

**From National Diversity Towards Transnational Homogenization? –
Corporate Governance Regulation
Between Market and Multi-Level Governance**

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1. Introduction

Whether distinct national “varieties of capitalism” will survive in an increasingly globalizing economy has become one of the most hotly debated issues in Comparative Political Economy since the early 1990s. We are currently in the process of preparing a research project which seeks to address the “convergence-divergence-conundrum” by focussing on the transformation of national corporate governance regimes. Corporate governance is ideally suited to explore these issues for two reasons. On the one hand, it constitutes a core element of the institutional structures of national economies, which should be highly resistant to pressures for change. On the other hand, the scope for sustaining distinct national models of capitalism seems to be shrinking rapidly in light of the internalization of trade and finance, the efforts of the European Union to create a harmonized legal framework for the single market and the changing strategies of big corporations and institutional investors. Because of these developments, national political economies find themselves under increasing pressure to adopt essentially similar economic institutions and practices.

Will economic and political integration lead to convergence, persistent divergence or the evolution of new hybrid structures within national corporate governance regimes? Which factors are driving or obstructing processes of regime transformation? We want to trace these questions in a comparative analysis of regime change in three European countries – Germany, France, Great Britain – and the US. Our specific focus will be on the role of national and transnational players and of private and public actors in the formulation and cross-national transfer of corporate governance rules and standards.

While the field of corporate governance is turning into an academic growth industry, there is still a dearth of thorough empirical studies which trace the evolution of national corporate governance regimes and, especially, of corporate governance regulation in the context of globalization and Europeanization. In terms of theoretical approaches, two contrary propositions lie at the heart of the debate. Whereas institutionalist approaches emphasize the stickiness of national institutional configurations, studies in International Political Economy observe the global diffusion of a neo-liberal version of market capitalism and regulation. We treat the transformation of national corporate governance regimes as a predominantly empirical question. Prioritizing one set of variables – either domestic institutional arrangements or international forces – will not yield a satisfactory explanation of the processes of change. In our opinion,

the most promising route to take is to link comparative institutionalism with the transnational orientation of the International Political Economy literature. Thus, we see the dynamics of regime transformation as shaped by a nationally distinct interplay of national and transnational actors and institutions.

In this paper, we intend to present some preliminary observations on the driving forces and patterns of regulatory reform in corporate governance in our three European case studies. Since the 1990s, the corporate governance regimes of France, Germany and Great Britain have moved towards a greater market-orientation and increased control of managerial discretion aimed at promoting and safeguarding shareholder interests. Although the general direction of the reforms has been roughly the same in all cases, pressures for change have been filtered and modified by national political and economic institutions and the power relationships which are embedded in these arrangements. The degree of market-orientation and transnationalization apparently differs not only across nations, but also between different control mechanisms. In the field of accounting and auditing, the ongoing reform processes seem to be characterized by a comparatively high degree of transnationalization and harmonization of standards and oversight structures. Convergence is promoted not only by initiatives of the European Union, but also by measures taken at the national level. A significantly lower amount of convergence is occurring with regard to the role and the composition of the internal monitoring board, as the influence of transnational variables is weakened by different board structures and the specific configurations of interests reflected in these structures. Similarly, the regulation of the main external control mechanism – the market for corporate control – is apparently determined to a considerable amount by national variables. Here, we can observe substantial differences in the timing and process of reforms and in the policy output.

2. The Problem: Corporate Governance and the Transformation of National Models of Capitalism

That capitalist economies may be structured by rather diverse institutional arrangements, has already been noted by scholars early in the last century (cf. Hilferding 1910, Marshall 1919). Notwithstanding this recognition of diversity, a new ideal economic model has been heralded about every ten years or so (Amable 2003: 3). While the German consensus economy was seen as a model worth emulating in the 1970s and 1980s, the superior economic performance of the Anglo-Saxon economies during the last decade has led to their institutional make-up being proclaimed as the

standard model of the “New Economy”. However, these days, the pressure to adopt the institutions and practices considered to be the most efficient seems to have intensified a lot as the boundaries between national political economies have eroded. The current environment is likely to be much less tolerant of national “varieties of capitalism” than the “Golden Age” of post-war capitalism.

In studies on comparative political economy, one commonly finds a basic distinction between two ideal types of market capitalism (cf. Lütz 2004 for a review of the literature). In *Anglo-Saxon liberal market economies*, market relationships constitute the predominant mode of interaction between firms and between employers and employees, state intervention occurs on a comparatively low level and is mainly oriented towards correcting market failures. In contrast, inter-firm relations and labour relations in the *coordinated market economies of Continental Europe* are managed to a considerable extent via non-market modes of coordination. The state takes on a more prominent role in the economy and pursues more extensive social and industrial policies.

Corporate governance is a core element of the institutional architecture of national political economies. While economic approaches usually apply a rather narrow focus which restricts the term to the relationship between shareholders and managers, we favour a more inclusive perspective. We define corporate governance as the structures and practices shaping the distribution of influence and control among different groups of stakeholders. These institutional patterns circumscribe the role of managers, shareholders, creditors, workers, cooperating firms and the state in governing and monitoring large listed corporations (Goyer 2001: 135; Hopt/Prigge 1998: v; O’Sullivan 2001b:1; Streeck/Höpner 2003: 14; Weimer/Pape 1999: 152).

In corporate governance research, the distinction between liberal and coordinated market economies is matched by two ideal types of corporate governance regimes: market-oriented “outsider” systems and network-oriented “insider” systems. (Berglöf 1997; Franks/ Mayer 1995; Hall/Soskice 2001; Moerland 1995; Rhodes/van Apeldoorn 1998; van den Berghe 2002). In the former model, share ownership is widely dispersed among a multitude of investors who generally have an arm’s length relationship with the firm and rarely intervene into its affairs. Therefore, market-based mechanisms of monitoring and disciplining management serve to direct corporate strategy towards maximizing shareholder value. The latter model is found in Continental Europe, where ownership concentration is generally high, and the relation-

ships among firms are often characterized by cross-shareholdings and cross-directorates. Via such networks, specific groups of actors whose configuration may differ among countries gain direct influence on corporate decision-making, which tends to be informed by a more collective concept of governance not solely in the interest of shareholders, but of the firm as a whole.

Several interrelated economic and political developments – the globalization and liberalization of business and financial markets, the harmonization of legal rules in the context of the European single market project, the rise of institutional investors and the transformation of businesses practices and strategies – pose significant challenges to national corporate governance regimes. Whereas liberal models of capitalism and corporate governance are apparently better suited to cope with these new challenges, their destabilizing effect on traditional patterns of influence and control seems to be particularly high in network-oriented systems. However, despite the fact that the literature on corporate governance is growing on a daily basis, we lack sound empirical knowledge on how national corporate governance regimes respond to the “new times”. In particular, there is a dearth of studies analyzing the political dimension of corporate governance, especially in a comparative perspective. This deficit is all the more striking, as recent economic and legal works in the field are emphasizing the strong influence of political and legal rules and institutions on the evolution of national modes of corporate finance and control (cf. La Porta et al. 1998; Milhaupt 2004; Prowse 1995; Roe 1994). If law and politics play such a crucial role, we need to know more about the formation of regulatory policies in corporate governance and the dynamics of regulatory change.

The debate in political economy offers two contrary propositions on the likely course of the regulatory reforms, which have been initiated in all major industrialized countries since the mid-1990s, and the concomitant transformation of corporate governance regimes. In the field of *Comparative Political Economy*, the most prominent theoretical framework predicting persistent diversity is the “varieties of capitalism” approach (Hall/Soskice 2001). In this perspective, institutional complementarities and comparative advantages resulting from the specific national institutional arrangements create powerful incentives for national actors to respond to external pressures in path-dependant ways. In contrast, studies in *International Political Economy* see the competition for the most mobile segments of capital as the driving force of a much greater convergence among national political economies (e.g. Cerny 1997). In

emphasizing the global diffusion of a neo-liberal version of market capitalism and regulation, this literature tends to neglect the influence of national variables.

We perceive the reorganization of national corporate governance-regimes as a predominantly empirical question. Our empirical research is oriented towards contributing to the discussion whether the evolution of national economies is shaped by persistent divergence, convergence or the emergence of new hybrid models combining old and new, “Anglo-Saxon” and “continental” elements. With the institutionalist approaches of *Comparative Political Economy*, we share the view that national institutional architectures still provide powerful restrictions and opportunity structures for national players. The distinct modes of coordination in the economic sphere, political institutions like state structures and patterns of interest intermediation mould the preferences and strategies of national political and economic actors. However, we think that the “varieties of capitalism” approach overrates the staying power of national institutional arrangements which is seen to flow from institutional complementarities between the different elements of a national political economy. With *International Political Economy*, we share the interest in transnational actors and institutions. Yet, we expect their influence to be mediated and filtered by national variables. In linking comparative institutionalism with the transnational orientation of the International Political Economy literature, we see the interplay of national and transnational actors and institutions as the crucial factor shaping the processes and the outcome of regulatory regime transformation.

3. National Diversity – Corporate Governance-Regimes in the early 1980s

In describing the different channels of monitoring and disciplining management, one can distinguish between internal and external control mechanisms (cf. Hopt 2003a: 34ff; Böcking 2003: 250f; Mann 2003: 78ff). Internal control mechanisms operate within the internal institutional framework of a firm. The board of the company constitutes the most important internal monitoring device. Another example for this category is the general meeting where shareholders can exert influence on company decisions by exercising their voting rights. In the regimes of Continental Europe, corporate governance is primarily based on internal control, whereas the Anglo-Saxon regimes rely more strongly on external mechanisms. External control is exercised by market forces and by actors, which do not operate within the internal institutional architecture of a company, but intervene from an outsider position. The main external control mechanism is the capital market in its function as market for corporate con-

trol. Furthermore, the stock market may engender disciplinary power when firms need fresh capital (Mann 2003: 89; Prowse 1995: 6). Located at the interface between internal and external corporate governance, between supplying information on the financial situation of a company to inside actors and to outside actors in the capital market, are accounting and auditing. (Baetge/Thiele 1998: 722; Hommelhoff/Mattheus 2003: 645ff; Wiedmann 2003: 201). In the continental European model, financial disclosure and auditing are geared to the interests of the insiders, in outsider systems the provision of information for the capital market is predominant.

Which control mechanisms prevail in a given system, also depends on the dominant mode of coordination between the actors involved in a company's affairs. By describing these different modes, the Comparative Political Economy has made an important contribution to the analysis of the internal and external relationships of a firm (cf. Hall/Soskice 2001). The state shapes the structures and the functioning of the different control mechanisms primarily through company law and capital market regulations. Statutory (or self-regulatory) rules may structure mechanisms more directly, e.g. through prescriptions for the institutional design of the board, or more indirectly, e.g. via transparency and disclosure requirements which are essential for the functioning of external control mechanisms. As the more recent corporate governance research has shown, the legal and regulatory environment also has an impact on ownership structures (cf. La Porta et al. 1998; Prowse 1995; Roe 1994). Ownership structures are important especially in shaping the incentives and resources of different groups to participate in monitoring activities. In situations of high ownership concentration, blockholders have greater cause and better opportunities to supervise management via internal control mechanisms than the shareholders of a widely-held firm.

The style and the normative orientation of state regulation, the dominant mode of coordination and the ownership structures vary systematically between the different models of capitalism. So do the patterns of influence and control, as they are shaped by these three dimensions. Needless to say that although the ideal-types of capitalism are useful heuristical devices, it would be wrong to overestimate their uniformity. This is why we have chosen two specific versions of the continental European model – France and Germany. In the following paragraphs, we outline the traditional corporate governance regimes of these two countries and of Great Britain (cf. table 1).

Table 1: Traditional Corporate Governance Regimes in the Early 1980s

	Great Britain	Germany	France
<i>Dominant Mode of Coordination</i>	Market	Network	State
<u>Ownership Structure</u>	Dispersed, high level of institutional ownership	Concentrated, cross-shareholdings, family ownership	concentrated, state and family ownership, cross-shareholdings
<u>Corporate Control</u>			
Internal Control Mechanisms	- One-tier board, dominated by management	+ Two-tier board, pluralistic composition (particularly banks, other corporations, employees)	+ One-tier board, dominated by elite networks and blockholders
External Control Mechanisms	+ Highly developed capital market Selective intervention by institutional investors Active market for corporate control	- Relative immunity from capital market pressures	- Relative immunity from capital market pressures

Great Britain – Managerial Control and Institutional Investors

In the European context, Great Britain can be considered as the paradigmatic example of a political economy, in which the relationships within a company as well as between companies are primarily market-based. Dispersed ownership already developed in the first half of the 20th century, and in the 1950s and 1960s, institutional investors began to replace families as dominant owner category (Franks et al. 2004: 9). Inside the corporate architecture, managers were able to operate largely without the direct interference of other interest groups (Schmidt 2003: 539; Vitols 2001: 344f). Senior management, and especially the CEO, tended to dominate the one-tier board. Institutional investors generally did not take seats on the board. At the most, the in-

tervened from outside, if a company was in severe crisis (Black/Coffee 1994: 2002f; Cheffins 2002: 153f).

British company law scantily regulated the structures, functioning and composition of the board of directors (Davies 2001: 276). Amendments of the *Companies Act* largely focused on extending financial disclosure requirements (Donnelly et al. 2000: 11, 24; Franks et al. 2004: 19). Further demands in terms of disclosure and shareholder protection were laid down in the Listing Rules of the London Stock Exchange (Charkham 1994: 280; Mann 2003: 226). Oversight of the capital market largely took place via self-regulatory structures (Lütz 2002: 74ff). A self-regulatory approach was also adopted for takeover regulation. The emergence of a hostile market for corporate control in the 1950s led to the formulation of the 1967 “City Code on Take-overs and Mergers” which established transparent and shareholder-friendly rules for the conduct of bidders and targets. Two of its main features were the mandatory bid rule which guarantees equal treatment of shareholders in the target company and the neutrality principle which disallows defensive measures of the board of the target company unless they have been specifically approved by shareholders at a general meeting. Thus, the disciplinary effect of the market for corporate control was boosted by a market-friendly takeover regulation (Donnelly et al. 2000: 25, 44f; Franks et al. 2004: 22ff). Protecting shareholder interests was also the guiding principle of accounting and auditing practices attempting to deliver an accurate and transparent picture of a company’s finances (Kraakman et al. 2004: 81).

Germany – Stakeholder Networks

Germany traditionally constituted the model case of an inclusive corporate governance regime, in which influence and control were dispersed between a broad set of stakeholders (Cioffi/Höpner 2004: 27). Network structures were already embedded in the ownership structures: among the typical blockholders of German firms, one could not only find families, but also other corporations and banks. Both non-financial and financial firms pursued long-term goals via their investment, either the cultivation of relationships with suppliers or clients or the stabilization of credit relationships (Hall/Soskice 2001: 23; Streeck/Höpner 2003: 23). The cross-shareholdings were matched by interlocking directorates. The comparatively strict and detailed rules of German company law provided for a two-tier board model which assigned the day-to-day running of the company to a separate management board (“Vorstand”). Nomination and control of the members of this board were entrusted to a supervisory board

("Aufsichtsrat") most notable for its pluralistic composition. Due to mandatory labour co-determination, labour spokespersons sat side by side with the representatives of blockholders and banks (Davies 2001: 287ff; Vitols 2003b: 136f).

Intransparent balance sheets based on the "precaution" principle and comparatively undemanding disclosure requirements gave the "insiders" much better access to company information than small shareholders (Höpner 2002: 12; v. Werder 2003: 18). This was especially true for the banks in their double function as shareholders and providers of credit. Multiple and capped voting arrangements protected the position of the "Insiders" and, in connection with the personal and capital networks, made hostile takeovers virtually impossible (De Jong 1997: 9; Streeck/Höpner 2003: 23). Predominantly bank-mediated forms of finance also played an important role in sheltering German companies from the pressures of the capital market (Charkham 1994: 51f). Low protection of minority shareholders and weak oversight of the financial markets round off the description of a corporate governance regime geared towards balancing a broad range of interests.

France – Statism

In contrast, the French post-war economy was marked by a pronounced leadership role of the state. In corporate governance and finance, state direction was visible in significant direct ownership of business enterprises, in a system of indicative planning and in state control over credit allocation (Cioffi/Höpner 2004: 7; Culpepper 2004: 4; Schmidt 2002: 113ff). Apart from the state, families still played an important role as owners even in big companies (Berglöf 1997: 101; Fanto 1998: 44). A number of larger companies were connected via cross-shareholdings and interlocking directorates, but these ties did not have the strong network character of German inter-firm relations. Moreover, French banks did not exert similar oversight and coordinating functions (Schmidt 2002: 185).

To a large degree, corporate strategies were determined through negotiations between state actors and managers (Goyer 2001: 151f). Both spheres were linked by an elite network comprising graduates of the "grandes écoles". The members of this network usually started their career in the state administration and then moved on to leading positions in private and public companies and banks (Clift 2004: 93; Hancké 2001: 313; O'Sullivan 2003: 35f). Within the companies, highly centralized structures of decision-making and control allowed for the largely undisputed implementation of

corporate policies furthering the interests of the political-corporate elites and blockholders (Cioffi/Höpner 2004: 8). French company law, while being strongly prescriptive and rule-oriented, offered a choice between a one-tier and a two-tier board structure. But most listed companies preferred a single board, with the highly powerful “Président Directeur Général” being the dominant player (Berrar 2001: 107; Wymeersch 1998: 1113f). Although work councils were mandated by law, they only had – largely inconsequential – information and consultation rights with regard to issues of corporate management (O’Sullivan 2001a: 11). Minority shareholders had little insight into the company’s affairs. Rather than providing information to market actors, accounting was predominantly oriented towards the information requirements of the state in terms of fiscal compliance and national economic statistics (Standish 2001: 29). Unequal voting rights further disadvantaged smaller stockholders (Goyer 2003: 3; Hancké 2001: 321). The French capital market was underdeveloped, as were disclosure requirements and regulatory oversight and enforcement (Cioffi/Höpner 2004: 7f; Fanto 1998: 48ff).

4. The End of Diversity? – Transnational and National Constellations of Actors and Institutions

Since the 1980s, but mostly during the 1990s the corporate governance regimes of the three countries that we are looking at have become the target of reform efforts of both private and public actors. The preliminary impression that we have gained through an analysis of the existing literature is that there are common trends in the reform of pivotal control mechanisms – the takeover market, the board system and accounting/auditing. The general direction of reform has been towards greater commodification and stricter control of management primarily to the benefit of shareholder interests. But the impact of these overarching trends has been filtered and modified by national factors. In these processes of regime transformation, we expect the interplay of national and transnational variables to differ not only between countries, but also between control mechanisms.

Pressures for change are likely to emanate from a range of transnational actors and institutions (cf. Figure 1). Our short overview will begin with a look at important private economic actors. *Anglo-American institutional investors* are pursuing increasingly international investment strategies. They exert indirect as well as direct influence on the evolution of national corporate governance regimes (Höpner 2002: 75f). In making investment decisions, the managers of these funds tend to take into ac-

count the corporate governance structures of individual companies. Institutional investors like the well-known *California Public Employees' Retirement System* (CalPERS) and international investor organizations have issued general and country-specific corporate governance recommendations (Becht et al. 2002: 66f; Nölke 2004: 164ff). Among the main topics addressed in these statements are shareholders' rights and issues related to the election, operation and composition of boards. Although international *rating agencies* are not active players in corporate governance reform, they also contribute to the diffusion of liberal, shareholder-oriented standards. Their criteria for assessing the credit rating of a company include questions of corporate governance. Furthermore, two agencies have developed specific „corporate governance rating systems“ (Mallin 2004: 73; Nölke 2004: 167). The high concentration of auditing assignments in the hands of a few *international auditing firms* furthers the homogenization of standards and practices in the field of auditing and accounting (Hansman/Kraakman 2004: 45; Wymeersch 2002: 4).

In this area, we can also observe a transfer of standard setting from the national level to private transnational standard setting bodies. The *International Accounting Standards Board* (IASB), an organization originally founded by national professions from nine industrialized countries, has developed a core set of *International Financial Reporting Standards (IFRSs)*, which, in recent years, have been increasingly applied by multinational corporations outside the US (Achleitner/Behr 1998: 43ff; Nölke 2004: 169f). The IASB is closely cooperating with the *International Federation of Accountants* (IFAC). Through a subcommittee, the latter organization has been busy creating its own international standards (*International Standards on Auditing, ISAs*) (Achleitner/Behr 1998: 28f; Dewing/Russell 2004: 296).

This brings us to transnational political actors. The *European Union* has abandoned its own efforts to harmonize accounting standards in favour of adopting the standards produced by the IASB. In 2002, it passed a regulation mandating that all listed companies use IFRSs by 2005 (Lütz 2005; Posner 2004: 6). Similarly, the Commission plans to require ISAs for all EU statutory audits from 2005. The Commission also intends to reinforce auditor independence and to integrate the auditor more closely into the internal control of a company's financial reporting. Furthermore, its proposed new auditing directive aims at strengthening public oversight of the audit profession by laying down common criteria for national oversight bodies to ensure that they are sufficiently independent from the profession (Kommission der Europäischen Gemeinschaften 2004). In terms of corporate governance reform in a narrower sense, the

Commission has described its long-term goal as working towards establishing a real shareholder democracy within the EU (Kommission der Europäischen Gemeinschaften 2003: 17). Its 2003 Action Plan on "Modernising Company Law and Enhancing Corporate Governance in the EU" contains a range of proposals to strengthen shareholders' rights and to enhance efficient and independent oversight by the board of directors. As announced in the Action Plan, the Commission issued a recommendation on the role of non-executive or supervisory directors in internal corporate governance in October 2004 (IP/04/1182). However, the content of this recommendation has been substantially watered down due to resistance from the member states. The same can be said for the takeover directive passed in 2003. For the time being, this directive is the end result of a 20-year struggle by the Commission to establish a liberal model of takeover regulation based on the British example (Callaghan/Höpner 2004). While the Commission's first efforts to harmonize company law date back to the late 1960s, they have generally resulted in broadly construed framework directives often containing optional rules. So far, with some exceptions, measures taken at the European level have largely allowed member states to retain the characteristics of their national regimes (Lannoo 1999: 280ff; Rhodes/van Apeldoorn 1998: 422; Schaede 1995: 105f; Wouters 2000: 261ff).

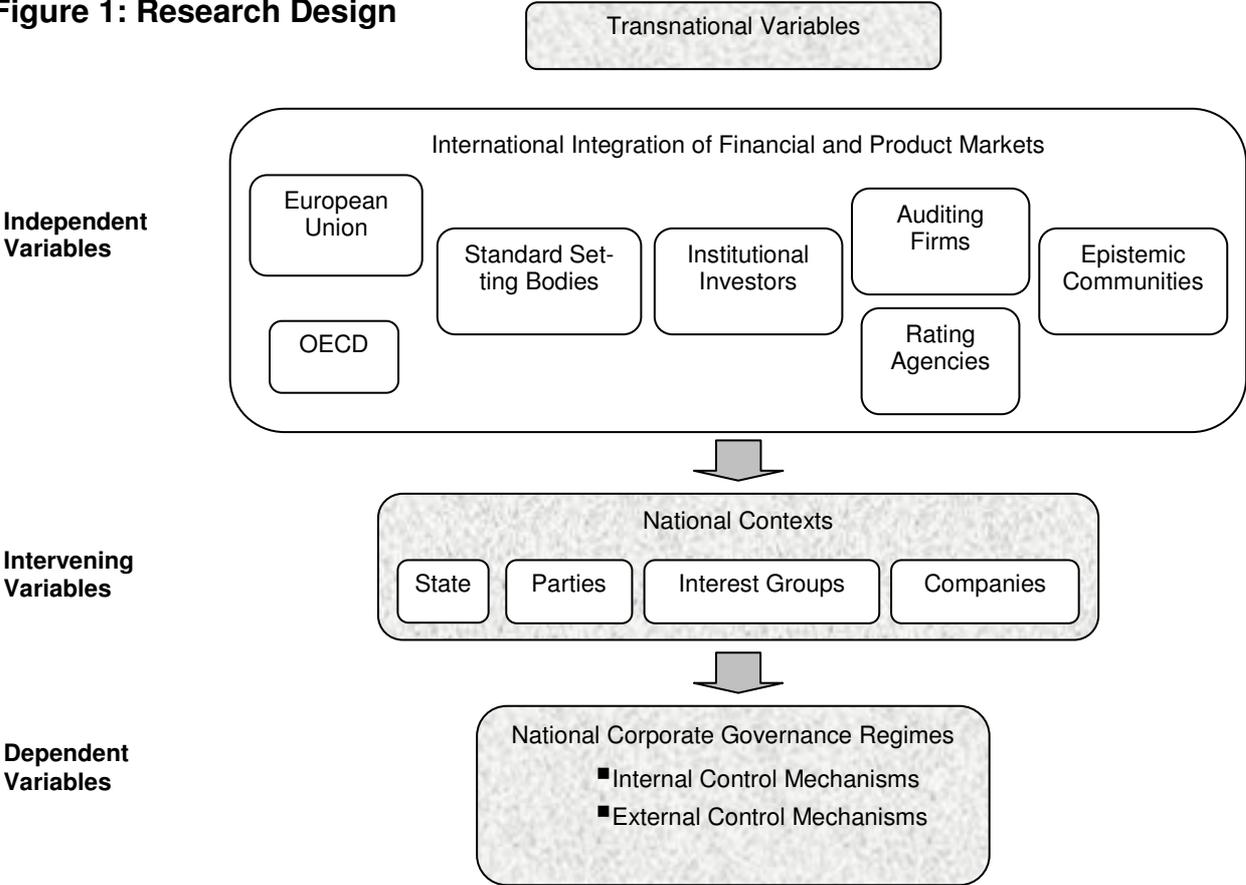
International organizations have also been active in developing guidelines for "good corporate governance". The relatively broad, non-binding 1999 *OECD „Principles of Corporate Governance“* have served as a benchmark in the reform discussions of European countries like Germany and France (OECD 1999). Besides, some research institutes constitute well-known forums for transnational discussion of corporate governance issues, e.g. the *Centre for European Policy Studies* und the *European Corporate Governance Network*. Both conduct widely noticed research in this area and, as nodes within the *epistemic community*, bring together academics, politicians and practitioners.

In turning to the national scene, it is practically self-evident that the national context of corporate governance regulation differs considerably between our three cases. For example, due to their unitary, centralized state structures and few veto points, both the French and the British *state* have higher governance capacities than the decentralized German state. While France has traditionally used this capacity for highly interventionist policies, Great Britain has often preferred to give economic actors scope for flexible arrangements and self-regulatory initiatives (Schmidt 2002: 113ff). The distinct state and society structures, the different patterns of interest intermedia-

tion and the “policy legacies” that we have described above are bound to leave their imprint on the politics and the policy output of regulatory reforms. Judging from recent research, the party affiliation of national decision-makers also seems to play an important role. Cioffi/Höpner (2004) argue that corporate governance reforms have been driven by centre-left parties. Thus, parties should be conceptualized as a separate factor in the empirical analysis.

The power of national interest groups to influence political reform processes will depend to a certain extent on their position in the traditional corporate governance regimes. For example, German trade unions have been important veto players in recent company law reforms. However, associations often perform a dual function. Besides their lobbying activities, their own governance capacity in terms of organizing self-regulatory arrangements is of importance for the transformation of national corporate governance regimes. Similarly, as market actors, large corporations drive change at the micro-level of the firm, and they try to push through their interests at the political level.

Figure 1: Research Design



5. Regulatory change – A Brief Look at the Transformation of National Corporate Governance Regimes

As noted before, the corporate governance regimes of Great Britain, Germany and France have undergone important transformations during the last two decades. In the following section, we do not intend to provide an exhaustive analysis of these changes. The current state of our research only allows us to point out reform trends with regard to internal control, control at the interface of inside and outside via accounting and auditing and external control in the takeover market (cf. Table 2).

Table 2: The Transformation of National Corporate Governance Regimes

	Great Britain	Germany	France
<i>Dominant Mode of Coordination</i>	Intensified commodification	Weakening of networks	Retreat of the state
<u>Ownership structure</u>	Very high level of institutional ownership	Network dissolution, rising level of institutional ownership	Privatization/network dissolution, high level of institutional ownership
<u>Corporate Control</u> Internal Control Mechanisms	Strengthening of the oversight function of the board, nomination of independent directors; but: efficiency unclear	Strengthening of the oversight function of the Aufsichtsrat, but: still two-tier system, co-determination and networks	Strengthening of the oversight function of the board, nomination of independent directors; but: still strong position of the PDG, elite networks
Interface Internal/External Control	Greater regulation of accounting and auditing Enhanced role of the auditor	Greater regulation of accounting and auditing Enhanced role of the auditor Capital market orientation of accounting and auditing	Greater regulation of accounting and auditing Enhanced role of the auditor Capital market orientation of accounting and auditing
External Control Mechanisms		Takeover regulation with market-creating and market-restricting elements	Takeover regulation with market-creating and market-restricting elements, state intervention rights

Great Britain – Towards Intensified Commodification

In Great Britain, economic and political actors have more and more come to believe that the check on management behaviour emanating from external control mechanisms is not sufficient to protect shareholders' interests (Donnelly 2002: 206). Starting with the Cadbury Committee of 1991, several committees made up of representatives of the business and financial community and the accountancy profession have developed recommendations in the form of a self-regulatory "Code of Best Practice" which aimed at strengthening the accountability and the monitoring function of the board and making its operations more transparent. The first version of the Code advocated, amongst other things, the nomination of several non-executive directors who are independent from the company and its management, and the separation of the role of CEO and chairman of the board. It also expected executive directors to report on the effectiveness of internal control procedures and to disclose their remuneration. A remuneration committee staffed predominantly with non-executive directors should review executive directors' pay. Furthermore, an audit committee of non-executive, predominantly independent directors was recommended. This committee was expected to review the financial reporting of the management and to liaise with external auditors (Davis 2001: 437ff; Donnelly 2002: 200f; Donnelly et al. 2000: 43f; Lannoo 1999: 282f).

These recommendations point to an increasing emphasis on the distinction between management and control in one-tier boards (Hopt/Leyens 2004: 19). Independent non-executive directors and committees in areas in which conflicts of interest between the managers and the company as such are particularly likely are supposed to provide an internal check on the power of a company's management. The current version of the Code from 2003 further tightened the requirements with regard to independent directors. Now, at least half of the members of a board should be independent, and the audit and remuneration committees should consist entirely of independent directors. The revised Code strengthened the role of the audit committee in monitoring financial reporting and in reinforcing the independence of the external auditor. It also recommends a more open and productive dialogue between companies and institutional investors (FRC Press Release, 23 July 2003: 1).

While the acceptance of the Code is seen as high, the efficiency of some of the measures has been questioned (Becht et al. 2002: 94ff; Davis 2001: 293). On a general level, commentators have expressed doubts about the benefits expected from

oversight through independent directors. More specifically, compliance with the requirement to disclose executive remuneration policies has been deemed insufficient by the government. Since 2002, individualized disclosure of executive pay is mandated by law. Furthermore, a non-binding shareholder vote on directors' pay packages was introduced (Ferrarini/Moloney 2005: 14ff). As part of a general review of company law initiated in 1998, the government has recently proposed further statutory reforms. While the proposals do not directly relate to board structure and functioning, one aim of the reform is to enhance transparency and accountability within the company's operations by promoting shareholder engagement and clarifying directors' duties. However, in 2004, the government relaxed the legal provisions on directors' liability to a certain extent (DTI 2005b: 16ff; Ferrarini/Moloney 2005: 22ff).

In the field of accounting and auditing, where self-regulation through the professions has traditionally been prevalent, one can observe a pronounced move towards greater public involvement in regulation (Donnelly et al. 2000: 46; Ferran 2001: 1). In reaction to EU directives, the first statutory accounting and reporting standards were formulated in the 1980s. The 1989 *Companies Act* provided for the creation of an *Accounting Standards Board*, a government-supported, but non-governmental body responsible for the regulation of accounting standards. In response to the collapse of Enron and WorldCom, the government has submitted auditors to a regulatory regime independent of the profession. In 2004, an already existing regulatory body which is sponsored by public and private players has been given new responsibilities and powers to set and enforce auditing and accounting standards, develop standards for auditor independence and to oversee the self-regulatory professional bodies. This *Financial Reporting Council*, of which the ASB is a subsidiary, is aptly described as "sit[ting] in the rather fuzzy public/private middle ground" (Ferran 2001: 28)¹. This year, the government introduced a new instrument of financial reporting, a more inclusive and forward-looking "Operating and Financial Review", which will also have to be reviewed by the auditors (Arden 2003: 275; DTI 2005b). In conjunction with the proposed Company Law Reform Bill, further measures to enhance audit transparency and shareholder involvement in the audit process are planned (DTI 2005b: 27).

The wave of hostile takeovers that swept Great Britain in the 1980s illustrates that the external, market-based control of management has further gained in importance. This rapid increase in hostile takeovers led to demands by British firms and their organizations for new rules which would have made takeovers more difficult. But nothing

¹ It has also been made responsible for further adaptations of the Combined Code (FRC 2003)

came out of these initiatives (Black/Coffee 1994: 2036; Callaghan 2004: 20f). Currently, the government is in the process of implementing the European Takeover Directive, and it intends to retain the core features of the present system (DTI 2005a).

Germany – The Weakening of Network Governance

The German corporate governance regime is apparently undergoing more far-reaching changes than its British counterpart. In terms of ownership structures, foreign and German institutional investors have become more important in the 1990s, while the capital-based and personal ties between companies have gone down considerably (Beyer/Höpner 2003: 182ff; Höpner 2002: 74f). Of special importance in this gradual dissolution of the corporate network is the significant retreat of the big banks, as they did not only constitute the nodes of the network, but have also been the main players in the internal monitoring of companies. At the political level, a round of capital market law reforms during the 1990s brought stronger state regulation of the financial markets geared to increasing transparency and protecting minority investors (Cioffi/Höpner 2004: 12; Lütz 2002: 234ff). The first legislative measures specifically aimed at overhauling the corporate governance regime only followed in the late 1990s. From 1998 onwards, a series of laws were passed which explicitly supported and promoted the processes of greater market-orientation and disentanglement visible at the firm level. Although policy-makers refrained from radical measures against the dominance of the banks and other corporations in internal corporate governance, several provisions of the 1998 “Control and Transparency Act” (KonTraG) weakened the capacities of the traditional “insiders” to exert influence within the company. For example, the law introduced the “one share, one vote” rule and imposed restrictions on the voting rights of the banks in the general meeting. At the same time, the KonTraG and another law from 2002 strengthened the Aufsichtsrat in its supervisory function, e.g. by mandating more frequent meetings, requiring more extensive reporting of the Vorstand to the Aufsichtsrat and extending the obligations and powers of the latter in overseeing financial reporting and auditing (Berrar 2001: 57ff; Strunk/Kolaschnik 2003: 31ff).

In response to the corporate scandals that have taken place in the US and in Germany in the last years, the government initiated another set of reforms in 2003 which aimed at strengthening investor confidence in the capital market. One of the new laws which were passed in 2004 and 2005 facilitates derivative suits against directors and supervisory board members, but is also designed to curb abusive shareholder

suits. Another law provides for a new form of class-action suit. It is now possible for one investor to claim for damages on behalf of a greater number of shareholders. A third law strengthened investor protection by, inter alia, reforming the regulations on insider trading and market manipulation (SZ, 04.01.2005: 26). Recently, the government has introduced a binding obligation to disclose executive pay on an individual basis² (SZ, 04./05.06.2005: 26). As in Great Britain, the “Act on the Disclosure of Executive Pay” was prompted by the failure of several major companies to comply with a non-binding recommendation to disclose individual pay packages.

In 2002, Germany also saw the introduction of a self-regulatory code. Yet, the “Corporate Governance Kodex” was drafted by a commission appointed by the German government. While making recommendations on issues like the provision of information to shareholders and the disclosure of management remuneration, its main focus also is on improving the accountability and efficiency of the Aufsichtsrat (Peltzer 2004: 43). Contrary to the British code, it applied a rather conservative and selective approach towards the nomination of independent members (Hopt/Leyens 2004: 7). It only advocated that the board at any time should include members which are sufficiently independent and that no more than two members should be former members of the management board. Also, there were no specific requirements for independent members on the audit committee that the Aufsichtsrat is expected to establish. However, members of the Aufsichtsrat are supposed to disclose conflicts of interests which may arise from relations to a client, supplier, creditor or other business partner of the company.

The independence requirements of the code were tightened somewhat in 2005. Now, the code recommends a “sufficient number of independent members” in the Aufsichtsrat and provides a definition of independence (FAZ, 03.06.2005: 11). Furthermore, it states that the appointment of a former member of the Vorstand as chairman of the Aufsichtsrat which currently is a common practice “should not be the rule”. However, these new provisions do not constitute a real departure from the reserved approach to independence, which is obviously related to the structural constraints set by the rules on labour codetermination. So far, these rules which provide for parity codetermination in companies with more than 2000 employees have been left untouched by the regulatory reforms. But a reform proposal issued by the German employers’ federations last November which aims at a radical reduction of co-

² However, firms may refrain from individualized disclosure, if a 75 percent majority of shareholders agrees.

determination has prompted a lively debate on the merits of the current system (SZ, 10.11.2004: 21). The government responded by setting up a commission to review codetermination (SZ, 11.07.2005: 19). As public debate has been fuelled further by recent allegations that the management of Volkswagen bribed members of the work council, the upcoming federal election may prove critical for the future of codetermination since the Conservatives and the Liberals are in favour of restricting employee rights. Thus, another pillar of the traditional German regime may be weakened. In light of the unravelling of cross-shareholdings, the corporatist “Deutschland AG” was already pronounced dead by some commentators. But it is not clear yet how far the current trends will go. In a comparative perspective, both ownership concentration and the amount of corporate shares held by other corporations still seem to be relatively high (SZ, 19.04.2005: 20; Vitols 2003: 140ff). Sigurt Vitols has argued that what we are seeing right now is the emergence of a “mixed’ system of large shareholders and dispersed institutional investors” which would mean that the traditional stakeholder coalition has not been replaced, but augmented (Vitols 2004: 372).

The KonTraG and its successor, the 2002 TransPuG, also enhanced the role of the auditor in controlling management. The auditor’s mandate was extended and now additionally covers the review of risk-management systems. This also means a more risk- and problem-oriented approach in checking the company’s financial statements. Furthermore, the reforms tied the auditor more closely to the Aufsichtsrat. Provisions for auditor independence were tightened somewhat (Seibert 1999: 23; Hopt/Leyens 2004: 9f; Strunk/Kolaschnik 2003: 111ff). As part of its 2003 reform package, the government established a two-tier system of public oversight. In this system of “self-regulation in the shadow of hierarchy”, a private body will control audits and auditing practices. If this form of control fails, the capital market regulator may intervene and investigate the books of a company (Lütz 2004). With another reform measure, the “Act on the Reform of Accounting Legislation”, requirements for auditor independence were stepped up (SZ, 17.11.2004: 34). An important step towards more transparent balance sheets was made with a 1998 law which gave listed companies the option to apply capital market oriented international accounting standards, i.e. IAS or US-GAAP (Beyer/Höpner 2003: 190f).

Due to the economic and political changes of the 1990s, hostile takeovers, while still extremely rare, have become a credible threat for German managers, as the Mannesmann/Vodafone case has shown (Höpner/Jackson 2003). This new situation is reflected in the takeover act which was passed in 2002 after an earlier self-regulatory

takeover code had proven to be ineffective (Krause 2002: 504ff). The act established a transparent procedure for takeovers and, like the British code, is aimed at ensuring equal treatment of the target company's shareholders through a mandatory bid rule. But it gives the Vorstand much more scope for defensive tactics. Through a resolution passed in advance of a hostile bid, the general meeting can empower management to use certain defensive mechanisms. Such a resolution may be valid for up to 18 months. Furthermore, the supervisory board may give management permission to take defensive measures in the occurrence of a bid (Kraakman et al. 2004: 169; Krause 2002: 507ff). Thus, the law can be seen as a combination of market-creating and market-restricting elements.

France – The Retreat of the State

In France, the state has retreated from its ownership position and its coordination function since the mid-1980s. In the process of privatization, the state constructed elaborate cross-shareholding structures. However, the collapse of these structures in the late 1990s was followed by a drastic change in the ownership pattern of large companies which is now marked by relatively dispersed stockholding and a strong position of Anglo-American investors. In 2002, foreign investors on average held more than 40% of the shares of CAC 40 firms (Goyer 2001: 144f; Goyer 2003: 2; Schmidt 2003: 187ff). Similar to Germany, the state, in the late 1980s, concentrated its reform activities on furthering a more active and transparent capital market. The first initiative to reform internal corporate governance structures came from French business associations. A committee instituted by these associations drafted "best practice" recommendations in 1995. As the British code, the so-called Viénot Report centred on the performance and the accountability of the board. It advocated nominating at least two independent directors, creating board committees and providing more information to shareholders (Fanto 1998: 86f; Lannoo 1999: 284). On the whole, its recommendations lagged behind the British code. However, again similar to the British experience, the recommendations were tightened over the years. The 2003 code requires half of the board of companies with dispersed ownership to be independent and a majority of independent directors in the audit and compensation committee. Contrary to the provisions in Great Britain and Germany, where companies are either via the listing rules or by law required to declare their degree of compliance with the code in their annual report, the French code lacks an enforcement mechanism. Nonetheless, the composition of French boards has changed considerably throughout the 1990s, with the percentage of independent directors and the pres-

ence of specialized committees approximating Anglo-Saxon levels – a development which is no doubt related to the rise of institutional investors (Goyer 2001: 138ff).

Legal reforms concerning the functioning and the structure of the board only occurred in 2001 with the “Nouvelles Régulations Économiques” (Fanto 2002: 81ff). Among other things, these measures lowered maximum board size from 24 to 18 and strengthened the board vis-à-vis the PDG through emphasizing its control function and giving members more rights to obtain firm-specific information. Furthermore, the separation of the role of the PDG and chairman of the board was made possible. The new law also strengthened the role of minority shareholders and stepped up disclosure requirements. Specifically, individualized disclosure of executive pay has been made obligatory. After public outrage over huge severance payments to departing CEO's, the French government, in April 2005, announced a draft bill that would allow shareholders to have a say in deciding on the size of compensation packages (SZ, 25.04.2005: 25). Yet, despite the legal changes, in practice, the PDG even seems to have gained in independence, as the state has retreated from its strong oversight role. A further element of continuity can be seen in the persistent existence of elite network patterns (Schmidt 2002: 195ff).

In the field of accounting and auditing, important statutory reforms already took place in the 1980s. They increased the role of the auditor in corporate governance, inter alia, through an extension of the review mandate and stricter rules regarding auditor independence. As in Great Britain and Germany, the Enron, WorldCom and other recent financial scandals have triggered new reform initiatives by the securities markets regulator, the employers' organizations and the auditing profession itself (MEDEF/AFEP-AGREF 2002). The French parliament passed an “Act on Financial Security” in 2003 which established a new oversight board for the auditing profession, prohibited the provision of non-audit services by auditors to their clients and mandated the selection of auditors by an audit committee comprised of non-executive directors. The act also introduced the obligation to publish an annual corporate governance statement (Enriques 2003: 918ff). In the field of accounting, the institutional regime for standard-setting was overhauled and strengthened in the later 1990s and the use of international accounting standards by listed companies was allowed under certain conditions (Standish 2001: 12ff).

Takeover regulation also dates back to the 1980s. A 1989 bill introduced transparency requirements, gave employees information rights and required a mandatory bid

for outstanding shares, though not for 100% as the British code. The latter provision was amended in 1992 (Callaghan 2004: 18ff). French takeover regulation does not contain a neutrality rule. The board of the target company is required to disclose defensive measures to the securities regulator who has the right to express its view (Kraakman et al. 2004: 170). The state has kept certain rights of intervention. For example, it can prevent a non-EU party from acquiring more than 20% of the shares of a French company (Cioffi/Höpner 2004: 15). The conservative government which came into office in 2002 displays a strong protectionist attitude and has intervened several times to prevent cross-border acquisitions of French-based firms. Economic nationalism reached a new height when the French parliament adopted a law last November which requires pre-approval of takeovers by the Ministry of Finance in strategically important sectors of the economy (SZ, 20.01.2005). Thus, the French set of takeover rules also comprises a specific mixture of market-creating and market-restricting elements, with a rather statist complexion.

6. Convergence and Transnationalization – Some Preliminary Hypotheses

The changes in national regulatory regimes that we have outlined above point to the following conclusions: First, external, market-based control has intensified in all of the three countries that we have looked at. In Great Britain, the disciplining effect of the market for corporate control was bolstered indirectly through the inactivity of politicians and other influential actors who did not react to the calls for greater constraints on takeover activity. In the two continental regimes, a transparent and predictable framework has been created which enhances legal security for both bidders and targets. However, the market-creating character of these regulations is mitigated by certain restrictions and defensive options. Second, internal control devices and the mechanisms located at the interface of internal and external control have been reorganized and strengthened. Reform in these areas has been mainly directed towards weakening the influence of insiders and aligning the monitoring of management more strongly with broader shareholder interests. Thus, reforms of the internal governance structures have enhanced the accountability and the oversight function of the board and promoted greater independence of members, at least at the formal level. In all three countries, we can observe efforts to increase the quality and scope of financial disclosure and to reinforce the role of the auditor in corporate governance. Also, the auditors themselves are regulated more strictly.

These common trends towards a greater market-orientation and increased control of managerial discretion seem to have triggered a process of hybridization of the national corporate governance regimes. The British system departs from its traditional pathway in as much as a predominantly external control of management is no longer seen as sufficient. The series of codes testifies to the great importance that is now attached to internal control. In Germany and France, we see the adoption of elements that have so far been regarded as characteristic of the Anglo-Saxon model. Hostile takeovers have to a certain extent gained acceptance as part of corporate governance in both countries, as the national takeover regulations show. The move towards more transparency-oriented standards of accounting and auditing signals a significant change in the function of these control mechanisms. From an insider-oriented perspective, they are now redirected towards providing information for the capital market. While external and interface controls have gained in strength, the retreat of traditional insiders – the banks in Germany and the state in France – suggests an all in all decreasing intensity of internal monitoring.

Overall, change has been more fundamental in the continental countries. There, we see a greater transformation not only in corporate governance structures and practices, but also in the normative orientation. Whereas the push towards a stronger market-orientation has intensified the liberal character of the British model, commodification and shareholder value are harder to reconcile with the more collective concept of corporate governance traditionally found in continental Europe. Several factors indicate that regime transformation was more profound in France than in Germany: the shift from state-led to market-based coordination, the drastic break in ownership structures, the more far-reaching regulatory board reforms and the changes in board composition, the higher amount of hostile bids and the negative stance of the securities regulator towards extreme defensive measures of managers (cf. Cioffi/Höpner 2004: 16, 35; Fanto 1998: 79; O'Sullivan 2003: 40ff). However, this picture might change as the pace of transformation seems to be accelerating in Germany.

The influence of transnational variables seems to vary not only between countries, but also between different control mechanisms. Due to the harmonization efforts of private standard setting bodies and the EU, we can observe a high degree of transnationalization in the field of auditing and accounting. In mandating IFRSs for listed companies, the EU has opted for a regulation – a legal instrument with a very high harmonization effect. In consequence, member states will no longer be able to im-

pose additional financial reporting requirements on their companies or somehow restrict the use of IFRSs by these firms (van Hulle 2004: 363). The Commission plans to apply the same approach to the implementation of the *International Standards on Auditing*. Especially in the field of auditing, convergence also seems to have been promoted from below, as the reform measures taken at the national level show strong similarities.

With regard to the structure and the functioning of the board, we find a lower degree of convergence so far. The trend of national reforms towards a greater oversight role and more independent members corresponds in principle with the ideas of the European Commission and the demands of other transnational actors, especially Anglo-American institutional investors. Yet, the influence of transnational factors is apparently diluted by the nationally distinct board structures, the traditional role of the board within the national corporate governance regime and the specific constellations of interests reflected in these structures and functions. German labour co-determination is a case in point. As noted above, the Commission's recommendation on independent directors does not only constitute a weak instrument of harmonization, its provisions also had to be softened because of the resistance of member states and business organizations. Thus, this recommendation will probably not be very effective in changing national patterns.

Similarly, the impact of transnational variables appears to be rather low in the field of takeover regulation. Apparently, there are remarkable differences between the national regulatory regimes. The substantial variations in the timing and process of reforms and in the policy output seem to indicate that the respective rules are strongly shaped by the preferences and the domestic power resources of important national interest groups like company managers and financial interests. For example, the shareholder-friendly British regime has to be attributed to the strong position of the City. The final version of the EU takeover directive gives considerable scope for continued national divergence.

National differences can also be observed in the interplay of state, collective organizations and market actors. The nationally distinct structures of state and society, the patterns of interest intermediation and the specific constellations of interests make for different political styles and inertial forces. Obviously, British decision-takers still show a strong preference for self-regulatory arrangements, while we see a greater amount of statutory regulation in Germany and France, for example with regard to

board structures and operations. In this field, self-regulatory codes have come into existence in all three countries, but their emergence shows interesting variations in terms of process and actors. As noted, the British codes were formulated by committees sponsored by the business and financial community and the accountancy profession. In France, employers' federations were responsible. In Germany, the government took the initiative and assembled a commission – which also comprised a labour representative. One of the main aims of our research project is to learn more about the politics of corporate governance at the national and transnational level, to find out how the interactions between public and private actors play out and how market-driven changes and political reforms intersect in the transformation of national regimes.

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