Convergence in corporate governance systems and sustainability culture

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Abstract: The aim of this paper is to encourage a debate about the effective adoption of a sustainability approach by companies’ boards, being a substantial factor of convergence between insider and outsider corporate governance systems. Corporate social responsibility (CSR) and sustainability are based on good corporate governance, grounded on stakeholder engagement, fairness, transparency and accountability. All these principles are related to sustainable boards and determine a governance approach directed to the growth of corporate value in the long-term. Leadership aiming at sustainability requires CSR to be transferred from top management to the entire organisation, spreading a real culture of sustainability into organisation. In this sense, the CSR, if properly realised, can be considered as a factor of substantial convergence between the different systems of corporate governance existing worldwide.

Keywords: sustainability culture; leadership; convergence in corporate governance; corporate social responsibility; CSR.


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1 Introduction

Sustainability culture in leadership emphasises the change that companies, which want to be leaders in sustainability, must deal with, accentuating the central role of corporate governance bodies as promoter and guarantor of the change’s effectiveness. A real corporate culture inspired to values of sustainable development implies the Board of Directors to be really engaged in sustainability: therefore, the most important actors in the process of achievement of sustainability leadership are the board’s members. In this sense, we can say that leadership starts at board level: the executive members of the board must recognise the principles of sustainability, sharing these principles with non-executive members and transferring them in the long-term direction of the organisation. This process depends on the base principles that characterise the corporate culture.

Board’s members must recognise the importance of the transition from an oriented strategic approach to the optimisation of economic performance, mainly favouring shareholders, to a policy oriented to the appreciation of the interdependence among economic, social and environmental responsibility that satisfies relevant stakeholders’ expectations.

Considering corporate governance as means to favour and lead a company’s performance, this paper deems the assertion of corporate social responsibility (CSR) and sustainability can represent significant factors of substantial convergence among corporate governance systems characterising different countries. In particular, our study underlines how policies oriented to CSR principles imply the overcoming of some divergence in key performance indicators that traditionally characterises insider and outsider corporate governance systems. In other words, the need of companies to compete on global markets requires strategies built on values of corporate development in the long-run. The satisfaction of shareholders and other stakeholders’ expectations guarantees the company’s success, irrespective of formal structural corporate differences characterising different corporate governance systems.
In this context, the starting point to be developed in this paper is about the board’s engagement in CSR and sustainability as key success factor to compete in global markets and a potential element of convergence between corporate governance systems. Our question for reflection is the following:

- *Are there shared factors within the corporate governance that are abstract from the specific characteristics of corporate governance systems and that could promote a path of convergence between these systems?*

Reflecting on the most recent innovations in corporate governance and the involved actors, the paper is structured as follows:

- Section 2 is the analysis of the major relevant literature on the interrelation between corporate governance, CSR and sustainability leadership, emphasising the characteristics that corporate governance bodies should have to effectively assuming the role of a change promoter in global markets
- Section 3 meditates on the starting question, emphasising the contribution of this paper for the development of existing literature
- Section 4 concludes on the importance that a corporate culture inspired to sustainability can have as a success factor on global markets, favouring a convergence process between different corporate governance systems.

## 2 Literature review

The ownership characteristics and the connected degree of separation between ownership and control, imply differences between outsider and insider corporate governance systems.

For a long time, orientation towards shareholders and profit maximisation prevailed, especially in outsider or market-oriented systems, characterised by high openness towards risk capital markets, clear separation between ownership and management, one-tier corporate governance system and control functions exercised by markets (Berle and Means, 1932; Friedman, 1962; Jensen and Meckling, 1976).

The outsider corporate governance systems distinguish because of the high dispersion of shares: shareholders tend to associate the corporate success with the profit maximisation and the board is annually appreciated by the company’s economic performances. This situation determines the tendency for a short-term orientation by governance bodies.

Vice versa, the insider systems are characterised by a high capital’s concentration among majority shareholders (often founder families) that are frequently engaged in management as executive directors. In this situation, the board is strongly influenced by majority shareholders that are generally oriented to the maximisation creation of value in the long-term.

However, the differences in the corporate governance systems existing worldwide mainly depend on characteristics of ownership structure (Morck et al., 1988; McConnell and Servaes, 1990) and ownership engagement in the board structure (Maassen, 2002; Leblanc, 2004; Solomon, 2007). These structural differences could be an obstacle for companies competing on global markets when the short-term interests, essentially
corresponding to the length of board’s mandate, dominate on a long-term vision, oriented to sustainable development in the interests of all stakeholders. In this sense, the role of companies in society must be reinterpreted, referring to sustainable development and stakeholder relation management (Steurer et al., 2005; Cadbury, 2006). A wide vision of corporate responsibility, based on the appreciation of links between long-lasting company’s success and a fair settlement of stakeholders’ expectations, is the base of a company’s success and it implies changes in terms of spirit of governance.

The acceptance of CSR determines the assumption of sustainability objectives as important business performance indicators. This does not mean that the adequate shareholders’ remuneration is ignored, but that the corporate value can increase because of the interdependence among stakeholder relation management, economic and socio-environmental responsibility, results (economic and not economic ones), and capability to obtain consents and resources (Salvioni and Astori, 2013), favouring the satisfaction of all relevant stakeholders (shareholders, employees, investors, suppliers, customers, competitors, public administration, community and environment). A board leadership capable to manage the complexity along the ‘triple bottom line’ and capable to engage the relevant stakeholders in business becomes necessary (Salvioni and Gennari, 2016).

Stakeholders’ engagement is a necessary condition for the creation of value based on responsible and sustainable governance. In this context, the sustainability leadership, being the essential element in sustainability by board of directors, is the requisite for coordination of behaviours within the organisation (Salvioni, 2010; Salvioni et al., 2014).

The CSR implies changes primarily regard the following:

- the appreciation of a governance vision, which is socially responsible, based on effective stakeholder’s engagement processes
- the development of control systems that are fully embedded to the goals’ evolution and that enable risks monitoring with regard to different dimensions of responsibility
- the change in the variables to be monitored, with a greater appreciation of sustainability culture and critical factors for the optimisation of relations with stakeholders.

Since the 1960s scholars and international bodies emphasise the relation between corporate governance and CSR, highlighting a socially responsible governance to sustain the corporate creation of value over-time (Carroll, 1999; Dahlsrud, 2008; European Commission, 2011; Law, 2011; Jo and Harjoto, 2012). The integration between decisions of leaders and day-to-day activities is the way to promote a real CSR culture in the entire organisation, guaranteeing the coherence among board’s strategies, organisation’s values and everyday practices (Painter-Morland, 2006).

Board members should be aware that they cannot draft an ideal framework of corporate culture. In fact, the last originated values declared by the board were stronger over time because of the coherence between what the company says and what it does.

Several studies confirm that what really matters for CSR corporate performance is not the board’s structure, but the involvement of board members in sustainability principles (Ricart et al., 2005; Ayuso and Argandona, 2007; Salvioni and Gennari, 2014).

So, the focal point of criticism on CSR is the boards of directors, as this key group defines and implements corporate strategy and serves to safeguard the interests of key stakeholders (Mason and Simmons, 2014). In fact, board members first identify relevant
stakeholders and must then balance stakeholders’ interests, by means of the strategies that include stakeholders’ expectations (Wang and Dewhirst, 1992; OECD, 2004). In this sense, some models are directed to stimulate the stakeholder’s engagement within the board already exist (e.g., the German co-determination or the French representation rights), but they are focused only on some stakeholder groups. Furthermore, when binding rules exist, the formal compliance does not ensure the development CSR corporate culture. Vice versa, the value of compliance should be embedded in corporate culture, as a shared principle that guides the behaviour of the entire organisation and constitutes the basis for managing any type of risks connected to global corporate responsibility.

Also the European Parliament adopted a resolution, in which the importance of a commitment by the board on CSR matters is stressed (2012/2098(INI), reminding that corporate responsibility must not be reduced to a marketing tool and that the only way to fully develop CSR is to embed it in a company’s overall business strategy, implement it and translate it into reality in its day-to-day operations and financial strategy.

This board’s commitment in CSR matters determines strategies and objectives to be achieved, encouraging corporate behaviours that are oriented to long-term value creation, regardless the formal differences in corporate governance systems (e.g., board’s composition, duration of directors’ mandate). In this sense, we can talk about CSR as a potential factor of substantial convergence in corporate governance systems. According to several scholars, a gradual path of convergence in corporate governance systems is occurring (Aguilera and Jackson, 2003) and can be observed according to these dimensions (Gilson, 2004; Yoshikawa and Rasheed, 2009; Lazarides and Drimpetas, 2010): the ‘formal’ convergence refers to a convergence of rules at national level and it is promoted by internationally recognised principles on good governance, while the ‘substantial’ one refers to corporate strategies, irrespective from corporate governance systems’ characteristics. Empirical studies about convergence in corporate governance systems exist for years, with a major attention towards de jure aspects, but they do not explicitly consider the sustainability approach by companies as a factor of a de facto convergence.

In our opinion, sustainability leadership tends to align companies’ strategic approaches independently from ownership characteristics (conditions differentiating insider and outsider systems) and relations between corporate governance bodies (conditions differentiating one-tier and two-tier systems).

Furthermore, the convergence is promoted also by the different attitude that institutional investors have when they privilege socially responsible companies, oriented to the value creation in the long-run.

3 The role of sustainability culture for the convergence in corporate governance systems

Sustainable companies draw attention to the improvement of relations with stakeholders and to long-term performances. Scholars highlight that they are characterised by (Maritz et al., 2011; Miller and Serafeim, 2014; Salvioni et al., 2016):

- long-term business orientation, that means the crossing of divergence in time orientation about economic results between outsider and insider systems
• the systematic commitment of the board in sustainability goals, also by means of specific committees and chief officers
• the belief that a sustainability-oriented board is the key to ensure the dynamic CSR matters are integrated into corporate objectives and business operations.

The previous considerations are based on companies’ declarations about their engagement in sustainability. The reliability of communications is essential for building trust with internal and external stakeholders and to guarantee the maintenance of the value linked with relationships created by company with relevant stakeholders.

In light of what previously observed, corporate decision makers will consider the company’s proactive contribution to sustainable development implementation and promote transparency, sharing coherence of individual behaviour and internal controls. The systematic, coordinated, effective and efficient sustainable development orientation is conditioned by the ability of facing in advance the complexity in which the company works, through an integrated approach, which aims at valorising the culture of ethics and the CSR responsibility at corporate governance boards and at organisation level. The transformation of board’s decisions into outcomes implies the adoption of suitable tools and processes: in this context the dissemination of ethical principles and values of sustainability within the organisation, thanks to the board commitment, has relevant importance.

It seems appropriate to point out that the integration of responsibilities along the triple bottom line, supported by suitable control systems to promote sustainable culture throughout the organisation, tends to allow for more effective risk management and to increase the ability to limit the negative effects of the same. The need to identify and manage critical elements underlines the importance of focussing on the development of an internal control system that enables to monitor the risks and the dissemination of a positive approach to reporting and the direction of the same within the organisation.

The corporate governance body defines the guidelines of internal control in line with the company’s needs in order to achieve appropriate responsibilities in all managerial behaviours. Internal control is then delegated to specific dedicated bodies but sees the involvement of the management and their behaviour determines the timing and means to achieve the objectives.

The critical factors in business success that affect the internal control, therefore, register significant changes, with the progressive acknowledgement of the critical role of specific intangible components (Franzoni, 2013). Consequently, internal control systems should be based on any subsequent changes made in relevant variables and considering that the spreading of a culture of sustainability takes primary importance.

Indeed, the sustainable growth of the company depends on board’s ability to identify the significant variables that may affect the successful integrated management of corporate responsibility and the sustainability culture as a key factor driving the internalisation of values and principles shared by the top management and the organisation. In fact, culture facilitates the correct implementation of governance processes, promotes the adoption of an effective management approach, supports the creation of positive relations between the company and its stakeholders and risk control.

Culture affects all corporate behaviour, determining the conditions of consonance and internal sharing, the potential for the image to assert itself, and the pursuit of consensus and managerial effectiveness. The existence of a strong culture, shared by top
management and the organisation and permeating the entire network of corporate relations, is therefore a critical element for CSR.

Internal controls aim to transfer corporate responsibilities in the operating processes and to optimise the potential for success and durability compared to different changing internal and external phenomena.

4 Conclusions

The adoption of a wide concept of responsibility by companies fosters a change in corporate performances, modifying the business orientation and creating the prerequisites for substantial convergence in corporate governance systems.

Sustainability becomes a formal business driver. This induces to a review of governance tendencies and of interaction between corporate governance bodies and organisation, but also between listed companies and shareholders. Furthermore, a deep revision of critical variables for performance optimisation must be considered.

Assertion and sharing of values that are significant for responsible and sustainable governance are conditions for behaviours’ coordination and uniformity, which are important assets for the company’s success. In particular, the internalisation of values and principles shared by leaders and organisation favours the correct exercise of governance, promotes effective and efficient management approach, facilitates the creation of positive relations between company and stakeholders and favours risks control.

Sustainable leadership goes with control structures and processes more and more articulated. Hence, irrespective of formal characteristics of corporate governance systems, companies, which effectively integrate CSR, sustainability and leadership, have modified their corporate policy giving importance to the creation of sustainable values as a condition for their growth and development in the long-term. So one of the most important elements of divergence between insider and outsider corporate governance systems, related to the different time tendency to results decreases.

Furthermore, companies characterised by sustainable leadership can be more attractive for investors, increasing their opportunities in obtaining resources and growth of their capital value. In fact, the downfall of barriers among markets and capital circulation, on one hand, increased investors’ choices and, on the other hand, highlighted that the creation of value in the long-term can represent an important element for investment risk reduction.

The failure to transfer the values of accountability to the various managerial tasks can jeopardise the correct implementation of management decisions, to the detriment of the general corporate well-being. In this respect, global companies have highlighted the advisability of adopting ethical codes and behaviour that clearly outline the principles, values and responsibilities that the organisation must share, take on board and respect.

References


