



# **Globalization, Governance and Growth**

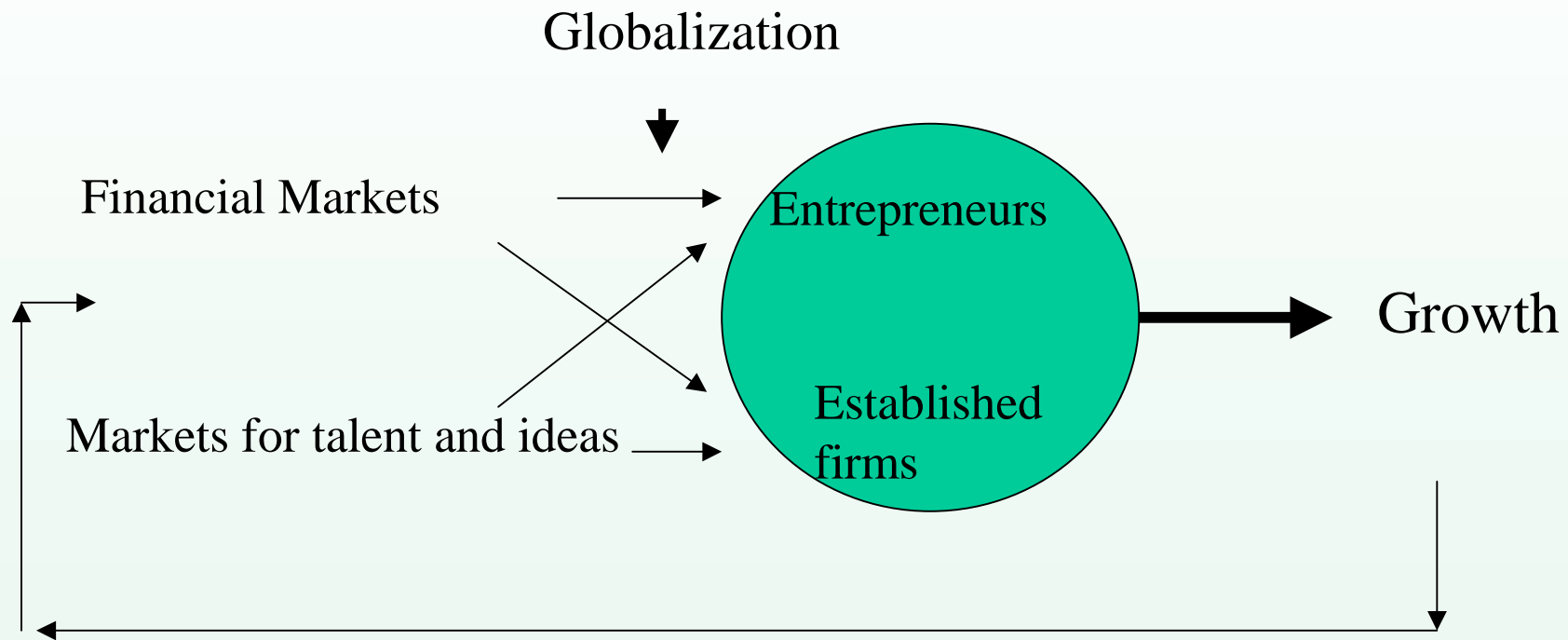
Tarun Khanna & Krishna Palepu

Australian Graduate School of Management  
Executive Forum

November 2001

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# Globalization, Governance and Growth



# Research Question

## Does globalization cause convergence in corporate governance?

### Motivating Examples

Infosys  
(Khanna & Palepu)

Pressure from global talent markets causes partial convergence (in form; de facto and de jure)

*but*

Mexican  
ADRs (Siegel)

Instances of governance problems not constrained by U.S. courts

Banco Galicia  
(DiTella, Pil & Khanna)

Argentina bank takes actions inconsistent with U.S. rules despite having ADRs in place

Transition economy  
companies (Pistor)

Transplant effect drives a wedge between de facto and de jure effects

EU takeover  
directive (Subramanian)

20 years after first proposed, still no action. Attempted harmonization between polar opposite concerns of UK and Germany

Japan  
Meiji Restoration (Westney)  
Post-WWII (Yafeh)

Partial adaptability of foreign institutions  
Failure of imposition of Allied plans



## Motivating Example

# Old Mutual

Founded in 1845, Africa's largest and most trusted financial institution.

“Is it going to fly? Can you take a top South African demutualised company and relocate it 6,000 miles away and sell it as one of the biggest IPOs of 1999 to U.K. and U.S. investors with the background of an emerging market crash in 1998? There are question marks about management, question marks about Africa, about what happens when Mandela goes as president ... what happens if the South African election goes wrong?” Mike Levett, CEO

Wrenching transformation of a success story:

Convert from mutual to stockholding company

Change primary listing from Johannesburg to London

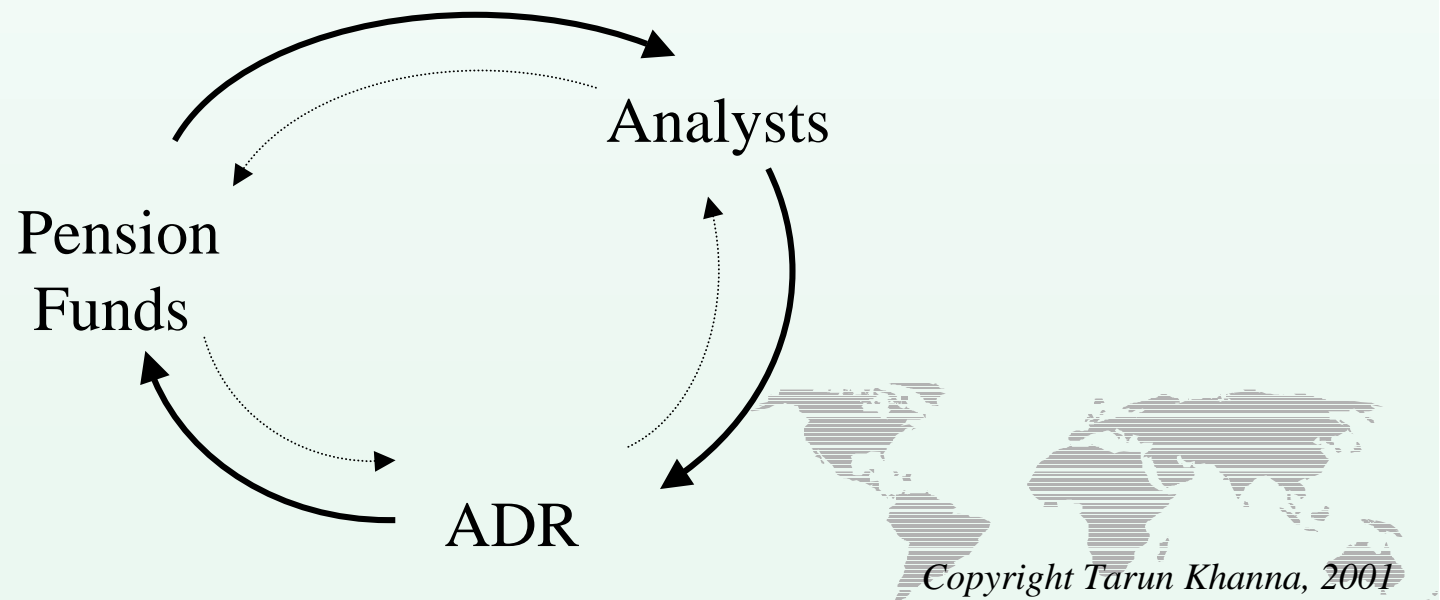
Educate millions of first-time shareholders about financial markets

## Motivating Example

# Empresas CAP

As part of a long-running transformation -- from state-owned to privatized steel company, to successful diversified business group, to a collection of stand-alone businesses -- Compañía Acero del Pacifico issues ADRs on the NYSE. It joins a small number of Chilean companies in doing so.

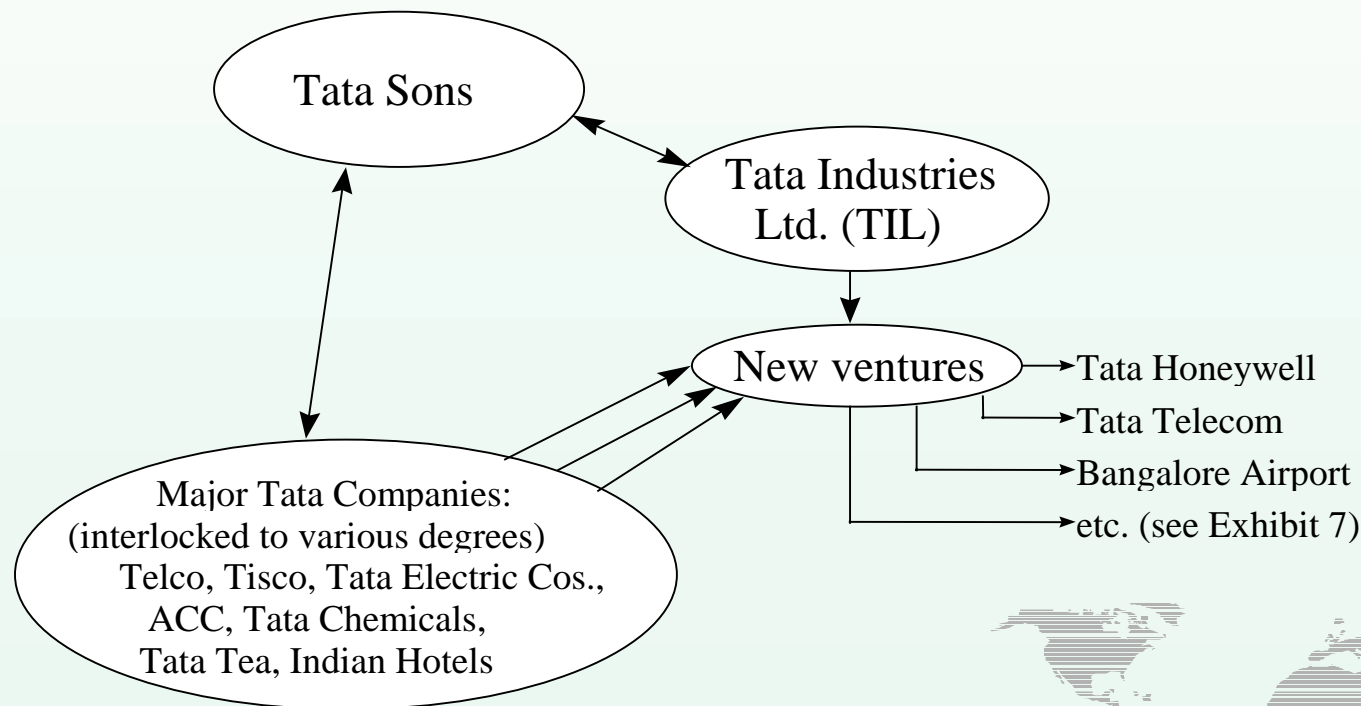
This sets in motion a string of mutually reinforcing events which help jump-start domestic capital markets



## Motivating Example

# House of Tata

Ratan Tata, head of India's largest group, must decide whether to focus (disband?) the Tata group in response to India's liberalization in 1991, as suggested by 'conventional wisdom' and by international consulting firms. He refrains, and does so successfully.



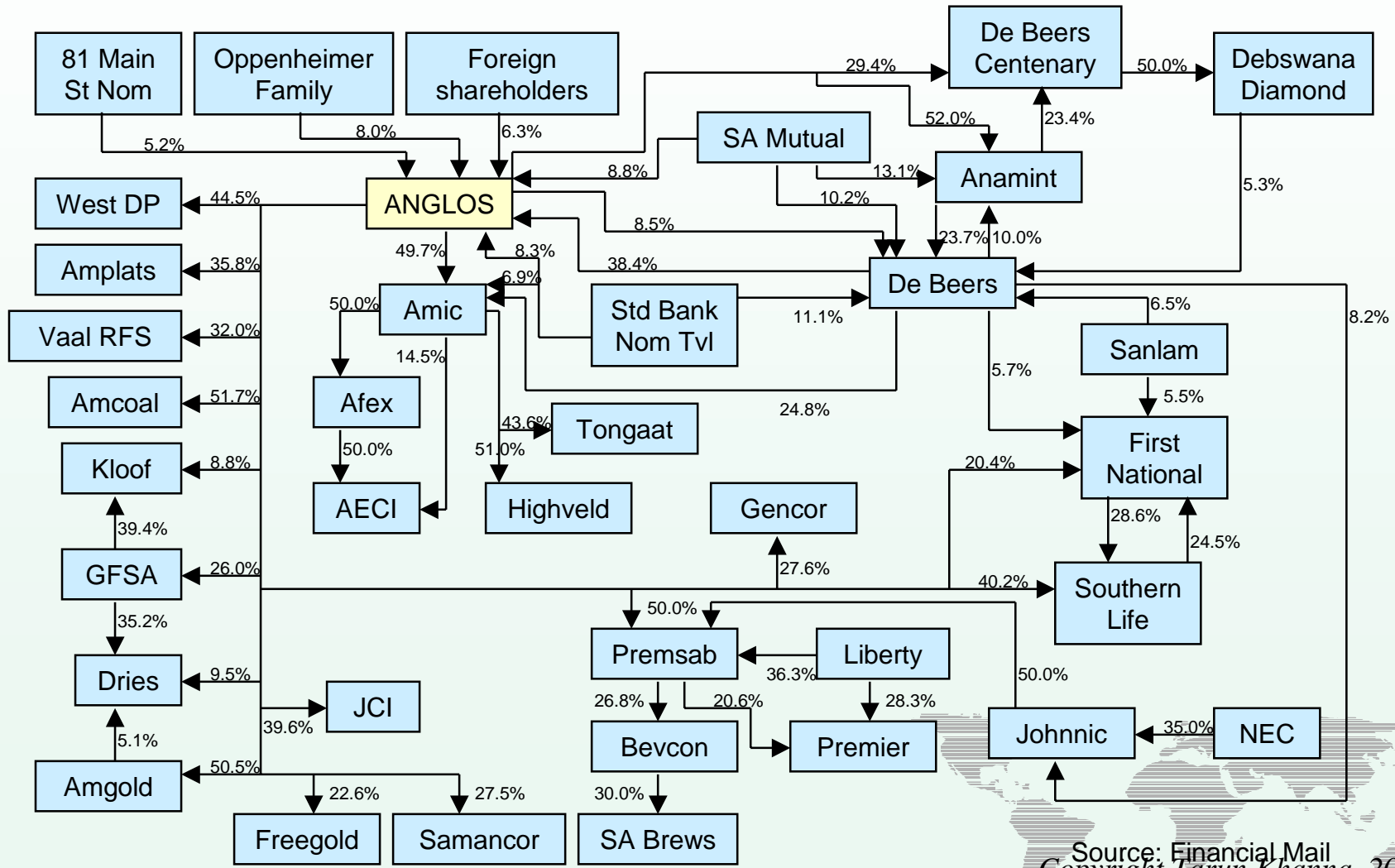
Arrows indicate investment flows.

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# Motivating Example

# Business Groups

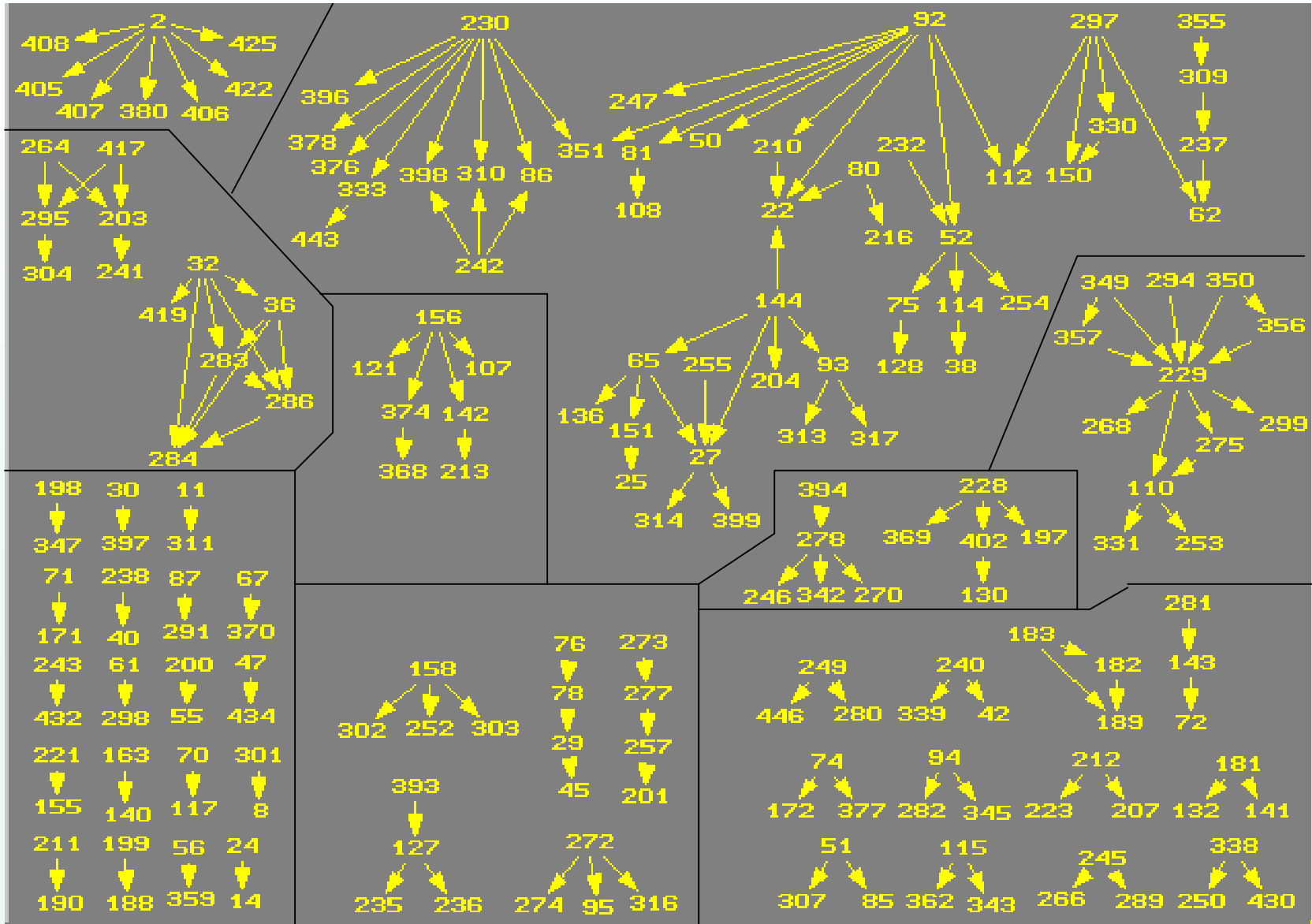
## Anglo American Group (South Africa)



Source: Financial Mail  
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# Motivating Example

## Gallery of Chilean Pyramids

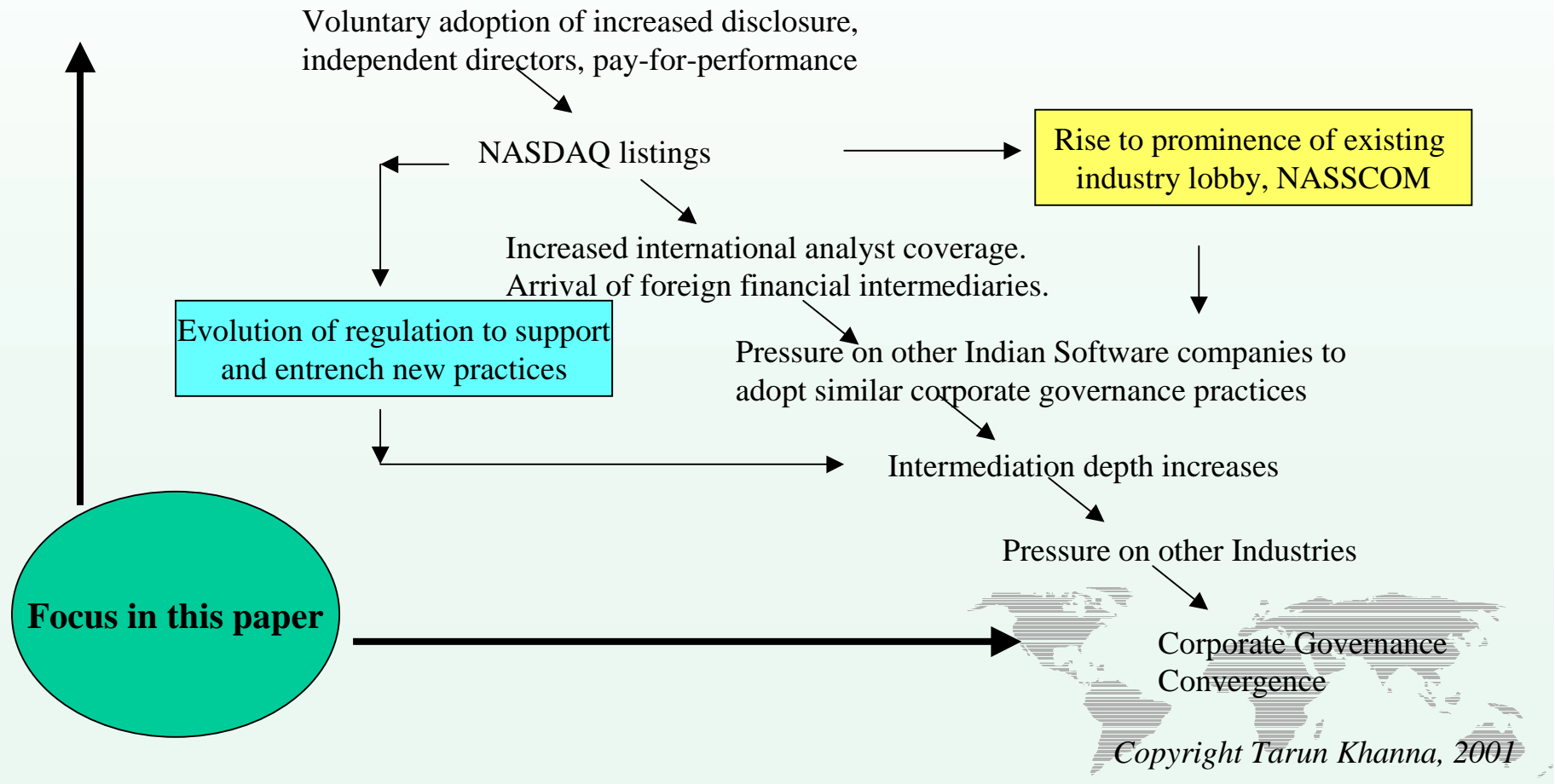


# Motivating Example

## Unpacking the Infosys Effect

Software companies need to compete globally

- Global talent pool
- Need to offer options as part of compensation package
- Gaining credibility with customers
- Global M&A activity



# Tricky Questions

*What is convergence? & What is globalization?*

At some level there is obviously convergence

Firms should create value

Resource providers should be protected and receive sufficient return

Good information and contract enforcement needed for good governance

*But*

Which resource providers?

(Shleifer & Vishny; Berglof & Von Thadden; Tirole)

How should good information be provided?

Markets and/or relationships

(Diamond; Aoki; Rajan; Milgrom & Roberts)

How should contracts be enforced?

Social sanctions and/or economic mechanisms (Greif; Aoki)

And what about Globalization?

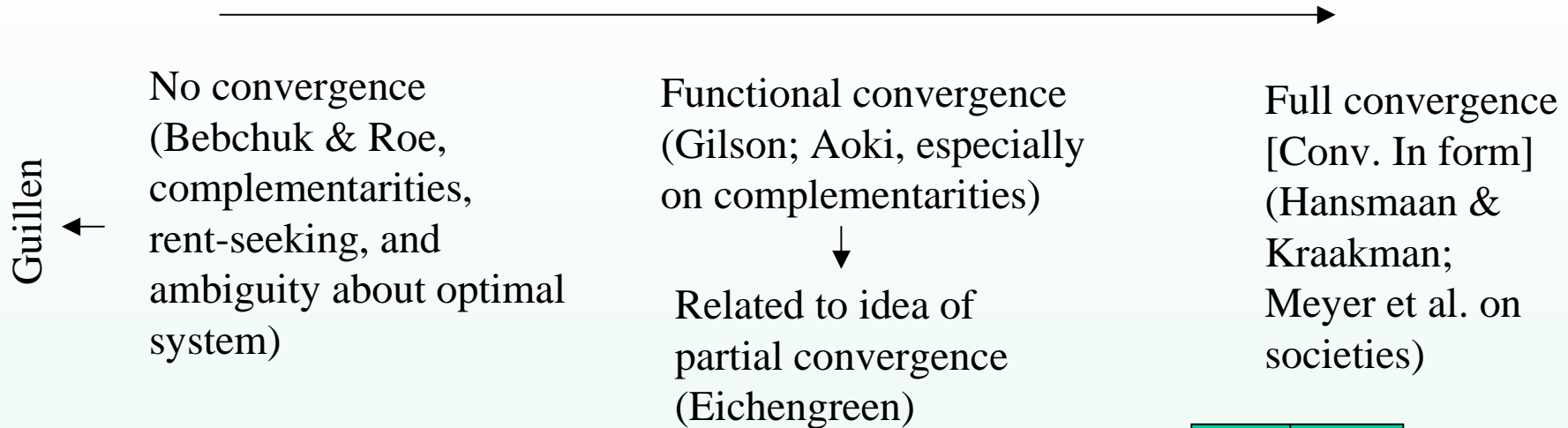
Pax Americana? Or economic interdependence?

Product and factor markets

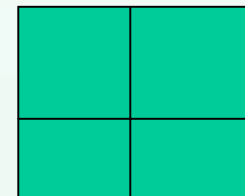


# Research Question

**Does globalization cause convergence in corporate governance?**



*De jure* versus *de facto* convergence  
Pistor and co-authors



Pressure from global competition is the implicit agent for convergence  
Typically pressure from global capital market intermediaries  
History (US states tax revenue competition through incorporation terms  
Easterbrook & Fischel; Romano)

# Research Question

## **Does globalization cause convergence in corporate governance?**

What can we learn from history?

Past globalization epoch: 1850-1914

From repeal of Corn Laws & Irish famine-migration to WWI

Some lessons from Atlantic Economy countries (roughly OECD + Argentina)

Convergence in income (GDP/capita)

Even more rapid convergence in real wages/capita

Role of migration

Role of trade

Transportation Costs ↓ – Railways, steamships and refrigeration

Role of ideas and role of single-power hegemony in initiating process

Distributional consequences create potential for globalization backlash

O'Rourke & Williamson

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# Data Sources

## Credit Lyonnais Securities Asia (CLSA)

### *De facto convergence*

57 questions at firm level:  
Fiscal discipline; Acctg disclosure  
Board accountability; Equitable  
treatment of shareholders; Social  
awareness

25 emerging markets  
March 2001 data

## Auxiliary Sources

### Method

Convergence in form  
Convergence in function  
Country, Industry and Firm-level analyses

## La Porta et al. 1997 data

### *De jure convergence*

Legal rules regarding  
Shareholder rights  
Credit rights  
Legal families

49 developing/developed  
countries

Déminor, ProxInvest, Fortune  
Egregious scandals index from India

Governance 'distance' metric  
Single score achievable in numerous ways

# Data Sources

<u>CLSA Category</u>	<u>My Category</u>	<u>Assessment</u>
Discipline	Empire Building	? 2 odd questions (out of 9)
Transparency	Disclosure	Excellent
Independence	Board & Auditor Independence	Very Good
Accountability	Board Accountability	
Responsibility	Enforcement/Sanctions	? 1 odd question (out of 6)
Fairness	Minority Shareholder Protection	Excellent
Social Awareness	Stakeholder Concerns	Okay
PROCESS		Excellent

# Independent variables

## Country level

“Law of one price”

Wage equalization

Freeman & Oostendorp

Co-movement in stock prices

“Quantity” effects

Actual

Trade & FDI

Potential

Geography, Common language, Legal Origin

## Firm Level

Institutional investors, Top shareholders from U.S./U.K.

U.S. listing, Capital market intermediaries (auditors, investment banks)

Export intensity

Foreign management and directors



# Results Summary

## Country Level Analysis

No evidence of *de jure* or *de facto* functional convergence to U.S. standards

No evidence of *de facto* convergence in form among pairs of countries

Robust evidence of *de jure* convergence in form among pairs of countries

Trade variables significant at 10% level

Common legal origin and geographic distance at 1% level

Factor analysis reveals globalization & common legal origin significant

*De jure* convergence in form is even stronger when U.S. is out of the picture

Contrary to conventional wisdom of U.S. driving convergence

Trade and FDI variables more significant

Factor analysis reveals even larger effect of globalization

Conclusion:

*De jure* but no *de facto* convergence in form (Pistor et al, Siegel)

Globalization as economic interdependence rather than Pax Americana

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# Entrepreneurship in Emerging Markets

## Groups and Non-Groups

Three possibilities

Crowding out, Symbiosis, Parallel Environments

Limited evidence of crowding out or symbiosis, but data are consistent with a parallel environment story, where groups and non-groups are each suited for different kinds of opportunities

Groups focus on capital intensive projects, non-groups on knowledge-intensive

Groups cite groups as rivals, non-groups cite non-groups

Pros and cons of parallel environments

De novo efforts are not crowded out generally

Opportunities for symbiosis are left untapped



# Multinationals and Localization

MNCs have often overestimated homogeneity of demand

Revlon's introduction of beauty products into China in 1976 and India in 1994.

Microsoft's misreading of the importance of localization of its PC software in China in 1993.

Kellogg's over-estimation of the demand for breakfast cereal in India

McDonald's over-estimation of taste homogeneity in the Philippines.

Star TV's over-estimation of demand for recycled Western TV content in South and South-East Asia.

Coke's over-estimation of the value of its brand in India.

# Multinationals and Entrepreneurship

Multinationals are constrained in their response to entrepreneurial opportunities

Managers of multinationals defer to decisions in the home country, thus failing to capitalize on local opportunity.

Managers of multinationals often do not have the incentives that reward the pursuit of risky ventures.

Multinationals, as focused entities, shy away from complementary opportunities.



# Multinationals and Entrepreneurship

## Facilitators or Barriers

### Facilitating role

Breeding ground for individual entrepreneurs

Major customers of new businesses

Major suppliers of new businesses

Major investors in recent ventures

Main source of key professional labor

### Impeding role

Reliance on home country intermediaries by multinationals can lower demand for host country intermediaries.



# Multinationals and Entrepreneurship

Multinationals generally work better with non-groups than with groups

Non-groups use talent from multinationals much more than do groups, especially in the start-up stage

Non-groups have multinational customers much more often than do groups

Non-groups generally do not perceive multinationals as competitors while groups do

Groups are more common alliance partners of multinationals than are non-groups.

(India evidence: Such partnerships frequently dissolve into competing relationships between multinationals and groups)

# Conclusion

Evidence of *de jure* convergence in corporate governance.

No/limited evidence of *de facto* convergence in corporate governance.

Interpretation: Implementation significantly lags adoption

Globalization as economic interdependence rather than Pax Americana

Consistent with evidence of increased regionalism

A variety of governance arrangements can co-exist with significant, under-exploited room for realizing complementarities.

Symbiosis between established firms and entrepreneurs

Symbiosis between multinationals and domestic firms.