Institutional Transformation and Changes in Corporate Governance : The Case of Asia

Ji-Yong LEE

GREThA, UMR CNRS 5113, Montesquieu – Bordeaux IV University, France

Abstract

Asia's economy has undergone a number of changes in corporate ownership and financial structure in the last several years. This paper addresses the evolving patterns of corporate governance among Asian countries since the crisis in 1997. Based on institutional theory, the discussion in this article is intended to illuminate in particular the notion of hybridization of institutional change in the form of corporate governance. The paper shows how Asian economies are reshaping their corporate governance features, leading to a fascinating diversity of corporate governance forms. This result suggests that there is no evidence of convergence on a shareholder-oriented model.

Key Words: Corporate governance, institutional change, institutional complementarity, hybridization, Asian capitalism.

JEL Classification: B52, G32, G34, N25, O16

Introduction

There has been a surge of interest in corporate governance among academic and business circles as well as policy-makers across the world. One of the major issues is whether corporate governance in various countries has become divergent or convergent. Some argue that powerful forces of international competition, the process of globalization, and the diffusion of best practices are operating to drive institutional convergence toward the Anglo-Saxon model: the specificities of national corporate governance disappear, and the liberal model gradually becomes unique (Hansmann and Kraakman, 2001). Other scholars do not agree with the victory of one corporate system over another and attempt to explore the extent to which the practices could in fact be effectively transferred (Aoki, 2007; Boyer, 2004; Clarke, 2009; Deeg, 2004; Jackson, 2007).

The debate on the convergence/divergence of national systems of corporate governance is closely related to the national varieties of capitalism in which the systems are embedded. Regarding corporate governance, many traditional academic studies concern two models: shareholder *vs* stakeholder. It is quite clear that these two models of corporate governance today are undergoing a gradual process of change. One of the outstanding features employed in this device is that changes in corporate governance practice in recent years have mostly occurred in coordinated market economies (CME). The process of transformation in CME is especially interesting from our point of view. From the perspective of the Variety of Capitalism literature, change in corporate governance is less likely to take place in CME than in liberal market economies (LME). Since CME are characterized by tight institutional inter-lock and discontinuous innovations, incremental changes in institutions are more likely to happen in these economies. The nature of the interlinkages and the complementarities of institutional subsystems in CME are often portrayed as obstacles to change (Amable, 2005; Aoki, 2001; Bebchuck and Roe, 1999; Hall and Soskice, 2002; Sako, 2007).

The evidence of the changes that are taking place in the corporate landscape has recently attracted the attention of the institutional approach, combining elements of the complexity of institutional settings and dynamic institutional change. According to the institutional approach, the issue behind the hypotheses on corporate governance reforms and ownership convergence is the character of institutional transformation overtime, and the key question to be asked is how it might be conceptualized (Aguilera and Jackson, 2003; Aoki, 2001; Boyer, 2005; Jackson, 2007; Lane, 2004; Morgan, 2004). The narrow focus of corporate governance exclusively upon agency problems between owners and managers presents a limited view to understand the extent and exact nature of current transformations in the corporate governance system. For example, agency theory cannot explain why there is a considerable variation in corporate governance models around the world. One important implication of the institutional approach is that corporate governance should be viewed as being embedded with various institutional contexts that shape the interaction among stakeholders in the process of decision making and control over firm resources. In this regard, it needs to be emphasized that corporate governance reflects institutional interconnectedness is not an isolated bi-lateral relationship between shareholders and company managers. Furthermore, corporate governance can be understood with system logic (Aoki, 2007; Gordon and Roe, 2004). This corresponds to a situation in which configurations of parts are connected and interact together continuously in a relationship with the external environment. These interdependencies play a central role in understanding institutional change: the corporate governance mechanisms do not exist in a steady state; the dynamic nature of the corporate governance leads to constant changes and modifications.

In this discussion, as Asia has long been considered as a case of CME, the process of competitive transformation in corporate governance practices in this area is of particular interest. As poor governance was identified as one of the major causes of the Asian financial crisis, there have been significant changes in the corporate governance framework since the crisis. As a matter of fact, the snapshot of changes in recent years, in particular legal reform and changes in ownership structure, suggest the tendency of convergence toward more market-oriented corporate governance systems as found in the Anglo-Saxon sphere. However, as far as we have seen, no detailed investigations have been conducted regarding the recent transformation of the corporate governance landscape in several Asian countries. For the most part, recent studies about this matter have tended to center on the questions of regulatory bodies' reform and focused on one or two more developed countries.

The aim of this study is to provide an overview of the recent changes in corporate governance practice in fourteen Asian countries in terms of institutional continuity and change.[1] To this extent, the literature on hybridization in corporate governance and financial markets is useful for understanding the ongoing corporate governance reform in Asia. The article is organized as follows. The first section briefly develops the theoretical framework for this study, focusing on institutional change as a process of hybridization. The second section explores changes in the Asian system of corporate governance and identifies both external sources of change and internal powerful actors who promote the process of transformation. The third section presents the main empirical findings by introducing emerging hybrid forms of corporate governance in Asia.

[1] Bangladesh, China, Hong Kong, India, Indonesia, Japan, Malaysia, Pakistan, Philippines, Singapore, South Korea, Sri-Lanka, Taiwan and Thailand.

1. Institutional change as hybridization

Although the role of institutions in the functioning of economies has been widely discussed in recent years, the issue of institutional change has not attracted much attention. In the 1970s and 1980s, as the conditions for economic transformation, successful economic development, and institutional reform were becoming increasingly central in economics, interest in institutional change began to grow significantly. The analysis of institutional change reminds us of the institutional complexity and provides us with important conceptual or theoretical tools for understanding the institutional change. The relevant literature, however, does not bear the same or similar tendencies in the process of institutional change.

Some recognize that institutional change is driven by a logic of selection according to the efficiency of institutions. In other words, institutional change is a functional response to a change in the environment that decreases the efficiency of existing institutions. This efficacy-based or functionalist theory stems from the idea that institutions set up by the actors are necessarily efficient — the rationality of the economic actors leads an institutional arrangement to be optimal. In this view, unless inefficient resistance intervenes, the transplantation of institutions is likely to be successful. According to this theory, corporate governance reform for better governance and performance can lead to a convergence of both ownership structures and the behavior of firms. However, the efficacy-based hypothesis tends to have difficulties in explaining the different institutional arrangement that accomplishes the same functions or why inefficient institutions survive for a long time in some countries. Despite claims that the rise of economic globalization is a competitive force that drives convergence toward the best form of the corporate governance (standard shareholder-oriented model), the resilience of the stakeholder model in most European or Asian countries would seem to contradict such a postulate.

Contrary to the proponents of the functionalist and efficiency arguments, some scholars developed the idea that institutions do not change rapidly, and they generally change in 'path-dependent' ways due to rent-protection behaviors, lock-in through sunk cost, and politics (Bebchuck and Roe, 1999; Hall and Soskice, 2001; Hollingsworth and Boyer, 1997; Roe, 1993, 1994). Much of the literature on institutional change within this perspective pays close attention to the history of the difficulties of institutional change, often arguing that institutions are strongly influenced by initial conditions and historical events making it possible for institutional inertia to arise. Based on dependency theory, some theorists have tried to push this perspective in a more dynamic direction that could explain institutional diversity. They argue that the process of institutional change leads to a ‘multiple equilibria’ situation instead of a convergence toward a unique equilibrium. The multiplicity of equilibrium solutions to identical economic problems could happen because the outcome depends crucially on the history. This is in sharp contrast to theories of the neo-classical economics tradition that focus on single outcomes.

With the concept of the path dependency, one of the most important insights about institutional change concerns complementarities among institutions. The notion of institutional complementarity refers to the joint influences of two or more institutions in different domains of the economy. We could say that two institutions (A and A’) are complementary when the return (R) of the conjunction of A and A’ is higher than the return of each individual institution.

$$R(A, A') > R(A) \text{ and } R(A, A') > R(A')$$

For example, complementarities may extend to such things as financial institution and industrial relations. In the United States, the short-termism in investment strategies, the developed stock market, and the weak representation of employees in management result in the shareholder-oriented corporate governance. In contrast, in Germany and Japan, the coordinated model of corporate governance results from the corporation’s long-term relationship with banks and the long-term commitments to employees. The concept of institutional complementarities is largely used to explain why these diverse forms of capitalism persist and why institutional change tends to occur in an incremental fashion, rather than a radical change. Recall that the varieties of capitalism literature argue that the most important differences among nations stem from the presence of institutional complementarities and institutions change in a path-dependent manner. The use of the notion of complementarity looks static since the strong complementarities could lead to inefficient lock-in effects. Conversely, this vision could be understood in a more dynamic way. As Aoki emphasizes, complementarities suggest potential institutional change because changing one institution implies change in complementary institutions as well since they are tightly interconnected.

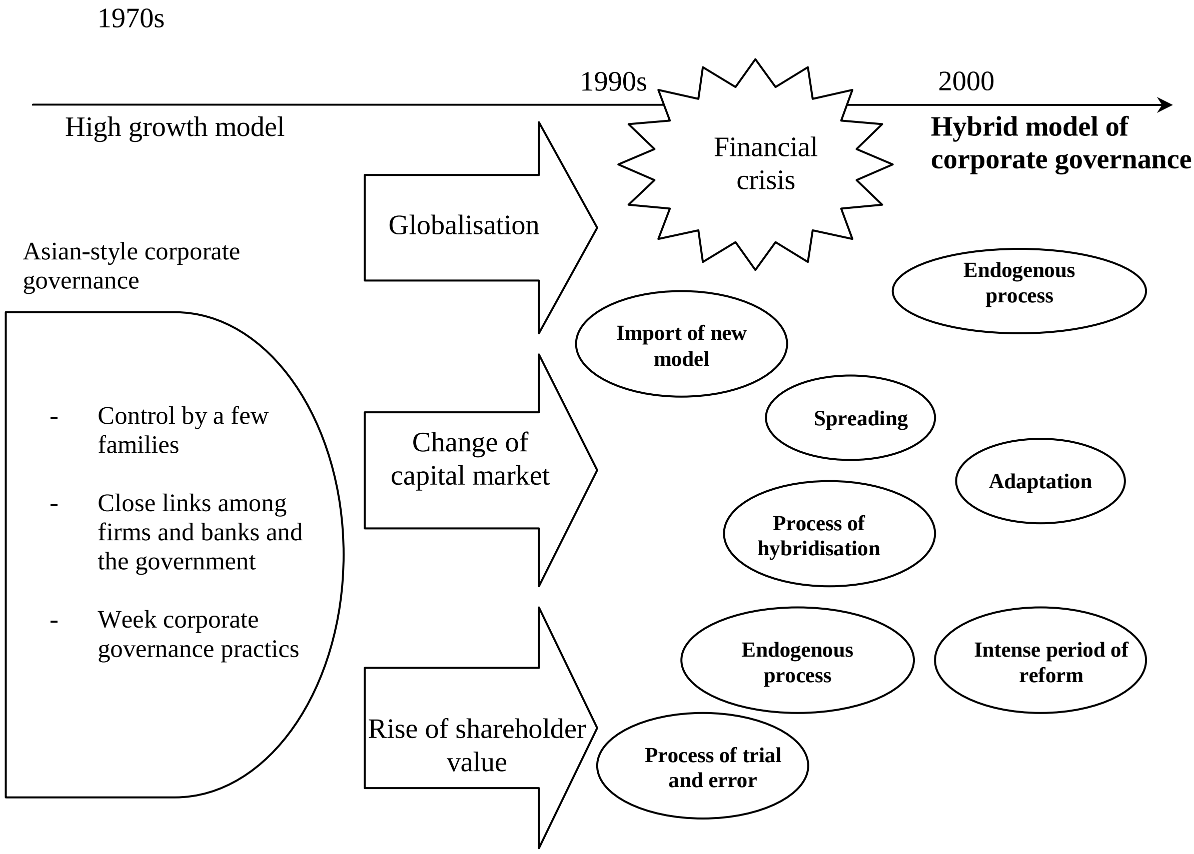
Another important insight about institutional change is the notion of the hierarchy of institutional forms. The hierarchy of institutional forms describes a configuration in which transformation of a particular institutional form drives to a change of one or several other institutional forms. For instance, Boyer (2000, 2005) showed that internationalization and financialization have precipitated changes in the forms of competition and in the organization of the wage labor nexus of Fordism. The complementarity of the institutions may come from the existence of a hierarchy in which certain institutional arrangements are designed to be compatible with the dominant institution.

In this paper, we argue that the current transformation in the corporate governance systems is experiencing the process of hybridization. We also place great importance on the influence of internal dynamics — changes initiated endogenously by the role of actors and inner tensions among institutions. Early observations of institutional transformation assume that change is precipitated by exogenous shocks of various sorts. This is common for the approach of the path dependency theory and theorists who conceptualize a change in the institution as a functional response to technological and environmental conditions. But more recent interest in institutional change has introduced questions about the endogenous sources that bring about change. Thelen (2003), for example, developed mechanisms of change that may arise endogenously within the path that lead to profound change: *layering* and *conversion*. Thelen's essays gave fresh impetus to the debate about understanding the nature of institutions as well as their change. Related to endogenous sources of change, there is also the argument that institutional transformation can be triggered endogenously by individual and collective actors. The term '*institutional entrepreneurs'* has been presented to describe their role in creating new institutions or shifting existing ones in another direction for actors' interest. (DiMaggio, 1988). According to the institutional change view argued by Deeg (2004), coordination between economic and political actors is needed to initiate changes in the institutional framework. In a similar vein, regulation theory employs the concept of '*endometabolism*' to formalize endogenous processes of structural change. '*Endometabolism*' is defined as the 'process by which the functioning of the structure alters the structure itself' (Saillard and Boyer, 2002). Boyer (2004) uses this notion to show the transformation of the accumulation regime in the USA and in Japan through its own internal dynamics. In his paper, the author argues that the dynamics of the transformation of capitalism have rendered it necessary to consider the concept of '*endometabolism*' and hybridization.

Recently, interest in the hybridization of institutional forms has understandably been gaining visibility in the face of substantial transformation in core institutional arrangements. Hybridization refers to the dynamic process of transfer and adaptation of an organizational practice from one context to another (Boyer, 1997). Hybridization involves the transformation of imported institutions via the interaction with different national and institutional contexts and the attempts to reconcile two approaches initially seen as contradictory, so the emergence of original configuration. This concept of hybridization has been applied in research of production models in the automobile industry (Boyer, Charron, Jürgens and Tolliday, 1998) and more recently in the forms of corporate governance (Aoki, 2007; Boyer, 2005; Jackson and Miyajima, 2007). The concept of hybridization presented here rejects the dominant discussion of the transportability of a particular practice around the world, leading to convergence toward a single best model. Hybridization also stresses heterogeneity among the institutions (Höpner, 2001; Jackson, 2003). Morgan (2005), in support of this thesis, focused on how institutional heterogeneity facilitates innovation through re-orientation in thinking of actors with alternative strategies when many key elements of the old system remain.

In this respect, we argue that the direction of corporate governance reform in Asia involves experimenting with hybridization processes by undergoing adaptation of a new model to local circumstances supported by economic actors and political leaders. Through the process of trial and error, the outcome of the confrontation between newly imported practices and existing ones is highly uncertain, leading to divergent corporate governance models. Although the adoption of shareholder value is spreading through Asian's countries, the impact of this movement will be expressed in many different ways in different countries. Figure 1 shows the new institutional path of Asian corporate governance as an outcome of a combination of exogenous and endogenous factors.

Figure 1-Transition of Asian corporate governance



2. Review of changes in corporate governance and finance

2.1. General features of Asian corporate governance

Before we embark upon an analysis of the changes taking place in Asia's corporate governance, we will briefly examine the historical sketch of the preceding model. Asian corporate governance systems are very different from the Anglo-Saxon system in which the ownership of the firm is dispersed across a multitude of various categories of shareholders—the 'outsider' system. In many Asian economies, concentration of ownership, usually an individual or a family, is a common phenomenon, and the dominant shareholders play a key management role in the firm—the 'insider' system. Often insiders may control a company without owning a large block of shares by using some combination of parallel devices: pyramidal ownership, cross-shareholdings, and dual classes of shares (Bebchuk, Kraakman and Triantis, 2000; Classen, Djankov and Lang, 2000; Drysdale, Hong, Kang and Park, 2004; La Porta, Lopez-de-Silanes and Shleifer, 1999). The differences in the ownership and control structure may produce different corporate issues. The most significant corporate governance issue in Asia is alleviating the conflict of interest between the controlling and minority shareholders whereas in the Anglo-Saxon model the agency problem basically arises between shareholders and managers. According to modern corporate governance theory, concentrated ownership is regarded as one strategy to overcome the agency problem between shareholder and managers (Shleifer and Vishny, 1986; Claessens et al., 2000). The controlling shareholders are likely to have strong incentives to monitor managers and replace poorly performing management, which are the benefits that minority owners also enjoy. However, numerous studies have made the point that such concentrated ownership can engender costs as well. There are two hypotheses explaining the negative effects associated with large shareholders. The first one emphasizes the opportunistic behavior of large shareholders toward small owners (Demsetz and Lehn, 1985; Faccio and Lang, 2002; La Porta, Lopez-de-Silanes and Shleifer, 1999). In this case, large investors may attempt to seek benefits driving from expropriation of minority shareholders. A second problem is associated with a trade-off between liquidity and control. Large shareholders are willing to keep some shares off the public market, as it can lead to reducing the liquidity of stock market. The relationship between concentrated ownership and liquidity has been addressed by a number of studies, including those by Heflin and Shaw (2000), Holmströme and Tirole (1993), and Biebuyck, Cappelle, and Szafarz (2005). Generally, large shareholders tend to prefer retaining ownership and control to having liquidity for strategic reasons. This issue is even more significant given the lack of protection of minority shareholders and transparency of information (La Porta, Lopez-de-Silanes and Shleifer, 1997).

Other particular characteristic of the Asian corporate landscape is that banks typically dominate the corporate finance markets and often have complex and long relationships with companies. Before the crisis occurred, this close relationship between banks and firms was regarded as a strength relative to the arm's-length relationships of equity markets since this relationship allowed firms to have a lower cost of capital and higher investment. Due to the over-dependence on banks in this area, direct financing by firms through the capital markets was not a common source of finance. The Asian model has also been associated with strong state intervention in the market. The government has decided, for example, the amount and type of loan to be allocated to certain borrowers. Often, the government selected industries for development and required banks to lend money to borrowers even when they were unable to repay. Thus, the bundle of characteristics of those economies result from the complementarity between banks' long-terms relationships with client firms, ownership concentration, government role in credit allocation, and weak disclosure standards. The nature of these interlinkages protects companies from hostile takeovers and short-term stock market pressures. As in the bank-based financial system with few legal rules to ensure transparency and to protect minority shareholders, it is by no means a coincidence that ownership has ended up being relatively concentrated.

2.2. Key trends in the change in the corporate governance landscape

Though the Asian model may have contributed to rapid economic growth during the past three decades, the Asian crisis has revealed a major weakness in the inter-connections system of the region (Claessens and Fan, 2002; OECD, 2003; World Bank, 1998). Notably, banks, which were often under the strong influence of government or large family shareholders, could not really be effective at monitoring firms, particularly when those borrowers are selected by the government. Another weakness was that the dominant position of bank intermediaries associated with an implicit government guarantee led to the underdevelopment of capital markets. This problem undoubtedly stems from the absence of the incentive for regulatory authorities in order to reduce agency costs and protect minority shareholders, which in turn caused the inefficient allocation of resources in these economies.

Thus, Asian countries have come under severe internal and external pressure to reform their financial and corporate governance systems since the near-collapse of economic systems in 1997. Despite very real differences in reform processes in different countries, the main objective is to improve shareholder protection and to develop an external control with improvements in the legal system and the disclosure environment. Several drivers of corporate governance reform have been associated with the economic crisis. First, the progressive deregulation of financial markets has allowed an increase of equity flow into Asia, thereby increasing the availability of funds, including bonds and equity. Growing choices in sources of financing led to a progressive erosion of the over-dependence on banks in financial intermediation. Second, in response to globalization and the governance scandal, large companies appear to be adopting global standards and practices, and enhancing corporate transparency since corporate governance figures prominently in investment decisions. As the new Anglo-Saxon logic of corporate governance is diffusing beyond the major listed firms, the maximization of shareholder’s equity is became more and more corporations’ central objective. The last, but not least, innovation in information and communication technologies (ICT) has been an important source of change. ICT allowed financial markets to evaluate the firms more efficiently, since it enables borrowers to access much more information about the firms in a more timely manner than non-ICT sources may allow.

It seemed evident that the economic crisis and the acceleration of the globalization process initiated reforms and changes. But all these factors depend not only on external shocks but also on the endogenous process of change. Changes were spurred as part of the domestic players' efforts to establish stable financial systems and better corporate governance, in particular in the reconstruction of the banking sector and development of capital markets. Core economic actors and political leaders have begun to be challenged to recognize their old practices, which do not fit well with the new 'rules of game.' Enough has been said to demonstrate that Asian regulators and policy-makers have been extremely active in reforming the corporate governance code and trying to enhance the efficiency of the capital market since the crisis. The Asian Corporate Governance Association (ACGA) (2005), OECD (2008), Asian Development Bank (ADB) (2008), and Andrew Sheng (2006) provide an overview of recent Asian corporate law reform. In addition to external factors that played an important supporting role by imposing discipline on economic policies, there is no doubt that there was considerable will of decision-makers to promote internal change. Accordingly, the external forces combined by remodeling the old institutional forms by both market and political actors have given rise to recent institutional change in Asian economies.

An important component of the changes in Asia in recent years related to corporate governance is the growing importance of the stock market. The ratio of market capitalization to GDP as a measure of stock market development has almost tripled in the region since 1997 (IMF and World Federation). Within the set of Asian stock exchanges, the Tokyo stock exchange is the largest stock exchange in terms of market capitalization followed by the Shanghai and Hong Kong stock exchanges. Over the past ten years, Asian governments have launched several initiatives to develop domestic markets and to be less dependent on bank loans. Countries in the region have made considerable progress in strengthening financial-sector supervision and regulation. One reflection of the efforts over the past decade is that the stock market is now playing an increasing role as a funding source (from 33. 5% in 1996 to 37. 4% in 2006) along with declining bank dependence.

Another interesting change is the increasing foreign ownership in Asian listed firms, in the sense of contribution to improved corporate governance. The fast-growing equity investment by non-residents was observed even before the crisis broke out in 1997. It is not unreasonable to postulate that the structural improvements in regional stock markets could boost the region's attractiveness to foreign investors. Another underlying factor is the restriction on foreign investor participation in equity markets has been gradually diminished over time. The emergence of several types of institutional investors as increasingly important participants in the stock market is also a part of the picture of present ownership structure. According to our analysis, investment industry assets grew from $439,606 million in 1997 to $2,310,240 million in 2008, an increase of 426 percent. In some cases, foreign financial institutions hold more than half of the total shares of institutional investment. Especially, the shareholding ratio of American institutional investors has surged dramatically in recent years. For example, Korea and the Philippines are the countries where the American investors' detention rate is more important. This rate rises to 54.39% in the Philippines and 47.44% in Korea. Kho, Stulz and Warnock (2006) have pointed out that American investors increased their investment in countries in which insider ownership is low or diminished. In light of these considerations, it is highly probable that the loosening of traditional cross-holdings and interlocking directors' structures in some countries has led to the increase of foreign ownership (Kuroki, 2003; Kuroki and Miyajima, 2007; Nitta, 2008; Gu, Sim and Jung, 2008; Scher, 2001). Furthermore, the decline of complex ownership structures can also be seen as the change of the manner in which the corporate finance and ownership structures are linked to each other. Due to the increased globalization of investment, foreign investors can be expected to have an important influence in many countries.

Other recent changes include the banks' new role. Since the crisis, there has been substantial privatization and consolidation in the banking sector. Responding to growing competition and liberalization in the investment banking sphere, many Asian banks in recent years have significantly altered their strategy from providers of debt finance to active actors in capital markets. Banks in the region have been traditionally engaged in lending and deposit-taking activities with corporations and households. Although retail banking financial activities remains the core business, many retail banks have begun to diversify their operations into different products and markets: universal banking and bancassurance. The ADB (2008) investigated the Asian banking systems since 1997 crisis and assembled data showing the banks' operational diversification in Hong Kong, China, Korea, and Singapore is especially notable.

2.3. Persistence of the Asian model

With greater pressures from international governance standards, the developing influence of institutional investors, and endogenous changes in firms, a process of corporate governance reform in Asia will likely attempt to approximate some form of 'one-best-way' strategy adopted by the convergence thesis; it looks like only a matter of time. However, this perspective has little bearing on the persistence of many features of the traditional characteristics and the rising new path between the shareholder-oriented model and the Asian model. For example, despite the collapse of the banking sector during the financial crisis, the role of banks as intermediaries is still significant in Asian systems. Banks remain the key players in external finance, and their dominance may be maintained by diversifying their activities as mentioned earlier. In addition, the rapid development of stock markets in Asia does not suggest that the stock market plays an active role in disciplining corporate management as in the shareholder model; many countries still have relatively small stock markets.[2]

Table 1 presents data on the structure of shareholding of listed firms by type of owner in 2006. Several important trends appear in the ownership structures in Asia. As we can see, though institutional investor ownership may be gaining ground due to the process of financialization and in part due to changing demographics, strategic investors play an important role in corporate governance (52.75%). The Asian pattern of share ownership looks quite distinct from that of its Anglo-Saxon model in which ownership of capital is dispersed among institutional investors. In the countries like Hong Kong (86%), China (83%), and Indonesia (83%), there is a preponderance of the strategic ownership structure.

Table 1- Break-down of market capitalization by type of shareholders

	%/ Total
Sovereign Wealth Fund	10,44%
Hedge Fund	0,73%
Investment Advisor (Mutual Fund + bank +Insurance Company)	25,80%
Pension Fund	0,68%
Private Equity	0,29%
Others	0,46%
Total institutional investors	38,40%
Bank	5,55%

[2] World Federation of Exchanges

Corporation	41,95%
Government Agency	4,40%
Insurance Company	0,84%
Total Strategic Entities	52,75%
Total Individual	8,85%
Total	100,00%

Source: Author's calculation based upon data from Thomson Reuters.

Regarding the investor sub-categories, the predominant ownership pattern is corporation control. It seems that this pattern is consistently linked to the participation of business conglomerates, such as chaebol in Korea and keiretsu in Japan, and family business groups. In addition, the emergence of sovereign wealth funds (SWF) as increasingly important participants of equity assets is one of the distinguishing features of the present financial landscape. SWFs are not a new phenomenon in the region,[3] yet the number of SWFs has grown rapidly due to the region's remarkable accumulation of foreign exchange (FX) reserves in the post-crisis period. The surplus FX reserves can be interpreted as Asian countries' intention to protect their economies against the massive outflow of capital since the crisis. A shift of FX reserves into such funds is likely to continue in the years ahead for managing FX more actively. If pension funds remain a marginal investment category in the stock market, pension funds might have been invested in domestic government or corporate bonds in Asia though they globally have enjoyed phenomenal growth across the industrial countries. Consequently, it appears that the corporate governance system in this region is in a state of flux and strategic investors, institutional investors, shareholder value, and owner's long-term stable relationships with the company continue to be negotiated.

3. Growing variety of the Asian model

In this section, we employ a cluster analysis to analyze the pattern of change of corporate governance in Asia.[4] The data used in our analysis are drawn from a number of sources, primarily the 2008 Financial Development Report and Thomson Reuters. Our sample

[3] The history of Singapore's SWFs (Government of Investment Corporation [GIC] and Temasek Holdings) dates back to the 1970s.

[4] We performed a hierarchical cluster analysis using SPSS. Hierarchical clustering is appropriate for smaller samples like our analysis. We requested the Dendrogram in the output using the Ward Method to have a visual representation of the distance at which clusters are combined. Four methods of combining clusters (single linkage, complete linkage, average linkage, and Ward's method) were initially used to have better results. These procedures provide a good test of the reasonable number of clusters.

contains 14 countries, and the data obtained from Thomson Reuters include shareholders whose fraction of shares is more than $5 million in each country. Within this sample, there are 11,147 equity investors in 14 countries' stock markets at the end of 2006. Ten variables were included in our analysis in which we examine four possible outcomes from the present insistent pressure to deliver shareholder values, and the institutional persistence encountered.[5] We cross two criteria: the financial dependence (banking deposits/equity securities), which contrasts the Anglo-Saxon financial system with the continental system as represented by Asia and continental Europe, and the ownership characteristics are concentrated or dispersed (strategic investors /institutional investors) (see Table 2).

Table 2 - Different Processes of Change

	Instiutional investors	**Strategic investors**
Bank finance	Inverse Hybridization	Model A
Market finance	US Model	Hybridization A

a) Inverse Hybridization refers to the hybrid pattern in which there is strong bank finance but a high level of participation of institutional investors.

b) Model A refers to the traditional Asian model, which has not committed to the reform of corporate governance. The attributes of this model are diametrically opposed to the US model.

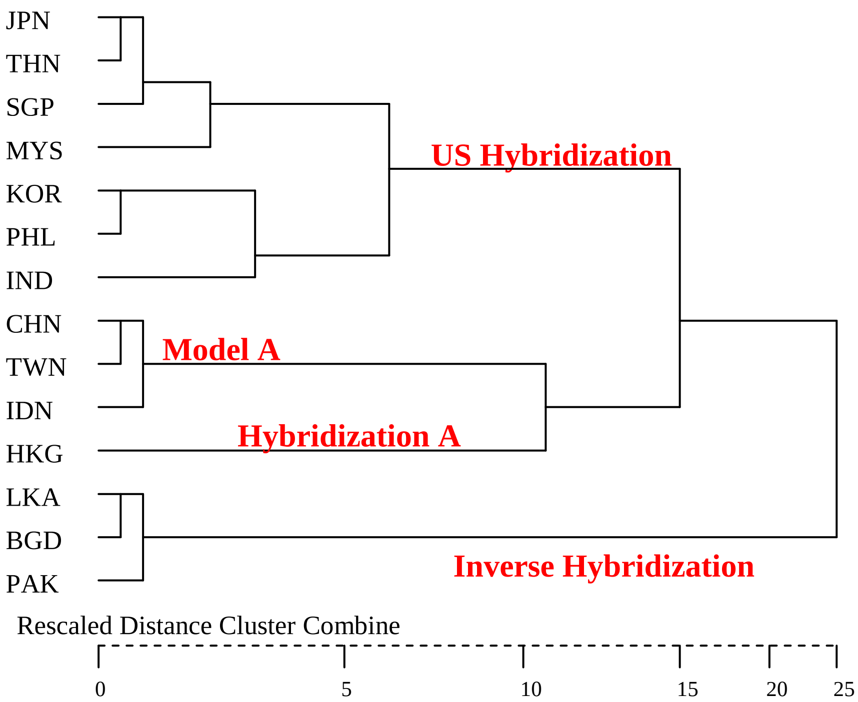
c) US model assembles market-oriented finance and diverse ownership characteristics.

d) Hybridization A represents another hybrid model. The countries in this group use market finance as a source of finance but retain high levels of ownership by strategic investors.

The cluster analysis results are summarized in Figure 2. Contrary to all of the predictions of convergence theory, the approach allows us to apprehend the diverse pattern of corporate governance even within the current context of adherence to the Anglo-Saxon model. As can be seen in Figure 2, four groups are identified involving financial and ownership characteristics.

[5] The variables used and their descriptions are listed in Appendix Table 1.

Figure 2- Actual pattern of Asian corporate governance



Note: Dendrogram from ward's method of cluster analysis

Countries in the first group (Model A: China, Indonesia, and Taiwan) represent the traditional Asian model in which banks are the dominant institutions providing finance and the key shareholders are strategic investors. The results also show that these countries exhibit low corporate governance scores, especially in the categories of auditing and accounting standards and the protection of minority shareholders' interests. Although reform continues to progress slowly, the China stock market remains dominated by state-owned enterprises and family-controlled companies dominate the corporate landscape of Indonesia and Taiwan.

In the second cluster (Hybridization A), the role of equity finance is central, but the pattern of ownership is characterized by strategic investors. Only Hong Kong belongs to this group. Large family business groups are still prevalent, but Hong Kong appears to maintain significantly higher scores on all variables of corporate governance than the rest of the countries. The family-based system is being reformed gradually, and foreign investors' ownership in Hong Kong is high. Both the banks and the equity markets are much stronger than those in other Asian countries. Given the special features of Hong Kong, the combination of strong equity market orientation and family ownership does not necessarily imply compatibility, but this inverse hybrid pattern suggests the emergence of unexpected complementarity by incremental but transformative changes in institutions.

The third cluster is not presented in Table 2. We find a hybrid model that can be described as the intermediate position between the model A and the US model. We call this group as US Hybridization. This cluster is more heterogeneous than the other clusters and can be further divided into three sub-groups. Countries of the first sub-group (3a) have made progress on building good governance and attained increased participation of institutional shareholders. This group includes Malaysia, Singapore, Japan, and Thailand. The long-term economic slump and banking crisis in Japan led to a significant decrease in cross-shareholdings between banks and corporations and among corporations. As an international financial center of the Asian region, Singapore had high standards of disclosure and corporate governance even before the crisis. Although this country has not been severely affected by the crisis, Singapore promoted the divesture of government ownership and relaxation of the foreign ownership limit. The second sub-group (3b), which includes Korea and the Philippines, has strong foreign investors and is more likely to adopt market finance. Meanwhile, the levels of ownership by strategic investors are higher than in the 3a group. Finally, the third sub-group (3c)—India—is actually very similar to the US model among Asian countries with high levels of institutional ownership and equity-oriented finance, as well as strong reforms in terms of accounting standards and disclosure requirements. In all events, we observe changes toward market-oriented finance and ownership in this cluster, and they are now the predominant patterns based on the number of countries among Asian countries.

The countries in the fourth cluster (Inverse Hybridization) show the lowest level of reform in corporate governance (Bangladesh, Pakistan, and Sri Lanka). The strong use of banks as sources of finance is similar to the model A, but foreign institutional ownership dominates these countries, because the undeveloped equity market and the absence of investor protection in these countries were not sufficient for domestic investors to emerge, in contrast to foreign investors who are driven by profit opportunities in emerging markets.

In general terms, the analysis shows that there is no radical institutional change toward identical systems of governance; instead, a diverse mode of corporate governance practices exists in Asian countries. Since there is broad diversity in the way that corporate governance change is implemented based on different institutional environments, the evolving patterns in different countries are naturally different. In view of the recent evolution, corporate governance in Asia can be described as being in a ‘hybrid model,’ with a mixture of new market-oriented elements and old practices of the Asian model. Given the traditional complementarity among banks, firms, and government through family and ownership connections in sources of competitiveness, such a move to a new (hybrid) path would then question the robustness of actual new institutional arrangements. This question has implications extending to how we identify complementarity between two different logics of governance. A relevant way to answer this question is that institutional complementarity does not mean compatibility among institutions. Boyer (2005) suggests that institutional complementarity needs to be distinguished from compatibility. Compatibility among institutions is generally observed *ex-post*, rarely in an *ex ante* design.

Conclusions

Having briefly discussed the nature and the outcomes of institutional changes, this article presented a theoretical tool to help us better understand the recent change in two important aspects of the corporate governance features of Asian companies: ownership structure and financial arrangement. The dynamic properties of the corporate sector, which requires constant interaction with different elements of the system and keeps up with the ever-changing scenario, provide a better understanding of the changing patterns.

In this study, we examined the direction of the changes in Asian countries' corporate governance systems, and whether the current trend converges toward the shareholder-based model. Our empirical data and analysis suggest that the current Asian model could be conceptualized as a hybrid form and this new path would be more complex than the old one. Even a series of legislative and regulatory changes in Asia have been patterned after the US model; the reform was undertaken with the view of improving corporate governance in the region through learning from failures and achievements from the past - not just copying best practices. It would be a serious oversight to conclude that global best practices, which may not exist, will work on different grounds. Jacoby's work (2001) offers useful insights into the globalization of corporate governance, focusing on the notions of institutional complementarities. In contrast to the much-studied transportability of corporate governance practices around the world fostering convergence, he pointed out that it is difficult to expect the same performance or outcomes when particular practices are imported from one country to another. Against the claims that the shareholder-oriented model is optimal, a more realistic global perspective may be that an optimal model is contextual and varies with economic, political, and social conditions.

This paper does not argue that the hybrid model can necessarily result in a stable system. The change in corporate governance is not supposed to be finished, and new developments take place even today. The insider characteristic of the governance system involving equity finance and shareholder value can lead to tensions and disequilibria among core actors and institutions during the trial period. It is true that there are a number of barriers or instabilities to move toward a new mode of corporate governance in several Asian countries. These moves are all in their initial stages, and the directions this will take moving forward remain open. The scenario for continuous adjusting of a series of institutional forms that are initially disconnected and independent might be more complex and unpredictable. Of course, we believe that fundamental questions about the effectiveness of new models of corporate governance in the future remain. It seems an open question whether they can play a role in economic growth compared to the past period of the "Asian miracle" model, and face a big challenge to balance traditional systems and Western style.

Certainly, the present paper was limited in scope. One of the limitations of our article is that it covers only listed companies. Further studies of different large-scale assessments are needed. The change in small and medium-sized firms as well as some internal aspects of governance, such as board reform and employee participation, should be addressed.

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Appendix

1. Data description.

Ownership	
II	Ratio of institutional investors
SI	Ratio of strategic investors
Foreign	Ratio of foreign investors
Financial dependence	
Bank	Bank borrowing ratio
Equity	Equity ratio
Corporate governance rating	
EIC	Extent of incentive-based compensation Based exclusively on salary or performance-based benefits (bonus, stock options, etc.)
ECB	Efficacy of corporate board
RPM	Reliance on professional management
SAS	Strength of auditing and accounting standards
PMSI	Protection of minority shareholders' interests
CG total	Total Index of corporate governance by country

2. Correlations among the observed variables.

	Bank	Equity	EIC	ECB	RPM	SAS	PMSI	CGtotal	Foreign	II	SI
Bank	1										
Equity	-,570*	1									
EIC	-,356	,494	1								
ECB	-,380	,345	,754**	1							
RPM	-,369	,246	,640*	,938**	1						
SAS	-,710**	,635*	,381	,618*	,598*	1					
PMSI	-,702*	,415*	,427	,697*	,561	,725**	1				
CGtotal	-,329	,707*	,220	,403	,445	,779**	,350	1			
Foreign	-,376*	,101**	-,502	-,557	,579*	,070*	,068**	,149**	1		
II	,264	176*	-,419	-,255	-,152	,398*	,244*	,390	,686**	1	
SI	-,275	,298	,420	,202	,102	-,358	-,196	-,304	-,575*	-,967**	1

*. Correlation is significant at the 0.05 level (2-tailed).

**. Correlation is significant at the 0.01 level (2-tailed).