17 Comparative models of corporate governance: a sociocultural perspective

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Introduction

Two relevant questions that scholars in the area of corporate governance have posed are whether there is, and whether it is appropriate for firms to utilize, a universal corporate governance system. It is of interest that the two questions posed above actually suggest that there may be significant variations in the way corporations are governed across nations.

This chapter discusses different models of corporate governance that exist in business, and how culture has significantly constructed these governance systems by outlining how culture influences economic systems and ownership structures. The chapter highlights the area of managerial assessment to discuss the possible biases that may arise when firms adopt a universal corporate governance system. In particular, the chapter discusses how ownership structures and various corporate governance systems may influence the way corporate boards (firms) evaluate their managers. It illustrates how corporate governance practices are affected by macro cultures by providing an example from the field of social psychology and leadership studies. The example highlights how biases may disadvantage managers when factors in the environment are not accounted for during performance evaluation. The chapter concludes with a number of simple yet practical recommendations that can be applied to alleviate some of the biases that corporate governance boards may have during performance evaluation.

Corporate governance as a socially constructed concept

In recent years there has been a wealth of studies on corporate governance; however most have focused on the principal–agent paradigm. The literature also indicates that only a modest amount of systematic research has been done on the determinants of international differences in corporate governance (Gedajlovic and Shapiro, 1998; Groot, 1998; Pedersen and Thomsen, 1999). This chapter endeavors to contribute to the literature concerning the origins of variation in corporate governance from a sociocultural perspective, as well as the impact of these cultural differences on corporate governance practices. It aims to do so by adopting a business systems perspective and

conceptually illustrating variations in corporate governance structures that stem from societal and cultural variables. Therefore the underlying premise of this chapter is that business systems are socially constructed; thus society constructs distinctive economic systems in which business systems and management practice are developed (Berger and Luckman, 1966; Bhagat *et al.*, 1990; Roe, 1993; Whitley, 1992b). The chapter also focuses on corporate ownership as a variable that causes variations in corporate governance practices.

The second goal of the chapter is to identify the linkages between societal variables such as cultural values and institutions and their impact on corporate governance. Thus it integrates social cognition into the equation of corporate governance to draw attention to the fact that information processing plays a significant part in the corporate governance process in international business. This information-processing view naturally poses the question of whether it is valid to have a ubiquitous model of corporate governance, or whether the context must be fundamentally incorporated into corporate governance structure. Although the chapter will not alleviate the lack of empirical research on the topic, as identified by several authors (Buhner *et al.*, 1998; Gedajlovic and Shapiro, 1998; Groot, 1998; Pedersen and Thomsen, 1999), it will provide some foundation on which future empirical research may be undertaken.

Comparative models of corporate governance

A number of authors have conceptualized corporate governance as the system by which companies are directed and controlled with the aim of ensuring sustained growth of the company, in addition to being accountable to shareholders and stakeholders (Charkham, 1992, 1995; Kuada and Gullestrup, 1998; Pedersen and Thomsen, 1999). It is important to note that the above conceptualization of corporate governance shared by a number of authors is virtually the same as Whitley's (1992a, 1994) view on the way business systems function and govern in various societies. Other authors have also agreed that the means of control by which companies govern may come from a number of sources, such as indirect and direct influences of financial markets, government, culture and ownership structure, which in turn leads to differences in corporate governance structures across countries (Buhner *et al.*, 1998; Charkham, 1992; Demirag, 1998; Lashgari, 2003; Li, 1994).

Theorists have further claimed that business systems also reflect the structures of a given society or are even 'isomorphic' to each other (Clegg and Redding, 1990; Orru *et al.*, 1997). It can be argued, therefore, that contextual variables such as key social institutions within nations and states, are important determinants of economic systems and corporate governance structures. The influence of key institutions has been documented by Roe

(1993), who argued that differences in corporate structure among countries are substantial, such that German and Japanese structures would be illegal in the United States. Moreover, existing corporate theories, which focus on economic factors and do not consider political forces, cannot adequately explain the differences.

In other words, there are factors apart from financial economy that explain differences in economic systems, namely, different histories, economic developments and cultures.

The key points of the business systems framework proposed by Whitley (1992a, 1994) are that national business systems differ as a function of key social institutions such as government regulations, financial systems and culture. It follows that the more differentiated the key social institutions, the greater the variations found in the business systems, and the greater tendency of each system to develop its own business structures in conducting business. In essence, this framework views culture as the foundation on which accepted rules of appropriate managerial behavior are built. Thus the cultural divide between nations, industries and companies can explain the diversities in corporate governance structures and processes in different countries.

International studies in corporate governance indicate that countries do differ significantly with regard to the institutional environment that corporate governance exists in, which in turn directly affects the structure of corporate ownership and corporate boards (Fukao, 1995; Charkham, 1995; Roe, 1993). This chapter also identifies corporate ownership as a variable that can significantly contribute to international differences in corporate governance. It acknowledges that, by focusing only on ownership structure, it runs the risk of oversimplifying the complexities that are associated with corporate governance systems in a global context. However it chooses to do so for two reasons. One is simply the fact that ownership is measurable (Demirag, 1998; Gedajlovic and Shapiro, 1998; Kuada and Gullestrup, 1998; Li, 1994; Pedersen and Thomsen, 1997, 1999). Second, the literature has extensively documented the fact that ownership, coupled with sociocultural forces, is a significant factor that determines corporate governance structures and practices in different nations (Demirag, 1998; Gedajlovic and Shapiro, 1998; Hamilton and Biggart, 1988; Kuada and Gullestrup, 1998; Li, 1994; Pedersen and Thomsen, 1999; Roe, 1993; Whitley, 1992a).

Culture and ownership structure as determinants of international differences in corporate governance

The fact that institutions reflect the underlying values of a society implies that corporate ownership preferences might also be a by-product of values of a particular culture. In some countries political institutions favor direct state ownership and corporate control as a way to ensure equitable distribution

of wealth. In contrast, other nations encourage private ownership. To some extent, members of these nations perpetuate these differences because, in societies where private ownership of wealth is dominant, financial systems are designed to develop growth of this private wealth (Kuada and Gullestrup, 1998).

The literature indicates that there are two general categories of corporate governance system that characterize control and ownership structure. One is generally used to describe the system in the United States (USA) and the United Kingdom (UK), which is characterized by a dispersed ownership structure. The second is generally used to describe systems in East Asia, South East Asia, Continental Europe and Japan, and is characterized by concentrated ownership (Fukao, 1995; Groot, 1998; Orru *et al.*, 1997; Pedersen and Thomsen, 1997; Wilkinson, 1996). In general, the UK and USA have a dispersed market-oriented ownership structure, and have been described as 'outsider' corporate governance structures. In contrast, many Continental European nations, such as Germany, and East and South East Asian nations, such as Japan, South Korea and Indonesia, have a concentrated network-oriented ownership structure. Hence they have been described as 'insider' corporate governance structures (Buhner *et al.* 1998; Kuada and Gullestrup, 1998; Lashgari, 2003; Li, 1994; Pedersen and Thomsen, 1999; Pekerti, 2003; Whitley, 1992a, 1994).

The insider–outsider corporate governance distinction as a function of culture and ownership structure

The term 'insider–outsider' corporate boards is used to differentiate between corporate boards, which consist of board members that are also managers in the firm and those who are not, respectively (Demirag, 1998; Li, 1994). This implies that in many Continental European nations and East and South East Asian nations numerous corporate boards consist of board members that are also managers in the firm, as well as board members who are shareholders. Studies have also observed that in some Nordic European nations, East and South East Asian countries the firms are family-owned; thus one person or a family owns a (voting) majority of the company (Pedersen and Thomsen, 1997).

The sociocultural literature supports the above conclusion and indicates that East and South East Asian business systems and firms are very much a by-product of the values that are salient in these societies. Wilkinson (1996, p. 430) describes the East and South East Asian business systems as 'embedded in networks of institutionalized relationships'. He further elaborates and categorizes East Asian businesses as having an institutionalized ascription to a centralized consensual decision-making structure. Other authors such as Hamilton and Biggart (1988), Hamilton *et al.* (1990), as well as Whitley

(1991, 1994) express the same view. For example, Japan can be described as possessing a communitarian management practice, Korea as patrimonial, Taiwan as patrilineal, with Taiwan and Hong Kong having an economic familism management practice (Biggart, 1990; Hamilton and Cheng-Shu, 1990; Whitley, 1991, 1994), the point being that the management practices ascribed by East Asian businesses reflect the structures of these societies (Whitley, 1990), thus substantiating Clegg and Redding's (1990) claim that society and business cultures are essentially isomorphic.

Other studies also suggest that the institutionalized ascription to a centralized consensual decision making structure in East and South East Asia is due to the combination of values ascribed by people in these societies, namely, the complementary by-product of Confucian philosophy as well as collectivist and high-power distance orientation (Smith and Bond, 1994; Triandis *et al.*, 1993). In other words, these values contribute to developing and complementing the paternalistic business culture, as well as the network-oriented ownership structure found in East and South East Asia, the relevant issue being that the variations in corporate governance due to cultural factors affect the way in which corporate governance operates in each respective nation.

Implications of ownership structures for corporate governance control

A number of studies have also shown that regulations of financial institutions dictate whether countries such as the USA implement a market-based system that results in a dispersed ownership structure, while countries such as Germany and Japan adopt a bank-based system that results in a concentrated ownership structure (Roe, 1990, 1993). Li (1994) found that ownership structure is a significant element that influences corporate governance. Specifically firms that have concentrated ownership also tend to have smaller percentages of outside directors. Li suggested that that agency theory is useful in explaining differences in corporate governance under this institutional arrangement. In other words, in concentrated ownership situations large shareholders take a leadership role in monitoring management, as well as reducing the risk involved with managerial discretion.

It can be argued that Li's (1994) findings are consistent with one of the premises underlying agency theory; that is, the only legitimate stakeholders in firms are shareholders. It also supports the view that the primary aim of corporate governance is one of ensuring a return for investors and protecting the shareholder's interest (Demirag, 1998). The smaller percentages of outside directors found in a concentrated ownership structure, therefore, imply that large shareholders are looking after their own interest and investment. This instrumental view of corporate governance of course stems from the belief

that managers may take actions that hurt shareholders (Tirole, 1999; Walsh and Seward, 1990). Again agency theory suggests that the smaller percentage of outside directors in concentrated ownership is logical since it serves the dual purpose of reducing the agency cost and potential conflict between shareholders and managers (Demirag, 1998).

Managerial discretion and control

Other studies have further fueled the notion that the participation of large shareholders in both the board and management is significant as regards the company's financial performance. Specifically discretion and control of firms by non-shareholders have been found to lower company's profits (Gedajlovic and Shapiro, 1998). Gedajlovic and Shapiro (ibid., p. 535) have gone as far as to summarize: 'where managerial discretion is present, firm profitability will be reduced'. This chapter therefore argues that it makes sense for firms to have an insider corporate board and concentrated ownership structure where the legal institutions allow it, since it reduces agency costs and potential conflict between shareholders and managers.

Other authors have suggested that this is the main reason why banks play a critical (insider) role in Germany and Japan, where they act as both investors and debt-holders (Buhner *et al.*, 1998; Demirag, 1998; Lashgari, 2003; Li, 1994). Effectively this allows the banks to have the comparative advantage of being able to obtain inside information about the firm.

Another inherent advantage for firms that use a concentrated, insider corporate structure is the fact that it can evaluate the firm's performance from a 'long-term' perspective. In other words, the fact that the bank (financier) and boards have good knowledge of the business (for example, its current and future strategy) helps to provide cheaper and safer capital for the business (Demirag, 1998; Shleifer and Vishny, 1986). Li (1994) has also documented that, in non-market systems where concentrated ownership is the norm, members of boards who are shareholders effectively have access to a considerable amount of privileged information. Again it is logical that knowledge of certain privileged information, such as current and future strategy, gives the boards the capability to review the firm's situation and performance from a *long-term* perspective. Thus, directors should be in a position to incorporate internal factors affecting the firm into their decisions (Demirag *et al.*, 1994; Demsetz and Lehn, 1985; Shleifer and Vishny, 1986). Demirag (1998) further suggests that a concentrated ownership is also advantageous for shareholders in that it can yield better returns, because it is a powerful constraint on managerial discretion.

It is of interest to note that the long-term perspective associated with concentrated ownership stems from the fact that the board embraces the goal of corporate wealth maximization as opposed to pure shareholder

wealth maximization (Demirag, 1998; Demsetz and Lehn, 1985; Kuada and Gullestrup, 1998; Tirole, 1999). This is relevant to the discussion since it further suggests that, apart from structural variations between the concentrated and dispersed corporate ownership system, there is also an implicit difference in the managerial goals of the two systems. Specifically, in a dispersed ownership system where managers have discretion, their goal is to ensure the well-being of the firm: that is, ensuring that it grows and survives, which in turn safeguards the managers' jobs (Gedajlovic and Shapiro, 1998; Shleifer and Vishny, 1986). In contrast, in concentrated ownership systems, managers endeavor both to ensure the wellbeing of the firm and to maximize profits for shareholders, because the managers themselves are also shareholders. This explains why some authors have argued and documented that, in the USA, where diffused ownership is practiced, managers are partly motivated by the risk of losing their jobs, while in countries like Japan and Continental Europe, where concentrated ownership is practiced, managers view their positions as relatively stable (Tirole, 1999; Charkham, 1992; Monks and Nell, 1996).

Evaluation of management by corporate boards

One obvious conclusion that can be derived from the discussion above is that firm value maximization (long-termism) and shareholder value maximization (short-termism) are not always consistent objectives (Demirag, 1998; Demsetz and Lehn, 1985; Gedajlovic and Shapiro, 1998; Li, 1994; Tirole, 1999; Walsh and Seward, 1990). Therefore the literature suggests that there has been no set and established universal way to measure firm performance by international corporate boards. To complicate matters further, Monks and Nell (1996) argue that some failures in large companies can be partly attributed to the failure of their corporate governance structure.

The fact that there are implicit variations in managerial goals between the concentrated and dispersed ownership system indicates that there may also be differences in the way that corporate boards evaluate firm performance in various systems. Buhner and colleagues (1998), Charkham (1992) and Lashgari (2003) agree that significant differences in corporate governance practices that have been influenced by nations and cultures also imply differences in competitive outcomes depending on the nation where the firms are located. For example, Demirag (1998) believes that firm performance is very much linked to the way financial systems are structured in particular nations. In financial environments where there is great need to have high levels of current profits, short-termism may be the mode of operation. In other words, firms accept projects with either 'an excessive discount rate and/or a foreshortened time horizon' (ibid., p. 7).

This chapter argues that the relevant issue for international corporate governance is that short-term pressures tend to stem from within the firm; therefore evaluators (that is, corporate boards) will also have biases stemming from these internal firm goals (Demirag, 1998; Marsh, 1990). Other studies indicate that there are also other biases associated with short-termism and long-termism. Demirag and colleagues (1994) as well as Ittner and Larcker (1997) suggested that companies that rely too much on a financial control system have a tendency to emphasize short-term financial objectives. Furthermore it is believed that short-termism is practiced at the expense of reduced future investments, while long-termism considers future investments to be part of the firm's objectives (Demirag *et al.*, 1994; Demirag, 1998; Kuada and Gullestrup, 1998).

The obvious concern for corporate boards when evaluating a firm's performance is that they are under constant pressure to ensure that their companies are performing optimally in the stock market. Thus corporate boards are accountable and have to take action when their firms are performing poorly. In many cases, corporate boards attempt to determine the source of the firm's suboptimal performance, and in many situations implicitly assume that it is directly related to the actions of managers: suboptimal performance is blamed on management (Walsh and Seward, 1990).

This chapter argues that corporate boards cannot simply assume that suboptimal performance is directly related to the actions of managers. Tirole (1999) in fact argues that that there is a false assumption that management has formal control, when in essence it has not. Management often has to refer to higher authorities in its decision-making process. This chapter asserts that corporate boards must ask the question of whether the situation and environment caused the suboptimal performance, the rationale being that attributional processes are situationally bound (Dasborough and Ashkanasy, 2002).

Sternberg and Vroom (2002) suggests that, when evaluating people in a leadership position, we should also take account of the situations in a way that acknowledges the dimensions on which situations vary. Therefore, in measuring performance, we have to take account of both persons and situations. The problem, however, as Walsh and Seward (1990) pointed out, is that in many cases the board of directors simply do not have enough information to conduct a fair and accurate assessment. This chapter, therefore, also asserts that the lack of information to conduct a fair and accurate assessment may be an inherent limitation that exists in a dispersed corporate governance system, especially one that operates in the short-term mode.

Culture, ownership and performance evaluation

In theory it has been suggested that a good corporate governance structure should be one that is able to select the best managers and those who are then

accountable to shareholders; and, in turn, the boards should then consider social interest in their actions (Cutting and Kouzmin, 2000; Tirole, 1999). It has been argued, therefore, that in general decisions made by a corporate board should also reflect the sociocultural environments where the firms exist (Biggart and Hamilton, 1987). The previous section highlighted the fact that performance criteria which corporate boards use to evaluate firm performance may differ according to the financial system and ownership structure in which firms operate. This chapter argues that evaluation of firm performance by corporate boards may also be influenced by cognitive and cultural biases associated with the ownership structure. Moreover it argues that there is indirect evidence to show that corporate boards evaluate firm performance on the basis of their sociocultural environments.

In general theorists working in the area of corporate governance suggest that managers should be rewarded as a function of the measurement variables that are within their control and/or that their behavior can affect (Buhner *et al.*, 1998; Charkham, 1992; Demirag, 1998; Lashgari, 2003; Tirole, 1999). Therefore performance measurement must be a flexible and changing concept that takes account of the context. Monks and Nell (1996) have advocated that someone other than management, that is, the board of directors, should also set the standard of performance. This chapter argues that, in many cases, especially in a dispersed ownership system, boards of directors do not have enough information to conduct a fair and accurate assessment of management's actions. Indirect evidence suggests that this problem may be limited to corporate boards that operate in a dispersed ownership system, that is, an outsider corporate board structure.

This chapter asserts that corporate governance systems which operate under a dispersed ownership structure may be subject to short-term mode biases that can lead to inaccurate performance evaluations. In contrast, in concentrated ownership situations where there are smaller percentages of outside directors, the boards are in effect also evaluating themselves as managers and thus are more likely to have a longer-term perspective. For example, in concentrated ownership systems shareholders play a direct and major part in corporate governance. Studies suggest that in many situations a self-evaluation process may prove to be more advantageous for management, as well as the corporate boards.

It is this chapter's observation that theorists have categorized nations which operate on the dispersed corporate ownership structure as operating on the short-term financial system (for example, the UK and USA), while nations that operate on the concentrated corporate ownership structure have been described as operating under a long-term financial system (for example, Japan; East Asia and South East Asia: Demirag, 1998; Demirag *et al.*, 1994; Ittner and Larcker, 1997; Kuada and Gullestrup, 1998; Marsh, 1990). The relevant point is that corporate boards that operate in a dispersed ownership system appear to be the ones that are most likely to have a short-term bias, while corporate boards that operate in a concentrated ownership system are most likely to have a long-term perspective. This claim is consistent with cultural studies which indicate that nations such as Japan, East Asia and South East Asia, where concentrated ownership is practiced, are most likely to have a long-term perspective, since members of these nations tend to favor long-term orientation (Hofstede, 1991; Kuada and Gullestrup, 1998; Whitley, 1990, 1994).

Monks and Nell (1996) noted that directors could never know as much about the operation as management and people who are in day-to-day charge of the firms. Therefore boards of directors are dependent on being supplied with necessary, accurate and timely information by management. Despite the view that management may not be fully in control of firm performance, Tirole (1999) believes that in many cases managers possess accurate and necessary information to make fundamental decisions concerning the firm, the relevant issue being that corporate boards in concentrated ownership systems have more information that in turn might lead to a more accurate evaluation of a company's performance.

Role of information in the evaluation process

Kuada and Gullestrup's (1998) work suggests that culture does affect organizational members in a corporate governance system. This chapter argues that corporate governance practices are influenced by culture at the 'macro culture' level.

Research in the area of leadership attribution indicates that the way people generate explanations for events and people's behavior can vary with the information that people have at the time (Lee and Hallahan, 2001; Lee and Tiedens, 2001; Lord *et al.*, 1999; Pekerti, in press). Research findings in attribution processes are relevant for corporate governance since the way in which corporate boards attribute performance has consequences for workers and managers in the company. For example, if a board decides to attribute suboptimal performance of a firm to management's actions as opposed to other factors (such as a downturn in the economy), this will affect the board's future decisions concerning the firm and/or management (for example, management will be held accountable).

Errors and biases due to lack of information

One of the most basic and pervasive tendencies uncovered by attribution research has been referred to as the 'fundamental attribution error' (Ross, 1977); that is, the tendency for perceivers not to take account of situational factors, thus overattributing causality to internal factors in the actor.[1] The

error lies in the perception that the actor's actions are the foremost causal factor when the situation is, in fact, as much a contributing factor.

Another source of error that has been found in the attribution process is the actor–observer bias. Jones and Nisbett (1971) suggested that actors and observers are attuned to different sets of information that in turn lead to differences in causal attribution. Actors were described as having a propensity to overattribute causes to situational factors, while observers have a tendency to overattribute the same actions to dispositional factors. For example, an actor bias suggests that, when a firm underperforms, management will attribute this sub optimal performance to causes in the environment. In contrast, the corporate board, which is the observer evaluating management, will attribute this suboptimal performance to a lack of ability and/or effort on the part of management (observer bias).

Another bias that may affect the performance evaluation process is the self-serving bias, that is, the tendency for people to take more credit for their successes and blaming failure on other people or circumstances. For example, when a firm performs well, management will attribute this success internally, that is, as directly due to the actions of management. In contrast, when the firm underperforms, management will attribute this to external factors, such as poor economic conditions.

What the above discussion clearly indicates is that, when there is deficiency in information, coupled with our natural cognitive limitations and biases, the process of assigning causality to events is a less than optimal process. This chapter argues that all of the above biases that plague the cognitive process of evaluators during performance evaluation may also plague corporate boards when they are attempting to determine the source of the firm's optimal or suboptimal performance (Walsh and Seward, 1990).

Culture's influence on the corporate governance evaluation process

Of particular interest to this chapter's argument concerning ownership structure and its effect on corporate board evaluation is the self-serving bias and actor–observer bias, especially on boards that have high percentages of board members who are also managers in the firm. The work of Martinko and Douglas (1999), as well as Lord and colleagues (1999), suggested that leaders (at least in Western cultures) are prone to self-serving biases during performance evaluation processes. At the same time these authors have suggested that the way in which people perceive themselves may also affect their attributions (Lord *et al.*, 1999; Martinko and Douglas, 1999).

Differences in causal attributions have been explained with reference to the attention paid to particular types of information. For example, Morris and Peng (1994) found that writers and editors of American newspapers tended to make more internal attributions to social events and crimes. In contrast, Chinese writers and editors provide more situational explanations for similar social events and crimes. Other studies have confirmed Morris and Peng's findings and provide other explanations for the way cultures affect information processing. Pekerti (2001) found that there were significant differences in culturally based communication styles between people from low- and high-context cultures.[2] It was suggested that variations in communication styles may be explained with reference to people's self-concept and preference for certain types of information. Specifically members of low-context cultures are socialized to be independent, and thus have a propensity to attune themselves to self-referent and task-relevant information. This in turn biases them to make internal types of attributions. In contrast, members of high-context cultures are socialized to be interdependent. As a result, they have a propensity to attune themselves to situational relevant information and this, in turn, biases them to make external types of attributions, one of the rationales being that their interdependent self-concept predisposes them to take account of the situational factors to ensure in-group harmony.

The relevance of the above studies to this chapter's discussion is that cultures described by Hall (1976) as being low- and high-context are very similar to the individualistic–collectivistic cultures described by Hofstede (1980): see (Gudykunst *et al.*, 1988). Moreover cultures that are described as being individualistic and low-context are also the ones that are more likely to operate under the dispersed, corporate ownership structure, such as the UK and USA, while cultures that are described as being collectivistic and high-context are the ones likely to operate under the concentrated ownership structure, such as Japan, East Asia and South East Asia (Demirag, 1998; Demirag *et al.*, 1994; Ittner and Larcker, 1997; Kuada and Gullestrup, 1998; Marsh, 1990). In other words, it is possible that corporate boards that operate under the dispersed ownership structure are prone not to take account of situational information. In contrast, because corporate boards in concentrated ownership structures have a large percentage of their members who are also part of the management team, they are more likely to take account of situational information since they act as both *actor* and *observer*. More importantly they are less likely to attribute a company's suboptimal performance to direct actions by management because they are partially evaluating their own performance.

Implications concerning board of directors under the insider and outsider corporate governance structure

In the context of firm performance evaluation by corporate boards, it is this chapter's contention that insider corporate boards are effectively also conducting a self-evaluation process. Stated in another way, in concentrated ownership corporate governance systems where there are large percentages

of corporate board members who are also managers in the firm, the board of directors are in essence conducting an evaluation of their own performance as managers. Consequently these boards of directors (as actors) are also more likely to take account of situational factors and less likely to attribute a company's suboptimal performance to direct actions by management.

Research in the area of leadership attributions, for example, indicates that attribution errors are reduced when evaluators know more about people they are to evaluate (Jones and Nisbett, 1971). There is also supporting evidence to suggest that closer monitoring of workers by their managers has increased external attributions. In the same way, this chapter suggests that corporate board members who are also managers (actors being observed) would tend to be self-serving, attuned to the environment and more likely to make external attributions for suboptimal performances of their firm.

This chapter also asserts that, along with the advantage of being able to conduct a self-evaluation process, corporate boards that operate under an insider corporate governance structure also have an advantage in that they have access to privileged information that outsider boards do not. In other words, insider corporate boards would have access to both internal and external information that reduces the likelihood of their making a fundamental attribution error. Furthermore they are also more likely to be able to make an accurate assessment of the company's performance because they have information concerning current and future strategy. In essence, corporate boards that operate under the insider corporate governance structure should take into account the range of internal factors of the firm, as well as the dimensions on which situations vary.

The major implication for corporate boards that operate in a dispersed market-oriented ownership structure and under an outsider corporate governance structure is that they may perform evaluations without adequate information (Monks and Nell, 1996; Tirole, 1999). In this case, there is a strong possibility that, when corporate boards are attempting to determine the source of the firm's optimal or suboptimal performance they may be prone to biases and make observer attributional errors; in turn, this may disadvantage management.

Despite the apparent additional information that is available for corporate boards in concentrated ownership structures, it is this chapter's contention that it may also be prone to other cognitive biases that can lead to suboptimal results for the firm. This chapter asserts that, in concentrated ownership structures where a high percentage of insider corporate board members are present, there is the potential for a hegemonic mind-set to exist. The risk of these types of limitations existing is high; for example, cognitive overload is likely to occur when the CEO and chairman of the board are the same person. In the same manner a social phenomenon, such as groupthink, is

also likely to occur when there are high percentages of board members who are also managers in the firm (Cutting and Kouzmin, 2000). Likewise Tirole (1999), for example, has also observed that undivided control generally creates biased decision making.

Practical suggestions to reduce cultural and cognitive biases during performance evaluations

Cutting and Kouzmin (2000) suggest that one of the ways to ensure accuracy during performance evaluation by corporate boards is to include solutions to avoid cognitive errors in corporate governance structures (for example, devil's advocate role). This chapter argues that, again, works in the area of leadership are useful. For example, the work of Martinko and Douglas (1999) suggests that attributional training might be a valuable intervention to reduce attributional biases. In brief, attributional training involves making people aware of their own potential biases and how these can affect attribution processes.

Another bias this chapter has discussed that occurs during performance evaluation is caused by deficiency in information. It is of interest that Lee and Tiedens (2000) found attributional biases not only to be caused by lack of external information, but also to be due to people's lack of sensitivity and attention to situational information. This chapter asserts that that sensitivity to situational information can be increased through training and other interventions such as utilizing disconfirmatory strategies. Disconfirmatory strategies include evaluators being open to information that disconfirm expectations and should, therefore, include alternative sources of information. Causal explanations of performance from individuals who are being evaluated from the worker's perspective may also function as an alternative source of information in the evaluation process. Another simple but useful disconfirmatory strategy is to ask a colleague with no stake to examine the existing information and conduct the evaluation (Feldman, 1981). Eminent leadership scholars actually suggest that leaders should always consult with others if possible, since this is one of the ways that leaders can be informed about stakeholders' interests (Sternberg and Vroom, 2002).

Interestingly a commitment to being accurate and rigorous during decision making has been shown to reduce cognitive biases that occur during performance evaluation. The work of Kunda (1990) suggests that specific informational prompting can influence both behaviors and subsequent attributions. For example, Kunda found that subjects are less prone to making judgments based on internal factors when they are motivated to be accurate. Therefore prompts that remind evaluators to be accurate may reduce the occurrence of fundamental attribution error, or at least result

in people taking account of situational conditions, which in turn may lead to evaluations that are more accurate.

As Jones and Nisbett (1971) found, attribution errors are reduced when evaluators know more about people they are to assess or when they decrease their 'psychological distance'. Therefore this chapter recommends that corporate boards serve shareholders and management well by becoming more familiar with management activities. This, in turn, may provide corporate boards with both an observer and a pseudo-actor perspective. In other words, Jones and Nisbett suggest that, when people make an attribution concerning behaviors of a familiar person, a similar process is activated to that used in a self-attribution process. Therefore, as an actor, one would be attuned to the environment and external information, which in turn would reduce fundamental attribution errors.

In general this chapter argues that attributional training, as well as a commitment to accuracy and rigor during performance evaluation, would be useful for all corporate boards regardless of culture and/or ownership structure. However, as Cutting and Kouzmin (2000) suggest, utilizing a disconfirmatory strategy and asking a third party to take on the role of devil's advocate may be most beneficial for corporate boards with a high percentage of board members who are also managers in the firm. In contrast, decreasing the psychological distance between corporate boards and management may be most beneficial for corporate boards operating under the dispersed ownership structure. In other words, familiarity with management and their activities may result in the board of directors taking account of both internal and situational conditions.

Conclusions and implications for future research

This chapter acknowledges that it comprises very much a theoretical discussion; therefore one major direction for the future in corporate governance research is empirical and multicultural validation of the assertions made in the chapter.

Future research directions

One major assertion discussed was the idea that corporate boards are cognitively biased according to their cultural environment. Specifically, corporate boards that operate in a low-context culture are more likely to make fundamental attribution errors when they evaluate management performance. In contrast, corporate boards that operate in a high-context culture are less likely to make fundamental attribution errors when they evaluate management performance. Apart from testing the validity of these propositions cross-culturally, there are also a number of possible research avenues associated with the above propositions.

First, it would be fascinating to test these propositions. Second, it would be of interest to test whether or not having corporate boards who are also managers in the firm (insider corporate boards) affect the board's evaluation of a firm's optimal and suboptimal performance. Third, it would be fascinating to vary the type and amount of information to which insider corporate boards can gain access, and how it affects the board's evaluation of a firm's optimal and suboptimal performance. Finally, it would also be useful to investigate whether corporate boards within concentrated ownership structures have a higher risk of suffering cognitive overload and/or are more vulnerable to social phenomena, such as, groupthink.

This chapter contends that the future directions for corporate governance research suggested above can make significant contributions to the field. Testing the propositions contained in this chapter within and across cultures as well as across populations may also provide corporate governance scholars and corporate boards with further insights concerning variables that may cause performance evaluation in various situations.

Summary

To summarize, this chapter has discussed different models of corporate governance that exist in business. The discussion suggests that, as socially constructed entities, business systems and corporations are subject to cultural, cognitive and political biases. The discussion has therefore, partially answered both questions posed at the beginning of the chapter. That is, there is evidence to suggest that there is no universal corporate governance system in international business. Furthermore the fact that the differences go beyond national boundaries distinction, and actually affect how people process information indicates that adopting a universal corporate governance system may be inappropriate.

The discussion highlighted the fact that corporate boards may be biased towards attributing the cause of suboptimal performance of their firms to the direct actions of management, when other factors may have contributed equally to such outcomes. It suggested that the error of not taking account of situational information might be more prevalent in low-context cultures and nations, as well as those that operate under the dispersed corporate ownership structure. In contrast, in high-context cultures, those that operate under the concentrated ownership structure are less prone to these errors, thanks to their interdependent self-concept and the fact that there are large percentages of corporate board members who are also managers in the firm. Therefore they are cognitively able to take on the roles of both actors and observers, which in turn attune them both to internal and to external information concerning the firm and environment, respectively.

There is also evidence that preferences for different types of corporate ownership structures are influenced by strong cultural values. For example,

the concentrated ownership structure found in East Asian and South East Asian cultures may be attributed to the values that are salient in these societies, such as long-term network relationships (Hamilton and Biggart, 1988; Hamilton *et al.*, 1990; Whitley, 1991, 1994). Likewise the cognitive biases found in different cultures has been linked to differences in the way cultural members perceive themselves, which in turn predisposes them to be more attuned to certain types of information (Pekerti, 2001). The relevant point is that harmonizing or adopting a universal corporate governance system may not fit the cognitive preference, as well as culturally based preferences for ownership structures. Moreover the fact that financial institutions dictate whether countries implement a market-based system that results in a dispersed ownership structure or adopt a bank-based system that results in a concentrated ownership structure suggests these institutions will not accommodate a universal corporate governance system (Roe, 1990, 1993).

In closing, this chapter contends that the belief systems and cultural differences that have given rise to a concentrated ownership structure and dispersed ownership structure are still prevalent. For example, Demirag (1998) observed that, despite globalization, in Japan movement towards market corporate control is slow to non-existent, thus suggesting that the non-market structure of corporate governance will continue to exist. Therefore, adopting a universal corporate governance system in international business is inappropriate. Whitley (1992a) effectively made a similar argument, that business systems are different in different contexts; therefore 'recipes' for business success which are effective in one nation or region will not be successful in another region or over time.

In general, the consensus among theorists is that there are too many variables to consider in corporate governance to adopt a ubiquitous or harmonized approach to corporate governance. Many also agree that we should not have just one corporate governance system (Buhner *et al.*, 1998; Charkham, 1992; Demirag, 1998; Lashgari, 2003; Tirole, 1999).

Notes

1. Internal and/or dispositional factors are those perceived as coming from a person's character and/or temperament, while situational factors are factors perceived as coming from outside a person's character and/or temperament, for example the environment.
2. Low context: societies where people tend to have many connections of shorter duration or for specific reason. High context: societies or groups where people have close connections over a long period of time.

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