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Comparative Corporate Governance: Old and New

Law Working Paper N° 321/2016

July 2016

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ECGI Working Paper Series in Law

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Abstract

The most fundamental comparative corporate governance debates have often focused on two issues. The first one concerns ownership structure: Why are large corporations in some corporate governance system owned by a multitude of disempowered shareholders, thus effectively giving management free rein? Why are corporations typically governed by a controlling shareholder or a coalition of controlling shareholders in other systems? The second issue is the role of other 'constituencies' of the corporation besides shareholders, of which labor is most central to the debate. Some jurisdictions explicitly give labor an influential voice in corporate affairs, whereas in others its influence is developed through factual power or unintended consequences of legislation. This chapter explores the interactions between firm ownership and labor, focusing on the United States on the one hand and Continental Europe, particularly Germany, on the other. It distinguishes between 'old' and 'new' comparative corporate governance, the former referring to the dichotomy studied by scholars of comparative corporate law up to the early 2000s. Recent changes, heralded by intermediated, but widespread share ownership are leading us to a new equilibrium whose contours have only begun to emerge. Over the past decades, outside investors have gained power both in the United States and in Continental Europe. However, neither in the US nor in Continental Europe has the traditional corporate governance system been completely superseded by a new one. The US remains to a large extent manager-centric. Continental Europe retains powerful large shareholders, and labor as an independent force has remained more important than in the United States. Outside institutional investors – sometimes from the US – have become a player to be reckoned with, thus adding an additional layer of complexity to the system.

Keywords: Berle-Means corporation, law and finance, varieties of capitalism, holdup, human capital, shareholder activism, retail investors, occupational pension plans, PAYGO, shareholder rights

JEL Classifications: K22, J50

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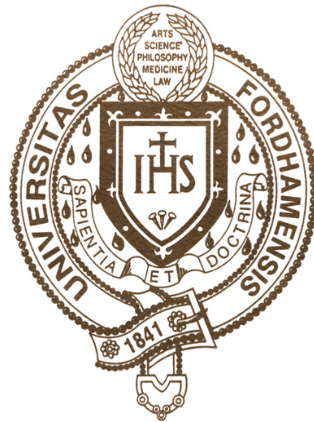

March 2016

Comparative Corporate Governance: Old and New

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UNDERSTANDING THE COMPANY: CORPORATE GOVERNANCE AND THEORY (BARNALI CHOUDHURY & MARTIN PETRIN EDS., CAMBRIDGE UNIVERSITY PRESS, FORTHCOMING 2016).

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Final version to be published in:
Understanding the Company: Corporate Governance and Theory (Barnali Choudhury & Martin Petrin eds., Cambridge University Press, forthcoming 2016).

I. Introduction

Whose interests should a corporation serve? Should it have a higher social purpose beyond the financial gain of shareholders? These questions have befuddled theorists of corporate law since the Berle-Dodd debate in the early 1930s US,[1] and the discussion in the Germany of the 1920s and 1930s about the *Unternehmen an sich* – a term aptly coined by opponents of the writings of Walther Rathenau, who seemed to endorse a public purpose for the corporation.[2] Since then, the discussion has flared up with predicable recurrence both in common law and civil law jurisdictions over the past century, and without clear winning arguments, even if one model or the other has dominated at times.[3]

[1] A.A. Berle, Jr., 'Corporate Powers as Powers in Trust' (1931) 44 *Harvard Law Review* 1049; E. Merrick Dodd, Jr., 'For Whom Are Managers Trustees?' (1931) 45 *Harvard Law Review* 1145; A.A. Berle, Jr., 'For Whom Corporate Managers Are Trustees: A Note'(1931) 45 *Harvard Law Review* 1365.

[2] W. Rathenau, *Vom Aktienwesen: Eine geschäftliche Betrachtung* (Berlin: Fischer Verlag, 1917). Rathenau's leading critic was Hausmann. See F. Haussmann, *Vom Aktienwesen und vom Aktienrecht* (Mannheim: Besheimer,1928), p. 20; F. Haussmann, 'Gesellschaftsinteresse und Interessenpolitik in der Aktiengesellschaft' (1930) 30 *Bank-Archiv* 57 at 64-65. For an overview of the debate in English, see e.g. M. Gelter, 'Taming or Protecting the Modern Corporation? Shareholder-Stakeholder Debates in a Comparative Light' (2011) 7 *New York University Journal of Law & Business* 641 at 686-686.

[3] Gelter, above n 2 at 667-678 (discussing the US), 678-704 (Germany), and 704-718 (France). For some recent contributions, see e.g. L.M. Fairfox, 'The Rhetoric of Corporate Law: The Impact of Stakeholder Rhetoric on Corporate Norms' (2006) 31 *Journal of Corporation Law* 675; W.W. Bratton and M.L. Wachter, 'Shareholder Primacy's Corporatist Origins: Adolf Berle and the Modern Corporation' (2009) 34 *Journal of Corporation Law* 99 at 101; R. Reich-Graefe, 'Deconstructing Corporate Governance: Absolute Director Primacy' (2011) 5 *Brooklyn Journal of Corporate, Financial & Commercial Law* 341; L. Stout, *The Shareholder Value Myth: How Putting Shareholders First Harms Investors, Corporations, and the Public* (Oakland, CA: Berrett Keohler Publications, 2012); W.W. Bratton and M.L. Wachter, 'Shareholders and Social Welfare' (2013) 36 *Seattle University Law Review*

Electronic copy available at: http://ssrn.com/abstract=2756038

Meanwhile, comparative corporate governance debates have focused on two important issues. The first issue concerns ownership structure: are large corporations in a particular corporate governance system owned by a multitude of disempowered shareholders, thus effectively giving management free rein? Or are corporations typically governed by a controlling shareholder or a coalition of controlling shareholders that keep management on a tight leash, but have their own devices for the corporation?[4]

The second issue is the role of other 'constituencies' of the corporation besides shareholders, of which labor is most central to the debate, as the question of corporate purpose comes into play more directly. Some jurisdictions explicitly give labor an influential voice in corporate affairs,[5] whereas in others its influence is developed through factual power or through either unintended or subtly intended consequences of legislation.[6]

This chapter explores the interactions between ownership of firms and labor, focusing on the United States on the one hand and Continental Europe, particularly Germany, on the other. I distinguish between 'old' and 'new' comparative corporate governance, the former referring to the dichotomy studied by scholars of comparative corporate law up to the 1990s and 2000s. Recent changes, heralded by intermediated, but widespread share ownership are leading us to a

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489; K. Greenfield, 'Sticking the Landing: Making the Most of the "Stakeholder Moment"' (2015) 26 *European Business Law Review* 147.

[4] For example R.K. Morck, 'Introduction', in Randall K. Morck (ed.), *Concentrated Ownership Structure* (University of Chicago Press, 2000), p. 1; R.J. Gilson, 'Controlling Shareholders and Corporate Governance: Complicating the Corporate Taxonomy' (2006) 119 *Harvard Law Review* 1641 at 1645-1650 (both summarizing cross-country evidence).

[5] Several jurisdictions require employee representation on the supervisory board or board of directors. This includes Germany, Austria, the Netherlands, Slovenia, Slovakia, Hungary, Luxembourg, Denmark, Sweden, and Norway. See, e.g., T. Raiser, 'Unternehmensmitbestimmung vor dem Hintergrund europarechtlicher Entwicklunge' (2006) Gutachten B für den 66. *Deutschen Juristentag* at B 42; M. Gelter and G. Helleringer, 'Lift not the Painted Veil! To Whom are Directors' Duties Really Owed?' (2015) *University Of Illinois Law Review* 1069 at 1077-1079.

[6] See, generally, M. Gelter, 'The Dark Side of Shareholder Influence: Managerial Autonomy and Stakeholder Orientation in Comparative Corporate Governance' (2009) 50 *Harvard International Law Journal* 129 at 168-173; L.E. Strine, Jr., 'The Soviet Constitution Problem in Comparative Corporate Law: Testing The Proposition That European Corporate Law is More Stockholder-Focused Than U.S. Corporate Law', Research Paper No. 15-39 (University of Pennsylvania Institute for Law and Economics, 2015), available at http://ssrn.com/abstract=2688018, at 17.

brave new world of corporate governance whose contours have only begun to emerge. The central tenet, in any event, is that labor matters for corporate governance and is thus important for a proper comparison. Part II begins by describing the traditional juxtaposition of US and Continental (mainly German) corporate governance in the comparative literature and Part III discusses the changes of the past 20 years, and the new world in which we seem to be moving. Part IV concludes.

II. Old Comparative Corporate Governance

A. The US: Berle-Means or 'Strong Managers – Weak Owners'

Old corporate governance in the United States was characterized – in Berle and Means's words – by the 'separation of ownership and control'[7], or – maybe more precisely in Mark Roe's words – by 'strong managers and weak owners'.[8] Regardless of the terminological question whether it is legally and economically accurate to characterize shareholders as owners[9], what is clear is that shareholders had very little influence over the corporation. With its relatively high proportion of retail investors[10] and a securities law that made coordination between institutional investors difficult[11] − backed by a managerially oriented state corporate law − management remained

[7] A.A. Berle, Jr., and G. Means, *The Modern Corporation and Private Property* (New York: Macmillan, 1932), p. 90.

[8] M.J. Roe, *Strong Managers, Weak Owners – The Political Roots of American Corporate Finance* (Princeton University Press, 1994).

[9] M.M. Blair, 'Corporate "Ownership"' (1995) 13 *Brookings Review* 16.

[10] See, e.g., R.J. Gilson and J.N. Gordon, 'The Agency Costs of Agency Capitalism: Activist Investors and the Revaluation of Governance Rights' (2013) 113 *Columbia Law Review* 863 at 874 (noting that in 1950 "[e]quities were still held predominately by households").

[11] M.J. Roe, 'A Political Theory of American Corporate Finance' (1991) 91 *Columbia Law Review* 10 at 26-29.

nearly all-powerful while shareholders suffered from a classic collective action problem that quashed any nascent influence that may have existed.[12]

The situation gave rise to the development of agency theory.[13] With management distant from the masses of shareholders, but affecting shareholders' financial well-being with its decisions, the corporation became the paradigmatic case for the application of agency theory. In the mainstream view, employees became mainly a distraction from efficiency.[14] At best, unaccountable managers did not make sufficient efforts to keep labor in line, thus squandering more shareholder wealth. At worst, they were, in the purely shareholder-focused agency perspective, actively collaborating with employees against shareholders; takeovers – which historically were opposed both by managers and shareholders – serve as a good example.[15] Overall, corporate governance institutions such as boards of directors were not well tailored to monitoring management.[16]

While the manager-labor coalition may have carried the day during that period the role of labor needs to be seen in a more nuanced light. Corporate defined benefits pension plans from the 1950s through 1970s typically had features tying employees to the firm by penalizing job changes. Admittedly, the so-called Taft-Hartley pension plans were often jointly administrated by

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[12] See, e.g., H. Wells, 'Shareholder Power in America, 1800-2000: A Short History', in J.G. Hill and R.S. Thomas (eds.), *Research Handbook on Shareholder Power* (Northampton, MA: Edward Elgar Publishing, 2015), pp. 13, 21 ("In the Berle-Means corporation, shareholder powerlessness was a given.").

[13] M.C. Jensen and W.H. Meckling, 'Theory of the Firm: Managerial Behaviour, Agency Costs and Ownership Structure' (1976) 3 *Journal of Financial Economics* 305. On the rise of agency theory see, e.g. R. Khurana, *From Higher Aims to Hired Hands: The Social Transformation of American Business Schools and the Unfulfilled Promise of Management as a Profession* (Princeton University Press, 2007), p. 316; *Ibid.,* at 23.

[14] See L.A. Stout, 'Takeovers in the Ivory Tower: How Academics Are Learning Martin Lipton May be Right' (2005) 60 *Business Lawyer* 1435 at 1445 (criticizing that principal-agent thinking has pushed the interests of labor to the margins of corporate law debates); e.g. F.H. Easterbrook and D.R. Fischel, *The Economic Structure of Corporate Law* (Harvard University Press, 1991), p. 11 (discussing how employees are sufficiently protected by contract).

[15] See, e.g., E.W. Orts, 'Beyond Shareholders: Interpreting Corporate Constituency Statutes' (1992) 61 *George Washington Law Review* 14 at 24-25 (discussing labor support for antitakeover legislation).

[16] See, e.g., J.N. Gordon, 'The Rise of Independent Directors in the United States 1950–2005: Of Shareholder Value and Stock Market Prices' (2007) 59 *Stanford Law Review* 1465 at 1514-1526 (tracing the development from a managerial board to a monitoring board).

firms and unions and seen as a way of securing labor peace.[17] However, since workers had pension wealth that was often tied to the firm,[18] and because they may sometimes have had specialized human capital as well, it is unlikely that the situation was one where workers were too strongly exposed to opportunism by or on behalf of shareholders, given that they otherwise would not allowed themselves to be exposed to such a situation. The prevailing corporate governance arrangements thus must have helped to protect worker interests. Overall, a 'balancing' board of directors, as proposed by Blair and Stout's team production theory,[19] thus provides a good fit for the 'old' system of corporate governance in the United States.[20] Both capital and labor contributed, and the board was neither strongly accountable to either group, nor did it have incentives to favor shareholders over other interests in the corporation, which began to emerge during the 1980s.[21]

B. Continental Europe: Conflict and Legal Arrangement

From a global perspective, the Berle-Means corporation remained an exception.[22] Even in the UK, which developed dispersed ownership during the second half of the 20th century, institutional investors held a larger proportion of shares than in the US[23] and were able to coordinate and

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[17] See e.g., S. Sass, 'The Development of Employer Retirement Income Plans: From the Nineteenth Century to 1980', in G.L. Clark and A.H. Munnell (eds.), *Oxford Handbook on Pensions and Retirement Income* (Oxford University Press, 2007), pp. 76, 86.

[18] See generally R.A. Ippolito, *Pension Plans and Employee Performance: Evidence, Analysis, and* Policy (Chicago University Press, 1997), pp. 10–29 (discussing how DB plans were used to create an implicit contract between employers and employees that resulted in low turnover); M. Gelter, 'The Pension System and the Rise of Shareholder Primacy' (2013) 43 *Seton Hall Law Review* 909 at 922-923.

[19] See generally M.M. Blair and L.A. Stout, 'A Team Production Theory of Corporate Law' (1999) 5 *Virginia Law Review* 247.

[20] Similarly, Gordon, above n 16 at 1514, footnote 187.

[21] See e.g. Wells, above n 12 at 24 (describing increasing shareholder power and changing corporate governance in the 1980s).

[22] See e.g. B.R. Cheffins, *Corporate Ownership and Control: British Business Transformed* (Oxford University Press, 2008), pp. 5-6.

[23] See e.g. B.S. Black and J.C. Coffee, Jr., 'Hail Britannia? Institutional Investor Behavior Under Limited Regulation' (1994) 92 *Michigan Law Review* 1997 at 2002; J. Armour, B.R. Cheffins and D.A. Skeel, Jr., 'Corporate Ownership Structure and the Evolution of Bankruptcy Law: Lessons from the United Kingdom' (2002) 55 *Vanderbilt Law Review* 1699 at 1750 (both noting that as of the 1990s, 70% of UK stock were held by institutional

influence the trajectory of corporate law and governance more strongly when ownership dispersion established itself.[24] In Continental Europe, dispersed ownership was not fully developed yet; as late as the 2000s, in major countries such as Germany, France, and Italy, large firms remained dominated by large owners, including financial institutions, government entities, families and other businesses, with a different controlling coalition in each country.[25]

Corporate black-letter law in Continental Europe did not follow the lead of US corporate law and avoided a managerialist turn over the course of the 20th century. Shareholders retained stronger powers relating to agenda-setting, regarding the appointment and removal of directors, and financial decision-making such as share issues, preemptive rights and dividends. In some jurisdictions, including France and the UK, shareholders formally retained the power to give binding instructions to management, a power they never had in the United States.[26]

The origin of this important distinction – which, strangely, was hardly touched upon in the comparative corporate law literature until the 2000s – is not entirely clear. One possibility is that in the United States, management came into a position where it could exploit the regulatory competition process to erode shareholder powers, a mechanism that was not available in

investors, while the figure was only 50% in the US); *Ibid*., at 344-346 (discussing the rise of institutional share ownership in the UK during the mid-20th century).

[24] See, e.g., J. Armour and D.A. Skeel, Jr., 'Who Writes the Rules for Hostile Takeovers, and Why? – The Peculiar Divergence of U.S. and U.K. Takeover Regulation' (2007) 95 *Georgetown Law Journal* 1727 at 1767-1776 (discussing how UK institutional investors established their influence in the 1950s and 1960s – much earlier than their US counterparts – and used it to shape takeover regulation).

[25] See, e.g., M. Becht and A. Roëll, 'Blockholdings in Europe: An International Comparison' (1999) 43 *European Economic Review* 1049; R. La Porta, F. Lopez-de-Silanes and A. Shleifer, 'Corporate Ownership Around the World' (1999) 54 *Journal of Finance* 471; M. Faccio and L.H.P. Lang, 'The Ultimate Ownership of Western European Corporations' (2002) 65 *Journal of Financial Economics* 365 at 379-380; P.A. Gourevitch and J. Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance* (Princeton University Press, 2005), p. 18; P.D. Culpepper, *Quiet Politics and Business Power* (Cambridge University Press, 2011), pp. 31-32; W.-G. Ringe, 'Changing Law and Ownership Patterns in Germany: Corporate Governance and the Erosion of Deutschland AG' (2015) 68 *American Journal of Comparative Law* 493 at 496-498 (discussing different types of blockholders in Germany).

[26] See, e.g., S. Cools, 'The Real Difference in Corporate Law Between the United States and Continental Europe: Distribution of Powers' (2005) 30 *Delaware Journal of Corporate Law* 697 at 737-750.

Europe.[27] In any event, with the exception of the UK, in Europe managers would not have been in the position to capture such a process anyway.[28] Continental Europe had, of course, controlling shareholders to take advantage of a shareholder-centric core corporate law. Even if corporate laws had taken a managerial turn, the law likely would have done little to curb shareholder power. Even in the US, we see that controlling shareholders typically do not find it difficult to impose their will on managers[29] – given their ability to elect directors – and the hurdles set up in securities law against shareholder influence really only affect the coordination between institutional investors.[30] Consequently, both the European and US experience seem to suggest that corporate law reflects a particular ownership structure, and helps to entrench it, rather than precipitating it.

On another level, however, Continental European corporate laws do not appear shareholder-friendly at all, namely when we look at the role of labor.[31] The major Continental European countries are known for stronger pro-labor employment laws that, for example, make firing workers or changing workplace conditions more costly and thus give more bargaining powers to unions.[32] While corporate governance analysts have often overlooked the very important role of these labor and employment law mechanisms, they were strongly aware of

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[27] One example is the directors' power to issue stock without seeking shareholder approval and without preemptive rights that would hinder managerial flexibility. As Marco Venturozzo notes, "[it] might be argued that in listed or publicly held corporations, where the separation between ownership and control is more profound in the U.S., directors and managers influenced the development of corporate law toward the abolition of mandatory preemptive rights." M. Ventoruzzo, 'Issuing New Shares and Preemptive Rights: A Comparative Analysis' (2013) 12 *Richmond Journal of Global Law and Business* 517 at 542.

[28] Regulatory arbitrage opportunities in Europe are more likely to be exploited by controlling shareholders. See e.g. M. Gelter, 'The Structure of Regulatory Competition in European Corporate Law' (2005) 52 *Journal of Corporate Law Studies* 247 at 269-275.

[29] This is illustrated by the imposition of a fiduciary duty of loyalty on controlling shareholders in the US. See e.g. W.T. Allen, R. Kraakman and G. Subramanian, *Commentaries and Cases on the Law of Business Organization* (New York: Aspen Publishers, 2012), pp. 295-309.

[30] See in particular Roe, above n 11 at 26; Gelter, above n 6 at 148-149 (discussing coordination problems between institutional investors exacerbated by Rules under §§ 13 and 14 of the Securities Exchange Act.

[31] See e.g. Strine, above n 6 at 17-18.

[32] See e.g. Gelter, above n 6 at 171-173.

German codetermination, which allows employees and unions to appoint half of the directors of the largest firms.[33] Similar mechanisms – although these, with the exception of the Netherlands[34], were not quite as extensive – were implemented in several other Central, Eastern, and Northern European countries.[35] Even in countries that did not have employee participation on boards, such as (until recently) France[36] and Italy, labor unions were influential. Mechanisms such as mandatory works councils in much of Continental Europe[37] and, more generally, restrictive employment laws that made dismissals difficult and costly enhanced the bargaining position of unions. While this likely was not the only relevant factor, it clearly detracted from corporations' ability to focus on producing returns for shareholders even without labor's formal involvement in corporate decision-making.

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[33] See e.g., L. Enriques, H. Hansmann and R. Kraakman, The Basic Governance Structure: Minority Shareholders and Non-Shareholder Constituencies, in R. Kraakman, *et al*., (eds.), *The Anatomy of Corporate Law* (New York: Oxford University Press, 2009), pp. 90, 100-102; M.J. Roe, 'German Codetermination and German Securities Markets (1998) *Columbia Business Law Review* 167.

[34] Under the "structure regime", one-third of the members of the supervisory board of the largest firms is nominated by the works council (although elected by shareholders). See A. de Jong and A. Roëll, 'Financing and Control in the Netherlands: A Historical Perspective', in R.K. Morck (ed.), *A History of Corporate Governance around the World* (University of Chicago Press, 2005), pp. 467, 473; P.J. Phoelich, 'Report from the Netherlands' (2009) 6 *European Company Law* 92 at 92-94. Until the 2004 reform, board members were appointed following a system of co-optation that only gave veto powers to both shareholders and the works council. P.W. Moerland, 'Complete Separation of Ownership and Control: The Structure Regime and Other Defensive Mechanisms in the Netherlands', in J.A. McCahery, *et al.,* (eds.), *Corporate Governance Regimes* (New York: Oxford University Press, 2003), pp. 286, 287-288; E. Groenewald, 'Corporate Governance in the Netherlands: From the Verdam Report of 1964 to the Tabaksblat Code of 2003' (2005) 6 *European Business Organization Law Review* 291 at 297.

[35] This includes Austria, Denmark, Finland, Hungary, Luxembourg, Norway, Slovakia, Slovenia, Sweden, and formerly the Czech Republic. See e.g., G. Jackson, 'Employee Representation on the Board Compared: A Fuzzy Sets Analysis of Corporate Governance, Unionism and Political Institutions'(2005) 12 *Industrielle Beziehungen* 1 at 4-6 (2005); T. Raiser, above n 5 at B 43–B 44; J. Lau Hansen, 'The Danish Green Paper on Company Law Reform – Modernising Company Law in the 21st Century' (2009) 10 *European Business Organization Law Review* 73 at 89–90; see C. Rose, 'The Challenges of Employee-Appointed Board Members for Corporate Governance: The Danish Evidence' (2008) 9 *European Business Organization Law Review* 215 at 224–226; Enriques, *et al*., above n 33 at 100 and footnote 47; M. Gelter, 'Tilting the Balance between Capital and Labor? The Effects of Regulatory Arbitrage in European Corporate Law on Employees' (2010) 33 *Fordham International Law Journal* 792 at 803-804.

[36] France has recently introduced employee representatives on the board. See Code de Commerce art. L225–27–1, introduced by Loi n° 2013-504 14 June 2013 relative 'à la sécurisation de l'emploi'. See S. de Vendeuil and O. Rault-Dubois, 'Représentation des salariés au conseil d'administration ou de surveillance de grandes entreprises' (2013) *JCP E* Etude 1379.

[37] See e.g. L.A. Cunningham, 'Commonalities and Prescriptions in the Vertical Dimension of Global Corporate Governance' (1999) 84 *Cornell Law Review* 1133 at 1141-1142; Gelter, above n 6 at 171-172. For a discussion of the interaction between board representation and the works council in Germany, see Paul Davies, 'Efficiency Arguments for the Collective Representation of Workers', Law Working Paper No. 279/2015 (European Corporate Governance Institute, 2015), available at http://ssrn.com/abstract=2498221, at 19.

C. Explaining the Difference

Why did the US and Continental Europe integrate both capital and labor into corporate governance in such distinct ways? One possibility is that the corporate law systems of Continental European countries are inefficient.[38] The law and finance literature provided significant fodder for this point of view. Studies have found a correlation between corporate law protecting investors on the one hand and developed capital markets and ownership dispersion on the other, with "good corporate law" leading to greater dispersion and larger capital markets, and "bad corporate law" resulting in concentrated ownership.[39]

This empirical observation can be explained in various ways. A potential functional explanation is that powerful blockholders are needed to curb excessive managerial power and to keep agency costs in check,[40] particularly when pro-labor mechanisms such as codetermination render pro-shareholder institutions such as the board of directors dysfunctional.[41] However, it is equally plausible that the absence of an effective corporate law makes the persistence of controlling shareholders more likely because a controlling shareholder retains the ability to extract private benefits of control, thus creating an incentive to remain in a controlling position.[42]

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[38] See e.g. H. Hansmann and R. Kraakman, 'The End of History for Corporate Law' (2001) 89 *Georgetown Law Journal* 439 at 443-451 (characterizing corporate governance models deviating from shareholder primacy as inefficient, and mustering market forces as driving forces for convergence).

[39] R. La Porta, *et al*., 'Legal Determinants of External Finance' (1997) 52 *Journal of Finance* 1131; R. La Porta, *et al.*, 'Law and Finance' (1998) 106 *Journal of Political Economics* 1113 at 1145-1151; S. Djankov, *et al.,* 'The Law and Economics of Self-Dealing' (2008) 88 *Journal of Financial Economics* 430.

[40]See e.g. J.C. Coffee, Jr., 'The Future as History: The Prospects for Global Convergence in Corporate Governance and its Implications' (1999) 93 *Northwestern University Law Review* 641 at 647-648; B.S. Black, 'The Legal and Institutional Preconditions for Strong Securities Markets' (2001) 48 *UCLA Law Review* 781 at 834-835; B.R. Cheffins, 'Does Law Matter? The Separation of Ownership and Control in the United Kingdom' (2001) 30 *Journal of Legal Studies* 459 at 461-465.

[41] M.J. Roe, *Political Determinants of Corporate Governance Political Context, Corporate Impact* (New York: Oxford University Press, 2003), pp. 29-37.

[42] L.A. Bebchuk, 'A Rent-Protection Theory of Corporate Ownership and Control' NBER Working Paper No. 7203 (National Bureau Economic of Research, 1999); W.W. Bratton and J.A. McCahery, 'Incomplete Contracts Theories of the Firm and Comparative Corporate Governance' (2001) 2 *Theoretical Inquiries in Law* 1 at 34-36; Gilson, above n 4 at 1644 at 1654.

Mark Roe has explained the persistence of concentrated ownership with political factors. In an influential body of scholarship, he treats labor codetermination and other pro-employee laws as an exogenous influence on corporate governance, resulting from the political necessity of the tumultuous times of the mid-20th century. By making pro-shareholder mechanisms (such as the board in the case of codetermination) ineffectual, it necessitated and allowed the persistence of blockholders, and thus inhibited the development of capital markets.[43]

And yet, it does not seem plausible that a simple inefficiency explanation can account for international differences that have persisted over long periods of time. How can it be that economically successful nations such as Germany retain governance structures so different from the ones typically perceived to be economically efficient in the predominant paradigm?

A way forward may be to integrate the interests, incentives, and investments of workers not just within a political analysis, but also within the economic paradigm by studying how corporate governance may help to secure labor supply. Such a perspective can be grounded in human capital theory. An employee's human capital – that is knowledge and skills that are used on the job – can in principle be firm-specific,[44] meaning that it cannot be transferred to another job either because the skill or combination of skills can only be used to its full productive

[43] M.J. Roe, 'Political Preconditions to Separating Ownership from Corporate Control' (2000) 53 *Stanford Law Review* 539 at 542; Roe, above n 41.

[44] See, generally, G.S. Becker, *Human Capital: A Theoretical and Empirical Analysis, with Special Reference to Education* (Chicago University Press, 1964), pp. 11-36; see also H. Hansmann, *The Ownership of Enterprise* (Harvard University Press, 1996), p. 26; J.M. Malcomson, 'Individual Employment Contracts', in O. Aschenfelter and D. Card (eds.), *Handbook of Labor Economics* (Amsterdam: Elsevier, 1999) vol. 3, pp. 2291, 2311-2337 (reviewing the literature on contractual protection of specific investment); D. Neumark, 'Productivity, Compensation, and Retirement' in Clark and Munnell, above n 17 at 721, 722.

potential at the current job[45] or because alternative positions are, for example, geographically distant, thus hindering transfers of human capital with transaction costs.[46]

For a contract to fully protect an employee's specific investment, the contract would have to be complete contingent; that is, all future possible states of the world are foreseen and verifiable with payoffs being specified for each possible future states of the world.[47] In the context of long-term employment relationships this is a highly unrealistic condition, thus rendering a key element of prevalent shareholder primacy theory highly problematic.[48] Consequently, with shareholders enjoying at least some control rights and management working on behalf of shareholders, employees are subject to the risk of 'holdup', meaning that quasi-rents that employees may have been expecting based on their investment in the employer-employee relationship will be expropriated for the benefit of shareholders.[49]

Another important factor has traditionally related to company pensions. In the United States, in the heyday of the Berle-Means corporation, firms typically provided employees with defined benefit (DB) pensions that made it financially costly to switch to another firm because

[45] E.P. Lazear, *Inside the Firm* (Oxford University Press 2011), p. 342 (giving the example of work in a tax software company requiring knowledge of computer programming, economics, and tax law).

[46] See A.L. Saxenian, *Regional Advantage: Culture and Competition in Silicon Valley and Route 128* (Harvard University Press, 1994), p. 35 (quoting an engineer comparing the difficulty of getting another job in the same industry in Texas and in Silicon Valley). Social capital may also reduce worker mobility by making relocation more costly for employees due to the need to reorient social relationships. See M. Bräuninger and A. Tolciu, 'Should I Stay or Should I Go? Regional Mobility and Social Capital' (2011) 167 *Journal of Institutional and Theoretical Economics* 434 at 434–436.

[47] For a definition of incomplete contracts, see e.g. A. Schwartz, 'Incomplete Contracts', in P. Newman (ed.), *The New Palgrave Dictionary of Economics and the Law* (London: Palgrave Macmillan, 1998), vol. 2, p. 277.

[48] See e.g., K. Greenfield, *The Failure of Corporate Law: Fundamental Flaws and Progressive Possibilities* (Chicago University Press, 2006), pp. 55–59 (arguing that workers are residual claimants like shareholders because of pension benefits and their inability to diversify).

[49] See e.g. T. Eger, 'Opportunistic termination of employment contracts and legal protection against dismissal in Germany and the USA' (2004) 23 *International Review of Law and Economics* 381 at 384-385 (discussing opportunistic wage renegotiations); J.C. Coffee, Jr., 'Shareholders Versus Managers: The Strain in the Corporate Web' (1986) 85 *Michigan Law Review* 1 at 70, footnote 194 (discussing termination of pension plans).

pensions could not be fully transferred.[50] Consequently, human capital that was by its nature not firm-specific, sometimes became firm-specific, thus tying workers to the corporation.[51]

If we widen the analysis to include employees, the dichotomy between the US, on the one hand, and the Continental European jurisdictions, on the other, gains a new dimension. In the United States, 'strong managers' and a powerful board were relatively well-positioned to balance the interests of various stakeholder groups. The function of the board must thus have been to 'slow down' the exercise of shareholder power to avoid short-termism and to prevent it from overwhelming other constituencies.[52] However, as we have explored above, the disempowerment of shareholders in the US – combined with the equally idiosyncratic ownership structure – is also unusual among capitalist economies.[53] The longstanding influence of institutional shareholders in the UK, and even more so given the power of controlling shareholders in Continental Europe, clearly pose a problem to those theories extolling the virtues of managerial power.

How can the board provide any form of corporate commitment to any constituency if it serves essentially at the discretion of a controlling shareholder or coalition of large blockholders? Hierarchical theories of the corporation, such as the team production[54] and director primacy[55]

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[50] Pension benefits were often calculated on the bases of the highest yearly salaries or a fixed dollar amount for each year of service. See e.g. E.A. Zelinsky, *The Origins of the Ownership Society: How the Defined Contribution Paradigm Changed America* (Oxford University Press, 2007), p. 1; A.H. Munnell, 'Employer-Sponsored Plans: The Shift from Defined Benefit to Defined Contribution', in Clark and Munnell, above n 17 at 359, 365; E.A. Zelinsky, 'The Cash Balance Controversy' (2000) 19 *Virginia Tax Review* 683 at 687.

[51] See generally Ippolito, above n 18 at 10-29 (discussing how DB plans were used to create an implicit contract between employers and employees that resulted in low turnover); A.H. Munnell and A. Sundén, *Coming Up Short: The Challenge of 401(k) Plans* (Washington, DC: Brookings Institution Press, 2004), p. 2; Munnell, above n 50 at 365; Sass, above n 17 at 87 (explaining that typically pension claims only vested after ten years with the same employer).

[52] R.B. Thompson, 'The Power of Shareholders in the United States', in Hill and Thomas, above n 12 at 441, 446.

[53] See above n 26-30 and accompanying text.

[54] Blair and Stout, above n 19.

[55] S.M. Bainbridge, 'Director Primacy: The Means and Ends of Corporate Governance' (2003) 97 *Northwestern University Law Review* 547.

models, and the commitment model[56] of the corporation, therefore face considerable hurdles as positive theories of the nature of the corporation outside the Anglo-Saxon world.[57] For a comparative analysis, however, such an explanation is less than satisfactory. For instance, in the German (or generally Continental European) system, corporations are characterized by strong owners and weak managers, but also by strong labor.[58] A strong power of management vis-à-vis shareholders can only manifest itself if the CEO himself is a significant blockholder in the firm or, in individual cases, where a particularly strong personality in top management is able to assert the board's strength vis-à-vis a controlling shareholder.

The various institutions strengthening the power of labor (board representations and labor laws strengthening union power) can thus be seen as protecting employees vis-à-vis hold-up risks emanating from the presence of influential large shareholders who potentially both have the incentive to expropriate labor – at least at certain points in time – and would also have the power to do it if it were not for the presence of pro-labor laws and regulations.[59] The weighing and balancing of interests between capital and labor, which in the mediating hierarch model of US corporate governance is left to a board serving as a large independent third party, is, in the European context, thus put on the level of influences of shareholders – created by strong share ownership – and legally buttressed by the influence of labor. Thus, the weighing of interests between these groups happens at the level of the law rather than at the level of a board.

To put it differently, economic and legal arrangements can be seen as commitment mechanisms protecting the firm – and those with specific investments in it – from the excessive

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[56] C. Mayer, *Firm Commitment: Why the Corporation is Failing Us and How to Restore Trust in It* (Oxford University Press, 2013); C. Mayer, 'Conceiving Corporate Commitment: Creation and Confirmation' in Hill and Thomas, above n 12 at 211.
[57] See L.A. Bebchuk, 'The Case for Increasing Shareholder Power' (2005) 118 *Harvard Law Review* 833 at 908-909 (defending shareholder empowerment on the grounds that those supporting limitations on the power of dispersed shareholders would equally have to "support limiting the intervention power of controlling shareholders").
[58] See above n 31-37 and accompanying text.
[59] Gelter, above n 6 at 168-173.

influence of one group, which includes particularly large or well-coordinated shareholders. In the US, capital has traditionally resigned itself to a residual influence and provided commitment through the Berle-Means structure and backed up by managerialist corporate law. In concentrated ownership systems, it was able to do so only through a legal arrangement that strengthened the powers of the most important non-capital group, namely labor. Ultimately, the US and Continental equilibria may thus achieve relatively similar results, but they do it by incorporating two different elements, namely weak labor and weak owners on one side of the Atlantic, and strong owners and strong labor on the other, thus yielding two different balances of power.

As shown in Table 1, one might speculate that strong shareholders must be balanced by strong labor to foster human capital development, while in situations with weak shareholders, strong labor power would be problematic because it would exacerbate agency problems.[60]

A	weak shareholders weak labor	**B**	strong shareholders weak labor
C	weak shareholders strong labor	**D**	strong shareholders strong labor

Table 1: Local optima of shareholder influence and labor power

In this light, one is tempted to conclude that a political theory deriving concentrated ownership from labor power may have it backwards. Chronologically, it is clear that concentrated ownership came first, and labor-strengthening laws came later, often fully falling into place after

[60] For a more detailed explanation see *Ibid.*, at 176-181.

World War II.[61] By contrast, concentrated ownership is inevitably the primeval state of the world for a corporate governance system, since firms are normally set up by a founder, and the separation of ownership and control can only be set at a subsequent stage when firms are already big enough to make use of the capital market as their primary means of finance.

As Ugo Pagano suggests, control of capital in the early 20th century may have reflected the larger picture of political and social organization in a particular country, namely either democratic or aristocratic and family oriented, with the respective pattern perpetuating itself in economic governance.[62] The reasons why particular systems originally came into place may have been exogenous and mainly political at that point in time,[63] and they may have perpetuated long-standing social structures. It appears that to some extent two elements – namely strong labor and strong shareholders on one hand and weak labor and weak shareholders on the other – reinforced each other as a set of institutional complementarities.[64] Changing one without changing the other would have been costly and would have either exacerbated holdup risk, increased agency costs, or would have caused costly regulation without much benefit. Consequently, each system exhibited inertia and path-dependent resistance to change.

III. New Comparative Corporate Governance

A. United States

In the United States, the transition to the new corporate governance model began in the 1970s. Corporations became more mindful of their shareholders and dissatisfaction with the

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[61] Roe, above n 41 at 78; *Ibid*., at 181-184.

[62] U. Pagano, 'The Evolution of the American Corporation and Global Organizational Biodiversity' (2012) 35 *Seattle University Law Review* 1271 at 1279-1290.

[63] See also M.J. Roe, 'Legal Origins, Politics, and Modern Stock Markets' (2006) 120 *Harvard Law Review* 461 at 295-500 (suggesting that political disruption inflicted by the Depression and World War II may be responsible for the persistence of concentrated ownership in Continental Europe).

[64] M.J. Roe and M. Vatiero, 'Corporate Governance and Its Political Economy', Discussion Paper No. 5/2015 (Harvard Olin Center, 2015), available at http://ssrn.com/abstract=2588760, at 14.

performance of the board of directors led to the corporate governance movement and the American Law Institute's ALI Principles.[65] Concurrently, the SEC became more strongly involved with corporate governance issues, for example, by providing rules requiring boards to have independent directors that were intended to monitor on behalf of shareholders.[66]

The 1980s saw the takeover wave, which allowed shareholders in some cases to extract rents at the expense of labor,[67] but often also to make firms more efficient.[68] This was followed by the introduction of performance-oriented executive compensation, which helped make managers more focused on stock prices. While this may seem the normal state of affairs to us today, this was not typically the case in prior periods. However, the market for corporate control remained incomplete as a mechanism for focusing managerial actions on shareholder interests given the scarcity of takeovers and the reticence of Delaware law, which essentially entrenched managerialism by permitting firms to defend against takeovers with the *Moran*[69] and *Unocal*[70]

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[65] The ALI project was initiated in 1978, a first draft was produced in 1982, and the final "Principles of Corporate Governance" were promulgated in 1992. See R.B. Perkins, 'The Genesis and Goals of the ALI Corporate Governance Project' (1987) 8 *Cardozo Law Review* 661 at 666-668 (discussing the Corporate Governance project as a way of addressing corporate problems and preempting federal regulation); S.M. Bainbridge, 'Independent Directors and the ALI Corporate Governance Project′ (1993) 61 *George Washington Law Review* 1034 at 1044-1052 (discussing crisis as the initial impetus for launching the project); Gordon, above n 16 at 1481 ("Throughout the 1980s and 1990s, various panels and 'blue ribbon' committees developed somewhat influential 'best practice' guidelines for relationship tests.").

[66] See e.g. R.S. Karmel, 'Is the Independent Director Model Broken?' (2014) 37 *Seattle University Law Review* 775 at 780-781 (describing SEC involvement relating to independent directors). Note, however, that the empirical evidence on the effects of independent board members on shareholder wealth is, at best, mixed. See M.M. Blair, 'Boards of Directors and Corporate Performance under a Team Production Model' in Hill and Thomas, above n 12 at 249, 250-255.

[67] The theory of LBOs in particular as redistributing from employees to shareholders was established in, for example, A. Shleifer and L. Summers, 'Breach of Trust in Hostile Takeovers', in A.J. Auerbach (ed.), *Corporate Takeovers: Causes and Consequences* (University of Chicago Press, 1988), pp. 33, 37. It is most plausible in the context of pension plan "terminations for reversion." See M.A. Petersen, 'Pension Reversions and Worker-Stockholder Wealth Transfers'(1992) 107 *Quarterly Journal of Economics* 1033; M.M. Blair, 'The Great Pension Grab: Comments on Richard Ippolito, Bankruptcy and Workers: Risks, Compensation and Pension Contracts' (2004) 82 *Washington University Law Quarterly* 1305; Gelter, above n 18 at 933-936.

[68] For an overview of the empirical literature, see S. Bhagat and R. Romano, 'Empirical Studies of Corporate Law', in A.M. Polinsky and S. Shavell (eds.), *Handbook of Law and Economics* (Amsterdam: Elsevier, 2007), vol. 2, pp. 945, 987-992.

[69] *Moran* v. *Household International, Inc.,* 500 A 2d 1346 (Del. 1985).

[70] *Unocal Corp.* v. *Mesa Petroleum Co.,* 493 A 2d 946 (Del. 1985).

doctrines.[71] Similarly, executive compensation turned out to be, to a significant extent, a rent-seeking device for corporate management[72] and has arguably often been a driver of corporate short-termism.[73]

Consequently, corporate governance analysts put high hopes into institutional investors, whose shareholder activism became more noticeable from the 1990s onwards.[74] With state pension funds leading the way, this movement bore full fruition only in the second half of the first decade of the 2000s when various elements of the voting system were changed. This led commentators to declare that US corporations had now entered a 'shareholder-centric reality';[75] that is, a situation resembling that of the UK. At the same time, commentators observed a 're-concentration of share ownership',[76] namely a higher proportion of shares being held by institutional investors with retail investors progressively leaving the market. With share ownership being slightly more concentrated within firms and strongly more concentrated across the market, the political situation for more shareholder power seems ripe. Even Delaware judges are becoming more skeptical about their treasured managerialism, given that shareholders are now more sophisticated and probably less in need of self-protection.[77]

The labor side of corporate governance has concurrently become weaker. Not only has labor become more mobile and its share in the income of the American economy decreased in the

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[71] The *Unitrin* test arguably made it easier for boards to defend against hostile bids under the *Unocal* test. *Unitrin, Inc.* v. *American General Corp.*, 651 A 2d 1361 (Del. 1995).

[72] See e.g. L.A. Bebchuk and J.M. Fried, 'Executive Compensation as an Agency Problem' (2003) 17 *Journal of Economic Perspectives* 71.

[73] P. Bolton, J. Scheinkman and W. Xiong, 'Pay for Short-Term Performance: Executive Compensation in Speculative Markets' (2005) 30 *Journal of Corporate Law* 721.

[74] See e.g. E.B. Rock, 'The Logic and (Uncertain) Significance of Institutional Shareholder Activism' (1991) 79 *Georgetown Law Journal* 445.

[75] E.B. Rock, 'Adapting to the New Shareholder-Centric Reality' (2013) 161 *University of Pennsylvania Law Review* 1907.

[76] Gilson and Gordon, above n 10 at 886-888.

[77] See e.g. *Air Products and Chemicals* v. *Airgas*, 16 A 3d 48 at 57 (Del. Ch. 2011) (suggesting that the poison pill has served its purpose in this case, but that precedent case law dictates that the courts respect the board's decision in identifying a "cognizable threat" under *Unocal.*

past decades, but in an environment with higher labor mobility, workers are less strongly dependent on specific jobs. Pension plans have gradually moved from the DB to the DC system – for regulatory reasons largely outside of the purview of corporate governance[78] – thus likely reducing the degree to which human capital is artificially rendered firm-specific.[79] The transition has also ensured that employees are no longer creditors of their employer with a fixed DB pension claim, but rather shareholder-investors and typically much more diversified in the market. Americans have become more dependent on the capital market with their retirement wealth since employers' guarantees do not exist in a DC plan.

Paradoxically, the most active institutional investors are typically DB plans – often those connected with government employees – and not mutual funds with whom 401(k) money is typically invested.[80] While mutual funds are not typically shareholder activists,[81] they often 'vote

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[78] U.S. Department of Labor, Employee Benefits Security Administration, 'Private Pension Plan Bulletin Historical Tables and Graphs' (2009) available at http://www.dol.gov/ebsa/pdf/1975-2006historicaltables.pdf (tracing historical trends in occupational pensions); See Zelinsky, above n 50 at 38-55; G.A. (Sandy) MacKenzie, *The Decline of the Traditional Pension* (Cambridge University Press, 2010); Gelter, above n 18 at 929-936 (all discussing reasons for the shift).

[79] Gelter, above n 18 at 947-948; see also Munnell, above n 50 at 367 (discussing the fit between DB plans and industries with a stable workforce on the one hand, and the fit between DC plans higher labor mobility on the other); S.M. Jacoby, 'Labor and Finance in the United States', in C.A. Williams and P. Zumbansen (eds.), *The Embedded Firm: Corporate Governance, Labor, and Finance Capitalism* (Cambridge University Press, 2011), pp. 277, 286 (suggesting that firms no longer invest in long-term projects such as employee training due to the short-term horizon of institutional investors).

[80] See e.g. S.M. Jacoby, 'Convergence by Design: The Case of CalPERS in Japan' (2007) 55 *American Journal of Comparative Law* 239 at 243–254 (describing the history of shareholder activism by CalPERS); S.J. Choi and J.E. Fish, 'On Beyond CalPERS: Survey Evidence on the Developing Role of Public Pension Funds in Corporate Governance' (2008) 61 *Vanderbilt Law Review* 315 at 315; A. Lucchetti and J.S. Lublin, 'Corporate Governance: Calpers Targets Directors Who Neglect Holders', Wall Street Journal, 16 April 16, at p. C1 (describing CalPERS's renewed efforts at shareholder activism); see also *Westland Police & Fire Retirement Systems* v. *Axcelis Technologies Inc.*, 1 A 3d 281 (Del. 2010) (public sector pension plan seeking to put a majority voting bylaw amendment on the target company's proxy statement).

[81] L.E. Strine, Jr., 'The Delaware Way: How We Do Corporate Law and Some of the New Challenges We (and Europe) Face' (2005) 30 *Delaware Journal of Corporate Law* 673 at 687; see also S.M. Jacoby, 'Finance and Labor: Perspectives on Risk, Inequality, and Democracy' (2008) 30 *Comparative Labor Law & Policy Journal* 17 at 55; A. Tucker, 'The Citizen Shareholder: Modernizing the Agency Paradigm to Reflect How and Why a Majority of Americans Invest in the Market' (2012) 35 *Seattle University Law Review* 1299 at 1302–1307 (highlighting agency problems between investors and mutual funds managers).

with their feet' by selling shares if they are discontent with management.[82] In an environment where corporate managers are often dependent on their firms' stock price because of executive pay practices, an alignment of managerial performance with shareholder interests does not require shareholder activism since market prices similarly create the appropriate incentives. In any event, on the political level, pro-shareholder policies have gained ground relative to pro-labor policies, given that the retirement wealth of politically relevant American voters means that Middle America has a large stake in corporate America. It is therefore not surprising that the center-left has sometimes taken up the cause of pro-shareholder reforms, which some political scientists have described as a 'transparency coalition' between shareholders and workers.[83]

Theories of US corporate governance emphasizing managerial power, including those emphasizing an equilibrium between stakeholder groups or commitment to them as central for corporate law, face serious problems in light of the developments of the past decades. If interpreted as descriptive theories, they are certainly less persuasive in today's environment where the balance is increasingly tipping toward shareholders. While managerial powers and the central role of the board have only been eroded on the margins, the incentive of the relevant actors are now much more strongly tied to shareholder interests than they were 30 years ago. If we interpret managerial theories as normative prescriptions, however, then US corporate governance clearly has been pushed out of a balance that served the country well.

Alternatively, one might argue that an increased attention to shareholder interests may well be efficient *ceteris paribus*, given that Americans have become so strongly dependent on the

[82]See e.g. D. Gross, 'Some Mutual Funds Are Joining the Activist Bandwagon', New York Times, 15 January 2006, available at http://www.nytimes.com/2006/01/15/business/mutfund/15active.html (quoting an investment analyst).
[83] The terms goes back to Gourevitch and Shinn, above n 25 at 210–211. See also J.W. Cioffi, *Public Law and Private Power* (New York: Cornell University Press, 2010), pp. 108–136; C.M. Bruner, 'Corporate Governance Reform in a Time of Crisis' (2011) 36 *Journal of Corporation Law* 309 at 338; Gelter, above n 18 at 949-950.

capital market with their retirement wealth.[84] If the classical agency problem of separation of ownership and control has thus been largely resolved,[85] the issue of intermediated agency capitalism comes to the fore: Do fund managers actually pursue the best interest of their investors when filling the shareholder role? Future corporate governance analysis will thus have to shed light on the agency problem between shareholders and fund managers, both in the domestic and comparative dimensions.

B. Continental Europe

On the other side of the Atlantic, corporate governance in the various Continental European systems underwent considerable change during the period most strongly identified with the movement toward convergence, namely the late 1990s and early 2000s. Abandoning or eroding state-centric and labor-centric corporate governance models, countries across the continent began to implement reforms ostensibly strengthening shareholders, in particular, outside investors not belonging to the traditional elite coalition. This trend went hand in hand with a growing international dispersion of ownership, which was made possible by more open capital markets that allowed an influx of institutional investment. CalPERS, ever at the vanguard of corporate governance trends, began to promote a set of 'Global Corporate Governance Principles' with an international audience in the 1990s.[86]

During this period a European 'corporate governance movement' arose, which was characterized by the adoption of corporate governance codes following the British 'comply or

[84] Gelter, above n 18 at 946-948.
[85] Rock, above n 75 at 1926 (suggesting that the "shareholder-manager agency cost problem has been brought under control").
[86] T.J. André, 'Cultural Hegemony: The Exportation of Anglo-Saxon Corporate Governance Ideology to Germany'(1998) 73 *Tulane Law Review* 69 at 76-83 (describing CalPERS' portfolio and its code of principles).

explain' model.[87] Most countries introduced pro-shareholder reforms, such as the German Control and Transparency Act of 1998,[88] the French 'Nouvelles régulations économiques' of 2001[89], and the Italian reforms of 2004.[90] Subsequently, the EU Commission's 'High Level Report of Company Law Experts' of 2002[91] promoted the shareholder agenda, and the 2007 Shareholder Rights Directive[92] required a number of reforms compliant to the tastes of English and American institutional investors. Since a 2006 amendment, the EU Accounting Directive has required that publicly traded firms must disclose whether the company applies a corporate governance code and explain if it does not apply some of its provisions.[93] Nevertheless, the significance of these codes in Continental Europe is questionable, given that there is little − if any − empirical evidence showing positive effects. In retrospect, corporate governance codes seem to have been mainly a marketing instrument.[94] They provided a superficial benefit to 'international

[87] R.V. Aguilera and A. Cuervo-Cazurra, 'Codes of Good Governance' (2009) 17 *Corporate Governance* 376 at 377-379 (describing the spread of codes from their English origins). The European Corporate Governance Institute provides a list at http://www.ecgi.org/codes/all_codes.php.
[88] Gesetz zur Kontrolle und Transparenz im Unternehmensbereich (KonTraG), 3 March 1998, BGBl I Nr.24 S. 786, 30 April 1998. See e.g. Mariana Pargendler, 'State Ownership and Corporate Governance' (2011) available at http://ssrn.com/abstract=1854452 (discussing the role of the KonTraG and privatization for the development of shareholder value thinking in Germany); P.-Y. Gomez and H. Korine, *Entrepreneurs and democracy: A political Theory of Corporate Governance* (Cambridge University Press, 2008), p. 192; However, the ostensible motivation of this comprehensive legal reform was actually a number of corporate failures in the late 1990s. For an overview of the act, see U. Seibert, 'Control and Transparency in Business (KonTraG): Corporate Governance Reform in Germany' (1999) *European Business Law Review* 70 at 70 (describing the collapse of Metallgesellschaft as a main trigger for the debate).
[89] B. Clift, 'French Corporate Governance in the New Global Economy: Mechanisms of Change and Hybridisation within Models of Capitalism' (2007)55 *Political Studies* 546 at 553-557.
[90] See also L. Enriques and P.F. Volpin, 'Corporate Governance Reforms in Continental Europe' (2007) 21 *Journal of Economic Perspective* 117 at 127-137 (surveying Continental European reforms).
[91] High Level Group of Company Law Experts, 'Report on a Modern Framework for Company Law in Europe' 4 November 2002.
[92] Directive 2007/36/EC of the European Parliament and of the Council of 11 July 2007 on the exercise of certain rights of shareholders in listed companies, OJ 2007 No. L184/17 (implementing e.g. a record date system and facilitating voting for international investors).
[93] Since 2013, the provision is in art. 20 of the recast Accounting Directive. Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC, OJ No. L182/19.
[94] For alternative interpretations see S. Thomsen, 'The Hidden Meaning of Codes: Corporate Governance and Investor Rent Seeking' (2006) 7 *European Business Organization Law Review* 845 (interpreting codes as a rent-seeking mechanism for institutional investors); L.-C. Wolff, 'Law as Marketing Gimmick – The Case of the German

investors' in order to tap international capital markets and keep institutions interested, while at the same time, did little that would actually harm the dominant corporate governance coalition.

Even if these adjustments remained minor, they need to be understood against the backdrop of societal and cultural changes that brought the European 'coordinated capitalism' more in line with American (and English) 'liberal' capitalism.[95] One major cultural, if not yet economic, change emanated from the retirement system. Spurred by the OECD, Continental Europeans were told for at least a quarter of a century that their pensions – which tend to be governed-run, DB-style systems – are unsustainable for demographic reasons.[96] Encouraged to reform their PAYGO retirement systems by the OECD and the World Bank, Continental European countries thus attempted to move to a more balanced mix of the 'three pillars' in retirement, thereby strengthening the role of individual responsibility in the form of private pension accounts.[97] Private stock ownership and private investment were also heavily promoted and, at least for a while, obtained a significance in the public perception that they probably did

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Corporate Governance Code' (2004) 3 *Washington University Global Studies Law Review* 115 at 132-133 (plausibly describing the German code as a marketing instrument aimed at foreign investors); A. Zattoni and F. Cuomo, 'Why Adopt Codes of Good Governance? A Comparison of Institutional and Efficiency Perspectives' (2008) 16 *Corporate Governance* 1 at 13 (suggesting that the content and adoption process of codes supports a "legitimation theory" for the adoption of codes in civil law countries); M.M. Siems, *Convergence in Shareholder Law* (Cambridge University Press, 2008), pp. 56-59.

[95] See generally P.A. Hall and D. Soskice, 'An Introduction to Varieties of Capitalism', in P.A. Hall and D. Soskice (eds.), *Varieties Of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford University Press, 2001), p. 1.

[96] See e.g. L. Schruff, 'Pensions and Post-Retirement Benefits by Employers in Germany' (1998) 64 *Brooklyn Law Review* 795 at 797-798 (describing demographic trends in Germany); D. Blanchet and F. Legros, 'France. The Difficult Path to Consensual Reforms', in M. Feldstein and H. Siebert (eds.), *Social Security Pension Reform in Europe* (Chicago University Press, 2002), pp. 109, 113-116 (describing the 1990 reform debate in France); D. Franco, 'Italy. A Never-Ending Pension Reform', in Feldstein and Siebert, above n 96 at 211 (describing demographic problems in Italy); B. Rürup, 'The German Pension System. Status Quo and Reform Options', in Feldstein and Siebert, above n 96 at 137, 160 (describing the German PAYGO system as "threatened by demographic changes within German society); Mackenzie, above n 78 at 145 (table showing the growth of life expectancy in 10 OECD countries).

[97] The "three pillars" represent a commonly used definitional framework proposed by the World Bank. See World Bank, *Averting the Old Age Crisis* (Oxford University Press, 1994), p. 15; J. Marshall and S. Butterworth, 'Pensions Reform in the EU: The Unexplored Time Bomb in the Single Market' (2000) 37 *Common Market Law Review* 739 at 741-744.

not have at any time since the Great Depression.[98] All of this may have resulted in a greater political acceptance of shareholder interests in corporate governance.[99]

It remains yet to be seen what impact the financial crisis will have on the new, emerging balance. Many private (but tax-subsidized) pension plans have run into considerable problems in the late 2000s.[100] Continental capital markets have not, in many cases, regained the vigor of the convergence period. Union membership is still eroding across the continent and employment protection has been under attack in the name of more flexibility and lower unemployment for at least two decades. The 'convergence in corporate governance' period led to a discussion about codetermination in Germany, but not to a fundamental reassessment or change.[101] Ultimately, the political power of labor and its entrenched institutions were yet too resilient and not sufficiently eroded to give way during this now infamous phase. However, the Netherlands – often an outlier on the Continent in many parts of the political economy – weakened its co-optive 'structure model' of employee participation to a more moderate one in 2004.[102]

With the financial crisis having led to a prolonged recession, no clear trend in labor and corporate governance seems to be emerging. Whereas one country – the Czech Republic –

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[98] See e.g., J.A. Fanto, 'Persuasion and Resistance: The Use of Psychology by Anglo-American Corporate Governance Advocates in France' (2002) 35 *Vanderbilt Journal of Transactional Law* 1041 at 1086-1087 (suggesting that Anglo-American "corporate governance advocates – consciously or not – used psychological factors to manipulate or persuade [French] policymakers […] to support a particular form of corporate finance and governance").

[99] See Gourevitch and Shinn, above n 25 at 220–221 (suggesting a shift in the political preferences of workers toward minority shareholder protection); Gelter, above n 18 at 967-968; see also A. Dignam and M. Galanis, *The Globalization of Corporate Governance* (Farnham: Ashgate Publishing, 2009), pp. 66–70 (discussing retirement savings of workers as reason for the political importance of shareholders); G.F. Davis, 'The Twilight of the Berle and Means Corporation' (2011) 34 *Seattle University Law Review* 1121 at 1129.

[100] See e.g. B. Ebbinghaus, 'The Privatization and Marketization of Pensions in Europe: A Double Transformation Facing the Crisis' (2015) 1 *European Policy Analysis* 56 at 56-57 ("The financial market crash in 2007/2008, however, has challenged the merits of private funded pensions as their assets experienced a substantial decline within a short time […]. As a result, trust in the expected long-term returns of funded pensions has been shattered at a time when saving for retirement has become more important.").

[101] See e.g. E. McGaughey, 'The Codetermination Bargains: The History of German Corporate and Labour Law', LSE Law, Society and Economy Working Papers No. 10/2015 (London School of Economics and Political Science Law Department, 2015) available at http://ssrn.com/abstract=2579932, at 40-42 (surveying recent debates and noting that codetermination has not been seriously questioned since 1979).

[102] Groenewald, above n 33 at 297-300.

abandoned employee representation on the board recently,[103] the recent espousal of employee representation by France seems a much greater victory for the idea. Employee representation in France was introduced in the wake of the election of President Hollande within the context of pro-employment reforms that seemed to be bringing back some traditional left-wing policies.[104]

We can probably say that the 'convergence in corporate governance' period has been the result of political and possibly demographic developments exogenous to the financial system. In contrast to the United States, it seems that no stable equilibrium state of the politics of corporate governance has emerged yet. Political scientists have pointed out that German corporate governance systems have been shifting toward a 'transparency coalition', which pitches the interests of investors and workers against those of managers and other corporate insiders.[105] That coalition, however, did not prove itself stable with the failure of the largely pro-shareholder Schroeder government – which was cannibalized from the left – being a prominent example.[106] Subsequently, the financial crisis dealt a significant blow to the emerging liberal consensus of the previous decade.

Nevertheless, it seems that the time of the government as an important shareholder, the all-powerful role of banks and other financial institutions and the eminent role of unions of decades past is not destined to return. Institutional investors, rather international than local ones, continue to gain ground on the Continent. In Germany, in particular, it appears that large shareholders are losing ground with the ownership structure of the largest corporations no longer

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[103] L. Fulton, 'Board Representation' (Czech Republic), available at http://www.worker-participation.eu/National-Industrial-Relations/Countries/Czech-Republic/Board-level-Representation.

[104] Code de Commerce art. L225–27–1, above n 36.

[105] Gourevitch and Shinn, above n 25 at 160-167.

[106] Cioffi, above n 83 at 9 (pointing out that pro-shareholder reforms were spearheaded by the center-left Schröder government). This episode may illustrate Marco Pagano and Paolo Volpin's theory, according to which proportional voting systems are more likely than majoritarian ones to produce stronger employment and weaker investor protection. M. Pagano and P.F. Volpin, 'The Political Economy of Corporate Governance' (2005) 95 *American Economic Review* 1005.

resembling the 'powerful blockholder' dynamic of old, but a new equilibrium transitional between dispersed and concentrated ownership.[107] The end result will likely be a modified version of the respective traditional corporate governance system of each country, with the powers of large shareholders and other insiders only diminished slightly, but coupled with larger and more restless outside investors. While power structures will likely be more balanced than they were in the past, this is not the sea change the convergence literature expected.

IV. Conclusion

Over the past decades outside investors have gained in power both in the United States and in Continental Europe. However, neither in the US nor in Continental Europe has the traditional corporate governance system been completely superseded by a new one. The US is still to a large extent manager-centric, although managerial incentives are more aligned with shareholder interests. The role of labor has changed fundamentally, and employees have effectively become shareholders as a result of defined contribution pension plans. Continental Europe still has coordinated corporate governance systems, with powerful large shareholders, and often powerful other groups. Labor as an independent force has remained more important than in the United States, but outside institutional investors – sometimes from the US – have become a player to be reckoned with. One could say that investor influence has added an additional layer of complexity to the respective corporate governance system. The underlying substrate or deep structure of each system persists.

[107] Ringe, above n 25 at 508-517.

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