1

Introduction: Political Partisanship and the Puzzle of Corporate Governance Change in Europe

> Much of the institutional scenery of two decades ago – distinct national business elites, stable managerial control over companies and long-term relationships with financial institutions – is disappearing into economic history. We have, instead the triumph of the global over the local, of the speculator over the manager and of the financier over the producer. We are witnessing the transformation of mid-20th century managerial capitalism into global financial capitalism.
>
> Martin Wolf, *Financial Times*, June 19, 2007.

Since the early 1990s, evidence has been accumulating of significant change in the regulation and practice of corporate governance in the nonliberal economies of continental Europe. Corporate enterprises in these countries have increasingly eschewed their traditional stakeholder-orientation in favor of a strategy centered on the maximization of "shareholder value." This has occurred during a period in which social democratic or labor-oriented political parties have played a significant role in European government. Such a concurrence of events is puzzling, as the pro-shareholder stance of business would appear to be alien to many of the traditional goals of the Left, such as high wage levels, employment security, and income equality. What is even more surprising is that Left government has not only acquiesced in these changes, but – in many cases – actively encouraged them (Höpner 2003; Cioffi and Höpner 2006).

The purpose of this book is to present a hypothesis of corporate governance change in nonliberal market economies that explains this paradoxical outcome. In the coming chapters, I will argue that the prevalence or absence of economic rents in such economies plays a key role in the politicization of corporate governance. When economic rents are abundant (due to a lack of competition in product markets), the main political parties on both the

http://www.pbookshop.com

Left and Right of the political spectrum – along with their respective core constituents – perceive little benefit in pushing for a transition to a shareholder-oriented corporate governance regime. In such circumstances, the political complexion of government does not matter for corporate governance. However, if these rents diminish (due to greater competition), corporate governance becomes a more polarized area of policy. The Left increasingly favors a shift to a shareholder orientation, while conservative political parties retain a preference for the status quo. Consequently, a shift toward more shareholder-orientated corporate governance in nonliberal market economies will be associated with the interaction of Left government partisanship and product market competition.

A detailed exposition of these theoretical claims is reserved for Chapter 2. In the first half of this chapter, a range of evidence on recent corporate governance developments in continental Europe is presented in order to substantiate the assertion that European economies have experienced significant pro-shareholder change during the last ten to fifteen years. This is followed by a discussion of the likely relationship between partisanship and corporate governance. An assessment is made of the extent to which the actual experience of European corporate governance change since the early 1990s has been consistent with such expectations. However, before proceeding further, it is worthwhile considering why corporate governance is such an integral component of the institutional framework of a modern political economy. In other words, why does corporate governance matter?

http://www.pbookshop.com

1.1 WHY CORPORATE GOVERNANCE MATTERS

The corporation is one of the most successful socioeconomic institutions of modern society.[1] Since the end of the nineteenth century, it has firmly established itself as the preeminent economic unit of capitalism, having overcome inauspicious beginnings in the seventeenth and eighteenth centuries.[2] Along with markets, firms serve to mobilize and coordinate the

[1] In the opinion of Bakan (2004) and Micklethwait and Wooldridge (2003), the firm is the most successful of all modern institutions, having outpaced rivals such as the political party, the commune, the parish church, the feudal manor, the monarchy, and even the state (Micklethwait and Wooldridge 2003: 2).

[2] The first joint stock company – The United East India Company – was chartered by the Dutch Republic in 1602 (Frentrop 2002). However, joint stock companies were banned in Britain in 1720, following the collapse of the South Sea Company. In the same year, the collapse of John Law's Mississippi Company almost destroyed the French economy. Limited liability

use of capital in the generation of economic growth (Roberts 2004: 74). However, unlike markets, firms organize production in terms of hierarchical authority relations between economic agents (Coase 1937). Their pervasiveness in modern economic life is arguably even greater than that of markets. According to McMillan (2002: 168), 70 percent of transactions in the US economy occur within firms, as compared to only 30 percent in markets.

Although the key features of the corporate institutional form – such as separate legal personality, limited liability, shared ownership by investors, a board structure, and transferable shares – are salient in firms around the world, the authority and power structure (i.e., the governance) of a firm can be organized in a variety of ways. The wide range of possibilities is reflected in the postwar diversity of national corporate governance practices, which appear to have defied the harmonizing impulses of economic globalization (Nenova 2003; Dyck and Zingales 2004b; Stulz 2005). Recent empirical research suggests that the choice among governance alternatives is important for a number of reasons. First, corporate governance affects the organizational structure of firms, which in turn differentiates their response to common external challenges (Knetter 1989; Hall and Soskice 2001; Roe 2003; Morck and Steier 2005). This leads corporate governance to play a key role in the prevailing style of capitalism (Aoki 1988; Hollingsworth and Boyer 1997; Hall and Soskice 2001). Second, corporate governance has been implicated as a key factor in the determination of a number of economic and political outcomes, including levels of economic growth and efficiency (Carlin and Mayer 2003; Mueller 2005); innovation capability (Allen and Gale 2000; Huang and Xu 1999); levels of competition (Fulghieri and Suominen 2005); financial openness (Stulz 2005); relative prevalence of public and private companies; levels of control premia (Dyck and Zingales 2004a); and the emergence of social democracy (Belloc and Pagano 2005).

http://www.pbookshop.com

A particularly distinctive approach to corporate governance has underpinned the nonliberal economic models of continental Europe.[3] Unlike firms operating according to the Anglo-American business model, European corporations have existed within a framework of incentives that have shielded them from engagement in short-term earnings and share-price maximization. This has facilitated their cooperation with other social actors in fulfillment of

companies only became legalized in Britain in 1856, and were introduced in the United States and elsewhere at the end of the nineteenth century (Bakan 2004: 6).

[3] The term "nonliberal market economy" is used here rather than Hall and Soskice's "coordinated market economy" terminology, in order to encompass 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 (Rhodes 1997; Hall and Soskice 2001: 19; Streeck and Yamamura 2003: 3).

the postwar "corporatist compromise" (Goldthorpe 1984). More stable corporate behavior has also given rise to an environment in which economic actors are more willing to engage in long-term commitments and nonmarket forms of cooperation (e.g., training, R&D, industrial relations, etc.). This proved to be a particularly efficient form of economic organization in the early postwar era of "diversified quality production" (Porter 1992; Streeck 1992; Hall and Soskice 2001).

There is, however, evidence of significant change underway in European corporate governance, particularly since the mid-1990s. The postwar framework gave a privileged position to controlling shareholders (or blockholders), who were willing to restrain their profit-maximizing impulses in order to be viewed as reliable social partners by other social actors, for example, employees and social democratic parties.[4] However, a key development over the last decade has been a rebalancing of corporate governance in favor of minority shareholders. This has significant implications for the operation of the corporate sector, as minority shareholders are more likely than blockholders to impose a strategy of shareholder value maximization on company management.

According to Frank Dobbin and Dirk Zorn, a shareholder value system gives rise to a distinctive pattern of corporate behavior. First, corporate management focuses attention on maximizing the firm's stock price. Other possible objectives, such as the pursuit of growth, sales, employment stability, or broader social goals, are subservient to this goal. Second, firms are incentivized through the stock price to focus on activities that reflect their "core competencies." The adoption of diversified conglomerate structures is viewed as inefficient and inappropriate; risk diversification is the job of company owners within their investment portfolios, not corporate managers. Third, a high stock price is sustained by fulfilling the short-term corporate earnings expectations of capital market participants, particularly securities analysts and institutional fund managers. A key task for corporate managers, therefore, is to generate earnings growth that "make the quarter" (Dobbin and Zorn 2005: 195).

Adoption of this kind of business model has significant implications for the nature of European capitalism, and ultimately represents a shift in the direction of the Anglo-American business model, which has based its activities on a shareholder value philosophy since the early 1980s (Fligstein 2005: 225).[5]

http://www.pbookshop.com

[4] Such actors are described by Hall and Soskice (2001) as "patient capital."

[5] Although the corporate governance scandals of recent years in the United States (Enron, Worldcom, Tyco International, Hollinger International, etc.), and the rise of shareholder activism, suggest that – even in liberal market economies – the ideal of a shareholder-aligned public corporation is often only imperfectly realized (Fligstein 2005: 226).

The next section considers evidence that suggests the balance of power in continental European corporate governance is indeed shifting toward minority shareholders, along with their favored strategy of shareholder value maximization.

1.2 RECENT DEVELOPMENTS IN EUROPEAN CORPORATE GOVERNANCE

The rebalancing of European corporate governance in favor of minority shareholders – the class of shareholder holding relatively small, noncontrolling ownership stakes (i.e., typically less than 3%) in individual companies – is evident from a variety of perspectives. First, the regulatory landscape has shifted in their favor, as national governments have attempted to redefine the "rules of the game" in which firms operate. The European Union (EU) and other international organizations have also sought to influence corporate behavior, both through European legislation and the promotion of "best practice" codes of conduct. Second, and most importantly, the actual behavior of European companies has exhibited a growing tendency to emphasize the interests of minority shareholders *vis-à-vis* other corporate stakeholders. Sections 1.2.1 and 1.2.2 present evidence of change from both of these perspectives in turn.

http://www.pbookshop.com

1.2.1 Changes in the regulatory environment

Regulatory reform in Europe has sought to improve the position of minority shareholders in a variety of ways (Enriques and Volpin 2007: 125). First, internal governance mechanisms, such as boards and audit committees, have been strengthened in many countries. A function of the board of a company in a pro-shareholder system is to counter the influence of company insiders – such as management or blockholders – on behalf of company stakeholders as a whole. However, in Europe, boards have traditionally done little to favor minority shareholders, although codetermination (i.e., the participation of employee representatives on company boards) has played a role in safeguarding the interests of employees (most notably in Germany). Recent reforms in Europe have sought to empower the ability of boards to monitor and oversee business processes that are of concern to minority shareholders, such as auditing, the setting of executive compensation, approval of related-party transactions (i.e., company transactions giving rise to a conflict of interest), and disclosure of company information to outsiders.

Second, the legal rights of minority shareholders across Europe have been upgraded. It is now more feasible for shareholders to sue company management when their interests have been ignored or overridden. Furthermore, they have acquired more power to determine the outcome of deliberations at company general meetings. Measures have been taken to reduce the cost of voting at these meetings – which are often impracticable for minority shareholders to attend in person – and to mandate improved representation of minority shareholders on company boards. Progress has been made, albeit unevenly, toward the objective of a "one-share, one-vote" ownership structure through the abolition of multiple voting rights on particular classes of share. Such shares have traditionally been used by blockholders to exert disproportionate influence over the operation of the firm.

Third, traditionally opaque European companies have been mandated to improve financial disclosure to outsiders. International accounting standards were adopted in all EU member states in 2006, and legislation has been introduced in many countries regarding the public disclosure of executive compensation, related-party transactions, and price sensitive information (which could potentially be used for insider trading). Measures have been taken by governments to improve the enforcement of corporate governance regulation, and increase the sanctions for corporate malfeasance (see Table 1.6).

In the specific case of France, the interests of the state have traditionally overshadowed the interests of other stakeholders, such as minority shareholders (Enriques 2004). Until the early 1980s, state involvement in the corporate sector was reflected in state blockholdings, state involvement in the allocation of credit, and a high level of interlinkage between French corporate and governmental elites (Schmidt 1996). At that time, the state was the sole owner of thirteen of the twenty largest industrial firms and all of the leading banks, and had ownership stakes of various sizes in many other enterprises (Zysman 1983; O'Sullivan 2001).

However, the state withdrew from the allocation and rationing of credit in the mid-1980s, and commenced a substantial program of privatization (Loriaux 1997). The first major steps to improve the situation of minority shareholders occurred in the late 1980s/early 1990s through attempts to promote the development of capital markets. New rules on disclosure, insider trading, and market manipulation were introduced, and a mandatory bid rule was instituted (to ensure equal treatment of minority shareholders during takeover transactions).

The most significant reforms have occurred since 1995. The New Economic Regulations of 2001 improved disclosure of company finances and executive compensation, and facilitated the ability of shareholders to sue company management. In 2002, the rights of shareholders were improved in terms of facilitating their ability to call shareholder meetings and appoint experts to review manage-

http://www.pbookshop.com

ment decisions. Since 2003, public companies have been required to publish a dedicated report on their corporate governance arrangements, and justify any deviations from a newly introduced national corporate governance code.

In Germany, the key source of external influence over corporations has traditionally been private universal banks rather than the state, with the big three universal banks (Deutsche Bank, Dresdner Bank, and Commerzbank) acting as the main conduits of influence between the private and public spheres (Dyson 1986). Unlike in France, German companies have traditionally enjoyed a dual board structure, consisting of a management board (*Vorstand*) and a supervisory board (*Aufsichtsrat*). Bank representatives have played a major role on supervisory boards due to both their extensive blockholdings in individual companies and voting power derived from acting as proxy shareholders for small shareholders (whose shares are held in their custody accounts) (Prowse 1994; Fohlin 2005).[6] German supervisory boards have also been characterized by the strong representation of employees. The *Mitbestimmungsgesetz* (codetermination law) of 1976 mandated companies with more than 2,000 employees to allocate half of the seats on their supervisory boards to employee representatives. Such a board structure – dominated by representatives of management, banks, other blockholders, and employees – was, therefore, not structured in a manner that was likely to give much of a voice to minority shareholders (Theisen 1998).

Some limited pro-shareholder measures were implemented in Germany in the early 1990s to encourage the development of *Finanzplatz Deutschland* (i.e., Frankfurt as a leading financial center), including the creation of a securities market regulator (*Die Bundesaufsichtamt für den Wertpapierhandel*),[7] and the outlawing of insider trading. However, the first major policy shift in favor of minority shareholders came in 1998 with the so-called KonTraG law,[8] which, *inter alia*, authorized share buybacks and stock option plans, restricted deviations from the principle of "one-share, one-vote," and weakened the voting power and supervisory board representation of blockholders and universal banks. A symbolic aspect of the law was that it recognized shareholder value as a valid corporate objective for the first time in German corporate history.[9] Another major action to counter the extent of

http://www.pbookshop.com

[6] It should be noted, however, that the largest cross-shareholdings in the German system have been held by corporations rather than banks (Franks and Mayer 1997: 283).

[7] This was superseded by *Die Bundesanstalt für Finanzdienstleistungsaufsicht* (BaFin) in May 2002.

[8] *Gesetz zur Kontrolle und Transparenz im Unternehmensbereich* – Law for Control and Transparency in the Corporate Sector (1998).

[9] This measure was praised by Espen Eckbo of the Tuck School of Business as a "giant step forward for German corporate governance. Adam Smith would have approved" (Eckbo 2005: 3).

blockholding was the abolition of capital gains tax on blockholdings in 2002, which removed a potential disincentive to the unwinding of cross-shareholdings. Subsequent reforms have improved corporate disclosure, enhanced the litigation options of shareholders, and introduced a mandatory bid rule. As in France, it has also become necessary (since 2002) for German companies to explain any deviation from a national code of corporate governance.

Like in France, the postwar corporate sector in Italy has been characterized by a strong relationship between corporate elites and the state. Even as late as the mid-1990s, eight out of the largest twenty corporations were state-owned (La Porta et al. 1998). However, unlike in France, a major role has also been played by a small group of elite families – the so-called *salotto buono* – which hold blockholdings in many large corporations. This has led to the description of the Italian corporate sector as "family capitalism" (Pagano and Trento 2002). Such a regime has traditionally placed a low priority on securing the rights of minority shareholders.

Although insider trading was made illegal in the early 1990s, the first major reform of corporate governance in favor of minority shareholders was the so-called Draghi law of 1998.[10] This introduced a range of measures to improve the rights of minority shareholders, improve disclosure, and improve the board accountability of audit committees. In the same year, a mandatory bid rule was introduced. In 2003, Italy followed Germany in abolishing the payment of capital gains tax on the sale of cross-shareholdings. As in France and Germany, a national corporate governance code was introduced in 2005, with which companies must either comply or explain their divergence.

Most substantive reform in European corporate governance regulation has been driven by regulators at the national level (Enriques 2006). However, a number of transnational organizations – most notably the Organisation for Economic Co-operation and Development (OECD) – have also played a role in recent years in promoting the interests of minority shareholders.[11] The OECD published its Principles of Corporate Governance in 1999 (although they were revised and reissued in 2004). Although the Principles have no legal enforceability, they have become an influential benchmark in the design of national level corporate governance codes and regulation. The primary objective of the OECD code is to outline the key components of a corporate governance regime that protects the interests of non-insiders in general,

http://www.pbookshop.com

[10] This was named after Mario Draghi, the Director General of the Italian Treasury, and Chairman of a commission on corporate governance reform. See Chapter 10.

[11] Other international organizations that have sought to promote "good," that is, pro-shareholder, corporate governance include the World Bank, the International Corporate Governance Network, the International Accounting Standards Board (formerly the International Accounting Standards Committee), and the International Organization of Securities Commissions.

although the overwhelming focus is on minority shareholders. Key sections of the Principles cover the rights of shareholders, the equitable treatment of shareholders, disclosure and transparency, and the responsibilities of the board – all key areas of concern for minority shareholders.

The EU has signaled support for minority shareholder interests through a number of recent directives (although enacted measures have often served to systematize protections that were already embodied in national level legislation). An EU law passed in 2002, for example, required that all listed corporations in the EU prepare their accounts according to international financial reporting standards (IFRS) from 2006 onward. International accounting standards – as well as establishing a level playing field for the comparison of companies on a transnational basis – often require greater disclosure than many national accounting codes in respect of items such as hidden reserves, which have historically been used by European corporate insiders to retain resources within the company for strategic rather than profitability reasons.[12] The market abuse directive of 2003 defined the type of price-sensitive information to be disclosed by companies in order to prevent insider trading, and required directors and related persons to disclose trading activities.[13] These requirements were incorporated into national law between 2003 and 2005. In June 2007, a shareholder rights directive[14] was adopted, which outlined measures to reduce the cost of voting for minority shareholders, eliminate share blocking, allow shareholders to question management, and receive relevant information regarding shareholder meetings. EU law requires that these protections be adopted into national laws by 2009.

However, the EU has also experienced setbacks when it has attempted to move too fast in the direction of pro-shareholder corporate governance reform. For example, in July 2001, a draft directive to promote the development of a European market for corporate control was blocked by the European Parliament and several European governments (see Section 1.2.2). More recently, the European Commission announced, in October 2007, its abandonment of previously announced plans to enforce the principle of "one-share, one-vote" across the EU, following opposition from the French, Spanish, and Swedish governments (Bounds and Burgess 2007). Reflecting these nationally located political constraints, the Commissioner for the Internal

http://www.pbookshop.com

[12] Regulation (EC) No 1606/2002 of the European Parliament and of the Council of July 19, 2002 on the application of international accounting standards.

[13] Directive 2003/58/EC of the European Parliament and of the Council of July 15, 2003 amending Council Directive 68/151/EEC, as regards disclosure requirements in respect of certain types of companies.

[14] Directive 2007/36/EC of the European Parliament and of the Council of July 11, 2007 on the exercise of certain rights of shareholders in listed companies.

Market, Charlie McCreevy, has conceded the impracticability of imposing a "one-size-fits-all" corporate governance model on member states through EU legislation (McCreevy 2007).

1.2.2 Changes in "firm-level" corporate governance

Although the reform of corporate governance regulation may change the formal "rules of the game" in which firms operate, it does not necessarily imply a corresponding change in the actual corporate governance behavior of companies (Culpepper 2005: 176; Khanna et al. 2006). Nevertheless, a substantial body of evidence suggests that firm-level governance has also shifted in a pro-shareholder direction in many European countries since the early to mid-1990s.

In the case of Germany, Beyer and Höpner (2003) contend that corporate governance change has actually been led from the "bottom-up," that is, by the changed behavior of companies, rather than by top-down reforms in corporate governance regulation (which have been reflective rather than causative of changed *de facto* outcomes). During the second half of the 1990s, devices such as profitability goals, measures to increase financial transparency, investor relations activities, and stock options as a method of executive remuneration, were introduced by major German companies such as Bayer, Hoechst, DaimlerChrysler, and VEBA. Furthermore, between 1996 and 2000, the number of cross-shareholding networks between the 100 largest German companies declined significantly (from 169 to 80). The hostile takeover of Mannesmann in 2000 by the British firm Vodafone was the first ever acquisition of a large German corporation by a foreign bidder.[15]

As will be described in Chapter 9, a fundamental change also occurred in the role of the major German banks. These former guardians of "patient capital" increasingly found themselves promoting shareholder rights and capital markets through their activities in investment banking. A landmark event reflecting their changing role related to the 1997 takeover battle between Krupp and Thyssen. Both Deutsche Bank and Dresdner Bank supported (and provided M&A advice) for Krupp's hostile bid for Thyssen, despite also having seats on Thyssen's supervisory board. A further indication of the banks' increasing rejection of its network guardian role came to light in 2001, when Deutsche Bank announced that it would entirely withdraw from

[15] According to Franks and Mayer, between 1945 and the early 1990s, there were only four hostile takeovers in Germany (Franks and Mayer 1997: 41).

http://www.pbookshop.com

supervisory board chairmanships in other companies. All of these developments occurred largely independently of state-driven regulatory change (Beyer and Höpner 2003: 180).

Gregory Vincent (2004) documents an insightful case study of bottom-up change in French corporate governance practices in the late 1990s. In 1997, the AXA insurance group merged with another French insurer – UAP – which stood at the center of a network of cross-shareholdings coordinated by the Banque Nationale de Paris (BNP). In defiance of the French government's desire to establish a *keiretsu*-style network of cross-shareholding (*noyaux durs*) centered on BNP – the new management of the combined AXA–UAP group pledged to manage its financial assets according to "Anglo-Saxon norms of profitability" (Morin 2000; Vincent 2004). This undermined the viability of the proposed BNP-coordinated cross-shareholding network, and catalyzed other major companies to reconsider their attitude to strategic ownership. As can be seen in Table 1.1, the result was an unwinding of a number of major cross-shareholdings in the French corporate sector in subsequent years (Culpepper 2005).

A newly available means by which corporate governance practices can be measured at the level of the firm is through corporate governance ratings (Tucker 2004). Ratings agencies – such as Standard & Poor's and Moody's – have long provided assessments of the credit ratings of individual companies for their institutional clients. However, during the last few years, a number of companies – such as Institutional Shareholder Services (ISS) and GovernanceMetrics International – have begun rating companies in terms of corporate governance. The proprietary criteria with which companies are assessed vary by rating agency. However, the ratings embody a common

http://www.pbookshop.com

Table 1.1 Percentage of shares in selected French Companies represented by cross-shareholdings

Company	1995	1996	1997	1998	1999	2000
BNP	16.9	16.8	16.1	11.0	8.2	8.6
St. Gobain	22.7	22.6	22.3	22.3	13.5	7.6
Suez/Lyonnaise des Eaux	9.0	8.4	8.4	8.4	1.7	1.4
UAP/AXA	9.0	9.0	9.0	6.9	6.9	6.9
Vivendi	17.9	16.5	15.1	14.1	8.7	4.9
AGF	2.8	4.5	5.6	6.0	2.5	2.5
Alcatel	8.0	7.0	6.7	8.4	5.0	4.4
Aventis	10.8	11.5	12.3	14.4	7.5	6.9
Société Générale	21.5	23.0	24.7	28.8	15.0	13.7

Source: Culpepper (2005: 191).

commitment toward minority-shareholder orientation, and ratings are frequently structured in a similar manner to the OECD Principles of Corporate Governance (Balling et al. 2005).

Most of the newly created indices of corporate governance have not been around long enough to permit an assessment of temporal change over a significant period of time. However, Deminor – a Brussels-based rating agency – has produced ratings since 2000.[16] Their figures evaluate companies on a scale of 1 to 10 in four categories of corporate governance behavior: shareholders' rights and duties, disclosure, board structure, and functioning and takeover defenses, and relate to the 300 constituents of the FTSE Eurotop index of large European companies. A higher score represents a more pro-shareholder orientation. Dariusz Wójcik (2006) has compared the Deminor country ratings in 2000 and 2004 for evidence of change in European corporate governance. A country breakdown of his results is shown in Table 1.2.

The conclusions of Wójcik's study need to be treated with some caution, given the small number of companies involved in calculating the median country ratings of certain countries. For example, the country score relating to Austria is based on only two companies, as Austria contributes only two companies to the FTSE Eurotop index. Furthermore, the comparison between the 2000 and 2004 ratings can only be undertaken with 190 companies, as the composition of the FTSE Eurotop index changes over time,[17] and a ratings comparison is only made with companies that appear in the index in both years (i.e., on a like-for-like basis). Taking account of these data limitations, a nonparametric test of statistical significance is presented alongside each item of data.

Notwithstanding these caveats, and despite the relatively short time frame of comparison (i.e., four years), the data suggests that companies in most continental European countries have undergone a major process of change in respect of minority-shareholder orientation in recent years. For example, the Deminor rating of shareholder rights and duties improved substantially over the four-year period in the Netherlands, Norway, Spain, and Switzerland. Even more significant was the substantial improvement of disclosure practices in Germany, the Netherlands, Portugal, Spain, Sweden, and Switzerland. Board structure and functioning made major progress in Finland, the Netherlands, and Switzerland.

[16] Deminor's corporate governance rating unit was merged into ISS in 2005.

[17] The composition of the FTSE Eurotop index is periodically adjusted to take account of changes in the relative value of companies. This results in new companies entering the index, while others drop out. In addition, companies may disappear from the index due to delisting (i.e., going private), takeover, or bankruptcy.

http://www.pbookshop.com

Table 1.2 Corporate governance ratings (median values) of large European companies (by country) – 2004 versus 2000

Country	Number of firms in 2004 sample	Shareholder rights and duties		Disclosure		Board structure and functioning		Takeover defenses	
		2004 rating	Change since 2000	2004 rating	Change since 2000	2004 rating	Change since 2000	2004 rating	Change since 2000
Austria	2	6.7		6.0		3.8		2.6	
Belgium	9	6.1**	−0.2***	5.8***	1.7***	5.0	0.5	1.0**	0.5
Denmark	5	6.7	0.4	6.2	2.9*	3.6	1.8	1.0**	0.0
Finland	5	7.5	−0.2	7.0	1.6	6.7**	2.9*	1.0	−3.2
France	42	6.5***	0.1***	6.9**	2.3	6.0	1.4	1.0	1.0
Germany	32	6.9	−0.2***	6.7**	3.1***	4.5*	1.7	1.0***	−1.6**
Greece	6	6.7	−0.3	5.3**	0.8	3.7**	−0.1	1.0**	−9.0
Ireland	7	7.8	0.7	7.6	1.5*	7.0*	1.0*	9.0***	−1.0
Italy	25	5.7***	−0.6***	6.6	1.9	5.1***	1.5	1.0***	1.0
Netherlands	21	5.5**	1.8**	8.1	3.2***	6.6**	3.3***	3.8	1.0***
Norway	5	7.7**	1.9	5.9**	2.6	5.2	2.7	1.0	−0.8
Portugal	4	4.9	0.7	6.6	4.3*	4.6**	2.5*	1.0**	1.0
Spain	17	6.8	1.2	6.5**	3.4**	5.1	1.1	1.0***	1.0
Sweden	16	6.2	0.8	6.8**	3.3**	5.2**	1.8	5.1	−1.4
Switzerland	17	7.0	1.1*	5.9***	3.5***	5.7	3.4**	1.0	0.0
United Kingdom	81	8.0***	1.1***	8.1***	1.5***	7.3***	1.1***	9.0***	1.0***
Total	296	7.0	0.6	7.2	2.3	5.8	1.5	2.7	1.0

Note: The significance tests are based on a nonparametric means of testing the null hypothesis that a country rating has the same median rating as the sample as a whole. Asymptotic significance based on calculated Chi-square values: *p < .1, **p < .05, and ***p < .01.

Source: Data presented in Wójcik (2006).

http://www.pbookshop.com

However, an area where negligible progress was made relates to takeover defenses. It is argued in the finance literature that the threat of hostile takeover represents an important mechanism whereby minority shareholders can align management behavior with shareholder interests (Manne 1965). According to this perspective, a corporate manager who does not maximize shareholder value runs the risk that his or her company's share price falls low enough to attract an external bidder. If the bidder is able to gain control of the company from existing shareholders (e.g., by offering a significant premium to the existing market price), the existing management regime is likely to be dismissed. The possibility of hostile takeover, therefore, provides incumbent management with an incentive to vigorously generate shareholder value, a strategy which is consistent with the interests of minority shareholders. However, if management perceives the risk of takeover to be remote – regardless of the level of the share price – management may feel less pressure to pursue a pro-shareholder approach. The threat of takeover may be reduced by the ability of the firm to implement takeover defenses[18] or by the behavior of national governments, which may seek to deter or block advances from "undesirable" potential corporate suitors.[19]

An EU directive in 2001 aimed to curb a number of the main mechanisms – such as poison-pill defenses – used by European firms to deter hostile takeovers. However, the directive was opposed by the German government, and finally blocked by an exceptionally close vote of the European Parliament in July 2001 (Höpner 2003: 10). A compromise version of the directive was adopted in 2004, allowing member states to opt out of provisions requiring companies to seek shareholder approval for poison-pill defenses after a bid had been announced (the board neutrality rule), and preventing voting restrictions, share transfers or multiple voting rights being used at

[18] According to the European Commission, there are two main categories of defensive mechanism in common use in Europe. "Post-bid defenses" are put in place once a company has become subject to a takeover bid. Such defenses include share buybacks aimed at reducing the number of shares the bidder can acquire or the issue of share capital – so as to increase the cost of the bid. "Pre-bid defenses" may constitute barriers to the acquisition of shares in the company (e.g., share transfer restrictions contained in the company's articles) or to the exercise of control in the general meeting (e.g., voting restrictions or shares with multiple voting rights) (European Commission 2007).

[19] Two recent European examples of this phenomenon are particularly noteworthy. At the end of 2005, the Governor of the Bank of Italy – Antonio Fazio – was forced to resign due to allegations that he had attempted to thwart the foreign takeover of an Italian bank – Banca Antonveneta – by a Dutch bank (ABN AMRO). In August 2005, the French government announced that it planned to protect ten industry sectors from takeover by non-EU firms, following market rumors that PepsiCo of the United States was considering a bid for Danone. This provoked concern from the European Commission that France might overstep EU legal provisions relating to the protection of "strategic sectors" (*Financial Times*, August 29, 2005).

http://www.pbookshop.com

the shareholder meeting authorizing such defensive measures (the breakthrough rule). Despite the voluntary nature of these two opt-out provisions, it was hoped that they would not be exploited by most countries. However, a report by the European Commission in February 2007 observed that almost all member states had taken advantage of the opt-outs (except those countries where the protections already existed), and concluded that the success of the directive in promoting an open European market for corporate control had been limited.[20]

The low level of the indices presented in Table 1.2 confirms that continental European companies have retained their ability to resist hostile takeovers (Wójcik 2006: 651). Although mergers and acquisitions are increasingly common among European companies, the vast majority of these transactions are of a "friendly" or mutually agreed nature. Hostile takeovers remain extremely rare.[21]

1.2.3 Convergence in European corporate governance?

http://www.pbookshop.com

The changes that have occurred in European corporate governance have provoked a vigorous debate as to whether they are indicative of a process of convergence on the corporate governance systems of the liberal market economies (O'Sullivan 2003). A number of researchers have argued that the changes – although significant – do not fundamentally alter the European corporate governance landscape, and the role it plays in underpinning national varieties of capitalism (Deeg and Perez 2000; Vitols 2001; Aguilera and Jackson 2003). Blockholding remains a more prevalent form of company ownership in Europe than in liberal market economies, and the market for corporate control has yet to function properly. Both Vitols and Jackson suggest that the changes in Germany represent a hybridization of old and new approaches rather than convergence on a liberal market economy (LME) approach, with measures favoring minority shareholders coexisting with more traditional features of German corporate governance, for example, codetermination and powerful works councils (Jackson 2003; Thelen and Kume 2003; Vitols 2003). In a cross-country study of both developed and developing economies, Khanna et al. (2006) conclude that significant convergence in *de jure* corporate governance has occurred between economically

[20] Report on the implementation of the Directive on Takeover Bids (European Commission, February 21, 2007).

[21] Even in the United Kingdom and the United States – whose markets for corporate control are more open than those of continental Europe – less than 1 percent of merger and acquisition activity is of a hostile nature (Armour and Skeel 2006: 13).

interdependent countries, but convergence on US standards has yet to take place. Furthermore, firm-level corporate governance practices have converged much less than corporate governance law and regulation (Khanna et al. 2006: 84).

An alternative perspective on convergence is provided – in respect of Germany – by Beyer and Höpner (2003), who claim that the changes of the late 1990s represented a fundamental break from the previous system (Beyer and Höpner 2003: 180). Christel Lane (2003: 16) goes further, arguing that "the German financial system of corporate governance has converged on the Anglo-American model." Chris Mallin (2004: 207) concludes that beyond Germany "there does seem to be convergence on certain core principles based usually around the OECD Principles of Corporate Governance." Perhaps the most outspoken statement of the convergence thesis has been made by Yale law professors Henry Hansmann and Reinier Kraakman in their paper, *The End of History for Corporate Law*:

> Despite the apparent divergence in institutions of governance, share ownership, capital markets, and business culture across developed economies, the basic law of the corporate form has already achieved a high degree of uniformity, and continued convergence is likely. A principal reason for convergence is a widespread normative consensus that corporate managers should act exclusively in the economic interests of shareholders. [. . .] Since the dominant corporate ideology of shareholder primacy is unlikely to be undone, its success represents the 'end of history' for corporate law (Hansmann and Kraakman 2001: 89).

http://www.pbookshop.com

Resolution of the convergence debate is beyond the scope of this book, particularly as it is difficult to define what convergence really means or to pinpoint when it has finally occurred (Gourevitch 2003: 328; Yamamura and Streeck 2003: 41). For example, should convergence be defined as occurring when systems achieve equivalence in their functioning, or is equality of institutional form also a necessary precondition (Gilson 2001)? Putting aside the convergence debate, a snapshot of current firm-level corporate governance practices in Europe is provided by Aggarwal et al. (2007).[22] They report details of a sample of 2,234 non-US and 4,070 US companies in terms of forty-four corporate governance attributes derived from the ISS corporate governance rating methodology. These attributes relate to board function and structure, audit approach, antitakeover defenses, and compensation and ownership (for a list of the forty-four attributes, see Aggarwal [2007: 41]). The scores for individual companies are aggregated by country to create a country GOV score (see Table 1.3).

[22] Unfortunately, this assessment is made for one year only – 2005 – so it does not allow an evaluation of change over time.

The message conveyed by the GOV scores is largely consistent with the firm-level Deminor ratings shown in Section 1.2.2 (although the latter relate to the year 2004, and are calculated from a smaller sample of companies, i.e., FTSE Eurotop 300 constituents). The GOV scores suggest that, by 2005, minority shareholder orientation in two continental European economies – Finland and Switzerland – was comparable with that of corporations in most LMEs. The gap between firm-level corporate governance in the Netherlands and Germany and the LMEs was also relatively small. In contrast, firm-level corporate governance in Belgium, Portugal, Italy, Norway, and Sweden continued to exhibit significant divergence from that of LMEs.

These conclusions are underscored by disaggregated data provided by Aggarwal et al. (2007), which summarizes how companies perform in terms of several specific corporate governance attributes, such as board independence, the role and independence of audit committees, and the prevalence of different classes of stock (see Table 1.4). A higher percentage score represents a greater shareholder orientation in respect of each particular attribute. With

Table 1.3 Shareholder orientation of firm-level corporate governance, 2005 (aggregate country scores)

Country	GOV score (%)	Number of firms in sample	Sample as % of total market capitalization
Austria	46	19	81
Belgium	39	25	80
Denmark	45	22	80
Finland	56	31	87
France	48	83	84
Germany	50	85	74
Greece	45	44	79
Italy	41	71	82
Japan	43	589	81
Netherlands	51	47	52
Norway	41	21	77
Portugal	39	14	86
Spain	46	54	88
Sweden	43	43	85
Switzerland	55	58	89
United Kingdom	55	530	88
United States	59	4,070	–

Note: The governance score for each firm is calculated as the percentage of governance attributes for which the firm meets or exceeds a minimum satisfactory standard. The scores relate to the year 2005. Sample as percentage (%) of total market capitalization is calculated by dividing the market capitalization of the sample firms by the total market capitalization of all firms in Worldscope for a particular country.

Source: The forty-four attributes evaluated in this process are listed in Aggarwal et al. (2007: 41).

http://www.pbookshop.com

Table 1.4 Country scores in relation to specific corporate governance attributes (in %), 2005

Country	Board independence	Board size	Chairman/CEO separation	Board structure	Audit committee independence	Auditor ratification	Stock classes
Austria	0	67	100	0	0	100	100
Belgium	25	85	60	0	20	5	95
Denmark	71	79	100	64	7	100	57
Finland	64	80	100	84	40	100	68
France	28	78	49	2	22	35	38
Germany	40	82	100	0	3	100	100
Greece	3	90	90	3	7	97	100
Italy	0	87	77	0	3	33	100
Japan	1	80	0	42	2	2	100
Netherlands	83	73	98	7	54	51	68
Norway	69	46	100	23	15	0	100
Portugal	43	100	43	0	0	14	86
Spain	6	80	60	3	6	89	100
Sweden	60	97	100	100	17	14	66
Switzerland	75	81	98	19	58	98	98
United Kingdom	32	90	96	8	68	99	99
United States	89	81	41	52	88	68	94

Note: The percentage of firms in each country that meets or exceeds a minimum threshold for each governance attribute. The seven attributes are: *Board Independence*: board is controlled by more than 50% independent outside directors; *Board Size*: board size is greater than five but less than 16; *Chairman/CEO Separation*: chairman and CEO are separated or there is a lead director; *Board Structure*: annually elected board (no staggered board); *Audit Committee Independence*: audit committee comprised solely of independent outsiders; *Auditor Ratification*: auditors ratified at most recent annual meeting; *Stock Classes*: only single share class, common stock (no dual class).

Source: Aggarwal et al. (2007: 46).

http://www.pbookshop.com

respect to these criteria, Finnish, Swiss, and Dutch companies perform in a manner comparable to their British and American peers, in contrast to firms in Belgium and France.

To conclude, it appears that corporate governance diversity persists in Europe, particularly in relation to the market for corporate control. However, it is also apparent that in areas such as shareholder rights, the role and functioning of boards, and corporate disclosure, European companies are much closer to their Anglo-American counterparts than in 1990, and in some cases the gap has entirely disappeared. Although "convergence" may be an inappropriate description, European corporate governance has come a long way in the last ten to fifteen years.

1.3 CORPORATE GOVERNANCE AND PARTISANSHIP

http://www.pbookshop.com

In a recent survey of comparative political economy, James Alt (2002: 159) points to the growing use of partisanship as an explanatory variable in studies of economic outcomes. Since the pioneering work of Douglas Hibbs (1977, 1987), the role of partisanship has been examined with respect to areas such as monetary policy (Alesina et al. 1997; Way 2000), size of government (Hicks and Swank 1992; Blais et al. 1993, 1996; Alt and Lowry 2000; Garrett 2001), fiscal balance (Alesina et al. 1997; Franzese 2002), wage inequality (Pontusson et al. 2002), labor market institutions (Lange and Garrett 1985), the welfare state (Huber and Stephens 2001; Allan and Scruggs 2004), trade policy (Milner and Judkins 2004), and taxation (Cusack and Beramendi 2006).

The likely stance of political parties with respect to many policy areas may be inferred (albeit somewhat simplistically) from widely held conceptions regarding the ideological preferences of Left and Right. For example, it is often assumed that Left parties will be more enthusiastic than conservative parties about policies that promote the interests of low-income and disadvantaged groups. In contrast, the Right might be expected to prioritize measures that favor more affluent parts of the income distribution. Left parties are often viewed as more sympathetic toward an interventionist role for the state, including greater government spending, more generous welfare provision, and a highly progressive structure of taxation. Conversely, parties of the Right are frequently conceptualized as favoring smaller government, lower taxation, and a central role for markets in the allocation of societal resources (Hibbs and Dennis 1988; Bobbio 1997; Freeden 1999: 49; Klingemann et al. 2006: 5).

The application of this type of intuitive logic to corporate governance can be used to rationalize a positive (i.e., same-direction) relationship between

conservative government and the adoption of greater minority-shareholder orientation. This presumption arises from a number of plausible expectations about the likely socioeconomic implications of a corporate sector focused on the maximization of shareholder value. In contrast, corporate governance arrangements that encourage patient or dedicated owners of capital appear more consistent with Left government. The reasons for these expectations concerning partisanship and corporate governance are considered in turn.

A first consideration relates to the job security and employment conditions of employees. According to Shleifer and Summers, the short-term pressures operating on firms within the shareholder model force managers to break implicit contracts with workers relating to job security and long-term career progression (Shleifer and Summers 1988: 41). A firm that is oriented toward fulfilling the short-term earnings growth expectations of capital markets and sustaining a high share price is incentivized to adopt a "hire and fire" approach to its workforce. Labor costs form a significant proportion of the total costs of many enterprises, and the ability to manage these in a flexible way – both through reductions in headcount and wage restraint – helps firms to reduce operational gearing, and thereby protects levels of profitability during economic downturns. However, this greater flexibility comes at the expense of the employment security and wage levels of employees.

These fears about shareholder-oriented systems are underpinned by empirical data relating to labor markets. According to Jackson (2001: 124), the elasticity of employment in response to output changes in Germany and Japan has typically been around one-quarter of that of the United States. Frick (1997: 215) and Aoki (1988) note the substantial difference in job tenure and labor market turnover between these two groups of countries. Such differences between liberal and nonliberal market economies serve to substantially increase levels of insecurity among workers (Cappelli et al. 1997: 37; Lazonick and O'Sullivan 2000: 18; Barker and Rueda 2007). For these reasons, a Left government might not be expected to favor a form of corporate governance that pushes firms toward a more ruthless and cost-oriented attitude *vis-à-vis* employees.

A second consideration concerns income inequality. Firms in liberal market economies – particularly those in the United States – have traditionally exhibited much higher levels of pay disparity between senior executives and the median worker than those of continental Europe (see Table 1.5).[23] One of the causes of the more unequal remuneration environment in LMEs arises

http://www.pbookshop.com

[23] Between 1945 and the mid-1980s, the ratio of median executive pay (including bonuses and stock options grants) to average wages in the United States remained relatively stable. However, this ratio broke down between 1985 and 2000, increasing from around 40 times to almost 120 times average wages (*The Economist* 2007: 6).

Table 1.5 Median compensation of the CEO of a medium-sized company, 1996

Country	Base salary and bonus (US$ in thousands)	All benefits and perquisites (US$ in thousands)	Long-term compensation (US$ in thousands)	Total CEO compensation (US$ in thousands)	Ratio of CEO compensation to average manufacturing wage
Belgium	285	161	0	447	11.8
Canada	347	76	88	511	13.9
France	274	122	68	464	16.1
Germany	294	74	0	368	8.0
Italy	328	139	19	486	17.0
Japan	202	91	0	292	11.4
Netherlands	295	76	0	371	9.6
Spain	314	89	0	403	15.6
Sweden	147	94	0	241	7.4
Switzerland	264	69	12	345	11.8
United Kingdom	297	123	74	494	17.0
United States	548	97	260	905	24.3

Note: The data relates to a sample of companies with annual revenue of $200–500 million in 1990 US dollars. Benefits include pension contributions, health care costs, and other services, evaluated on an annualized basis. Long-term compensation includes stock options (the right to purchase company stock at a given price), restricted stock (stock that cannot be sold for some specified period of time), and performance share plans (formula-based stock compensation).

Source: Abowd and Kaplan (1999).

http://www.pbookshop.com

from the difficulties faced by a minority-shareholder-oriented governance system in controlling the remuneration decisions of top management. This contrasts with a blockholder system, where owners retain direct control over management remuneration (Bebchuk and Fried 2004). However, in addition, shareholder-oriented corporate governance offers greater scope for senior managers to negotiate the granting of stock options and performance bonuses. Stock options offer management the chance of achieving significant levels of personal wealth if they succeed in boosting the share price over a reasonably short time frame. Minority shareholders may encourage such techniques of remuneration, as they can be viewed as increasing the alignment of managers with the interests of shareholders. However, such a remuneration policy will clearly be detrimental to the income equality and redistributional objectives of left-of-center political actors and their core constituents.

A third reason why Left government may not be associated with minority-shareholder-oriented corporate governance is identified by Mark Roe (2003). According to Roe's argument, owners prefer a system of corporate governance based on blockholding in economies which are dominated by strong labor

movements and left-wing political parties. Owners fear that the strength of the Left will translate into policy measures that favor the interests of employees in the authority structure of the firm (e.g., employment protection, codetermination rights, centralized collective bargaining, etc.). They determine that the best way to counter these potential agency costs is to take large blockholdings in individual firms. These provide owners with more direct and reliable control over the management of firms, and give them the power to ensure that management administers the firm in their interests. However, after taking controlling ownership stakes, blockholders will have little incentive to promote the interests of minority shareholders, and will anyway view a value-maximizing approach as unrealistic in a labor-dominated environment (i.e., due to political constraints). In short, the strength of the Left will give rise to a corporate governance environment that is unfavorable to the interests of minority shareholders (Roe 2003).

A final link between corporate governance and partisanship concerns the role of patient capital in an economic system oriented toward nonmarket mechanisms of economic coordination. As Hall and Soskice (2001) have argued, it is necessary for capital to exhibit a long-term behavioral profile in order to persuade workers and other social actors to invest in "specific," that is, nontransferable, skills. However, Carr and Tomkins (1998: 223) report that the average time horizon for corporate investment among UK firms (i.e., firms operating in a pro-shareholder system) is 3.3 years, almost half that of their German peers. A more ruthless, short-termist ownership approach affects the willingness of employees to commit themselves to firm-specific types of role. Furthermore, patient or dedicated capital is complementary with a range of other institutional features in so-called coordinated market economies (CMEs), such as the nature of vocational training and education, industrial relations, and interfirm relations (Aoki 1988; Porter 1992; Hall and Soskice 2001: 6). It seems unlikely that Left government would promote the dismemberment of such a variety of capitalism – given the favorable position that labor has occupied within it – in favor of economic coordination based on more market-determined outcomes.

These expectations regarding the likely relationship between partisanship and corporate governance find support in cross-sectional data relating to the early 1990s. Figure 1.1 shows a scatter diagram of the Left–Right ideology of governments in individual countries and the extent of ownership concentration. The former is measured by Thomas Cusack's index of the ideological center of gravity of the cabinet,[24] which in turn is based on an expert

http://www.pbookshop.com

[24] For further details, see Cusack and Fuchs (2002).

classification of the ideological Left–Right stance of governing parties undertaken by Castles and Mair (1984), Laver and Hunt (1992), and Huber and Inglehart (1995). The partisanship values presented in Figure 1.1 are mean values across the period 1970–92. The ownership concentration data is based on data compiled by Gourevitch and Shinn (2005: 299), and relates to the early 1990s. It shows the percentage of national equity markets that are closely held, that is, the proportion of firms with individual owners holding stakes in excess of 20 percent of their total market capitalization. A high value is therefore indicative of blockholding. Roe (2003) argues that this type of data is suggestive of an empirical association between the power of the Left and an unfavorable environment for minority shareholders. Conversely, a more Right-oriented political environment – such as in the United States and United Kingdom – appears more conducive to shareholders with a more diffuse equity ownership, that is, less blockholding, and hence with a greater affinity for minority shareholder-oriented corporate governance.

The arguments in favor of a positive correlation between Right partisanship and shareholder-oriented corporate governance appear plausible enough. However, they sit uncomfortably with the observation that pro-shareholder

http://www.pbookshop.com

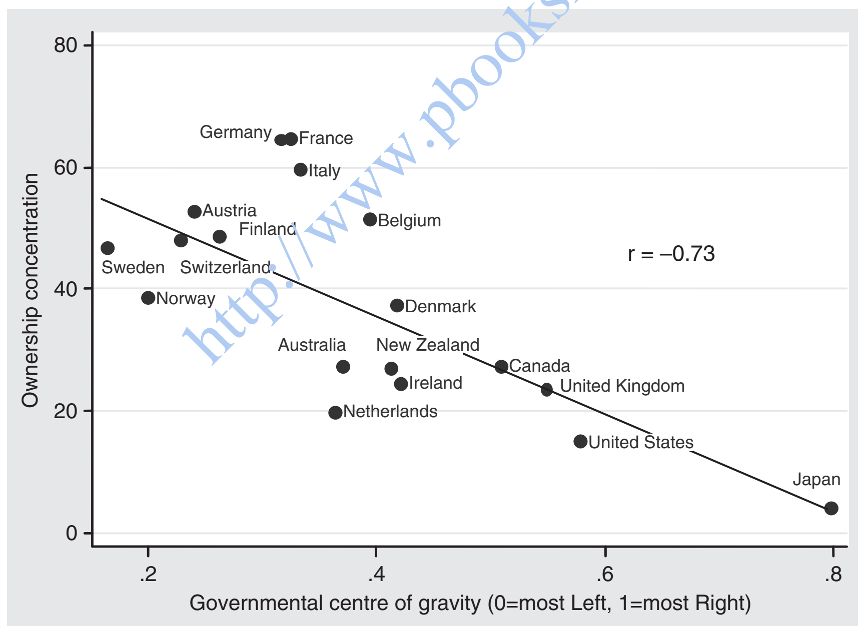

Figure 1.1 The relationship between government ideology and ownership concentration

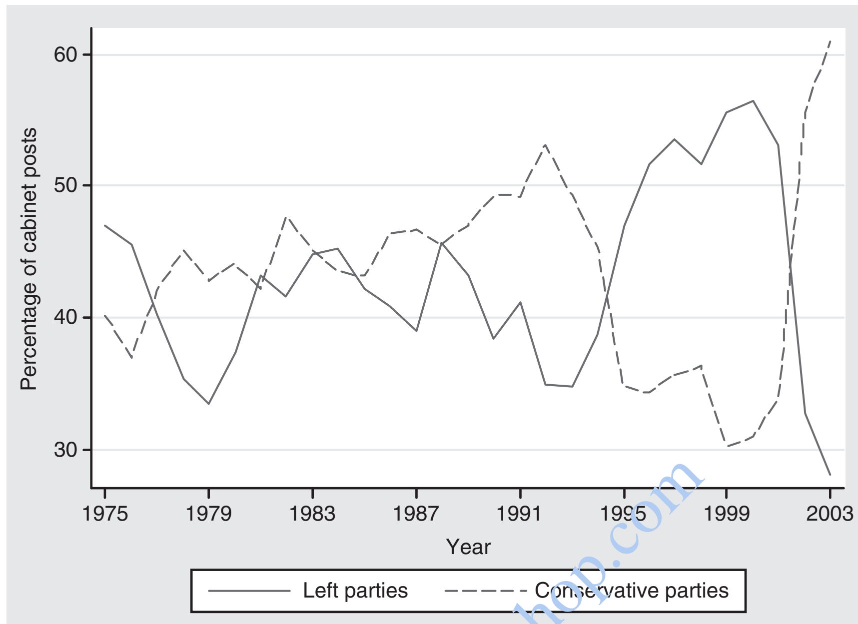

Figure 1.2 Participation of Left and conservative parties in European government, 1975–2003 (mean percentage of cabinet posts)

http://www.pbookshop.com

reform in Europe since the mid-1990s has coincided with significant periods of Left or Center-Left government in many European countries. John Cioffi and Martin Höpner have termed this phenomenon "the political paradox of finance capitalism,"[25] and have examined the role of Center-Left governments in pro-shareholder reform through case studies relating to three European countries: Germany, France, and Italy (Cioffi and Höpner 2006).[26]

Support for Cioffi and Höpner's contention that the last decade has witnessed a "greater than usual" role for the Left in European government is provided by the data presented in Figure 1.2. The graph summarizes the involvement of both the Left and conservative parties in the cabinets of fourteen European nonliberal market economies since 1975. During the second half of the 1990s, the Left participated in government to a greater

[25] Cioffi and Höpner define Finance Capitalism as "an economic order characterized by increasing competition, the expansion and deepening of financial markets, and more extensive regulation of the corporate firm's financial and governance practices consistent with the growth of market-driven finance" (Cioffi and Höpner 2006: 31).

[26] Cioffi and Höpner's article also considers the relationship between corporate governance reform and partisanship in the United States.

extent than at any time over the previous two decades.[27] Left-oriented governments were notable features of the political landscape in Belgium, Denmark, Finland, France, Germany, Greece, Italy, Portugal, and Sweden (although Austria and Spain provided counterexamples to this trend). In contrast, the influence of conservative parties in many countries reached a low ebb in the mid- to late 1990s, and only rebounded in the final two years of the time series.

Cioffi and Höpner's case studies (2006) – and the relative prevalence of Left government over the last decade – give rise to a number of questions concerning the relationship between partisanship and corporate governance. First, has the association between Left government and pro-shareholder reform – which Cioffi and Höpner observe in the cases of Germany, France, and Italy – been a general feature of the experience of other European economies? In other words, is such an unexpected pattern of partisanship a widely observed phenomenon in a large number of European economies, or specific to a relatively small number of special cases? Second, what explains this apparently puzzling association of Left government and pro-shareholder reform over the last ten years? Finally, does the apparent association between Left partisanship and changes in corporate governance policy (*de jure* corporate governance) – which is the focus of Cioffi and Höpner's case studies – also hold with respect to changes in firm-level corporate governance behavior (*de facto* corporate governance), which is the ultimate concern of this book?

The approach of this book is to seek a resolution of these issues through a detailed empirical analysis of the relationship between partisanship and firm-level corporate governance change in nonliberal market economies. This is undertaken in the context of testing a new hypothesis of *de facto* corporate governance change, which argues that the effect of partisanship on corporate governance change is conditional on the level of a specific economic variable: product market competition (which determines the level of economic rents in a political economy). The ultimate conclusion of the analysis is that, although Cioffi and Höpner have usefully highlighted the role played by Left government in several recent cases of pro-shareholder regulatory reform, they have crucially omitted the essential role played by economic rents in determining the corporate governance preferences of political actors and their core constituents. The relationship between partisanship and corporate governance change on a cross-country basis is more generally explained – and with greater empirical significance – in the context of partisanship's interaction with product market competition. This interaction forms the basis of the hypothesis of corporate governance change proposed by this book (which is described in Chapter 2).

[27] Table 1.7 in the appendix of this chapter provides a detailed summary of the party composition of European governments during the period 1990–2005.

http://www.pbookshop.com

1.4 PLAN OF THE BOOK

Given the cross-country nature of its theoretical claims, this book emphasizes a top-down macro-comparative approach in its analysis of European corporate governance change, although case study evidence is also examined. The hypothesis of the book – linking corporate governance change to the interaction of partisanship and product market competition – is outlined in Chapter 2. The relationship of this hypothesis to existing explanations of corporate governance – which derive from a number of academic literatures, including those of economics, finance, legal studies, economic sociology, and political science – is described in Chapter 3.

The subsequent methodological strategy involves establishing the validity of the theoretical claims by means of panel data econometric analysis. These techniques are applied to a pooled data set containing data relating to fifteen nonliberal industrialized democracies over the period 1975–2003. The choice of empirical proxies for two of the key variables in the data set – corporate governance and product market competition – is justified in Chapters 4 and 5. Chapter 6 presents the results emerging from the quantitative analysis. Chapter 7 examines the robustness of these results through sensitivity analysis and dynamic modeling. In the final part of the book, the relevance of the hypothesis in the European context is qualitatively investigated by means of two country case studies. The rationale for the choice of cases is outlined in Chapter 8. Chapters 9 and 10 present case study evidence for the chosen countries: Germany and Italy. The conclusions of the book are summarized in Chapter 11. The final chapter also offers some reflections on the book's broader implications for policy makers and the future of corporate governance.

http://www.pbookshop.com

1.5 CHAPTER APPENDIX

Table 1.6 provides a detailed listing of the most important changes in corporate governance regulation in the three largest nonliberal European economies – France, Germany, and Italy – since the early 1990s.[28] Table 1.7 provides the partisan composition of governments in continental Europe from 1990 to 2005.

[28] Corporate governance changes in Germany and Italy are examined in more detail in the case study chapters of this book (Chapters 9 and 10).

Table 1.6 Summary of regulatory reforms favoring minority shareholders in France, Germany, and Italy (since 1990)

Type of reform measure	France	Germany	Italy
Improving board effectiveness	Separation of CEO and Chairman allowed (2001).	Greater role for supervisory board (1998).	New rules on information to be provided to boards (1998 and 2003).
	New rules on information to be provided to boards (2001 and 2003). Board approval required for nonroutine transactions involving blockholders, and some forms of executive compensation. Requirement to disclose to board significant self-dealing transactions (2001, 2003, and 2005).		Minorities represented on board (2005) and audit committee (1998). Greater power and independence of audit committee (1998 and 2005).
			Requirements for increased disclosure to boards, and new procedural requirements for related-party transactions (2003).
Enhancing shareholder rights	Approval required at annual shareholder meeting of nonroutine transactions involving blockholders, and some forms of executive compensation (2001, 2003, and 2005).	Easier exercise of shareholder voting rights (2001).	Shareholder approval of stock-based compensation (2005).
	Easier exercise of shareholder voting rights (2001). Lower thresholds for minority shareholder rights (2002).	Communication among smaller shareholders facilitated (2005).	Easier exercise of shareholder voting rights (2003). Qualified majority required for major resolutions at shareholder meetings (1998). Lower thresholds for minority shareholder rights (1998 and 2005).

(*Continued*)

http://www.pbookshop.com

Table 1.6 Continued

Type of reform measure	France	Germany	Italy
Promoting shareholder democracy		Multiple voting shares banned, and banks' influence over shareholder meetings curbed (1998).	Voting caps banned (2003).
			Limits on validity of blockholder-shareholder agreements (1998).
Encouraging unwinding of cross-shareholdings		Sale of corporate shareholdings made tax exempt (2002).	Sale of corporate shareholdings made tax exempt (2003).
Improving private legal enforcement options	Ability of individual shareholders to bring derivative suits against company already in place.	Derivative suits made easier for shareholders (2005).	Derivative suits for minorities owning at least 2.5% of shares allowed (1998 and 2005).
		Civil actions by shareholders for securities fraud made easier (2003).	Contingency fees allowed (2006).
			Direct shareholder suit for damages stemming from abuse of corporate control introduced (2003).
Equalizing treatment of shareholders during control transactions	Mandatory bid rule (1992).	Mandatory bid rule (2002).	Mandatory bid rule (1998).
Improving corporate disclosure	Corporate governance report required by each company (2003).	Implementation of national corporate governance code on a comply-or-explain basis (2002).	Implementation of national corporate governance code on a comply-or-explain basis (2005).
	Implementation of national corporate governance code on a comply-or-explain basis (2003).		

http://www.pbookshop.com

	Financial reporting according to international accounting standards — IAS/IFRS 24 (agreed 2002, effective 2006).	Financial reporting according to international accounting standards — IAS/IFRS 24 (agreed 2002, effective 2006).	Financial reporting according to international accounting standards — IAS/IFRS 24 (agreed 2002, effective 2006).
	Disclosure of nonroutine transactions with blockholders, and some forms of executive compensation (2001, 2003, and 2005).	New rules concerning disclosure of price-sensitive information (1994 and 2004).	New rules concerning disclosure of price-sensitive information (1991 and 2005).
	New rules concerning disclosure of price-sensitive information (2005).	Disclosure of directors' and company officers' trading activities (2002 and 2004).	Disclosure of directors' and company officers' trading activities (2005).
	Disclosure of directors' and company officers' trading activities (2005).	Disclosure of individual compensation of top managers (2006).	Disclosure of individual compensation of top managers (1999).
	Disclosure of individual compensation of top managers (2001).		Disclosure of major shareholders' trades (2005).
	New rules concerning appointment and activities of auditors (2003).	New rules concerning appointment and activities of auditors (1998 and 2004).	New rules concerning appointment and activities of auditors (1998 and 2005).
Supervisory and enforcement reform	Merger of securities and banking authorities (2003).	Creation of securities regulator (1994).	Increased investigative and sanctioning powers for regulator (1998 and 2005).
		Merger of securities and banking authorities (2002).	

(*Continued*)

http://www.pbookshop.com

Table 1.6 Continued

Type of reform measure	France	Germany	Italy
		Increased investigative and sanctioning powers for regulator (various years).	
	Market abuse regime tightened (2005).	Criminal sanctions for insider trading (1994) and market manipulation (2002).	Criminal sanctions for insider trading (1991) and market manipulation (1998).
		Market abuse regime tightened (2002 and 2004).	Market abuse regime tightened (2005).
	Creation of public company accounting oversight board (2003).	Securities agency review of financial reports of public companies (2004).	Securities agency review of financial reports of public companies (2005).
		Creation of public company accounting oversight board (2004).	Securities regulator's power over audit firms strengthened (2005).

Source: Enriques and Volpin (2007) and author's own research.

http://www.pbookshop.com

Table 1.7 Partisan composition of governments in continental Europe, 1990–2005

Austria	*Prior to 1999*: Coalition of the Social Democratic Party of Austria (SPÖ) and Austrian People's Party (ÖVP). Chancellors: Franz Vranitzky (SPÖ, 1986–97); Viktor Klima (SPÖ, 1997–9). *2000–6*: Coalition of the Austrian People's Party (ÖVP) and the Freedom Party of Austria (FPÖ). Chancellor: Wolfgang Schüssel (ÖVP).
Belgium	*Prior to 1999*: Christian Democrat (CVP)-led coalition. Prime Minister (from 1992): Jean-Luc Dehaene (CVP). *1999–2008*: "Rainbow Coalition" of Flemish and French-speaking Liberals, Social Democrats, and (until 2003) Greens. Prime Minister: Guy Verhofstadt (VLD).
Denmark	*Prior to 1993*: Conservative People's Party (CON)-led coalition. Prime Minister (from 1982): Poul Schlüter (CON). *1993–2009*: Social Democrat (SD)-led coalition. Prime Minister: Poul Nyrup Rasmussen (SD). *2001–2009*: Liberal Party (Venstre)-led coalition. Prime Minister: Anders Fogh Rasmussen (Venstre).
Finland	*Prior to 1991*: National Coalition Party (KOK) coalition. Prime Minister (from 1987): Harri Holkeri (KOK). *1991–5*: Center Party (KESK)-led coalition. Prime Minister: Esko Aho (KESK). *1995–2003*: Social Democrat (SDP)-led coalition. Prime Minister: Paavo Lipponen (SDP). *2003–present*: Center Party-led coalition. Prime Minister: Matti Vanhanen (KESK).[29]
France	*Prior to 1993*: Socialist (PSF)-led government. Prime Ministers: Michel Rocard (1988–91); Édith Cresson (1991–2); Pierre Bérégovoy (1992–3). *1993–7*: Rally for the Republic (RPR) government. Prime Ministers: Édouard Balladur (1993–5); Alain Juppé (1995–7). *1997–2002*: Socialist (PSF)-led government. Prime Minister: Lionel Jospin (1997–2002). *2002–7*: Union for a Popular Movement (UMP)-led government. Prime Ministers: Jean-Pierre Raffarin (2002–5); Dominique de Villepin (2005–7).
Germany	*Prior to 1990*: Christian Democrat-led coalition. Chancellor (from 1982): Helmut Kohl (CDU). *1998–2005*: Social Democratic Party (SPD) and Green Party coalition. Chancellor: Gerhard Schröder (SPD).
Greece	*1990–3*: New Democracy (ND) government. Prime Minister: Constantine Mitsotakis. *1993–2004*: PASOK government. Prime Ministers: Andreas Papandreou (until 1996); Costas Simitis. *2004–present*: New Democracy government. Prime Minister: Kostas Karamanlis.
Italy	*Prior to 1992*: Christian Democrat-led coalition. Prime Minister (from 1989): Giulio Andreotti. *1992–1993*: Socialist-led coalition. Prime Minister: Giuliano Amato. *1993–4:* Independent government. Prime Minister: Carlo Azeglio Ciampi.

[29] Anneli Jäätteenmäki became the first female Prime Minister of Finland in April 2003, but left office after only two months.

http://www.pbookshop.com

	1994–5: Forza Italia (FI) government. Prime Minister: Silvio Berlusconi. *1995–6*: Independent government. Prime Minister: Lamberto Dini. *1996–2001*: Center-left coalitions: Prime Ministers: Romano Prodi (1996–8); Massimo D'Alema (1998–2000); Giuliano Amato (2000–1). *2001–6*: Forza Italia (FI) government. Prime Minister: Silvio Berlusconi.
Netherlands	*Prior to 1994*: Christian Democrat (CDA)-led coalition. Prime Minister (from 1982): Ruud Lubbers (CDA). *1994–2002*: Labour Party (PvdA)-led coalition. Prime Minister: Wim Kok (PvdA). *2002–present*: Christian Democrat (CDA)-led coalition. Prime Minister: Jan Peter Balkenende (CDA).
Norway	*1990–7*: Labour Party (AP) government. Prime Ministers: Gro Harlem Brundtland (1990–96); Thorbjørn Jagland (1996–97). *1997–2000*: Christian Democrat-led coalition. Prime Minister: Kjell Magne Bondevik (CPP). *2000–1*: Labour Party (AP) government. Prime Minister: Jens Stoltenberg *2001–5*: Christian Democrat-led coalition. Prime Minister: Kjell Magne Bondevik (CPP).
Portugal	*Prior to 1995*: Social Democratic Party (PSD) government.[30] Prime Minister (from 1985): Aníbal Cavaco Silva. *1995–2002*: Socialist Party (PSP) government. Prime Minister: António Guterres. *2002–5*: Social Democratic-led coalition. Prime Ministers: José Manuel Barroso (PSD, 2002–4); Pedro Santana Lopes (PSD, 2004–5). *2005–present*: Socialist (PS) government. Prime Minister: José Sócrates.
Spain	*Prior to 1996*: Spanish Socialist Workers' Party (PSOE) government. Prime Minister (from 1982): Felipe González. *1996–2004*: Peoples' Party (PP) government. Prime Minister: José María Aznar. *2004–present*: Spanish Socialist Workers' Party (PSOE) government. Prime Minister: José Luis Rodríguez Zapatero.
Sweden	*Prior to 1991*: Social Democratic Party (SDA)-led coalition. Prime Minister (from 1986): Ingvar Carlsson (SDA). *1991–4*: Moderate Party (MUP)-led coalition. Prime Minister: Carl Bildt (MUP). *1996–2006*: Social Democratic Party (SDA)-led coalition. Prime Minister: Göran Persson (SDA).
Switzerland	Permanent grand coalition. *Prior to 2003*: Federal Council formed according to the "magic formula" as follows: Free Democratic Party (FDP): 2 members; Christian Democratic People's Party (CVP): 2 members; Social Democratic Party (SPS): 2 members; Swiss People's Party (SVP): 1 member. *Since 2003*: 1 seat reallocated from CVP to SVP.

Source: Constructed by the author.

[30] Contrary to the impression given by its name, the Portuguese Social Democratic Party (Partido Social Democrata, PSD) is a party of the center-right.

http://www.pbookshop.com