

Insiders, Outsiders, and Change in European Corporate Governance

Roger M. Barker
Doctoral Student
Department of Politics and International Relations
University of Oxford
roger.barker@politics.ox.ac.uk

**Paper presented at the Council for European Studies Conference, Chicago,
March 31, 2006**

Abstract

Preliminary data and anecdotal evidence suggest that European corporate governance systems have been moving in an ‘outsider’ direction during the last 5-10 years. This paper presents a theoretical framework with which to explain such change, based on an insider-outsider conception of post-war European corporatism. Three prerequisites for corporate governance change in non-liberal European economies are identified: changes in product market competitiveness, ‘insider’ financing capacity and labor power. Preliminary evidence is supportive of the relationship between these proposed explanatory variables and corporate governance. Furthermore, observed variation in both dependent and explanatory variables over the last decade appears consistent with this paper’s theoretical claims. However, a full assessment of their causative validity and significance awaits the outcome of more detailed empirical analysis.

An Insider-Outsider theory of European corporate governance change

Introduction

The authority structure of firms can be organized in a variety of ways. The range of possible permutations is reflected in the post-war diversity of national corporate governance practices, which appear to have defied the harmonizing effects of economic globalization (Stulz 2005; Dyck and Zingales 2004; Nenova 2003). Capitalist diversity has been particularly apparent within the non-liberal economies of continental Europe¹, whose corporate sectors have developed on a very different basis to those of liberal market economies (such as the United States and the United Kingdom). Explaining change in the corporate governance systems of these economies is the focus of this paper.

Post-war economic history suggests that a single blueprint for corporate governance is not necessarily a prerequisite for economic success. Corporate sectors have flourished in a variety of institutional settings. Even at the start of the twenty-first century, when the dynamism of the American economy is much admired, a number of European economies apparently do not require the American business model in order to remain at the top of international rankings of national competitiveness (e.g. Finland, Sweden, Denmark: World Economic Forum 2004).

Nevertheless, there are anecdotal grounds for believing that change in the post-war models of European corporate governance is underway, particularly since the late-1990s. Dennis Mueller identifies a number of developments that point towards a greater shareholder orientation in many European corporate sectors, including the introduction of national codes of corporate governance, widespread prohibition of insider trading, adoption of international accounting standards, the listing of many companies on the London and New York stock exchanges, and attempts by the European Commission to introduce pan-European codes on corporate governance and takeovers (Mueller 2005: 23). Furthermore, the momentum for corporate governance reform has been sustained both by a number of recent European corporate scandals (e.g. Parmalat in Italy, Ahold in the Netherlands, Vivendi in France) and the shock-waves from legislative change in the US (e.g. the Sarbanes-Oxley Act of 2002).

With respect to Europe's largest economy - Germany – Jürgen Beyer and Martin Höpner (2003) also agree that significant change is underway in corporate governance (in contrast to the '*Reformstau*' in other policy areas). At the company level, shareholder orientation is being increased through the use of profitability goals, measures to increase financial transparency, investor relations activities and the increased use of stock options (Beyer and Höpner 2003: 179). The amendment of German corporate law in 1998 to include the 'protection of shareholder value' as a valid corporate objective for the first time in German history is praised by Espen Eckbo as a 'giant step forward for German corporate governance. Adam Smith would have approved' (Eckbo 2005: 3).

Given these developments, the objective of this paper is to propose a politically grounded theoretical framework with which to explain these changes. Although empirical work to test the viability of the proposed framework is still at an early stage, the paper also provides an indication of how the theoretical claims might be operationalized, and *prima facie* evidence

¹ The term 'non-liberal market economy' is used here in preference to Hall and Soskice's 'coordinated market economy' terminology, in order to include a number of 'Mediterranean Capitalist' economies – such as France, Italy, Spain, Portugal and Greece – whose relatively liberal arrangements in labor markets do not qualify them as coordinated market economies (Hall and Soskice 2001: 19; Rhodes 1997). According to Streeck and Yamamura, non-liberal market economies are defined in terms of significant hierarchical and organisational coordination that often overrides private contractual exchange, and a higher level of social obligations amongst economic agents (Streeck and Yamamura 2003: 3).

concerning the likely strength of the relationship between relevant dependent and explanatory variables. Prior to detailed elucidation of the paper's argument, the next section describes the nature of the dependent variable to be explained in more detail.

1. Categorizing systems of corporate governance

An issue that must be addressed by any analysis of corporate governance is the problem of measurement. Although a definition of corporate governance in terms of the authority structure of the firm may appear straightforward enough², the firm's authority structure is not something that can be observed and measured directly. The relative power of actors over the governance of the firm can only be inferred from levels of observable proxy variables. Possible proxy measure of corporate governance might relate, for example, to the actual behavior of companies, or to the legislative and regulatory 'rules of the game' in which corporations are required to operate (Gourevitch 2003: 315).

A commonly observed categorization of corporate governance is the distinction is between shareholder and stakeholder systems (O'Sullivan 2001; Kakabadse and Kakabadse 2001; Friedman and Miles 2002). A 'shareholder' oriented system of corporate governance consists of firms maximizing profits in the interests of private shareholders (Letza et al 2004: 242). In contrast, the firm in a 'stakeholder' system is motivated by broader obligations to a wider range of stakeholders (e.g. employees, suppliers, the state and local community), and may be conceptualized as a social entity rather a vehicle for the optimization of private interests (Freeman 1984; Hutton 1995). Such a distinction seeks to demarcate corporate governance practices according to the differing behavioral objectives and obligations of firms.

Although conceptually attractive from a political science perspective, the shareholder/stakeholder distinction is not the main taxonomy utilized in most empirical studies in the law and financial economics literature. Although the shareholding and stakeholding perspectives may capture differing ideological perspectives vis-à-vis the appropriate behavioral orientation of the firm, they are difficult concepts to define and measure with any precision (Donaldson 1989). There is no agreement, for example, regarding which actors are the legitimate stakeholders of a firm, and how the differing interests of these actors should be measured and reconciled. Consequently, the shareholder/stakeholder categories are more useful as normative models of corporate governance policy than as a means of establishing a proxy measure of the actual authority structure of the firm.

A more common distinction in empirical work has been in terms of the most dominant form of owner, e.g. systems favoring external minority shareholders or internal blockholders. This is a slightly misleading demarcation, as it seems to imply that only owners are justified in contesting management for control over the firm – the traditional view of the economic theory of the firm - which is not necessarily the case. Labor, for example, can exert significant influence over corporate governance through its indirect power over legislative and regulatory constraints (Roe 2003).

In evaluating such a categorization, it is important to distinguish between corporate governance viewed as a description of power relations between actors concerned with the firm (e.g. as the outcome of distributional model of contestation between owners, labor, management) – which is the ultimate focus of this paper – and corporate governance viewed as a technical activity concerned with the monitoring, oversight and control of management (Shinn 2001).

² 'Corporate Governance refers to the authority structure of firms – the distribution of power in the firm, shaping who makes decisions, who monitors the decision-makers, and what measures are used' (Gourevitch 2003: 307).

According to the latter conception, the authority structure of the firm is assumed to have been exogenously determined, and corporate governance practices are simply a means of fulfilling the interests of hegemonic actors as efficiently as possible. The latter activity is always undertaken by some kind of owner - regardless of the underlying power structure - as management is clearly not in a position to monitor itself, and it is difficult for labor to directly monitor an agent to which it is hierarchically subservient.

The ownership categorization of corporate governance systems is hence only a measure of what type of owner has been empowered to undertake this monitoring, oversight and control function. It is not necessarily a direct measure of the firm's authority structure. However, it is nonetheless a useful proxy for what that authority structure might be. For example, monitoring, oversight and control undertaken by external investors is likely to be reflective of a different corporate authority structure than oversight undertaken by internal blockholders.

In particular, the role of different types of owner offers a way of testing the theoretical claim of this paper: that European corporate governance is shifting towards a system in which the monitoring, oversight and control of firms is becoming increasingly undertaken by external investors rather than insider blockholders, and that this is reflective of an underlying shift in the relative power and preferences of several key social actors in European non-liberal market economies. The ownership orientation of corporate governance systems is hence the basis used for the operationalization of the dependent variable in the rest of this analysis.

A system in which the main corporate governance functions are undertaken by external owners is defined here as an 'outsider' system of corporate governance. An 'outsider' capital model is typified by the US and UK corporate governance systems. In such systems, firms' ownership is normally dominated by portfolio-oriented institutional investors, with ownership stakes of typically less than 3% per investor. Such owners undertake their governance functions 'outside' the firm, and do not generally involve themselves actively with the management of their companies. Influence is exerted over company management through 'exit' rather than 'voice', i.e. by selling their equity stakes rather than through hierarchical control (Hirschman 1970). Not surprisingly, 'outsider' systems tend to exhibit a bias towards publically-listed rather than privately-held companies (which remain hierarchically controlled) - an outcome which is promoted by the existence of well-developed stockmarkets, which provide the institutional mechanism with which to achieve a diffuse pattern of ownership.

Adolph Berle and Gardiner Means - in their 1932 classic, 'The Modern Corporation and Private Property' - first described how diffuse ownership could create potential agency problems due to the removal of management from the hierarchical control of blockholders. Alfred Chandler depicts this in terms of a shift of control from the 'visible hand' of company insiders, to the 'invisible hand' of company outsiders, i.e. the market (Chandler 1990).

To compensate for these risks, the 'outsider' model of corporate governance is also characterized by a range of complementary institutional features to empower the information, oversight and control activities of company outsiders. These include non-executive boards elected by shareholders, a major role for 'reputational intermediaries' (such as external auditors, stock exchanges, bond-rating agencies and stock market analysts) in providing externally visible performance information, the use of the stock price as a key indicator of the firm's prospects, an active market for corporate control, and incentive-based pay, to further align the interests of management (the firm's agents) with those of the shareholders (the firm's principals).

In contrast, an 'insider' model of corporate governance arises where owners monitor, oversee and control companies from within. This is achieved by owners taking large ownership stakes in individual companies, and cooperating actively with management. This allows investors to

retain direct hierarchical control over management, and thereby reduce agency costs. The insider model has been the predominant pattern of corporate governance observed in continental Europe (and in most other countries apart from the UK and US) during the post-war period (see table 1 below). Individual investors often have large ownership stakes (typically greater than 10-20%, which normally provides effective control). Furthermore, there tends to be a greater preponderance of privately-held companies, even amongst the largest firms.

‘Insider’ systems tend to have poor legal protections for minority shareholders. Blockholders rather than external shareholders are fulfilling the disciplinary and monitoring role vis-à-vis company management, and therefore the empowerment of external minority shareholders is not a social necessity. A lack of rights and safeguards discourages minority shareholder involvement in the ownership structure (which tends to be reflected in the discounted price they are willing to pay for the stock) – they are unwilling to expose themselves to the risk of possible expropriation by blockholders (e.g. due to self-trading or asset stripping), which the latter can undertake due to their higher level of direct control over company management.

‘Insider’ systems may take different institutional forms. In certain countries the predominant blockholders may be banks or other industrial firms (e.g. as in the post-war German model). In others they may be families or ethnic networks (e.g. as in Sweden or many less developed countries). Alternatively the blockholding role may be taken by the state (e.g. as in the ‘state capitalism’ of post-war France).

Tables 1 and 2 utilize two types of proxy variable to distinguish between ‘insider’ and ‘outsider’ corporate governance outcomes in various non-liberal European economies (along with the US, the UK and Ireland for comparison). Table 1 looks at levels of the commonly cited ownership concentration measure in the mid/late 1990s. A low level of ownership concentration is taken to imply a high level of ‘outsider’ ownership power. This is based on the assumption that diversified portfolio investors, i.e. investors that prefer to take low ownership stakes, are more likely to participate in corporate ownership if the rights of minority shareholders are secure.

Table 2 presents various legislative measures of corporate governance, in the form of indices that quantify the regulatory protections of minority shareholders, i.e. ‘outsider’ owners (Gourevitch and Shinn 2005: 48). A higher index value equates to better ‘outsider’ protections. These measures also relate to the mid/late 1990s. Both sets of data are consistent with the argument that the post-war systems of corporate governance in the non-liberal European economies have been significantly more insider-oriented than those of liberal market economies (at least until the mid/late 1990s).

The main anomaly in this data is the ownership concentration figure for the Netherlands, which implies that Dutch corporate governance is relatively similar to that of the liberal market economies. However, this impression is misleading, due to a form of synthetic blockholding prevailing in the Netherlands. This arises from the frequent separation of the cash-flow and ownership rights of company stock. Although company stock is widely held (as indicated by table 1), ownership rights are concentrated in company trust offices (*administratiekantoor*), which prevents outsider shareholders exerting governance power over the firm (Go-Feij 1999). Consequently, the Netherlands may also be categorized in terms of an insider system of corporate governance, an argument which is supported by the metrics of table 2.

2. An Insider-Outsider theory of European corporate governance

The underlying presumption of the proposed theoretical framework is that the adoption of an ‘insider’ or ‘outsider’ system of corporate governance is primarily determined by political

factors. Contrary to the economic theory of the firm, the corporate governance outcome is not seen as best explained as the outcome of an economic process (e.g. based on efficiency considerations), an assertion supported by the predominant location of corporate governance variation at the level of the nation state rather than at the sectoral or functional level (Stulz 2005). The rest of this section offers a framework for the political contestation of European corporate governance, and derives three falsifiable propositions with which to test the explanatory power of that framework.

The context in which corporate governance change is assumed to occur is post-war European corporatism. The institutional features of European corporatism have been well documented (e.g. Schmitter and Lehmbruch 1979; Cameron 1984; Alvarez et al 1991). Although there has been some debate concerning the precise configuration of corporatist arrangements (e.g., bipartism or tripartism as a defining feature), a common theme has been the mutual dependence of labor and capital through the incorporation of organized producer interest groups into the policy-making and policy implementation process (Grant 2003: 122).

One area in which opinions have evolved since the early neocorporatist literature is in respect of the role of labor. Writers such as Philippe Schmitter (1974) and John Goldthorpe (1984) emphasized the defining role of organized labor in corporatism, particularly in terms of striking bargains with the state. However, later writers - such as Katzenstein (1985a; 1985b) and Offe (1981) - placed more stress on the organization of business interests. Hall and Soskice's conception of a 'coordinated market economy' goes even further, placing the firm at the centre of a system of political economy, and viewing labor as merely one agent with which the firm coordinates relationships (Hall and Soskice 2001: 6).

The Varieties of Capitalism approach has been helpful in emphasizing the central coordinating role of the firm in a modern political economy. However, Hall and Soskice's framework does not provide an explanation of whose interests the firm is ultimately pursuing. The authority structure of the firm is not endogenously determined by their framework. As in the economics literature, corporate governance is viewed as an activity concerned with coordinating the relationship between management and investors in order to raise finance, abstracting from the issue of which actors actually control of the firm (Hall and Soskice 2001: 6). This is not helpful for our theoretical framework, in which corporate governance change is the endogenous variable and not exogenously given.

However, rather than revert to a model of corporatism in which the corporate governance outcome is determined by simple labor power (which is the essence of Roe's (2003) framework of corporate governance), corporatism is conceived here in terms of an 'insider' system of political economy. An 'insider' political economy is defined as a system controlled and managed in the interests of a relatively narrow group of interests. Such a group may consist of actors, or coalitions of actors, that are either relatively homogeneous, or are at least have a shared core of crucial economic interests. By working together, and denying 'outsiders' equal access to economic opportunities, they are able to attain a hegemonic position in the operation and institutional design of a political economy. Such 'insider' groups may in principal be composed of particular groups of owners ('insider capital'), management, employees ('insider labor') or a combination of all three.

In the European context, 'insider capital' is defined as referring to the incumbent domestic capitalist interests of the immediate post-war period, who became the most significant corporate sector blockholders. This includes actors such as wealthy families (such as the Wallenbergs in Sweden), banks (such as the big three private banks in Germany) and the state (e.g. in France). 'Insider labor' consists of those labor market groupings enjoying secure employment in sectors driving the post-war recovery (i.e. predominantly export-led manufacturing), whose interests have been typically represented by powerful trade unions (Rueda 2005).

The hypothesis of this paper is that a post-war ‘insider’ partnership between insider labor and capital was cemented by three broad factors. Firstly, the greater power of ‘insider’ labor over the political process in an age of universal suffrage meant that regulation and legislation could be introduced to impose the wishes of labor on ‘insider’ capital, regardless of capital’s own preferences. This incentivized insider capital to make compromises with labor, contrary to the pre-war experience. Furthermore, it crucially provided insider labor with the ultimate power to determine whether an insider or outsider system of corporate governance would be adopted or retained.

Secondly, in a world of capital immobility, insider capital networks provided the main source of investment capital for a political economy. This fostered the dependence of insider labor on the resources of outsider capital interests. Equally, capital immobility meant that ‘insider’ capital was effectively imprisoned in its domestic political economy - it could not reallocate its assets offshore, or sell-out to foreign investors, and was forced to make the best of it at home.

Finally, insider labor was willing and able to deliver a restriction of competition in domestic product markets. This allowed ‘insider’ capital to be cushioned from the short-term imperatives of profit maximization, due the generation of oligopolistic rents in product markets, which was clearly a favorable outcome for insider capital. However, such a cushioning was also consistent with the interests of insider labor, as it ultimately facilitated ‘insider’ capital’s ability to deliver job stability and higher wages to employees.

This kind of insider corporatist compromise necessitated a complementary system of corporate governance. In particular, it made more sense for the monitoring, oversight and control of firms to be undertaken by those owners whose interests were most aligned with insider labor, i.e. insider capital. Consequently, an insider system of corporate governance was adopted by insider labor. Blockholders rather than external minority shareholders were chosen to undertake the key corporate governance functions, keeping management under direct hierarchical control through high ownership stakes. At the same time, ‘outsider’ capital was effectively excluded from any form of monitoring, oversight or control function vis-à-vis management, due to an absence of effective minority shareholder protections.

In short, the adoption of an insider system of corporate governance was a direct reflection of the a post-war corporatist alliance between insider labor and insider capital. The implication of this theoretical framework is that a change in European corporate governance – from an insider to an outsider system – is only likely to occur in response to changes in the nature of the underlying relationship between insider labor and insider capital. This gives rise to three hypotheses that define the conditions under which corporate governance change might occur:

Proposition 1: An increase in domestic product market competitiveness increases the probability of a shift to an outsider system of corporate governance.

A number of writers have highlighted the importance of product market rents in incentivizing domestic producer interests to resist possible deregulation at the microeconomic level. Sophia Perez (1997), for example, has described the way in which producer interests in the Spanish banking sector resisted banking sector deregulation and the development of capital markets in the 1980s and 1990s, notwithstanding the liberalization of credit markets and the lifting of capital controls in the previous decade. Rajan and Zingales (2003) and Stulz (2005) have both pointed to a correlation between trade and the development of stockmarkets, based on Olson’s (1984) argument that greater trade openness breaks down the ability of domestic interest groups to sustain product market rents.

Such results suggest that insider capital interests will resist any transition to a system of corporate governance that offers greater market entry opportunities to outsider capital interests as long as they are still able to benefit from domestic product market rents. However, once product market imperfections start to erode, the incentives facing insider capital will start to change.

Ownership of a large percentage of an individual company creates significant concentration risk for an investor. If incumbent owners can no longer benefit from product market rents, they will be increasingly incentivized to support a system of corporate governance that encourages external investors to purchase their stakes at as high a share price as possible. This will be accompanied by a concomitant unwillingness to fulfill the role of directly monitoring, overseeing and controlling company management, which was previously undertaken as a *quid pro quo* for the supernormal rents obtained from uncompetitive product markets. Incumbent owners will also directly encourage their companies to adopt corporate governance practices that favor external investors, and thereby increase their potential to sell-out at a premium.

In such an environment, insider labor may also feel inclined to support the introduction of minority shareholder protections, and reorient corporate governance in an outsider direction – otherwise there will no longer be any effective monitoring, oversight and control of company management, which is an undesirable outcome for all social actors (with the obvious exception of management itself).

The overall result is that change in corporate governance – from an insider to an outsider system – is likely to be correlated with a decline in the competitiveness of domestic product markets.

Proposition 2: *The less a political economy is able to finance investment from domestic savings, the greater the probability of a shift to an outsider system of corporate governance.*

Deeg and Perez (2000: 119) have argued that the abolition of capital controls in many European economies during the 1980s and early 1990s was not in itself sufficient to drive convergence in systems of corporate governance, e.g. towards an Anglo-American outsider system. This finding is consistent with a well-established finding in the economics literature: that the abolition of capital controls has not led to a fully integrated global capital market. A significant correlation between national levels of savings and levels of investment was retained in many OECD countries up until the mid-1990s (Feldstein and Horioka 1980; Mussa and Goldstein 1993; Feldstein 2005).

A full discussion of the causes of global capital market integration is beyond the scope of this paper. However, it can be argued that one of the factors encouraging a political economy to seek access to global capital markets is the insufficiency of its domestic savings to finance domestic investment requirements. In the context of European corporatism, this may be equivalent to arguing that domestic insider capital networks are increasingly unable to mobilize sufficient capital resources to fulfill domestic financing needs.

Consequently, greater integration of a European political economy into global capital markets may be taken as a proxy for the increased inability of insider capital to fulfill the capital needs of other social partners. This may be causative of a shift in the preferences of insider labor in favor of an outsider system of corporate governance.

A country which is able to fulfill its capital requirements from domestic insider sources is less likely to reform its existing corporate governance practices. The supply of capital at the disposal of the domestic economy is abundant, and therefore likely to be available at low cost. However, if capital requirements grow beyond the capabilities of insider capital networks, insider labor may feel increasingly penalized in retaining an insider system of corporate

governance, as this detracts from its ability to secure financing from outsider capital (e.g. due to a lack of minority shareholder protections). Insider labor may perceive that this runs contrary to its interests, due to the adverse employment prospects created by an inability of firms to secure financing at a competitive price. It may therefore be willing to accommodate a switch to an outsider corporate governance systems, based on the prospect of securing more plentiful – and hence cheaper – sources of financing.

Insider capital networks may experience difficulties in mobilizing sufficient savings for a variety of reasons. From a microeconomic perspective, they may be inefficient in their role as financial intermediaries, i.e. channeling excess savings to areas of the economy with insufficient savings. From a macroeconomic perspective, an economy may simply be consuming too much, and generating an insufficient level of aggregate savings. Alternatively, the running of a large government deficit may absorb an excessive portion of the existing pool of domestic savings, and thereby increase the need of the corporate sector to attract capital from external sources ('crowding out'). Similarly, the running of a sustained current account deficit increases the need to secure external financing (as the capital account counterpart of the current account deficit), and thereby may also foster a greater need for external finance.

Recent empirical work reported by Alan Greenspan (2005a; 2005b) and John Helliwell (2004) suggests that the segmentation of global capital markets has declined significantly since the mid-1990s. For example, they report that the average savings retention coefficient – measuring the relationship between domestic savings (as a % of GDP) and domestic investment (as a % of GDP) – of 16 large OECD countries has declined from a range of 0.55 to 0.69 in the decades between 1980 and 1992, to 0.19 in the decade up to 2002 (Feldstein 2005: 8). This suggests that domestic sources of finance – and by implication domestic insider networks – may be becoming less important sources of finance, and that there is a greater demand for external finance.

However, related work by Martin Feldstein and John Friedman argues that the magnitude of this decline in capital market segmentation is not uniform across all countries. In particular, the savings coefficients of larger OECD countries appears to be falling less than those of smaller political economies (Feldstein 2005: 8). The lower integration of larger countries into global capital markets suggests that insider networks in larger countries may somehow possess a greater ability to fulfill domestic investment needs than insider networks in smaller countries.

Regardless of what is causing greater capital market integration, the implication of this second proposition is that there will exist a correlation between the extent of changes in corporate governance and the magnitude of a change in the savings retention coefficient of a political economy. A lower savings retention coefficient is in effect a proxy for the increased preference of insider labor for an outsider system of corporate governance.

Proposition 3: *The resilience of insider labor will determine the extent to which a shift to a outsider system of corporate governance is also associated with the development of a market for corporate control.*

The previous two propositions have identified the conditions under which the relationship between insider labor and insider capital may break down, and insider labor may shift the monitoring, oversight and control of companies function towards outsider capital. This transition is achieved through the introduction of minority shareholder protection measures, such as those listed in table 2.

The possibility of an alliance between labor and external capital has been discussed by Martin Höpner in the context of recent pro-outsider regulatory initiatives in Germany, which were initiated by the previous SPD/Green controlled government (Höpner 2003). Gourevitch and

Shinn (2005: 25) describe such a potential alliance as a 'transparency coalition'. Sigurt Vitols (2003:7) and Gregory Jackson (2003: 263) are both optimistic that an accommodation between these actors is possible, in the form of a hybrid system of 'negotiated shareholder value' (Vitols 2003: 13).

However, such an alliance between insider labor and outsider capital is likely to be inherently problematical. 'Outsider' capital has an interest in eliminating managerial agency costs of all kinds, including those that derive from labor power. It may hence be eager to promote the interests of 'outsider labor' – those parts of the labor force that are not in secure employment, and which would benefit from active labor market policies and the removal of the job protections enjoyed by insider labor (Rueda 2005). Such a development in the labor market would be in direct conflict with the interests of insider labor.

Furthermore, one of the favored mechanisms by which outsider capital seeks to reduce managerial agency costs is through the operation of an active market for corporate control. The encouragement of such a market is clearly contrary to the interests of insider labor, as it increases the prospect of significant job market instability and disruption.

It is not clear, however, to what extent insider labor can pick and choose in the type of measures that outsider capital should utilize in its monitoring, oversight and control of company management. The implication of proposition three is that their ability to do this will depend on the resilience of their own level of power. For example, a shift to an outsider system of corporate governance that is associated with minimal reductions in organized labor power is likely to be correlated with corporate governance changes that do not include the development of a significant market for corporate control. In terms of the categories of corporate governance regulation identified in table 2 above, there will be an increase in the indices of minority shareholder protection relating to information, oversight and incentive, but not to the index of control. However, a significant concomitant reduction in labor power implies that insider labor will be less able to impose its corporate governance wishes over outsider capital, and an outsider corporate governance will also include an increase in the market for corporate control, as measured by the control index in table 2.

To summarize, the above insider framework of European corporatism suggests that corporate governance systems may change due to the shifting preferences of both 'insider' labor and 'insider' capital. Insider capital is at risk of defection from the corporatist compromise if competition increases in domestic product markets. Insider labor is incentivized to defect if insider capital networks can no longer fulfill domestic capital requirements. The result of either or both of these defections may be a shift to an outsider system of corporate governance. The extent to which this will also include a market for corporate control will depend on changes in the resilience of organized labor.

3. The obstacles to corporate governance change

One of the difficulties of any theory of political change based on the changing preferences and power endowments of social actors is explaining how the inherently conservative effects of existing institutional constraints will be overcome. Changes in actors' preferences – such as those described in the above explanatory model - need not necessarily translate into changes in societal 'outcomes' due to the capacity of institutions to constrain the behavior of individual agents (North 1990, p.3; Rogowski 1989, p.20). Marx's observation is perhaps still relevant: 'men make their own history, but not in circumstances of their own choosing' (Marx 1852).

The neo-institutionalist literature in political science has emphasized the resilience of institutional forms, due to factors such as institutional path dependency, the rationality of actors of working within existing institutional frameworks and the veto power of incumbent

interests (North 1990; Zysman 1983; Hollingsworth and Boyer 1997; Berger and Dore 1996; Keohane and Milner 1996; Garrett and Lange 1996; Kitschelt et al 1999; Hall and Soskice 2001; Swank 2002). Institutional constraints have been used to explain why there has not necessarily been a strong contemporaneous correlation between socioeconomic change, e.g. the abolition of capital controls, and the collapse of the 'insider' nature of European political economies (Deeg and Perez 2000, p.142). Institutional resilience may also mean that it is possible for outdated institutions to coexist with unsupportive distributional coalitions due the costs involved in demolishing the existing set-up and establishing something new (David 1985: 332; Gourevitch 2003: 318).

In the context of corporate governance, the comparative political economy literature has largely focused on two significant institutional barriers to change. The first is the consensus nature of European political institutions (Pagano and Volpin 2001). Most non-liberal European political economies have electoral systems based on proportional representation, which is less sensitive to a swing in voting preferences than a majoritarian system, and contains larger numbers of veto players (Lijphart 1999). This may inhibit significant regulatory and legislative change in European corporate governance.

The second constraint is represented by the notion of 'complementarity', which is a central concept of Hall and Soskice's Varieties of Capitalism approach (Hall and Soskice 2001; Aoki 1990; Milgrom and Roberts 1990). A corporate governance system can be viewed as a single component of a highly interrelated national production system. It is argued that changes in corporate governance are only likely to occur as part of much broader changes in labor relations, education and training, R&D and other areas that contribute to the operation of an integrated political economy. A corporate governance system that does not sustain coherence with these other components endangers a nation's comparative institutional advantage. The incentive structure generated by the system's internal logic will militate against such an outcome.

In the context of European corporatism, both of these institutional constraints have been supportive of an environment in which 'credible commitments' can be made by economic actors. This has promoted a stable, long-term strategy in the employment of economic resources. Such characteristics are typical of Hall and Soskice's conception of a coordinated market economies – an economic system that is more oriented towards non-market mechanisms of resource allocation than Liberal Market Economies, such as the US and the UK (Hall and Soskice 2001).

For example, consensus political institutions provide reassurance to actors that policy will not change quickly, and that investment in physical and human 'specific' assets will be worthwhile. Similarly, a system of corporate governance presided over by 'insider' capital complements a coordinated market economy by shielding firms from the short-term economic pressures imposed by outsider capital, and therefore encourages their support of cooperative and long-term oriented economic behavior.

Both consensus electoral systems and institutional complementarity can be viewed as representations of the embedded interests of the post-war corporatist 'insiders', who established them as a means of cementing the post-war compromise between 'insider' capital and 'insider' labor.

It is often difficult to predict the ability of a particular institutional constraint to neutralize the changed preferences and power endowments of social actors on an *a priori* basis. For example, a consensus oriented political system may appear to place more barriers in the way of corporate governance change than a majoritarian system. However, there is nonetheless evidence (as presented in the introduction) that regulatory change relating to corporate governance has occurred in the non-liberal European economies in recent years. A consensus

political system may not, therefore, be an insurmountable obstacle to realization of the changed preferences of actors. The magnitude of that obstacle in the context of European corporate governance is something that need to be evaluated empirically.

The extent of the constraint imposed by complementarity is, however, something that can be questioned on conceptual grounds. Unlike the existence of an electoral system, the existence of complementarity in a particular context is subjective. It may appear – in the eyes of political scientists – that an intrinsic logic is guiding an economic system, which stands in the way of any significant change. However, this may be an illusion. For example, the institutions of ‘industrial democracy’ in Germany, e.g. codetermination, were strongly criticized by the business community in the 1970s (when they were being expanded), and it was argued that they would disrupt the entire German economic model. However, subsequent depictions of the German economic model have frequently cited codetermination as an intrinsic component of Rhineland capitalism. What was once incoherent is now complementary.

The argument put forward to explain corporate governance change in section 2 is not entirely inconsistent with Hall and Soskice’s notion of complementarity. It incorporates the idea that a system of corporate governance is not an isolated component of a political economy, unlike many treatments of corporate governance in finance and law. Corporate governance change is crucially dependent on what happens elsewhere in the system. However, the theory seeks to be more parsimonious than the varieties of capitalism approach by focusing only those interlinkages within the non-liberal European economies that are most important for sustaining or changing systems of corporate governance, rather than stressing the complementarity of the entire system.

4. Establishing relationships: some preliminary empirical evidence

In the next two sections, some preliminary suggestions of how to operationalize the proposed theoretical framework are presented. These are then used to provide *prima facie* evidence of the relationship between the variables highlighted by the theoretical claims, and thereby justify the undertaking of more sophisticated econometric work. In addition, some insight into the likely conclusions of the analysis is provided by a review of how proxies for the relevant dependent and explanatory variables have been changing since the early/mid 1990s.

Data is primarily presented in terms of bivariate correlations between levels of relevant variables. This, of course, ignores the possibility that any apparent relationship between two variables may arise due to their mutual dependence on other unrevealed variables. Nor does it provide an insight into the dynamics of any possible relationship. Indeed, the theoretical claims described above are intended to explain change in corporate governance, rather than their relative levels, and this will need to be operationalized directly in future empirical analysis. Nonetheless, it is hoped that the evidence presented will persuade the reader that further investigation of the proposed relationships is a worthwhile enterprise.

Proposition 1: *An increase in domestic product market competitiveness increases the probability of a shift to an outsider system of corporate governance.*

An initial relationship between corporate governance and product market competitiveness can be established utilizing the proxies for corporate governance presented in tables 1 and 2 – ownership concentration and the Gourevitch-Shinn index of minority shareholder protection. These are presented in figures 1 and 2. The proxy adopted for product market competitiveness is the OECD index of Product Market Regulation (Conway et al: 2005). This is an indicator of the overall regulatory slant in product markets, and is calculated as a weighted average of three component indices: a Barriers to Entrepreneurship index (31% weighting), a State Control index (29%) and a Barriers to Trade and Investment index (41%). A lower index

value indicates more liberalized product market regulation, and is hence suggestive of more product market competition.

Index values were initially calculated by the OECD for 1998, however they have been recently updated to take account of the situation in 2003. However, in figures 1 and 2 the 1998 values are used, given their closer temporal proximity to the proxy variables for corporate governance, both of which relate to the mid/late 1990s. The position of the United States is also included in the scatter diagram for purposes of comparison.

In figure 3 a more up-to-date proxy for corporate governance is utilized. The Anti-Self-Dealing index has been recently published by Djankov, La Porta, Lopez-de-Silanes and Schleifer (2005) as a measure of the legal protection of minority shareholders against expropriation by corporate insiders (either managers or controlling shareholders). It considers the extent to which a national legal framework favors outsider or insider interests - in areas such as disclosure, approval and litigation - when evaluated in relation to a common corporate transaction across 72 countries (Djankov et al 2005: 5). The index values relate to the legal situation prevailing in 2003.

Figure 4 uses two alternative proxies for corporate governance and product market competition. A high stockmarket capitalization as a percentage of GDP is potentially indicative of a more outsider-oriented corporate governance system. It suggests a greater weight of public listed companies in an economy (rather than private unlisted enterprises), and a greater orientation towards equity as a means of long-term corporate finance, both of which are characteristic of outsider corporate governance systems. However, it does suffer from the disadvantage of including the closely held equity holdings of insiders, and may be dominated by a large number of large companies (Rajan and Zingales 2003). Consequently, it may give a somewhat false impression of the extent to which a corporate sector as a whole is being monitored, overseen and controlled by outsider actors. However, notwithstanding these disadvantages, it remains a useful indicator of corporate governance orientation.

The proxy for product market competition in figure 4 represents an attempt to measure actual market conditions, rather than the regulatory environment. The Profit Mark-Up Indicator is calculated by subtracting annual growth in unit labor costs from annual inflation in the GDP deflator. The aim is to provide a rough estimate of the incremental profit margin available to producers after deduction of the growth in wage costs. A decline in the Profit Mark-Up indicator is assumed to imply more competitive conditions in product markets. Figure 4 suggests that those European countries experiencing more challenging product market conditions in recent years are those with a greater orientation to stockmarkets.

Proposition 2: *The less a political economy is able to finance investment from domestic savings, the greater the probability of a shift to an outsider system of corporate governance.*

Section 2 above proposes to measure the extent of insider financing capacity in terms of the Feldstein-Horioka savings retention coefficient, which is utilized in the economics literature as a measure of capital market integration (Feldstein 2005). This coefficient is obtained from regressions between savings-GDP and investment-GDP ratios. However, prior to calculating this proxy in future empirical work, it is possible to establish a link between other more generally available measures of domestic financing capacity and corporate governance.

In figure 5, the Anti-Self-Dealing index is juxtaposed with the level of private sector net saving (as a percentage of GDP), and exhibits the expected negative correlation. Net saving measures that part of net national disposable income (i.e. net national income plus the balance of current transfers with the rest of the world) that is not used on consumption and may

therefore be used for net investment (i.e. investment beyond just replacing depreciation) or, possibly, capital transfers to the rest of the world.

In figure 6, the widely cited household savings ratio is used to proxy insider financing capacity. Households represent the main part of the private sector generating a financial surplus, and are therefore the biggest contributors to private sector savings. However, unlike corporate savings, household savings are channeled to investment through the intermediation of the financial system.

The household savings ratio is plotted against a revised version of the Anti-Directors Rights index originally devised by La Porta, Lopez-de-Silanes, Schleifer and Vishny (1997, 1998). This is calculated as the aggregate score in respect to assessments of shareholders' rights in six areas (voting by mail, depositing shares prior to general meeting, cumulative voting, oppressed minority rights, pre-emptive rights, and amount of capital required to call a shareholders' meeting).

The original index has been criticized in the literature for some mistakes in its coding and for conceptual ambiguity regarding the definitions of its six component categories (Pagano and Volpin 2005). In particular, it is argued that the scores do not differentiate sufficiently between legal provisions that enable (but not require) shareholders' rights to be protected, and measures that set-out mandatory or default rules. This leads to an overestimation of shareholders' rights, for example, in the case of the United States (particularly in the cumulative voting category). The new index has been calculated by Djankov, La Porta, Lopez-de-Silanes and Schleifer (2005), and while retaining the same six component categories, attempts to rectify the previous shortcomings. It also exhibits a negative correlation with the household savings ratio.

Proposition 3: *The resilience of insider labor will determine the extent to which a shift to a outsider system of corporate governance is also associated with the development of a market for corporate control.*

A proxy for insider labor power used by David Rueda in his analysis of insider-outsider politics in industrialized democracies is the OECD's overall protection against dismissal's index (Rueda 2005: 6). The relationship between this index and ownership concentration has already been identified by Mark Roe (2003: 139). A similar relationship is demonstrated in figure 7, however this time utilizing the Gourevitch-Shinn MSP index as a proxy for corporate governance.

It should be noted, however, that there is a difference in the interpretation of the link between labor power and corporate governance offered by Roe and the theoretical framework presented in this paper. Roe's argument is that an insider system of corporate governance arises due to the response of owners to labor power. Shareholders choose to adopt an insider system in order to counteract the power that labor may have over management (via their influence over the legal and regulatory framework).

However, there are several problems with this argument. The first is that most non-liberal European economies had insider systems of corporate governance well before the advent of labor power in the post-war period. It is thus difficult to argue that insider corporate governance was a 'response' to labor power. Secondly, labor power – as measured by the employment protection index – has shown little change in most European political economies since the late 1980s (see figure 13). Indeed, in the cases of Germany and France, it has registered a slight increase. Consequently, changes in raw labor power do not appear to offer much explanatory power in explaining the corporate governance changes that have occurred in Europe during the last decade.

The argument presented here views an insider system of corporate governance in a corporatist political economy as reflecting the choice of insider labor rather than the choice of owners. However, insider labor may be willing to seek an outsider system of corporate governance if the balance of costs/benefits in their relationship with insider capital is unfavorable. However, it is assumed that the strength of insider labor will determine their ability to define an outsider system of corporate governance without a market for control.

Consequently, the adoption of an outsider system of corporate governance in Portugal, the Netherlands, Austria and Greece is less likely to be associated with a market for corporate control than an outsider system in Denmark or Switzerland. Some evidence for this claim is provided by the correlation in figure 8, which utilizes a result from the WEF's Global Competitiveness Survey concerning the ease of mergers and acquisitions (particularly hostile takeovers) in national political economies (WEF 2004).

5. Variable dynamics: what's changed since the 1990s?

Having provided some preliminary evidence of the links between various proxies for corporate governance and explanatory variables relating to product market competition, insider financing capacity and labor power, this final section considers the nature of the change experienced by some of these variables since the mid-1990s, and considers if observed variation has been consistent with the paper's theoretical claims.

One of the main challenges facing an analysis of corporate governance change is identifying proxies for the dependent variable that are available as a time series. Many of the measures of corporate governance identified above – such as ownership concentration, the Gourevitch-Shinn MSP index, the Anti-Self-Dealing index and the revised index of Anti-Director rights – are only available as snapshots relating to a specific time point, and therefore tend only to be utilized in cross-sectional analyses of relative corporate governance 'levels'.

However, figures 9 and 10 illustrate the change that has occurred in values of two proxies that are available for temporal comparison: stockmarket capitalization as a percentage of GDP, and the values of LLSV's original Anti-Director Rights index. Both provide some support for the anecdotal evidence provided at the start of this paper, suggesting a shift towards a more outsider system of corporate governance in many political economies since the mid-1990s.

In respect of the proposed explanatory variables, figure 11 shows that there has been a significant liberalization of product market regulations since 1998 in all European economies. According to recent assessment by the European Central Bank, product market reform has occurred at a faster pace within the euro area than elsewhere in the OECD over the last decade. The ECB economists do not offer a definitive explanation of why this has occurred, although they attribute more credit to the effects of 'economic crisis' than the adoption of a single currency (Duval and Elmeskov 2006: 37).

European economies also appear to have experienced a reduced capacity to generate savings during the 1990s, as illustrated in figure 12. More significantly, the capacity of domestic savings generation to fulfill domestic investment requirements also seems to have deteriorated, as implied by a calculation that divides national investment levels (as a percentage of GDP) by national savings levels (table 3).

Finally, there is little evidence of a significant decline in the power of insider labor in non-liberal European economies, at least when measured in terms of the extent of employment protection legislation (figure 13). This implies that is more to an explanation of corporate governance change than the simple weakening of labor *per se*. The resilience of insider labor

also implies that any shift to an outsider political economy that may be occurring in Europe is proceeding without a concomitant development in the market for corporate control.

In short, observed variation in European corporate governance outcomes, product market competition and domestic financing capacity over the last 5-10 appears to be consistent with the theoretical framework presented in this paper. In addition, the relative ability of economies to develop a market for corporate control also appears to be compatible with our theoretical claims.

6. Conclusion

The purpose of this paper has been to identify the conditions for a shift from an insider to an outsider system of corporate governance in non-liberal European political economies. Preliminary data and anecdotal evidence suggest that European corporate governance systems have been moving in an outsider direction during the last 5-10 years. Furthermore, this has been accompanied by supportive changes in the explanatory variables identified by this paper's theoretical framework. However, precise determination of the causal validity and significance of the proposed relationships must await the outcome of more sophisticated econometric analysis during the next few months.

References

- Aoki, Masahiko, and Ronald Philip Dore. *The Japanese Firm: The Sources of Competitive Strength*. Oxford: Oxford University Press, 1994.
- Belloc, Marianna, and Ugo Pagano. "Co-Evolution Paths of Politics, Technology and Corporate Governance." *ECGI Law Working Paper*, no. 36 (2005).
- Berger, Suzanne, and Ronald Philip Dore. *National Diversity and Global Capitalism, Cornell Studies in Political Economy*. Ithaca; London: Cornell University Press, 1996.
- Berle, Adolf Augustus, Gardiner Coit Means, and Columbia University. Council for Research in the Social Sciences. *The Modern Corporation and Private Property*. New York: Macmillan, 1932.
- Beyer, J., and M. Hopner. "Corporate Governance and the Disintegration of Organised Capitalism in the 1990s." *West European Politics* 26, no. 4 (2003): 179-98.
- Black, B. S. "The Legal and Institutional Preconditions for Strong Securities Markets." *Ucla Law Review* 48, no. 4 (2001): 781-856.
- Botero, J. C., S. Djankov, R. La Porta, F. Lopez-de-Silanes, and A. Shleifer. "The Regulation of Labor." *Quarterly Journal Of Economics* 119, no. 4 (2004): 1339-82.
- Boyer, Robert. "The Diversity and Future of Capitalisms: A Régulationnist Analysis." In *Capitalism in Evolution: Global Contentions--East and West*, edited by Geoffrey Martin Hodgson, Makoto Itô and Nobuharu Yokokawa. Cheltenham: Edward Elgar, 2001.
- Bradley, M., C. A. Schipani, A. K. Sundaram, and J. P. Walsh. "The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads." *Law And Contemporary Problems* 62, no. 3 (1999): 9-86.
- Cameron, David R. "Social Democracy, Corporatism, Labor Quiescence, and the Representation of of Economic Interest in Advanced Capitalist Society." In *Order and Conflict in Contemporary Capitalism*, edited by John H. Goldthorpe, Social Science Research Council (U.S.) and Joint Committee on Western Europe., 143-78. Oxford: Clarendon Press, 1984.
- Chandler, Alfred Dupont. *The Visible Hand: The Managerial Revolution in American Business*. Cambridge, Mass.; London: Harvard University Press, 1977.
- Chandler, Alfred Dupont, and Takashi Hikino. *Scale and Scope: The Dynamics of Industrial Capitalism*. Cambridge, Mass; London: Belknap Press of Harvard University Press, 1990.
- Charkham, Jonathan P. *Keeping Good Company: A Study of Corporate Governance in Five Countries*. Oxford: Clarendon Press, 1994.
- Charkham, Jonathan P., and Anne Simpson. *Fair Shares: The Future of Shareholder Power and Responsibility*. Oxford: Oxford University Press, 1999.

- Conway, Paul, Véronique Janod, and Giuseppe Nicoletti. "Product Market Regulation in Oecd Countries: 1998 to 2003." *OECD Economics Department Working Papers*, no. 419 (2005).
- David, Paul. A. "Clio and the Economics of Qwerty." *American Economic Review*, no. 75 (1985): 332-7 (May).
- Davis, Global Advisors. "Leading Corporate Governance Indicators." (2002).
- Deeg, R., and S. Perez. "International Capital Mobility and Domestic Institutions: Corporate Finance and Governance in Four European Cases." *Governance* 13, no. 2 (2000): 119-54.
- Donaldson, John. *Key Issues in Business Ethics*. London: Academic Press, 1989.
- Djankov, S., R. La Porta, F. Lopez-de-Silanes, and A. Shleifer. "The Law and Economics of Self-Dealing." *Nber Working Paper Series* (2005): ALL.
- Duval, Romain, and Jørgen Elmeskov. "The Effects of Emu on Structural Reforms in Labour and Product Markets." *European Central Bank, Working Paper Series*, no. 596 (2006).
- Dyck, A., and L. Zingales. "Private Benefits of Control: An International Comparison." *Journal Of Finance* 59, no. 2 (2004): 537-600.
- Eckbo, B. E. "Mastering Corporate Governance." *Financial Times*, 20 May 2005.
- Faccio, M., and L. H. Lang. "The Ultimate Ownership of Western European Corporations." *Journal Of Financial Economics* 65, no. 3 (2002): 365-95.
- Feldstein, M. "Monetary Policy in a Changing International Environment: The Role of Capital Flows." *Nber Working Paper Series* (2005): ALL.
- Feldstein, Martin, and Charles Horioka. "Domestic Savings and International Capital Flows." *Economic Journal* 90, no. 358 (1980): 314-29.
- Freeman, R. Edward. *Strategic Management: A Stakeholder Approach, Pitman Series in Business and Public Policy*. Boston: Pitman, 1984.
- Friedman, A. L., and S. Miles. "Developing Stakeholder Theory." *Journal Of Management Studies* 39, no. 1 (2002): 1-22.
- Go-Feij, Denise. "Corporate Governance and Technical Innovation in the Netherlands." In *Report to the European Commission*, 1999.
- Gompers, P. A., J. L. Ishii, and A. Metrick. "Corporate Governance and Equity Prices." *Nber Working Paper Series*, no. 8449 (2001): ALL.
- Gourevitch, Peter Alexis. "Corporate Governance - Global Markets, National Politics." In *Governance in a Global Economy: Political Authority in Transition*, edited by Miles Kahler and David A. Lake, xi, 498. Princeton, NJ; Oxford: Princeton University Press, 2003.
- . *Politics in Hard Times: Comparative Responses to International Economic Crises, Cornell Studies in Political Economy*. Ithaca; London: Cornell University Press, 1986.
- Gourevitch, Peter Alexis, and James Shinn. *Political Power and Corporate Control: The New Global Politics of Corporate Governance*. Princeton, N.J.; Oxford: Princeton University Press, 2005.
- Greenspan, Alan. "Stability and Economic Growth: The Role of the Central Bank." Paper presented at the Banco de Mexico's 80th Anniversary International Conference, Mexico City, November 14 2005.
- Hall, Peter A. "The Political Economy of Europe in an Era of Interdependence." In *Continuity and Change in Contemporary Capitalism*, edited by Herbert Kitschelt, xvi, 527. Cambridge: Cambridge University Press, 1999.
- Hall, Peter A., and David W. Soskice. *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*. Oxford: Oxford University Press, 2001.
- Helliwell, J. F. "Demographic Changes and International Factor Mobility." *Nber Working Paper Series* (2004): ALL.
- Hirschman, Albert O. *Exit, Voice, and Loyalty: Responses to Decline in Firms, Organizations, and States*. Cambridge, Mass.: Harvard University Press, 1970.
- Hollingsworth, J. Rogers, and Robert Boyer. *Contemporary Capitalism: The Embeddedness of Institutions, Cambridge Studies in Comparative Politics*. Cambridge: Cambridge University Press, 1997.
- Hopner, M. "European Corporate Governance Reform and the German Party Paradox." *Max-Planck-Institute for the Study of Societies Programme for the Study of Germany and Europe Working Paper No.03.1* (2003).
- Hutton, Will. *The State We're In*. London: Cape, 1995.
- Jackson, G., M. Hopner, and A. Kurdelbusch. "Corporate Governance and Employees in Germany: Changing Linkages, Complementarities, and Tensions." Paper presented at the Corporate governance and labour management; an international comparison, Manchester 2003.
- Jacobs, Michael T. *Short-Term America: The Causes and Cures of Our Business Myopia*. Boston, Mass: Harvard Business School Press, 1991.

- Kakabadse, Andrew, and Nada Kakabadse. *The Geopolitics of Governance: The Impact of Contrasting Philosophies*. Basingstoke: Palgrave, 2001.
- Katzenstein, Peter J. *Corporatism and Change: Austria, Switzerland, and the Politics of Industry, Cornell Studies in Political Economy*. Ithaca; London: Cornell University Press, 1984.
- . *Small States in World Markets: Industrial Policy in Europe, Cornell Studies in Political Economy*. Ithaca: Cornell University Press, 1985.
- La Porta, R., F. Lopez-de-Silanes, and A. Shleifer. "Corporate Ownership around the World." *Discussion Paper- Harvard Institute Of Economic Research* (1998): ALL.
- La Porta, R., F. Lopez-De-Silanes, and A. Shleifer. "Corporate Ownership around the World." *Journal Of Finance* 54, no. 2 (1999): 471-518.
- La Porta, R., F. Lopez-de-Silanes, A. Shleifer, and R. Vishny. "Investor Protection and Corporate Governance." *Journal Of Financial Economics* 58, no. 1-2 (2000): 3-27.
- . "Investor Protection and Corporate Valuation." *Journal Of Finance* 57, no. 3 (2002): 1147-70.
- La Porta, R., F. Lopez-de-Silanes, A. Shleifer, and R. W. Vishny. "Law and Finance." *Journal Of Political Economy* 106, no. 6 (1998): 1113-55.
- La Porta, R., F. Lopez-De-Silanes, A. Shleifer, and R. W. Vishny. "Legal Determinants of External Finance." *Journal Of Finance* 52, no. 3 (1997): 1131-50.
- Lane, C. "Changes in Corporate Governance of German Corporations: Convergence to the Anglo-American Model?" *ESRC Centre for Business Research, University of Cambridge, Working Paper*, no. 259 (2003): 1-29.
- Lehmbruch, Gerhard, and Philippe C. Schmitter. *Trends Towards Corporatist Intermediation, Sage Studies in Contemporary Political Sociology; Vol.1*. Beverly Hills; London: Sage, 1979.
- Letza, S., X. Sun, and J. Kirkbride. "Shareholding Versus Stakeholding: A Critical Review of Corporate Governance." *Corporate Governance* 12, no. 3 (2004): 242-62.
- Lijphart, Arend. *Parliamentary Versus Presidential Government, Oxford Readings in Politics and Government*. Oxford: Oxford University Press, 1992.
- Lijphart, Arend, and Arend Lijphart. *Patterns of Democracy: Government Forms and Performance in Thirty-Six Countries*. New Haven, Conn.; London: Yale University Press, 1999.
- Loriaux, Michael Maurice. *Capital Ungoverned: Liberalizing Finance in Interventionist States*. Ithaca, N.Y.; London: Cornell University Press, 1997.
- Marx, Karl. *The Eighteenth Brumaire of Louis Bonaparte*. 3rd rev. ed ed. Moscow: Progress Publishers, 1954.
- Mueller, Dennis C. "The Economics and Politics of Corporate Governance." *ECGI Law Working Paper*, no. 37 (2005).
- Mussa, M., and M. Goldstein. "The Integration of World Capital Markets." Paper presented at the Changing capital markets: implications for monetary policy, Jackson Hole; WY, Aug 1993.
- Nenova, T. "The Value of Corporate Voting Rights and Control: A Cross-Country Analysis." *Journal Of Financial Economics* 68, no. 3 (2003): 325-51.
- North, Douglass Cecil. *Institutions, Institutional Change and Economic Performance, Political Economy of Institutions and Decisions*. Cambridge: Cambridge University Press, 1990.
- . *Structure and Change in Economic History*. New York; London: Norton, 1981.
- North, Douglass Cecil, and Institute of Economic Affairs (Great Britain). *Understanding the Process of Economic Change, Wincott Memorial Lecture; 27*. London: Institute of Economic Affairs for the Wincott Foundation, 1999.
- Olson, Mancur. *The Rise and Decline of Nations: Economic Growth, Stagflation, and Social Rigidities*. New Haven, Conn.; London: Yale University Press, 1982.
- O'Sullivan, Mary. *Contests for Corporate Control: Corporate Governance and Economic Performance in the United States and Germany*. Oxford: Oxford University Press, 2001.
- Offe, Claus. "The Attribution of Public Status to Interest Groups: Observations on the West German Case." In *Organizing Interests in Western Europe: Pluralism, Corporatism, and the Transformation of Politics*, edited by Suzanne Berger and Joint Committee on Western Europe., x, 426. Cambridge: Cambridge University Press, 1981.
- Organisation for Economic Co-operation and Development. "Oecd Employment Outlook." (2004).
- Pagano, M., and P. Volpin. "The Political Economy of Corporate Governance." *Discussion Paper Series- Centre For Economic Policy Research London*, no. 2682 (2001): ALL.
- Pagano, M., and P. F. Volpin. "Managers, Workers, and Corporate Control." *Journal Of Finance* 60, no. 2 (2005): 841-68.
- . "The Political Economy of Corporate Governance." *American Economic Review* 95 (2005): 1005-30.

- Perez, S. "From Cheap Credit to the Ec: The Politics of Financial Reform in Spain." In *Capital Ungoverned: Liberalizing Finance in Interventionist States*, edited by Michael Maurice Loriaux, vii, 234. Ithaca, N.Y.; London: Cornell University Press, 1997.
- Pierson, P. "Increasing Returns, Path Dependence, and the Study of Politics." *American Political Science Review* 94, no. 2 (2000): 251-68.
- Prowse, Stephen, and Bank for International Settlements. Monetary and Economic Department. *Corporate Governance in an International Perspective: A Survey of Corporate Control Mechanisms among Large Firms in the United States, the United Kingdom, Japan and Germany, Bis Economic Papers; 41*. Bank for International Settlements, Basle, 1994.
- Rajan, R. G., and L. Zingales. "The Great Reversals: The Politics of Financial Development in the Twentieth Century." *Journal Of Financial Economics* 69, no. 1 (2003): 5-50.
- Roe, Mark J. *Political Determinants of Corporate Governance: Political Context, Corporate Impact*. Oxford: Oxford University Press, 2003.
- . *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance*. Princeton, N.J.: Princeton University Press, 1994.
- Rueda, D. "Insider-Outsider Politics in Industrialized Democracies: The Challenge to Social Democratic Parties." *American Political Science Review* 99, no. 1 (2005): 1-14.
- Shinn, James. "Private Profit or Public Purpose? Shallow Convergence on the Shareholder Model." Princeton University, 2001.
- Sinclair, Timothy J. *Global Governance: Critical Concepts in Political Science*. 4 vols. London: Routledge, 2004.
- Stulz, R. M. "The Limits of Financial Globalization." *Journal Of Finance* 60, no. 4 (2005): 1595-638.
- Swank, Duane. *Global Capital, Political Institutions, and Policy Change in Developed Welfare States, Cambridge Studies in Comparative Politics*. Cambridge: Cambridge University Press, 2002.
- Towers, and Perrin. "Worldwide Total Remuneration Report." (1999).
- Vitols, S. "Changes in German Finance: Introducing More "Market" into a Bank-Based System." *EIFC Working Paper*, no. 03-29 (2003).
- . "Negotiated Shareholder Value: The German Version of an Anglo-American Practice." *Discussion Paper, Wissenschaftszentrum Berlin*, no. SP II 2003-25 (2003).
- . "Varieties of Corporate Governance: Comparing Germany and the Uk." In *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage*, edited by Peter A. Hall and David W. Soskice, 337-60. Oxford: Oxford University Press, 2001.
- Yamamura, Kâozão, and Wolfgang Streeck. *The End of Diversity? Prospects for German and Japanese Capitalism, Cornell Studies in Political Economy*. Ithaca: Cornell University Press, 2003.
- Zingales, L. "Corporate Governance." *Discussion Paper Series- Centre For Economic Policy Research London* (1998): ALL.

**Table 1: Ownership Concentration (%) – mid/late 1990s
(20% blockholding threshold)**

United States	15.0
Netherlands	20.0
United Kingdom	23.6
Ireland	24.6
Denmark	37.5
Norway	38.6
Sweden	46.9
Switzerland	48.1
Finland	48.8
Belgium	51.5
Austria	52.8
Spain	55.8
Italy	59.6
Portugal	60.3
Germany	64.6
France	64.8
Greece	75.0

Original data sources: LLSV (1999): United States, Denmark, Netherlands, and Greece.
Faccio and Lang (2002): Other European countries.
As quoted in Gourevitch and Shinn (2005: 299).

Table 2: Indices of Minority Shareholder Protections – mid/late 1990s

	Information	Oversight	Control	Incentive	Total MSP
United States	86	100	100	100	97
United Kingdom	81	60	100	53	74
Ireland	69	71	80	59	70
France	64	37	60	47	52
Spain	57	14	80	50	50
Norway	66	29	80	16	48
Sweden	67	36	60	22	46
Finland	60	36	60	16	43
Switzerland	59	36	40	16	38
Netherlands	57	0	40	47	36
Denmark	44	43	40	16	36
Belgium	43	32	0	59	34
Germany	44	29	20	41	33
Austria	40	36	40	6	30
Greece	53	14	40	0	27
Portugal	43	0	60	0	26
Italy	69	7	20	0	24

Quoted in Gourevitch and Shinn (2005: 48).

Original data sources:

Information: Average of LLSV's (1998) measures of accounting quality and financial disclosure.

Oversight: Davis Advisor's (2002) measure of the percentage of non-executive directors on boards.

Control: average of LLSV's (1998) measures of minority shareholder rights.

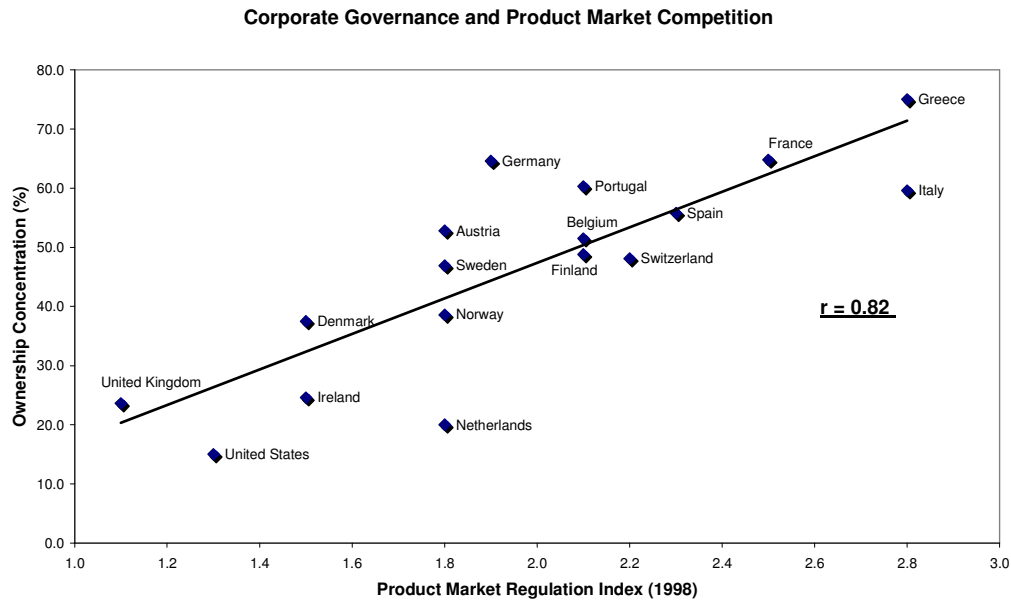
Incentive: Derived from Towers and Perrin (1999) measure of incentive compensation as a proportion of total compensation.

Table 3: Gross Fixed Capital Formation, Private Sector (% GDP) as a proportion of Net Savings, Private Sector (% GDP)

	1992-1994	1995-1997	2000-2002
Belgium	1.04	1.34	2.09
Denmark	2.19	2.77	3.50
Germany	2.45	2.23	2.91
Greece	-	1.24	2.69
Spain	-	1.58	3.46
France	1.79	1.73	2.02
Italy	1.15	1.32	2.49
Netherlands	1.37	1.20	2.01
Austria	-	2.39	3.30
Portugal	-	3.04	9.25
Finland	-0.56	2.20	3.66
Sweden	1.12	1.17	2.52
United Kingdom	2.12	2.08	8.68

Data sources: Net Savings: Eurostat Database; Gross Fixed Capital Formation: EU AMECO Database.

Figure 1: Ownership Concentration (mid/late 1990s) and OECD Product Market Regulation Index (1998)



Data points: All countries listed in Table 1 above.

Original data sources:

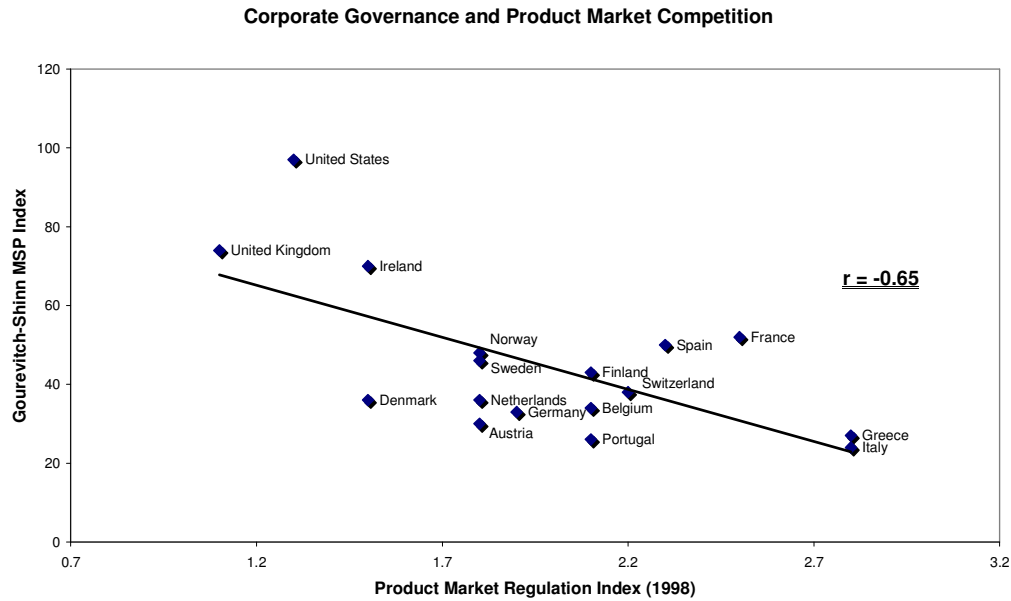
1. Ownership Concentration: LLSV (1999): United States, Denmark, Netherlands, and Greece.

Faccio and Lang (2002): Other European countries.

As quoted in Gourevitch and Shinn (2005: 299).

2. Overall Product Market Regulation Index: Conway et al (2005: 59).

Figure 2: Gourevitch-Shinn Index of Minority Shareholder Protections (mid/late 1990s) and OECD Product Market Regulation Index (1998)

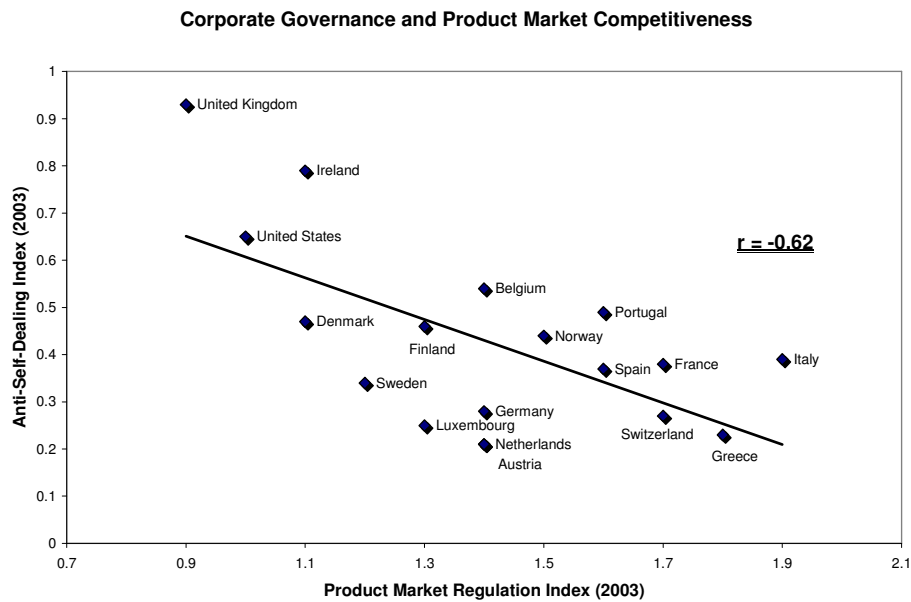


Data points: All countries listed in Table 2 above.

Original data sources:

1. Overall MSP Index: Gourevitch and Shinn (2005: 48).
2. Overall Product Market Regulation Index: Conway et al (2005: 59).

Figure 3: Anti-Self-Dealing Index (2003) and Product Market Regulation Index (2003)

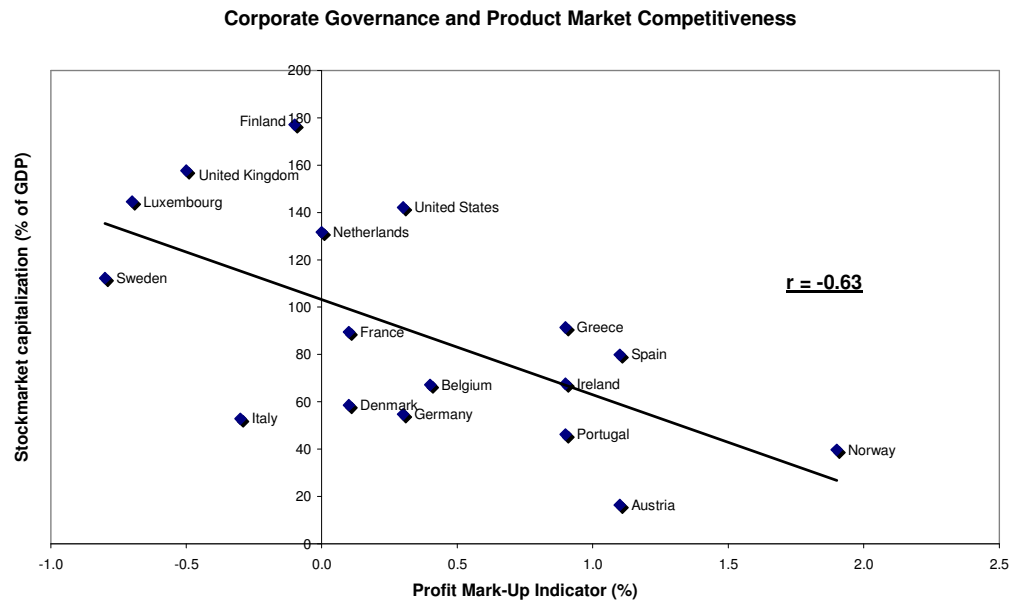


Data points: EU 15 plus Norway, Switzerland and US.

Original data sources:

1. Anti-Self-Dealing Index: Djankov, La Porta, Lopez-de-Silanes and Schleifer (2005: 52).
2. Product Market Regulation Index: Conway et al (2005: 59).

Figure 4: Stockmarket Capitalization (% of GDP) and Profit Mark-Up Indicator

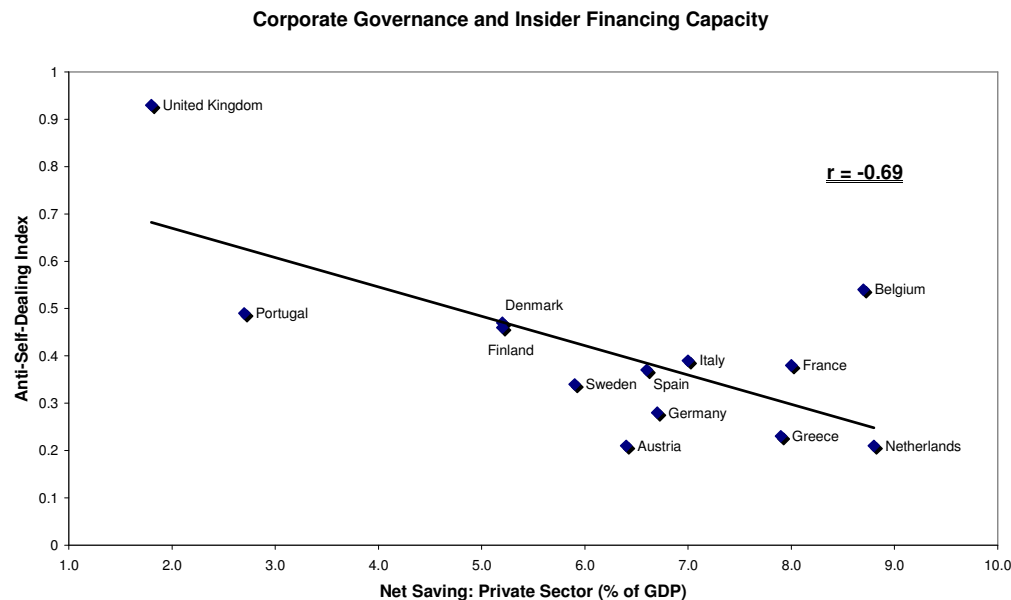


Data points: EU 15 plus Norway and US.

Original data sources:

1. Stockmarket capitalization as % of GDP, 1999-2003, Djankov et al (2005: 56).
2. Profit Mark-Up Indicator: Annual GDP deflator growth minus annual growth in unit labor costs, 2000-2004 average. Data components from EU AMECO database.

Figure 5: Anti-Self-Dealing Index (2003) and Net Saving, Private Sector (as % of GDP), 2000-2003

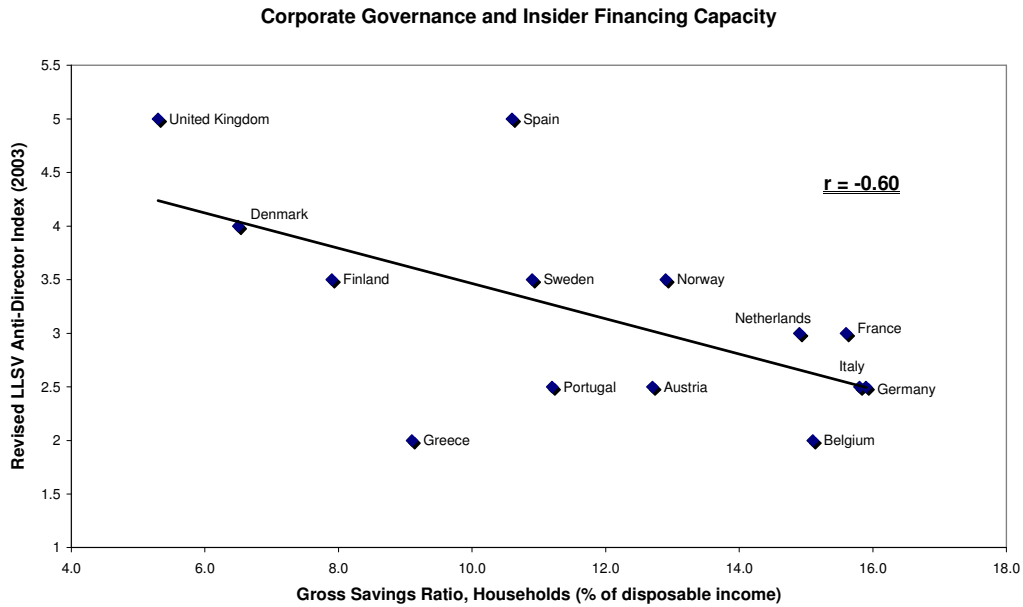


Data points: EU 13.

Original data sources:

1. Anti-Self-Dealing Index: Djankov, La Porta, Lopez-de-Silanes and Schleifer (2005: 52).
2. Net Saving: Private Sector, as % GDP, 2000-2003: Eurostat Database.

Figure 6: Revised LLSV Anti-Director Index (2003) and Gross Savings Ratio, Households (2000-2004)

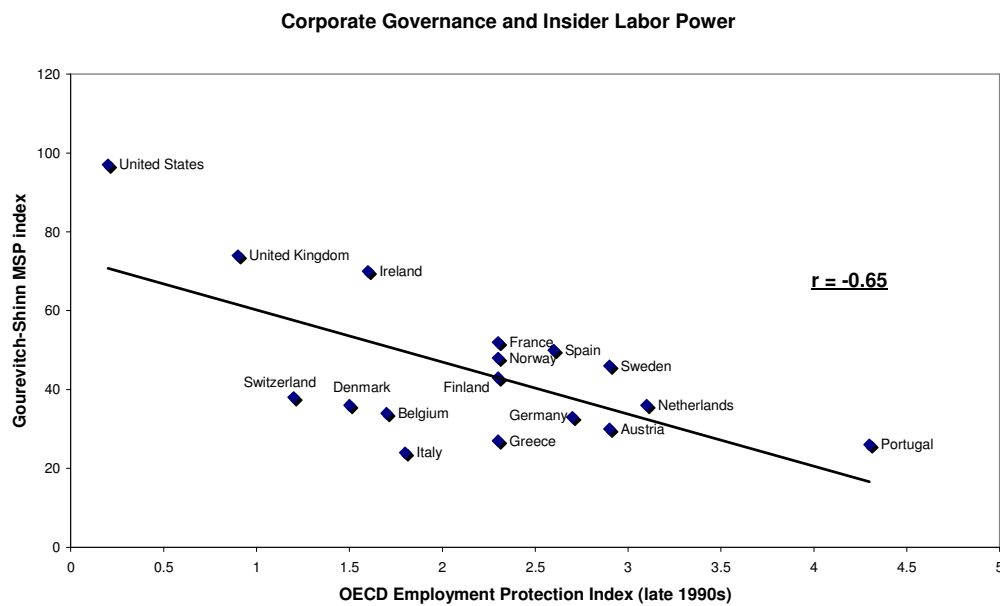


Data points: EU 13.

Original data sources:

1. Revised Anti-Director Index (2003): Djankov, La Porta, Lopez-de-Silanes and Schleifer (2005: 62).
2. Gross Savings Rate, Households (as % of Disposable Income), 2000-2004: EU AMECO Database.

Figure 7: Gourevitch-Shinn Index of Minority Shareholder Protections (mid/late 1990s) and OECD Employment Protection Index (late 1990s)

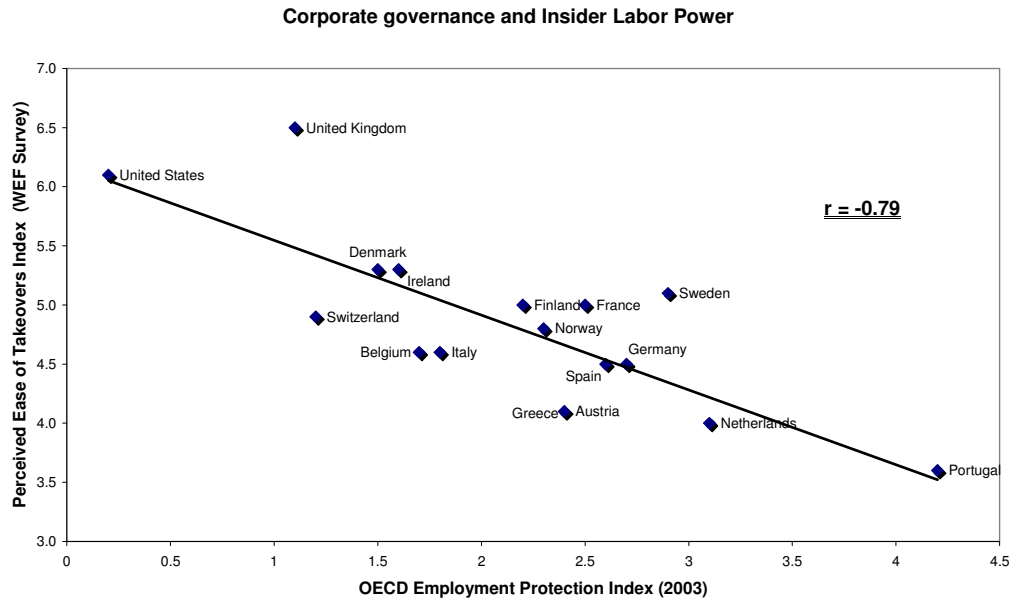


Data points: EU 15 (excluding Luxembourg), plus Norway, Switzerland and US.

Original data sources:

1. Overall MSP Index, mid/late 1990s: Gourevitch and Shinn (2005: 48).
2. OECD Employment Protection Index (late 1990s): OECD Employment Outlook (2004: 112).

Figure 8: Ease of Takeover Index (2004) and OECD Employment Protection Index (2003)

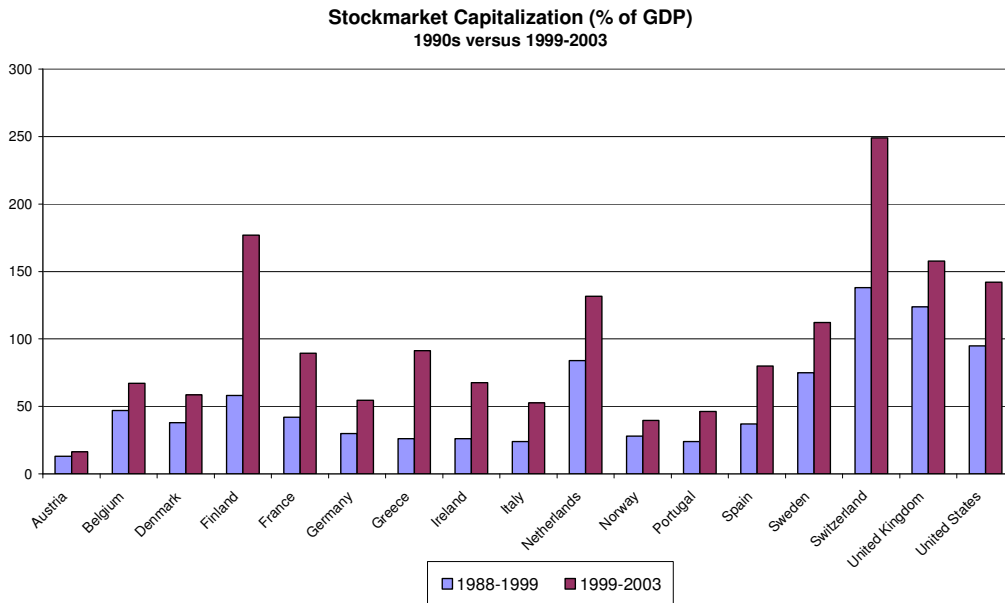


Data points: EU 15 (excluding Luxembourg), plus Norway, Switzerland and US.

Original data sources:

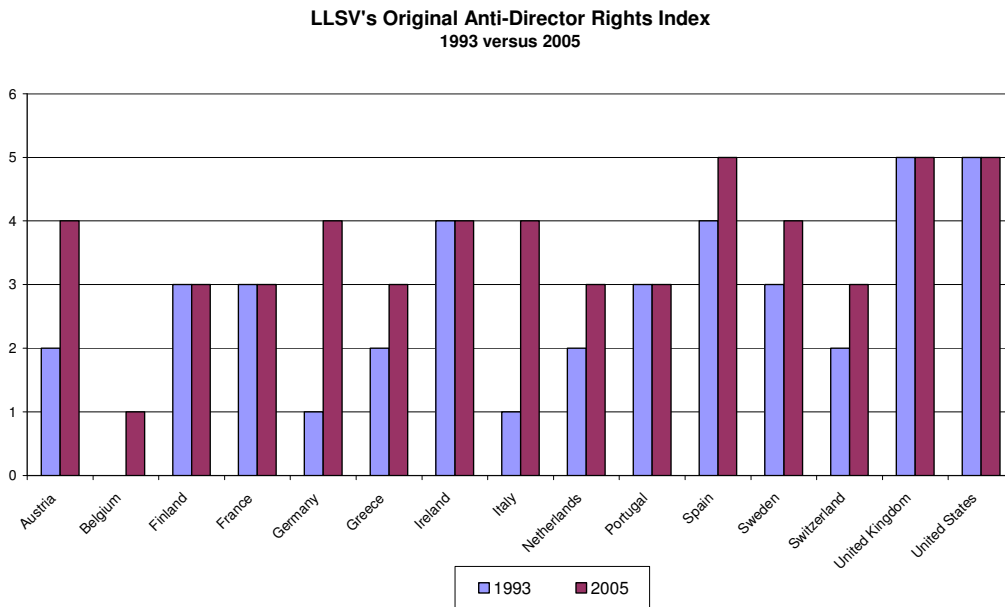
1. Ease of Takeover Index (2004): Survey result from Global Competitiveness Report (WEF: 2004).
2. OECD Employment Protection Index (2003): OECD Employment Outlook (2004: 112).

Figure 9: Greater Reliance on Equity Markets



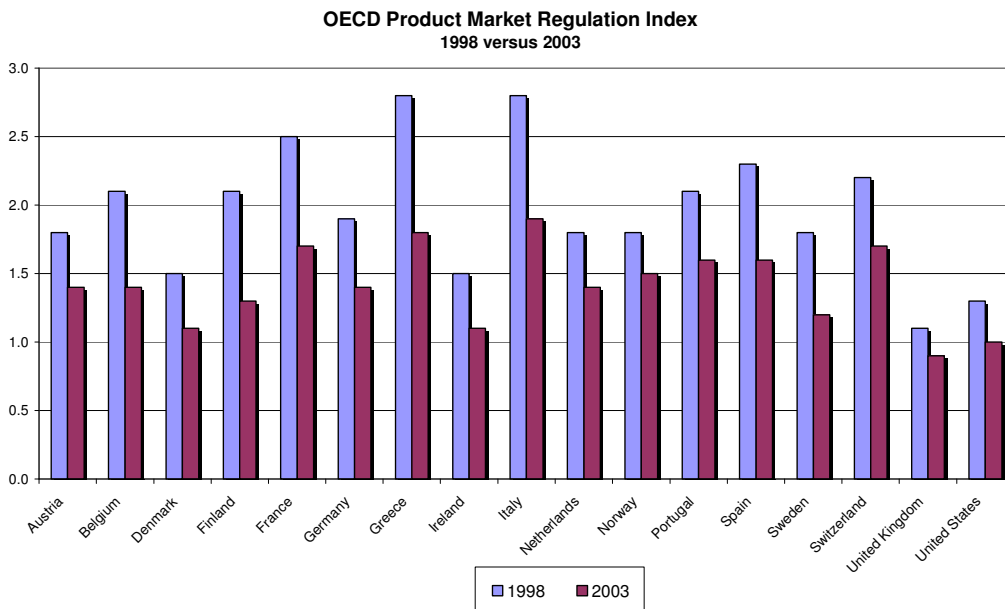
Data source: 1988-1999 values: Stulz (2005: 60); 1999-2003 values: Djankov et al (2005: 56).

Figure 10: Improvements in Shareholders' Rights



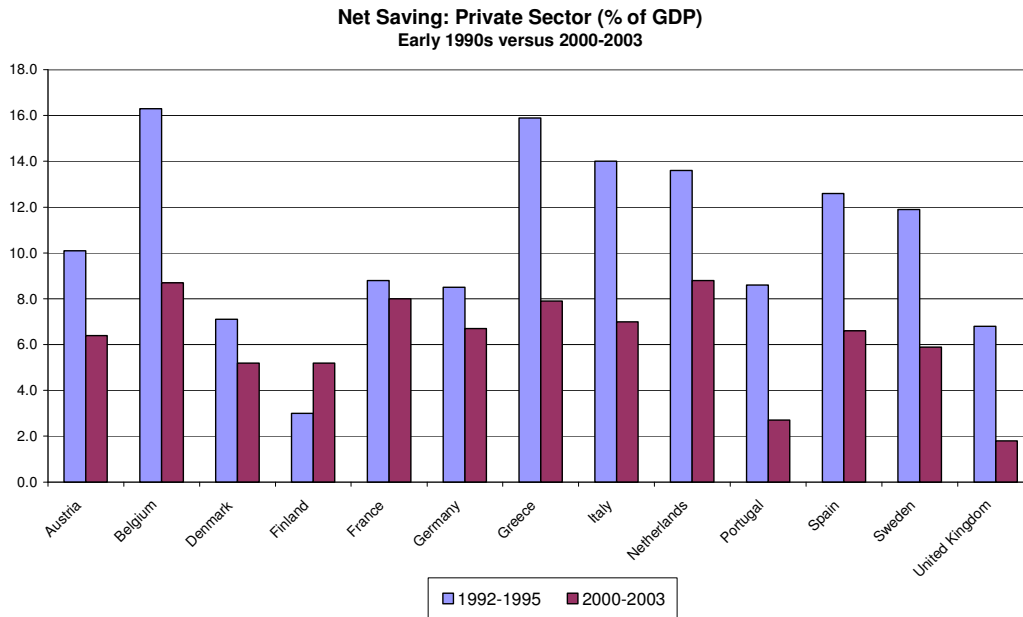
Data sources: 1993 values: LLSV (1998); 2005 values: OECD Corporate Governance and Company Law Database (2005).

Figure 11: Increasing Convergence in Product Market Regulation



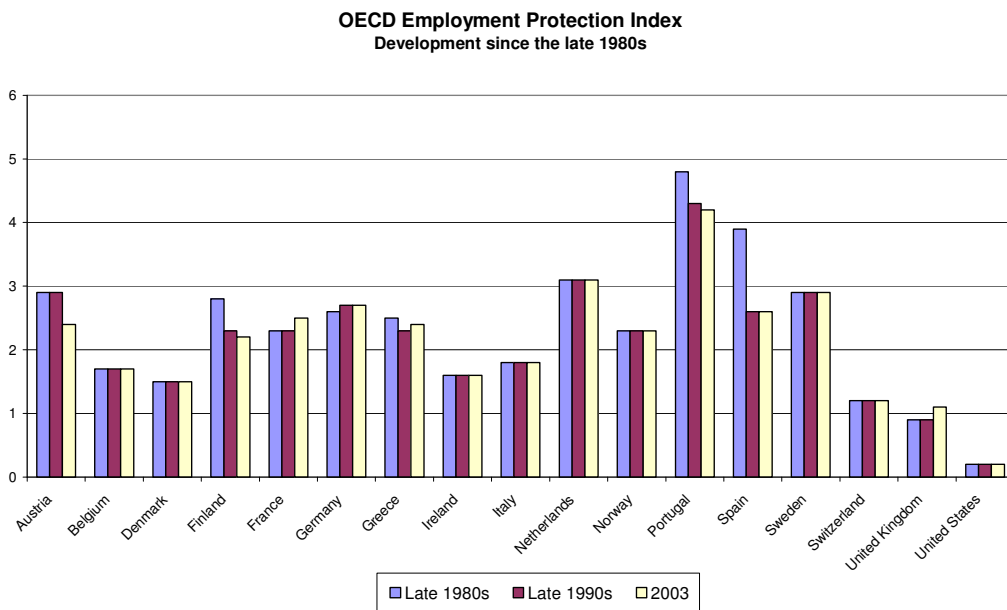
Data source: Conway et al (2005: 59).

Figure 12: Reduced Domestic Savings Capacity



Data source: Eurostat Database.

Figure 13: Little Evidence of Insider Labor Weakness



Data source: OECD Employment Outlook (2004: 112).