8-1-2006

The Effects of Corporate and International Culture on Achieving and Maintaining Strong Corporate Governance

Cindy Saad
Pace University

Follow this and additional works at: http://digitalcommons.pace.edu/honorscollege_theses

Recommended Citation
http://digitalcommons.pace.edu/honorscollege_theses/28

This Article is brought to you for free and open access by the Pforzheimer Honors College at DigitalCommons@Pace. It has been accepted for inclusion in Honors College Theses by an authorized administrator of DigitalCommons@Pace. For more information, please contact rracelis@pace.edu.
The Effects of Corporate and International Culture on Achieving and Maintaining Strong Corporate Governance

Abstract

The issue of implementing strong corporate governance has grown immensely in recent years, and has shifted the way organizations structure their decisions, from board composition to reporting and compliance processes. In light of the numerous scandals ranging from Enron to WorldCom, among others stemming from the dot.com boom and bust of 2000, some steps have been taken to restore investor and regulator confidence, Sarbanes-Oxley being the most popular phrase relative to corporate governance concerns here in the United States. Compliance and regulatory reporting have come to the forefront of firm priorities, but there are still implications for achieving strong corporate governance that need further solution development. The implication I will be exploring in this paper is twofold, that of the affect of culture on influencing, and the implications for establishing and maintaining good corporate governance. The aspect of corporate culture will be discussed, and then the more globally related subject of international culture, the cultural dimensions, and the implications they pose for global firms for achieving strong corporate governance. Findings on corporate and international culture relative to corporate governance will be based on the five elements of corporate governance to manage strategic risk, by Drew, Kelley and Kendrick, among other factors relevant to investors.

1. Introduction to Corporate Governance

In 2002, the Sarbanes-Oxley Act was passed in the United States, providing the costly but necessary need for more senior executive oversight toward risk and extensively
detailed reporting, as well as more streamlined processes. Of course, we live in a
globalized market, and so the need to develop stronger oversight extends well beyond the
United States. In the United Kingdom, the Turnbell Report achieves the same purpose, as
does the European Commission’s agenda. While these are just some steps toward
changing the way companies view and implement good corporate governance and
adopting the priority of ethics as a firm value, they still do not speak to managing risk in
terms of firm success, competition and a myriad of other important aspects, but after all,
this is a beginning of a worldwide business reform that still has a long way to go.

Corporate governance has been given many definitions and can be seen from
several perspectives. For instance, economists define corporate governance as “the
institutions that influence how business corporations allocate resources and returns” (O’
Sullivan, 2000) and “the organizations and rules that affect expectations about the
exercise of control of resources in firms” (World Bank, 2002). As Salacuse points out,
corporate managers, investors, policy makers and lawyers view corporate governance
even more specifically as “…the system of rules and institutions that determine the
control and direction of the corporation and that define relations among the corporation’s
primary participants- the shareholders, board of directors, and company management”
(Monks and Minows, 1995).

There are variations in industries and how they distinctly model their businesses
and operations, there are variations in cultures across the world and the values and
priorities each tend to attach to certain behaviors and business practices, so naturally, it
would be a daunting challenge to establish one set of rules that can be applied to all.
However, steps can be taken to at least provide guidelines and understanding of what
certain cultural values imply, what particular behaviors stem from, and suggestions for responding to such implications that may arise in the efforts to establishing and maintaining good corporate governance. As Gandossy and Sonnenfeld (2005) state, “good governance cannot be legislated even though vague guidelines can exacerbate bad governance”. Similarly, cookie-cutter governance templates would be impractical and would not accommodate globally sensitive standards. The Securities and Exchange Commission chief Donaldson expresses this concern best:

“I believe we should go slowly in mandating specific structures and committees for all corporations…there are vast differences in the function, structure and business mandate of the thousands of corporations struggling with the issues of good corporate governance. I believe that these differences dictate that once the board determines the ethical culture that is to prevail, each company board should be afforded a level of flexibility to create their own approach to its structure…to insist on one rule for all belies the dynamics of the fast changing business and corporate environs and the nature of varied business situations” (Gandossy and Sonnenfeld, 2005).

Donaldson also states that one of the most interesting evaluations of boards he’s ever read was conducted by an organizational behaviorist, which is fitting as many of the aspects of corporate governance discussed in this paper deal with social and human interactions and belief systems, in a corporate and national cultural context. While certain controls within firms are quantitative and can be measured against standards, benchmarks and requirements, controls for human behavior and interaction are naturally qualitative, and are extremely different, requiring very different considerations.
Drew, Kelley and Kendrick (2006) present five elements of corporate governance relevant to managing strategic risk. Strong corporate governance can be achieved by managing strategic risk properly, and upon closer inspection of the various ailments that caused the failures of companies such as WorldCom, Enron, and Lucent, among many others, clearly, the poor judgment and management of strategic risk by top executives and managers contributed greatly to their troubles. Drew, Kelley, and Kendrick organize the elements of corporate governance into a five-element model comprised of: Culture, Leadership, Alignment, Systems, and Structure (hereby referred to as CLASS).

According to Drew, Kelley, and Kendrick, the five elements cannot stand alone, and instead exist in an interrelated and interdependent relationship. They argue that corporate culture is shaped and influenced by the firm’s leadership, and similarly, systems support structure, thereby also shaping corporate culture. The element of alignment serves to harmonize all five elements in an, and so culture is also reinforced by the firm’s leadership, and systems reinforce culture. According to Sison (2000), “corporate culture” relates to “national culture” via the “…shared values of their members and citizens, respectively”.

2. Corporate culture relative to risk

A firm’s corporate culture provides a framework of the values and social norms within which managers and other employees derive their behavior and performance patterns from and operate in; corporate culture, therefore, influences strategy, decision-making ability, and judgment. Nowadays firms encourage employees to pursue the role of team player, and if the culture of the company encourages engaging in questionable business practices to achieve certain target and performance objectives, a manager may
be inclined, and pressured, to do as senior executives expects from him or her, for fear of implications for his or her career growth and even sustained employment with the firm. Drew, Kelley, and Kendrick refer to such a threatening environment as the cultural intolerance for failure, and further explain that this type of corporate culture will lead to excessive risk-taking, rule-bending, and system manipulation.

Another corporate culture characteristic that would adversely affect performance behavior is that of one that encourages profit chasing through any means necessary, a behavior pattern that at times might be motivated by such things as performance incentives, for example, bonuses, tremendous pay packages, and company perks (loans, aircraft, et cetera). Such materialistic incentives contribute largely to forming a short-term vision focus for employees, according to Castellano and Lightle (2005). Gandossy and Sonnenfeld refer to this as “golden shackles”, a term for the great financial temptation and pressure to overlook wrongdoing. Excessive internal rivalry may also lead to poor judgment and decision making, since the manager is not acting in accordance with the company’s goals but his or her own relative to outperforming fellow employees; internal rivalry may be caused by pressure to make the numbers, as stated by Castellano and Lightle. Unfortunately, as pointed out by Gandossy and Sonnenfeld (2005), employees are recognized for their performance and dollar savings, but not very often for being careful.

Gandossy and Sonnenfeld (2005) discuss a culture with the tendency for the diffusion of responsibility of seeing and acting upon wrongful practices and behavior. Diffusion of responsibility is caused by “Bystander apathy, the division of responsibility between specialists and organizations, obedience to the authority and professional codes of
conduct…” (Gandossy and Sonnenfeld, 2005). This type of corporate culture will not prioritize accountability and would result in the oversight of information needing much attention that may prevent business failures and disasters. The concentration of vital information in few hands and lack of information sharing is also destructive to companies, as it not only allows room for devious motives and actions, but also creates a corporate culture of alienation and detachment of employee to firm. Instead of feeling a part of and performing in a team environment, a manager may feel exclusive from the firm and its activities, and such discouragement might result in the pursuit of self-interests at the firm’s expense.

The persecution of whistle blowers will discourage managers from voicing concern over potential problems within the firm, creating a fear driven working environment, and affecting performance significantly. According to Gandossy and Sonnenfeld (2005), whistleblowers all too often meet resistance and conflict in response to their actions, due to the challenging of the “…deniability some seek in an effort to hide within the layers of the command structure”. According to Simms (2003), some corporations do not embrace the concept of whistleblowing because they feel it will only be an outlet for anonymous complaining or “mischief making or may lead to a culture of denunciation”. Other firms, where the culture promotes cosiness and familiarity and everyone knows each other, feel they have no need for whistle blowing policies. However, this only makes it harder to report unethical corporate practices, as employees have no resources to reach out to, and the underlying problems will eventually simply snowball beyond the firm’s control, making it too late to take any corrective action. The negative attitude toward whistle blowing is due to the approach firms at times have taken with such policy. They have
presented it as a “defensive measure, rather than as part of good corporate governance and corporate social responsibility”, according to Guy Dehn in Simm’s article.

Overall, potential cultural characteristics of firms that Drew, Kelley, and Kendrick state can be counterproductive to achieving good corporate governance and risk management are summarized as follows:

- Unethical behavior
- Excessive internal rivalry
- Intolerance of failure
- Propensity for risk-taking
- Secretiveness
- Persecution of people who speak up (“whistle blowers”)

Therefore, in pursuing the attainment of strong corporate governance, it is crucial for a firm to hold corporate culture’s affect on performance as a top priority, and build on such an initiative through various employee programs that promote and solidify an established culture that encourages positive work behavior. Castellano and Lightle propose the use of cultural audits performed by an outside firm every three years as a way to monitor, discover and improve corporate culture relative to employee performance, as well as external audits to assess the “tone at the top”. According to Castellano and Lightle, the three main areas that the cultural audit would explore would include:

* The degree to which preoccupation with meeting the analysts' expectations permeates the organizational climate;

* The degree of fear and pressure associated with meeting numerical goals and targets; and
* The compensation and incentive plans that may encourage unacceptable, unethical, and illegal forms of earnings management.

Drew, Kelley, and Kendrick suggest the following ways to alleviate cultural weaknesses within firms:

* Implementing new and stronger controls;

* Restructuring incentive systems;

* Educating employees;

* Creating communication programs; and

* Providing individual and team coaching

Drew, Kelley, and Kendrick also discuss the element of Leadership as part of the five element model for corporate governance, which is crucial in developing values, ethical character in followers, culture, and organization-building. Leadership is described by Ty Warren (2005) as no longer being of the command and control nature as it was in American business for years. Furthermore, Warren states that 40 percent of corporate productivity flows from "people skills" rather than "task skills”, and so task skills are more useful than hard skills in developing not only followers, but future leaders.

Drew, Kelley, and Kendrick refer to Professor Conger (1990, 1999), and his description of the “dark side of leadership” (1990, pg. 10), which asserts that the very same characteristics that help people rise to become leaders may also lead to their demise. The focus here is on charismatic leadership as an example. Charismatic leadership may potentially cause over commitment to a particular vision, preventing other ideas and perspectives from being brought to the table. It may also cause followers to become dependent and put leaders up on pedestals, as well as contribute to the ever frustrating problem of groupthink, in which group members simply agree with their
Saad 9

leader as opposed to formulating and expressing their own distinct point of view and decision making insight.

Gandossy and Sonnenfeld define groupthink as “…submissiveness to the firm, industry or profession’s culture at all costs…” caused by the pressures of an all around tolerance for unethical behavior within the corporation (2005). An example of this is the methods by which managers attempt to soften the seriousness of certain crimes and unethical practices via the manipulative use of language, a skill that would usually come easily and naturally to charismatic leaders, such as the use of “double hooking”, “double-discounted” loans and “dipsy-doodle” leases, which are simply manifestations of fraud and theft (Gandossy and Sonnenfeld, 2005). They go on to explain that such an approach using language makes the “…subject matter somehow more acceptable”.

There are several solutions to groupthink suggested by Gandossy and Sonnenfeld (2005). First, vital information must be shared among managers in advance so as to allow the absorption of the situation and allow for corrective action before the problems escalate. Second, factions and in groups within corporations should not exist, instead, a sense of team involvement and governance should be instilled within the corporate culture. Third, newer executives and those that have been with the company a longer time should be mixed together rather than be allowed to form subgroups or cliques, so as to diversify perspectives and avoid a one-way-to-go mindset.

The authors also cite DeCelles and Pfarrer (2004), who suggest that when the charismatic leadership style joins forces with efforts of maximizing shareholder value, corruption becomes more likely (p. 11). Charisma is a positive quality for a leader to
have, in terms of attracting “external support” for a firm, for example, outside investors, due to the likeability factor, however, it is more indicative of higher CEO compensation packages as opposed to better company performance, according to a study by Professors Tosi, Misangyi, Fanelli, Waldman, and Yammarino (2004). Drew, Kelley, and Kendrick suggest the following in order to revamp leadership and its affect on corporate governance:

* Making formal appointments to roles such as chief risk officer;

* Centralizing key risk management activities in a corporate department;

* Planning a balance of competencies and experience in executive teams; and

* Developing and coaching executives.

In addition, the authors cite Professors Grojean, Resick, Dickson, and Smith (2004) and their suggestions for building an ethical climate and preventing against unethical leadership:

1. Using values-based leadership;
2. Setting an example;
3. Establishing clear expectations of ethical conduct
4. Providing feedback, coaching, and support regarding ethical behavior;
5. Recognizing and rewarding behaviors that support organizational values;
6. Being aware of individual differences among subordinates; and
7. Establishing leadership training and mentoring.
Alignment refers to the ability “to align key functions and their responsibilities in the face of rapidly changing environments”, a element that Drew, Kelley, and Kendrick assert can result in coordination, performance and financial problems if not regarded sufficiently. As mentioned earlier, the advent of Sarbanes-Oxley (SOX), the Turnbell Report, and other measures in recent years are aimed at strengthening the alignment among corporate governance, financial reporting, and risk management. Achieving alignment can be made possible by resolving conflict between functions, and eliminating unnecessary overlaps among jobs and areas of responsibility, as well as minimizing any gaps in responsibility and accountability. According to Drew, Kelley and Kendrick, alignment can be aided by:

* Ensuring strategy-making processes align performance objectives with risk propensity and regulatory demands of the firm;

* Aligning organizational changes and structural redesign with regulatory compliance and desired ethical standards of behavior;

* Designing new information and knowledge management systems to support enterprise risk management;

* Creating new senior management integrating roles; and

* Training and developing managers to raise awareness about risk and compliance issues throughout the organization.
The fourth element of corporate governance discussed by Drew, Kelley, and Kendrick is that of systems. Effective control systems help senior executives better monitor and assess whether or not organizational risk is being managed properly or not, due to the information they provide. Systems should be able to identify, analyze, forecast, and manage a wide range of business and strategic risks, according to Drew, Kelley, and Kendrick. Therefore, automation, streamlining, increased uniformity in controls, and accountability by process owners help improve systems by improving the usefulness of and efficiency in which vast amounts of information are organized, viewed, understood, and thereby used. Some improvements and investments in systems, suggested by Farrell (2004, p.12), are:

*Establishing a risk framework and common risk vocabulary

*Establishing and maintaining a chief risk officer or risk committee;

*Measuring and monitoring continuously; and

*Updating the risk assessment framework periodically.

Finally, the element of structure relative to corporate governance is discussed by the authors. Board composition may seriously impact the way executives view themselves, and their roles, and what they are able to get away with versus the behavior to which they should behave in accordance. According to Drew, Kelley, and Kendrick, “the potential for abuse of power and need for independent thinking have led many reformers to oppose combining the roles of CEO and Chairman, and having large numbers of insiders on boards”. Gandossy and Sonnenfeld (2005) suggest alternating role
playing of both the devil’s advocate and enthusiasts, so that no one is trapped in one rigid predetermined pattern of behavior, thinking, and therefore management approach.

Another suggestion that the authors offer regarding the element of board structure relative to achieving strong corporate governance is to avoid adding members to the corporation’s board who join numerous and various boards just for the sake of collecting these positions, since such a commitment now requires about 200 hours per year; four should be the limit, unless the candidate is also employed.

The authors also cite a research finding by Uzun, Szewczyk, and Varma (2004) that finds a significant correlation between board composition and the structure of board oversight committees and the incidence of corporate fraud. Conversely, the more independent outside board directors represented on a board, as well as its audit and compensation committees, the less incidence of corporate fraud. While there is an extreme need to disabuse senior executives of their greed and taking advantage of power, and promote the idea of independent thinking, Professor Collins (1997) suggests participatory and democratic management systems versus autocratic. The following are suggestions by Drew, Kelley, and Kendrick:

*Understanding the changing nature of risk organizations face as they grow and evolve;

*Understanding how major structural transformations lead to changes in strategic risk exposure; and

*Designing improved strategic risk management practices into structural change programs.
3. Enforcement as a means to strong corporate governance

Berglof and Claessens explore the topic of enforcement and good corporate governance in developing countries and transition economies, and point out that more than regulation and laws, enforcement is “key to creating an effective business environment and good corporate governance” (2006). However, this all depends on the enforcement environment, which in developing countries can be problematic, affecting things such as external financing due to the risk of default.

Berglof and Claessens find that the mere presence of anti insider trading laws, for example, is not sufficient in explaining the turnover of CEOs; the extent to which they are enforceable is far more important. According to Berglof and Claessens, some laws are more easily enforced than others, so that the enforcement environment shapes what laws are preferable and the nature of how the law is written may also influence the breadth for enforcement.

Weak enforcement environments influence ownership, control and how different corporate governance aspects function, because a firm that is unable to follow through with its loan agreements for example would need to compensate by involving insider control and ownership concentration in few hands, as a form of collateral for the person staking a company in a weak enforcement environment. There are several types of enforcement: private ordering initiative, private enforcement of the law, public enforcement, and state control (Djankov and others 2003).
Private ordering initiatives take place in the absence of laws and courts or other public enforcement institutions; they can be unilateral, bilateral, or multilateral. Unilateral enforcement mechanisms “involve efforts by individual firms to improve their commitment power”, which would be ideally done through the firm’s own actions by creating valuable assets that would be lost should earlier agreements and standards be violated, the prime example given by Berglof and Claessens being reputation built via costly advertising.

Another type of unilateral enforcement mechanism is investment strategy that is only lucrative as long as the firm continues to be able to receive external financing. Private enforcement involves private agents take advantage of regulations and laws in order to take action against deviations from contracts, using the state to enforce legal judgment; this naturally requires the public law to be effective, and the laws and regulations need private enforcement. Public enforcement is enforcement carried out by the government law. In such situations, enforcement is shaped by the environment, and so if regulators are paid little, this may be counterproductive and instead provide incentive for more corruption in developing countries.

4. Corporate governance from the investors’ perspectives

According to Monks and Minow (1995, p. 297), global companies are in need of capital, and likewise, there are countries who are eager to provide such capital to these companies. While investors are focused on the growth potential for their investments, part of this vision of growth potential, or lack thereof, comes from the confidence that the company’s corporate governance practices instill in the investor. Monks and Minow list
several criteria by which investors may or may not feel assured in terms of the firm’s actions or practices:

- an effective legal and regulatory system that minimizes the chances that their capital will be squandered or stolen (especially if they are minority shareholders)
- a board of directors who are genuinely vigilant protectors of shareholder interests and value;
- properly audited accounts that give a real view of the company’s performance;
- a fair voting process that allows them to be consulted before major corporate decisions are taken;
- corporate reporting that offers a real-world view of the company’s future prospects;
- the freedom to sell their shares to the highest bidder.

In other words, “…investors demand transparency and accountability in return for their capital” (Monks and Minow, 1995).

5. International culture

One of the most undermined yet significant factors in shaping corporate governance systems has been the role of ethnic culture. As we witness the ever increasing momentum of globalization, and countries continue to collaborate and leverage resources and best practices off of one another, there is the need to understand the cultures of others and therefore the implications that the many variations and values present in terms of business practices, and more importantly for the purposes of this paper, the ability to
achieve strong corporate governance across various cultures and the implications that may arise due to cultural differences.

Jeswald W. Salacuse raises the question of whether or not this obvious difference in corporate governance systems across the globe introduces opportunity for convergence, cooperation, or conflict. As pointed out by Licht, Goldschmidt, and Schwartz, “…national culture may impede reform and may induce path dependence in corporate governance systems” (2005). They also state that culture may influence law-making in two ways: cultural values can encourage lawmakers and interest groups to favor particular legal arrangements as opposed to others; second, culture may retard reforms that are misaligned with prevailing cultural values. It is because of this that culture is referred to as the mother of all path dependencies. This is understandable, for it is a challenging task to be raised and molded by one set of values and suddenly face the task of having to adopt another, completely different set of foreign values; of course, this is impractical and is not at all a solution to the concern of culture and the role it plays in gaining strong corporate governance among firms globally.

Salacuse defines culture as “an integrated pattern of basic assumptions, values and artifacts that sets the stage for action, belief and policy” (1999). In his 2003 article, he defines it as “…the socially transmitted behavior patterns, attitudes, norms and values of a given community”. He asserts that culture has two social functions:

*to permit a community or organization to survive and adapt to the external environment and;
to integrate its internal processes and personnel to ensure its capacity to survive and adapt.

Pierre Bourdieu defines culture as referring to “…the complex of meanings, symbols, and assumptions about what is good or bad, legitimate or illegitimate that underlie the prevailing practices and norms in a society” (1994). Hofstede defines culture as “…a people’s acquired pattern of thinking, feeling and acting” (Sison, 2000). However diverse and distinct cultures may be, in terms of their values, norms, and belief systems, there are some areas that overlap among cultures, where values have quite close, universal, and similar meanings across cultures, as in studies by Licht, Goldschmidt, and Schwartz using 56 values of guiding principles, of which 45 shared similar understanding.

There are several ways to classify aspects of culture, and one of the most well known is that of Hofstede’s cultural dimensions: individualism/collectivism, high uncertainty avoidance/low uncertainty avoidance, high power distance/low power distance, masculinity/femininity, and long-term orientation/short-term orientation. The first set of dimensions, individualism and collectivism, refer to the relationship between an individual and his or her fellow members of a society or cultural group. Individualistic cultures are more concerned with individual goals, and are loosely interconnected with their other cultural or social group members. Individual rights are seen as important, and rules ensure independence and freedom of speech. There is no need or desire to conform to the rest of society, and people do things on their own and rely on their selves, as opposed to depend on others. To depend on anyone is shameful in individualistic cultures.
Individualism focuses on the individual as the central role, and is seen in American culture, the most individualistic country according to Hofstede’s study (scoring a 91 out of 100), through the emphasis on individual rights and individual legal remedies to secure such rights. Licht, Goldschmidt, and Schwartz mention that “…a national culture that promotes assertiveness in reconciling conflicting interests and that promotes tolerance for the uncertainty this creates is consistent with using litigation to deal with economic conflicts” (2005). Licht, Goldschmidt, and Schwartz also state that individualism legitimizes the pursuit of personal interests as opposed to the decisions and interests of others (2005).

Collectivistic cultures put the goals of their group (family, company, et cetera) before their own individual goals, and are more closely knit with the other members of their groups. There is a wider use of the “we” versus the “me” mentality. People of such cultures are encouraged to conform to the rest of society, act in the best interests of the group’s goals, and refrain from saying or doing anything that contradicts the group norms. Group, family, or rights for the common good are far more important than individual rights in collectivistic societies. Standing out and being independent is shameful, and members of collectivistic societies are expected to work together and cooperate.

Uncertainty avoidance refers to the extent to which members of a society deal with or how they view uncertainty. High uncertainty avoidance cultures will tend to take steps to reduce uncertainty, because their culture has taught them to try to control uncertainty by learning about it and providing information. Usually, high uncertainty
avoidance cultures try to avoid risk in business. Populations of high uncertainty avoidance cultures are usually ethnically homogenous and tend to have a negative view of foreigners. Citizens of such cultures tend to criticize their own nations. However, low uncertainty avoidance cultures are socialized into accepting uncertainty, and so they do not take any measures to reduce any existing uncertainty. Therefore, low uncertainty avoidance cultures tend to incorporate risk into and value risk in their business. Low uncertainty avoidance cultures tend to be more ethnically diverse and encourage assimilation. Citizens are usually proud of their nation in such cultures. In addition, low uncertainty avoidance is associated with the tendency of constituencies to challenge one another, via public media and courts or meetings.

Power distance refers to how a society responds to the unequal distribution of power and hierarchy, and the extent to which society members may or may not feel threatened by this unequal distribution of power. According to Licht, Goldschmidt, and Schwartz, power distance plays a role in how power within an organization is exercised. High power distance cultures are aware of and hold respect for the distance between one member and another, such as a manager and executive in a corporation, and recognize a boundary that accords a particular behavior for such people. In a high power distance culture, if something goes wrong, it is usually blamed on the employee and not the executive. In high power distance cultures, important work is not often given to subordinates, and a supervisor is expected to show his authority. Power is granted to those who control uncertainty, and high power distance cultures also tend to view conflict within the organization as unnatural.
In low power distance cultures, people do not view unequal distribution of power as a big deal and therefore see no need to behave in a way that widens or accommodates any power gap between two people. In low power distance cultures, if something goes wrong, the superior is blamed for his or her unrealistic expectations. Also, in low power distance cultures, subordinates may be trusted with important work, giving them the opportunity to show initiative and their skill sets, and therefore, get promoted more quickly than someone in a high power distance culture. Superiors in a low power distance culture are expected to treat subordinates with respect and equally. Masculine societies are characterized by clearly defined social gender roles, while feminine societies tend to consist of overlapping social roles. Masculine cultures focus on achievement, wealth, expansion and war. Manufacturing and business are seen as more important than arts and healing. Conflicts in such cultures are usually solved by aggression. Business professionals in masculine societies work long hours and do not vacation much. In feminine cultures, relationships, nurturance, environmental protection, and quality of life are priorities. Arts and healing are more important than manufacturing and business. Unlike masculine societies, feminine societies resolve conflict through negotiation, aggression being a last resort. Business professionals in a feminine culture tend to work shorter hours and use their vacation time.

Long-term orientation and short-term orientation simply deal with the time orientation and foresight of cultures. According to Salacuse, a culture’s preference for individualism or collectivism is a value preference that “can have profound impact on a wide range of systems from compensation to decision making”.
5.1 International cultural values of emotion

Ethnic culture plays a tremendous role in shaping and guiding a group of people’s belief system, and therefore, behavior patterns, as a result of the values that a culture instills within its members, at large. Velayutham and Perera (2004) discuss the influence of emotions and culture on accountability and governance, specifically noting the two cultural emotions of guilt and shame and how various groups interpret and transcend these elements into their accountability practices. Shame is a common emotion in collectivistic, high power distance and high uncertainty avoidance cultures, and Velayutham and Perera argue that in such cultures, accountability is likely to be weak and members of the culture will view the practice of disclosing information in a negative manner.

Conversely, guilt is a more frequently found emotion in individualistic, low power distance and low uncertainty avoidance cultures, and so members of such cultures will view information disclosure in a more positive manner. In Western countries, such as the United States, an individualistic culture, accountability is a method through which responsibility is attributed to a person or role, and so in the event that the responsibility that has been assigned is not handled properly, the owner of the role him or her self would experience the emotion of guilt.

However, in Asian cultures for example, such assumptions about the purpose of accountability are very different, as Asian countries are mainly collectivistic and focus on the aspect of shame, through the loss of face in Chinese culture specifically (Velayutham and Perera). The equivalent of this loss of face is found in the Japanese culture, which
regards shame as the root of virtue (Benedict, 1946, p.224). In addition, Japan’s religion is not tied to one exclusive God, making the feeling of being shamed in front of others the worst thing for this culture.

Conversely, the European culture’s interpretation of such emotions is one whose fundamentals lie in the understanding that as members of society, group members are to take responsibility for their actions before God, which would make each person own up to his or her individual guilt. This feeling of guilt before God is more powerful and more serious than guilt before others, as a member of a guilt culture relies “on an internalized conviction of sin” and can “…get relief by unburdening himself” (Benedict, 1946, p.223).

Conversely, shame cultures are driven by external sanctions, and this shame is “…a reaction to other peoples criticism (real or imaginary)” (Benedict, 1946). Therefore, the authors point out that perhaps accountability is not the most viable solution for disseminating responsibility in Asian firms, and that in addition to accountability being weak in such cultures, members would even go as far as to take extra efforts to hide incriminating information that may bring shame to the company, as opposed to disclosing it, as well as hide information about positive outcomes as well, due to the fact that shame cultures are also mostly modest cultures.

Shame is associated with a helpless self, and “hiding the head or face and/or averting the gaze”, thereby communicating “deference and submission to others” (Lewis, 1971). Furthermore, shame makes one feel exposed and vulnerable, perhaps feeling as if he or she is being noted and judged by other members of the cultural group. These characteristics of shame all involve the idea of collectivistic societies, as they all pertain
to a person’s view of him or herself and the failure to be in line with the goals of the
group as a whole, and therefore, how the other members of the group must think or feel
toward that person.

On the other hand, a person in an individualistic society would not be as
concerned about how his or her actions affect the larger group or bigger picture he or she
is a part of as much as rectifying the failure to adhere to the group’s goals, or rectifying
it. This is because guilt motivates an alleviating course of action, such as confession or
apology, or as Velayutham and Perera point out, “guilt-prone individuals would be more
open and ready to account or explain…and tell others about the wrongdoing and to show
others that he or she understand the standards and wishes to follow them”. Guilt-prone
cultures also would tend to encourage others to hold themselves accountable, as a result
of their own experiences with such failures.

Kitayama et al. (1992) concludes that interdependent, collectivistic cultures are
more concerned with appraisals by others more than self-appraisal, whereas independent,
individualistic cultures prize self-appraisals more than other-appraisals. This observation
helps explain why collectivistic cultures are more prone to feel ashamed of errors or
failures in their business practices, and would be more reluctant to disclose such
information even for the sake of fixing the underlying problems, in order to save face in
front of others, whereas individualistic cultures would be more likely to feel guilty about
errors or oversights within their business practices, and therefore, disclose such
information in order to proceed with corrective action.
Velayutham and Perera conclude that collectivistic, high power distance cultures would prefer confidentiality, oppose the free disclosure of information to individuals other than those who are involved with management and financing activities, and enjoy accounting values that represent statutory control, uniformity, conservatism and secrecy, whereas individualistic, low power distance cultures would rather a higher degree of accountability and information disclosure and transparency, and accounting principles that represent professionalism, flexibility, and optimism. Clearly, the lack of understanding such complex, yet significant differences regarding cultural views toward information disclosure would have severe implications for global firms venturing abroad, and vice versa, particularly in terms of achieving strong corporate governance in the context of the new cultural relationship that would inevitably be formed as a result of such moves by firms.

5.2 Cultural differences and similarities within corporations of various countries

5.2.1 Share dispersion

In the United States, the number of shares of a firm is dispersed across many investors, reducing the individual interests and exercise of control over the corporation in which they own shares, thereby rendering them powerless. According to Berle and Means (1932), such dispersed share ownership is largely attributed to the Americans and the British, whereas corporations in other countries, such as those in Europe, Latin America and Japan, are for the most part run by the state, control groups, or families with “substantial equity interests”.
Here, the challenge is to protect shareholders from controlling owners with large interests in the company. Therefore, share ownership, and hence, voting power in publicly traded corporations is far more concentrated in Europe than the United States and United Kingdom. Voting rights are an immensely important facet of corporate governance, due to the fact that they outline the extent to which shareholders can exercise some power over corporate decision-making.

In the case of dispersed or concentrated ownership, there exists the governance concern of protecting minority shareholders, be it from executive managers who have no significant ownership incentives and would therefore manage the firm with their own agenda, or large shareholders who may use their high stake in the firm to advance their own interests. A big concern raised by Berle and Means is what they call the divorce of ownership from control, which as seen in the case of the Enron disaster, helped executives walk out with significant gains as investors and employees suffered huge losses. In the United States, it is the individualistic culture that causes firms to regard the shareholders as the true owners of the corporation. Great Britain’s view is in line with the United States, being another individualistic culture, with a score of 89 out of 100 on Hofstede’s cultural dimension of individualism.

Santema, Hoekert, van de Rijt, and van Oijen (2005) state that “when equity ownership is more concentrated in a country, the need for disclosure would be smaller”, such as in France and Germany. Since a smaller number of shareholders are involved in the market, they are most likely thoroughly informed via other channels. Countries with a lower concentration of ownership, such as in the Netherlands and Poland, would tend to
disclose a relatively higher amount of information, in order to inform the higher number of shareholders. Also, the authors mention the extent to which a country’s legal system protects shareholders, and the level of enforcement: “Countries with low investor protection are generally characterized by high concentration of equity ownership within firms and a lack of significant public equity markets”.

The United States and the United Kingdom provide the strongest level of protection of shareholder rights. This larger degree of protection will also result in transparency and accountability, due to the fact that companies in countries with strong legal protection of shareholder rights disclose more information, because of the law, causing shareholders and stakeholders to be better informed. Countries like Germany and the Netherlands, and even more so France and Poland, would be expected to have less disclosure.

5.2.2 Community v. contractual governance

The American model of corporate governance is focused on protecting shareholder right and interests, and maximizing shareholder assets, where the shareholders control managers for purposes of shareholder profit. In European countries such as France and Germany, countries in which share ownership is far less dispersed than in the United States, the focus of corporate governance includes the rights of the community relative to the corporation, or “…society controlling corporations for purposes of social welfare (corporate social responsibility)”; this is called the shareholder model (Salacuse, 2003). Where Americans have separated the issues of corporate
governance from corporate social responsibility, Europeans have combined them in relation to managing and regulating corporations.

In addition, Europeans and others, such as the Japanese, hold that the corporation should be managed for the benefit, not just of its shareholders, but also of all its “stakeholders”, including shareholders, employees, customers, suppliers, and interest groups within the community; this is called the stakeholder model (Salacuse, 2003). This significant difference is a result of differences in cultural values, particularly individualism versus collectivism. While the individualist culture views the individual as the end and improvements to communal arrangements as the means to achieve it, the collectivist culture views the group as the end, and improvements to the individual as a means to such an end (Trompenaars and Hampden-Turner).

5.2.3 Compensation

An important measure of corporate governance in the United States is the use of stock and stock options as executive and managerial compensation, typically allocating 1.4 percent of equity to such compensation packages.

5.2.4 Board of Directors; Structure

In the United States and the United Kingdom, the firm structure consists of a single board of directors, called a unitary board system, while many European countries such as Germany, Austria, the Netherlands, and Denmark utilize a two-tiered system comprised of a management board as well as a supervisory board. According to Santema, Hoekert, van de Rijt, and van Oijen, in their studies of strategy disclosure across five
different European cultures, “…in the dual board-system, the stakeholders can get the information they need on strategy or other issues from these boards directly and are sometimes even entitled to cooperate in the decision making process” (2005). They argue that because of this, the need for strategy disclosure tends to be smaller than in unitary board governance systems. However, more strategy disclosure is expected in the United Kingdom, which used the unitary board system.

Another board related distinction is that in the United States, due to the individualistic culture, the role and the importance of the CEO and his or her importance is epitomized. Americans attribute the performance of a firm to the CEO, the leadership, as opposed to the efforts of the group as a whole. In more collectivist cultures such as that of Germany and Japan, the management of the corporation is viewed more as a group effort, affecting CEO compensation relative to other employees much differently than in the United States. These cultures tend to view the CEO as a “…patriarch or father figure within the corporation, rather than the heroic standing that American culture accords its own CEOs” (Salacuse, 2003).

5.2.5 Social reporting relative to Hofstede’s dimensions

According to Santema, Hoekert, van de Rijt, and van Oijen, high uncertainty avoidance societies are expected to have more detailed reporting rules than low uncertainty avoidance cultures. Since high uncertainty avoidance cultures take steps to reduce uncertainty, they are more likely to provide more information than do low uncertainty avoidance cultures, as learning and information are the mechanisms with which high uncertainty avoidance cultures diffuse uncertainty. The highest uncertainty
avoidance cultures in their study are Poland and France, therefore producing the highest level of disclosure. The authors also pose that high power distance countries, France and Poland, demand less accountability, and reporting is less thorough and only geared toward those in positions of power.

Germany and the United Kingdom, the lowest power distance countries in the study, are expected to have a higher amount of disclosure of information. They expect that masculine (United Kingdom, Germany, and Poland) societies’ reporting will concentrate mainly on economic and financial issues, as they are more geared at progress and growth, and will be at a higher level of disclosure than feminine countries (the Netherlands), which would focus on environmental and social issues. Individualistic societies are expected to demand more accountability and disclose strategy information more than collectivistic cultures, as individualistic shareholders demand such disclosure and have stronger legal protective rights (United Kingdom and the Netherlands). Collectivistic cultures will aim reporting at institutional investors at a very small level of disclosure (Poland).

Short-term oriented cultures are expected to disclose with more transparency and accountability, as they are more focused on results and realization of goals and therefore would demands more information and forecasts. The only long-term oriented culture in the study is that of the Netherlands, and so a low level of disclosure is expected. While two hypotheses were partially rejected, and one fully rejected, this study raises some implications for going abroad and the different disclosure demands of stakeholders in
various countries’ cultures, as they most likely will not expect the same level of disclosure as shareholders at home.

6. Abilities and challenges of different cultures to adopt elements that achieve strong corporate governance

According to Drew, Kelley, and Kendrick, the following conditions existing within corporate cultures are counterproductive to establishing strong corporate governance:

- Unethical behavior
- Excessive internal rivalry
- Intolerance of failure
- Propensity for risk-taking
- Secretiveness
- Persecution of people who speak up (“whistle blowers”)

Unethical behavior would be responded to differently by corporations in individualistic and collectivistic cultures, as collectivistic cultures tend to feel shamed by wrongdoing, and individualistic cultures tend to feel guilty about wrongdoing. A member of a collectivistic culture, concerned by how the fellow members of the group will observe and judge the person accountable for the wrongdoing, will be more inclined to hide the wrongdoing so as to save the group face. On the other hand, a member of an individualistic culture will feel guilty, and is more likely to take corrective action and apologize for what was done.
Excessive internal rivalry would be attributed more to an individualistic culture, where members of such societies are focused on individual achievement and independence; therefore, there may be the temptation to do so by any means, however questionable and wrongful to the corporation and its activities. In a collectivistic culture, members of the society are more concerned with developing the self in order to contribute to and advance the bigger picture, the goals of the group as a whole. They are not as competitive with each other as in individualistic cultures. This may incline them to behave less opportunistically than members of an individualistic society, because they approach their success and goals in a team context and not just in context of the self.

Intolerance of failure may be attributed to collectivistic cultures, where the state of emotion is predominantly shame because of the need to save face in front of fellow group members and for the group members as a whole. Shame is a result, in such cultures, of a person feeling as if he has failed his fellow group members. Therefore, such a culture would tend to have a high intolerance of failure. In an individualistic culture, tolerance of failure may be a bit more easily accepted, as one would be more ready to apologize out of guilt, but would still be high because the individualistic culture is so results-driven and opportunistic, it may create pressure and incentive to commit wrongdoing simply in order to appear as if the employee has not failed.

Propensity for risk-taking might be higher for low uncertainty avoidance cultures, because they are socialized into accepting uncertainty and instead use litigation to settle conflicts. On the other hand, high uncertainty avoidance cultures dislike uncertainty and try to minimize the gap between what they know and what the future holds by learning
and finding out information about something. Therefore, they are less likely to have a propensity for risk-taking.

Collectivistic cultures with high power distance would tend to be more secretive, particularly on social reporting disclosure. This is because high power distance cultures respect the gap in authority and hierarchy within the corporation, and so they would accept that certain information should only be in a few select, powerful hands, and would not demand to know. Since high power distance culture superiors do not entrust employees with important tasks, it is likely that they may also not entrust them with certain information. However, individualistic cultures, with their emphasis on independent rights, and protection of shareholder rights, et cetera, would be more inclined to demand accountability and transparency, and so there would be a lower level of secretiveness. Even if companies try to be secretive, shareholders become rightfully more demanding of this information, especially since the shareholder model prevails in such cultures, where executives are to act in the best interests of the maximization of shareholder value.

The persecution of whistle blowers would be expected to be prevalent in collectivistic, high power distance cultures, where conflict is seen as unnatural. Although it has occurred, it would not be expected that the persecution of whistle blowers would be prevalent in the low power distance cultures such as in the United States, as members of such a culture litigate conflicts, and demand information and transparency. As suggested by Drew, Kelley, and Kendrick, such factors can be monitored and improved on by the
use of cultural audits by an independent party every three years, with specific attention in the audit paid to the following:

* The degree to which preoccupation with meeting the analysts' expectations permeates the organizational climate;

* The degree of fear and pressure associated with meeting numerical goals and targets; and

* The compensation and incentive plans that may encourage unacceptable, unethical, and illegal forms of earnings management

The degree to which a firm is preoccupation with meeting analysts’ expectations permeates the corporate culture is important and must be monitored to make sure that such emphasis on meeting this goal is reasonable and not pressuring to the point where there is intolerance of failure to meet these expectations and the incentive or threat to undertake unethical behavior. In collectivistic cultures, the use of this measure must keep in mind that collectivists are shame-driven, and so the failure to meet analysts’ expectations is an example of something that would result in shame, although no wrongdoing has been committed necessarily.

The same goes for the degree of fear and pressure associated with meeting numerical goals and targets, as collectivists are very focused on meeting group goals. In individualistic cultures, there may not be too much fear to meet targets and goals, as individuals are focused on self interests, an example of which can be seen in individualistic cultures’ tendency to divorce ownership from share control, dispersing shares across a large number of people, and not taking a large interest or stake in the firm
itself. Some managers therefore may not even care to meet such goals, which is also a point of concern, in either extreme.

Compensation and incentive plans are extremely important relative to managerial performance and good corporate governance. Individualistic cultures such as the United States compensate executives heavily, especially with stock options, where collectivistic cultures are opposed to this approach. As mentioned earlier, earnings or cost savings performance is well rewarded financially, but doing the right thing often is not rewarded, and this is something that does not seem to be addressed by any particular cultural dimension group. Perhaps this is one of many areas in which further work and development should be considered. It seems both collectivistic and individualistic cultures would appreciate being rewarded for doing the right thing, as collectivists would do so for the sake of the group, and individualists would do so for the sake of the individual reward.

In terms of leadership, collectivistic cultures such as Japan tend to see the CEO as a fatherly, patriarch figure, whereas in individualistic cultures such as in the United States, the CEO is put up on a pedestal as a hero would be. Charismatic leadership, a factor already mentioned, can play a big role in the success and failure of a CEO, as the likeability factor will gain the corporation the needed external financing, however, the charisma of the CEO will encourage groupthink and a sole vision with the firm among employees.

Grojean, Resick, Dickson, and Smith (2004) suggest the following for building ethical leadership:
(1) Using values-based leadership;

(2) Setting an example;

(3) Establishing clear expectations of ethical conduct

(4) Providing feedback, coaching, and support regarding ethical behavior;

(5) Recognizing and rewarding behaviors that support organizational values;

(6) Being aware of individual differences among subordinates; and

(7) Establishing leadership training and mentoring.

A sense of teamwork can be incorporated into the firm’s culture, mixing the new and older executive members to diversify perspectives and prevent one view or agenda from dominating the contributions of others. This may be challenging in individualistic societies as the United States, which mainly tend to see the CEO as the sole leader of the firm, idolizing him or her in a sense.

Collectivistic cultures view themselves in context of the group, and so they might be able to instill teamwork easily, however, the challenge for them lies in their perspective and high power distance between subordinates and the CEO. They may be more inclined to let the CEO push his own vision and agenda, and because collectivistic cultures do not object to the goals of the group, employees may not voice their concerns or opposition. However, instilling the feeling that the firm is being governed by the entire board, and that its fate does not rest solely in the hands of one person would create a
more secure environment and a more positive, productive culture that fosters ideas and involvement. Using value-based leadership would accomplish this, and it seems both individualistic and collectivistic cultures would be easily able to incorporate this aspect of corporate governance.

The idea of providing feedback is important and very much related to the possibility of whistle blowing. Management needs to cultivate a culture conducive to the sharing of information and opinions. In collectivistic culture of high power distance, perhaps this is challenging, since ideas are not to deviate from the group’s goals.

7. Conclusion

Licht, Goldschmidt, and Schwartz suggest that reforms of corporate governance are far more likely to produce desired results if their designers take pains to adjust them to the cultural environment and appropriately assess the practicality of “transplanting legal mechanisms from one nation to another” (2005). For instance, the relationship between Harmony and Uncertainty Avoidance suggests that in such cultures, the advent of a new legal regime would necessitate an alternative approach to the court system. The way a corporation shapes its culture has a dramatic effect on the way managers and executives will act and the extent to which they will practice and enforce good governance themselves. This in turn has major influences on the way employees feel in terms of their own contributions to the firm, seen through the negative effects of groupthink, and the unpleasant responses to whistle blowing.
In a global sense, the variations across culture values are important in that they provide a guideline or framework with which to shape and form corporate governance policy reform. As mentioned, there cannot be one uniform way of assuring human behavior; that would be absurd and non applicable to the business world. However, by understanding the differences in how our global counterparts perceive themselves and those around them, we can better understand how to plan our own behavioral strategies and policies.
Berglof, E., Claessens, S., 2006. Enforcement and good corporate governance in
developing countries and transition economies. The World Bank Research Observer 21,
123-130.

Drew, S., Kelley, P., Kendrick, T., 2006. Five elements of corporate governance to

Gandossy, R., Sonnenfeld, J., 2004. I see nothing, I hear nothing’: culture, corruption and

International Review of Law and Economics 25, 229-255.


Salacuse, J., 2003. Corporate governance, culture and convergence: corporations
American style or with a European touch?. European Business Law Reviews 14, 471-
496.

annual reports across europe: a study on differences between five countries. European


Sison, J., 2000. The cultural dimensions of codes of corporate governance: a focus on the