEOs of large listed companies in USA, Germany, and Japan via fax. The questionnaires were faxed or mailed to Southern New Hampshire University. There were two reminders (follow-ups) via fax. Total pages of the questionnaire were six pages including one page cover letter.

The questionnaire used fixed alternative questions and checklist questions (Zikmund, 2000). The fixed alternative questions were used for question two (Yes, No, Planning to introduce). The checklist questions were used for question one and three (multiple choices).

[23] The hybrid structure is called as HIG or Hybrid Integrated Governance Structure. See, Takei and Fellman (Fall, 2002) for English written descriptions and Minowa and Miura (2002) for Japanese written descriptions of HIG. See Aoki (1998 and 2000) for potential efficiencies of vertically and horizontally integrated information flows in hybrid organizations.

To support the field research, the research web was launched. This web contained cover letters, goals, contributions, questionnaires, related information, and communication tools. The web was written in three languages: English, Japanese, and German.

6-3: Description of Data

For samplings, two databases in library of Southern New Hampshire University were used. One was Business and Company Resources Center in the Infotrac Database. This database was mainly used for sampling US corporations. The other one was Mergent Online that was used for sampling Japanese and German corporations.

US samples were 282 NYSE listed corporations with more than 15000 employees. 89 companies rejected receiving fax automatically or disconnected faxes. Consequently, questionnaires were sent to 193 firms via fax. Japanese samples were 242 the first category of the Tokyo Stock Exchange listed corporations with more than 5000 employees. 40 companies rejected receiving fax automatically or disconnected faxes. Consequently, questionnaires were sent to 202 firms via fax. German samples were 65 listed companies with more than 3000 employees. 4 companies rejected receiving fax automatically or disconnected faxes. Consequently, questionnaires were sent to 61 firms via fax. Both Japanese and German firms had tickers. Financial institutions were excluded from our samples of three countries because they are subjected to strong regulations and controls and therefore would have fundamentally different governance structures, functions, and objectives (Laing and Weir, 1999; Vafeas, 1999).

Response rates were reasonable with the exception of Japan. The response rates were 20.2% for USA, 34.4% for Germany, and 7.4% for Japan. While Germany has higher response rate, this high rate was due to its small initial sample size. Consequently, received samples for this research were 39 US firms, 15 Japanese firms, and 21 German firms.

6-4: Questionnaires and Questions

Each question was carefully designed to measure specific values of corporate governance structures. There are five contractarian values that U.S. governance structures have maintained and other five communitarian values that Japanese and German governance structures have maintained. These values were already shown in previous sections. Following tables show both the questions and the values.

Items from 1 to 3 of question 1 were designed to see current situations of indigenous governance structures of the three nations. While these three items are respectively indicating changes and reactions in the current movements, these items are showing different levels of the movements.

As table 7 shows, items from 4 to 10 of question 1 were designed to see current changes in indigenous governance values in U.S. and Japanese and German governance structures. These questions initially measure tendencies of value shifts among the indigenous governance structures.

In addition to the tests of the current movements, these questions were also designed to see the remediability and equilibrations of indigenous values with different types of path dependences.

The samples were asked to select important values in question 2. The important values are what current environments request and could be utilized in HIGs through the vertically-horizontally-integrated information and interaction flows. As table 8 indicates, each item of question 2 measures the same 10 indigenous values.

Table 7: Question 1 and measuring values

Q1	Values	Defined Values
4	Market orientation, Shareholder welfare orientation, Short-term perspectives	Respect shareholder's wealth more.
5	Insider orientation, Total welfare orientation, Long-term perspectives	Respect Employees' and corporate wealth more.
6	Market orientation, Contractual aspects, Short-term perspectives	Willing to have international investors.
7	Relational aspects, Long-term perspectives	Willing to have steady shareholders.
8	Participation, Long-term perspectives	Willing to accept shareholders' participations into governance.
9	Market orientation, Board independence	Willing to have more non-executive outside directors.
10	Insider orientation, Relational aspects, Long-term perspectives	Willing to have cross-shareholdings between alliances.

Table 8: Question 2 and measuring values

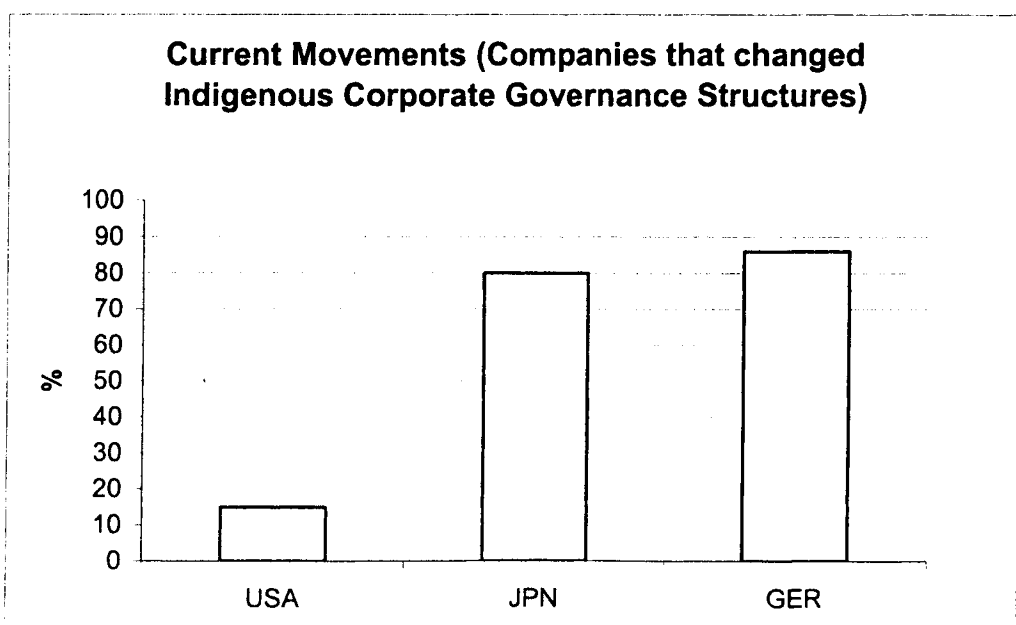
Q2	Values	Defined Values
1	Board independence, Shareholder welfare orientation	Performance evaluation of directors
2	Market orientation	Performance evaluation of executive directors
3	Board independence, Shareholder welfare orientation	Definitions of tasks, authorities, and responsibilities of directors
4	Relational aspects, Participation, Total welfare orientation, Long-term perspectives	Interest alignment among shareholders, directors, and executives
5	Board independence, Shareholder welfare orientation	Nomination, selection, and succession of directors
6	Market orientation	Nomination, selection, and succession of executive directors
7	Market orientation, Shareholder welfare orientation, Short-term perspectives	Disclosure
8	Market orientation, Shareholder welfare orientation, Short-term perspectives	Transparency
9	Market orientation, Contractual aspects, Short-term perspectives	Foreign investor relations
10	Market orientation, Shareholder welfare orientation, Short-term perspectives	Monitoring by shareholders
11	Market orientation, Board independence, Shareholder welfare orientation, Short-term perspectives	Monitoring by directors
12	Relational aspects, Participation, Total welfare orientation, Long-term perspectives	Mutual trust between shareholders (directors) and executives
13	Market orientation, Contractual aspects, Board independence, Shareholder welfare orientation, Short-term perspectives	Optimum board composition representing shareholders and their interests
14	Board independence	Board independency
15	Market orientation	Performance-based compensation such as stock-option system
16	Market orientation	Non-financial relationship with financial institutions
17	Market orientation, Contractual aspects, Shareholder welfare orientation, Short-term perspectives	Fair treatment to shareholders

6-5: Findings

As figure 13, 14, and 15 shows, the U.S. samples have changed their governance structures somehow.[24] 15% of the sample has implemented new governance structures. Some of the U.S. structure has been undergoing transition processes to new governance structure. While these portions are not high, at least, we could see undergoing movements of the U.S. governance structure.

On the other hand, both Japanese and German samples showed aggressive movements in their current governance structures. 80% of Japanese samples and 86% of German samples have already changed their governance structures. 20% of Japanese samples and 29% of German samples have moved their governance structures towards new structures. 40% of Japanese samples and 43% of German samples have planned some changes in their respective structures. We can clearly see undergoing movements of Japanese and German governance structures.

Figure 13: Current Movements (Changed)



[24] All samples were allowed to select three situations of the current movements.

Figure 14: Current Movements (Changing)

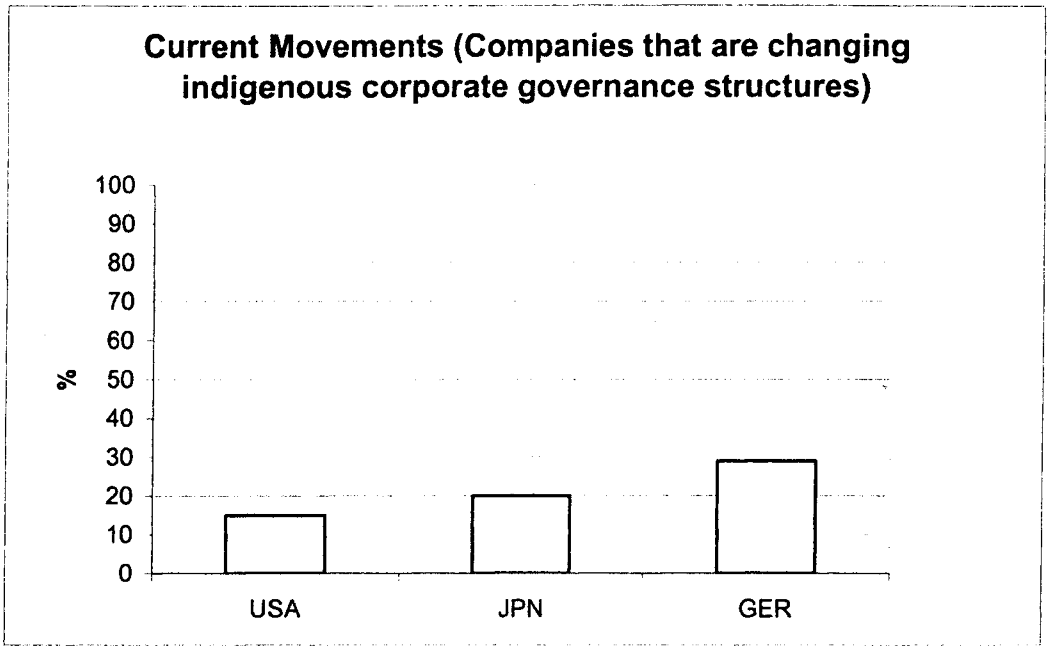
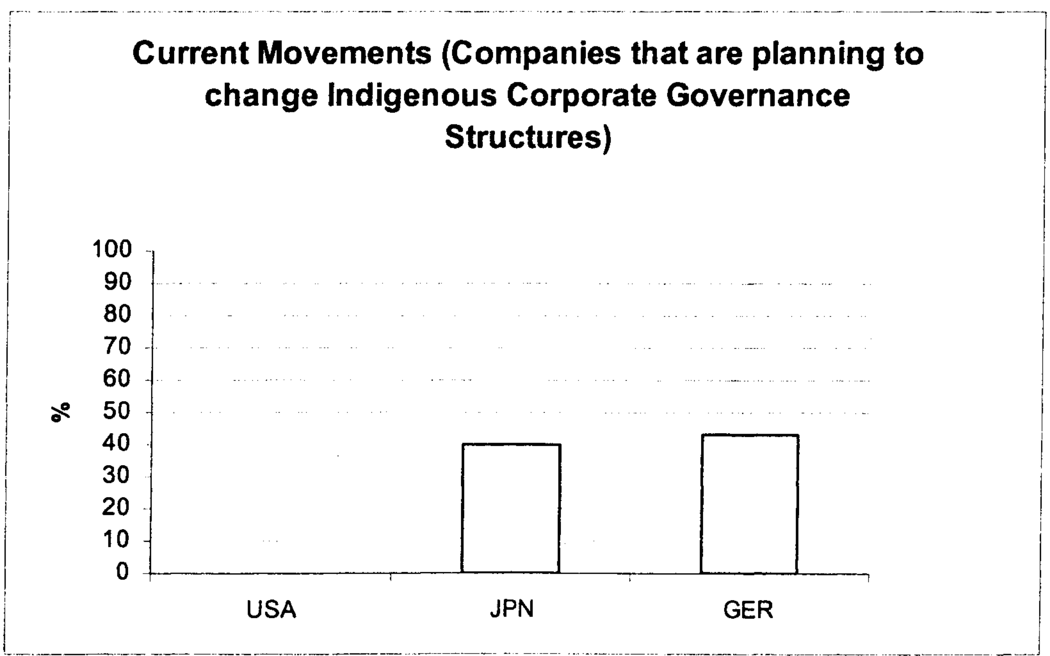
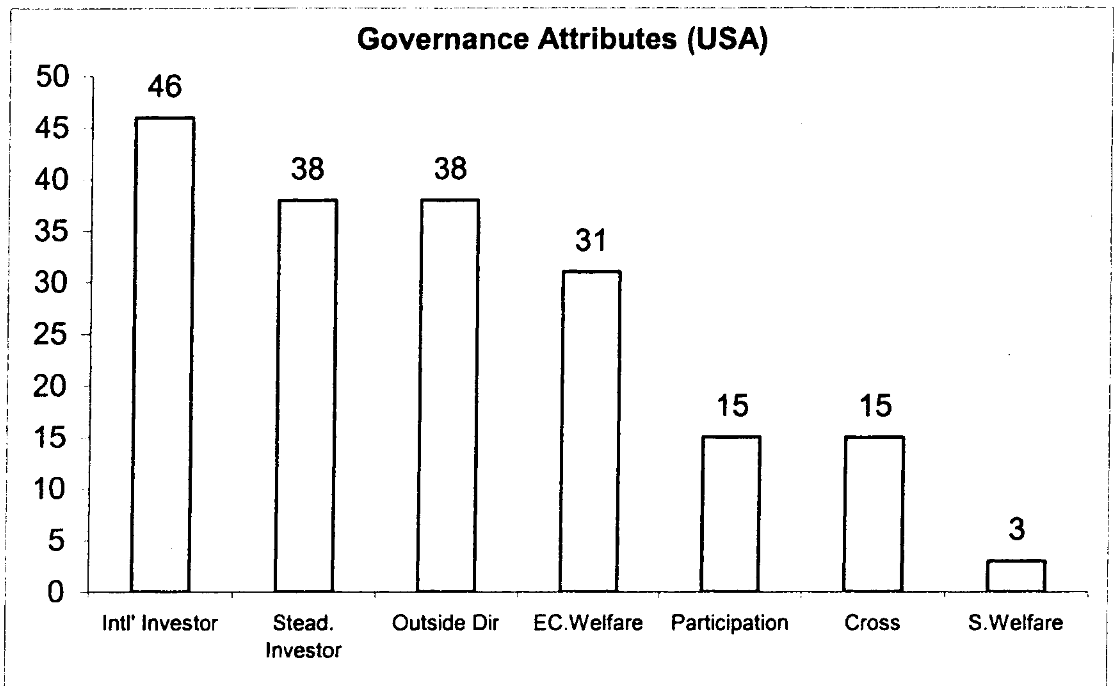


Figure 15: Current Movements (Planning)



While all three indigenous governance structures have been undergoing changes, I tried to see how such changes have influenced values of corporate governance practices. As figure 16 shows, US samples considered international investors, steady shareholders, non-executive outside directors, and employee and corporate wealth as important values for better corporate governance structures. However, U.S. samples have not shown high values of shareholder wealth, shareholder participations, and cross-shareholdings. Especially, the value of shareholder wealth was quite low (3%).

Figure 16: Balances of various indigenous governance values in the U.S. samples

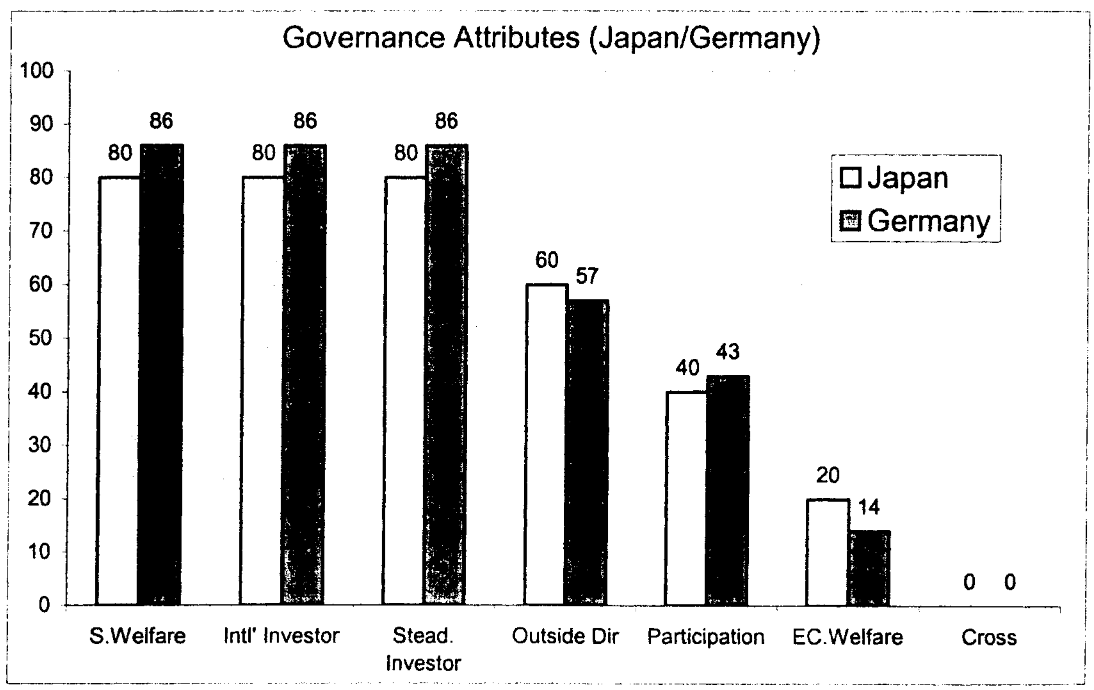


It was quite clear that the U.S. samples have tried to respect both the traditional contractarian values and the communitarian values for new governance structures. However, the samples also showed less respectful values for the new structures. While fewer respects to some communitarian values such as participations and cross-shareholdings are quite reasonable in the contractarian-based structures, less respect to shareholder welfare was a surprising result because the U.S. firms have traditionally focused on the shareholder welfare as a main business goal. Such lower respect to the shareholder welfare offsets to more respects given to the employee and corporate welfares.

General characteristics of value mixtures in the new governance structures for the U.S. samples are balanced mixtures of the traditional contractarian values and the communitarian values. The tendencies of the value migrations are shifts towards more long-term perspectives and relational values while market orientations such as non-executive outside directors and the shareholder wealth are still maintained. Importance of the international investors reflects the current globalizations.

On the other hand, as figure 17 shows, both Japanese and German samples considered shareholder wealth, international investors, steady shareholders, non-executive outside directors, and shareholder participations as critical values of governance practices.

Figure 17: Balances of various indigenous governance values in Japanese and German samples



The samples considered, however, cross-shareholdings and employee and corporate wealth as less important values. Especially, as reflecting current movements, none of the sample valued cross shareholdings.

These results gave critical implications for the current hybridizations of indigenous governance structures that OECD and Guillen reported (Guillen, 2000). More respects to shareholder wealth and non-executive outside directors are quite reasonable based on the current movements to more liquid securities markets in Japan and Germany. Continuous respects to steady shareholders and shareholder participation strongly reflect relational values in their traditional structures. Such higher respects to the steadiness of the shareholders have been also confirmed by several professional researches (Kumagai, 2002; MITI, 2003). Similar to the U.S. samples, the importance of the international investors reflects the current market globalizations.

Fewer respects to the employee and corporate wealth and the cross-shareholdings are also quite reasonable. Higher respects to the shareholder wealth offsets to fewer respect to the employee and corporate welfare. Especially, no respect to the cross-shareholdings strongly reflects the current dissolutions of the reciprocal equity holdings in Japan and Germany.

General characteristics of value mixtures in the new governance structures for Japanese and German samples are also balanced mixtures of the traditional communitarian values and the contractarian values while the contractarian values seem to be more dominant in the mixtures. The tendencies of the value migrations are shifts towards more market orientations such as non-executive outside directors and the shareholder wealth while long-term perspectives and relational values are still strongly maintained.

In sum, as the HIGs assumed, the HIG for the U.S. firms and the HIG for Japanese and German firms are quite different in compositions of critical values and conditions of value mixtures even though the general characteristics of value mixtures are quite identical. In other words, while both U.S. structures and Japanese and German structures have moved towards hybrid conditions of both the contractarian values and the communitarian values, these are two different hybrid models, as indicated in figure 10, due to the differences in weights and importance of value compositions. Consequently, the OECD governance model is not a simple convergence model, but a new model with special values that current environments look for.

While I confirmed the existence of HIGs with optimum value mixtures, I must still confirm the remediability and the equilibrations of indigenous values of U.S., Japanese, and German structures. To confirm these, I tried to see levels of potential value utilizations of the HIGs.

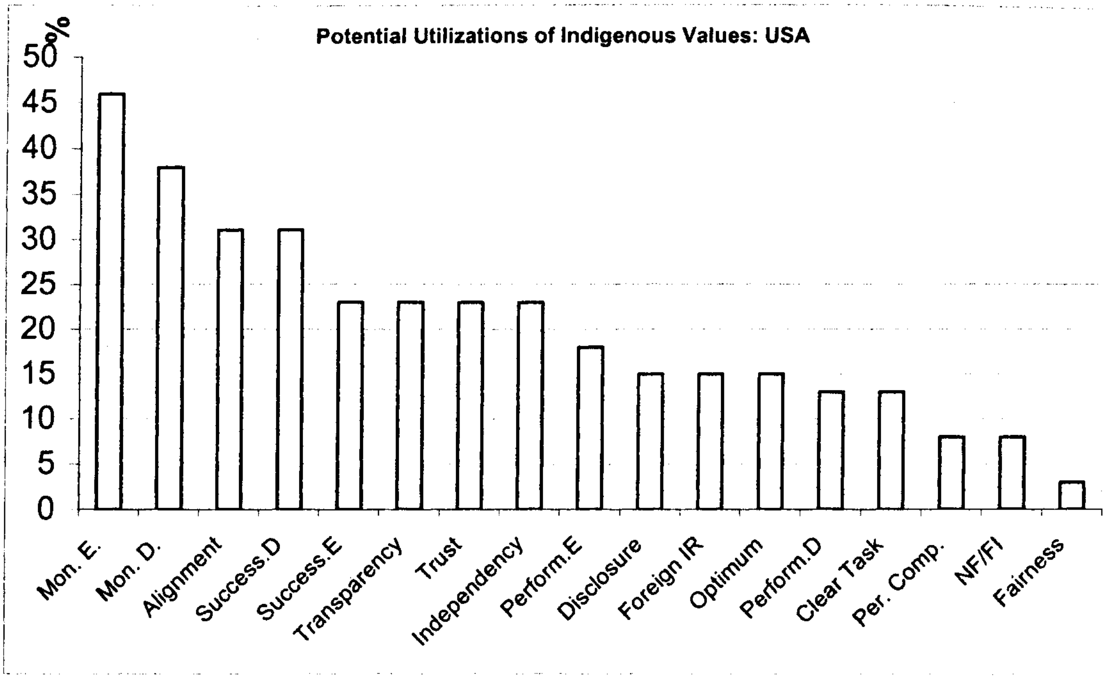
Because there have not been the HIGs in practice, I used another hypothetical HIGs with efficient information and interactions flows through the advanced information technologies and networks in governance structures. As I had mentioned earlier, such information and interactions flows are called as the vertically-horizontally-integrated information and interactions flows.

Such levels of the potential utilizations are critical for stabilities of the HIGs because the HIGs are expected to be effective for optimum values mixtures for better governance performances. Consequently, the HIGs with such optimum value mixtures will not be quite stable when such values are not utilized in the models. In addition, such value utilizations mean continuous maintenances of critical values in optimum conditions in the HIGs.

As figure 18 shows, U.S. samples answered that values of comprehensive monitoring by both shareholders and directors could be significantly utilized. This means great extensions of traditionally high transparencies of the U.S. governance practices through higher monitoring by outside directors and efficiencies of markets to solve serious information asymmetry and agency problems.

Potential utilizations of values of director nomination and succession process could solve unbalanced power distributions among main constituencies of governance. Since such unbalanced power distributions have been inherent problems of the U.S. governance practices, overall governance performances will be improved by the HIG.

Figure 18: Potential Utilization of Indigenous Values: US samples



While such unbalanced power distributions would be more normalized in the HIG, the values of fair treatments of shareholders have been strongly maintained. This means that the normalized power distributions in the HIG do not sacrifice importance of equity holders as traditional communitarian governance structures with more balanced power distributions have sacrificed.

Values of transparencies would be utilized quite well. This would make the traditionally high levels of transparencies far greater. With the values of monitoring, potential utilizations of transparency values would significantly improve indigenous U.S. governance practices.

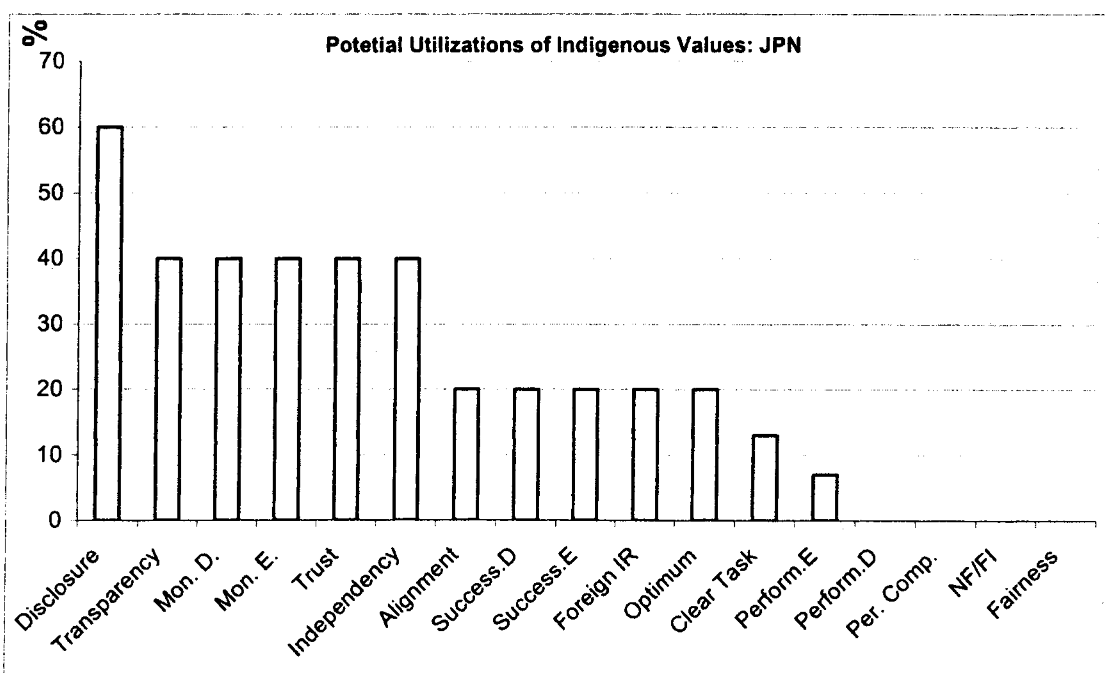
Performance evaluation of directors and executives, clearer task definitions of directors, disclosure, foreign investor relations, optimum board composition, and performance-based compensation were considered as reasonably utilized values in the HIG.

U.S. samples thought that newly acquired values such as interest alignment among the three governance constituencies and mutual trusts could be utilized well in the HIG. These value utilizations indicate partial equilibrations of different indigenous values.

Based upon these results, differentiations of the HIG from unstable Williamson governance model are confirmed in the U.S. samples. The HIG for the U.S. firms is stable hybrid model that utilizes both the contractarian and the communitarian values in optimum value mixtures.

As figure 19 shows, Japanese samples answered that values of disclosure, transparency, comprehensive monitoring, and board independence could be utilized in the HIG. Since all these values are what Japanese firms have currently looked for, the HIG would serve the Japanese firms quite well.

Figure 19: Potential Utilizations of Indigenous Values: Japanese samples



On the other hand, Japanese samples answered that values of interest alignments and mutual trust would be highly utilized in the HIG. Interest alignments and mutual trusts are resources for long-term perspectives and strong collaborations. Therefore, maintaining these values means maintenances of such indigenous advantages of Japanese corporate governances.

While the HIG could utilize the critical contractarian values and the communitarian values for Japanese firms, it is remarkable that performance evaluations, performance-based compensations, non-financial relationship with financial institutions, and fair treatment to shareholders were considered as less utilized values in the HIG.

These are quite important points because these values are not easily utilized in the HIG even if the HIG could partially equilibrate these values. However, there are potential reasons for these results. For example, performance-based evaluations have been to be unsatisfied by the new mode. Japanese firms have had difficulties to implement the performance-based compensations and evaluations. With these difficulties, Japanese samples have been skeptical to the implementation of the performance-based compensations and evaluations. However, as Japanese companies have started introducing the stock options as performance-based compensations to directors and executives, there are still strong potentials in Japanese organizations to implement the performance-based compensation and evaluations structures.

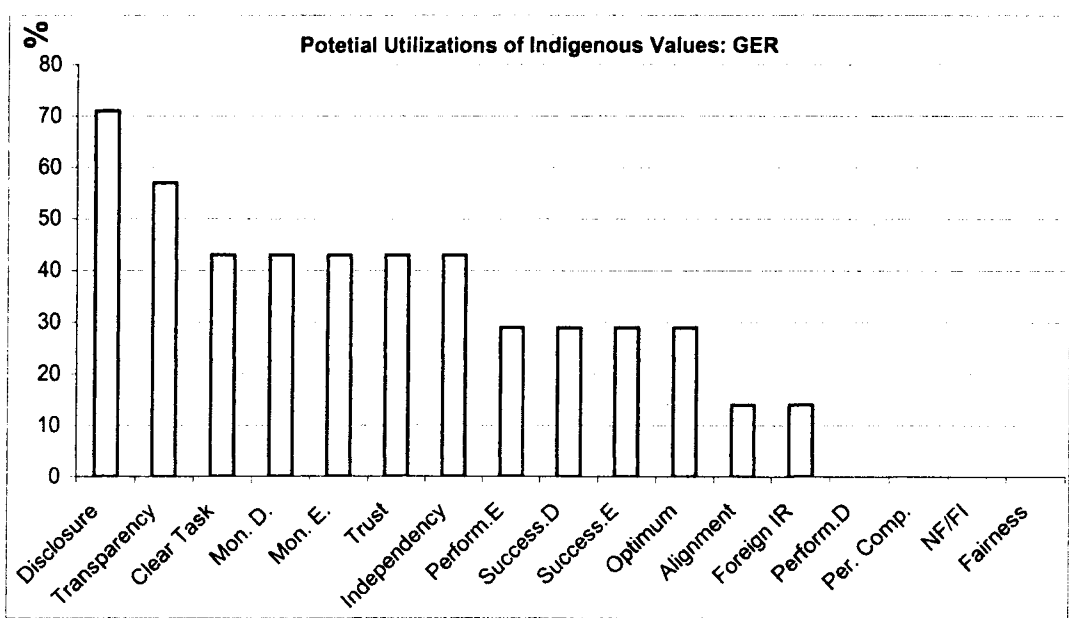
Values of non-financial relationships with financial institutions have been just introduced into Japanese organizations as deregulations of financial sectors have progressed. While Japanese companies have considered that such non-financial relationships are new business relationships and ideal conditions, such non-financial relationships are still in the primitive stage. Consequently, Japanese samples are highly uncertain for the non-financial relationships at this point.

Finally, Japanese samples thought that the HIG might not utilize values of fair treatments to shareholders while the samples considered shareholder-welfare orientations are important and partially equilibrated. Again, the indigenous relational values reflect to this answer. The possible interpretation of this result is that Japanese samples consider shareholder welfare orientation as important while fair treatments to the shareholders are not necessarily critical in their organizations where still relational values are strong for their business operations.

Based upon these results, differentiations of the HIG from unstable Williamson governance model are confirmed in Japanese samples. The HIG for Japanese firms is also stable hybrid model that utilizes both the communitarian and the contractarian values in optimum value mixtures.

As figure 20 shows, German samples showed quite similar results to the Japanese results. However, German samples considered values of foreign investor relations and interest alignments as less utilized in the HIG. These points need some discussions because foreign investor's relations are critical for the current German equity markets while interest alignments have been strong values of German governance structure.

Figure 20: Potential Utilizations of Indigenous Values: German samples



Possible interpretation of the less utilized values of foreign investor relations is that the foreign relations have already been satisfied through voluntary liquidations of cross-shareholdings and shaping up their governance practices for better decisions to increase stock values. These actions were strongly supported by both German equity markets and the German government.

Possible interpretation of the less utilized values of interest alignments is that German firms have already been giving up the values through the voluntary liquidations of cross-shareholdings and shaping up their governance practices for better decisions to increase stock values. These actions have significantly reduced the values of the alignment since these actions are initially to make footwork of decision-makings better through shortening time for the alignments. German governance has looked for such quick and timely decisions to catch up with global dynamics of markets and operations.

Based upon these results, differentiations of the HIG from unstable Williamson governance model are confirmed in German samples. The HIG for German firms is also stable hybrid model that utilizes both the communitarian and the contractarian values in optimum value mixtures.

Table 9 and table 10 show models of the remediability and the equilibrations of indigenous values of U.S., Japanese, and German structures. There are two categories of partial equilibrations because there are two different types of values that were initially considered as partially equilibrated values. Such differences depend on levels of potential utilizations of the values. The two different types are respectively called as equilibrated values and failed equilibrations.

While there are new values to be added to indigenous values in the HIGs, all such new values cannot be equilibrated completely in the HIGs due to differences in levels of path dependences. Some new required values cannot simply equilibrate and become utilized even where the values are considered as critical in the HIGs. Such new, unmet values are categorized as failed equilibrations.

There are two categories of non-equilibrations because of two different levels of utilizations of traditional values. Similar to the partially equilibrated values, such differences depend on levels of the potential utilizations of the values. These two types are respectively called as utilized values and unutilized values.

Table 9: Model of the optimum balances of indigenous values (U.S. samples)

Equilibrated values of JPN/GER structures	Partial equilibrium	Stable shareholders Employee and corporate welfares
Failed equilibrations of values from JPN/GER structures (Equilibration failure)	Partial equilibrium	Shareholder participations Cross shareholdings
Maintained U.S. values with strong utilities (Utilized Values)	No equilibrium	International investors Non-executive outside directors
Maintained U.S. values with weak utilities (Unutilized Values)	No equilibrium	Shareholder wealth

While indigenous values would have strong path dependences enough to be maintained in the HIGs, simple maintenances and actual utilizations should be clearly distinguished. Even if such strong indigenous values were held in the HIGs, the values would not be utilized if the values have not been critical in the current situations. Such maintained but less critical indigenous values are categorized to the non-equilibrated unutilized values.

Table 10: Model of the optimum balances of indigenous values (Japanese and German samples)

Equilibrated values of U.S. structure	Partial equilibrium	International investors Non-executive outside directors Shareholder wealth
Failed equilibrations of values from U.S. structure (Equilibration failure)	Partial equilibrium	None
Maintained JPN/GER values with strong utilities (Utilized Values)	No equilibrium	Stable shareholders Shareholder participations
Maintained JPN/GER values with weak utilities (Unutilized Values)	No equilibrium	Cross shareholdings Employee and corporate welfares

Table 11 shows details of the HIGs based upon these findings of this field study. This table uses 10 indigenous governance values that I showed in table 5. These 10 indigenous values are derived from tables for measured values that table 10 and 11 showed.

Table 11: Refined HIGs

	HIG for U.S. A	HIG for Japan/Germany
Normal equilibrium	Liquid market, market globalizations, Networks through IT.	Liquid market, market globalizations, Networks through IT.
Partial equilibrium (Equilibration)	Insider orientation Relational aspects Long-term perspectives **Total welfare orientation**	**Market orientation** **Contractual aspects** **Board independence** **Shareholder welfare orientation** **Short-term perspectives**
Partial equilibrium (Equilibration Failure)	Insider orientation Relational aspects Long-term perspectives **Participation**	None
No equilibrium (Utilized)	Market orientation Short-term perspectives **Contractual aspects** **Board independence**	Relational aspects Long-term perspectives **Participation**
No equilibrium (Unutilized)	Market orientation Short-term perspectives **Shareholder welfare orientation**	Relational aspects Long-term perspectives **Total welfare orientation** **Insider orientation**

As table 11 clearly shows, there are significant differences in governance values between the HIG for U.S.A. and the HIG for Japan/Germany even though both models acquired and maintained almost all required governance values for the current situations. Especially, items indicated by bold fonts are strongly equilibrated or utilized in the HIGs. These items make each HIG special so that no single structure can be the same.

7: Conclusion

The indigenous governance structures of Japan, Germany and the United States have undergone significant changes in the last five years. As the OECD and Guillen have argued, these changes are the result of value migration towards a middle-ground (hybrid) between the more contractarian Anglo-American corporate governance structure and the more communitarian Japanese and German structures (Guillen, 2000). In this process of hybridization, U.S. corporate governance structure has incorporated important Japanese and German values with respect to stakeholder interest without giving up its traditional values. Specifically, modern U.S. corporate governance structures are attempting to acquire a more long-term perspective, a higher degree of tolerance for relational financing, and a greater focus on total welfare-orientation without sacrificing the U.S. market-orientation and the emphasis on creating shareholder value.

On the other hand, both the Japanese and the German corporate governance structures have increased the degree to which they can accommodate the U.S. corporate values such as its emphasis on shareholder value, without sacrificing their own traditional values. In particular, Japanese and German corporate governance structures are now being modified to reflect a greater degree of market orientation, the ability to accomplish short-term financial objectives, as well as increasing their shareholder orientation. At the same time, German and Japanese corporations are working to maintain as their long-term perspective and their institutional history of strong relational governance into their new models.

In essence, this hybridization is not a convergence to the Anglo-American standards of governance. We have seen that both systems are moving closer to a common middle ground, the vast majority of researchers, as well as institutions have rejected the common convergence assumptions as put forth by Bradley et al (1998). The results from survey data with respect to corporate governance and the two different HIGs shown in table 4 and table 5 illustrates how hybridization differs from pure convergence. These differences are the result of different equilibrium levels for each system as well as the degree to which institutions and corporate actors are constrained by path dependence and the historical development of indigenous institutions and values.

As we have seen, historical and cultural influences on indigenous values are not easily removed (Margolis and Liebowitz, 1999). However, when second degree path-dependent values are forced to change (typically through the process of globalization and especially as a result of the globalization of financial markets) value migrations away from traditional indigenous governance structures invariably take place.

As we have seen, the OECD governance model of corporate governance does not demonstrate convergence. Rather, through the process of ongoing hybridization, we can expect to see several different OECD governance models arising as the country-specific hybrid systems for OECD member states. We may even expect to see more of a role played by regional institutional values in the way that Austrian and Swiss corporate governance are heavily influenced by the German model. This is expected because the general phenomenon of hybridization is the result of moving towards a stable middle ground between a market-orientation and a communitarian or purely stakeholder-driven orientation. In addition, we can expect each OECD governance model to have its own distinct balance between varying indigenous values and the newly acquired hybrid values.

Using the HIG (table 11), we can delimit the boundary conditions for the optimum balance between indigenous values and newly acquired values. Further, based on statistical results from the corporate questionnaires the participating corporations selected exactly those values which the HIG predicts. Although, there are minor differences between the anticipated and actual results, they are not significant. Some of those differences are due to the differing historical and cultural values across the countries surveyed, and some variation was the result of path-dependent indigenous values.

In the foregoing study, one of the most important results was the confirmation of value migration and the actual utilization of new corporate governance values very closely matching the values predicted by the HIG. Further, with respect to the scope of change among hybrid corporate governance systems, the study demonstrates that the range of potential new values corresponds quite closely to the measured values which the study's respondents characterized as critically necessary values. One outcome of this is that we can expect the ongoing revolution in information technology and networking to further support the adoption of OECD-type models which offer better value utilization for member states and member corporations. One implication of this finding is that it is expected that OECD-type models will have superior performance compared to purely indigenous governance structures through more efficient asset allocations and a greater capability to interact with international financial and product markets.

Along these lines, we can expect Japanese and German corporate governance structures which have not yet shifted to hybrid structures to begin that shift in the near term. Those that have already begun to shift can be expected to stabilize during the next few years. In practical terms this means that the new hybrid structures can be expected to acquire and utilize a more market-oriented governance system even though they will preserve some of the traditional relational values of corporate governance. This research has shown and is also supported by earlier OECD studies, hybrid structures should be both stable and effective in the Japanese and German corporate systems. In the same vein, US governance structures can be expected to shift in the direction of a more common hybrid structure. However, the U.S. hybrid governance structure is not expected to be quite so stable as the hybrid governance structures of Germany and Japan. The reason is that U.S. corporate governance is still very strongly driven by short-term market dynamics and the need to provide quarterly income to investors. While new stable hybrid forms may eventually develop in the United States, their stability is not yet assured.

In conclusion, for Japan and Germany as well as for the surrounding states, we can predict the emergence of a cluster of related corporate governance forms, which are hybrid in nature and simultaneously preserve various. We expect this kind of hybridization to be permanent and unidirectional (i.e., stable). In the U.S., the situation is less clear. Many U.S. corporations are still preoccupied with short-term financial results and, as a result, may not be adequately sensitive to the needs of foreign investors. Over the long-run, U.S. corporation my either have to adapt to foreign cultural imperatives or face being shut out of many product and financial markets. Surprisingly, this study shows that U.S. corporations have very little planning to support the values and utilization of their corporate governance structure, with change virtually always coming after the fact. In this regard, the long-term effects of employing an unmodified Anglo-American governance system may need some serious and careful rethinking.

Glossary

Asset specificity: Asset specificity means levels of frequencies of uses of assets that organizations use for the coordination and consensus to deal with disturbances (Williamson, 1984 and 1996). High asset specificity means higher frequency of use of a certain asset. If governance structures have assets with high asset specificities, the structures tend to have more effectiveness for the organizational coordination and consensus.

Formal convergence: The formal convergence refers a complete convergence to a system that is absolutely superior to the other systems. Especially, when the convergence concepts emerged, the formal convergence refers complete transformations of indigenous political and economic systems to the U.S. systems (Harbison and Myers, 1959; Kerr et al, 1960; Guillen, 2000). This idea was used to explain some globalizations of various indigenous governance structures. For example, Hangman and Karaka attributed the formal convergence to the absolute effectiveness of the U.S. governance structure and its environments (McDonnell, 2002).

Frequency of disturbances: The frequency of disturbances means levels of environmental volatilities to corporate governance. If the environmental volatilities become very high, governance structures need prompt coordination and responses (Williamson, 1996).

Functional convergence: The functional convergence refers modifications of their own governance structures through adaptations of different governance functions of various governance systems (Khanna et al, 2001). The functional convergences have been considered as contingent movements or modifications of indigenous governance structures (Gilson, 2001).

Institutional environments: "The institutional environment is the set of fundamental political, social and legal ground rules that established the basis for production, exchange and distribution. Rules governing elections, property rights, and the right of contract are examples..." (Williamson, 1996).

OECD governance model: "Philosophical differences about the corporation's mission continue, although views appear to be converging.' ... the experts assembled by the OECD point out that convergence is not towards the U.S. approach but towards a middle ground between the shareholder and stakeholder-centered models" (Guillen, 2000).

Path dependence: The path dependence is defined as "the tendency of corporate governance systems to preserve conditions that existed in the past due to economic or political reasons or simply due to historical accident" (Licht, 2001). Such historical accident includes both initial conditions and historical events (Liebowitz and Margolis, 2002; Yoda, 2003).

P-equilibrium: "Where the optimal organization mode for each particular industry is applied within that industry and skill types that correspond to each of the modes are employed; the A-equilibrium, where the choice of functional skills becomes the prevalent strategy regardless of industry; and the J-equilibrium, where the formation of malleable / contextual skills becomes the prevalent strategy regardless of industry. The economic gains derived from the diversity of organizations can be maximized at the P-equilibrium" (Aoki, 2000).

Remediability: "Williamson [1993b: 140] introduces the term 'remediability' to refer to the circumstance in which known feasible and preferable alternatives exist. He argues that it is necessary to establish remediability in this sense, in making any claim that an allocation is inefficient. Demsetz 1973, Coase 1964, Calabresi 1968, and Dahlman 1979 have made similar points" (Margolis and Liebowitz, 2003).

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