The Effect of Capitalism on Corporate Governance:
Legal Transplantation in a Globalized World

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The candidate confirms that the work submitted is his/her own and that appropriate credit has been given where reference has been made to the work of others.

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Abstract

The objective of this thesis is to examine the relationship between corporate governance and capitalism and the potential effect of this relationship on the legal transplantation of corporate governance rules. The thesis aims to take the question of legal transplantations one step beyond the dominant ‘cultural diversity’ discourse. It seeks to ascertain whether cultural diversity, or for that matter legal origins and political theory, can *per se* provide a reliable answer to the legal transplantation dilemma in the field of corporate governance. It argues that corporate governance is a field inextricably linked with capitalism and presumes that any approach toward the problem of legal transplantation in the context of corporate governance that does not take into account the link between the capitalist economy and corporate governance probably will not provide adequate analytical tools for the problem. Thus, this thesis aims to provide a new analytical framework to address the problem of corporate governance convergence based upon the potential link between capitalism and corporate governance.

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Chapter 1
Introduction

Legal transplantations are increasingly gaining more prominence in the current historical juncture of increased economic, political and legal interdependence. The global revolution of telecommunications, transportation, and international trade has been bringing with it ever more trans-nationalising tendencies in every aspect of life. In a world characterised by growing economic and cultural interdependencies, it is questionable whether the law—including corporate governance rules—can remain constrained within the borders of the nation state. This is particularly evident in the field of corporate governance due to the alleged need for the incorporation of the efficient and effective Western legal frameworks by inexperienced less developed economies and economies in transition. Nonetheless, the tendency towards direct legal transplantations from one legal order to another has raised concerns on the part of regulators and legal scholars. The dominant concern revolves around the appropriateness of direct legal transplantations between culturally diverse societies.

This thesis advances a novel approach to the study of legal transplantations in the field of corporate governance. It enriches the ‘legal transplantations’ discourse with a more thorough review of the overall relationship between corporate governance rules and practices and capitalism. Without foreclosing the suitability of legal transplants, this thesis argues that the controversy surrounding them should not revolve around the issue of cultural diversity which dominates current critiques. It should instead be grounded on a more sophisticated study of the capitalist economies relationship to national corporate governance models.

This chapter aims to introduce the thesis's main arguments. Thus, it will briefly define the concepts of legal transplants, corporate governance and capitalism. It will then give a brief background to the issue of legal transplantation in general and legal transplantation in the field of corporate governance in particular. It will then propose a novel approach to the issue of legal transplantation in the area of corporate governance. Finally, this chapter concludes with the research questions, objectives and the methodology of the research as well as providing an outline of the entire thesis.

1.1 Working Definitions

1.1.1 Legal transplants

According to the Oxford English Dictionary, ‘to transplant’ means ‘to implant, move, take (a living tissue or an organ) and implant it in another body’.[1] In day-to-day language, transplantation is often associated with surgical operations by which a part of the human body is moved to another place or person. On the other hand, ‘legal transplants’ are defined as the practice of moving a rule, set of rules or institutions from one country to another.[2] The word ‘transplant’ in this context then is used to imply risks of failure similar to the risks associated with surgical transplants.[3] In the legal literature and for the purposes of this thesis, the words legal borrowing,[4] circulating,[5] adopting,[6] transferring,[7] copying[8] and transplanting are all equally used to refer to the process of moving a legal rule,[9] institution,[10] practice, or norm[11] from one country to another.

Although the discourse of legal transplants did not start until the 1970s, according to Watson, a legal scholar to whom the creation of the term ‘legal transplants’ is often attributed,[12] the practice of moving a rule from one country to another or from one people or group to another has been common since the earliest recorded history.[13] The earliest recorded instance of legal

[1] Oxford English Dictionary, ‘Transplant, n’ (*OED Online, OUP 1989*) <http://www.oed.com/view/Entry/204998> accessed 8 December 2016

[2] Alan Watson, *Legal Transplants: An Approach to Comparative Law* (2nd edn, The University of Georgia Press 1993) 21

[3] Otto Kahn-Freund, ‘On Uses and Misuses of Comparative Law’ (1974) 37 Modern Law Review 1, 6

[4] See for example, David Nelken and Johannes Feest (eds), *Adapting Legal Cultures* (1st edn, Hart Publishing 2001) 17

[5] See for example, Edward M Wise, ‘The Transplant of Legal Patterns’ (1990) 38 American Journal of Comparative Law 1, 1

[6] See for example, Nuno Garoupa and Anthony Ogus, ‘A Strategic Interpretation of Legal Transplants’ (2006) 35 Journal of Legal Studies 339, 341

[7] See for example, Gunther Teubner, ‘Legal Irritants: Good Faith in British Law or How Unifying Law Ends Up in New Divergencies’ (1998) 61 Modern Law Review 11, 15

[8] Hideki Kanda and Curtis J Milhaupt, ‘Re-Examining Legal Transplants: the Director's Fiduciary Duty in Japanese Corporate Law’ (2003) 51 American Journal of Comparative Law 887, 887

[9] See most of Alan Watson work, for example, Watson, *Legal Transplants: An Approach to Comparative Law* (n 2) 21; Alan Watson, *The Nature of Law* (1st edn, Edinburgh University Press 1977)

[10] See for example, Helen Xanthaki, ‘On Transferability of Legislative Solutions: The Functionality Test’ in Constantin Stefanou and Helen Xanthaki (eds), *Drafting Legislation: A Modern Approach* (1st edn, Routledge 2016) 1

[11] See for example, Garoupa and Ogus, ‘A Strategic Interpretation of Legal Transplants’ (n 6) 341

[12] Mathias Siems, ‘Malicious Legal Transplants’ (2018) 38 Legal Studies 103, 104

[13] Watson, *Legal Transplants: An Approach to Comparative Law* (n 2) 21

transplantation, according to Watson, can be found in one of the laws of Eshnunna (18th century B.C), the Babylonian Code of Hammurabi (17th century B.C), and Exodus (centuries after the Babylonian Code of Hammurabi) concerning the requirement to restrain a goring ox or pay compensation if anyone is killed by it. Watson concluded that the three codes contain very similar text in both form and substance, which shows that some connection must have existed between them and excludes the possibility of parallel development.[14]

1.1.2 Corporate Governance

The term 'corporate governance' is considered a relatively new term, that was rarely encountered before the 1970s.[15] It only gained common use after the US Federal Securities and Exchange Commission mentioned it in its official reform agenda in 1976.[16] However, the concept of corporate governance and the debate about some aspects of it have been in existence since the 16th and 17th centuries.[17] Although the term 'corporate governance' is now common and frequently used by academics, business managers, and the media, its definition varies greatly across the academic literature. This thesis uses the term in a very broad sense to mean the allocation of power among for profit companies' stakeholders, such as the shareholders, board of directors, executives, employees and creditors. This is so because this thesis views all stakeholders as integral parts of the corporate governance discourse.

1.1.3 Capitalism

Capitalism as a term only gained acceptance in the English, French, and German languages and acquired the particular meaning it has for us today in the second half of the nineteenth century.[18] A large number of classical scholars whose writing shaped the everlasting debate on capitalism such as Adam Smith, John Stuart Mill, and Karl Marx never actually used the word.[19] The first use of the term in print was in 1788 in a French journal. However, the

[14] Ibid, 22-27

[15] Brian R Cheffins, 'The History of Corporate Governance' in Mike Wright and others (eds), *The Oxford Handbook of Corporate Governance* (1st edn, Oxford University Press 2013) 47

[16] Ibid

[17] Harwell Wells, 'The Birth of Corporate Governance' (2010) 33 Seattle University Law Review 1247, 1251

[18] Jürgen Kocka, *Capitalism: A Short History* (Jeremiah Riemer tr, English edn, Princeton University Press 2016) 2

[19] Michael Merrill, 'How Capitalism Got its Name' (2014) 61 Dissent 87, 87

paper did not draw much attention until 1849 when Louis Blanc condemned what he called 'capitalism'.[20] The term then gained gradual usage after that.

As a concept, for a long time capitalism has been evading a simple definition and provoking lasting arguments as to what it involves exactly. Therefore, this thesis avoids giving or choosing a formal definition of capitalism. Presenting a proper definition requires a substantially long study that is beyond the scope and objectives of this research. Instead, an enumeration of capitalism's basic features should suffice in explaining the concept and this is done in Chapter 4. As Chapter 4 explains, private property, profit motive, competition, limited role of government, and the freedom of markets and choice are the distinguishing features of capitalism.

1.2 Overview of Legal Transplants

The current discourse on legal transplants is dominated by the cultural diversity issue. Scholars often either adopt a critical stance toward the practice of legal transplants and see it as inefficient, or even impossible, or else praise it and see it as a medium for legal development. The main line of argument adopted by both sides focuses on whether or not the practice of legal transplantations can take into sufficient consideration the unique cultural and socio-political frameworks existing in different countries.

The advocates of legal transplantation assert that legal rules, concepts, and systems can be easily transplanted into very different societies.[21] They argue that social needs do not necessarily, or even often, bring about legal development and that laws that serve no apparent social needs survive for generations and sometimes centuries, because the mechanisms of legal change are largely controlled ‘internally’ within legal systems by legal professional elites such as makers of codes or drafters of legislation.[22] Therefore, cultural differences between societies play no role in the success or failure of legal borrowing. They even argue that legal transplantation is the principal factor of legal development.[23]

On the other hand, one of the main critics of the legal transplantation practice, Pierre Legrand, argues that legal transplants are impossible because

[20] Ibid, 88

[21] Alan Watson, *Law Out of Context* (1st edn, University of Georgia Press 2000) 1

[22] Roger Cotterrell, ‘Is there a Logic of Legal Transplants?’ in David Nelken and Johannes Feest (eds), *Adapting Legal Cultures* (Hart Publishing 2001) 72

[23] Alan Watson, *The Evolution of Law* (2nd edn, Johns Hopkins University Press 1985) 119

legal rules are not only the propositional statement of the statutes, they are in fact a necessary incorporative cultural form, and since it is impossible to transport a culture, it is impossible to transplant a rule.[24] The only possible legal transplants, according to Legrand, occur when both the propositional statement of the legal rule and its meaning, which jointly constitute the legal rule, are transferred from one country to another.[25] However, given that the meaning of the rule is itself culturally specific, it is difficult to conceive how this could happen. Any imported rule is inextricably ascribed a different local meaning, which makes it a different rule.[26]

1.3 Legal Transplants in the Corporate Governance Context

Similarly, in the context of corporate governance, legal transplantations are becoming all the more widespread partly as a result of the need of developing nations struggling to build their market economies to rely arguably on the frameworks of the experienced and legally more efficient developed countries. Thus, for example, after the collapse of the Soviet Union it was more or less given that new Central and East European economies in transition would adopt an external model of corporate governance, the question revolving merely around whether this would be the German or the Anglo-Saxon one.[27]

Moreover, the discourse of legal transplantation is also often articulated along with cultural diversity issues and less often with the variations in legal origins and political ideologies.[28] Scholars either adopt an optimistic view and call for convergence in the field of corporate governance, or adopt a critical stance toward legal borrowing and call for a very cautious assessment of the cultural, legal, and political distance between the borrowing and lending countries before transplanting, if it occurs at all.[29]

[24] Pierre Legrand, ‘The Impossibility of" Legal Transplants"’ (1997) 4 Maastricht Journal of European and Comparative Law 111, 116

[25] Ibid, 117

[26] Ibid

[27] See for example, Boris Marinov and Bruce Heiman, ‘Company Law and Corporate Governance Renewal in Transition Economies: The Bulgarian Dilemma’ (1998) 6 European Journal of Law and Economics 231

[28] Valentina Bruno and Stijn Claessens, ‘Economic Aspects of Corporate Governance and Regulation’ in H. Kent Baker and Ronald Anderson (eds), *Corporate Governance: A Synthesis of Theory, Research and Practice* (1st edn, John Wiley & Sons 2010) 613

[29] Mario Krenn, ‘Convergence and Divergence in Corporate Governance: An Integrative Institutional Theory Perspective’ (2016) 39 Management Research Review 1447, 1447-1448

In particular, proponents of convergence agree that there are increasing tendencies toward homogeneity in corporate governance practice. However, they do not agree on the outcome of such convergence. The first group of proponents believes that globalisation will cause corporate governance practice to converge on the 'efficient' American model, while the second group thinks that it will converge on a hybrid model combining features from both the Anglo-American and Germany-Japan models.[30] Finally another group of advocates asserts that the practice of corporate governance will converge on the, as yet unknown, best and most efficient model, which will eventually prevail over time.[31]

Conversely, opponents of convergence and legal transplants often argue that domestic legal rules, expressing as they do the social climate, the culture of a political formation (nation state) or legal origins, are incorporated into the respective corporate governance framework[32] or, worse, are less important for investor protection than the social and political values that they reflect.[33] As a result, some critics argue either for a complete abandonment of legal transplantations or for the need for a 'cross-cultural theory of corporate governance systems'.[34]

Looking at the debate above, it becomes obvious that the core of the legal transplantation critique in the corporate governance context comes down to the issue of cultural diversity. More recently, scholars, having acknowledged the 'cliché' nature of this position, have opted for more interdisciplinary approaches, notably by incorporating the psychological factor into the discourse.[35] However, this more recent approach remains restricted within the confines of the 'cultural diversity' discourse, while enriching it with arguments concerning human behaviour.

[30] Palka Chhillar and Ramana Venkata Lellapalli, 'Divergence or Convergence: Paradoxes in Corporate Governance?' (2015) 15 Corporate Governance 693, 693

[31] Mauro F Guillén, 'Corporate Governance and Globalization: Is There Convergence Across Countries?' in Thomas Clarke (ed), *Theories of Corporate Covernance: The Philosophical Foundations of Corporate Governance* (Routledge 2000) 225

[32] Lucian Arye Bebchuk and Mark J Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance' (1999) Stanford Law Review 127, 153

[33] Amir N Licht, Chanan Goldschmidt and Shalom H Schwartz, 'Culture, Law, and Corporate Governance' (2005) 25 International Review of Law and Economics 229, 230-231

[34] Amir N Licht, 'The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems' (2001) 26 Delaware Journal of Corporate Law 147

[35] See for example, Licht, Goldschmidt and Schwartz, 'Culture, Law, and Corporate Governance' (n 33)

1.4 Central Research Questions

The above argumentative approach to direct legal transplantations of corporate governance practice certainly merits consideration. Indeed, cultural factors do play a crucial role in the overall function of a legal framework. However, there are indications that the fields of culture, politics and legal origins are unable to provide critics with adequate analytical tools in determining the framework of business law, and corporate governance in particular, and its prospects for trans-nationalisation. Therefore, this thesis investigates this issue and poses the following main questions:

1. Do the fields of culture, politics and legal origins provide an adequate answer to the diversity of corporate governance systems and are they the only factors to be taken into account in considering the merits of legal transplantation?
2. If not, to what extent does corporate governance relate to capitalism and how, if at all, does this relationship affect the transplantation process?

However, in order to arrive at an answer to these two main research questions, the following sub-questions must first be addressed:

1. What is corporate governance? And how does it relate to the issues addressed in this thesis?
2. Are corporate governance models converging? And what is the status of this convergence?
3. What are the factors, offered in the literature, that can explain the current state of convergence and do they exhaust the issue?
4. How does capitalism relate to the issues explored in this thesis?
5. What is the relationship between corporate governance and capitalism and how does it pertain to the legal transplantation issue?
6. Can the relationship between corporate governance and capitalism explain the diversity of corporate governance models?

1.5 Argument and Contribution to Knowledge

The objective of the thesis is to take the question of the appropriateness of legal transplantations one step beyond the dominant ‘cultural diversity’ discourse. It seeks to ascertain whether cultural diversity, or for that matter legal origins and political theory, can *per se* provide a reliable answer to the legal transplantation dilemma. It examines the potential link between capitalism and corporate governance practices to establish whether this link can provide an explanation for the diversity of corporate governance models and legal transplantation.

Without providing any *a priori* answer to the question of the propriety of legal transplantations in the field of corporate governance, this thesis will contribute to the relevant academic discourse by proposing a radically different analytical framework to the one presented above. This thesis argues that corporate governance is a field inextricably linked with the capitalist economy. In fact, corporations are considered 'one of the primary institutions of capitalism' and one of the most important institutions for wealth creation in capitalist economies.[36] Therefore, any approach in relation to the suitability problem of legal transplantation in the context of corporate governance that does not take into account the link between the capitalist economy and corporate governance will probably not provide adequate analytical tools to address the problem of legal transplantation. Thus, this thesis examines the question of whether, and to what extent, corporate governance is tied to the capitalist economy within the more central dilemma of convergence.

The answer to this question will improve our understanding and enable us to re-approach the issue of legal transplantations and their appropriateness through a completely different lens, as no scholar has hitherto considered the potential relevance of capitalism to the legal transplantation issue in corporate governance. If the variations in corporate governance models are found to be dependent on the various capitalist forms, then legal transplantations in the field of corporate governance should not be so concerned with the cultural, legal or political issues. If, however, the capitalist economy and corporate governance are found to be independent from one another, then the cultural, legal and political critiques may be more relevant.

[36] Joseph McCahery, Sol Picciotto and Colin Scott (eds), *Corporate Control and Accountability: Changing Structures and the Dynamics of Regulation* (Oxford University Press 1994) 2; Margaret M Blair, ‘For Whom Should Corporations be Run?: An Economic Rationale for Stakeholder Management’ (1998) 31 Long Range Planning 195, 195

1.6 Methodology

One of the most important steps towards achieving the objectives of any research is to choose the right methodology, which should be consistent with the research problem. In this research, the hypothesis, as mentioned above, is that the literature does not currently provide critics with adequate analytical tools to examine the issue of the legal transplantation of corporate governance practices. Thus, this thesis seeks to fill the gap in the literature by determining the relationship between capitalism and corporate governance and its effects on the transplantation process, which will give us a better understanding of how the law operates in its social, political, and economic context, contributes to the resolution of a social problem and informs legislatives and policy-makers. To achieve these objectives, the chosen methodology will involve library-based theoretical work in a legal framework centring upon an explanatory design that draws upon existing empirical studies. Reference will be had to secondary resources, mainly journal articles and texts from various disciplines.

1.7 Outline of the Thesis

This thesis addresses the research questions in an analysis spanning seven chapters. **Chapter one** is a preliminary chapter, which introduces the research. It defines and explains relevant terms, provides a brief background, highlights the original arguments of the thesis, proposes a research methodology and enumerates the aims and objectives of the research. Following the introduction, **Chapter two** provides a theoretical background of corporate governance to set the context for the remainder of this thesis. The chapter first defines the concept of corporate governance and then surveys the main theories and models in the field of corporate governance, concluding with an enumeration of good corporate governance features.

Chapter three aims to provide a comprehensive review of the literature on the convergence of corporate governance. Since scholars are debating whether corporate governance models have already converged to some degree and whether they will converge in the future, it was necessary to examine the possibility of convergence between corporate governance models and the extent of this convergence. Knowing the current state of convergence helps in structuring the entire thesis and enables a more accurate analysis of the thesis's main issue. If corporate governance systems are found to be converging without resistance, then all the cultural, legal, political, and psychological critiques of legal transplantation in the literature would be irrelevant. Therefore, the chapter reviews both the theoretical and empirical research on the convergence issue, covering both sides of the debate and explains every possible form or method of convergence.

Chapter four defines and explains capitalism. Determining whether a relationship exists between corporate governance and capitalism is not possible without comprehending these two concepts. Hence, this chapter is designed to provide an overview of the subject of capitalism. This chapter aims to identify the nature of capitalism, define the concept, explain its features and relate the different types of capitalisms. In particular, the chapter, first, answers the question of what is capitalism? Then, it provides an overview of two theoretical approaches to capitalism and some regional models. The purpose of discussing the theoretical approaches to capitalism is to identify capitalism in its purest and optimal forms, while the purpose of describing some of the various regional forms is to depict a clear picture of capitalism as it has been practised around the world. Achieving these objectives helps in understanding capitalism and contributes to enabling us to answer the main questions of the thesis.

Chapter five investigates the relationship between corporate governance and capitalism. The objective of this chapter is to answer the first part of the main research question, namely, whether a relationship exists between corporate governance and capitalism as well as the extent of this relationship. The chapter will discuss this issue in four different sections. The first section will discuss the potential link between the policies of the capitalist economy and company behaviours. The second section will examine the relationship between economic conditions in capitalist countries and company behaviours. The third section will focus on the relationship between corporate governance and the capitalist economies in the different varieties of capitalism considered in the literature. Finally, the fourth section will discuss the relationship between the free market and social market approaches to capitalism and corporate governance models. The aim of these four sections is to examine and potentially confirm the relationship between capitalism and corporate governance from different perspectives.

Chapter six answers the remaining parts of the research questions. The chapter starts by evaluating the dominant explanations for the current state of corporate governance convergence. Specifically, it examines the cultural, legal and political accounts of divergence and reports on whether they can provide a sufficient explanation for the convergence issue. The chapter then moves to link the relationship, discussed in Chapter 5, between corporate governance and capitalism to the legal transplantation issue. In particular, it discusses how capitalism could be the main reason for corporate governance diversity and how it could be a barrier to corporate governance convergence. Finally, the chapter concludes by discussing the possibility of corporate governance convergence in the future.

Chapter seven concludes the thesis by clearly summarising the main ideas and arguments presented in the research and providing suggestions and recommendations for policy-makers and future researchers.

Chapter 2
The Nature and Features of Corporate Governance

Because this thesis is concerned with the legal transplantation of corporate governance practices between judicial systems and the effects of capitalism on this process, and because it also aims to study the relationship between corporate governance and capitalism, it is certainly necessary to explore the nature and features of corporate governance in order to set the scene for the rest of this thesis. Determining whether a relationship exists between corporate governance and capitalism is not possible without comprehending these two concepts. Hence, this chapter is designed to provide an overview of the subject of corporate governance. In particular, it first defines the concept of corporate governance. It then surveys the main theories and models in the field of corporate governance and concludes with an enumeration of some features of good corporate governance practices.

2.1 What is Corporate Governance?

The term ‘corporate governance’ is considered a relatively new term, which, as was mentioned earlier, was rarely encountered before the 1970s.[1] It only gained common use after the US Federal Securities and Exchange Commission mentioned it in its official reform agenda in 1976.[2] However, the concept of corporate governance and the debate about some aspects of it have been in existence since the 16th and 17th centuries.[3] The concept, and the debate about it, can be traced back to the time when the use of the corporate form first created the possibility of conflict between managers and shareholders. In other words, it is generally felt that it arose with the launch of the East Indian Trading Company, the Levant Company and other large companies of the 16th and 17th centuries.[4]

[1] Brian R Cheffins, ‘The History of Corporate Governance’ in Mike Wright and others (eds), *The Oxford Handbook of Corporate Governance* (1st edn, Oxford University Press 2013), 47

[2] Ibid

[3] Harwell Wells, ‘The Birth of Corporate Governance’ (2010) 33 Seattle University Law Review 1247, 1251

[4] Cheffins, ‘The History of Corporate Governance’ (n 1) 46

Although the use of the term ‘corporate governance’ is now commonplace, many scholars have described it as an ambiguous concept[5] or, even worse, as indefinable.[6] Thus, vague descriptions of the term are very common in the literature, such as Thomas Clarke’s definition in which he described it as the exercise of power in companies[7] or Gillan and Starks assertion that corporate governance is whatever controls the operations at a company.[8] However, this is not the case with every definition in the literature. A great variety exists among them.

Some descriptions take broader approaches to the concept, stating that corporate governance is ‘the system by which companies are directed and controlled’,[9] ‘the framework that defines the division of wealth and power in the corporation’,[10] or the structure concerned with the direction and performance of the company.[11] Others adopt even broader approaches: Hasan states that corporate governance is ‘the entire network of formal and informal relations involving the corporate sector and their consequences for society in general’[12] and Keasey et al. include in it ‘the structures, processes, cultures and systems that engender the successful operation of organizations’.[13]

[5] See John H. Farrar, *Corporate Governance : Theories, Principles, and Practice* (3rd edn, Oxford University Press 2014) 3

[6] J. J. Du Plessis, James McConvill and Mirko Bagaric, *Principles of Contemporary Corporate Governance* (2rd edn, Cambridge University Press 2011) 3

[7] Thomas Clarke, ‘Intorduction: Theories of Governance: Reconceptualizing Corporate Governance Theory After the Enron Experience’ in Thomas Clarke (ed), *Theories of Corporate Governance: The Philosophical Foundations of Corporate Governance* (1st edn, Routledge 2004) 1

[8] Stuart Gillan and Laura Starks, ‘A Survey of Shareholder Activism: Motivation and Empirical Evidence’ (1998) 2 Contemporary Finance Digest 10, 13

[9] The Cadbury Committee, *Report of the Committee on the Financial Aspects of Corporate Governance* (Gee Professional Publishing 1992) (The Cadbury Report) Article 2.5.

[10] Amir N Licht, Chanan Goldschmidt and Shalom H Schwartz, ‘Culture, Law, and Corporate Governance’ (2005) 25 International Review of Law and Economics 229, 234

[11] Geof P Stapledon, ‘Institutional Shareholders and Corporate Governance’ (1997) 9 Otago Law Review 177, 177

[12] Zulkifli Hasan, ‘Corporate Governance: Western and Islamic Perspectives’ (2009) 5 International Review of Business Research Papers 277, 278

[13] Kevin Keasey, Steve Thompson and Mike Wright, ‘The Corporate Governance Problem: Competing Diagnoses and Solutions’ in Kevin Keasey, Steve Thompson and Mike Wright (eds), *Corporate Governance: Economic and Financial Issues* (1st edn, Oxford University Press 1997) 2

In contrast, some authors opt for specific descriptions of corporate governance. Marc Goergen, for example, contends that corporate governance is merely a matter of resolving or mitigating the conflict between and among management and other stakeholders.[14] Similarly, other scholars assert that corporate governance is only about directors making decisions[15] or even stakeholders influencing managerial decision-making.[16]

Another set of descriptions, including the one adopted by the Organisation for Economic Co-operation and Development (OECD), employ a functional approach, treating corporate governance primarily as the instrument that manages the aggregate of the 'relationships between a company's board, its shareholders, and other stakeholders'.[17] A more utilitarian approach sees corporate governance as the tool through which investors ensure returns,[18] protect their rights[19] or enhance their wealth.[20]

[14] Marc Goergen, *International Corporate Governance* (1st edn, Pearson Education M.U.A. 2012) 6; See also for examples, Simon S. M. Ho and Kar Shun Wong, 'A Study of the Relationship Between Corporate Governance Structures and the Extent of Voluntary Disclosure' (2001) 10 Journal of International Accounting, Auditing and Taxation 139, 142; Richard G. Sloan, 'Financial Accounting and Corporate Governance: A Discussion' (2001) 32 Journal of Accounting and Economics 335, 335; Randall Morck, Daniel Wolfenzon and Bernard Yeung, 'Corporate Governance, Economic Entrenchment, and Growth' (2005) 43 Journal of Economic Literature 655, 660

[15] Michael Useem, 'Corporate Governance is Directors Making Decisions: Reforming the Outward Foundations for Inside Decision Making' (2003) 7 Journal of Management and Governance 241, 242; Peter O Mülbert, 'Corporate Governance of Banks after the Financial Crisis-Theory, Evidence, Reforms' (2010) European Corporate Governance Institute Working Paper N 151/2010 accessed 5 February 2018, 4

[16] Jeroen Weimer and Joost Pape, 'A Taxonomy of Systems of Corporate Governance' (1999) 7 Corporate Governance: An International Review 152, 152

[17] Organisation for Economic Co-operation and Development, *OECD Principles of Corporate Governance 2004* (OECD Publishing 2004) 11; See also Marc Goergen and Luc Renneboog, 'Corporate Governance and Shareholder Value' in David Lowe (ed), *Commercial Management of Projects* (1st edn, Blackwell Publishing Ltd 2006) 100

[18] Andrei Shleifer and Robert W Vishny, 'A Survey of Corporate Governance' (1997) 52 Journal of Finance 737, 737

[19] Rafael La Porta and others, 'Investor Protection and Corporate Governance' (2000) 58 Journal of financial economics 3, 4

[20] Nigel Kendall and Arthur Kendall, *Real-World Corporate Governance: A Programme for Profit-Enhancing Stewardship* (1st edn, Pitman Publishing 1998)

Finally, some scholars even refrain from defining the concept itself, only indicating that the allocation of power between corporate shareholders and directors is its most fundamental principle.[21]

As discussed in the first chapter, this thesis adopts a broad description as a working definition of corporate governance. For the purposes of this thesis, corporate governance refers to the allocation of power among a company's stakeholders, such as the shareholders, board of directors, executives, employees and creditors. This is so because this thesis views all stakeholders as integral parts of the corporate governance discourse.

2.2 A Survey of Corporate Governance Theories

Corporate governance theories are the main disciplinary source of ideas about corporate structure and practices. Providing an overview of the main theories in the field helps in understanding the topic of corporate governance and enables a more comprehensive answer to the question ‘What is corporate governance?’ Each one of the theories discussed in this section contributes a different perspective of governance. Agency and stewardship theories shed some light on the shareholder-manager relationship from different angles, while stakeholder and shareholder approaches discuss the corporate objective that guides the governance agenda to different ends. Finally, resource dependency theory addresses the external challenges of companies.

2.2.1 Agency Theory

One of the most important theories in the corporate governance literature is the theory of agency, which is widely considered to be the cornerstone of the field, not only theoretically but also in terms of policy and practice.[22] This theory was first highlighted by Adam Smith, then developed by economists Berle and Means, and expanded and publicised by Jensen, Meckling and Fama.[23] It refers, in the corporate governance context, to the contractual relationship between the owners (the shareholders) of the company, as the principal, and its directors, as the agents.[24] When the shareholders of the

[21] *MM Companies, Inc. v. Liquid Audio, Inc* 741 P2d 840 (Del 1987)

[22] Luh Luh Lan and Loizos Heracleous, ‘Rethinking Agency Theory: The View from Law’ (2010) 35 Academy of Management Review 294, 294

[23] Josh Bendickson and others, ‘Agency Theory: Background and Epistemology’ (2016) 22 Journal of Management History 437, 437-439

[24] Sorin Nicolae Borlea and Monica-Violeta Achim, ‘Theories of Corporate Governance’ (2013) 23 Studia Universitatis "Vasile Goldis" AradSeria Stiinte Economice 117, 119

company delegate to directors to run the corporation for them, they create an agency relationship between themselves and the directors of the company.[25] However, the theory assumes that because this relationship is between human beings, it will be based on opportunism.[26] The agents will rationally act in their own self-interest, causing the so-called 'agency dilemma', specifically under two circumstances: First, when (a) the agent and the principal have different goals and interests and (b) it is expensive or difficult for the principal to verify what the agent is actually doing. The problem here is that the principal cannot confirm whether his or her agent has acted in his or her or best interests. Second, a problem appears when the agent and his or her principal have different evaluations of a particular risk. The problem here is that each of them may prefer a different action toward addressing the present risk.[27] Agency theory is mainly concerned with resolving these problems by developing mechanisms that limit the agent's self-serving behaviours and reconcile the differences in risk tolerance between the agent and the principal.[28]

In particular, the literature offers principals two propositions to solve the agency problem: The first proposal is to offer the agent an incentive in an effort to align his or her interests with the principal’s. For example, a top executive can be awarded commissions, stock options, equity ownership, profit sharing, price rates, bonuses, sharecropping, deductibles, etc. in order to limit the conflict between the executives and their principals.[29] The idea is that sharing some of the profit with managers or offering them equity ownership induces them to maximise the value of the company’s shares, which will, obviously, benefit the shareholders. Moreover, inadequate management compensation packages may tempt managers to use the firm’s resources for their own personal gain. Periodic compensation revision can

[25] Michael C. Jensen and William H. Meckling, ‘Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure’ (1976) 3 Journal of Financial Economics 305, 308

[26] Kathleen M Eisenhardt, ‘Agency Theory: An Assessment and Review’ (1989) 14 Academy of Management Review 57, 59

[27] Ibid, 58

[28] Ronald J Gilson, ‘Corporate Governance and Economic Efficiency: When Do Institutions Matter’ (1996) 74 Washington University Law Review 327, 331; Eisenhardt, ‘Agency Theory: An Assessment and Review’ (n 26) 59; Susan P Shapiro, ‘Agency Theory’ (2005) 31 Annual Review of Sociology 263, 265

[29] Shapiro, ‘Agency Theory’ (n 28) 265

diminish such self-interested behaviours.[30] The literature is full of studies describing and evaluating each compensation option.[31] Second, the agency problem can also be mitigated by monitoring agents. The argument here is that when the principal has the appropriate tools to verify agent behaviour, the agent is more likely to act in the principal's best interests.[32] Among other devices, the principal can monitor his or her agent through the use of independent directors, supervisory boards, auditors and other structural arrangements. The literature provides a great number of studies on such monitoring mechanisms.[33]

The market can also play a role in mitigating the agency dilemma. The managerial labour market and the market for corporate control can discipline managers and encourage them to maximise the realisation of shareholders best interests. The managerial labour market estimates the value of the managers' human capital by their previous performance. Failure to maximise firms' values decreases the opportunity for managers to get better positions and compensation, while success proves their real worth to their current and prospective firms.[34] Likewise, the market for corporate control, to be discussed later, can place great pressure on management to maximise shareholders' value. A poorly performing firm may tempt other firms to acquire it and replace the inefficient management, who are not maximising shareholders' wealth, with new management.[35]

[30] Brahmadev Panda and NM Leepsa, 'Agency theory: Review of Theory and Evidence on Problems and Perspectives' (2017) 10 Indian Journal of Corporate Governance 74, 83

[31] See for example, Lisa K Meulbroek, 'The Efficiency of Equity-linked Compensation: Understanding the Full Cost of Awarding Executive Stock Options' (2001) 30 Financial Management 5; Edward A Dyl, 'Corporate Control and Management Compensation: Evidence on the Agency Problem' (1988) 9 Managerial and Decision Economics 21; Anne T. Coughlan and Ronald M. Schmidt, 'Executive Compensation, Management Turnover, and Firm Performance: An Empirical Investigation' (1985) 7 Journal of Accounting and Economics 43

[32] Eisenhardt, 'Agency Theory: An Assessment and Review' (n 26) 60

[33] See for example, Mike W. Peng, 'Outside Directors and Firm Performance During Institutional Transitions' (2004) 25 Strategic Management Journal 453; Benedicte Millet-Reyes and Ronald Zhao, 'A Comparison Between One-Tier and Two-Tier Board Structures in France' (2010) 21 Journal of International Financial Management & Accounting 279

[34] Eugene F Fama, 'Agency Problems and the Theory of the Firm' (1980) 88 Journal of Political Economy 288, 288

[35] Omesh Kini, William Kracaw and Shehzad Mian, 'The Nature of Discipline by Corporate Takeovers' (2004) 59 Journal of Finance 1511, 1511

However, employing such mechanisms to solve the agency problem does not come free of cost. Ordinarily, three types of costs, known as 'agency costs', are incurred: the monitoring expenditures by the principal, the bonding expenditures by the agent, and the residual loss.[36] First, the monitoring expenditures are the costs of observing and controlling management’s behaviours. For example, the board of directors at a company is a device mainly intended to monitor management for the shareholders’ sake. Thus, having a board of directors, or a supervisory board in some jurisdictions, and paying for its members are considered an agency monitoring cost. The cost of monitoring is usually borne by shareholders; however, some scholars argue that this cost is ultimately borne by managers as their compensations are adjusted to cover such costs.[37] Second, bonding expenditures are the opposite of monitoring costs. Bonding expenditures are the costs that managers incur when they pursue the shareholders’ interests instead of their own. Therefore, when the bonding cost increases, the monitoring cost decreases.[38] Third, the residual loss is the costs that remain after the monitoring cost. It is the reduction in value experienced by the shareholders due to the divergence between managers’ decisions and those decisions that if taken would maximise shareholders’ wealth.[39] This is so because monitoring managers can only limit, but probably not eliminate, the divergence in interests between managers and shareholders.[40] Agency cost is the sum of these three types of costs.

2.2.2 Stewardship Theory

The stewardship theory presents a complementary, and often contrasting, model of management to agency theory.[41] While agency theory is based on a

[36] Jensen and Meckling, ‘Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure’ (n 25) 308

[37] Patrick McColgan, ‘Agency Theory and Corporate Governance: A Review of the Literature From a UK Perspective’ (2001) Department of Accounting & Finance, University of Strathclyde Working paper <https://pdfs.semanticscholar.org/79c5/2954af851c95a27cb1fb702c23feaae86ca1.pdf> accessed 2 Feburary 2018, 5; Eugene F. Fama and Michael C. Jensen, ‘Separation of Ownership and Control’ (1983) 26 Journal of Law & Economics 301, 304

[38] Panda and Leepsa, ‘Agency theory: Review of Theory and Evidence on Problems and Perspectives’ (n 30) 84

[39] Jensen and Meckling, ‘Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure’ (n 25) 308

[40] Ibid, 312-313

[41] Andrew Keay, ‘Stewardship Theory: Is Board Accountability Necessary?’ (2017) 59 International Journal of Law and Management 1292, 1296

highly individualistic model of opportunistic, self-interested managers rationally maximising their own wealth at the shareholders' expense, the stewardship theory maintains that there is no inherent conflict of interest between directors and shareholders. It recognises different human motives, such as the orientation towards achievement, commitment to meaningful work and altruism.[42] Therefore, even when the interests of managers and shareholders are not aligned, managers opt to engage in cooperative behaviours because they perceive greater utility in that way. However, the theory does not imply that managers lack self-interest. It simply states that managers believe that the utility gained by working toward the objectives of the corporation and its owner is higher than the utility gained through individualistic, self-serving behaviours.[43]

According to stewardship theory, the behaviour of a manager is collective and pro-organisational.[44] In situations where the objectives of the shareholders and other stakeholders—such as creditors, employees, customers and the manager himself—are competing, the steward realises that the best way to approach such settings is by promoting the success of the organisation. Even in the most complicated situations, stewardship theorists assume that most parties desire a successful company. Hence, a steward will rationally choose to increase the organisation's wealth to satisfy most stakeholders.[45]

A fundamental distinction between agency and stewardship theories is the proposed motivations by the advocates of each theory that align the interests of agents with their principles.[46] In agency theory, scholars propose that there are tangible extrinsic exchangeable rewards that have a measurable market value to align the interests of both parties.[47] These

[42] Clarke, ‘Intorduction: Theories of Governance: Reconceptualizing Corporate Governance Theory After the Enron Experience’ (n 7) 8-9

[43] See, James H Davis, F David Schoorman and Lex Donaldson, ‘Toward a Stewardship Theory of Management’ (1997) 22 Academy of Management Review 20, 25

[44] Melinda Muth and Lex Donaldson, ‘Stewardship Theory and Board Structure: A Contingency Approach’ (1998) 6 Corporate Governance: An International Review 5, 10

[45] Davis, Schoorman and Donaldson, ‘Toward a Stewardship Theory of Management’ (n 43) 25

[46] David Pastoriza and Miguel A Ariño, ‘When Agents Become Stewards: Introducing Learning in the Stewardship Theory’ (1st IESE Conference, Humanizing the Firm & Management Profession, Barcelona, July 2008), 5

[47] Davis, Schoorman and Donaldson, ‘Toward a Stewardship Theory of Management’ (n 43) 27

rewards form the core mechanisms that compel agents to consider shareholders' interests. As mentioned earlier, the management team, for example, can be offered commissions, stock options, equity ownership, profit sharing, price rates, bonuses, sharecropping or deductibles to ensure that they are working to achieve their principle objectives. Each of these control mechanisms rewards is extrinsic to the agent and has a monetary value. In contrast, stewardship theorists perceive that the key motivator for management and employees is not solely financial but the intrinsic satisfaction they get from a job well done.[48] The desire for personal growth, achievement, affiliation, and self-actualization, according to the stewardship theorists, are the main stimulators for the actions of management and employees.[49]

A good practical example of the difference in management between the agency approach and the stewardship perspective is the potentially dual role of the CEO. As stated previously, agency theorists assume that humans are opportunistic and self-interested; thus, managers will pursue their own goals at the expense of shareholders unless they are monitored and given some proper incentives. One of the major structural mechanisms used to monitor managers is the board of directors. Agency theorists argue that monitoring will be more effective if the chairman of the board of directors is independent from management and that shareholders' interests will be sacrificed if the same person acts as both CEO and the board of directors' chairman.[50] On the other hand, some stewardship theory advocates argue that allowing the CEO to exercise complete authority over the company and serve as both CEO and board of directors' chairman improves firm performance and increases shareholder returns.[51] They explain that the CEO can do this because he or she will be professional and act for the best interests of the company.[52]

[48] Beata Glinkowska and Bogusław Kaczmarek, ‘Classical and Modern Concepts of Corporate Governance: Stewardship Theory and Agency Theory’ (2015) 19 Management 84, 88

[49] Justin B. Craig and others, ‘Stewardship Climate Scale: Measurement and an Assessment of Reliability and Validity’ (Academy of Management Annual Meeting Proceedings, Texas, Agust 2011) 2-3

[50] Lex Donaldson and James H Davis, ‘Stewardship Theory or Agency Theory: CEO Governance and Shareholder Returns’ (1991) 16 Australian Journal of management 49, 50-51

[51] Ibid

[52] Ibid, 51

2.2.3 Stakeholder Theory

In a corporate governance context, the term ‘stakeholder’ refers to anyone who can affect or is affected by the corporation, such as its shareholders, managers, customers, employees, suppliers, governments, competitors, consumers, environmentalists, the media and other special interest groups.[53] However, this definition of the term is often criticised as being too broad. Most, if not all, stakeholder theorists agree that individuals who make explicit contracts with the company are among its stakeholders but disagree as to whether stakeholders include people with implicit or no contracts.[54] Clarkson gives a narrow definition of the term, which is one of the most popular descriptions in the field, stating that a stakeholder is anyone who "bear some form of risk as a result of having invested some form of capital, human or financial, something of value, in a firm" or "are placed at risk as a result of a firm's activities."[55]

The stakeholder theory is based on the belief that corporations do not exist solely to serve shareholders’ interests and that corporations should be socially responsible and managed in the interest of all its stakeholders.[56] It views shareholders as merely one of many competing groups that have interests in the company and presumes that managers have the duty to create optimal value not only for shareholders but also for all other stakeholders.[57] Indeed, the theory does not prioritise shareholders’ interests over those of any other groups of stakeholders, and it equally honours the rights of all stakeholders.[58] Managers should balance the interests of all concerned

[53] R Edward Freeman, *Strategic Management: A Stakeholder Approach* (1st edn, Cambridge University Press 2010) 54

[54] James J Brummer, *Corporate Responsibility and Legitimacy: An Interdisciplinary Analysis* (1st edn, Greenwood Press 1991) 145

[55] Max B. E. Clarkson, ‘A Risk Based Model of Stakeholder Theory’ (Proceedings of the Second Toronto Conference on Stakeholder Theory, Centre for Corporate Social Performance, University of Toronto, 1994) quoted in Ronald K Mitchell, Bradley R Agle and Donna J Wood, ‘Toward a Theory of Stakeholder Identification and Salience: Defining the Principle of Who and What Really Counts’ (1997) 22 Academy of Management Review 853, 858

[56] Sumanjeet Singh, ‘Balancing the Interests of Shareholders and Stakeholders through Corporate Governance’ in Roger Blanpain and others (eds), *Rethinking Corporate Governance: From Shareholder Value to Stakeholder Value* (Kluwer Law International 2011) 339

[57] Andrew Keay, ‘Stakeholder Theory in Corporate Law: Has it Got What it Takes’ (2010) 9 Richmond Journal of Global Law & Business 249, 255

[58] Ibid, 257

parties and play a mediator role between them.[59] However, balancing the interests of all stakeholders does not mean that the company should be equally answerable to all of them. This act of balancing must be in light of stakeholders’ contributions, costs and risks.[60]

The theory is supported by several different arguments. One of the arguments is simply that managers should serve the interests of all stakeholders because it is more reasonable and beneficial for the firm to do so.[61] A company cannot typically become and remain a thriving business unless it satisfies its customers, employees, suppliers and shareholders.[62] Businesses are conducted through a number of transactions among suppliers, customers, employees, communities, managers and shareholders. All these transactions must be creating value for everyone involved or else they will not continue doing business with the company. Thus, it is asserted that a reasonable manger will try and create as much value as possible for all stakeholders.[63]

Another argument behind this theory is that all the stakeholders of a corporation have some equal rights.[64] This argument is based on either the 'firm as a contract' view of the company or the notion of a fairness rationale. The 'firm as a contract' view conceptualises a company as a series of multilateral contracts among shareholders, employees, suppliers, consumers, and the community where all the contracts are administered by managers and argues that each of these groups affected by a contract have an equal right to bargain about the distribution of the contract's effects.[65] Therefore, some governance rules must be devised to ensure a minimal condition of 'fair contracting' is given to all stakeholders and that the interests of all parties are

[59] Roberta S Karmel, ‘Implications of the Stakeholder Model’ (1993) 61 George Washington Law Review 1156, 1176

[60] Robert Phillips, R. Edward Freeman and Andrew C. Wicks, ‘What Stakeholder Theory Is Not’ (2003) 13 Business Ethics Quarterly 479, 488

[61] Janice Dean, *Directing Public Companies: Company Law and the Stakeholder Society* (1st edn, Cavendish Publishing Limited 2001) 251

[62] Ibid

[63] R Edward Freeman, Andrew C Wicks and Bidhan Parmar, ‘Stakeholder Theory and" The Corporate Objective Revisited"’ (2004) 15 Organization Science 364, 365

[64] Thomas Donaldson and Lee E Preston, ‘The Stakeholder Theory of the Corporation: Concepts, Evidence, and Implications’ (1995) 20 Academy of Management Review 65, 79

[65] R Edward Freeman and William M Evan, ‘Corporate Governance: A Stakeholder Interpretation’ (1990) 19 Journal of Behavioral Economics 337, 352

at least taken into consideration.[66] The notion of fairness argument, on the other hand, suggests that not only shareholders but also each stakeholder has a property right which needs protection.[67] Suppliers have a property right to benefit from the supplies they sell to the company. Employees have a property right to their labour. Communities have a property right to public goods. Each one of these rights, along with shareholders' rights, deserve to be equally taken into account by managers on the basis of fairness.[68]

Another similar argument that attempts to justify a stakeholder approach to management is the stakeholder-agency perspective.[69] Like the previous argument, the stakeholder-agency perspective departs from the view of the corporation as a nexus of implicit and explicit contracts between all stakeholders and the company.[70] It argues that the managers of a company are not only the agents of the shareholders but also the agents of all other stakeholders.[71] It identifies several parallels between the stakeholder–agent relationships and the principal–agent relationship articulated in the agency theory literature. One of the identified parallels is the notion that the purpose of both stakeholder–agent and principal–agent relationships is to reconcile divergent interests. Another similarity is that both relationships are regulated by governance structures. Finally, most of the concepts and language found in agency theory literature can be applied to the stakeholder–agent relationship.[72] All this resemblance suggests, according to this argument, that the agency theory can be generalised to accommodate the relationships between managers and all other stakeholders.[73]

2.2.4 Shareholder Primacy Theory

Shareholder primacy theory is central to the field of corporate governance especially in the Anglo-American system. This theory is often presented in the literature as a rival to the stakeholder theory. Proponents of this theory believe that maximising shareholder value should be the ultimate goal of corporate

[66] Ibid

[67] R. Edward Freeman and Robert A. Phillips, 'Stakeholder Theory: A Libertarian Defense' (2002) 12 Business Ethics Quarterly 331, 338

[68] Ibid

[69] Charles W. L. Hill and Thomas M. Jones, 'Stakeholder-Agency Theory' (1992) 29 Journal of Management Studies 131, 131

[70] Ibid, 132

[71] Ibid

[72] Ibid, 134

[73] Ibid

managers.[74] They assert that the objective of corporations is to maximise shareholders' value, as the famous ruling of the Michigan court in *Dodge vs. Ford Motor Company* states: *'the business corporation is organized and carried on primarily for the profit of stockholders. The powers of directors are to be employed for that end.'*[75] However, this does not mean that managers should have no regard at all for the interests of other stakeholders. Many shareholder theorists believe that managers should also consider the interests of other stakeholders but as a secondary to the shareholders' interests.[76]

Shareholder Primacy advocates argue that directors must manage corporations to maximise shareholder value for the following reasons: First, they assert that mangers must redirect their decisions to serve the shareholders' interests because arguably they have a fiduciary duty to them;[77] thus, it is the ethical thing to do.[78] They explain that under a legal system of private ownership and freedom of contract, when a person carries on a business, he or she has no duty to conduct business for the benefit of other people. He or she normally manages a business for his or her own benefit and gain. Similarly, when the business owner appoints an agent to assist in running the business, the situation does not change. The agent must manage the business for the sole benefit of the owner. He or she has a fiduciary duty to do so and must loyally serve the principal's interests.[79]

[74] David Millon, 'Radical Shareholder Primacy' (2012) 10 University of St Thomas Law Journal 1013, 1013; Stephen M Bainbridge, 'In Defense of the Shareholder Wealth Maximization Norm: A Reply to Professor Green' (1993) 50 Washington and Lee Law Review 1423, 1423

[75] *Dodge v. Ford Motor Co.* 204 Mich 459, 170 NW 668, 1919 Mich

[76] Brummer, *Corporate Responsibility and Legitimacy: An Interdisciplinary Analysis* (n 54) 103; Andrew Keay, 'Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?' (2010) 7 European Company and Financial Law Review 369, 376

[77] Article 170(1) of the UK Company Act of 2006 clearly states that directors owe their duties to the company. However, some commentators in the US argue that the duties are owed solely to the shareholders. See for example, E Merrick Dodd, 'For Whom Are Corporate Managers Trustees?' (1932) 45 Harvard Law Review 1145, 1145-1146; Alexei M Marcoux, 'A Fiduciary Argument Against Stakeholder Theory' (2003) 13 Business Ethics Quarterly 1, 1. Moreover, some courts in the US have ruled that directors owe their duties to both the shareholders and the company. For more on this matter see, Andrew Keay, *Board Accountability in Corporate Governance* (1st edn, Routledge 2015) 113-118

[78] Marcoux, 'A Fiduciary Argument Against Stakeholder Theory' (n 77) 5-12

[79] Dodd, 'For Whom Are Corporate Managers Trustees?' (n 77) 1145

Second, managers must maximise shareholders' value because shareholders are the only residual claimants.[80] Some defenders of the shareholder primacy theory depart from the notion that the firm is a nexus of contracts among stakeholders.[81] They believe that the contracts between the company and non-shareholder groups—such as creditors, suppliers, managers and employees—are explicit contracts that entitle them to specific rewards in exchange for their services to the company. Shareholders on the other hand rely on an implicit contract that entitles them to whatever remains after the firm fulfils its obligations under its explicit contracts with the other stakeholders. Thus, they describe shareholders as the residual claimants and argue that corporations should be managed for the benefit of shareholders because shareholders, as opposed to fixed claimants, are the only group with an implicit contract and therefore have the least legal protection.[82]

Third, maximising shareholder value results in an increase in social wealth.[83] A number of shareholder primacy theory advocates believe that the same actions that maximise share value also benefit society. They argue that maximising profit for equity investors requires an efficient management and handling resources efficiently to benefit the entire society.[84] To illustrate, in order to increase share value, managers need to ensure that their companies are run efficiently which means producing high quality goods or services at the lowest possible prices, developing new products and technology, and creating value for customers. Such actions not only profit shareholders but also the whole society and increases the possibility of the company growing and adding more jobs to the market.[85] Indeed, some advocates of the theory assert that running a business for profit rather than concerning oneself with social welfare is the best way to achieve desirable social ends.[86]

Finally, some proponents of the shareholder primacy theory argue that managers should serve shareholders' interests because it is difficult or even

[80] Frank H Easterbrook and Daniel R Fischel, *The Economic Structure of Corporate Law* (1st edn, Harvard University Press 1996) 90-91

[81] Lynn A Stout, 'Bad and Not-So-Bad Arguments for Shareholder Primacy' (2001) 75 Southern California Law Review 1189, 1192

[82] Ibid, 1192-1193

[83] E.F. Brigham and M.C. Ehrhardt, *Financial Management: Theory & Practice* (14th edn, Cengage Learning 2014) 10

[84] Easterbrook and Fischel, *The Economic Structure of Corporate Law* (n 80) 38

[85] Brigham and Ehrhardt, *Financial Management: Theory & Practice* (n 83) 11

[86] Milton Friedman, 'The Social Responsibility of Business is to Increase its Profits' in Walther Ch. Zimmerli, Markus Holzinger and Klaus Richter (eds), *Corporate Ethics and Corporate Governance* (Springer 2007) 173-174

impossible to serve all stakeholders at the same time.[87] Stakeholder theorists suggest that the company should be managed on behalf of multi-stakeholders. However, according to some of the proponents of shareholder primacy theory, it is logically impossible to maximise in more than one direction at the same time. Thus, telling the managers that the objective of the firm is to maximise value for all stakeholders is like telling them that the firm has no objective.[88] According to some of them, it is far more efficient for managers to maximise for one group, namely the shareholders.

2.2.5 Resource Dependence Theory

While the above theories discuss the internal dilemmas of corporations, the resource dependence theory approaches the external challenges of corporate governance. It perceives the corporate board as a 'mechanism for managing external dependencies, reducing environmental uncertainty and reducing the transaction cost associated with the environmental interdependency'.[89] It is based on the belief that one of the central ways to understand corporate choices and actions is by focusing less on the internal dynamics or the values and beliefs of the leaders, and more on the environment and social context of the firm.[90]

The theory proposes five actions that companies can take to minimise external dependencies. First, companies may engage in a merger and acquisition to control some aspects of their external environment.[91] For example, companies can eliminate competition by acquiring or merging with their main competitor, controlling its source of input or output by acquiring or merging with their suppliers or distributors, and diversifying their operations to lower their risks by merging or acquiring different businesses. Second, firms can also control their environment by forming joint ventures.[92] Establishing joint venture relationships, such as strategic alliances, joint marketing and

[87] Michael C Jensen, ‘Value Maximization, Stakeholder Theory, and the Corporate Objective Function’ (2001) 14 Journal of Applied Corporate Finance 8, 10-11

[88] Ibid; Anant K Sundaram and Andrew C Inkpen, ‘The Corporate Objective Revisited’ (2004) 15 Organization Science 350, 354

[89] Amy J Hillman, Albert A Cannella and Ramona L Paetzold, ‘The Resource Dependence Role of Corporate Directors: Strategic Adaptation of Board Composition in Response to Environmental Change’ (2000) 37 Journal of Management studies 235, 236

[90] Jeffrey Pfeffer and Gerald R. Salancik, *The External Control of Organizations: A Resource Dependence Perspective* (2nd edn, Stanford University Press 2003) 1

[91] Ibid, 114

[92] Ibid, 152-154

buyer–supplier associations, can reduce environmental uncertainty and transaction costs. Third, the board of directors can also manage, to a large degree, companies' environmental interdependencies.[93] The theory classifies the board of directors, for the purpose of managing the external environment, into the following four categories: insiders who are familiar with the firm and who provide expertise in in that area; business experts who assist in the business strategy and decision-making process; support specialists, such as lawyers and bankers on the board giving advice in their field of expertise; and influential community members, such as political and social leaders who help companies overcome external challenges.[94] Fourth, companies can control their environment through political actions. Firms constantly attempt to influence government regulations so that they create a more favourable environment.[95] Finally, executive succession can also play a role in reducing environmental uncertainty. Some scholars have reported the positive relationship of environmental dependence with executive turnover and tenure, as well as with the type of the new executive selected.[96]

2.3 Corporate Governance Models

Although evidence suggests that every country has a different corporate governance system, scholars tend to classify corporate governance practices according to the common patterns that can be observed within this diversity. Typically, corporate governance models are classified into two main models or frameworks, the shareholder- and stakeholder-centred models.[97] This section, provides a description of the two main models.

2.3.1 The Shareholder Model

In the legal literature, both the US and UK, along with the other Anglo-Saxon countries, are categorised under the shareholder model of corporate governance because they all apply a version or another of the shareholder

[93] Ibid, 161; Hillman, Cannella and Paetzold, 'The Resource Dependence Role of Corporate Directors: Strategic Adaptation of Board Composition in Response to Environmental Change' (n 89) 235

[94] Haslinda Abdullah and Benedict Valentine, 'Fundamental and Ethics Theories of Corporate Governance' (2009) 4 Middle Eastern Finance and Economics 88, 92

[95] Amy J. Hillman, Michael C. Withers and Brian J. Collins, 'Resource Dependence Theory: A Review' (2009) 35 Journal of Management 1404, 1411

[96] Ibid, 1413

[97] Marc Goergen, Miguel C Manjon and Luc Renneboog, 'Is the German System of Corporate Governance Converging Towards the Anglo-American Model?' (2008) 12 Journal of Management & Governance 37, 37-38

primacy theory, discussed previously. This model of corporate governance is often referred to, in the literature, as the Anglo-Saxon or Anglo-American model and can be distinguished by the following characteristics, among others.

First, the ownership structure of large companies is relatively widely dispersed.[98] In any typical Anglo-Saxon corporation, the ownership is dispersed in such a way that there is no individual shareholder or group with sufficient voting power or incentives to affect managerial decisions,[99] Thus, this structure creates a separation between ownership and control. According to some empirical studies, the ownership of the largest five shareholders in US and UK companies account, on average, for only about 25% of the total shares as compared with 58% in China,[100] 79% in Germany,[101] and 57.8% in the Czech Republic.[102] Moreover, the identity of these shareholders in the Anglo-American system has shifted from individual shareholders to institutional shareholders—not affiliated with the company. Until the early 1960s, institutional investors, foreign and domestic, held only about 10% of the total quoted shares in the UK and US. However, this trend has changed intensely as the percentage ownership of institutional investors had sprung to over 70% in both countries by the end of 2016 in US and 2012 in UK.[103]

[98] Rafael La Porta, Florencio Lopez-De-Silanes and Andrei Shleifer, 'Corporate Ownership Around the World' (1999) 54 Journal of Finance 471, 491-493

[99] Dennis Leech and John Leahy, 'Ownership Structure, Control Type Classifications and the Performance of Large British Companies' (1991) 101 Economic Journal 1418, 1418

[100] See, Xiaonian Xu and Yan Wang, 'Ownership Structure and Corporate Governance in Chinese Stock Companies' (1999) 10 China Economic Review 75, 76; Stephen David Prowse, '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' (1994) Bank for International Settlements Economic Paper No 41 <http://www.bis.org/publ/econ41.pdf> accessed 24 April 2017, 33-34

[101] Xu and Wang, 'Ownership Structure and Corporate Governance in Chinese Stock Companies' (n 100) 76

[102] Stijn Claessens, Simeon Djankov and Gerhard Pohl, 'Ownership and Corporate Governance: Evidence from the Czech Republic' (1997) World Bank Group Policy Research Working Paper No 111 <https://doi.org/10.1596/1813-9450-1737> accessed 21 March 2017, 9

[103] Note that the shares held by domestic institutional investors has declined over the years with international institutional investors having the largest portion of shares. See, Stuart L. Gillan and Laura T. Starks, 'The Evolution of Shareholder Activism in the United States' (2007) 19 Journal of Applied Corporate Finance 55, 56; Mila R. Ivanova, 'Institutional Investors as Stewards of the Corporation: Exploring the Challenges to the Monitoring Hypothesis' (2017) 26 Business Ethics: A European Review 175, 177; Charles Mcgrath, '80% of Equity Market

Second, the Anglo-Saxon model of governance is characterised by a single board of directors that is usually dominated by outsiders.[104] Unlike Germany where companies have two completely distinct boards—a management board consisting entirely of executives and a supervisory board consisting of employee and shareholder representatives—the shareholder model of governance is based on a one-tier board system with executive and non-executive directors on a single board with the majority consisting of non-executive, outsider directors.[105] In a survey of 484 US firms, 56% had only one or two insiders on their boards, and only nine firms had a majority of executives.[106] Arguably, having a majority of independent outsider directors on boards mitigates agency problems which in turn affects company value.[107]

Third, the system is well-known for its developed capital market.[108] The current regulations and practices have resulted in the development of the US and UK capital markets and a reduction in the cost of capital.[109] Economists tend to use the number of listed firms in a stock market to test its development. The higher the number is in a country, means that more companies turn into equity finance to promote their businesses, which indicates the development of its stock market. The UK, a classical example of the shareholder model, has more than 2,150 listed companies as of September 2018, while Germany, for example, has only about 450 listed

Cap Held by Institutions' (*Pensions & Investments*, 2017) <https://www.pionline.com/article/20170425/INTERACTIVE/170429926/80-of-equity-market-cap-held-by-institutions> accessed 12 Dec 2019; Office for National Statistics, 'Ownership of UK quoted shares: 2018' (*Office for National Statistics, UK*, 2020) <https://www.ons.gov.uk/economy/investmentspensionsandtrusts/bulletins/ownershipofukquotedshares/2018> accessed 21 May 2020

[104] Steven N Kaplan, 'Corporate Governance and Corporate Performance: A Comparison of Germany, Japan, and the US' (1997) 9 Journal of Applied Corporate Finance 86, 86

[105] Pablo De Andres, Valentin Azofra and Felix Lopez, 'Corporate Boards in OECD Countries: Size, Composition, Functioning and Effectiveness' (2005) 13 Corporate Governance: An International Review 197, 199

[106] Sanjai Bhagat and Bernard Black, 'The Uncertain Relationship Between Board Composition and Firm Performance' (1999) 54 Business Lawyer 921, 921

[107] Fernando Lefort and Francisco Urzúa, 'Board Independence, Firm Performance and Ownership Concentration: Evidence from Chile' (2008) 61 Journal of Business Research 615, 615

[108] John C Coffee, 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' (2001) 111 Yale Law Journal 1, 3

[109] René M Stulz, 'Globalization, Corporate Finance, and the Cost of Capital' (1999) 12 Journal of Applied Corporate Finance 8, 15-16

companies as of December 2017 even though it has a larger economy than the UK.[110] Another economic measure for capital market development is the total stock market capitalisation as a percentage of GDP. In 2017, the total domestic market capitalisation of Germany amounted only to 57.13% of GDP, while it exceeded 122% in the UK.[111] Additionally, in both the US and UK, equity financing is often considered a common method of raising capital. Thus, it is not surprising that the US is the largest capital market in the world and the UK is the second in terms of the amount of new capital raised through equity issues.[112]

Fourth, the shareholder model of governance is also recognised for its unique market for corporate control. Corporate control is often defined "as the right to determine the management of corporate resources - that is, the rights to hire, fire and set the compensation of top-level managers"[113] In a takeover transaction, a buyer can, via a merger or tender offer, acquire a controlling share of a company and hire and fire management figures in order to construct a more favourable resource utilisation.[114] In a non-hostile takeover, a buyer makes an agreement with the target firm's managers to purchase the target company's common stock before going to a vote at the shareholders' meeting; in a tender offer (hostile), a buyer approaches the target firms' shareholders directly and offers to purchase their shares at a premium price.[115] Takeovers can also occur via a proxy contest, wherein an insurgent group—often a large shareholder or manager—attempts to procure controlling seats on a board of directors, and by this means gains control of the

[110] For the number of listed companies in the UK see, London Stock Exchange, ‘Companies on London Stock Exchange’ (*London Stock Exchange 30/09/2018*, 2018) <https://www.londonstockexchange.com/statistics/companies-and-issuers/companies-defined-by-mifir-identifiers-list-on-lse.xlsx> accessed 14/10/2018; For the number of listed companies in Germany see, The World Bank, ‘Listed Domestic Companies: Total’ (*The World Bank Open Data*, 2018) <https://data.worldbank.org/indicator/CM.MKT.LDOM.NO> accessed 14/10/2018;

[111] Siblis Research, ‘Global Market Cap to GNI/GDP Ratios for 28 Countries’ (*Siblis Research Ltd*, 2018) <http://siblisresearch.com/data/market-cap-to-gdp-ratios/> accessed 14/10/2018

[112] Brian J. Henderson, Narasimhan Jegadeesh and Michael S. Weisbach, ‘World Markets for Raising New Capital’ (2006) 82 Journal of Financial Economics 63, 73 and 75

[113] Michael C Jensen and Richard S Ruback, ‘The Market for Corporate Control: The Scientific Evidence’ (1983) 11 Journal of Financial economics 5, 5

[114] Ibid, 6

[115] Ibid, 6-7

company.[116] The takeover market, therefore, is widely recognised as a crucial mechanism whereby capital markets discipline management.[117] When managers fail to maximise the value of a firm, they tempt other interested parties to take over that firm, convert the company's structure to a value-maximising system and then harvest the increase in value that results from the introduced improvements.[118]

Fifth, the model is also acknowledged, according to some theorists, for its recognition of a director's fiduciary duty to maximise shareholder wealth.[119] A fiduciary duty arises when one party gives its assets to another party, an agent, only to care for it for the benefit of the first party. The receiver of the assets has discretionary power which the receiver must exercise with due care and loyalty. This relationship between the owner of the assets and the receiver, which resulted in a fiduciary duty, is arguably prescribed to the relationship between the shareholders and the company's mangers by some agency theory and shareholder primacy theory advocates arguing that managers must maximise shareholders' value because they have a fiduciary duty to them.[120]

Finally, the system is also recognised for its rigorous disclosure standards.[121] In comparison to other countries, the US has more detailed disclosure requirements than any other jurisdiction.[122] Generally, Anglo-Saxon corporations are required to disclose three types of information: annual and interim reports in specific forms, any material information, and any cross-jurisdictional disclosure requirements, if applicable.[123] Rigorous disclosure

[116] Ibid, 7

[117] Henry G Manne, 'Mergers and the Market for Corporate Control' (1965) 73 Journal of Political economy 110, 113

[118] Prowse, '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' (n 100) 46

[119] Jonathan R Macey, 'An Economic Analysis of the Various Rationales for Making Shareholders the Exclusive Beneficiaries of Corporate Fiduciary Duties' (1991) 21 Stetson Law Review 23, 23

[120] Carol Padgett, *Corporate Governance: Theory and Practice* (1st edn, Palgrave Macmillan 2012) 20

[121] Morris Mendelson, 'Economics and the Assesment of Disclosure Requirements' (1978) 1 Journal of Comparative Corporate Law and Securities Regulation 49, 49

[122] Reinier Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (2ed edn, Oxford University Press 2009) 277-285

[123] Carol A Frost and Grace Pownall, 'Accounting Disclosure Practices in the United States and the United Kingdom' (1994) 32 Journal of Accounting Research 75, 77

standards are required and justifiable under the Anglo-American model of governance since ownership is diffused among a great number of shareholders.

2.3.2 The Stakeholder Model

Despite the differences between the German and Japanese systems, they are both classified as stakeholder-orientated systems. This so because companies in both countries experience relatively considerable influence from non-shareholder constituencies.[124] The stakeholder model accommodates and promotes the following features.

First, the ownership structure is typically concentrated and arguably there is no clear separation of ownership and control. According to some empirical studies, in large German companies the ownership of the largest five shareholders account, on average, for about 79% of the total shares and 33% in Japan,[125] while in the US and UK companies account, on average, for only about 25% of the total shares.[126] Banks, inter-corporation networks, and families are typically the largest shareholders.[127] In Germany, banks are permitted to own shares in the companies to which they lend money and exercise greater influence and control over them through ownership and proxy voting on behalf of other shareholders.[128] A bank, in Germany, with holdings of deposited shares may exercise the voting rights attached to the shares according to the bank’s own discretion if no direction is given on how to vote.[129] Similarly, banks in Japan have influence over companies, but through a different mechanism. The cross-shareholding method, known as Keiretsu, provides a mechanism for banks to influence management. Most Japanese companies are grouped around a main bank and bound by ties of cross-holding where the main bank can exercise its influence through a powerful

[124] Mark J Loewenstein, ‘What Can We Learn from Foreign Systems? Stakeholder Protection in Germany and Japan’ (2002) 76 Tulane Law Review 1673, 1673

[125] Xu and Wang, ‘Ownership Structure and Corporate Governance in Chinese Stock Companies’ (n 100) 76

[126] Prowse, ‘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’ (n 100) 33-34

[127] Malek Lashgari, ‘Corporate Governance: Theory and Practice’ (2004) 5 Journal of American Academy of Business 46, 48

[128] Jeremy Edwards and Marcus Nibler, ‘Corporate Governance in Germany: The Role of Banks and Ownership Concentration’ (2000) 15 Economic Policy 238, 240

[129] Ibid, 241

ownership network.[130] Such concentration of ownership and control in both countries is perceived by some scholars as an effective monitoring and influencing system of management.[131]

Second, the stakeholder-oriented model of governance is marked by a reliance on corporate insiders as a mean for finance. Thus, it is sometimes referred to as an insider model of corporate governance or a bank-centred system of governance. In both Germany and Japan, strong commercial relationships between companies and banks as owners and creditors, simultaneously, result in long-term financial commitments that entail a dependence on banks to provide capital as well as on the enterprise to generate returns. This relationship leads to the availability of reliable external capital at a low cost and a continuity of small but fixed dividends.[132] This feature of the stakeholder-centred model of governance is considered by some scholars to be one of the main strengths of the model.[133]

Third, employees in stakeholder-oriented systems enjoy citizenship within the company. Workers and employers share mutual rights and obligations that take into account the differences in interests and capacities and disregard to some degree the unequal power of the two parties.[134] In Germany, employee citizenship is vested in the so called 'co-determination' system which entitles employees the right to information, consultation, and representation in the company's supervisory board.[135] Under the co-determination system and depending on the size of the company, employees

[130] Jean McGuire and Sandra Dow, ‘Japanese Keiretsu: Past, Present, Future’ (2009) 26 Asia Pacific journal of management 333, 334

[131] Gregory Jackson, ‘Corporate Governance in Germany and Japan: Liberalization Pressures and Responses During the 1990s’ in Kōzō Yamamura and Wolfgang Streeck (eds), *The End of Diversity? Prospects for German and Japanese Capitalism* (1st edn, Cornell University Press 2003) 282; Lashgari, ‘Corporate Governance: Theory and Practice’ (n 127) 48

[132] Gregory Jackson, ‘The Origins of Nonliberal Corporate Governance in Germany and Japan’ in Wolfgang streeck and Kōzō Yamamura (eds), *The Origins of Nonliberal Capitalism: Germany and Japan in Comparison* (1st edn, Cornell University Press 2001) 121; Hirotsugu Sakai and Hitoshi Asaoka, ‘The Japanese Corporate Governance System and Firm Performance: Toward Sustainable Growth’ (2003) Research Center for Policy and Economy Working Paper, Mitsubishi Research Institute <http://www.esri.go.jp/jp/prj/int_prj/prj-rc/macro/macro14/05mri1_t.pdf> accessed 1 April 2018, 3

[133] Sakai and Asaoka, ‘The Japanese Corporate Governance System and Firm Performance: Toward Sustainable Growth’ (n 132) 4

[134] Jackson, ‘Corporate Governance in Germany and Japan: Liberalization Pressures and Responses During the 1990s’ (n 131) 265

[135] Ibid

are given between 33% and 50% of the seats on the supervisory board where their representative can vote and counsel on the matters presented before the board.[136] In Japan, corporate citizenship is less formalised in comparison to Germany. However, employees have access to information and strong legal claims to employment security.[137] The management team is often internally promoted and enjoys a high degree of autonomy as long as the company is performing well.[138]

Finally, a company under a stakeholder-oriented model must take shareholders' interest, as well as those of all other stakeholders, into account.[139] Management teams in stakeholder systems play a mediating role between shareholders, employees, customers, and all other stakeholders' interests. In Germany, the system is explicit in that the objective of the corporation should not only be maximising shareholders' wealth.[140] Similarly, management's practices in Japan traditionally have been following pro-stakeholders' approaches and have been concerned with ensuring the most effective allocation of resources by taking into account a larger range of stakeholders.[141]

2.4 Features of Good Corporate Governance

Corporate governance practices vary significantly within and among countries in both characteristics and quality. However, organisations and academics remarkably agree, most of the time, on the general features of good corporate governance.[142] High-quality corporate governance practices positively affect long-term corporate success and stimulate economic growth. Good governance practices help companies reduce their cost to access capital and

[136] Larry Fauver and Michael E. Fuerst, 'Does Good Corporate Governance Include Employee Representation? Evidence from German Corporate Boards' (2006) 82 Journal of Financial Economics 673, 674

[137] Jackson, 'Corporate Governance in Germany and Japan: Liberalization Pressures and Responses During the 1990s' (n 131) 265

[138] Ibid, 266

[139] Andrew L Friedman and Samantha Miles, *Stakeholders: Theory and Practice* (1st edn, Oxford University Press on Demand 2006) 1

[140] Franklin Allen and Mengxin Zhao, 'The Corporate Governance Model of Japan: Shareholders are not Rulers' (2007) 36 Peking University Business Review 98, 98-101

[141] Ibid

[142] Ilir Haxhi and Hans Van Ees, 'Explaining Diversity in the Worldwide Diffusion of Codes of Good Governance' (2010) 41 Journal of International Business Studies 710, 711

reassure investors and all other stakeholders that their rights are protected. A large number of institutions and committees around the world have focused their energy on promoting good corporate governance practices and published many recommendations, principles and standards to guide legal systems and companies in developing their corporate governance practices. This section draws upon a number of widely recognised documents, such as the Cadbury Committee on the Financial Aspects of Corporate Governance (Cadbury Report), The G20/OECD Principles of Corporate Governance, the International Corporate Governance Network (ICGN) Corporate Governance Principles, the Commonwealth Association for Corporate Governance Guidelines and the King II and IV Report on Corporate Governance for South Africa. The aim of this section is to identify what the writers of these publications believe to be the features of good corporate governance practice.

2.4.1 Transparency

Transparency is one of the essential characteristics of good corporate governance practice.[143] It is often defined in the corporate literature as 'the ease with which an outsider is able to make meaningful analysis of a company's actions'. [144] A good corporate governance framework should ensure that companies' managements disclose all relevant information regarding the firm, including the financial situation, performance, ownership and governance of the company, to those concerned with them, in a timely and accurate manner.[145] The disclosed information, within the limits set by the company's competitive position, should be thorough and reflect a true picture of what is happening inside the company.[146]

The OECD recommends that companies disclose material information on at least the following: '(1) the financial and operating result of the company,

[143] The Cadbury Committee, *Report of the Committee on the Financial Aspects of Corporate Governance*, (n 9) Article 3.2; Organisation for Economic Co-operation and Development, *G20/OECD Principles of Corporate Governance* (OECD Publishing 2015), 7; Commonwealth Association for Corporate Governance, *CACG Guidelines: Principles for Corporate Governance in the Commonwealth : Towards Global Competitiveness and Economic Accountability* (Commonwealth Association for Corporate Governance 1999) 3

[144] King Committee on Corporate Governance, *King Report on Corporate Governance for South Africa 2002* (Institute of Directors in Southern Africa 2002) 12

[145] Organisation for Economic Co-operation and Development, *G20/OECD Principles of Corporate Governance* (n 143) 37

[146] The Cadbury Committee, *Report of the Committee on the Financial Aspects of Corporate Governance* (n 9) Article 4.51

(2) Company objectives and non-financial information, (3) Major share ownership, including beneficial owners, and voting rights, (4) Remuneration of members of the board and key executives, (5) Information about board members, including their qualifications, the selection process, other company directorships and whether they are regarded as independent by the board, (6) Related party transactions, (7) Foreseeable risk factors, (8) Issues regarding employees and other stakeholders, (9) Governance structures and policies, including the content of any corporate governance code or policy and the process by which it is implemented.'[147]

Disclosing such information reduces abundantly agency cost and mitigates the adverse selection problem. Equity investors in public capital markets usually know little about public companies unless they are informed. Thus, prospectus disclosures determine upon which terms, if any, equity investors wish to invest in the firm's shares.[148] Without enough information, investors are not likely to invest, and even if they do, the price at which they are willing to buy shares will be discounted because they are not well informed.[149]

2.4.2 Accountability

Another fundamental feature of good corporate governance practice is the accountability of the decision-makers in a company.[150] Accountability generally refers to 'the obligation to answer for the execution of

[147] Organisation for Economic Co-operation and Development, *G20/OECD Principles of Corporate Governance* (n 143) 38-42

[148] Kraakman and others, *The Anatomy of Corporate Law: A Comparative and Functional Approach* (n 122) 49

[149] G. Benston and others, *Following the Money: The Enron Failure and the State of Corporate Disclosure* (1st edn, Brookings Institution Press 2003) 20; Christian Leuz and Robert E. Verrecchia, 'The Economic Consequences of Increased Disclosure' (2000) 38 Journal of Accounting Research 91, 92

[150] The Cadbury Committee, *Report of the Committee on the Financial Aspects of Corporate Governance* (n 9) Article 3.2; King Committee on Corporate Governance, *King Report on Corporate Governance for South Africa 2002* (n 144) Article 18.4; Organisation for Economic Co-operation and Development, *G20/OECD Principles of Corporate Governance* (n 143) 7; International Corporate Governance Network, *ICGN Global Governance Principles* (5th edn, International Corporate Governance Network 2017) Article 1.1; Commonwealth Association for Corporate Governance, *CACG Guidelines: Principles for Corporate Governance in the Commonwealth : Towards Global Competitiveness and Economic Accountability* (n 143) 7

responsibilities'[151] and specifically, in the context of corporate governance, "accountability involves the board being constrained to provide to an accountee information about the company and the decisions made in relation to its business and affairs, and then to explain and justify those decisions and other board conduct; the accountee can put questions and make judgements and, as a result, the board might be subject to consequences".[152] Thus, according to this description of accountability, transparency is a prerequisite to accountability.[153] This accountability, unlike responsibility, cannot be delegated and differs depending on the accountee.[154] The board of directors, being the ultimate authority of the day-to-day affairs of a company, is, therefore, ultimately accountable and responsible for the performance of the company.

Good corporate governance practice must ensure that some mechanisms exist to allow for a board's accountability to shareholders, the company, or possibly all stakeholders, depending on the jurisdiction, for a variety of reasons. First, some scholars argue that since corporate directors are the agents of shareholders, they must be held accountable to them.[155] They argue that when a principal delegates tasks to his or her agent, that agent is ethically and sometimes legally bound to act in the principal's best interest. Thus, the principal has a right to verify whether the agent acted in his

[151] King Committee on Corporate Governance, *King IV Report on Corporate Governance for South Africa 2016* (Institute of Directors in Southern Africa 2016) 9

[152] Keay, *Board Accountability in Corporate Governance* (n 77) 60

[153] The relationship between transparency and accountability is viewed differently in the literature. First, some scholars give the two concepts the same meaning and refer to them in a way that they cannot meaningfully be distinguished as two different things. Second, other writers interpret the two concepts as separable but complementary, meaning that they must be combined to produce good corporate governance. Finally, a third group of writers view the two concepts as having different meanings and do not always have to be combined to produce good governance. For more on this subject see, Christopher Hood, 'Accountability and Transparency: Siamese Twins, Matching Parts, Awkward Couple?' (2010) 33 West European Politics 989

[154] King Committee on Corporate Governance, *King IV Report on Corporate Governance for South Africa 2016* (n 151) 9

[155] Mathias Koenig-Archibugi, 'Transnational Corporations and Public Accountability' (2004) 39 Government and Opposition 234, 236; Mayston David, 'Principals, Agents and the Economics of Accountability in the New Public Sector' (1993) 6 Accounting, Auditing & Accountability Journal 68, 69

or her interest and hold the agent accountable.[156] Second, accountability gives managerial power legitimacy.[157] It is generally accepted, especially in democratic societies, that a system of checks must accompany any granted authority or power and that the grantor has a legitimate right to demand accounting from the grantee to prevent any power exploitation.[158] This act of demanding accountability itself is said to be what gives legitimacy to any governance arrangement, just as divine designation once determined governmental legitimacy.[159] Third, accountability promotes the quality of decision-making.[160] When a director realises that he or she needs to explain and justify his or her decisions to an audience and then may even suffer some severe consequences if his or her actions were not satisfactory, the director will rationally make his or her decision carefully and objectively.[161] Finally, accountability produces trust.[162] It is been argued that trust is a crucial element of corporate life in which trust plays a central role in forming long-term business relationships.[163] The ability of shareholders and other stakeholders to hold management accountable should create some sort of trust that the management will act responsibly.[164]

2.4.3 Fairness

One of the most important features of any good corporate governance system is that it ensures fairness.[165] Fairness, refers to equal treatment and in a legal

[156] Barbara S. Romzek and Melvin J. Dubnick, ‘Accountability’ in Jay M. Shafritz (ed), *Defining Public Administration: Selections from the International Encyclopedia of Public Policy and Administration* (1st edn, Westview Press 2000), 393

[157] Cary Coglianese, ‘Legitimacy and Corporate Governance’ (2007) 32 Delaware Journal of Corporate Law 159, 159-162

[158] Keay, *Board Accountability in Corporate Governance* (n 77) 95

[159] Melvin J Dubnick and Kaifeng Yang, ‘The Pursuit of Accountability: Promises, Problems, and Prospects ’ in Donald C. Menzel and Harvey L. White (eds), *The State of Public Administration: Issues, Challenges, and Opportunities* (M.E. Sharpe 2011) 173

[160] Marco Moore, *Corporate Governance in the Shadow of the State* (1st edn, Hart Publishing 2013) 38

[161] John Roberts, ‘The Possibilities of Accountability’ (1991) 16 Accounting, Organizations and Society 355, 365

[162] Keay, *Board Accountability in Corporate Governance* (n 77) 82

[163] Seal Willie and Vincent-Jones Peter, ‘Accounting and Trust in the Enabling of Long-Term Relations’ (1997) 10 Accounting, Auditing & Accountability Journal 406, 407

[164] Moore, *Corporate Governance in the Shadow of the State* (n 160) 265

[165] International Corporate Governance Network, *ICGN Global Governance Principles* (n 150) 12; Organisation for Economic Co-operation and Development, *G20/OECD Principles of Corporate Governance* (n 143) 13; King

context, "is a concept of balance, of proportionality among the parties to a transaction or proceeding. It is a concept that largely has developed in connection with questions of the justice of contractual and procedural arrangements.".[166] Good corporate governance models should set out clear procedures that ensure fair dealing with every stakeholder, inside or outside the company. They must acknowledge and respect the rights of all stakeholders, balance their interests and provide equitable and reasonable treatment to them all.[167]

A good corporate governance system should have a set of mechanisms that promotes fairness. For example, to ensure the fairness of a related-party transaction, the board of directors could establish a committee of independent directors who have no interest in the transaction to review it and determine whether the terms of the transaction are fair and reasonable. They could also have the shareholders vote on such transactions during the annual general shareholders’ meeting.

Some corporate governance systems even require what is called a 'fairness opinion' to be obtained from an independent financial advisor to verify the fairness of some certain transactions.[168] The opinion, in the US, is typically delivered orally by an investment bank at the board of directors' meeting to evaluate the fairness of a proposed merger or acquisition transaction. The opinion, then, is confirmed by a letter of two or three pages stating the transactions terms and the investment bank's judgement.[169] The goal of such an opinion is to ensure that the transaction is within the range of values that the investment bank deems financially fair to a specified party.[170]

Committee on Corporate Governance, *King Report on Corporate Governance for South Africa 2002* (n 144) Article 18.6

[166] Lawrence E Mitchell, ‘Fairness and Trust in Corporate Law’ (1993) 43 Duke Law Journal 425, 426

[167] King Committee on Corporate Governance, *King IV Report on Corporate Governance for South Africa 2016* (n 151) 44

[168] Lucian Arye Bebchuk and Marcel Kahan, ‘Fairness Opinions: How Fair are They and What Can be Done about it’ (1989) 19 Duke Law Journal 27, 27; Steven M. Davidoff, Anil K. Makhija and Rajesh P. Narayanan, ‘Fairness Opinions in M&As’ in H. Kent Baker and Halil Kiymaz (eds), *The Art of Capital Restructuring: Creating Shareholder Value through Mergers and Acquisitions* (1st edn, John Wiley & Sons 2011) 484

[169] Steven M Davidoff, ‘Fairness Opinions’ (2006) 55 American University Law Review 1557, 1563-1665

[170] Ibid,1563

2.4.4 Ethics

Another fundamental feature of good corporate governance practice is that a company must base its business on ethics, moral principles and values.[171] Although this feature is similar to the previous one and overlaps with it in many circumstances, they are not identical and each one brings a unique emphasis. Ethical conduct in the corporate governance context refers to the ethical values applied to decision-making and the company's relationship with its stakeholders and with society as a whole.[172] It has been submitted that the board of directors should act ethically beyond mere legal compliance and promote ethical practices inside their organisations by: assuming responsibility for establishing an ethical culture inside the firm; setting ethical polices that encompass the internal and external affairs of the company, as well as the broader community; familiarising their employees and stakeholders with the firm's ethical standards; and both establishing an ethics committee and exercising ongoing oversight of it.[173]

Acting ethically encompasses acting responsibly with integrity and honesty to the extent of meeting the reasonable expectation of the company's stakeholders and the entire society as well.[174] For example, a company must provide a safe and non-discriminatory work environment for its employees and respect their human rights, merchandise honestly and justly with its suppliers and consumers, care about the environment and operate an environmentally-friendly business, and only deal with companies that have similar ethical standards.[175]

2.4.5 Independence

Good corporate governance practice must ensure that all decisions are made objectively without any improper influence from any conflicting parties.[176]

[171] International Corporate Governance Network, *ICGN Global Governance Principles* (n 150) 9; Organisation for Economic Co-operation and Development, *G20/OECD Principles of Corporate Governance* (n 143) 13; Commonwealth Association for Corporate Governance, *CACG Guidelines: Principles for Corporate Governance in the Commonwealth : Towards Global Competitiveness and Economic Accountability* (n 143) 17

[172] King Committee on Corporate Governance, *King IV Report on Corporate Governance for South Africa 2016* (n 151) 12

[173] Ibid, 44-45

[174] ASX Corporate Governance Council, *Corporate Governance Principles and Recommendations* (3rd edn, ASX Corporate Governance Council 2014) 19

[175] Ibid

[176] King Committee on Corporate Governance, *King Report on Corporate Governance for South Africa 2002* (n 144) Article 18.3

Thus, a set of mechanisms should be put in place to limit or even avoid any potential conflicts of interest that may exists among management, minority shareholders, block-holders, and other interested parties. Good corporate governance practices address this issue in a variety of ways. For example, corporate governance regulations could call for the formation of specialised independent committees, require a separation in the role of chief executive and the board's chairperson or mandate that the board of directors consists of a majority of independent and non-executive directors.[177]

In the corporate governance literature, independence is often considered important in many contexts and vital in three appointed posts. First, external auditors must be independent, competent and qualified auditors. Their main role is to verify for the shareholders and the board or supervisory board that the financial statements represent the real financial position of the firm. Thus, it is crucial that the auditors are independent from the company's management to be able to give an objective statement that reassures all interested parties. Second, internal auditors should also be independent of the colleagues they are auditing.[178] In addition to their many roles, the internal auditors are widely perceived as the eyes and ears of the board of directors or the supervisory board who provide them with assurance regarding the use of the company's assets, the quality of management reporting, and the management's compliance with relevant laws and regulations.[179] Such roles require absolute independence in order to achieve impartial judgments. Finally, the board of directors should be composed of a majority of independent non-executive directors. The objectivity and independence of the board of directors from management is essential to enable the board to exercise its duties of monitoring managerial performance. Independent board members often offer unfettered judgements of management and the performance of the firm and contribute meaningfully to the board's decision-making process.[180]

[177] Organisation for Economic Co-operation and Development, *G20/OECD Principles of Corporate Governance* (n 143) 50-53

[178] Shir Li Ng and Dennis W Taylor, 'Resourcing the Internal Audit Function: How Effective is the Audit Committee?' (2017) 9 Asian Journal of Finance & Accounting 161, 163

[179] Audrey A Gramling and others, 'The Role of the Internal Audit Function in Corporate Governance: A Synthesis of the Extant Internal Auditing Literature and Directions for Future Research' (2004) 23 Journal of Accounting Literature 194

[180] Organisation for Economic Co-operation and Development, *G20/OECD Principles of Corporate Governance* (n 143) 52

2.4.6 Balance of Powers

A good corporate system should ensure that no single person or block of persons has unlimited power over the public company.[181] Powers should be appropriately balanced among shareholders, management and the board of directors. The board should allow every one of its members to exercise their duties free from any improper pressure, comprise a balance of executive and non-executive directors, give equal consideration to the interests of dominant and minority shareholders, allow an independent director to seek independent professional advice in technical matters, assign the role of chief executive and board's chairperson to different people, etc. Following such techniques should ensure that no single individual or block of individuals dominates the company's decision-making.

2.5 Conclusion

The aim of this chapter was to give some background on corporate governance to enable a response to one of the research questions which investigates the relationship between capitalism and corporate governance. Answering such a question without first identifying what is corporate governance would certainly be injudicious. Thus, this chapter began by looking for an answer to the question: what is corporate governance? A number of descriptions by various scholars and institutions were detailed and a working definition was given.

However, since the term is ambiguous and definitions cannot fully explain the complexity of corporate governance structures, a section explaining the theories and reasoning of corporate governance was provided to both offer a clearer understanding of corporate governance and aid in answering the abovementioned thesis's research question.

Then, a section describing corporate governance models was provided for the same purpose and to help in answering the second part of the thesis's second research question which investigates the effect of the potential relationship between corporate governance and capitalism on the legal

[181] Commonwealth Association for Corporate Governance, *CACG Guidelines: Principles for Corporate Governance in the Commonwealth : Towards Global Competitiveness and Economic Accountability* (n 143) 7; King Committee on Corporate Governance, *King Report on Corporate Governance for South Africa 2002* (n 144) Article 41; Organisation for Economic Co-operation and Development, *G20/OECD Principles of Corporate Governance* (n 143) 9

transplantation of corporate governance practices. Moreover, the description of corporate governance main models was also intended to set the scene for the next chapter as it is not feasible to know the possibility, frequency or extent of the convergence among corporate governance models without first identifying them.

Finally, this chapter concluded with an enumeration of certain features of the best corporate governance practices to help to fulfil the general aim of this chapter.

Chapter 3
Globalisation and the Convergence of Corporate Governance Systems

Globalisation is a term that has been defined in a variety of ways.[1] However, providing a definition for it is not within the scope of this chapter. For our purposes, it will suffice to point out only that the current advances in transportation and telecommunication aided by the rapid growth in international trade and investments are integrating human societies culturally, economically and perhaps, legally. In a world characterised by growing economic and culture interdependencies, it is often argued whether it is possible that law—including corporate governance rules—can remain constrained within the borders of the nation state.[2] Arguably, globalisation has been encouraging ever increasing trans-nationalising tendencies in the legal domain and in the field of corporate governance.[3]

Thus, this chapter aims to provide a comprehensive review of the literature on the issue of the globalisation of corporate governance to explore the possibility of a convergence between corporate governance models and the extent of such a convergence. Knowing the current state of convergence helps in structuring the entire thesis and enable a more accurate analysis of the central issue identified in the thesis. If corporate governance systems are found to be converging, then all the cultural, legal, and political critiques of legal transplantation in the literature would be irrelevant. In this case, this thesis would only focus on providing an explanatory analysis of this result and to the role that capitalism has to play within this context. If however, the convergence of corporate governance systems are found to be limited or not occurring at all, then this thesis is able to proceed to evaluate, in the coming chapters, cultural, legal, and political factors and whether they are the

[1] For more see, Nayef RF Al-Rodhan and Gérard Stoudmann, 'Definitions of Globalization: A Comprehensive Overview and a Proposed Definition' in Nayef RF Al-Rodhan and Gérard Stoudmann (eds), *Pillars of Globalization* (The English edn, Slatkine 2006)

[2] James A Fanto, 'The Role of Corporate Law in French Corporate Governance' (1988) 31 Cornell International Law Journal 31, 33-35

[3] Brian R Cheffins, 'Current Trends in Corporate Governance: Going from London to Milan via Toronto' (1999) 10 Duke Journal of Comparative & International Law 5, 5-6

exhaustive aspects of legal transplantation. It will also, introduce capitalism as a potential novel approach to the issue.

This chapter will be divided into two main sections. The first section will review the theoretical work on corporate governance convergence. It will include an analytical survey of both sides of the debate on the propriety and extent of the convergence and the reasons for the existing diversity of corporate governance practices. The second section will investigate the empirical work on the subject in order to reveal the current status of corporate governance convergence in four countries, US, UK, Germany, and Japan which are the leaders in corporate governance developments.

3.1 Overview of the Theoretical Debate on Convergence

One of the main contemporary theoretical and policy debates in corporate governance is the debate about convergence. Whether there is a global convergence in the field and the extent of this possible convergence are questions subject to ongoing discussions among legal scholars. While some scholars advocate the convergence theory, predicting harmonization in corporate governance practices across nations, others disagree asserting that formal and sometimes functional convergence faces too many obstacles to be predicted.

3.1.1 Advocacy of Global Convergence in Corporate Governance

Authors in support of the globalisation theory in corporate governance may disagree on the extent of the current and expected level of convergence, but they agree that some form of convergence is happening and many think that it is happening for the following reasons.

First, some advocates of the globalisation theory argue that countries around the world have already achieved a high degree of convergence regarding the basic corporate form, hence, corporate governance models are likely to continue to converge.[4] They explain that despite the apparent divergence in current corporate governance models, the convergence on the basic corporate form itself is evidence of the ongoing process of convergence.[5] By the end of the twentieth century, almost all nations have already adopted the same basic corporate form, which constitutes a large part

[4] Henry Hansmann and Reinier Kraakman, ‘The End of History for Corporate Law’ (2000-2001) 89 Georgetown Law Journal 439, 439

[5] Ibid

of any corporate governance model. In particular, the following characterizes most, if not all, corporate governance systems: (1) full legal personality for the company, (2) limited liability for owners and managers, (3) shared ownership by investors of capital, (4) delegated management under a board structure, and (5) transferable shares.[6] Moreover, another example of achieved convergence is the continuous international harmonization of disclosure rules. Empirical evidence shows that the 75 largest companies in the world, located in 10 different countries, have already implemented similar disclosure rules regarding governance matters.[7]

Second, corporate governance rules and practices will come to a convergence because they will not be able to withstand the forces of globalisation.[8] The advances in transportation and telecommunication infrastructure have been integrating societies in many aspects even in areas previously seen as statist such as constitutional or administrative law.[9] Therefore, one can conclude that just like the economy and other aspects of life corporate governance is destined to converge.[10]

Third, one of the drivers of convergence in corporate governance is said to be the diffusion of good corporate governance codes,[11] which are usually a set of optional norms which have a focus on the behaviour and structure of the board of directors.[12] They attempt to improve overall company's corporate governance and represent what the developer of the codes believe to be the best practice in corporate governance. When such codes are published by a an organisation or a country, it creates pressure on all companies that are regulated by the organization or resident in that country and subject to its jurisdiction to comply, which in turn leads towards a convergence within the relevant jurisdiction. Likewise, the issuing of similar

[6] Ibid, 439-440

[7] Garen Markarian, Antonio Parbonetti and Gary John Previts, ‘The Convergence of Disclosure and Governance Practices in the World’s Largest Firms’ (2007) 15 Corporate Governance: An International Review 294, 294

[8] Klaus Gugler, Dennis C Mueller and B Burcin Yurtoglu, ‘Corporate Governance and Globalization’ (2004) 20 Oxford Review of Economic Policy 129, 148-149

[9] See for example, Martin Loughlin and Petra Dobner, *The Twilight of Constitutionalism?* (Oxford University Press New York 2010)

[10] Fanto, ‘The Role of Corporate Law in French Corporate Governance’ (n 2) 33

[11] Paul Collier and Mahbub Zaman, ‘Convergence in European Corporate Governance: The Audit Committee Concept’ (2005) 13 Corporate Governance: An International Review 753, 754-755

[12] Ruth V. Aguilera and Alvaro Cuervo-Cazurra, ‘Codes of Good Governance Worldwide: What is the Trigger?’ (2004) 25 Organization Studies 415, 417-418

codes by many countries could lead to a convergence among them.[13] For example, the OECD reports that 84% of its member countries have changed their corporate governance codes following its last issuance of the OECD Corporate Governance Principles in 2015, implying that they have influenced these codes.[14]

Fourth, countries around the world are competing against each other to bring more international investments to their markets. This robust competition is being matched by another robust competition in corporate governance models.[15] Countries are continuously amending their corporate governance rules and implementing what is regarded as the best practices from around the world to develop their respective corporate governance systems and to tempt more domestic and international investors to invest in their capital markets. This common movement toward one goal suggests prospective integration in corporate governance models.[16]

In other words, companies around the world face vary similar governance problems. All firms must gather capital, select and discipline managers and provide information to decision-makers. However, in our competitive global village, only firms that perform these tasks most efficiently will succeed, while the firms that do not adopt the best practices will run the risk of falling behind. Therefore, countries that fail to incorporate the most efficient rules will impose higher costs on their companies.[17] As a result, countries, arguably, are expected to converge on one single efficient form.[18]

3.1.1.1 Convergence on What?

As we have seen above, proponents of convergence agree that there are increasing tendencies toward homogeneity in corporate governance practices. However, they do not agree on the outcome of the convergence. The main

[13] Toru Yoshikawa and Abdul A Rasheed, ‘Convergence of Corporate Governance: Critical Review and Future Directions’ (2009) 17 Corporate Governance: An International Review 388, 391-392

[14] Organisation for Economic Co-operation and Development, *OECD Corporate Governance Factbook 2019* (1st edn, OECD 2019), 29

[15] Lawrence A Cunningham, ‘Commonalities and Prescriptions in the Vertical Dimension of Global Corporate Governance’ (1998) 84 Cornell Law Review 1133, 1146

[16] Ibid

[17] Lucian Arye Bebchuk and Mark J Roe, ‘A Theory of Path Dependence in Corporate Ownership and Governance’ (1999) Stanford Law Review 127, 134-135

[18] Ibid

line of argument adopted by most of them revolves around efficiency. They believe that corporate governance will converge on a single efficient form, but differ on the form on which systems would converge. Some of them assert that corporate governance models around the world will converge, or even have already to some degree converged, on the American shareholder-centred system,[19] while others submit that it will converge on a hybrid model combining features from both the shareholder and stakeholder models.[20] Finally, a third group of convergence advocates argues that the practice of corporate governance will converge on the, as yet unknown, best and most efficient model, which will eventually prevail over time.[21]

3.1.1.1.1 Convergence on the Shareholder-Centred Model

The first group of proponents believes that globalisation will cause corporate governance practices to converge on the 'efficient' American model,[22] which is characterised by dispersed ownership, rigorous disclosure standards, high market transparency, and a well-developed capital market.[23] They believe that converging on the American shareholder-centred model will result in three principal efficiency gains: (1) Substantial reduction in transaction costs and greater access to capital markets worldwide for issuers due to the implementation of the U.S. disclosure standards; (2) Reduced agency costs due to the greater legal control, in the American model, on the powers of controlling shareholders and insider traders; (3) Increased chances for issuers to undertake longer-term and higher risk investments, which usually generate economic growth.[24]

This group of proponents argue that the Anglo-American model will be widely adopted by countries, or even by foreign corporations at the firm-

[19] A classic example, Hansmann and Kraakman, 'The End of History for Corporate Law' (n 4) 455

[20] Mauro F Guillén, 'Corporate Governance and Globalization: Is There Convergence Across Countries?' in Thomas Clarke (ed), *Theories of Corporate Covernance: The Philosophical Foundations of Corporate Governance* (Routledge 2000), 225

[21] See, ibid

[22] See for example, Dariusz Wójcik, 'Convergence in Corporate Governance: Evidence from Europe and the Challenge for Economic Geography' (2006) 6 Journal of Economic Geography 639, 654

[23] John C Coffee, 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' (2001) 111 Yale Law Journal 1, 3

[24] John C Coffee Jr, 'Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications' (1988) 93 Northwestern University Law Review 641, 705

level.[25] They explain that this is so because, first, it is superior to all other models. According to Hansmann and Kraakman, there are three potential alternatives to the American model, which are the manager-oriented, the labour-oriented, and the state-oriented models of corporate law. Despite the fact that each one of them has some merit, it is argued that they have all lost much of their normative appeal.[26] Second, the forces of competition will compel corporate governance practices around the world to shift toward the American model. The recent increase in competition among countries in developing their local corporate laws – driven by a higher competition in trade and finance – will pressure them to incorporate the American model since it is, arguably, proven to be superior in practice and in the academic legal literature.[27] Finally, the rapid expansion in share-ownership among the public, coupled with a growing number of powerful institutional investors around the world, will create a new class of interest group that will push towards legal reforms favouring shareholders. Hence, countries will be under pressure to implement the Anglo-American shareholder-centred model.[28]

3.1.1.1.2 Convergence on a Hybrid Model

The second group of proponents believes that globalisation will cause corporate governance practices to converge into a hybrid model, combining the advantages of the shareholder-centred and stakeholder-centred models, the Anglo-Saxon and German-Japanese governance models.[29] This group of advocates, intrigued by the rapid economic growth of Germany and Japan in the second half of the 20th century and the Anglo-American corporate governance system, believes that the governance practices in Germany and Japan constitute efficient features that will be adopted across countries as well as some elements from the Anglo-Saxon model.[30]

[25] Gerald F Davis and Christopher Marquis, ‘The Globalization of Stock Markets and Convergence in Corporate Governance’ [2005] Economic Sociology of Capitalism 352, 352

[26] Hansmann and Kraakman, ‘The End of History for Corporate Law’ (n 4) 443-444

[27] Ibid, 449-451

[28] Ibid, 451-453

[29] See for example, Palka Chhillar and Ramana Venkata Lellapalli, ‘Divergence or Convergence: Paradoxes in Corporate Governance?’ (2015) 15 Corporate Governance 693, 701 and 702; Andy Mullineux, ‘Financial Sector Convergence and Corporate Governance’ (2007) 15 Journal of Financial Regulation and Compliance 8, 8

[30] Guillén, ‘Corporate Governance and Globalization: Is There Convergence Across Countries?’ (n 20) 225

This group of proponents base their argument on the concept that there is no single optimal model in all respects. They believe that induced by globalisation, countries and companies, will be forced to shop around for the best governance features from the two most efficient models to remain competitive, the Anglo-Saxon and the German-Japanese models.[31]

3.1.1.1.3 Convergence on an Undefined Model

Finally, another group of advocates asserts that the practice of corporate governance will converge into the, as yet unknown, best and most efficient model, which will eventually prevail over time.[32] They believe that there is no ultimate optimal model of corporate governance and that every single system has its own flaws and deficits as well as advantages and efficiencies. Countries will rationally adopt the best features of each system, which will consequently lead to a global convergence.[33]

This group of proponents believe that the harmonisation between corporate governance models occurs through a process referred to as 'cross-vergence', where the influence originates from two or more sources and results in an outcome different from the original influential sources,[34] therefore, creating the "yet unknown" model. In particular, this theory assumes that over time the corporate governance systems will come closer to each other by a way of cross adoptions of the best practices not only from US and Germany but also from all other countries around the world.[35] In this school of thought, the starting point of the new system does not matter.

[31] Organisation for Economic Co-operation and Development, *Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets: A Report to the OECD by the Business Sector Advisory Group on Corporate Governance* (OECD Publishing 1998) 19-20

[32] Guillén, 'Corporate Governance and Globalization: Is There Convergence Across Countries?' (n 20) 225

[33] See for example, Vipin Gupta and Jifu Wang, 'The Transvergence Proposition Under Globalization: Looking Beyond Convergence, Divergence and Crossvergence' (2004) 12 Multinational Business Review 37, 39-42; Julian Chang Alon, Christoph Lattemann, John R. McIntyre, Ilan Wenxian Zhang and Christoph Lattemann, 'On the Convergence of Corporate Governance Practices in Emerging Markets' (2014) 9 International Journal of Emerging Markets 316, 316

[34] David A Ralston, 'The Crossvergence Perspective: Reflections and Projections' (2008) 39 Journal of International Business Studies 27, 29

[35] Guillén, 'Corporate Governance and Globalization: Is There Convergence Across Countries?' (n 20) 225

Therefore, the outcome of the cross-vergence should be one and located between the two original influential sources.[36]

3.1.1.2 Methods of Convergence

Advocates of the convergence theory anticipate that convergence will happen through one or more of the following methods or mechanisms: (1) formal convergence or a convergence of legal forms, when a country borrows another country's rules or institutions;[37] (2) functional convergence, when a country's public institutions change their practices according to new circumstances without making any formal alterations;[38] and (3) contractual convergence, when a company voluntarily changes its governance practices without any formal or functional convergence.[39] However, before proceeding with identifying the methods, it is notable that many authors who predict convergence do not specify the method that will achieve it.

3.1.1.2.1 Formal Convergence (Convergence of Rules and Forms)

Most of the work on the globalisation of corporate governance explicitly or implicitly predicts that a convergence will occur through direct legal transplantation, where rules and institutional forms are moved across borders from one country to another.[40] Indeed, some scholars even believe that legal transplantation is the principal means to achieve any legal reforms.[41] Others even see a robust competition among countries to directly borrow the best practices from around the world for their own systems.[42]

The extreme advocates of legal transplantation assert that legal rules, concepts, and systems can be easily transplanted into very different societies.[43] This is so because they perceive legal rules as abstract entities,

[36] David A Ralston and others, ‘Differences in Managerial Values: A Study of US, Hong Kong and PRC Managers’ (1993) 24 Journal of International Business Studies 249, 258

[37] Alan Watson, *Legal transplants: An approach to comparative law* (2nd edn, University of Georgia Press 1974), 21

[38] Ronald J Gilson, ‘Globalizing Corporate Governance: Convergence of Form or Function’ (2001) 49 American Journal of Comparative Law 329, 237

[39] Ibid, 346

[40] Alan Watson, *Legal Transplants: An Approach to Comparative Law* (2nd edn, The University of Georgia Press 1993) 21

[41] Roger Cotterrell, ‘Is there a Logic of Legal Transplants?’ in David Nelken and Johannes Feest (eds), *Adapting Legal Cultures* (Hart Publishing 2001) 71-72

[42] Cunningham, ‘Commonalities and Prescriptions in the Vertical Dimension of Global Corporate Governance’ (n 15) 1146

[43] Alan Watson, *Law Out of Context* (1st edn, University of Georgia Press 2000) 1

arguing that social needs do not necessarily, or even often, bring about legal development and that laws that serve no apparent social needs survive for generations and sometimes centuries. Moreover, they assert that the mechanisms of legal change are largely controlled 'internally' within legal systems by legal professional elites such as makers of codes or drafters of legislation, not the entire society.[44] Therefore, cultural differences between societies play no role in the success or failure of legal borrowing.[45]

3.1.1.2.2 Functional Convergence

A second method of convergence is functional convergence, where the existing governance institutions are flexible enough to change their practices without changing their formal regulations.[46] In this form of convergence, the harmonisation of governance practices across countries occurs at the public institution level without any interference in performing the actual change from legislative bodies or corporations.[47]

Proponents of this method of convergence believe that formal convergence is unlikely and unforeseeable.[48] They believe that every system is path dependent, where changes to current governance practices are shaped by political views and historical events.[49] They also anticipate that interest groups organised around existing institutions can block any changes that affect their institutions. In addition, changing the form of an institution in order to enhance its own efficiency could result in a reduction in overall productivity because the new form may not be complementary to the other existing institutions.[50] Surprisingly, this group also believes that globalisation forces, such as financial and goods competition, technological and transportation advancements and international institutional investment movements will pressure diverse jurisdictions toward global convergence.[51] They consider the above barriers to convergence as only preventing formal

[44] Cotterrell, 'Is there a Logic of Legal Transplants?' (n 41) 72

[45] Ibid

[46] Gilson, 'Globalizing Corporate Governance: Convergence of Form or Function' (n 38) 338

[47] Ibid, 337

[48] Coffee Jr, 'Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications' (n 24) 679

[49] Reinhard H Schmidt and Gerald Spindler, 'Path Dependence, Corporate Governance and Complementarity' (2002) 5 International Finance 311, 313

[50] Gilson, 'Globalizing Corporate Governance: Convergence of Form or Function' (n 38) 339

[51] Coffee Jr, 'Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications' (n 24) 680-682

convergence. In their view, the institutions that have sufficient flexibility will find solutions within the limits of those barriers. Therefore, functional convergence comes first, and formal convergence only appears as a last resort.[52]

For example, functional convergence responds to the path dependency barrier with "powerful environmental selection mechanisms".[53] If an institution affected by path dependency cannot function effectively in comparison with its competitors, it will not survive. Therefore, the initial conditions that affect the institution grinds against demands of new circumstances, resulting in a functional solution.[54] Equivalently, functional convergence deals with interest groups and complementarity systems challenges in a way that does not trigger the interest groups nor does it require costly alterations.[55]

According to Professor Ronald Gilson, functional convergence is also supported by empirical research.[56] Gilson has hypothesised that reaching the same level of functionality in response to the same problem despite apparent different legal and institutional characteristics is evidence of functional convergence. He reviewed some empirical work on replacing poorly performing senior managers in Germany, Japan and the US.[57] He found that in all the reviewed studies, the three countries had equally the same sensitivity to poor performance. Therefore, he concluded, based only on this

[52] Gilson, ‘Globalizing Corporate Governance: Convergence of Form or Function’ (n 38) 336

[53] Ronald J Gilson, ‘Corporate Governance and Economic Efficiency: When Do Institutions Matter’ (1996) 74 Washington University Law Review 327, 332

[54] Ibid, 332-333

[55] Gilson, ‘Globalizing Corporate Governance: Convergence of Form or Function’ (n 38) 339

[56] See ibid, 337; Marc Goergen, Miguel C Manjon and Luc Renneboog, ‘Is the German System of Corporate Governance Converging Towards the Anglo-American Model?’ (2008) 12 Journal of Management & Governance 37, 37

[57] The reviewed work, Steven N Kaplan, ‘Top Executive Rewards and Firm Performance: A Comparison of Japan and the United States’ (1994) 102 Journal of Political Economy 510; Jun-Koo Kang and Anil Shivdasani, ‘Firm Performance, Corporate Governance, and Top Executive Turnover in Japan’ (1995) 38 Journal of Financial Economics 29; Steven N Kaplan, ‘Top Executives, Turnover and Firm Performance in Germany’ (1994) 10 Journal of Law, Economics, & Organization 142; Steven N Kaplan and Bernadette A Minton, ‘Appointments of Outsiders to Japanese Boards: Determinants and Implications for Managers’ (1994) 36 Journal of Financial Economics 225

evidence, that functional convergence is occurring and is far more feasible than formal convergence.[58]

3.1.1.2.3 Contractual Convergence

Another method of convergence is contractual convergence. When political and social barriers, among other factors, restrict formal responses to changing economic circumstances and when existing governance institutions lack the flexibility to respond without formal change, convergence takes the form of a contract. In this form of convergence, the harmonisation of governance practices occurs at the firm level without any interference in performing the actual change from legislative bodies or any other institutions.[59]

Proponents of this type of convergence share the view that functional convergence is far more feasible than formal convergence; however, they believe that both formal and functional convergence have failed to effectively respond to the demands of global competition many times. For instance, the existence of the venture capital industry is much stronger in stock-orientated markets, the Anglo-Saxon markets, than in bank-centred markets of Germany and Japan.[60] Because an active venture market is considered critical in encouraging innovation, Germany and Japan will rationally seek to improve the venture capital industry in their countries; however, their failure to develop a comparable venture capital market demonstrates, it is argued, the failure of both functional and formal convergence.[61] Therefore, this leaves their companies and entrepreneurs with no choice other than to seek a solution in one of the contractual convergence options. In particular, contractual convergence theorists offer two examples of such options: the security design form and the stock exchange listing. Nevertheless, contractual convergence is

[58] Gilson, 'Globalizing Corporate Governance: Convergence of Form or Function' (n 38) 337-338

[59] Ibid, 346

[60] See Ronald J Gilson and Bernard S Black, 'Venture Capital and the Structure of Capital Markets: Banks Versus Stock Markets' (1998) 47 Journal of Financial Economics 243, 274; Curtis J Milhaupt, 'The Market for Innovation in the United States and Japan: Venture Capital and the Comparative Corporate Governance Debate' (1997) 91 Northwestern University Law Review 865, 866; Leslie A Jeng and Philippe C Wells, 'The Determinants of Venture Capital Funding: Evidence Across Countries' (2000) 6 Journal of Corporate Finance 241, 242

[61] Gilson, 'Globalizing Corporate Governance: Convergence of Form or Function' (n 38) 342

not only sought as a last resort, this type of convergence is more flexible than the others and has the ability to evade all barriers to convergence.[62]

The first type of contractual convergence is convergence through a security design.[63] In this form of convergence, two or more parties design a contract that fits their needs and circumvents unfavourable regulations and practices. For example, a US venture capitalist who wants to invest in a European project could invest through a private equity limited partnership to avoid the familiar host of agency problems resulting from unequal voting regimes. This is so because any standard private equity limited partnership has two important features. The first is a fixed life, after which the partnership must be liquidated and its assets returned to investors. This feature balances the general partner's need for discretion and the investor's need for a mechanism of accountability, provides a method to measure the general partner's performance and holds the general partner accountable for the partnership performance. The second feature is that in a standard private equity limited partnership, the general partner is required to distribute any proceeds of investment that become liquid, which is a requirement that mitigates any potential free cash flow problems.[64] In this example, the high cost of formal convergence is avoided and the desired level of accountability to investors is achieved at a level that matches the level of accountability in the Anglo-American market.

The second type of convergence is convergence through stock exchange listing.[65] In this type of convergence, a foreign company voluntarily holds itself to higher governance standards by listing its shares on a sophisticated stock market, such as the US security exchange markets.[66] The listing contract, which the foreign company signs, provides that the company is to be listed on one of the US security exchange markets, and imposes on it a set of governance obligations including, a minimum number of independent

[62] See Coffee Jr, 'Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications' (n 24) 650 ; Gilson, 'Globalizing Corporate Governance: Convergence of Form or Function' (n 38) 346

[63] Gilson, 'Globalizing Corporate Governance: Convergence of Form or Function' (n 38) 346

[64] Ibid, 346-349

[65] Coffee Jr, 'Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications' (n 24) 650

[66] John C Coffee Jr, 'Racing Towards the Top?: The Impact of Cross-Listings and Stock Market Competition on International Corporate Governance' (2002) 102 Columbia Law Review 1757, 1757

directors, an audit committee and an equal opportunity rule with respect to tender offers.[67] Moreover, US security laws will also become applicable to it once it lists its shares on a US exchange, which has many corporate governance implications.[68]

3.1.2 The Divergence Theory

Opponents of the convergence theory share with its proponents the belief that globalisation is a revolution of telecommunication and transportation, but their expectations differ. While the proponents of the convergence theory view globalisation as a 'bulldozer' that will eventually eliminate the differences in corporate governance practices between countries, opponents of the theory expect globalisation to have very little effect on corporate governance systems.[69] Some of them even believe that globalisation will cause corporate governance models to diverge.[70] They argue that corporate governance models will not converge for the following reasons.

First, they argue that the advocates of the convergence theory mistakenly assume that corporate governance practices across nations will converge on one efficient model, which in reality is inconceivable for two reasons: First, the efficiency of any system is arguable.[71] For example, scholars have been arguing the efficiency of each kind of ownership structure since Berle and Means without reaching any consensus. For many of them, the concentrated ownership structure aggravates the asymmetric information problem and promotes self-dealing and insider trading, while for others it yields better monitoring of management because large block-holders will rationally be willing to incur greater costs in order to monitor management

[67] Gilson, ‘Globalizing Corporate Governance: Convergence of Form or Function’ (n 38) 349

[68] Coffee Jr, ‘Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications’ (n 24) 705

[69] Douglas M. Branson, ‘The Very Uncertain Prospects of Global Convergence in Corporate Governacne’ in Thomas Clarke (ed), *Theories of Corporate Governance: The Phiosophical Foundations of Corporate Governance* (Routledge 2001) 260-261

[70] Mauro F Guillén, ‘Corporate Governance and Globalization: Arguments and Evidence Against Convergence’ (1999) University of Pennsylvania Working Paper No S99 <http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.556.8556&rep=rep1&type=pdf> accessed 15 Sep 2017, 15

[71] Curtis J Milhaupt, ‘Property Rights in Firms’ (1998) 84 Virginia Law Review 1145, 1189

when compared with small shareholders.[72] The point is that scholars vary in their opinions about the best system or even the best features of a system, and if there is no one best model, it is impossible to know on what the systems could converge. Second, what is efficient in one country may not be efficient in another.[73] For instance, having outsider directors on board is often considered an efficient practice in the U.S. However, when other competitive firms are using their boards to team up personnel with close ties to the government, a common practice in Asia, focussing on employing independent directors may be a counterproductive strategy.[74]

The second reason for the position that corporate governance models will not converge is that even when scholars agree that a particular governance structure is efficient, it is not necessarily going to be implemented. Groups affected by the proposed reforms will not permit any change that is not in their best interests.[75] Historically, political coalitions have opposed corporate governance reforms only because it was not for their own political interests. For instance, in the 1950s, West German politicians and labour leaders rejected the direct implementation of the American model. They were clearly not happy with replacing their traditional ways of doing and organizing businesses by a foreign model that they believed to be a dangerous threat to their own positions.[76]

Resistance and opposition to new efficient practices of corporate governance does not necessarily come from groups outside companies; often rejection comes from within. In many cases when firms possess the decision to incorporate the best practices, they face resistance from people inside the company when such reforms do not serve their interests.[77]

[72] William W Bratton and Joseph A McCahery, ‘Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross Reference’ (1999) 38 Colum J Transnat'l L 213, 213-214

[73] Coffee Jr, ‘Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications’ (n 24) 659

[74] Ibid

[75] Guillén, ‘Corporate Governance and Globalization: Arguments and Evidence Against Convergence’ (n 70) 2

[76] Marie-Laure Djelic, *Exporting the American Model: The Post-War Transformation of European Business* (1st edn, Oxford University Press on Demand 2001) 21

[77] Coffee Jr, ‘Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications’ (n 24) 655

The third reason is that convergence will be challenged by existing complementarities among rules and institutions.[78] Scholars often identify a system as complementarity when it constitutes two elements or more with an interchangeable reciprocal relationship whereby one thing supplements or depends on the other.[79] Therefore, changes to any element affects the entire complementarity system. To illustrate, consider a country that has the most reputable and excellent corporate governance practices. This excellence of its governance practices cannot exist only based on the superiority of its corporate governance code or its corporate law. It is often the result of a system of complementary legal rules such as banking, labour, tax, and competition laws.[80] Thus, individually transplanting corporate governance rules will not necessarily improve the governance practices of the borrowing country and may even render the complete corporate system deficient because the new rules are not complementary to the other rules.[81] Moreover, simultaneously importing corporate governance rules as well as those relating to banking, labour, tax, competition and all other related laws together is exceedingly difficult, if not impossible.[82] This is so because adopting one foreign corporate governance rule might necessitate unlimited series of changes initiating an unstoppable chain reaction. Similarly, changing the form of an institution to enhance its performance will lead to the same challenge of system complementarities.[83]

Fourth, the impact of path dependency on corporate governance practices will prevent any potential convergence in the field. The very essence of the path dependence theory is that the initial starting point of any system matters.[84] For example, the pattern of the ownership structure that a country

[78] Abdul A. Yoshikawa Toru Rasheed, *The Convergence of Corporate Governance: Promise and Prospects* (1st edn, Palgrave Macmillan 2012) 13

[79] Wei Liu, Hideyuki Tanaka and Kanta Matsuura, 'Empirical-Analysis Methodology for Information-Security Investment and Its Application to Reliable Survey of Japanese Firms' (2008) 3 Information and Media Technologies 464, 586

[80] Guillén, 'Corporate Governance and Globalization: Arguments and Evidence Against Convergence' (n 70) 10-11

[81] Tarun Khanna, Joe Kogan and Krishna Palepu, 'Globalization and Similarities in Corporate Governance: A Cross-Country Analysis' (2006) 88 Review of Economics and Statistics 69, 71

[82] Guillén, 'Corporate Governance and Globalization: Arguments and Evidence Against Convergence' (n 70) 10-11

[83] Ibid

[84] Georg Schreyögg, Jörg Sydow and Philip Holtmann, 'How History Matters in Organisations: The Case of Path Dependence' (2011) 6 Management & Organizational History 81, 82

has at any point in time will affect the ownership pattern it will have in the future. Even when two countries converge on quite similar economies and legal rules, the differences they had previously in ownership structure are likely to persist due to their path of dependence.[85] Another classical example is the current relatively weak role of financial institutions in the US, which is viewed as an unequivocal case for path dependency. The American public's mistrust of large concentrated financial powers since the eighteenth century has persisted to shape the current status of the US financial institutions today.[86] Scholars offer two explanations for this path persistence. They postulate that corporate governance practices result in path dependence, either owing to the presence of complementarity,[87] as discussed previously, or to unaffordable switching costs.[88] When the cost of switching to a more efficient system is identified as higher than the potential gains that will resulting from the change, the rational approach of a given society is to retain the inefficient system.

Finally, unlike proponents of convergence, opponents believe that global competition over marketing and financing will induce corporate governance practices to diverge.[89] They believe that globalisation is not about converging to the best practice, but rather about leveraging differences.[90] They argue that, first, successful competition does not necessarily require a change in corporate governance practices because higher levels of efficiency in production and financing is not only related to corporate governance systems but also to other institutional features, and in many cases such efficiency is achieved without shifting from one corporate governance model to another.[91] Second, every country is equipped with different sets of

[85] Bebchuk and Roe, ‘A Theory of Path Dependence in Corporate Ownership and Governance’ (n 17) 129 and 130-131

[86] Mark J Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (Princeton University Press 1996) 46

[87] Schmidt and Spindler, ‘Path Dependence, Corporate Governance and Complementarity’ (n 49) 318

[88] Mark J Roe, ‘Chaos and Evolution in Law and Economics’ (1996) 109 Harvard Law Review 641, 643

[89] Guillén, ‘Corporate Governance and Globalization: Arguments and Evidence Against Convergence’ (n 70) 15

[90] Mauro F Guillén, *The Limits of Convergence: Globalization and Organizational Change in Argentina, South Korea and Spain* (1st edn, Princeton University Press 2001) 3; Heather Berry, Mauro F Guillén and Arun S Hendi, ‘Is There Convergence Across Countries? A Spatial Approach’ (2014) 45 Journal of international business studies 387, 388

[91] Guillén, ‘Corporate Governance and Globalization: Arguments and Evidence Against Convergence’ (n 70) 23

institutions that enable them to do different things, and every country will support what its firms can do best to survive in an increasingly borderless world.[92] Hence, German, French, Japanese, and American corporations are equally notable for their competitive edge despite the many differences in their companies' corporate governance practices.[93]

3.1.3 The Reasons for Corporate Governance Diversity

Every country has its own unique corporate governance system. Chapter 2 provides descriptions of the American, British, German, and Japanese corporate governance systems grouped under two models: the shareholder model and the stakeholder model. This section will review the literature on the causes of this diversity among national corporate governance systems.

3.1.3.1 The Cultural Explanation

Many scholars and practitioners have attributed the differences in corporate governance models to cultural diversity.[94] However, only a few of these people have developed a theory of how cultures contribute to this diversity.[95] One of these scholars is Amir Licht, who describes culture as the mother of all path dependence, arguing that cultural diversity is the lead factor that causes corporate governance systems to be diverse. This section reviews only Licht's work for several reasons. First, Licht work can be considered as a representative of other similar works, as this thesis is only concerned about whether and how culture influences corporate governance, and the answers to these two specific questions are essentially very similar across the

[92] Ibid, 12-13

[93] Ibid, 12

[94] See for example, Christophe Volonté, 'Culture and Corporate Governance: The Influence of Language and Religion in Switzerland' (2015) 55 Management International Review 77; Ilir Haxhi and Hans Van Ees, 'Explaining Diversity in the Worldwide Diffusion of Codes of Good Governance' (2010) 41 Journal of International Business Studies 710; Chuck CY Kwok and Solomon Tadesse, 'National Culture and Financial Systems' (2006) 37 Journal of International Business Studies 227; Ruth V Aguilera and Gregory Jackson, 'The Cross-National Diversity of Corporate Governance: Dimensions and Determinants' (2003) 28 Academy of Management Review 447

[95] See for example, Jeswald W Salacuse, 'Corporate Governance, Culture and Convergence: Corporations American Style or with a European Touch?' (2003) 14 European Business Law Review 471; Charles Hampden-Turner and Alfons Trompenaars, *The Seven Cultures of Capitalism: Value Systems for Creating Wealth in the United States, Japan, Germany, France, Britain, Sweden, and the Netherlands* (1st edn, Doubleday 1993); Shirley J. Daniel, Joshua K. Cieslewicz and Hamid Pourjalali, 'The Impact of National Economic Culture and Country-Level Institutional Environment on Corporate Governance Practices' (2012) 52 Management International Review 365

literature. Second, Licht's work is related directly to this thesis subject, as it discusses the influence of cultures on corporate governance while most of the other research addresses the topic less directly. Finally, Licht argues that almost every aspect of corporate governance is influenced directly or indirectly by culture while many other scholars study the relationship between culture and only one or two aspects of corporate governance.

Licht argues that although people's behaviours are assumed to be guided by rational choices and self-maximisation, their judgments are shaped by the culture of their own society. Different corporate governance systems therefore attain different levels of approval around the world, depending on their compliance with the cultural values of a particular country.[96] According to Licht, cultural values are the informal rules that constrain, motivate, or justify certain actions, as they include common tastes for certain types of conduct and institutions.[97] Thus, these cultural values possess the ability to influence the choice for a particular corporate governance model from a wide range of options.[98]

Licht depends on two studies from the field of cross-cultural psychology to support his arguments. The first study, conducted by Geert Hofstede,[99] identifies four values and four challenges, and then examines forty countries to see how each society acts in order to achieve these values with respect to the challenges.[100] In particular, the study measures how each society acts in respect to the following values: First, individualism versus collectivism, which measures the strength of the relationship of individuals to their communities. A high individualism score in a society implies that its members have weak interpersonal relationship with those outside their core families. In contrast, a

[96] Amir N Licht, Chanan Goldschmidt and Shalom H Schwartz, 'Culture, Law, and Finance: Cultural Dimensions of Corporate Governance Laws' (2001) Working Paper, SSRN 267190 <https://ssrn.com/abstract=267190> accessed 20 May 2019, 31-32

[97] Amir N. Licht, Chanan Goldschmidt and Shalom H. Schwartz, 'Culture Rules: The Foundations of the Rule of Law and Other Norms of Governance' (2007) 35 Journal of Comparative Economics 659, 661; Amir N Licht, 'The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems' (2001) 26 Delaware Journal of Corporate Law 147, 189

[98] Licht, 'The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems' (n 97)189; Amir N Licht, 'Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform' (2004) 22 Berkeley Journal of International Law 195, 198

[99] Geert Hofsteds, *Culture's Consequences: International Differences in Work-Related Values* (Abridged edn, Sage Publications 1980)

[100] Ibid, 11

high score in collectivism in a society indicates that its members have feelings of loyalty and responsibility to the entire group.[101] Second is power distance, which measures the degree of inequality that may exist in some societies and its acceptance by people. While a high score of power distance in a country means that its citizens accept the unequal distribution of powers, low scores indicates that powers are shared and widely diffused.[102] Third is masculinity versus femininity. In masculine societies, people value and generously reward achievement and heroism, and in feminine societies they value modesty, caring for the weak and harmony.[103] Finally, high scores in uncertainty avoidance indicate that a society feels uncomfortable in ambiguous circumstances, whereas low scores indicate the acceptance of uncertain situations.[104]

The second study, by Shalom Schwartz, deals with three values: embeddedness versus autonomy, hierarchy versus egalitarianism, and mastery versus harmony.[105] According to Schwartz, each society has a different appreciation of each value. *Embeddedness* typifies a society in which individuals value themselves through social relations and share a group-orientated way of life, whereas autonomy is represented in societies in which individuals find meaning in their lives through individual uniqueness.[106] The term *hierarchy* refers to cultures in which unequal distribution of power is accepted, while *egalitarianism* refers to societies in which people consider each other as morally equal and value voluntary cooperation in order to enhance everyone’s welfare.[107] *Mastery* describes societies that have a desire to master, change, and control the world, while *harmony* characterises cultures in which people want to fit in and accept the surrounding environment.[108]

Based on these two studies, Licht argues that the differences that exist among corporate governance systems in ownership structures, self-dealing

[101] MindTools.com, ‘Hofstede's Cultural Dimensions: Understanding Different Countries’ (2016) <https://www.mindtools.com/pages/article/newLDR_66.htm> accessed 10 July 2019

[102] Ibid

[103] Licht, ‘The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems’ (n 97) 173

[104] Ibid

[105] Shalom H Schwartz, ‘A Theory of Cultural Values and Some Implications for Work’ (1999) 48 Applied Psychology 23, 23

[106] Ibid, 27

[107] Ibid, 27-28

[108] Ibid, 28

regulations, insider-trading regimes, executive compensation, investors' protection and disclosure requirements are attributed to cultural diversity. In particular, he argues that, first, cultures that score high on uncertainty avoidance in Hofstede’s study, and harmony in Schwartz’s framework, such as Germany and France are more likely to have fewer shares of equity securities in household portfolios because people in such societies tend to avoid the risks associated with equity holding and try to maintain things as they are with a low risk to everyone, which consequently results in concentrated private and state ownership.[109] Moreover, such societies are also expected to have lower disclosure standards, as they may prefer to suppress transparency to preserve security and avoid conflict and competition.[110] They are also expected to have relatively weaker investor legal rights as high uncertainty avoidance is consistence with giving power to authority while perceiving the idea of going to the courts as unnatural.[111] According to Licht, France and Germany, as compared to the US and the UK, are good examples for these conclusions, as they have contrasting rankings in the uncertainty-avoidance dimension where France and Germany appear on top of the list of the most likely country to have uncertainty avoidance: namely, 9 for France, 29 for Germany, 43 for the US, and 47 for the UK.

Second, countries that score high on hierarchy and acceptance of unequal distribution of power are more likely to have hierarchical ownership structures such as stock pyramids. The idea is that people in these countries are more likely to accept such structures as just another facet of a proper social order.[112]

Third, societies that score high on individualism in Hofstede’s analysis, and high on autonomy and mastery in Schwartz’s framework, are more likely to be more aggressive against self-dealing and insider trading. Effective anti-self-dealing and insider trading rules give effect to every shareholder’s economic judgment by requiring the inside trader or self-dealer to take the other shareholders' votes on such transaction. Thus, the extent of individualism, autonomy, and mastery in a society affects its self-dealing and

[109] Licht, ‘The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems’ (n 97) 189

[110] Ibid, 202

[111] Amir N Licht, Chanan Goldschmidt and Shalom H Schwartz, ‘Culture, Law, and Corporate Governance’ (2005) 25 International Review of Law and Economics 229, 236

[112] Licht, ‘The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems’ (n 97) 195

insider-trading rules, as these values give greater weight to personal preferences.[113] The same argument can also be extended to minority protection, freeze-out mergers, and the amendments of company bylaws.[114]

Finally, mastery versus harmony, and hierarchy versus egalitarianism can work as a cultural explanation of the differences among countries in relation to executive compensation, employment policies, and corporate social responsibility. Mastery versus harmony in this context represents the level of reward for entrepreneurship, while hierarchy as opposed to egalitarianism represents the accepted levels of large pay differentials as well as employment policies and corporate social responsibility.[115] In particular, entrepreneurship is highly rewarded in societies with high levels of mastery, because elevated levels of mastery indicates the desire of humans to master, change, and exploit the world around them.[116] On the other hand, egalitarianism refers to the view of people as equal; thus, egalitarian countries are expected and empirically have been found to have a smaller wage gap between employees and executives, adopt more policies favouring workers, and be more considerate of human rights and corporate social responsibilities.[117]

The advocates for this explanation not only argue that cultural differences are the reason for the formal divergence among corporate governance models but also the reason for the informal divergence as well.[118] They argue that notwithstanding the law, management decisions are affected by the various cultural values of their society. Shafer, Fukukawa, and Lee (2016) conducted a study involving about 300 corporate managers and found that the manager's personal values have a significant impact on their

[113] Ibid, 196-197

[114] Ibid, 203

[115] Ibid, 200

[116] Jordan I Siegel, Amir N Licht and Shalom H Schwartz, ‘Egalitarianism, Cultural Distance, and Foreign Direct Investment: A New Approach’ (2013) 24 Organization Science 1174, 1179

[117] Ibid

[118] Amir N Licht and Renée B Adams, ‘Shareholders and Stakeholders Around the World: The Role of Values and Culture in Directors’ Decisions’ (2016) European Corporate Governance Institute Working Paper <https://ecgi.global/sites/default/files/Shareholders%20and%20Stakeholders%20around%20the%20World%3A%20The%20Role%20of%20Values%20and%20Culture%20in%20Directors%E2%80%99%20Decisions.pdf> accessed 20 May 2019, 28; Jordan I. Siegel, Amir N. Licht and Shalom H. Schwartz, ‘Egalitarianism and International Investment’ (2011) 102 Journal of Financial Economics 621, 621

perceived role regarding corporate social responsibility.[119] Similarly, Licht and Adams (2016) concluded that board members' support for shareholder versus stakeholder wealth maximisation is affected by their personal cultural heritage.[120] Their study of directors shows that board member who grew up in egalitarian and harmony-valuing countries are more likely to pursue a stakeholder approach of management, while directors who grew up in hierarchical and mastery-valuing countries are more likely to adopt a shareholder approach.[121]

3.1.3.2 The Legal Explanation

Another explanation for the diversity of corporate governance systems is offered by Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny. These four authors published a series of articles, beginning in 1997, that developed a theory of legal origins—a theory that has attracted a large volume of empirical and theoretical research as well as controversy.[122] La Porta et al argue that the historical origins of a country's legal system shape not only its corporate governance but also its law-making, economic nature, and political institutions.[123] Their argument is based on two premises.

First, they follow on Watson's argument, mentioned previously, that legal transplantation is the principal method of legal development. La Porta et

[119] William E Shafer, Kyoko Fukukawa and Grace Meina Lee, 'Values and the Perceived Importance of Ethics and Social Responsibility: The US Versus China' (2007) 70 Journal of Business Ethics 265, 265

[120] Licht and Adams, 'Shareholders and Stakeholders Around the World: The Role of Values and Culture in Directors' Decisions' (n 118) 1; See also, Renée B. Adams, Amir N. Licht and Lilach Sagiv, 'Shareholders and Stakeholders: How Do Directors Decide?' (2011) 32 Strategic Management Journal 1331, 1331

[121] Licht and Adams, 'Shareholders and Stakeholders Around the World: The Role of Values and Culture in Directors' Decisions' (n 118) 24

[122] Rafael La Porta and others, 'Law and Finance' (1998) 106 Journal of Political Economy 1113; Rafael La Porta and others, 'Legal Determinants of External Finance' (1997) 52 Journal of Finance 1131; Rafael La Porta and others, 'The Quality of Government' (1999) 15 Journal of Law, Economics, and Organization 222; Rafael La Porta, Florencio Lopez-De-Silanes and Andrei Shleifer, 'Corporate Ownership Around the World' (1999) 54 Journal of Finance 471; Rafael La Porta and others, 'Investor Protection and Corporate Governance' (2000) 58 Journal of financial economics 3; Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'The Economic Consequences of Legal Origins' (2008) 46 Journal of Economic Literature 285; Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, 'Law and Finance After a Decade of Research' in George M. Constantinides, Milton Harris and Rene M. Stulz (eds), *Handbook of the Economics of Finance*, vol 2 (1st edn, Elsevier 2013)

[123] La Porta, Lopez-de-Silanes and Shleifer, 'The Economic Consequences of Legal Origins' (n 122) 291, 301

al state that most countries receive their legal systems from other nations through conquest and colonialization.[124] They further argue that imported legal systems contain different ideas and strategies about the purpose and structure of the law, and that these broad ideas are incorporated into specific legal rules, political and economic institutions, and human capital and beliefs. Thus, transplanting a legal system brings with it these ideas, strategies, and beliefs.[125] These authors assert that the evidence suggests that, despite local amendments to the imported systems, the fundamental ideas from the borrowed legal systems survive for generations.[126]

Second, these authors group countries according to their legal origin under two categories—English common law countries and French civil law countries—and recognise an additional three types within the French civil law family: German law, Scandinavian law, and the socialist legal tradition.[127] Nonetheless, their theory leans mainly on the notion that England and France developed two dominant systems that later spread to every country around the world.[128] According to them, the common law family, arguably, includes the US, England, Australia, India, and Malaysia, whereas France, Germany, Spain, Russia, and China are categorised under the civil law family.[129] This classification is based on the shared "*(1) historical background and development of the legal system, (2) theories and hierarchies of sources of law, (3) the working methodology of jurists within the legal systems, (4) the characteristics of legal concepts employed by the system, (5) the legal institutions of the system, and (6) the divisions of law employed within a system*" among countries under a particular legal family.[130]

[124] Lisa M Fairfax, 'The Legal Origins Theory in Crisis' (2009) 2009 Brigham Young University Law Review 1571, 1575

[125] La Porta, Lopez-de-Silanes and Shleifer, 'The Economic Consequences of Legal Origins' (n 122) 286

[126] Ibid

[127] Gerhard Schnyder, Mathias Siems and Ruth V Aguilera, 'Twenty Years of 'Law and Finance': Time to Take Law Seriously' [2018] Socio-Economic Review 1, 4; La Porta, Lopez-de-Silanes and Shleifer, 'The Economic Consequences of Legal Origins' (n 122) 288

[128] Fairfax, 'The Legal Origins Theory in Crisis' (n 124) 1575; La Porta, Lopez-de-Silanes and Shleifer, 'Law and Finance After a Decade of Research' (n 122) 427

[129] La Porta, Lopez-de-Silanes and Shleifer, 'The Economic Consequences of Legal Origins' (n 122) 289

[130] Mary Ann Glendon, Michael Wallace Gordon and Christopher Osakwe, *Comparative Legal Traditions: Text, Materials and Cases on the Civil and Common Law Traditions, With Special Reference to French, German, English and European law* (1st edn, West Publishing Company 1994) 4-5 quoted in La Porta and others, 'Law and Finance' (n 122) 1118

Legal-origin theorists believe that the best way to explain corporate governance differences and understand the process of their reforms is through the legal origin approach.[131] In particular, they argue that the legal protection of shareholders and creditors is the key to understanding the differences in crucial aspects of corporate governance models. This is so because corporate governance, according to La Porta et al, is “a set of mechanisms through which outside investors protect themselves against expropriation by insiders”.[132] Thus, the quality of the legal rules that protect investors is an extremely important factor that determine the differences in key elements of corporate governance models such as ownership concentration, corporate finance choices, and the size of stock markets.

Furthermore, these four authors argue that empirical evidence suggests that the quality of the legal rules regarding investors’ protection does not randomly vary across countries. The evidence clearly shows a systematic variation in the quality of investor protection between common law and civil law countries, with the laws of common law countries being more effective in protecting outside investors than the laws in civil law countries.[133] Hence, the authors conclude that the origin of legal systems affects the quality of investor protection rules which in turn affect corporate governance models.[134]

In particular, La Porta et al explain how the quality of investor protection rules affect corporate governance practices by identifying three consequences of having effective legal rules that protect investors. Later researchers added other consequences.[135] The first consequence of investor protection rules is that when investors’ rights are poorly protected and expropriation is likely, the benefit of having a controlling share of a company

[131] La Porta and others, ‘Investor Protection and Corporate Governance’ (n 122) 3

[132] Ibid, 4

[133] La Porta, Lopez-de-Silanes and Shleifer, ‘The Economic Consequences of Legal Origins’ (n 122) 258-286

[134] La Porta, Lopez-de-Silanes and Shleifer, ‘Law and Finance After a Decade of Research’ (n 122) 435

[135] Other scholars have added several consequences of investor protection. For example, some studies show that better investor protection rules encourage positive risk taking (Kose John, Lubomir Litov and Bernard Yeung, ‘Corporate Governance and Risk-Taking’ (2008) 63 Journal of Finance 1679), enhance internal governance (Reena Aggarwal and others, ‘Differences in Governance Practices between U.S. and Foreign Firms: Measurement, Causes, and Consequences’ (2009) 22 Review of Financial Studies 3131), and affect dividend pay-out (Ivalina Kalcheva and Karl V Lins, ‘International Evidence on Cash Holdings and Expected Managerial Agency Problems’ (2007) 20 Review of Financial Studies 1087).

becomes enormously valuable, as it gives the controller the ability to extract private benefits from the company. Thus, it can be concluded that when investors' rights are poorly protected, ownership concentration is more likely to happen because it becomes a more attractive way of conducting business.[136]

Second, the quality of investor protection also has implications for the development of financial markets. When investors' rights are effectively protected from expropriation, investors will be more likely to pay more for securities, which in turn makes it more attractive for companies to issue more securities, leading to a developed capital market.[137] This applies only to shareholder rights not creditors' rights. When a country develops its shareholder-protection rights, it results in a developed equity market. When a country develops its creditors' rights, the result is some kind of bank-based corporate governance with higher levels of state ownership of banks, which implicate that the quality of investor-protection rules shapes the financial choices within countries.[138]

Finally, the higher quality of rules protecting investors in a country results in a higher valuation of that particular country's companies, which means that companies can acquire capital at a lower cost.[139] When shareholders are well protected, they are more likely to be willing to pay a premium, as their investment risk is lowered.[140]

Based on such consequences of investors protection rules and the assertion that legal origins determine the quality of such rules, La Porta et al. argue that the legal-origins theory is the ultimate explanation for the diversity of corporate governance models.[141]

The legal-origin theory is well supported by a large amount of empirical and theoretical research. The theory has developed remarkably over the years: from a theory of investor protection as an intermediary variable that is explained by legal origins to other variables that cover areas outside of the

[136] La Porta and others, 'Investor Protection and Corporate Governance' (n 122) 13

[137] Ibid, 15

[138] Ibid; Rafael La Porta, Florencio Lopez-De-Silanes and Andrei Shleifer, 'Government Ownership of Banks' (2002) 57 Journal of Finance 265, 275

[139] Andrei Shleifer and Daniel Wolfenzon, 'Investor Protection and Equity Markets' (2002) 66 Journal of Financial Economics 3, 3

[140] Rafael La Porta and others, 'Investor Protection and Corporate Valuation' (2002) 57 Journal of Finance 1147, 1147

[141] La Porta, Lopez-de-Silanes and Shleifer, 'The Economic Consequences of Legal Origins' (n 122) 308

finance and corporate-governance fields. La Porta et al., in 2008, listed a number of consequences of legal origin: namely, “(1) procedural formalism, (2) judicial independence, (3) regulation of entry, (4) government ownership of the media, (5) labour laws, (6) conscription, (7) company law, (8) securities law, (9) bankruptcy law, and (10) government ownership of banks”.[142] However, only the investor-protection variable, which encompasses company law and securities law, was discussed in this section, because it is the most relevant to the scope of this thesis.

3.1.3.3 The Political Explanation

The political explanation of the diversity in corporate governance systems is developed mainly by Mark Roe.[143] The political theory depends largely on the idea of complementarity and social peace in explaining the models differences, therefore, it can be described as an extension of social conflict theory. The theory asserts that political pressures can shape national corporate governance systems, and in order to establish its superiority over the cultural and legal explanation, the theory argues that corporate governance systems historically have been national.[144] For example, Germany has had its concentrated ownership and bank-based system, The US has had dispersed ownership, Japanese banks have had blocks of ownership in the largest companies, etc. Thus, the theory concluded that since the diversity of the systems tended to be national, the key explanation of this variation must also be national.[145]

[142] Ibid, 292

[143] Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (n 86); Mark J Roe, ‘Political Preconditions to Separating Ownership from Corporate Control’ (2000) 53 Stanford Law Review 539; Mark J. Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (illustrated, reprint edn, Oxford University Press 2006); Mark J. Roe and Massimiliano Vatiero, ‘Corporate Governance and Its Political Economy’ in Jeffrey N. Gordon and Wolf-Georg Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (1st edn, Oxford University Press 2018); For other scholar's work on the subject see for example, Pepper D Culpepper, *Quiet Politics and Business Power: Corporate Control in Europe and Japan* (1st edn, Cambridge University Press 2010), Ugo Pagano, ‘The Evolution of the American Corporation and Global Organizational Biodiversity’ (2011) 35 Seattle Uinversity Law Review 1271; P.A. Gourevitch, P.A.G.J. Shinn and J. Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance* (1st edn, Princeton University Press 2005)

[144] Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (n 143) 23

[145] Ibid

In particular, the theory argues that in countries where social democratic parties play a dominant role, Europe as the prime example, companies receive great pressure to favour employees over shareholders.[146] Germany, for example, settled upon a codetermination system that gives employees half the seats of boards in their largest companies. This system of codetermination indeed fostered a sort of social peace among employees.[147] However, it triggered a problem. Having employees' representatives and the management team in one board together limits to some degree the freedom of managers in managing their companies. Therefore, in order to give managers the required or wanted freedom, the German policy makers created a two-tier board system, a relatively weak supervisory board for employees and shareholders' representatives and a management board only for managers.[148] However, although this solution produced social peace among managers, it created another problem for shareholders. Since, according to the theory, weaker supervisory boards mean a weaker representation of shareholder interests, corporate ownership structures became concentrated to compensate for this problem. Moreover, in a concentrated ownership system there is no need to align managers-owners interests with large executive compensation schemes, the situation in Anglo-American systems, in order to address the agency problem, as large shareholders can provide enough monitoring to make sure that their interests are being considered by management.[149] As a result of this complementary series, the theory concluded that political pressure to favour employees directly or indirectly shaped almost the entire German model of corporate governance.

However, the political theory is not limited to Germany or other European countries where social democratic policies are dominant. It argues that its applicability extends to countries where social democratic policies are very weak or do not exist, such as in the US.[150] It further explains that countries cannot be productive unless they realise social peace, and that politicians across the world act differently, according to their interests, to

[146] Bebchuk and Roe, ‘A Theory of Path Dependence in Corporate Ownership and Governance’ (n 17) 169

[147] Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (n 143) 22

[148] Ibid

[149] Ibid, 23

[150] Roe, ‘Political Preconditions to Separating Ownership from Corporate Control’ (n 143) 541

realise this peace.[151] It asserts that these differences are the cause of corporate governance diversity. For example, the theory argues that the diffused ownership structure in the US is the result of coercive political actions, namely, the prohibition of financial institutions growing large or owning other companies' shares.[152] The advocates of the political theory argue that the American public's mistrust of large concentrated financial powers and the desire of local banks to keep their local monopolies caused the Congress during the nineteenth century to bar banks and other financial institutions from growing large or obtaining other companies' shares, which in turn forced companies to seek capital from the public, causing ownership to be dispersed.[153] They further argue that this political intervention to realise social peace among the American public and local bankers caused another social conflict within companies, namely, the conflict between the dispersed weak owners and strong managers.[154] Solving this internal conflict is what gives the American corporate governance system its unique characteristics, such as high executive compensation, a strong securities market, independent directors, a takeover market, and its board structure. Thus, they conclude that political pressure shapes corporate governance systems even in countries where social democratic policies are not active.[155]

3.2 Empirical Studies of Convergence

As the issue of convergence has become a central topic in corporate governance debates, a considerable number of scholars have begun to investigate the issue empirically in order to examine the validity of the claims of those on either side of the debate. During the last three decades, the fields of management, finance, economics, and law have been enriched by the introduction of several empirical studies on the issue of convergence in terms of various governance dimensions. Therefore, this section attempts to take advantage of the empirical evidence that has been accumulated over the past thirty years in order to develop a generalised conclusion regarding the current state of convergence. In particular, this section attempts to find out whether

[151] Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (n 143) 22-23

[152] Roe and Vatiero, ‘Corporate Governance and Its Political Economy’ (n 143) 61-64

[153] Ibid, 5

[154] Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (n 86) 3-6

[155] Roe and Vatiero, ‘Corporate Governance and Its Political Economy’ (n 143) 83

corporate governance models are converging or not. It will, first, identify any changes to the traditional characteristics of the major corporate governance models—the shareholder and stakeholder models. Then, it will assess whether these changes have resulted in a certain degree of convergence. This investigation will contrast the classical views of each model with the available empirical evidence in an attempt to observe any differences and to determine the existing level of convergence. However, this method will not enable the development of an accurate conclusion regarding the direction of convergence if a difference exists between the traditional views of the models and the empirical evidence. This is the case because such a difference could be either the result of an actual change towards to convergence or simply the consequence of an error in the traditional views of the models. Hence, this method will be aided by a second method, namely the tracking of changes over time where possible. The utilisation of both methods increases the accuracy of the resulting conclusion by allowing us to review a greater number of studies; conversely, using only the second method would limit us to a review of long-term studies or of studies that are identical in their samples, variables, and questions but considering different time periods.

In chapter 2 it was stated that in the legal literature that the UK and U.S systems of governance have been continuously presented as classical examples of the shareholder model and that the German and Japanese systems are regarded as standard examples of the stakeholder model. For this reason and due to the fact that most studies on this topic consider these four countries, the focus of this section will mainly be on these nations. Other countries, however, will also be mentioned in order to justify the presentation of a more generalised conclusion.

The indicators of convergence were chosen based on two criteria. First, only those indicators that have been used in studies pertaining to the US, UK, Germany and Japan are considered. All the indicators that were not used in studies of all the above countries are ignored. Second, the indicators should have been employed at least at two points in time or contrasted with the classical views of the shareholder and stakeholder models. Four indicators met these criteria: the ownership structure, the market for corporate control, management pay and foreign direct investments. A special focus, however, will be given to the first indicator, the ownership structure, since it is widely accepted that ownership structure determines to a significant degree the entire corporate governance system.[156]

3.2.1 Ownership Structure

One long established belief about corporate ownership is that ownership structures are dispersed in US and UK listed companies, as well as other countries adopting the Anglo-American approach, but are concentrated in most other companies around the world.[157] Table 1 examines the validity of this claim and investigates the possibility of convergence towards a dispersed model of ownership, as predicted by Berle and Means.[158] This table provides a summary of evidence on the ownership and control of firms in several countries between 1900 and 2018, placing a specific focus on the US, UK, Germany, and Japan. The studies described in this table range from studies of a single country during a single year to studies of several countries over an extended period of time. Moreover, in an attempt to investigate ultimate controlling shareholders, some of these studies consider dual class voting, pyramid ownership and cross-holding, while others report only on cash flow rights and direct stakes. In the following sub-sections, the ownership structures of each one of the four highlighted countries will be analysed in an effort to develop a general conclusion regarding convergence in ownership structure. However, It may be useful to explain briefly some of the concepts mentioned in this section before proceeding:

1. A Block-holder is the owner of a large shares of a company's stocks. Some of the studies reviewed in this section consider the owner of a 5% or more of the total shares of a company a block-holder. Others only describe a shareholder as a block-holder when their ownership reaches 10%, 20%, or 50% or more.

2. Dual class equity structure refers to the issuance of more than one type of shares by a single company. For example, a company, in some

[156] See for example, ; Ruth V Aguilera and Rafel Crespi-Cladera, 'Global Corporate Governance: On the Relevance of Firms' Ownership Structure' (2016) 51 Journal of World Business 50, 50-51

[157] See for example Julian Franks, Colin Mayer and Stefano Rossi, 'Ownership: Evolution and Regulation' (2009) 22 Review of Financial Studies 4009, 4009; Jean Tirole, *The Theory of Corporate Finance* (Princeton University Press 2010) 40; Diane K Denis and John J McConnell, 'International Corporate Governance' (2003) 38 Journal of Financial and Quantitative Analysis 1, 14

[158] Adolf Augustus Berle and Gardiner Coit Means, *The Modern Corporation and Private Property* (first published 1933, Transaction Publishers 1991) 47-65

jurisdictions, could issue shares with no voting rights and shares with more voting powers.

3. Cash flow versus voting rights: Cash flows refers to the right to claim on cash pay-outs while voting rights refer to right to vote. In some companies all the shares have equal voting and cash flow rights while in others some shares have more voting rights than the rest of the shares.

4. Pyramid ownership refers to a top-down chain of control where the real ultimate owner is at the top of that chain.

5. Cross ownership refers to the state in which two or more companies own shares in each other's.

Table 1

Ownership Structure

Author(s) and year of publication	**Time period**	**Sample**	**Block type**	**Finding(s)**
Franks et al., 2009	1900-2000	Three samples of listed and unlisted UK companies; the 1900 and 1960 samples included 20 firms each, all still in existence in 2001	Direct stake	Regarding the 1900 sample, the three largest shareholders' ownership accumulated to 64.39% in 1900 and gradually lowered to 30.36% in 2000. Similarly, the 1960 sample began at 92.29% in 1960 and fell to 32.64% in 2000.
Prowse, 1994	1970	85 UK-based manufacturing firms	Direct stake	On average, the top five shareholders in UK companies held 20.9% of total shares.
Gorton and Schmid, 2000	1975 and 1986	283 large German public firms in the 1975 sample, and 280 in the 1986 sample	Voting block	In the 1975 sample, 84% of firms had at least one block holder who owned 25% or more of total voting blocks; in the 1986 sample, 81% had such a large block holder.

Demsetz and Lehn, 1985	1980	511 large listed US firms	Direct stake	The top five shareholders combined owned an average of 24.81% of total shares, while the top 20 shareholders held an average of 37.66% of total the shares.
Prowse, 1992	1980 for the US and 1984 for Japan	734 listed Japanese firms and 457 listed US firms	Direct stake	In Japanese companies, the top five shareholders held 33.1% of total shares, on average; in the US the top five shareholders held an average of 25.4% of total shares.
Gedajlovic and Shapiro, 2002	1986-1991	334 listed Japanese firms	Direct stake	The mean value of the ownership level of the top five block holders was 33.66%
Goergen and Renneboog, 1998	1988-1992	250 UK listed firms	Voting block	The mean value of the largest voting block was 14.6% in 1988, 15.3% in 1989, 16.4% in 1990, 15.8% in 1991, and 15.2% in 1992.
Franks and Mayer, 1997	1990	A sample of listed companies in the UK, France and Germany	Direct stake	Only 16% of UK companies had a major shareholder who owned 25% or more of total shares, while 85% of German companies and 70% of French firms had a similarly-controlling shareholder.

Lehmann and Weigand, 2000	1991-1996	361 listed and unlisted German firms from the mining and manufacturing sectors	Voting block	The mean value of the largest shareholder's voting stake was 73.40% in listed corporations and 97.8% in unlisted companies.
Edwards and Weichenrieder, 1999	1992	102 German listed companies	Voting block	The average proportion of voting equity held by the largest shareholder was 46.30%
Becht, 1997	1992-1997	6,559 US listed firms	Direct stake	The mean value of the largest block was 22.8%, while the mean of the cumulated shares of the three largest shareholders was 32.3%.
Van der Elst, 2003	1994 for the UK, 1997 for the US, and 1999 for other countries	A large number of listed firms from Belgium, Italy, Spain, Germany, France, the UK, and the US	Voting block	The average size of the voting block of the largest shareholder in a US company was 22.7%, while the median value was only 15.1%. Similarly, the average value for UK companies was 22.5%, and the median value was 16.6%. The average value was 36.6% for Spanish firms, 41.7% for Belgian firm, 46.1% for German firms and 52% for French firms.

La Porta et al., 1999	1995	Listed companies from 27 countries	Voting block	The percentages of widely held companies with no single large shareholder in control of more than 20% of total voting blocks were 100% in the UK, 80% in the US, 90% in Japan, 50% in Germany, and 60% in France.
Holderness, 2009	1995	375 small and large listed US firms	Voting block	The ownership levels of all block holders who owned 5% or more of the total voting blocks averaged 43%; moreover, the average ownership level of the largest shareholder was 26%, and the percentage of firms with at least one block holder was 96%.
Becht and Boehmer, 1997 and 2003	1995-1996	430 German listed companies	Voting block	The average size of the largest block was 58.9%
Claessens, Djankov and Lang, 2000	1996	2,611 listed companies from 9 Asian countries	Cash flow and voting block	In Japan, the average value of the largest voting rights block was 10.33%, and the average value of the largest cash flow rights block was 6.90%

Tuschke and Sanders, 2003	1996–1999	All firms listed in Germany's DAX100	Direct stake	Ownership concentration level averaged 45.07%.
Dlugosz et al, 2006	1996-2001	7,649 large US listed firms	Voting block	The sum of all block holding was 21.7% in 1996, 21.3% in 1997, 24.5% in 1998, 24.9% in 1999, 25.5% in 2000 and 25% in 2001
Wójcik, 2003	1997 and 2001	415 German listed firms in 1997 and 463 in 2001	Voting block	In the 1997 sample, the mean value of the largest voting block was 67.43%; this value was roughly 20% and 15% for the second- and third-largest shareholders, respectively. In the 2001 sample, the mean value for the first-, second-, and third-largest shareholders were 60%, 20% and 10%, respectively.
Köke, 1999	1998	A large number of listed and unlisted German manufacturing firms	Voting block	The largest share block averaged 57.66% for listed companies and 83.23% for unlisted firms.
Faccio and Lang, 2002	Late 1990s	5232 listed firms in 13 Western European countries	Direct stake	Widely held corporations with no single shareholder in control of 20% or more of total shares averaged 63% in the UK, 27.57% in Switzerland, 39.19% in Sweden,

				26.42% in Spain, 21.84% in Portugal, 36.77& in Norway, 12.98% in Italy, 62.32% in Ireland, 10.37% in Germany, 14% in France, 28.68% in Finland, 20% in Belgium and 11.11 in Austria.
Aminadav and Papaioannou 2020	2004 – 2012	Listed Companies in 127 countries	Direct stake and voting blocks	Ownership is most concentrated in Africa and Eastern Europe, dispersed in the US and UK, and in the middle in Japan. Similarly, the percentage of controlled companies is about 70% in Germany, 45% in Japan, 25% in the US, and 15% in the UK
De La Cruz et al. 2019	2017	Listed companies in OECD Countries and Saudi Arabia	Direct stake	Ownership is most concentrated in Russia, Turkey and Indonesia, and dispersed in the US, UK, and Japan. About 40% of the German companies have a shareholder who hold more than 50% of the total shares while such ownership exists only in less than 5% of US and UK companies.

3.2.1.1 The United Kingdom

The evidence described in table 1 indicates that in most UK companies, ownership and control are indeed dispersed. In particular, La Porta et al. (1999) reported that in 1995, 100% of their sample of the largest publicly traded UK companies were widely held.[159] They investigated the 20 largest firms, by stock market capitalisation, in the UK and found that in every one of those firms, no single shareholder held 20% or more of the total direct and indirect voting rights; moreover, they observed that in 90% of these companies, the largest voting block did not exceed 10%. Similarly, Franks and Mayer in a 1997 study found that only 16% of quoted UK companies had a major shareholder who owned 25% or more of the company's shares.[160] Van der Elst (2003) also reported that only 333 of 1,332 listed UK companies did not have a single shareholder who controlled more than 10% of the company's shares; while this proportion of widely held companies is much lower than that found by La Porta et al., it is still very high when compared to the figures of other European countries. [161] In the other five European nations studied, the number of listed companies with no single shareholder in control of more than 10% of the total shares was only 98 out of 1318.[162]

Furthermore, Faccio and Lang (2002) showed that when cross-holding and pyramidal ownership are taken into consideration, the proportion of widely held corporations with no single shareholder in control of 20% or more of the total shares was an average of 63% in the UK; this figure significantly increased when the threshold was lowered to 10%.[163]

Recent studies also confirm that the traditional views of ownership structure in the UK is still valid. For example, Aminadav and Papaioannou (2020) report in their 2012 sample that 79.4% of publicly traded UK companies, were widely held, compared to only 32% in France, 31.3% in Germany, and

[159] La Porta, Lopez-De-Silanes and Shleifer, ‘Corporate Ownership Around the World’ (n 122) 492-493

[160] Julian Franks and Colin Mayer, ‘Corporate Ownership and Control in the UK, Germany, and France’ (1997) 9 Journal of Applied Corporate Finance 30, 32

[161] Christoph Van der Elst, ‘The Equity Markets, Ownership Structures and Control: Towards an International Harmonisation’ in Klaus J. Hopt and Eddy Wymeersch (eds), *Capital Markets and Company Law* (1st edn, Oxford University Press 2003), 35

[162] Ibid

[163] Mara Faccio and Larry HP Lang, ‘The Ultimate Ownership of Western European Corporations’ (2002) 65 Journal of financial economics 365, 378

27.8% in China.[164] Similarly, a report issued by Slaughter and May (2013) concluded that only 14.2% of the FTSE 350 companies have a controlling shareholder who owns 30% or more of the total shares of a company.[165] De La Cruz et al. (2019) also confirmed that at the end of 2017 the UK is the second market with the least ownership concentration among the OECD countries.[166] Their study shows that about 90% of UK listed companies are widely held in the sense that the combined ownership of the three largest shareholders does not exceed 50% of total shares.[167]

Moreover, Van der Elst (2003) documented that in 1994, the average size of the voting block held by the largest shareholder of UK listed companies was only 22.5%, with a median value of 16.6%; notably, this figure is at least two times lower than similar figures for other European countries.[168] The picture also appears to be very different when one investigates the second, third and fifth largest shareholders. Uniquely, the largest block holders in UK companies experience relatively high levels of competition, on average, over control from other shareholders.[169] Goergen and Renneboog (1998) noted that the median value of the largest shareholder's voting block in a random sample of quoted companies on the London Stock Exchange was 9.9%, while the median value of the second largest voting block was only 6.6%; this figure is very close in size to that of the first largest block which indicate a high level of competition over control.[170] In other European countries, the median value of the largest voting block is typically at least four times larger than that of the second largest block.[171] Furthermore, Franks et al (2009) conducted a long-term study of listed and unlisted UK firms and reported that during the twentieth century, the ownership levels of the fourth and fifth largest shareholders combined ranged

[164] Gur Aminadav and Elias Papaioannou, 'Corporate Control around the World' (2020) 75 Journal of Finance 1191, 1206-1208

[165] Slaughter and May, *More Effective Listing Regime? The FCA's Latest Proposals and Consultation on Listing Regime Effectiveness CP13-15* (Slaughter and May 2013)

[166] Adriana De La Cruz, Alejandra Medina and Yun Tang, 'Owners of the World's Listed Companies' [2019] OECD Capital Market Series, Paris, 18-19

[167] Ibid

[168] Van der Elst, 'The Equity Markets, Ownership Structures and Control: Towards an International Harmonisation' (n 161)34

[169] Marco Becht and Colin Mayer, 'Corporate Control in Europe' (2002) 112 Revue d'économie politique 471, 478

[170] Marc Goergen and Luc Renneboog, 'Strong Managers and Passive Institutional Investors in the UK: Stylized Facts' (1998) Tilburg University, Center For Economic Research Discussion paper No 1998/131 <https://pure.uvt.nl/portal/files/530600/131.pdf> accessed 26 April 2017, 38

[171] Becht and Mayer, 'Corporate Control in Europe' (n 169) 478

from 3.55% to 8.57%.[172] Interestingly, the UK median does not even decline rapidly after the second largest block-holder is taken into account. Indeed, the median figure for the tenth largest block holder in UK companies is more than 3% of total shares.[173]

In a similar vein, A study performed by Prowse (1994) also showed that the top five largest shareholders in UK companies jointly held, on average, only 20.9% of outstanding shares and that the median value of their holdings was only 15.1%.[174] However, these figures appear different when the study considers the possibility of shareholders' coalitions. When the voting rights of members from the same family are consolidated and the influence of the ultimate owner is considered, Aminadav and Papaioannou (2020) report that the average value of the largest voting block is 19.5% and the average value of the five largest voting blocs combined are 37.1%.[175] Compared to Germany and other European countries, these numbers are considerably lower. The same study shows that mean of the largest five voting block is around 60% in Germany, 63% in France and Italy, and 73.9% in Russia.[176] Similarly, De La Cruz et al. (2019) study shows that, at the end of 2017, the average block size of the three largest shareholders combined is about 25% for the UK compared to about 50% for Germany and 80% for Russia.[177]

3.2.1.2 The United States

In the case of the US, empirical evidence shows that most US corporations are widely held. La Porta et al. (1999) reported that only 20% of the largest quoted US firms had one major shareholder who controlled 10% or more of a company's voting rights.[178] Likewise, De La Cruz et al. (2019) indicated that listed companies in the US markets have the least ownership concentration

[172] Franks, Mayer and Rossi, 'Ownership: Evolution and Regulation' (n 157) 4024

[173] Goergen and Renneboog, 'Strong Managers and Passive Institutional Investors in the UK: Stylized Facts' (n 170) 38

[174] Stephen David Prowse, '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' (1994) Bank for International Settlements Economic Paper No 41 <http://www.bis.org/publ/econ41.pdf> accessed 24 April 2017, 35

[175] Aminadav and Papaioannou, 'Corporate Control around the World' (n 164) 1205-1208

[176] Ibid

[177] De La Cruz, Medina and Tang, 'Owners of the World's Listed Companies' (n 166) 18-19

[178] La Porta, Lopez-De-Silanes and Shleifer, 'Corporate Ownership Around the World' (n 122) 492

among other OECD countries.[179] The study reported that as of end of 2017 more than 90% of all the 622 studied US listed companies are widely held in the sense that the combined ownership of the largest three shareholders does not exceed 50% of total shares.[180]

Similarly, Dlugosz et al (2006) studied 7,649 large US-listed firms and found that between 1996 and 2001 the sum of all voting blocs in a company ranged from 21.7% to 25.5% when a block threshold of 5% was applied; they also reported that the average number of block holders in each company was between 2.10 and 2.50 persons.[181] Moreover, Dlugosz et al. found that the largest block-holder only controlled an average of between 10% and 10.2% of a company's shares; this figure represents the lowest reported mean for the US, as illustrated in Table 1.[182] In the US, the average proportion of shares controlled by the largest block of shareholders was roughly 22% according to the findings of Van der Elst (2003) and Becht (1997), while the average share of the largest five shareholders amounted to 24.81% in Demsetz and Lehn's (1985) study and 25.4% in Prowse's (1992) research.[183] Additionally, the accumulated holdings of the top 20 shareholders amounted to 37.66% in Demsetz's study (1985), 43.60% in Becht's (1997) research and about 50% in De La Cruz et al (2019).[184] These figures are in line with the finding of Holderness (2009), who found that the average ownership level of all block-holders was 43% and that the largest voting block mean was 26%.[185]

However, Holderness (2009) also reported that 96% of US listed companies had a major shareholder who controlled 5% or more of the

[179] De La Cruz, Medina and Tang, ‘Owners of the World's Listed Companies’ (n 166) 18-19

[180] Ibid, 8 and 18-19

[181] Jennifer Dlugosz and others, ‘Large Blocks of Stock: Prevalence, Size, and Measurement’ (2006) 12 Journal of Corporate Finance 594, 599

[182] Ibid

[183] See Van der Elst, ‘The Equity Markets, Ownership Structures and Control: Towards an International Harmonisation’ (n 161) 33; Marco Becht, ‘Beneficial Ownership in the United States’ in Fabrizio Barca and Marco Becht (eds), *The Control of Corporate Europe* (Oxford University Press 1997) 289; Harold Demsetz and Kenneth Lehn, ‘The Structure of Corporate Ownership: Causes and Consequences’ (1985) 93 Journal of Political Economy 1155, 1156; Stephen D Prowse, ‘The Structure of Corporate Ownership in Japan’ (1992) 47 Journal of Finance 1121, 1124

[184] Demsetz and Lehn, ‘The Structure of Corporate Ownership: Causes and Consequences’ (n 183) 1156; Becht, ‘Beneficial Ownership in the United States’ (n 183) 289; De La Cruz, Medina and Tang, ‘Owners of the World's Listed Companies’ (n 166) 19

[185] Clifford G Holderness, ‘The Myth of Diffuse Ownership in the United States’ (2009) 22 Review of Financial studies 1377, 1382

company's voting rights, and surprisingly, concluding that these companies are not widely held.[186] This finding challenges the conclusions of La Porta et al (1999) and De La Cruz et al (2019) who argued that 80% to 90% of US listed companies are indeed widely held. This contradiction could be the result of, among other explanations, the different samples used in each study. For example, La Porta et al.'s (1999) sample was comprised of the 20 largest firms, while Holderness (2009) selected his sample randomly from large and small listed companies; undeniably, large firms are expected to have more diffused ownership structures than their smaller counterparts.[187] Moreover, when La porta et al. (1999) considered listed medium sized firms, they found that about half had a major shareholder who controlled 10% of the voting rights, concluding that half of all medium sized firms in the US are widely held.[188] More importantly, it is not accurate, however, to assume a company is widely held or not based only on the presence of a block-holder in its ownership structure. Competition among block-holders of a particular company could prevent them from exercising control. Considering this point, Aminadav and Papaioannou (2020) report that about 10% of all listed companies in common law countries are widely held without any block-holder controlling 5% or more in voting rights, and that approximately 60% of all quoted companies are widely held but with a sizeable block.[189]

3.2.1.3 Germany

Table 1 provides a summary of the latest evidence on the ownership and control of German companies. This evidence confirms the long-standing belief that the ownership of most German firms is indeed concentrated.[190] In particular, Gorton and Schmid (2000) showed that 84% of the largest German public firms in 1975 and 81% in 1986 had at least one major shareholder in control of 25% or more of a company’s voting rights.[191] Similarly, Franks and Mayer (1997), Faccio and Lang (2002) and Becht and Boehmer (1999) all reported that in the 1990s, voting blocks that controlled 20% or more of a

[186] Ibid, 1382-1384

[187] Brian Cheffins and Steven Bank, ‘Is Berle and Means Really a Myth?’ (2009) 83 Business History Review 443, 464; Franks and Mayer, ‘Corporate Ownership and Control in the UK, Germany, and France’ (n 160) 32-37

[188] La Porta, Lopez-De-Silanes and Shleifer, ‘Corporate Ownership Around the World’ (n 122) 495

[189] Data for the US alone was not available. See, Aminadav and Papaioannou, ‘Corporate Control around the World’ (n 164) 1222

[190] Goergen, Manjon and Renneboog, ‘Is the German System of Corporate Governance Converging Towards the Anglo-American Model?’ (n 56) 43

[191] Gary Gorton and Frank A Schmid, ‘Universal Banking and the Performance of German Firms’ (2000) 58 Journal of Financial Economics 29, 38

company's total shares were common in more than 85% of German listed firms.[192] La Porta et al.'s study, nonetheless, showed that 50% of the 20 largest listed German firms had at least one voting block that controlled 20% or more of a firm's total shares.[193] Similarly, De La Cruz et al (2019) recent study that found that about 40% of the German listed companies had at least one shareholder who owns more than 50% of the total shares.[194]

Edwards and Weichenrieder (1999), Van der Elst (2003), Tuschke and Sanders (2003), Aminadav and Papaioannou (2020), and De La Cruz et al (2019) on the other hand, found that the largest block-holder controlled, on average, around 46% of a company's shares.[195] The finding of Becht and Boehmer (2003), Koke (1999) and Wojcik (2003) suggested an even higher percentage; in these studies, the mean value of the largest shareholder stake was approximately 60%.[196] Similarly, Lehmann and Weigand (2000) found that in listed mining and manufacturing firms, the mean of the largest shareholder's voting stake was 73.40%.[197] For unlisted companies, the mean of the largest shareholder's stake was, as expected, much higher. Indeed, Koke (1999)

[192] Franks and Mayer, 'Corporate Ownership and Control in the UK, Germany, and France' (n 160) 33; Faccio and Lang, 'The Ultimate Ownership of Western European Corporations' (n 163) 378; Marco Becht and Ekkehart Boehmer, 'Transparency of Ownership and Control in Germany' (1999) European Corporate Governance Network Working Paper <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=149774> accessed 29 April 2017, 37

[193] La Porta, Lopez-De-Silanes and Shleifer, 'Corporate Ownership Around the World' (n 122) 492

[194] De La Cruz, Medina and Tang, 'Owners of the World's Listed Companies' (n 166) 18-19

[195] Jeremy Edwards and Alfons Weichenrieder, 'Ownership Concentration and Share Valuation: Evidence from Germany' (1999) CESifo Group Munich Working Paper Series No 193 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=272627> accessed 28 April 2017, 17; Van der Elst, 'The Equity Markets, Ownership Structures and Control: Towards an International Harmonisation' (n 161) 34; Anja Tuschke and Gerard Sanders, 'Antecedents and Consequences of Corporate Governance Reform: The Case of Germany' (2003) 24 Strategic Management Journal 631, 641; De La Cruz, Medina and Tang, 'Owners of the World's Listed Companies' (n 166) 18-19

[196] Marco Becht and Ekkehart Böhmer, 'Voting Control in German Corporations' (2003) 23 International Review of Law and Economics 1, 3; Jens Köke, 'New Evidence on Ownership Structures in Germany' (1999) Centre for European Economic Research Working Paper No 99-60 <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=198929> accessed 29 April 2017, 10; Dariusz Wójcik, 'Change in the German Model of Corporate Governance: Evidence from Blockholdings 1997–2001' (2003) 35 Environment and Planning A 1431, 1443

[197] Erik Lehmann and Jürgen Weigand, 'Does the Governed Corporation Perform Better? Governance Structures and Corporate Performance in Germany' (2000) 4 European Finance Review 157, 170

reported that this average reached 83.23%, while Lehmann and Weigand (2000) found it to be 97.8%.[198]

3.2.1.4 Japan

Empirical studies on the ownership and control of Japanese firms have revealed that most Japanese firms are widely-held. La Porta et al. (1999) studied the 20 largest listed Japanese firms and found that 90% had no major shareholder in control of 20% or more of a company's total shares; furthermore, they found that 50% of companies did not even have a single major shareholder who owned as little as 10% of total shares.[199] Likewise, Claessens et al. (2000) reported that at a benchmark of 20% of total shares, 79.8% of Japanese quoted firms could be considered widely-held and that at a benchmark of 10%, 42% can be classified as widely-held.[200] Moreover, at a benchmark of 50%, De La Cruz et al (2019) indicated that about 90% of listed companies in Japan are widely-held.[201]

With regard to a company's five largest block holders, Gedajlovic and Shapiro (2002) Prowse (1992), and Aminadav and Papaioannou (2020) reported that the cumulative ownership value of this group averaged about 34%, while the largest single voting block averaged at 10.33% according to Claessens et al. (2000).[202] The largest cash flow rights block, however, averaged only 6.90%, which leaves the typical large-control holder in Japan with ten votes for each of six direct shares held.[203] Such a low ratio of voting rights places Japan among the highest-scoring jurisdictions in terms of separating ownership from control.[204] However, this does not necessarily suggest a convergence towards the Anglo-Saxon model of governance, since a

[198] Köke, 'New Evidence on Ownership Structures in Germany' (n 196) 10; Lehmann and Weigand, 'Does the Governed Corporation Perform Better? Governance Structures and Corporate Performance in Germany' (n 197) 170

[199] La Porta, Lopez-De-Silanes and Shleifer, 'Corporate Ownership Around the World' (n 122) 492-493

[200] Stijn Claessens, Simeon Djankov and Larry HP Lang, 'The Separation of Ownership and Control in East Asian Corporations' (2000) 58 Journal of Financial Economics 81, 103

[201] De La Cruz, Medina and Tang, 'Owners of the World's Listed Companies' (n 166) 18-19

[202] Eric Gedajlovic and Daniel M Shapiro, 'Ownership Structure and Firm Profitability in Japan' (2002) 45 Academy of Management Journal 565, 570; Prowse, 'The Structure of Corporate Ownership in Japan' (n 183) 1124; Aminadav and Papaioannou, 'Corporate Control around the World' (n 164) 1206; Claessens, Djankov and Lang, 'The Separation of Ownership and Control in East Asian Corporations' (n 200) 100

[203] Claessens, Djankov and Lang, 'The Separation of Ownership and Control in East Asian Corporations' (n 200) 100

[204] Ibid

great number of fundamental differences in ownership structures still exist between the two models.

One key characteristic that distinguishes the Japanese corporate structure from the Anglo-Saxon model is the presence of cross-corporate holding, whereby corporations invest heavily in the equity of other firms, thus creating a unique system of ownership.[205] In Japan, the overall cross-corporate ownership levels of the common stock of all listed firms averaged 24% in 1984 and about 40% at the end of 2017; in the US, however, non-financial firms ownership barely amounted to 11% in 1984 and less than 5% in 2017.[206] Additionally, in Japan, commercial banks alone own roughly 20% of the total outstanding shares of all quoted firms, while in the US, commercial banks are prevented by law from holding any corporate stock.[207] Similarly, insurance companies in Japan hold more than 17% of the nation's corporate stock, which is three times the amount held by their US counterparts.[208] Bae and Kim (1998) even reported that listed Japanese firms, on average, invest 30% of their net assets in the equity shares of other affiliated firms.[209]

3.2.2 The Market for Corporate Control

Corporate control is often defined as the ability to determine how corporate resources will be managed; this ability is exercised via the possession of the rights to hire, fire and set the compensation of top-level managers.[210] The term ‘market for corporate control’, however, refers to the takeover market. As discussed earlier in the thesis, in a takeover transaction, a buyer can, via a merger or tender offer, acquire a controlling share of a company and hire and fire management figures in order to construct a more favourable resource utilisation.[211] In a merger, a buyer makes an agreement with the target firm's managers to purchase the target company's common stock before going to a vote at the shareholders' meeting; in a tender offer, a buyer approaches the target firms' shareholders directly and offers to purchase their shares at a

[205] Li Jiang and Jeong-Bon Kim, ‘Cross-Corporate Ownership, Information Asymmetry and the Usefulness of Accounting Performance Measures in Japan’ (2000) 35 International Journal of Accounting 85, 85

[206] Prowse, ‘The Structure of Corporate Ownership in Japan’ (n 183) 1123; De La Cruz, Medina and Tang, ‘Owners of the World's Listed Companies’ (n 166) 19

[207] Prowse, ‘The Structure of Corporate Ownership in Japan’ (n 183) 1123

[208] Ibid

[209] Kee Hong Bae and Jeong-Bon Kim, ‘The Usefulness of Earnings Versus Book Value for Predicting Stock Returns and Cross Corporate Ownership in Japan’ (1998) 10 Japan and the World Economy 467, 472

[210] Michael C Jensen and Richard S Ruback, ‘The Market for Corporate Control: The Scientific Evidence’ (1983) 11 Journal of Financial economics 5, 5

[211] Ibid, 6

premium price.[212] Takeovers can also occur via a proxy contest, wherein an insurgent group—often a large shareholder or manager—attempts to procure controlling seats on a board of directors.[213] The takeover market, therefore, is widely recognised as a crucial mechanism whereby capital markets discipline management.[214] When managers fail to maximise the value of a firm, this tempts other interested parties to seek to take over that firm, convert the company's structure to a value-maximising system and then harvest the increase in value that results from the introduced improvements.[215] The strong presence of a takeover market in any country is considered by many scholars as a sign of good corporate governance and a healthy financial system for that reason.[216] However, traditionally such a presence is often believed to appear only in Anglo-Saxon markets and fades in importance elsewhere.

Empirical studies suggest that the activity of a takeover market is much higher in Anglo-Saxon countries than elsewhere in the world. It also suggests that this activity peaked in the second half of the 20th century and then declined. In particular, during the 1980s, the frequency of takeovers was 15 to 20 times higher in the US and 5 to 10 times higher in the UK than it is in Germany or Japan.[217] Other empirical evidence also suggests similar results. For example, Kaplan (1993) reported that about 22% of US companies in operation between 1980 and 1989 were taken over or merged with other firms; in contrast, this figure was only 2.52% for Japanese firms during the same period.[218] Franks and Mayer (1997) also found that during the 1980s, the total number of mergers in Germany was roughly one-half of those in the UK.[219] Moreover, Schneper and Guillen (2004) showed that while 751 takeover attempts were made in the US and the UK between 1988 and 2003, there was

[212] Ibid, 6-7

[213] Ibid, 6

[214] Henry G Manne, 'Mergers and the Market for Corporate Control' (1965) 73 Journal of Political economy 110, 112

[215] Prowse, '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' (n 174) 46-55

[216] Michael C Jensen, 'The Takeover Controversy' in John C Coffee Jr, Louis Lowenstein and Rose-Ackerman (eds), *Knights, Raiders, and Targets: The Impact of the Hostile Takeover* (1st edn, Oxford University Press 1988), 314-316

[217] Prowse, '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' (n 174) 46

[218] Kaplan, 'Top Executive Rewards and Firm Performance: A Comparison of Japan and the United States' (n 57) 515

[219] Franks and Mayer, 'Corporate Ownership and Control in the UK, Germany, and France' (n 160) 41

only three attempts made in Japan and seven in Germany.[220] However, when one takes into account full takeovers as well as purchases of majority stakes worth more than 50%, then the number of takeover attempts in 1988 increases to 534 in Germany, 537 in France and 937 in the UK.[221] Similarly, when takeover activities are measured by value, the Anglo-Saxon countries prevail. To this end, Guillen (2000) found that companies operating in Anglo-Saxon jurisdictions in the 1980s accounted for 96.9% of all global takeover activities as targets and 90.4% as acquirers; in terms of transaction values, these figures were roughly 89% and 88.4% in the 1990s, respectively.[222]

However, takeover activities have declined since then in the US and UK and increased in Japan. Caina, McKeon, and Solomon (2017) reported that hostile activities in the US peaked in 1967 at 40% of total merger and acquisition transactions and declined to about 8.6% in 2014.[223] In contrast, hostile takeover attempts in Japan increased gradually from only 1 in 1994 to 104 in 2007 and then decreased again to 55 attempts in 2013.[224] Nonetheless, the US, UK, Australia and Canada still have the highest numbers of takeovers and takeover attempts for the period between 1988 and 2016.[225] On the other hand, unfriendly takeovers are still very rare in Germany. Mager and Meyer-Fackler (2017) reported only 3 such takeovers in the German market between 2000 and 2010.[226] Others reported only 13 attempts between 2000 and 2005.[227]

[220] William D Schneper and Mauro F Guillén, 'Stakeholder Rights and Corporate Governance: A Cross-National Study of Hostile Takeovers' (2004) 49 Administrative Science Quarterly 263, 263-264

[221] Julian Franks and Colin Mayer, 'Capital Markets and Corporate Control: A Study of France, Germany and the UK' (1990) 5 Economic Policy 189, 198

[222] Guillén, 'Corporate Governance and Globalization: Is There Convergence Across Countries?' (n 20) 232-236

[223] Matthew D. Cain, Stephen B. McKeon and Steven Davidoff Solomon, 'Do Takeover Laws Matter? Evidence from Five Decades of Hostile Takeovers' (2017) 124 Journal of Financial Economics 464, 465

[224] Ralf Bebenroth, *International Business Mergers and Acquisitions in Japan* (1st edn, Springer 2015) 126

[225] Nan Zhou and Mauro F Guillén, 'Institutional Complementarities and Corporate Governance: The Case of Hostile Takeover Attempts' (2019) 27 Corporate Governance: An International Review 82, 83-84

[226] Ferdinand Mager and Martin Meyer-Fackler, 'Mergers and Acquisitions in Germany: 1981–2010' (2017) 34 Global Finance Journal 32, 34-36

[227] Daniel Detzer, 'Financialization Made in Germany: A Review' (2019) Berlin Institute for International Political Economy, Working Paper, No 122/2019 <https://www.econstor.eu/bitstream/10419/203147/1/1676017577.pdf> accessed 1 April 2019, 26

3.2.3 Management Pay

In theory, shareholders in Anglo-Saxon countries, where ownership is often diffused and the influence of managers is greater, should tend to compensate managers generously in order to ensure that management's interests are aligned with their own.[228] In contrast, shareholders in concentrated ownership systems experience fewer agency problems, at least involving the shareholder-manager relationship; therefore, the compensation of their managers should tend to be less than that granted by their Anglo-Saxon counterparts. Empirical evidence, however, only supports this claim to a certain degree. Table 2, adapted from the work of Goergen et al. (2008), demonstrates that in 2001–2002, the pay packages of CEOs were highest in the US and lower in the rest of the world, including the UK.[229] This result is confirmed by many other studies that have investigated this trend during different time periods.[230] For example, in a recent study by Bloomberg, it was concluded that American CEOs in 2016 and 2017 were paid about 78% more than their Japanese counterparts, and 50% and 24% more than the German and British CEOs respectively.[231]

Table 2
CEO remuneration around the world (2001-2002)

Total Remuneration ($)		Pay Components (as a percentage of total remuneration)			
		Basic Compensation	Variable Pay	Benefits	Perquisites
Belgium	696,697	46	24	28	2
France	519,060	46	26	21	7
Germany	454,979	47	36	12	5
Italy	600,319	43	33	20	4
Netherlands	600,854	47	36	13	4
Spain	429,725	51	36	10	3
Sweden	413,860	46	25	27	2
UK	668,526	43	30	21	6
USA	1,932,580	28	61	6	5

Source: Goergen, Manjon and Renneboog (2008)

[228] James P Walsh and James K Seward, 'On the Efficiency of Internal and External Corporate Control Mechanisms' (1990) 15 Academy of Management Review 421, 427

[229] Goergen, Manjon and Renneboog, 'Is the German System of Corporate Governance Converging Towards the Anglo-American Model?' (n 56) 52

[230] See for example, Guillén, 'Corporate Governance and Globalization: Is There Convergence Across Countries?' (n 20) 237; Marc Goergen and Luc Renneboog, 'Managerial Compensation' (2011) 17 Journal of Corporate Finance 1068, 1071

[231] Anders Melin, 'Executive Pay' (*Bloomberg*, 2018) <https://www.bloomberg.com/quicktake/executive-pay> accessed 20 April 2019

3.2.4 Foreign Direct Investments

Proponents of the convergence theory often argue that the increasing volume of foreign investments will pressure countries towards convergence. Some of them argue that American investments in other countries, in particular, will force these countries to resemble the American model.[232] However, after reviewing the empirical studies, it is not clear why American investments should produce a worldwide convergence on the American model since the impact of foreign investments originating from the Anglo-Saxon countries is waning.[233] Guillen (2000) study showed that in 1997, the proportion of the world's stock of outward foreign direct investments accounted for by the Anglo-Saxon countries fell from 66% in 1980 to approximately 50%.[234] Meanwhile, European and developing countries' share in the worldwide stock of outward foreign direct investment is growing.[235] Gammeltoft (2008) even reported that the European Monetary Union investments in foreign stock in 2004 outgrew the US foreign stock investments.[236] It has even became larger than the investments of the UK and US combined.[237] The largest outward investor in term of stock in 2004 was the European Monetary Union with a total investment of US$ 5,189,738 million followed by US with a total of US$ 2,018,205 million and UK with a total of US$ 1,378,130 million.[238] Similarly, the most recent OECD report regarding foreign direct investments showed that in the first half of 2019, Japan was the world leading outward investor, not the US.[239]

3.2.5 Summary

This section examined four indicators of convergence: ownership structure, market for corporate control, management pay and foreign direct investments. All four indicators showed no sign of convergence towards the Anglo-American model or any other model.

[232] Hansmann and Kraakman, 'The End of History for Corporate Law' (n 4) 453

[233] Guillén, 'Corporate Governance and Globalization: Is There Convergence Across Countries?' (n 20) 231

[234] Ibid

[235] Ravi Ramamurti and Jitendra V Singh, *Emerging Multinationals in Emerging Markets* (Cambridge University Press 2009) 7

[236] Peter Gammeltoft, 'Emerging Multinationals: Outward FDI from the BRICS Countries' (2008) 4 International Journal of Technology and Globalisation 5, 11-16

[237] Ibid

[238] Ibid

[239] Organisation for Economic Co-operation and Development, *FDI in Figures* (Organisation for European Economic Cooperation 2019) 4

Studies that examined the first indicator—the ownership structure—have revealed that it is still widely dispersed in the US and UK and concentrated in Germany and other European countries. Indeed, many studies have confirmed that listed companies in the US and UK markets have the least ownership concentration among other wealthy countries during the 1990s and by the end of 2017.[240]

It was documented that in the 1990s, the average size of the voting block held by the largest shareholder of listed companies in the US and UK was about 22% Furthermore, only about 27% of these companies had a single shareholder who controlled more than 10% of the company's shares.[241] In 2017, it was reported that the percentage of listed companies where the largest shareholder held more than 50% of the equity is close to zero in both markets.[242]

In comparison, many studies on German companies found that, on average, the largest block-holder controlled around 46% of a company's shares during the 1990s and 2017.[243] Moreover, it was reported that in the 1990s, voting blocks that controlled 20% or more of a company’s total shares were common in more than 85% of German listed firms.[244] Similarly, a 2017 study found that about 40% of the German listed companies had at least one shareholder who owned more than 50% of the total shares.[245]

Moreover, the studies reviewed have revealed that ownership is also widely dispersed in Japan. However, this does not indicate a convergence towards the American model for two reasons. First, Japan still has a unique ownership structure that places it far away from the Anglo-American model.

[240] La Porta, Lopez-De-Silanes and Shleifer, ‘Corporate Ownership Around the World’ (n 122) 492; De La Cruz, Medina and Tang, ‘Owners of the World's Listed Companies’ (n 166) 18-19

[241] Van der Elst, ‘The Equity Markets, Ownership Structures and Control: Towards an International Harmonisation’ (n 161) 33-35

[242] De La Cruz, Medina and Tang, ‘Owners of the World's Listed Companies’ (n 166) 18-19

[243] Edwards and Weichenrieder, ‘Ownership Concentration and Share Valuation: Evidence from Germany’ (n 195) 17; Van der Elst, ‘The Equity Markets, Ownership Structures and Control: Towards an International Harmonisation’ (n 161) 34; Tuschke and Sanders, ‘Antecedents and Consequences of Corporate Governance Reform: The Case of Germany’ (n 195) 641; De La Cruz, Medina and Tang, ‘Owners of the World's Listed Companies’ (n 166) 18-19

[244] Franks and Mayer, ‘Corporate Ownership and Control in the UK, Germany, and France’ (n 160) 33; Faccio and Lang, ‘The Ultimate Ownership of Western European Corporations’ (n 163) 378; Becht and Boehmer, ‘Transparency of Ownership and Control in Germany’ (n 192) 37

[245] De La Cruz, Medina and Tang, ‘Owners of the World's Listed Companies’ (n 166) 18-19

Second, the data presented in this section clearly shows that the concentration levels have not changed over time in Japan.

Moreover, it is important to note that the first indicator only discussed the ownership concentration and control of companies, not the identity of the shareholders which has under gone significant changes in recent years. For example, the ownership of foreign investors in the UK stock market rose from only 4% in 1981 to 54.9% by the end of 2018 of all quoted companies' shares.[246] Similarly, in the US institutional investors own about 72% of the total market capitalisation as of the end of 2017.[247] However, the ownership and control is still widely dispersed in the US, UK and Japan and concentrated in Germany, as described previously.

The other three indicators, reviewed in this section, all conform to the classical views of the models that distinguish the models from each other. They support the claim that there is only limited evidence that a convergence is actually taking place and that there are no major differences between the description of the models presented in the first chapter and the empirical findings. However, the data presented in this chapter show little change over a long time periods, which suggest a strong resistance to globalisation in the field of corporate governance.

3.3 Conclusion

This chapter reviewed the theoretical and empirical work on convergence to determine whether corporate governance models are converging. Initially, the theoretical work was reviewed which included the arguments of the proponents and opponents of the convergence theory as well as the proponents' vision of the future and views of the methods of convergence. The advocates of the convergence theory believe that the forces of globalisation and competition are going to eliminate the differences in corporate governance practices, declaring a soon end to the history of diversity among corporate governance models. They expect corporate governance models to converge on either the Anglo-American model, a hybrid model combining the features of the stakeholder and shareholder models, or an undefined model that will eventually prevail over time. On the other hand, the opponents of the convergence theory argue that corporate governance systems are unlikely to converge for variety of reasons

[246] Office for National Statistic, *Ownership of UK quoted shares: 2018* (Office for National Statistic 2020) 7

[247] Organisation for Economic Co-operation and Development, *OECD Corporate Governance Factbook 2019* 17

such as path dependence, complementarity and interest groups. They explain that the diversity in cultures, legal origins, and political interests caused corporate governance models to diverge and are likely to do so in the future.

Thereafter, the chapter analysed the empirical work on the convergence, which supported the opponents' theory to a large extent. In particular, the chapter examined four indicators to find out whether corporate governance models are converging or not, the ownership structure, the market for corporate control, management pay and foreign direct investments. All four indicators support the claim that there is only limited evidence that a convergence is actually taking place and indicates there are no major differences between the description of the models presented in the first chapter and the empirical findings.

By the end of this chapter, two broad conclusions emerged. First, despite the vigorous sophisticated position of the advocates of the convergence theory, there is only a small amount of empirical evidence supporting their claims. Second, the empirical data reviewed in this chapter suggest persistence of diversity in the corporate governance field. There was only a little change over the last four or five decades regarding the four studied indicators. Such limited convergence despite a global efforts of harmonisation and increasing international trades and communications indeed merit an explanation. The next chapters of this thesis will discuss whether the cultural, legal, political or capitalist theories can provide an adequate explanation for such limited convergence.

Chapter 4
Capitalism in Theory and Practice

As stated previously, one of the objectives of this thesis is to explore how corporate governance relates to the capitalist economy and the effect of this relationship on the legal transplantation process in the area of corporate governance. Therefore, defining and introducing the concept of capitalism is necessary. Determining whether a relationship exists between corporate governance and capitalism is not possible without comprehending these two concepts. Hence, a background on corporate governance was provided in the second chapter and now this chapter is designated to provide an overview of the subject of capitalism.

This chapter aims to explore the nature of capitalism, describe the concept, explain its features and relate the different types of capitalisms. In particular, the chapter, first, answers the question of what is capitalism? Then, it provides an overview of two theoretical approaches to capitalism and some regional models. The purpose of discussing the theoretical approaches to capitalism is to identify capitalism in its purest and optimal forms, while the purpose of describing some of the various regional forms is to depict a clear picture of capitalism as it has been practised around the world. Achieving these objectives helps in understanding capitalism and contributes to enabling us to answer the main questions of the thesis.

4.1 What is Capitalism?

Capitalism as a term only gained acceptance in the English, French, and German languages and acquired its particular meaning it has for us today in the second half of the nineteenth century.[1] A large number of classical scholars whose writing shaped the everlasting debate on capitalism such as Adam Smith, John Stuart Mill, and Karl Marx never used the word.[2] The first use of the term in print was in 1788 in a French journal. However, the paper did not draw much attention until 1849 when Louis Blanc condemned what he called 'capitalism'.[3] The term then gained a gradual usage after that.

[1] Jürgen Kocka, *Capitalism: A Short History* (Jeremiah Riemer tr, English edn, Princeton University Press 2016) 2

[2] Michael Merrill, ‘How Capitalism Got its Name’ (2014) 61 Dissent 87, 87-88

[3] Ibid, 88

As a concept, capitalism has evaded a simple definition and has provoked lasting arguments as to what it involves for a long time. Scholars have been arguing on the very nature of capitalism and what it constitutes. They have been debating whether is it a social system, an economic theory, a political doctrine, a religion, an organisational principle, or simply a theoretical approach, as well as what are the features that precisely define it and distinguish it from other systems of thought.

The Oxford dictionary, along with a large group of scholars, believe that capitalism is an economic system.[4] The dictionary states that it is *"an economic system in which private capital or wealth is used in the production or distribution of goods, and prices are determined mainly in a free market'.*[5] A second group of authors consider it a social system in which individual rights, including property rights, are recognised.[6] A third group of scholars argues that capitalism is a political system or at least *'an indirect system of governance based on a complex and continually evolving political bargain in which private actors are empowered by a political authority to own and control the use of property for private gain subject to a set of laws and regulations'* [7] emphasising the role that the government plays in capitalist countries.[8] Some scholars even believe that capitalism has some religious aspects.[9] Finally, other authors

[4] Oxford English Dictionary, *"capitalism, n.2"* (Oxford University Press). See for example, Erik Olin Wright, 'Compass Points: Towards a Socialist Alternative' (2006) 41 New Left Review 124, 106; Marc T. Jones, 'Missing the Forest for the Trees' (1996) 35 Business & Society 7, 9; Gregory Albo, 'A World Market of Opportunities? Capitalist Obstacles and Left Economic Policy' (1997) 33 Socialist Register 5, 8

[5] Oxford English Dictionary, *"capitalism, n.2"* (n 4)

[6] A. Rand and others, *Capitalism: The Unknown Ideal* (Penguin Publishing Group 1986). See for more examples, L. Patriquin, *Agrarian Capitalism and Poor Relief in England, 1500-1860: Rethinking the Origins of the Welfare State* (1st edn, Palgrave Macmillan 2007) 32; Geoffrey M. Hodgson, 'Capitalism, Complexity, and Inequality' (2003) 37 Journal of Economic Issues 471, 471

[7] Bruce R Scott, 'The Political Economy of Capitalism' (2006) Harvard Business School Working Paper No 07-037 <https://www.hbs.edu/faculty/publication%20files/07-037.pdf> accessed 25 Augest 2017, 4

[8] Lorand B. Szalay and Rita Mae Kelly, 'Political Ideology and Subjective Culture: Conceptualization and Empirical Assessment' (1982) 76 American Political Science Review 585, 590; Edward W Younkins, 'Morality and Character Development: The Roles of Capitalism, Commerce, and the Corporation' (2001) 4 Journal of Markets and Morality 94, 109

[9] Scholars have contrasting views of the relationship between religion and capitalism. Some authors, such as Karl Marx and Max Weber, argue that capitalism places value only on monetary commodities, which will result in dissolving societies' bonds and forcing religions to be powerless. Others assert that Jewish, Protestant, and Catholic teachings have great influence on capitalism, citing verses from the Bible and the Torah that praise wealth and denounce poverty. A

believe that capitalism is often thought of as having a real force with the capacity to effect change; while in reality, however, some scholars assert that capitalism is only a theoretical concept best treated like a metaphor.[10] They argue that capitalism is a passive market system which, in its perfect form, is autonomous and self-regulating.[11]

This ongoing debate on the nature of capitalism is matched by another controversy, namely its distinguishing features. Determining the nature of capitalism is inadequate in any attempt at defining it. Whether it is a social, political, economic, religious, or theoretical model, its characteristics must be identified precisely to distinguish it from other similar systems. For John Maynard Keynes, the founder of modern macroeconomics, capitalism is identified by *'a private ownership system marked by great openness to the new commercial ideas and the personal knowledge of private entrepreneurs'*.[12] Similarly, capitalism for Merrill (2014) '*refers to a kind of economy, variously characterized by private industry, free enterprise, competitive markets, and lots of investment opportunities, which most people believe are valuable parts of the way we live together'*.[13] Another definition with a focus on the role played by markets is provided by Wood who describes capitalism as:

> *'a system in which virtually all goods and services are produced for and obtained from, the market. More fundamentally, it is a system in which those who produce and those who appropriate the surplus labour of direct producers are dependent on the market for the basic conditions of their survival and self-reproduction'.*[14]

third group of scholars argues that the influence of religion over capitalism is only limited to the social market approach to capitalism, asserting that this approach is essentially a compromise between the laissez-faire, Catholic and Protestant ethics. Finally, some believe that there is only an indirect relationship between religion and capitalism, arguing that religions either allow or block the application of capitalism in a society. See, David W Haddorff, 'Religion and the Market: Opposition, Absorption, or Ambiguity?' (2000) 58 Review of Social Economy 483, 487; G. De Beuckelaer, *It's Broken, Let's Fix It: The Zeitgeist and Modern Enterprise* (1st edn, Springer 2002) 19, 20; Konrad Zweig, 'The Origins of the German Social Market Economy' (1980) Adam Smith Institute, Research Paper <https://www.adamsmith.org/s/social-market-economy.pdf> accessed 29 Decmber 2018, 2; John A Hall, 'Religion and the Rise of Capitalism' (1985) 26 European Journal of Sociology/Archives Européennes de Sociologie 193, 222

[10] Richard Grassby, *The Idea of Capitalism Before the Industrial Revolution* (1st edn, Rowman & Littlefield 1999) 2

[11] Ibid, 2-3

[12] Edmund S. Phelps, 'Corporatism and Keynes: His Views on Growth' in R. Dimand, R. Mundell and A. Vercelli (eds), *Keynes's General Theory After Seventy Years* (1st edn, Palgrave Macmillan 2010) 91

[13] Merrill, 'How Capitalism Got its Name' (n 2) 87

[14] Ellen Meiksins Wood, 'Peasants and the Market Imperative: The Origins of Capitalism' in A. Haroon Akram-Lodhi and Cristóbal Kay (eds), *Peasants and*

In a similar vein, Max Weber's definition of capitalism, according to Swedberg and Agevall (2016), is that it is '*where we find property as an object of trade and is utilized by individuals for profit-making enterprise in a market economy*'[15]

Furthermore, the freedom to determine prices is also regarded as a key distinguishing feature of capitalism. Douglas (1919) said *'capitalism is not a system of administration at all; it is a system of fixing prices in relation to effort'*.[16] Similarly, McEachern (2006) defines capitalism as *'an economic system characterized by the private ownership of resources and the use of prices to coordinate economic activity in unregulated markets'*.[17] Albert (1993) also describes it in the same way and adds to the freedom of prices determination, the idea that capitalism provides the freedom of conscience in a democratic environment.[18] Other scholars, such as McCloskey (2010), describes capitalism as '*merely private property and free labour without central planning, regulated by the rule of law and by an ethical consensus'*,[19] emphasising two pillars of capitalism, private property and free labour and their ethical impact on society. Finally, Gras (1947) points to the importance of capital utilisation in forming capitalism by stating that *'capitalism is a system of getting a living directly through the use of capital goods or intermediately through capital funds'*.[20]

The debate over the essence of capitalism and what it constitutes persists and will most likely continue to do so. This is so not only because scholars vary in their views of capitalism and their world but also for a variety of other reasons. First, the definitions of a capitalist economy differ significantly because capitalism has evolved through history. Thus, the conception of what constitutes capitalism has changed over time. A definition, for example, of eighteenth-century capitalism should differ significantly from a definition of a twenty-first-century capitalist economy. Second, some scholars define

Globalization: Political Economy, Agrarian Transformation and Development (1st edn, Routledge 2012) 37-38

[15] R. Swedberg and O. Agevall, *The Max Weber Dictionary: Key Words and Central Concepts* (2nd edn, Stanford University Press 2016) 27

[16] Major C. H. Douglas, 'What is Capitalism?' (1919) English Review, 1908-1937 166, 167

[17] William A. McEachern, *Economics: A Contemporary Introduction* (7 edn, Thomson South-Western 2006) 40

[18] Michel Albert, *Capitalism Vs. Capitalism: How America's Obsession With Individual Achievement and Short-Term Profit has Led it to the Brink of Collapse* (Paul Haviland ed, 1st edn, Four Walls Eight Windows 1993) 3

[19] Deirdre N. McCloskey, *The Bourgeois Virtues: Ethics for an Age of Commerce* (1st edn, University of Chicago Press 2010) 14

[20] NSB Gras, 'What Is Capitalism in the Light of History?' (1947) 21 Bulletin of the Business Historical Society 79, 83

capitalism for the purpose of distinguishing it from a particular system such as socialism or communism.[21] This practice has resulted in a great variety of definitions because these definitions only mention the characteristics that distinguish capitalism from these particular systems. For example, many academics define capitalism only as a system that recognises private property rights.[22] Such descriptions do not define capitalism, but merely distinguish it from socialism. Finally, definitions differ because while some scholars describe capitalism as a general theoretical system, others give a definition for capitalism as it been practised in every country or region.

This great diversity in defining capitalism makes it hard to choose a definition. Therefore, the thesis avoids giving or choosing a formal definition of capitalism. Presenting a proper definition requires a substantially longer study that is beyond the scope and objectives of this research. However, a description of the basic features of the most prominent two theoretical approaches to capitalism should suffice for the purposes of the thesis in explaining the concept and giving a good background to it.

4.2 Theoretical approaches to Capitalism

In this section, two theoretical approaches will be described. The first model is free market capitalism, which this thesis sometimes refers to as the pure, optimal, laissez-faire, free market, or classical form of capitalism. This theoretical form of capitalism is what classical economists, such as Adam Smith, Jean-Baptiste Say, David Ricardo, Thomas Robert Malthus, Karl Marx, and John Stuart Mill, discuss in their writings. The second model is social market capitalism. This model is sometimes referred to in the literature as neo-liberalism or ordo-liberalism. Both models, the free market and social market

[21] According to the oxford dictionary, socialism is ‘A political and economic theory of social organization which advocates that the means of production, distribution, and exchange should be owned or regulated by the community as a whole.’ ‘socialism.’ In Oxford Dictionary of English, edited by Stevenson, Angus. : Oxford University Press,, 2010. http://www.oxfordreference.com/view/10.1093/acref/9780199571123.001.0001/m_en_gb0788140.; And communism is ‘A theory or system of social organization in which all property is owned by the community and each person contributes and receives according to their ability and needs.’ ‘communism.’ In Oxford Dictionary of English, edited by Stevenson, Angus. : Oxford University Press,, 2010. http://www.oxfordreference.com/view/10.1093/acref/9780199571123.001.0001/m_en_gb0166990.

[22] See for example, William J Baumol, Robert E Litan and Carl J Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity* (1st edn, Yale University Press 2007) 62

capitalism, are theoretical, meaning that some of the ideas described in this section are hypothetical. However, both models are conceived as ideal, thus, they drive economic development. Their importance comes from the fact that they are the driving principles of the US, UK, and German economic systems as well as many other countries.

4.2.1 Free Market Capitalism

Free market capitalism is founded on the following pillars: right to private ownership; motivation to make a profit; competition among economic units; freedom of choice with respect to consumption, production and investment; determination of prices based on the market; utilisation of labour; and a limited role for government in the economy. However, it is important to note that economists, political economists, sociologists and historians have adopted different perspectives in their analyses of this form of capitalism. To many authors, not all these seven pillars are required to be present to form this type of capitalist economy. Pure capitalism is definitely found where all these pillars are present in a single national economy and may or may not be found when only some of these pillars exist, depending on different authors’ opinions.

4.2.1.1 Private Property

One of the most critical distinguishing features of pure capitalism is that it recognises the right to private ownership, which means that private individuals and firms have a legal 'right to obtain, own, control, employ, dispose of, and bequeath land, capital, and other property'.[23] As a consequence, in a capitalist economy private individuals and firms, not the government, own most of the property resources. It is this extensive private ownership that gives capitalism its name.[24]

From a capitalist point of view, private property should be generally preferred to public property.[25] Proponents of classical capitalism argue that it is beneficial in that it encourages investment, innovation, exchange, maintenance of property, and economic growth, while denying it for individuals discourages productive work. There is little incentive to build a factory, farm a land, or stock a store if, ultimately, the government or someone else could take that property away.[26]

[23] Campbell R. McConnell, Stanley L. Brue and Sean M. Flynn, *Economics: Principles, Problems, and Policies* (20th edn, McGraw-Hill Education 2015) 32

[24] Ibid, 33

[25] Andrei Shleifer, ‘State versus Private Ownership’ (1998) 12 Journals of Economic Perspectives 133, 147

[26] McConnell, Brue and Flynn, *Economics: Principles, Problems, and Policies* (n23) 33

4.2.1.2 Self-interest (Profit Motive)

One of the essential features of free market capitalism is the motivation to make a profit, that is the motivation of the various economic units to act in pursuit of their own self-interests, without regard for social or political pressure.[27] Every economic unit tries to achieve its ultimate goal by prioritising his or her interests over the interests of all others. This is manifested in property owners selling or renting their properties for the highest feasible price, entrepreneurs trying to maximise their profits and minimise their losses, workers seeking to find the highest paying job with the best working conditions, and consumers endeavouring to buy products at the lowest possible price.[28]

However, because people cannot obtain what they want without addressing the needs of their counter-party, namely the person or entity that is at the other end of the transaction, the motive of self-interest can direct such transactions towards a successful exchange that benefit the two parties to the transaction.[29] Indeed, such self-interest motivated transactions benefit not only the transaction's parties but also the whole society. This is because by acting selfishly, each individual ends up advancing the society as if, in the words of Adam Smith, he was guided by an 'invisible hand'.[30] The profit motive ensures that resources are being allocated efficiently and that there is a fair diffusion of profits amongst members of society. When the cost of creating an article is greater than its value, this is, then, a sign that the energy and capital devoted to making it is misdirected. In other words, struggling or failing to make a profit can tell entrepreneurs when an article is no longer worth making and when to redirect their resources into another venture in order to ensure no resources are wasted.[31]

4.2.1.3 Competition

The operation of pure capitalism depends on competition among economic units.[32] In the classical capitalist theory, ideal competition is based on four conditions: (1) Freedom of independent sellers to enter into or exit the industry, (2) All sellers produce similar products, (3) Sellers alone have no power

[27] Economic units refer to any legal person that carries out production, consumption, or exchange; ibid, 34

[28] Ibid

[29] Ibid, 41

[30] Adam Smith, *The Theory of Moral Sentiments*, vol 1 (Wells and Lilly 1817) 249

[31] Henry Hazlitt, *Economics in One Lesson: The Shortest and Surest Way to Understand Basic Economics* (1st edn, Three Rivers Press 2010) 105-106

[32] Adam Buick and John Crump, *State Capitalism: The Wages System Under New Management* (1st edn, Springer 1986) 7-9

whatsoever to affect the price, and (4) sellers and buyers are fully aware of prices, costs, market opportunities, and availability of the product.[33] Perfect competition can exist only when all these four conditions are met. While few, if any, markets in the real world actually meet these conditions, this model of perfect competition plays a crucial role in capitalist literature as it is often regarded as an ideal type by which to judge the shortcomings of real world markets.[34]

Moreover, theorists of classical capitalism believe that antitrust regulations designed to increase competition are unnecessary.[35] They call for deregulations as competitive markets are self-regulatory. They argue that these regulations poses a great danger as it could be used as a governmental instrument that prevents new businesses from entering the market.[36]

4.2.1.4 Freedom of Choice and Enterprise

The freedom to choose with respect to consumption, production, and investment is one of the key pillars of capitalism.[37] Freedom of choice is closely related to the right of private property and refers to the owners' right to choose how to exercise their legal rights over their properties, to the consumer freedom to choose the products and services they want, and to the workers the right to choose the work they are qualified for and where they want to work.[38] The freedom of enterprise, on the other hand, refers to the right of private entrepreneurs to obtain and use economic resources to produce and sell their choice of goods and services in any market they want.[39]

4.2.1.5 Prices are Determined by Markets

In free market capitalism, the market determines the price, not the government.[40] The capitalist system works autonomously and needs no central control. When there is a surplus in supply, prices fall ending the glut and when there is shortage in supply prices rise in an automatic and elastic process.[41]

[33] John Sloman, Alison Wride and Dean Garratt, *Economics* (8th edn, Pearson Education M.U.A. 2012) 173

[34] Ibid

[35] Deepak Lal, *Reviving The Invisible Hand The Case For Classical Liberalism In The Twenty-First Century* (Indian edn, Academic Foundation 2006) 56

[36] Ibid

[37] Sarwat Jahan and Ahmed Saber Mahmud, ‘What is Capitalism?’ (2015) 52 Finance & Development 44, 44

[38] McConnell, Brue and Flynn, *Economics: Principles, Problems, and Policies* (n 23) 33

[39] Ibid, 34

[40] Grassby, *The Idea of Capitalism Before the Industrial Revolution* (n 10) 3

[41] Ronald H Coase, ‘The Nature of the Firm’ (1937) 4 Economica 386, 387

However, that does not mean that there is a lack of planning by individuals, as millions of decisions are made by households and businesses every day. Free markets prices allow the capitalist system to work by itself and to coordinate these decisions.[42]

It is asserted by many that allowing the market to determine prices in a decentralized manner, through interactions between buyers and sellers, usually results in a better allocation of resources. Sellers, service providers, and workers will naturally seek the highest reward for their products, which will be paid by those who need it most, thus creating a better allocation of resources.[43]

4.2.1.6 Wage Labour Relation

One of the most designating features of classical capitalism is what some scholars refer to as the 'reserve army of workers'.[44] In any capitalist society, most of the population work for other people for a wage or salary.[45] Individuals must contract with other people, who privately own the means of production. They agree to contribute a certain quantity or quality of work in exchange for a sum of money, and the goods or services produced by these workers do not belong to them but to the owners of the means of production.[46]

Wage labourers in capitalist economies, unlike serfs or slaves, are free to sell their labour power to anyone. They are free to choose the line and amount of work they desire with no other labour obligation except for what they freely bond themselves.[47]

4.2.1.7 Limited Role of Government

According to classical capitalist thought, the role of government in capitalist economies should be limited to protecting the rights of all its people and to keep an orderly environment that ensures the proper functioning of markets.[48] For this particular reason, this type of capitalism is sometimes called a 'laissez-

[42] McConnell, Brue and Flynn, *Economics: Principles, Problems, and Policies* (n 23) 35

[43] Jahan and Mahmud, 'What is Capitalism?' (n 37) 44

[44] Karl Marx, *Wage-Labour and Capital* (Harriet E. Lothrop tr, Online edn, Socialist Labor Party of America 2000) 36

[45] Daivd Schweickart, *After Capitalism: New Critical Theory* (2nd edn, Rowman & Littlefield Publishers 2011) 25

[46] Ibid

[47] David M Kotz, 'Is Russia Becoming Capitalist?' (2001) 65 Science & Society 157, 161

[48] Jahan and Mahmud, 'What is Capitalism?' (n 37) 44; Des Gasper, 'Capitalism and Human Flourishing? The Strange Story of the Bias to Activity and the neglect of Work' in John B. Davis (ed), *Global Social Economy: Development, Work and Policy* (1st edn, Routledge 2010), 15-16

faire' approach, which means 'to let do' or to allow people to do as they choose without government intervention.[49] The rationale for this is that government interventions inhibit and disturb the efficient working of the free market system.[50] Supporters of classical capitalism argue that every act of government intervention to cure a negative effect itself raises other negative effects and limits individuals' freedom directly or indirectly.[51]

4.2.2 Social Market Capitalism

The term ‘social market economy’ was first coined by Alfred Müller-Armack, a German economist and sociologist, in 1946.[52] However, the ideas of social market capitalism started to formulate soon after World War I among a group of scholars, later described as ordo-liberal or neo-liberal, such as Walter Eucken, Franz Böhm, Friedrich von Hayek, Wilhelm Röpke and Alexander Rüstow.[53] Their objective was to establish an economic system that assures social justice, human dignity and freedom.[54] They were under the impression that neither laissez-faire nor communism can facilitate a functional social justice economy. They believed that laissez-faire capitalism, due to the absence of any market regulation by the state, leads to the creation of power concentrations that eventually make the state an instrument in the hands of a few powerful cartels.[55] Similarly, they argued that the central planning and comprehensive regulations that exist in the communist system are doomed to fail and that economic value cannot be determined by the arbitrary dictates of political authorities.[56] Therefore, they were looking for a new approach that assumes

[49] McEachern, *Economics: A Contemporary Introduction* (n 17) 40

[50] McConnell, Brue and Flynn, *Economics: Principles, Problems, and Policies* (n 23) 32

[51] Milton Friedman, *Capitalism and Freedom: Fortieth Anniversary Edition* (40th Anniversary edn, University of Chicago Press 2009) 32

[52] Christian Watrin, ‘The Principles of the Social Market Economy: Its Origins and Early History’ (1979) 135 Zeitschrift für die gesamte Staatswissenschaft / Journal of Institutional and Theoretical Economics 405, 405; For more details on the origin of the term 'social market economy' see Nils Goldschmidt and Michael Wohlgemuth, ‘Social Market Economy: Origins, Meanings and Interpretations’ (2008) 19 Constitutional Political Economy 261, 362-365

[53] Alfred Müller-Armack, ‘The Meaning of the Social Market Economy’ in A.T. Peacock and H. Willgerodt (eds), *Germany's Social Market Economy: Origins and Evolution* (1st edn, Macmillan for the Trade Policy Research Centre 1989) 82-83

[54] Siegfried G. Karsten, ‘Eucken's 'Social Market Economy' and Its Test in Post-War West Germany: The Economist as Social Philosopher Developed Ideas That Parallelled Progressive Thought in America’ (1985) 44 American Journal of Economics and Sociology 169, 169

[55] Zweig, ‘The Origins of the German Social Market Economy’ (n 9) 21

[56] Norman Barry, ‘The Social Market Economy’ (1993) 10 Social Philosophy and Policy 1, 21; Alfred Müller-Armack, ‘The Social Market Economy as an Economic and Social Order’ (1978) 36 Review of Social Economy 325, 326

the advantages of free market capitalism and avoids socialists' critiques. The result was a new kind of synthesis that depends largely on free market capitalism and combines a decentralised market system with one that is socially beneficial.[57] This combination is regarded as the key element of a social market economy.[58]

In principle, social market capitalism, just like free market capitalism, regards the recognition of private property and the freedom of exchange rights as the best means of exploiting scarce resources for the maximisation of human wealth.[59] It also adopts the view that government involvement in the market should be kept to a minimum. However, it differs significantly from free market capitalism in the degree of state involvement and morality of the market.[60] In this section, the main characteristics of social market capitalism will be described, focusing on the differences between the pure form of capitalism and this form.

4.2.2.1 Social Balance

One of the main drivers of social market ideology is the belief in the necessity to have a social order that can intervene at least temporarily in the events of undesirable market outcomes.[61] Social market theorists believe that economic policies should not view market transactors as producers and consumers, but as human beings who desire freedom as well as social justice.[62] They believe that extracting social norms and values from economic policies erodes social bonds and places individuals in a painful isolation; as happens also, of course, under communism.[63] Alexander Rüstow, one of the founding fathers of social market capitalism, expresses this necessity to build the market on an ethical basis by stating that:

> *'The Social Market Economy must be the servant of humanity and of trans–economic values. All social, ethical, cultural and human values are more important than the economy, yet the economy must prepare the ground for their fullest development. For this reason the economy must not take on forms which are incompatible with these*

[57] Müller-Armack, 'The Meaning of the Social Market Economy' (n 53) 83

[58] Arne Heise and Özlem Görmez Heise, 'The Social Market Economy Revisited: The German Variety of Capitalism in Retrospect' (2013) 1 Izmir Review of Social Sciences 7, 9

[59] Barry, 'The Social Market Economy' (n 56) 8

[60] Ibid, 12

[61] Heise and Heise, 'The Social Market Economy Revisited: The German Variety of Capitalism in Retrospect' (n 58) 8

[62] Müller-Armack, 'The Social Market Economy as an Economic and Social Order' (n 56) 327

[63] Ibid

> *trans–economic values. Hence, we are opposed to a planned or interventionist economy, because such an economy ends in collectivism. Only a socially orientated market economy yields personal freedom and the opportunity for the realisation of the transcendental values. The constitution of the market economy must never overlook these moral considerations and the fact that man is in the centre of things.'*[64]

However, although social market theorists agree on the need for a balanced social order, they differ on what constitutes that balance. They agree that the market should be free, but do not accept the result of the free market unless it leads to a social balance and that if such balance does not result from the market itself, the state should intervene to create that balance.[65] However, they don't give a precise meaning for social balance. While some of them limit the social policy to unemployment or loss of income caused by illness or old age, others include not only health, old age and unemployment, but also the improvements of towns, education, workplace and overall social environment.[66]

Social market theorists often justify this integration of social policy into the economic system based on ethical and moral grounds. However, some try to give a logical explanation for this integration. They explain that every person has entitlement rights over their property, including that of selling their own labour, and that these rights determine each person's material welfare.[67] Furthermore, they explain that the economic value of each individual's rights varies depending on the right itself and the individual's abilities. For example, the economic value of someone's labour usually vary depending on his or her abilities and level of education. Thus, some people may sometimes fail to accumulate enough of what is necessary to live an acceptable life. Charitable donations can relieve such situations. Nonetheless, history shows the limitations of charitable work.[68]

Therefore, they argue that by applying the integration of social policy into the economic system to Rawls's 'veil of ignorance' assumption, the result would be a general acceptance of a binding social contract that creates a socially balanced society based on logical grounds.[69] Rawls's veil of ignorance brings

[64] Zweig, 'The Origins of the German Social Market Economy' (n 9) 9

[65] Ulrich Witt, 'Germany's" Social Market Economy": Between Social Ethos and Rent Seeking' (2002) 6 Independent Review 365, 367

[66] Zweig, 'The Origins of the German Social Market Economy' (n 9) 9

[67] Witt, 'Germany's" Social Market Economy": Between Social Ethos and Rent Seeking' (n 65) 368

[68] Ibid

[69] Ibid; Viktor J Vanberg, 'Market and State: The Perspective of Constitutional Political Economy' (2005) 1 Journal of Institutional Economics 23, 31

people back to their original position by hypothetically assuming that none of the members of society know their place in society, their class, fortune, assets, abilities, strength, intelligence, psychologies and even the particular political and economic circumstances of their own society.[70] When people don't know who will be the future payer and receiver of charity, they will rationally and unanimously accept a socially binding contract to create a social balance based on a notion of fairness.[71]

4.2.2.2 Role of the State in the Market and Social Life

Social market theorists believe that the role of government in social market economies should be limited and that government interventions inhibit and disturb the efficient working of the market system. They also assert that every act of government intervention to cure a negative effect itself raises other negative effects and limits individuals' freedom directly or indirectly. However, they also believe in the necessity to integrate social values and norms into economic policies and that monopolistic powers, which could corrupt market competition and governments, will always emerge whenever laissez-faire market policies are applied. Thus, they call for a strong state that can apply social policies and design a clear institutional framework within which free and spontaneous market processes take place.[72] They are convinced that, as a general maxim, state interventions must be measured against the social market doctrine and that only those interventions that are compatible with free market principles and constitute a socially useful framework should pass.[73]

In particular, social market theorists propose four precise means to identify the conditions that determine the admissibility or non-admissibility of a government intervention. First, the admissibility of state involvements could be determined through the adoption of economic constitutions.[74] Some social market theorists believe that every community's political constitution must contain the characteristics of its economic system and then, all the government decisions must be driven both from and constrained by the principles embodied

[70] John Rawls, *A Theory of Justice* (Revised edn, Harvard University Press 1999) 118

[71] Witt, 'Germany's" Social Market Economy": Between Social Ethos and Rent Seeking' (n 65) 369

[72] Flavio Felice and Massimiliano Vatiero, 'Ordo and European Competition Law' in Luca Fiorito (ed), *A Research Annual: Research in the History of Economic Thought and Methodology*, vol 32 (1st edn, Emerald Group Publishing Limited 2014) 149

[73] Watrin, 'The Principles of the Social Market Economy: Its Origins and Early History' (n 52) 421

[74] Ignacio Herrera Anchustegui, 'Competition Law through an Ordoliberal Lens' (2015) 2 Oslo Law Review 139, 147

in the constitution.[75] Second, the admissibility could also be decided by the conformity principle.[76] Specifically, state interventions are only acceptable when they work with market forces, not against them. For example, attempts by the state to influence prices or quantities are not admissible as they are not conformable with free market principles, while the attempts to fight monopolistic practices are permissible. Third, the principle of indirect regulations is also a way of determining the scope of state interventions. The idea of the indirect regulations approach is that government should not direct the process of the market. It should only set up forms and structures within which the market can function properly.[77] Finally, some scholars propose that even though the state is responsible for the innocent victims of necessary economic change, it cannot intervene to make amendments where most individuals can make these amendments for themselves.[78] A role for the state arises only in the event of social life or market failure that cannot be corrected without state intervention.

According to social market theorists, without such balanced and careful design of the state's role in economic and social life, the government would be under the control of monopolistic powers. They oppose the very idea of the invisible hand and that free markets are self-regulatory and assert that order and justice cannot be maintained without such a balanced government role.[79]

4.2.2.3 Wage Labour Relations

In both, free market and social market capitalism, workers are free to choose the line and amount of work they desire with no other labour obligation except of what they freely bond themselves to. However, social market economists condemn classical capitalism for bringing, according to them, miserable social conditions to the workers.[80] They argue that in classical capitalism, individuals are dependent on the impersonal market rules that does not differentiate between the market for goods and the market for labours. They believe that the workers in a labour market that is only dominated by supply and demand cannot cope with it without excessive harm to themselves and society.[81] They

[75] David J Gerber, 'Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the "New" Europe' (1994) 42 American Journal of Comparative Law 25, 45

[76] Josef Molsberger, 'Convergence on the Market?' (1985) 5 Economic Affairs 27, 29

[77] Gerber, 'Constitutionalizing the Economy: German Neo-Liberalism, Competition Law and the "New" Europe' (n 75) 47

[78] Barry, 'The Social Market Economy' (n 56) 8

[79] Werner Bonefeld, 'Adam Smith and Ordoliberalism: On the Political Form of Market Liberty' (2013) 39 Review of International Studies 233, 238

[80] Werner Bonefeld, 'Human Economy and Social Policy: On Ordo-Liberalism and Political Authority' (2013) 26 History of the Human Sciences 106, 109

[81] Ibid, 110

explain, using Karl Marx argument, that making the right to work a commodity that can be exchanged in a market based only on supply and demand forces workers to accept work in unsatisfactory conditions for minimum wages which result in the worker having a double free situation, free from owning a productive property and free from acquiring the means of subsistence.[82]

Therefore, designing a social policy that empowers workers is essential to social market capitalism. The writers of social market theory call for a balanced employment policy that is not driven from the extreme unilateral views of classic capitalism, but does not also interfere with the free pricing mechanism.[83] Mandatory legal regulations against arbitrary firing are a good example of such policy.[84]

4.3 Regional Models of Capitalism

Economists classify capitalism into different typologies using various criteria. The sensitivity in the work of many authors to the peculiarities of each national economic system has prompted a large number of typologies. However, since the only purpose of this section is to understand capitalism not in its theoretical forms but as it has been practised around the world, only three typologies were selected for review. The selected three typologies should suffice to describe the commonplace forms of capitalism since similarity prevails among these classifications. The first reviewed typology is devised by Hall and Soskice where they divide capitalism into two types based on how production takes place in two diametrically opposed institutional settings, the liberal market and coordinated market economies. Hall and Soskice's typology was selected based on the fact that it is the most, or one of the most, influential works on the verities of capitalism literature. The second reviewed work is Baumol, Litan, and Schramm's typology which classifies capitalism based on the role of firms in promoting innovation and economic growth. This typology was chosen because of its novelty and because, unlike the first one, it incorporates the role of the state in guiding the economy. The third typology labels capitalism according to the relationship among labour, the state, and capital as market-

[82] Karl Marx, *Capital: A Critique of Political Economy*, vol 1 (Frederick Engels ed, Progress Publishers 2015) 507

[83] Müller-Armack, 'The Social Market Economy as an Economic and Social Order' (n 56) 330

[84] Heise and Heise, 'The Social Market Economy Revisited: The German Variety of Capitalism in Retrospect' (n 58) 10

led, state-led, or negotiated capitalism. This typology is founded on Albert's classification, the pioneering work in the verities of capitalism literature.

4.3.1 Liberal Market Economies Vs Coordinated Market Economies

Peter Hall and David Soskice developed one of the most popular theories of the varieties of capitalism.[85] Their framework aimed to understand differences and similarities between capitalism in different countries by placing companies at the centre of their analysis and emphasising their role as agents of economic change. To determine a nation's particular type of capitalism, they measured the responses of firms against five coordination problems. The first test, the industrial relation problem, explores how companies negotiate wages and working conditions with their employees. Wages and productivity levels that condition the success of the firm, as well as rates of unemployment that effect the economy, are at stake here. Second, the vocational training and education problem, which asks how firms secure a labour force with suitable skills. The outcome of this coordination problem is the success of individual firms, workers, and nation states as it effects the competitiveness level of the overall economy. Third, the financing problem questions how companies gain access to finance and in which countries investors seek assurance of returns on their investments. At stake here is the availability of finance and under which terms firms can secure funds. Fourth, the problem of inter-firm relations analyses how firms in each individual country form relationships. These relationships ensure a stable demand for the firms' products, appropriate supplies of inputs, and access to technology. Finally, employer-employee relations investigates how companies build a relationship with their employees and how this relationship affects common problems such as moral hazard, adverse selection, and information sharing.[86]

[85] See, Peter A. Hall and David Soskice, *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (1st edn, Oxford University Press 2001); Peter A. Hall, ‘The Evolution of Varieties of Capitalism in Europe’ in Bob Hancké, Martin Rhodes and Mark Thatcher (eds), *Beyond Varieties of Capitalism: Conflict, Contradictions, and Complementarities in the European Economy* (Oxford University Press 2007); David soskice, ‘Macroeconomics and Varieties of Capitalism’ in Bob Hancké, Martin Rhodes and Mark Thatcher (eds), *Beyond Varieties of Capitalism: Conflict, Contradictions, and Complementarities in the European Economy* (Oxford University Press 2007); David Soskice, ‘Divergent Production Regimes: Coordinated and Uncoordinated Market Economies in the 1980s and 1990s’ in H. Kitschelt and others (eds), *Continuity and Change in Contemporary Capitalism* (Reprint edn, Cambridge University Press 2003) <https://books.google.co.uk/books?id=p-dxteI78XMC>

[86] Peter A. Hall and David Soskice, ‘An Introduction to Varieties of Capitalism’ in Peter A. Hall and David Soskice (eds), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (1st edn, Oxford University Press 2001) 7

Based on their study of how firms around the world devised solutions to these five problems, Hall and Soskice formulated two main types of capitalism, liberal market economies and coordinated market economies which can be pictured as being located at both ends of a wide spectrum. From their examination of firms within twenty-two of the largest OECD nations, they classified six nations as liberal market economies (the USA, Britain, Australia, Canada, New Zealand, and Ireland) and ten as coordinated market economies (Germany, Japan, Switzerland, the Netherlands, Belgium, Sweden, Norway, Denmark, Finland, and Austria). They left six nations (France, Italy, Spain, Portugal, Greece, and Turkey) in more ambiguous positions.[87] Hall and Soskice concluded that firms under liberal market economies and coordinated market economies respond differently to the five test problems mentioned above. The following discusses how liberal market and coordinated market economies response to the various problems that the authors identified.

4.3.1.1 The Industrial Relations Problem

Many firms around the world rely on a highly skilled labour force, which make them vulnerable to 'hold up' by their employees and 'poaching' of skilled workers by other firms.[88] The coordinated market economies address such problems by setting wages through industry-level bargains between trade unions and employer associations, which normally results in equalizing wages at equivalent skill levels across an industry. Such a strategy assures workers that they are receiving the highest feasible wages and makes it difficult for other competitive firms to poach workers. On the other hand, firms in liberal market economies often find it difficult to secure such economy-wide wage arrangements. Therefore, they often tend to depend on macroeconomic policy and market competition to control wages and inflation.[89]

4.3.1.2 The Vocational Training and Education Problem

Normally, neither workers nor employers will be interested in investing in industry-specific or firm-specific training unless workers are assured that an apprenticeship or training of some sort will result in lucrative employment, and unless employers believe that their apprentice employees will not be poached by other competitive firms that do not make equivalent investments in

[87] Ibid 21, 22

[88] In economics the 'hold up' problem means "the ability of specifically trained employees to extract future wage concessions because of the absence of perfectly substitutable employees in future periods." Linda Elizabeth Deangelo, ‘Unrecorded Human Assets and the "Hold Up" Problem’ (1982) 20 Journal of Accounting Research 272, 273

[89] Hall and Soskice, ‘An Introduction to Varieties of Capitalism’ (n 86) 27, 31

training.[90] In coordinated market economies such as Germany, firms deal with this problem by relying on industry-wide employer associations and unions to supervise the training system and to pressure enough companies to participate in it. By doing so, they limit the free-riding problem.[91] In contrast, companies in the liberal market economies are loath to invest in apprenticeships, since there is no guarantee that other firms will not simply poach their apprentices. Instead, they depend on the formal education system to graduate workers with high levels of general skills.[92]

4.3.1.3 The Financing Problem

Corporations in coordinated market economies typically have access to finance that is not entirely dependent on publicly available financial data. This is so because investors have access to inside information through dense networks and concentrated ownership that exist among firms that enable them to judge the value of their investments.[93] The relevant contrast is with companies in liberal market economies, where investors rely exclusively on balance sheets and other publicly available information.[94]

4.3.1.4 The Inter-Firm Relations Problem

In liberal market economies, the relationship with other companies in an industry is very competitive and adversarial. Companies even depend on this adversarial relationship to secure the transfer of technology by hiring scientific or engineering personnel from other companies. However, these relations are often mediated by antitrust regulations.[95] In contrast, in coordinated market economies, firms tend to cultivate inter-firm relations to ensure the diffusion of technology in a cooperative environment. Some coordinated economies have even developed a unique system of contract law to encourage relational contracting among firms.[96]

4.3.1.5 The Employer-Employee Relationship

While firms in liberal market economies have no obligation to establish representative bodies for their employees and top management has unilateral

[90] Ibid, 25-26

[91] Ibid

[92] See ibid, 30; Pepper D. Culpepper, ‘Employers, Public Policy, and the Politics of Decentralized Cooperation in Germany and France’ in Peter A. Hall and David Soskice (eds), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (1st edn, Oxford University Press 2001) 277

[93] Hall and Soskice, ‘An Introduction to Varieties of Capitalism’ (n 86) 22-23

[94] Ibid, 29

[95] Ibid, 30-31

[96] Ibid, 26

control over the firm, including freedom to hire and fire, top management in coordinated market economies must secure agreements for major decisions from supervisory boards, which include employee representation.[97] This is particularly evident in Germany where co-determination exists as a critical element of corporate governance. Even in smaller companies, there are works councils which also enable employee input into the operation of a business.

4.3.2 Baumol et al. Typology of Capitalism

More recently, Baumol, Litan, and Schramm (2007) have identified four types of capitalism according to the role that entrepreneurship plays in the long term in developing capitalist economies; these types are, oligarchic capitalism, state-guided capitalism, big-firm capitalism, and entrepreneurial capitalism.[98] Each of these four types is very different from the others, with only one thing in common, namely private ownership. This is so because the authors define capitalism as an economic system in which the most or at least substantial portion of its production is held privately.[99]

However, before proceeding with identifying the types, it is notable that national capitalist economies are often different combinations of the four types at every stage of their histories.[100] A country's economy can be characterised as state-guided, for example, at one point of a time and oligarchic at another. It can also be characterised as a mix of two or more types at any one time. In fact, the authors believe that the best form of capitalism is a mix of two types, the entrepreneurial and the big-firm capitalisms.[101] Therefore, the authors sometimes identify the same country as an example of two types of capitalisms.

4.3.2.1 Oligarchic Capitalism

In oligarchic capitalism, the means of production are concentrated in the hands of a few families who retain effective control over the bulk of the activities of their nation's economy. These families are the oligarchs who determine a

[97] Ibid, 24

[98] William I Baumol, Robert E Litan and Carl I Schramm, 'The Four Types of Capitalism, Innovation, and Economic Growth' in Dennis C Mueller (ed), *The Oxford Handbook of Capitalism* (1st edn, Oxford University Press 2012) 119-121

[99] Baumol, Litan and Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity* (n 22) 62

[100] Ibid, 61

[101] Ibid, 61-62

country's economic policies. Countries in Latin America, Africa, the Middle East and Russia provide good examples of oligarchic capitalism.[102]

According to the authors, oligarchic capitalistic economies generally have several common characteristics. First, wealth is usually distributed extremely unequally. Most of the people in such economies are left in poverty with very few opportunities for improvement.[103] Second, informal economic activities are widespread. Informal activities are defined as usual constructive activities, such as selling goods and services, which are conducted illegally because they lack official approval or licencing. These informal activities have the potential to contribute to economic growth. However, they are intentionally kept that way by governments because they are not in the best interests of the oligarchic elites. Finally, oligarchic capitalistic economies are typically overwhelmed by corruption. Although corruption can be found in any economic system, the corruption in oligarchic systems is inherent.[104]

4.3.2.2 State-guided Capitalism

In state-guided capitalism, although a substantial proportion of the means of production is in private hands, the government still plays a powerful role in directing the economy by deciding which industries and even which individual firms should grow.[105] Good examples of this kind of economy are South Korea, following World War II, and China.[106] Some elements of limited state guidance are also observed in France, Germany and the United States.[107]

Unlike oligarchic capitalistic economies in which the main objective of government officials is to enrich oligarchic elites, governments under state-guided capitalism aim to actually maximise economic growth. As a result, growth in oligarchic capitalistic economies is often extremely modest or even negative, whilst in state-guided economies, actual growth can be realised, particularly in essentially stagnant economies.[108]

[102] Baumol, Litan and Schramm, ‘The Four Types of Capitalism, Innovation, and Economic Growth’ (n 98) 119

[103] Ibid

[104] Baumol, Litan and Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity* (n 22) 76-77

[105] Ibid, 62-63

[106] Baumol, Litan and Schramm, ‘The Four Types of Capitalism, Innovation, and Economic Growth’ (n 98)120

[107] Baumol, Litan and Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity* (n 22) 66

[108] Baumol, Litan and Schramm, ‘The Four Types of Capitalism, Innovation, and Economic Growth’ (n 98) 119-120

However, despite the success of state-guided economies in realising remarkable growth, state-guided capitalism has many pitfalls. First, economic growth of this type is often only short term, especially when the economy moves towards the technological frontier and government officials try to ascertain how to develop entirely new products.[109] 'After picking the low-hanging fruit, the difficulties of harvesting grow much greater.'[110] Second, guiding the economy towards a particular industry could result in an excessive investment. An example of this is what happened in South Korea in the late 1990s. The South Korean government encouraged its banks to provide loans to business conglomerates called 'chaebols'. In 1997, when the Asian financial crisis spread to South Korea, the entire South Korean economy came close to a collapse. The excessive investment of too many banks in a particular conglomerate led to overexpansion in that particular industry, which, in turn, dragged the entire economy into the crisis. Third, an obvious drawback of this type is that officials in state-guided economies could steer their countries in the wrong direction. Selecting the right industry to promote is very difficult, especially for countries approaching the technological frontier. Another disadvantage of this type is that state-guided capitalist systems are vulnerable to corruption. In economies where the success of any business is dependent on governmental support, firms are induced to try earning such a support legally or illegally. Finally, changing the course of the economy once a state has committed its resources towards a particular venue is difficult. Opposition from interest groups often prevent such changes.[111]

4.3.2.3 Big-Firm Capitalism

In big firm capitalism, government policy is characterised by restraint and most of the economy's production means are in the hands of a few companies. Typically, these companies are very large, have passive original founders, have ownership that is diffused among thousands of shareholders, are managed by professional managers, and finally, enjoy great governmental promotion. A good example of this type of economy is Japan in the post-World War II period, continental Europe, and South Korea.[112]

[109] Ibid, 120

[110] Baumol, Litan and Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity* (n 22) 67

[111] Ibid, 70

[112] Baumol, Litan and Schramm, ‘The Four Types of Capitalism, Innovation, and Economic Growth’ (n 98) 120; Baumol, Litan and Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity* (n 22) 80

According to the authors, big-firm capitalism has some disadvantages. First, big firm capitalism is often oligopolistic. This is so because when a firm that is promoted by a government succeeds in securing a large body of customers, it can block other competitors from entering the market, especially when the value of its products depends on the number of people using it. In such cases, the large firm, by itself, not through the market, can determine the prices of its products and charge more at times to ensure higher returns and less at other times to eliminate competition. Such practices render the markets to be highly concentrated or even sometimes monopolistic.[113] Second, firms in oligopolistic markets usually have no incentive to be innovative. Firms with pricing powers can earn profits higher than their counterparts in other competitive markets; thus, they tend to be lazy when it comes to innovation. They even sometimes leverage their power into other markets to prevent new technologies and innovations.[114] Finally, the large firms in this type of capitalism can become so bureaucratic and resistant to change that they fail to act properly on radical ideas. This resistance can infect employees and induce them to prioritise job security over personal growth and contribution to the company.[115]

However, although big firm capitalism can create oligopolistic markets, prevent innovation, and corrupt workers, empirical evidence shows that such enormous firms do not preclude economic development. In fact, they can play a critical role in stimulating productivity and economic growth.[116] Oligopolies could be the most efficient economic form for customers if the cost structure or network effects in a market can only bear a few companies. In other words, when the fixed and variable costs of manufacturing a product is substantially lower for larger companies than smaller companies or when the cost of the product falls with every additional user, then oligopolies can be advantageous. Hyundai and Samsung in South Korea and Toyota and Honda in Japan can represent the best of big firm capitalism. These firms have continuously developed their products and introduced many innovative ideas. However, that is not the typical pattern for large companies.[117]

[113] Baumol, Litan and Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity* (n 22) 80-81

[114] Ibid

[115] Ibid

[116] Baumol, Litan and Schramm, 'The Four Types of Capitalism, Innovation, and Economic Growth' (n 98) 120

[117] Baumol, Litan and Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity* (n 22) 82

4.3.2.4 Entrepreneurial Capitalism

The entrepreneurial model, unlike the first three types, is characterised by the dominance of a large number of small firms, and most innovations are introduced by these firms, not by the government or oligopolistic firms. When such small businesses thrive, they bring continuous prosperity to the whole economy.[118] A good example of this type of economy, is the United States since the 1990s.[119] Other countries, such as the United Kingdom and Ireland, seem to be in the process of limiting the guiding role of the state and shifting towards this type of capitalism.[120]

Individual entrepreneurs and small firms, not oligopolistic firms, are usually the first to identify promising innovations and introduce them to the world. This is so because successful radical innovation, if undertaken by an individual entrepreneur, promises a massive sum of money and wealth; whereas, when the same innovation is developed by an employee of a large firm, often the prize is nominal in comparison to what awaits their independent counterpart. Moreover, individual entrepreneurs enjoy another reward—a psychological or emotional reward. Being one's own boss, taking pride in self-accomplishments, and so forth are extra incentives for radical innovators in small businesses.[121] Finally, small businesses can take more risks than big firms as they do not need to justify their actions to a board or group shareholders. Therefore, it is often economical for large firms to wait for entrepreneurs to invent a product and then buy them out.[122]

4.3.3 Coates Typology of Capitalism

Coates typology of capitalism is based on Albert's classification, one of the classical typologies of capitalism. According to Albert, there are two kinds of capitalisms, neo-American and Rhine capitalisms. The neo-American model of capitalism is dominated by individualism and short-term financial gain while the Rhine model is based on collective success and long-term gains.[123] Albert's typology was then developed by Coates to include a third type, the state led capitalism, and to differentiate between the German and Japanese capitalism. Coates examined the relationships between the market and labour, the market

[118] Baumol, Litan and Schramm, 'The Four Types of Capitalism, Innovation, and Economic Growth' (n 98) 121

[119] Baumol, Litan and Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity* (n 22) ix

[120] Ibid, 89

[121] Ibid, 87-88

[122] Ibid

[123] Michel Albert, *Capitalism Against Capitalism* (1st edn, Whurr Publishers 1993) 18

and state, and the state and labour. Coates then concluded that capitalism can be differentiated by the three following types.

4.3.3.1 Market-led capitalism

Coates refers to this type of capitalism as 'liberal capitalism', while Albert often attaches the terms 'neo-American' and 'Anglo-Saxon' to this model of capitalism.[124] In market led capitalisms, the following features characterise the economy. First, companies are negotiable goods like any other commodity.[125] They enjoy a higher level of freedom to pursue their own short-term profit motives, to raise capital, and to manage their internal affairs.[126] Second, the labour market is largely unregulated, and worker unions are relatively weaker. Workers enjoy limited statutory rights and move between jobs many times during their careers. Their wages are fundamentally individualised and highly negotiable, and vocational training is often not an option.[127] Third, government intervention in the economy is limited. The market is typically left to regulate itself, and state involvement is always at the minimal level.[128] Finally, the overall economy is characterised by individualism and short-term financial gains. This particular individualism is probably what has encouraged the property view of companies, the freedom of the labour market, and the limited role of government.[129]

The United States is treated as the quintessential example of this type of capitalism by both Albert and Coates. However, for Albert the United States is the only example of this model, while for Coates the United Kingdom, since 1979, also has been a good example of this type.[130] According to Coates, the UK economy prior to 1979 settled closer to the German model than that of the US. Workers, in the UK prior to 1979, were given extensive welfare rights, access to industry-wide training, and freedom to join a labour union of their

[124] See, ibid; David Coates, *Capitalism: The Basics* (1st edn, Routledge 2016); David Coates, ‘Models of Capitalism in the New World Order: The UK Case’ (1999) 47 Political Studies 643; David Coates, *Models of Capitalism: Growth and Stagnation in the Modern Era* (1st edn, Polity Press 2000); David Coates, ‘Varieties of Capitalism and ‘the Great Moderation’’ in Matthias Ebenau, Ian Bruff and Christian May (eds), *New Directions in Comparative Capitalisms Research: Critical and Global Perspectives* (1st edn, Palgrave Macmillan 2015)

[125] Albert, *Capitalism Against Capitalism* (n 123) 117

[126] Coates, ‘Models of Capitalism in the New World Order: The UK Case’ (n 124) 650-651

[127] Ibid; Albert, *Capitalism Against Capitalism* (n 123) 117

[128] Albert, *Capitalism Against Capitalism* (n 123) 100-117; Coates, ‘Models of Capitalism in the New World Order: The UK Case’ (n 124) 650-651

[129] Coates, *Models of Capitalism: Growth and Stagnation in the Modern Era* (n 124) 57

[130] Coates, *Capitalism: The Basics* (n 124) 30; Albert, *Capitalism Against Capitalism* (n 123) 16

choice. The UK economy, at that time, was also marked by a large public sector and active state involvement. However, after 1979, the United Kingdom was again repositioned closer to the US model of capitalism.[131]

4.3.3.2 State-Led Capitalism

In this type of capitalism, economic development is driven by groups of private companies networked together around a common bank. In such companies, management decisions are often influenced by the leading bank and public agencies.[132] The labour market in this type is similar to the labour market in the market led capitalisms in that it provides workers with only limited statutory and social rights. However, the strong relationship that is often formed between workers and private corporations is an effective remedy. Employees in state-led capitalism markets are frequently offered lifetime employment in addition to many other welfare guarantees.[133] Finally, in such capitalism the cultural forms are likely to be nationalist and conservative in content.

According to Coates, a good example of this type of capitalism is the Japanese economy in the immediate post-war period and South Korea. Hence, this type is sometimes referred to as the 'Asian form of capitalism' or the 'developmental state model'.[134]

4.3.3.3 Negotiated/Consensual Capitalism

The last type of capitalism is the negotiated or consensual capitalism. The characteristics of this type were originally identified by Albert under the label the 'Rhine model'.[135] Companies in this type of capitalism are treated as a community not a commodity. Governments frequently intervene by setting up strong labour rights and welfare provisions that give organised worker unions the ability to maintain a strong position in the market and influence the decision-making process.[136] Companies are assumed to ensure their employees' job security, to provide vocational training and education opportunities for their labours, and to work to earn their workers' loyalty and trust.[137] Wages in the Rhine model are also different. Unlike wages in market led capitalism, wages in this type are not only based on productivity but also

[131] Coates, ‘Models of Capitalism in the New World Order: The UK Case’ (n 124) 651-652

[132] Coates, *Capitalism: The Basics* (n 124) 34

[133] Ibid; Coates, ‘Models of Capitalism in the New World Order: The UK Case’ (n 124) 651

[134] Coates, *Models of Capitalism: Growth and Stagnation in the Modern Era* (n 124) 10

[135] Albert, *Capitalism Against Capitalism* (n 123) 101-126

[136] Coates, ‘Models of Capitalism in the New World Order: The UK Case’ (n 124) 651

[137] Albert, *Capitalism Against Capitalism* (n 123) 117

qualifications, seniority, and nationally upon agreed pay scales.[138] Finally, the dominant distinguishing feature of this type is what Albert calls the 'well-managed consensus'.[139] The focus of this model is on mutuality and shared responsibilities. Companies take their decisions in a sharing environment that include shareholders, employers, employees, executives, and trade unions.[140]

Germany is the perfect example of this type of capitalism for both Albert and Coates. However, since there are only two types of capitalisms in Albert's writing, and since the first type of Albert's capitalisms include only the United States, most capitalist countries have been added under this model, such as Japan and the United Kingdom.[141]

4.4 Conclusion

The objective of this chapter was to provide a background on capitalism and what, in essence, it means. Therefore, the chapter reviewed the literature to define capitalism and, then, explored some of the theoretical and practical applications of capitalism. In particular, two theoretical and three practical models of capitalism were discussed.

The two theoretical approaches to capitalism are the free market and social market approaches to capitalism. The free market approach is characterised by its recognition of the right of the various economic units to own properties, act in pursuit of their own self-interests, choose freely with respect to consumption, production and investment and compete in free labour and goods markets without any intervention from the government. On the other hand, the social market approach to capitalism is similar to the free market approach and can be distinguished only by the following three aspects. First, social market theorists believe that economic policies must contain social values to create a socially balanced society. Second, whereas free market theorists argue that markets are self-regulatory, social market theorists assert that free markets cannot produce an efficient allocation of resources without government intervention. Third, social market economists condemn the indifferent view of a market that does not differentiate between the market for goods and the market for labour. Thus, designing an economic system that empowers workers is essential to social market capitalism.

[138] Ibid, 103

[139] Ibid, 110

[140] Ibid

[141] Ibid, 15-19; Coates, *Models of Capitalism: Growth and Stagnation in the Modern Era* (n 124) 64

Finally, the chapter also reviewed three typologies of capitalism. The first is devised by Hall and Soskice, whereby they divide capitalism into two types based on how production takes place in two diametrically opposed institutional settings, the liberal market and coordinated market economies. The second reviewed work is Baumol, Litan and Schramm's typology, which classifies capitalism, based on the role of firms in promoting innovation and economic growth, into four types: oligarchic capitalism, state-guided capitalism, big-firm capitalism and entrepreneurial capitalism. Finally, the third typology labels capitalism according to the relationship among labour, the state and capital as market-led, state-led or negotiated capitalism. This typology is founded on Albert's classification, a pioneering work in the verities of capitalism literature.

Chapter 5
The Relationship between Corporate Governance and Capitalism

One of the main concerns of this thesis is the relationship between corporate governance and capitalism and the effect of this relationship on the legal transplantation of corporate governance rules. This thesis argues that the potential link between capitalism and corporate governance could be the main reason for corporate governance diversity and a barrier for future convergence in the field. It argues that any approach toward the problem of legal transplantation in the context of corporate governance, discussed in Chapters 2 and 3, that does not take into account the link between the capitalist economy and the law probably will not provide adequate analytical tools for addressing the problem. Thus, it aims to provide a new analytical framework for the problem based upon the potential link between capitalism and corporate governance. Therefore, two chapters explaining the concepts of corporate governance and capitalism were given to set the scene for this particular chapter, which aims to investigate the relationship between corporate governance and capitalism.

The effect of capitalism on corporate governance theories and models is an issue that has received no or little attention in either the legal or the economic literature. Thus, this chapter will discuss this subject in four different sections. The first section will discuss the potential link between the policies of capitalist economies and companies' behaviours. The second section will examine the relationship between economic conditions in capitalist countries and companies' behaviours. The discussion in the first two sections concerns the behaviours of companies, instead of corporate governance in particular, because discussing companies' behaviours in these two sections provides a clearer picture of the role of corporate governance in relation to capitalist policies and conditions. In addition, the reference in these two sections to companies' behaviours is based on the contention of this thesis that companies' behaviour is the outcome of corporate governance, although some discussion of corporate governance in particular will be included in these two sections. The third section will focus on the relationship between corporate governance and the capitalist economies in the different varieties of capitalism considered in the literature. Finally, the fourth section will discuss the relationship between the free market and social market approaches to capitalism and corporate governance models. The aim of these four sections is to examine and potentially confirm the relationship between capitalism and corporate governance from different perspectives. However, it is possible to draw a generalised conclusion about the relationship between corporate governance and capitalism from each of these sections independently.

5.1 Companies' Behaviour and the Policies of the Capitalist Economy

This section will discuss the relationship between companies and national capitalist economies. In particular, it will explain how the behaviour of companies influences the formation of capitalist policies and how capitalist policies affect companies' behaviour. Hence, this section will be divided into two subsections, each dealing with one of foregoing these matters.

5.1.1 The Ability of Companies to Affect the Formation of National Capitalist Economies

Political economy scientists explain that interest groups, including companies, have, theoretically, different levels of ability to constrain government action, guide policy formation and affect the economy of any country as a whole, either in a pluralist or corporatist fashion.[1] The pluralist and corporatist approaches are the main political theories that have been put forward to explain how interest groups influence public and economic policy around the world.[2]

The first theory, pluralism, depicts the political life in some countries as a marketplace featuring perfect competition, where everyone has the ability to influence policy formation. However, because of the perfect competition, no single person can have a continuous influence on government over the influence of others.[3] This is, of course, a description of an ideal model. In practice, the influence of interest groups in the US is the closest representation of the pluralist theory.[4] On the other hand, the corporatist theory portrays political life in some countries as a company with a very clear, hierarchical

[1] Vivien A Schmidt, *From State to Market? The Transformation of French Business and Government* (1st edn, Cambridge University Press 1996) 15.

[2] It is important to note that pluralism and corporatism in this context differ from pluralism associated with how a company should be governed. For more on this subject, see Rick Molz, 'The Theory of Pluralism in Corporate Governance: A Conceptual Framework and Empirical Test' (1995) [Springer] 14 Journal of Business Ethics 789

[3] Clive S. Thomas, 'Interest Group' (*Encyclopædia Britannica*, 6 July 2017) <https://www.britannica.com/topic/interest-group/Factors-shaping-interest-group-systems> accessed 28 February 2019

[4] Ibid

structure. Only certain groups within this structure can influence the decision-making process.[5] Germany and some other European countries are primary examples of this model.[6]

The main difference between the pluralist and corporatist models, in the simplest terms, is that access to policy formation and economic manipulation is, in pluralist countries, available to a wide range of people, whilst in corporatist countries, this type of access is available only to certain organised interests.[7] Both approaches confirm the ability of companies to affect—and even guide—economic policy. However, this effect, in the two models, is not always the product of planned or deliberate lobbying and political pressure. Cumulated, routine business decisions, such as closing or opening new branches, could also have a great impact on policy formation in capitalist economies. Consequently, governments in capitalist countries have been sensitive to such activities and often respond by changing their regulations to attract more investment.[8]

In practice, the importance of companies to capitalist economies is undeniable.[9] In capitalist economies, which are characterised by economic openness and market freedom, the activities of companies influence or even shape national economies.[10] In such economies, companies increasingly are invoked to contribute to the development of their home state's national economy either in partnership with the government or by taking over certain operations from it.[11] The availability of large economic resources in the hands of a few large companies, coupled with their ability to move assets and

[5] Ibid

[6] Some scholars add a third model to explain the influence of interest groups in totalitarian states, such as Nazi Germany. They typically borrow the label 'corporatism' to describe the limited influence of interest groups in totalitarian countries and assign the label 'neo-corporatism' to what has been described above as corporatist theory. See ibid.

[7] For a pluralist approach see, Robert A Dahl, *Who Governs?: Democracy and Power in an American City* (2nd edn, Yale University Press 2005); For a corporatist approach see, Schmidt, *From State to Market? The Transformation of French Business and Government* (n 1)

[8] Ronald W Cox and Daniel Skidmore-Hess, *US Politics and the Global Economy: Corporate Power, Conservative Shift* (1st edn, Lynne Rienner Publishers 1999) 1

[9] The reference here is to incorporated firms. Although unincorporated firms are in some countries greater in number, incorporated companies in current capitalists economies typically have greater influence on national economies even when their number is only 1% or less of the total number of firms in a country. See, JE Parkinson, *Corporate Power and Responsibility: Issues in the Theory of Company Law* (first published 1993 edn, Oxford University Press 1996) 4

[10] Stephen Bottomley, *The Constitutional Corporation: Rethinking Corporate Governance* (1st edn, Ashgate Publishing, Limited 2007), 1

[11] Ibid

operation platforms from one country to another, give these companies substantial leverage over governments.[12] Therefore, some scholars argue that companies not only have the ability to influence the policy of national economies but also possess greater economic power than many states.[13]

5.1.2 The Effect of National Capitalist Economies on Companies

The above discussion of the influence of companies on forming the policy of national capitalist economise does not suggest a linear relationship between companies and capitalist economies. Rather, this thesis argues that their relationship is more in the nature of a complex feedback loop, where they both affect and have an effect on each other. In fact, the effect of the various policies of national capitalist economies on companies is more obvious than the effect of companies on them.

In theory, the institutions of capitalism affect companies in three different ways.[14] First, some of capitalism's institutions have a strong, direct impact on companies due to their power and formal hierarchy.[15] They usually have the power to supply some necessary resources to companies or even bestow formal sanctions on them. Policymakers, for instance, are often said to have such powers through the enactment of new regulations. Companies constantly have to change their own activities to meet the demand of such institutions. Second, institutions of capitalism can also influence companies by providing them with incentives to which companies respond in more or less predictable ways.[16] Tax reliefs for businesses that operate in an environmentally friendly fashion is a good example of this method of influence. Third, institutions of capitalism can work as socialising agencies. They can, for instance, introduce a set of values and norms and then instil them in those who work within the targeted area.[17] This method could be realised through the education system or

[12] Cox and Skidmore-Hess, *US Politics and the Global Economy: Corporate Power, Conservative Shift* (n 8) 1

[13] Carl Boggs, *The End of Politics: Corporate Power and the Decline of the Public Sphere* (1st edn, Guilford Publications 2000) 69

[14] The institutions of capitalism can be grouped under three categories. The first category comprises laws: legal rules that recognise the right to private property and promote market freedom are examples of this category. The second concerns administrative agencies such as government institutions that oversee commerce and the labour market. Finally, informal institutions, which represent informal rules and organisations that influence the capitalist system.

[15] Peter A. Hall and David Soskice, ‘An Introduction to Varieties of Capitalism’ in Peter A. Hall and David Soskice (eds), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (1st edn, Oxford University Press 2001) 4

[16] Ibid

[17] Ibid

training institutions. Each of these methods presents an important way through which the institutions of capitalism affect companies.

5.2 Corporate Governance and Economic Conditions in Capitalist Countries

This section discusses how corporate governance, in particular, and companies' behaviour, in general, relate to economic conditions in capitalist countries. The discourse in this section is only about economic conditions in capitalist countries because the influence of companies in these countries over economic conditions differs greatly from the influence of companies over such conditions in non-capitalist countries. This influence is also expected to vary within capitalist countries according to their capitalist form; however, the discussion of this matter is the subject of another section in the next chapter. In addition, the discussion in this section is about economic conditions because capitalism differs significantly from any other economic framework in its relation to economic conditions and crises. It is in the nature of capitalism to constantly grow and change, creating along the way positive and negative economic conditions. Indeed, some scholars assert that business cycles cannot be eliminated from capitalist countries unless they change their system from capitalism to an alternative economic model.[18] Accordingly, this section is divided into two subsections. The first discusses how companies' behaviour in capitalist countries in general and corporate governance in particular, along with other macro- and microeconomic factors, contribute to creating this unique feature of capitalism. The second section focuses on how such economic conditions influence companies' behaviour in general and corporate governance in particular.

5.2.1 The Effect of Companies' Behaviour on Economic Conditions in Capitalist Countries

The extent of the contribution of companies in creating negative and positive economic conditions can be understood by considering how much power such companies have. Based on data from the CIA World Factbook and Fortune Magazine, the list of the top 100 economic entities in the world by revenue in 2015 consists of 69 companies and only 31 countries, and the top 200 list consists of 153 companies and only 47 countries.[19] The total revenue of the

[18] Howard J. Sherman, *The Business Cycle: Growth and Crisis under Capitalism* (Princeton University Press 1991) 386-392

[19] Nick Dearden, ‘10 Biggest Corporations Make More Money than Most Countries in the World Combined’ (*Global Justice Now*, 12 Sep 2016)

world's top 10 companies is higher than the revenue of 180 countries combined, including relatively rich countries such as South Africa, New Zealand, Ireland, and Poland.[20] Moreover, companies in capitalist economies account for most of the employment opportunities, not the government.[21] The private sector across OECD countries is responsible on average for about 82% of the total employment, where the lowest levels of private employment are reported in Nordic countries, such as Denmark, Norway and Sweden, totalling near 70% of employment, and the highest levels of private employment are reported in Asia, totalling 94% and 92.4% in Japan and South Korea, respectively.[22] These private sector employment numbers indeed include incorporated and unincorporated firms; however, it is safe to assume that incorporated firms are the main contributor. This is so because typically incorporated firms employ more workers and in many countries are greater in numbers than unincorporated firms. For example, in the UK the total number of incorporated firms at the end of December 2018 was 4,159,466 while the number of unincorporated business was only about 1,508,534.[23] Moreover, in the US, for example, the top 0.3% of companies alone, not every incorporated company in the country, account for more than half of the total employment.[24] Walmart alone, a US-based company, provides more than 2.3 million jobs worldwide of which 1.4 million jobs are located in the US alone.[25] These numbers clearly demonstrate the extent of influence companies have over national economies and their ability to create economic conditions.

<https://www.globaljustice.org.uk//news/2016/sep/12/10-biggest-corporations-make-more-money-most-countries-world-combined> accessed 13/10/2018

[20] Ibid; The total revenue of the top 10 companies according to Fortune Magazine 2015 list is about 2856595000000, while the total revenue of the poorest 180 countries, according to CIA World Fact Book, for the same financial year is about 2809174980000.

[21] Ralph W. Estes, *Tyranny of the Bottom Line: Why Corporations Make Good People Do Bad Things* (1st edn, Berrett-Koehler Publishers 1996) 85

[22] Organisation for Economic Co-operation and Development, *Government at a Glance 2017* (1st edn, OECD Publishing 2017) 90,91

[23] See Chris Rhodes, *Business Statistics* (Briefing Paper to the House of Commons number: 06152, 12 December 2018); UK Company Register Activity, ‘Incorporated Companies in the UK: October to December 2018’ (*UK Government*, 2018) <https://www.gov.uk/government/publications/incorporated-companies-in-the-uk-october-to-december-2018/incorporated-companies-in-the-uk-october-to-december-2018> accessed 28 Feb 2019

[24] Anthony Caruso, *Statistics of US Businesses Employment and Payroll Summary: 2012* (The United States Census Bureau ,Economy-Wide Statistics Briefs, report number (G12-SUSB), 2015) 1

[25] Fortune Magazine, ‘Fortune 500: Walmart’ (*Fortune Magazine*, 2018) <http://fortune.com/fortune500/walmart/> accessed 13/10/2018

Moreover, not only can companies contribute to creating, to a large degree, economic conditions in capitalist systems, they can also bring about significant growth or disastrous outcomes. For instance, the recent 2008 global financial crisis was primarily caused by poor corporate governance practices. The accumulated actions of mortgage companies, banks, credit rating agencies, and other financial institutions led the US economy and then the rest of the world to the crisis.[26] Many governmental and non-governmental organisations and scholars have attributed the financial crisis to defective corporate governance practices.[27] This role of corporate governance in the crisis shows clearly the extent of the impact that companies can have on creating economic conditions and crises.

5.2.2 The Effect of Economic Conditions in Capitalist Countries on Companies' Behaviour

Companies around the world are very sensitive to economic conditions. Typically, they thrive with every economic growth period and wither during recessions. For example, during the first two years of the 2008 financial crisis, the financial institutions in the US, Europe and Japan experienced an aggregate write-down of approximately $4 trillion of asset value.[28] Moreover, during the worst phase of the crisis, company share prices throughout the world plunged by 35% to more than 50% of their total value.[29] A great number of businesses closed, merged, terminated employees and reduced expenses, or

[26] Bank for International Settlements, *79th Annual Report* (1st edn, Bank for International Settlements 2009) 16- 36; John C Coffee Jr, ‘What Went Wrong? An Initial Inquiry Into the Causes of the 2008 Financial Crisis’ (2009) 9 Journal of Corporate Law Studies 1, 1-3

[27] See for example, United Nations Conference on Trade and Development, *Corporate Governance in the Wake of the Financial Crisis* (Unedited edn, United Nations Publication 2010) 2; US 111th Congress, ‘S.1074 - Shareholder Bill of Rights Act of 2009’ (2009) <https://www.congress.gov/bill/111th-congress/senate-bill/1074> accessed 4 March 2019; Grant Kirkpatrick, ‘The Corporate Governance Lessons From the Financial Crisis’ (2009) 2009 OECD Journal: Financial Market Trends 61, 62; Peter Yeoh, ‘Causes of the Global Financial Crisis: Learning from the Competing Insights’ (2010) 7 International Journal of Disclosure and Governance 42, 42; G Fetisov, ‘Measures to Overcome the Global Crisis and Establish a Stable Financial and Economic System’ (2009) 52 Problems of Economic Transition 20, 20; Hussein Tarraf, ‘The Role Of Corporate Governance In The Events Leading Up To The Global Financial Crisis: Analysis Of Aggressive Risk-Taking’ (2011) 5 Global Journal of Business Research 93, 93

[28] Monetary and Capital Markets Department International Monetary Fund, *Global Financial Stability Report: Responding to the Financial Crisis and Measuring Systemic Risks* (1st edn, International Monetary Fund 2009) xv

[29] David Brett, ‘The Global Financial Crisis 10 Years on: Six Charts that Tell the Story’ (2017) <https://www.schroders.com/en/insights/economics/the-global-financial-crisis-10-years-on-six-charts-that-tell-the-story/> accessed 3 March 2019

experienced great dips in sales and profits. Companies are also sensitive to other positive and negative economic conditions, such as inflation, deflation, trade cycles, expansion, contraction and interest rates.[30] Therefore, many scholars and organisations are calling for better corporate governance practices that can absorb such economic shocks.[31] The OECD, for example, in response to the global financial crisis, launched a programme to address the shortcomings of corporate governance practices in four major areas: executive compensation, board practices, risk management and the exercise of shareholder rights.[32] The UK, US, Germany, and many other countries took similar measures to mitigate the apparent negative effects of adverse economic conditions on companies to safeguard them against excessive risk-taking during times of sound economic circumstances.[33]

5.3 Corporate Governance in the Varieties of Capitalism Discourse

This section will discuss the relationship between corporate governance and regional forms of capitalism. Economists classify the diverse applications of capitalism into different typologies using various criteria. The sensitivity in the work of many authors to the peculiarities of each national economic system has

[30] See for more on the subject, David E. Rapach, ‘International Evidence on the Long-Run Impact of Inflation’ (2003) 35 Journal of Money, Credit and Banking 23; Garima Vasishtha and Philipp Maier, ‘The Impact of the Global Business Cycle on Small Open Economies: A FAVAR Approach for Canada’ (2013) 24 North American Journal of Economics and Finance 191; Leora Klapper and Inessa Love, ‘The Impact of the Financial Crisis on New Firm Registration’ (2011) 113 Economics Letters 1

[31] P.M. Vasudev and Susan Watson, *Corporate Governance After the Financial Crisis* (1st edn, Edward Elgar 2012) 1-5; Kirkpatrick, ‘The Corporate Governance Lessons From the Financial Crisis’ (n 27) 2

[32] Organisation for Economic Co-operation and Development, ‘Corporate Governance and the Financial Crisis’ (2008) <http://www.oecd.org/daf/ca/corporategovernanceprinciples/corporategovernanceandthefinancialcrisis.htm> accessed 3 March 2019

[33] See for example, Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report: The Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States Including Dissenting Views* (1st edn, Cosimo, Inc. 2011); Matthias Köhler, ‘Corporate Governance and Current Regulation in the German Banking Sector: An Overview and Assessment’ (2010) ZEW-Centre for European Economic Research Discussion Paper number 10-200 <ftp://ftp.zew.de/pub/zew-docs/dp/dp10002.pdf> accessed 6 March 2019; Joshua Chircop, ‘Corporate Governance After the Financial Crisis: Overview of Some Major Evolutions in the United Kingdom and in Switzerland’ (2018) <https://blogs.kcl.ac.uk/kslrcommerciallawblog/2018/01/28/corporate-governance-after-the-financial-crisis-overview-of-some-major-evolutions-in-the-united-kingdom-and-in-switzerland/> accessed 6 March 2019

prompted a large number of typologies. As discussed in Chapter 4, this thesis views these typologies as descriptions of the current practices of capitalism. Therefore, the conclusion that will be drawn from this section will be how corporate governance relates to commonplace forms of capitalism. This section will discuss how corporate governance relates to three classifications of capitalism devised by Hall and Soskice, Baumol et al, and the typologies of Coates. These three typologies have been fully discussed in Chapter 4 and the aim here is to ascertain how these typologies of capitalism relate to corporate governance.

5.3.1 Hall and Soskice Typology and Corporate Governance

Hall and Soskice in their analysis, discussed in Chapter 4, divide capitalism into two types based on how production takes place in two diametrically opposed institutional settings, the liberal market and the coordinated market economies. Their framework aimed to understand differences and similarities between capitalism in different countries by placing companies at the centre of their analysis and emphasising their role as agents of economic change which is one of the main virtues and pitfalls of their work at the same time. Indeed, in capitalist countries that are characterised by economic openness, companies play a very important role and sometimes lead the economy, but for most capitalist countries they are not the only economic actor. Their analysis underestimates the role played by the state in adjusting the economy especially in developing countries. They argue that economic adjustment today is firm led and that the only role a state plays is to maintain a liberal, or encourage a coordinated, market environment for its firms.[34] However, that is probably not a very accurate assessment of many capitalist countries as many of them, especially in the developing world, intervene directly in their economies. Hall and Soskice further argue that, due to a system of complementarities, states will likely be unable to change the type of their markets and that the only thing states can do is provide incentives for their private sectors to continue acting in either a liberal or coordinated manner.[35] Moreover, in their analysis, state behaviour is not one of the five factors that they use to determine whether a country has a liberal or coordinated market economy. Firms' behaviours are the

[34] Hall and Soskice, 'An Introduction to Varieties of Capitalism' (n 15) 6, 45, 46

[35] Stewart Wood, 'Business, Government, and Patterns of Labor Market Policy in Britain and the Federal Republic of Germany' in Peter A. Hall and David Soskice (eds), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (Oxford 2001) 274

only determinant factor; for this particular reason, their analysis fits very well in the typology of corporate governance literature.

In particular, Hall and Soskice are looking in their analysis for firms' behaviours in response to five co-ordination problems to determine a nation's particular type of capitalism. Three of these problems concern the relationship between a company and its employees and the other two involve firm financing and inter-firm relations. Specifically, the first problem is the industrial relation problem, which explores how companies negotiate wages and working conditions with their employees. Wages and productivity levels that condition the success of the firm, as well as rates of unemployment that affect the economy, are at stake here.[36] Second, the vocational training and education problem, which asks how firms secure a labour force with suitable skills. The outcome of this co-ordination problem is the success of individual firms, workers and nation states as it affects the competitiveness level of the overall economy.[37] Third, the financing problem, which questions how companies gain access to financing and in which countries' investors seek assurance of returns on their investments. At stake here is the availability of finance and under what terms firms can secure funds.[38] Fourth is the problem of inter-firm relations analyses and how firms in each individual country form relationships. These relationships ensure a stable demand for the firms' products, appropriate supplies of inputs, and access to technology.[39] Last, employer-employee relations investigate how companies build a relationship with their employees and how this relationship affects common problems such as moral hazard, adverse selection and information sharing.[40]

Each of these problems, because they measure companies' behaviours, has a direct link to corporate governance and has been discussed to some degree as a corporate governance problem in the literature. Therefore, it can be concluded that there is a very strong connection between corporate governance and capitalism, as envisaged by Hall and Soskice. In fact, one could argue that the varieties of capitalism presented by Hall and Soskice, although only in part, are varieties of corporate governance to some degree. In other words, the varieties of capitalisms they describe match, to a large degree, the verities of corporate governance practices discussed by many authors. Most of the peculiarities of the German, Japanese, UK, US, and other capitalist

[36] Hall and Soskice, ‘An Introduction to Varieties of Capitalism’ (n 15) 7
[37] Ibid
[38] Ibid
[39] Ibid
[40] Ibid

systems that are identified by Hall and Soskice are in fact also peculiarities of these countries' corporate governance practices.

5.3.1.1 Corporate Governance in Coordinated Market Economies

As noted in previous chapters, despite the differences between the German and Japanese economic systems, they are both classified as co-ordinated market economies. Also, the corporate governance model in both countries is described as a stakeholder-orientated model. Companies in co-ordinated market economies often resolve the five test problems mentioned above through strategic interactions and long-term off-market relationships. This section will show how Germany and Japan's corporate governance practices respond to each of these five problems. In doing so, it will be clear how corporate governance relates to capitalism as regarded by Hall and Soskice.

The first three of the problems raised by Hall and Soskice's analysis are dedicated to examining the relationship between a company and its employees, namely: the industrial relations problem, which investigates how companies negotiate wages and work conditions with their workers; the vocational training and education problem, which asks how firms secure a labour force with suitable skills; and the problems of the relationship between employers and employees in general. Companies in co-ordinated market economies deal with these problems in a similar fashion. In Germany and Japan, employees enjoy citizenship within the company. Workers and employers share mutual rights and obligations that take into account their differences in interests and capacities.[41] In Germany, employee citizenship is vested in the so-called 'co-determination' system, which entitles employees to information, consultation and representation in the company's supervisory board.[42] Under the co-determination system, employees are given, depending on the size of the company, between 33% and 50% of the seats on the supervisory board where their representative can vote and counsel on the matters presented before the board.[43] In Japan, corporate citizenship is less formalised in comparison to Germany. However, employees have access to information and strong legal

[41] Gregory Jackson, ‘Corporate Governance in Germany and Japan: Liberalization Pressures and Responses During the 1990s’ in Kōzō Yamamura and Wolfgang Streeck (eds), *The End of Diversity? Prospects for German and Japanese Capitalism* (1st edn, Cornell University Press 2003) 265

[42] Ibid

[43] Larry Fauver and Michael E. Fuerst, ‘Does Good Corporate Governance Include Employee Representation? Evidence from German Corporate Boards’ (2006) 82 Journal of Financial Economics 673, 674

claims to employment security.[44] The management team is often internally promoted and enjoys a high degree of autonomy.[45] Furthermore, a company in a co-ordinated market economy must take shareholders' interests, as well as those of employees and all other stakeholders, into account.[46] Management teams in stakeholder systems play a mediating role in the interests of shareholders, employees and all other stakeholders. In Germany, the system is explicit in that the objective of the corporation should not only be maximising shareholders' wealth.[47] Similarly, management practices in Japan traditionally have followed pro-stakeholder approaches and have been concerned with ensuring the most effective allocation of resources by taking into account the interests of employees and a larger range of other stakeholders.[48]

The fourth test problem is the financing problem, which investigates how companies gain access to finance and how investors seek assurance of returns on their investments. Companies in co-ordinated market economies are recognised for their reliance on corporate insiders as a mean for finance. Therefore, corporate governance practice in these economies is sometimes referred to as an insider model of corporate governance or a bank-centred system of governance. In Germany and Japan, strong commercial relationships between companies and banks as both owners and creditors, simultaneously, result in long-term financial commitments that entail a dependence on banks to provide capital and on the enterprise to generate returns. This relationship leads to the availability of reliable external capital at a low cost and a continuity of small but fixed dividends.[49]

The final test problem is the inter-firm relations problem, which investigates how a company forms relationships with other corporations.

[44] Jackson, ‘Corporate Governance in Germany and Japan: Liberalization Pressures and Responses During the 1990s’ (n 41) 265

[45] Ibid

[46] Andrew L Friedman and Samantha Miles, *Stakeholders: Theory and Practice* (1st edn, Oxford University Press on Demand 2006), 1

[47] Franklin Allen and Mengxin Zhao, ‘The Corporate Governance Model of Japan: Shareholders are not Rulers’ (2007) 36 Peking University Business Review 98, 98-101

[48] Ibid

[49] Gregory Jackson, ‘The Origins of Nonliberal Corporate Governance in Germany and Japan’ in Wolfgang streeck and Kōzō Yamamura (eds), *The Origins of Nonliberal Capitalism: Germany and Japan in Comparison* (1st edn, Cornell University Press 2001) 121; Hirotsugu Sakai and Hitoshi Asaoka, ‘The Japanese Corporate Governance System and Firm Performance: Toward Sustainable Growth’ (2003) Research Center for Policy and Economy Working Paper, Mitsubishi Research Institute <http://www.esri.go.jp/jp/prj/int_prj/prj-rc/macro/macro14/05mri1_t.pdf> accessed 1 April 2018, 3

Companies in co-ordinated market economies depend on banks, inter-corporations networks and families in many aspects of their corporate governance practice. The basis of this dependence is the unique cross ownership in Japan and concentrated ownership structure in Germany. According to some empirical studies, banks, inter-corporation networks, and families are typically the largest shareholders in co-ordinated market economies.[50] The ownership of the largest five shareholders in Germany account, on average, for about 79% of the total shares and 33% in Japan, while in the US and UK companies account, on average, for only about 25% of the total shares.[51] Moreover, in Germany, banks are permitted to own shares in the companies to which they lend money and exercise greater influence and control over them through ownership and proxy voting on behalf of other shareholders.[52] A bank, in Germany, with holdings of deposited shares may exercise the voting rights attached to the shares according to the bank’s own discretion if no direction is given on how to vote.[53] Similarly, banks in Japan have influence over companies, but through a different mechanism. The cross-shareholding method, known as Keiretsu, provides a mechanism for banks to influence management. Most Japanese companies are grouped around a main bank and bound by ties of cross-holding whereby the main bank can exercise its influence through a powerful ownership network.[54] Such cross ownership and concentrated control in both countries is perceived to be what makes a perfect environment for non-market co-ordination in these countries.

5.3.1.2 Corporate Governance in Liberal Market Economies

In Hall and Soskice’s analysis, both the US and UK's capitalism, along with others, are described as liberal market economies. In these economies, corporate governance is in accordance with the shareholder model of corporate governance, which is often referred to as the Anglo-Saxon or Anglo-American

[50] Malek Lashgari, ‘Corporate Governance: Theory and Practice’ (2004) 5 Journal of American Academy of Business 46, 48

[51]Xiaonian Xu and Yan Wang, ‘Ownership Structure and Corporate Governance in Chinese Stock Companies’ (1999) 10 China Economic Review 75, 76; Stephen David Prowse, ‘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’ (1994) Bank for International Settlements Economic Paper No 41 <http://www.bis.org/publ/econ41.pdf> accessed 24 April 2017, 33-34

[52] Jeremy Edwards and Marcus Nibler, ‘Corporate Governance in Germany: The Role of Banks and Ownership Concentration’ (2000) 15 Economic Policy 238, 240

[53] Ibid, 241

[54] Jean McGuire and Sandra Dow, ‘Japanese Keiretsu: Past, Present, Future’ (2009) 26 Asia Pacific journal of management 333, 334

model of corporate governance. Companies in liberal market economies respond to the five test problems mentioned above similarly. In this section, the focus will be only on two countries of liberal market economies, the US and UK.

The first test problem identified by Hall and Soskice is the financing problem, which investigates how companies gain access to finance and how investors seek assurance of returns on their investments. The capital market in liberal market economies is well-known for its remarkable state of development.[55] The current regulations and practices have resulted in the development of the US and UK capital markets and a reduction in the cost of capital.[56] Economists tend to use the number of listed firms in a stock market to test its development. The higher the number is in a country, means that more companies turn into equity finance to promote their businesses, which indicates the development of its stock market. The UK, a classical example of liberal market economy, has more than 2,150 listed companies as of September 2018, while Germany, the classical example of coordinated market economies, has only about 450 listed companies as of December 2017 even though it has a larger economy than the UK.[57] Another economic measure for capital market development is the total stock market capitalisation as a percentage of GDP. In 2017, the total domestic market capitalisation of Germany amounted only to 57.13% of GDP, while it exceeded 122% in the UK.[58] Moreover, in liberal market economies, equity financing is often considered a common method of raising capital. Thus, it is not surprising that the US is the largest capital market in the world and the UK is the second in terms of the amount of new capital raised through equity issues.[59]

[55] John C Coffee, 'The Rise of Dispersed Ownership: The Roles of Law and the State in the Separation of Ownership and Control' (2001) 111 Yale Law Journal 1, 3

[56] René M Stulz, 'Globalization, Corporate Finance, and the Cost of Capital' (1999) 12 Journal of Applied Corporate Finance 8, 15-16

[57] For the number of listed companies in the UK see, London Stock Exchange, 'Companies on London Stock Exchange' (*London Stock Exchange 30/09/2018*, 2018) <https://www.londonstockexchange.com/statistics/companies-and-issuers/companies-defined-by-mifir-identifiers-list-on-lse.xlsx> accessed 14/10/2018; For the number of listed companies in Germany see, The World Bank, 'Listed Domestic Companies: Total' (*The World Bank Open Data*, 2018) <https://data.worldbank.org/indicator/CM.MKT.LDOM.NO> accessed 14/10/2018;

[58] Siblis Research, 'Global Market Cap to GNI/GDP Ratios for 28 Countries' (*Siblis Research Ltd*, 2018) <http://siblisresearch.com/data/market-cap-to-gdp-ratios/> accessed 14/10/2018

[59] Brian J. Henderson, Narasimhan Jegadeesh and Michael S. Weisbach, 'World Markets for Raising New Capital' (2006) 82 Journal of Financial Economics 63, 73 and 75

The second test problem is the inter-firm relations, which investigates how a company forms relationships with other corporations. Unlike companies in co-ordinated market economies, firms in the US and UK rely more on standard market relationships and formal enforceable contracts in their interactions with other firms; there is less institutional support for non-market relationships. This is so primarily because of the unique ownership structure in the US and UK. In both countries, the ownership structure is relatively widely dispersed in such a way that there is no individual shareholder or group with sufficient voting power or incentives to control or affect managerial decisions.[60] According to some empirical studies, the ownership of the largest five shareholders in US and UK companies account, on average, for only about 25% of the total shares as compared with 58% in China,[61] 79% in Germany[62] and 57.8% in the Czech Republic.[63] While in Germany and Japan large shareholders and banks facilitate non-market relationships among their companies, the ownership structure in the US and UK, where the influence of families and other corporations as owners is minimal, forces companies to rely on market relationships and formal enforceable contracts.

The remaining three test problems are dedicated to examining the relationship between a company and its employees. Companies in liberal market economies rely heavily on a highly fluid labour market from which to hire its employees. Such fluid labour market makes it relatively easy for firms to hire and fire employees and discourages apprenticeship schemes and firm-specific vocational training.[64] Firms in liberal market economies are under no obligation to establish employee representation in any form. This is unlike in Germany where some companies are required to have two completely distinct boards—a management board consisting entirely of executives and a supervisory board consisting of employee and shareholder representatives—

[60] Dennis Leech and John Leahy, ‘Ownership Structure, Control Type Classifications and the Performance of Large British Companies’ (1991) 101 Economic Journal 1418, 1418; Rafael La Porta, Florencio Lopez-De-Silanes and Andrei Shleifer, ‘Corporate Ownership Around the World’ (1999) 54 Journal of Finance 471, 471

[61] See, Xu and Wang, ‘Ownership Structure and Corporate Governance in Chinese Stock Companies’ (n 51) 76; Prowse, ‘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’ (n 51) 33-34

[62] Xu and Wang, ‘Ownership Structure and Corporate Governance in Chinese Stock Companies’ (n 51) 76

[63] Stijn Claessens, Simeon Djankov and Gerhard Pohl, ‘Ownership and Corporate Governance: Evidence from the Czech Republic’ (1997) World Bank Group Policy Research Working Paper No 111 <https://doi.org/10.1596/1813-9450-1737> accessed 21 March 2017, 9

[64] Hall and Soskice, ‘An Introduction to Varieties of Capitalism’ (n 15) 30

companies in the US and UK typically have a one-tier board system with executive and non-executive directors on a single board with the majority consisting of non-executive, outsider directors, and no employee representatives.[65]

5.3.2 Coates Typology of Capitalism and Corporate Governance

Coates typology of capitalism, as discussed in Chapter 4, is based on Albert's classification, one of the classical typologies of capitalism. According to Albert, there are two kinds of capitalisms, neo-American and Rhine capitalisms. The neo-American model of capitalism is dominated by individualism and short-term financial gain while the Rhine model is based on collective success and long-term gains. Albert's typology was then developed by Coates to include a third type, the state led capitalism, and to differentiate between the German and Japanese capitalism. Coates examined the relationships between the market and labour, the market and state, and the state and labour. Coates then concluded that capitalism can be differentiated by three types, Negotiated, state-led, and market-led models of capitalism. Each one of these models has a direct relationship with corporate governance and will be discussed separately in the following sub-sections.

5.3.2.1 Corporate Governance and Negotiated/Consensual Capitalism

The first type of capitalism is the negotiated or consensual capitalism. The characteristics of this type were originally identified by Albert under the label of the 'Rhine model' which is similar to Hall and Soskice's Coordinated Market Model of capitalism.[66] A strong and direct relationship exists between this model of capitalism and corporate governance, since both Albert and Coates depend on the type of corporate governance practiced to differentiate capitalist models. The dominant distinguishing feature of this type is the manner in which companies take decisions, which Albert describes as the 'well-managed consensus'.[67] According to them, the focus of this model is on mutuality and shared responsibilities. Companies take their decisions in a sharing environment that includes shareholders, employers, employees, executives, and trade unions.[68] Governments frequently intervene by setting up strong labour rights and welfare provisions that give organised worker unions the

[65] Pablo De Andres, Valentin Azofra and Felix Lopez, ‘Corporate Boards in OECD Countries: Size, Composition, Functioning and Effectiveness’ (2005) 13 Corporate Governance: An International Review 197, 199-200

[66] Michel Albert, *Capitalism Against Capitalism* (1st edn, Whurr Publishers 1993), 18

[67] Ibid, 110

[68] Ibid

ability to maintain a strong position in the market and influence the decision-making process.[69] In other words, the distinguishing feature of this model of capitalism for Albert and Coates is that companies in this model are adopting a stakeholder approach of corporate governance.

As a consequence of adopting the stakeholder approach, companies in this type of capitalism are treated as a community not a commodity. Companies are also assumed to ensure their employees' job security, to provide vocational training and education opportunities for their labours, and to work to earn their workers' loyalty and trust. [70] Wages in the Rhine model are also different. Unlike wages in market led capitalism, wages in this type are not only based on productivity but also on qualifications, seniority, and nationally agreed upon pay scales.[71]

5.3.2.2 Corporate Governance and Market-led Capitalism

Coates refers to this type of capitalism as 'liberal capitalism', while Albert often attaches the terms 'neo-American' and 'Anglo-Saxon' to this model of capitalism.[72] Corporate governance relates to each one of the following most essential features of the market-led model of capitalism. First, the decision-making process in companies in market-led economies is shareholder-driven and dividend-led.[73] Companies in this type of capitalism tend to adopt what is known in the corporate governance literature as the shareholder model. They enjoy a higher level of freedom to pursue their own short-term profit motives,[74] to raise capital, and to manage their internal affairs.[75] Second, workers are usually isolated from the decision-taking process, and the labour market is largely unregulated. They enjoy limited statutory rights and move between jobs many times during their careers. Their wages are fundamentally individualised and highly negotiable, and vocational training is often not an option.[76] Third,

[69] David Coates, ‘Models of Capitalism in the New World Order: The UK Case’ (1999) 47 Political Studies 643, 651

[70] Albert, *Capitalism Against Capitalism* (n 66) 117

[71] Ibid, 103

[72] See, ibid; David Coates, *Capitalism: The Basics* (1st edn, Routledge 2016); Coates, ‘Models of Capitalism in the New World Order: The UK Case’ (n 69); David Coates, *Models of Capitalism: Growth and Stagnation in the Modern Era* (1st edn, Polity Press 2000); David Coates, ‘Varieties of Capitalism and ‘the Great Moderation’’ in Matthias Ebenau, Ian Bruff and Christian May (eds), *New Directions in Comparative Capitalisms Research: Critical and Global Perspectives* (1st edn, Palgrave Macmillan 2015)

[73] Coates, *Models of Capitalism: Growth and Stagnation in the Modern Era* (n 72) 58

[74] In the US, Quarterly earnings are extremely important for boards of directors.

[75] Coates, ‘Models of Capitalism in the New World Order: The UK Case’ (n 69) 650-651

[76] Ibid; Albert, *Capitalism Against Capitalism* (n 66) 117

companies in market-led economies raise capital through the use of financial markets rather than banks.[77] This active use of equity finance caused the development of capital markets in market-led system countries and activated the market for corporate control. Finally, the overall economy is characterised by individualism and short-term financial gains. According to Coates, this particular individualism is probably what has encouraged the property view of companies, the freedom of the labour market, and the limited role of government.[78]

5.3.2.3 Corporate Governance and State-led Capitalism

The last type is the state-led model of capitalism. Like the above two types, this type is directly linked with corporate governance since Coates characterised it based on how companies raise capital, take decisions and manage its labour force. The prime example of this model, according to Coates, is Japan and the Asian Tigers, such as Thailand and Indonesia.[79] In this type of capitalism, economic development is driven by groups of private companies networked together around a common bank. However, even though the majority of companies are privately held, management decisions are often influenced by public agencies.[80] The labour market in this type is similar to the labour market in the market led capitalisms in that it provides workers with only limited statutory and social rights. However, the strong relationship that is often formed between workers and private corporations is an effective remedy. Employees in state-led capitalism markets are frequently offered lifetime employment in addition to many other welfare guarantees.[81]

5.3.3 Baumol et al. Typology of Capitalism and Corporate Governance

Chapter 4 also reviewed the work of Baumol, Litan, and Schramm (2007) on the types of capitalisms. These commentators identified four types of capitalism according to the role that entrepreneurship plays in the long term in developing capitalist economies. These types are oligarchic capitalism, state-guided capitalism, big-firm capitalism, and entrepreneurial capitalism.[82] Each of these

[77] Coates, *Models of Capitalism: Growth and Stagnation in the Modern Era* (n 72) 164
[78] Ibid, 57
[79] Ibid, 234
[80] Coates, *Capitalism: The Basics* (n 72) 34
[81] Ibid; Coates, 'Models of Capitalism in the New World Order: The UK Case' (n 69) 651
[82] William I Baumol, Robert E Litan and Carl I Schramm, 'The Four Types of Capitalism, Innovation, and Economic Growth' in Dennis C Mueller (ed), *The Oxford Handbook of Capitalism* (1st edn, Oxford University Press 2012), 119-121

four types is very different from the others, with only one thing in common, namely private ownership. This is so because the authors defined capitalism as an economic system in which the most or at least a substantial portion of production is held privately.[83]

Baumol et al. described each of these types as follow. First, in oligarchic capitalism, the means of production are concentrated in the hands of a few families who retain effective control over the bulk of the activities of their nation's economy. These families are typically corrupt and determine a country's economic and state policies.[84] Second, in state-guided capitalism, although a substantial proportion of the means of production are in private hands, the government still plays a powerful role in directing the economy by deciding which industries and even which individual firms should grow.[85] Third, in big-firm capitalism, government policy is characterised by restraint, and most of the economic production means are in the hands of a few companies. Typically, these companies are very large and managed by professional managers, have passive original founders and ownership that is diffused among thousands of shareholders, and enjoy great governmental promotion.[86] Finally, the entrepreneurial model, unlike the first three types, is characterised by the dominance of a large number of small firms, and most innovations are introduced by these firms, not by the government or oligopolistic firms. When such small businesses thrive, they bring continuous prosperity to the whole economy.[87]

Baumol et al. believe that each one of these types of capitalism has its own ability to generate different levels of economic growth. However, they believe that the best system that can create the outmost economic growth is a system that combines both the big-firm and entrepreneurial capitalism. This is so because radical innovation and substantial breakthrough often come from individual entrepreneurs and small businesses, and most of these innovative products and services could not be successfully commercialised without the interference of large companies. The ability of entrepreneurs to finalise and

[83] William J Baumol, Robert E Litan and Carl J Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity* (1st edn, Yale University Press 2007), 62

[84] Baumol, Litan and Schramm, ‘The Four Types of Capitalism, Innovation, and Economic Growth’ (n 82) 120

[85] Baumol, Litan and Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity* (n 83) 62-63

[86] Baumol, Litan and Schramm, ‘The Four Types of Capitalism, Innovation, and Economic Growth’ (n 82) 121

[87] Ibid

market their product is often limited. Therefore, they often sell their intellectual property rights to large companies that have enough resources to improve and commercialise these innovations.[88] However, such optimal system where small entrepreneurial organisations and large companies cooperate to create economic growth cannot be realised without the special supply-demand mechanism.

The special feature of the demand that prevails in today's highly competitive global economy is not only that it is very high, but also that firms are likely to lose their position in the market once they fail to meet it.[89] This is true especially in high-tech industries, and this special demand has already been realised in most countries. However, the special feature of the supply is the one with the challenge and is what directly links the analysis by Baumol et al. to corporate governance. The supply side of the innovation market is a special supply which is driven by incentive mechanisms that promote innovations. Large companies must be incentivised properly for Baumol et al.'s optimal capitalist system to exist. In other words, good corporate governance is, according to Baumol et al, a condition to realise their optimal capitalist system. The authors of this typology discuss an example that would advance the supply side of the innovation market, which grants employees, top management bodies, and CEOs a unique form of stock options. The idea is that current CEOs compensations are based on absolute performance, not relative performance. The authors, along with many other corporate governance scholars, argue that basing the compensation of CEOs and top management on relative performance encourages managers to outperform their peers and promotes companies innovation.[90] Baumol et al. only discussed this idea as an example.[91] However, they recognise all other forms of incentives discussed in the corporate governance literature and invite researchers to collaborate more on this matter.[92]

Unlike the other typologies of capitalism that were discussed in this chapter, the relationship between corporate governance and this analysis varies. The typologies devised by both Coates and Hall and Soskice are firm-centred and focus on how firms behave in certain settings. Thus, a direct

[88] Ibid, 87-89

[89] Ibid, 117

[90] Ibid 125; Martin J. Conyon, ‘Corporate Governance and Executive Compensation’ (1997) 15 International Journal of Industrial Organization 493, 496

[91] Baumol, Litan and Schramm, ‘The Four Types of Capitalism, Innovation, and Economic Growth’ (n 82) 125

[92] Ibid

relationship was found between corporate governance and capitalism, in which corporate governance changes according to the type of the capitalist economy. However, Baumol et al. classification of capitalism considers companies to be only one of the actors in the process of production and focuses more on the role played by the state in shaping the economy. Therefore, the relationship between corporate governance and the capitalist economies in this typology differs according to the role played by the state and companies in the economy.

As mentioned previously, Baumol et al. classify the application of capitalism into four categories: oligarchic, state-guided, big-firm and entrepreneurial capitalism. The role of the state in shaping the economy reaches its highest levels in oligarchic systems and decreases gradually in state-guided and big firm capitalism, reaching its lowest point in entrepreneurial capitalism. In contrast, the role of companies reaches its highest level in entrepreneurial economies and decreases gradually in big-firm and state-guided capitalism, reaching its lowest point in oligarchic systems. As a result, the role of corporate governance in shaping the capitalist economies that are described in this typology vary depending on the role of companies in shaping the economy. In other words, the extent of the circular influence amongst companies and capitalist economies, as discussed in section 5.1 and 5.2, is at its strongest level in entrepreneurial capitalism and decreases gradually, in the following order, in big-firm, state-guided, and oligarchic capitalism. However, that does not mean that corporate governance within oligarchic systems has no influence. In the analysis of Baumol et al., companies play a relatively crucial role in guiding the economy in all four types. Specifically, this crucial role is played by promoted companies in state-guided capitalism, by companies owned by a small number of families in oligarchic capitalism, by a few large companies in big-firm capitalism, and by many small companies in entrepreneurial capitalism.

5.4 Corporate Governance and Approaches to Capitalism

This section examines the relationship between corporate governance models and the social market and free market approaches to capitalism. Given that this thesis argues that the stakeholder model of corporate governance in Germany is influenced by social market capitalism and that the shareholder model is influenced by free market capitalism, this section contains two subsections. The first subsection explores the relationship between the German stakeholder model of corporate governance and social market capitalism, and the second subsection examines the relationship between the shareholder model of corporate governance and the free market approach to capitalism.

In the corporate governance literature, Germany and Japan offer the best representations of the stakeholder approach, although neither apply a pure stakeholder model. Nevertheless, given that Chapter 4 discusses only social market capitalism, the driving principles of the German economy, and free market capitalism, the driving principles of the US and UK economies, this section discusses only the corporate governance practices of these three countries.

5.4.1 The Influence of Social Market Capitalism over the Stakeholder Model

The social market approach to capitalism, in its essence, is a combination of laissez-faire capitalism and social policy.[93] The approach was formulated soon after the First World War by a number of German scholars.[94] It was mainly driven by a mistrust in the laissez-faire model of free market and a belief in the necessity of having a social order that can intervene at least temporarily in the event of undesirable market outcomes.[95] Social market theorists believe that the laissez-faire form of free market, due to the absence of any market regulation by the state, leads to the creation of power concentrations that eventually make the state an instrument in the hands of a few powerful cartels; according to these theorists, any economic system that does not include social norms and values will eventually erode social bonds and place individuals in a painful isolation leading to disastrous social outcomes.[96] They also believe that economic policies should not view market transactors as producers and consumers, but as human beings who desire freedom and social justice.[97] Thus, social market theorists call for a strong state that can apply social policies and design a clear institutional framework within which free and

[93] Alfred Müller-Armack, 'The Meaning of the Social Market Economy' in A.T. Peacock and H. Willgerodt (eds), *Germany's Social Market Economy: Origins and Evolution* (1st edn, Macmillan for the Trade Policy Research Centre 1989) 83

[94] Ibid, 82-83

[95] Arne Heise and Özlem Görmez Heise, 'The Social Market Economy Revisited: The German Variety of Capitalism in Retrospect' (2013) 1 Izmir Review of Social Sciences 7, 8

[96] Konrad Zweig, 'The Origins of the German Social Market Economy' (1980) Adam Smith Institute, Research Paper <https://www.adamsmith.org/s/social-market-economy.pdf> accessed 29 Decmber 2018, 21; Alfred Müller-Armack, 'The Social Market Economy as an Economic and Social Order' (1978) 36 Review of Social Economy 325, 327

[97] Müller-Armack, 'The Social Market Economy as an Economic and Social Order' (n 96) 327

spontaneous market processes take place.[98] The objective of this approach is to establish an economic system that brings continuous growth and assures social justice, human dignity and freedom.[99]

Moreover, social market economists condemn classical capitalism for allegedly bringing miserable social conditions to workers.[100] They argue that in classical capitalism, individuals are dependent on impersonal market rules that do not differentiate between the market for goods and the market for labour. Social market economists believe that workers in a labour market that is dominated only by supply and demand cannot cope with it without excessive harm to themselves and society.[101] Using Karl Marx's argument, they explain that making the right to work a commodity that can be exchanged in a market based only on supply and demand forces workers to accept work under unsatisfactory conditions for minimum wages; consequently, workers have a "double free" situation—free from owning productive properties and free from acquiring means of subsistence.[102]

As a result of this unique capitalist social market environment, the stakeholder model of corporate governance emerged in Germany. The justification of implementing government interventions to create a socially balanced society and empower workers, in the social market system, shaped directly or indirectly the current German stakeholder model of corporate governance. In addition, the unique features of German corporate governance were not only the result of the justification for the government to intervene by social market capitalism but also the result of the unique shifts in the German capitalist system through history. The distinctive evolution of capitalism in Germany that began in 1848 provided the foundation not only for the social market economy but also for the unique features of the German stakeholder model.

[98] Flavio Felice and Massimiliano Vatiero, 'Ordo and European Competition Law' in Luca Fiorito (ed), *A Research Annual: Research in the History of Economic Thought and Methodology*, vol 32 (1st edn, Emerald Group Publishing Limited 2014), 149

[99] Siegfried G. Karsten, 'Eucken's 'Social Market Economy' and Its Test in Post-War West Germany: The Economist as Social Philosopher Developed Ideas That Parallelled Progressive Thought in America' (1985) 44 American Journal of Economics and Sociology 169, 169

[100] Werner Bonefeld, 'Human Economy and Social Policy: On Ordo-Liberalism and Political Authority' (2013) 26 History of the Human Sciences 106, 109

[101] Ibid, 110

[102] Karl Marx, *Capital: A Critique of Political Economy*, vol 1 (Frederick Engels ed, Progress Publishers 2015) 507

The German model of corporate governance is often distinguished by its employment representations and citizenship, stakeholder oriented management, two tier-board structure, concentrated ownership, tendency for insider financing, and cooperation among its companies. Each of these features is tied to the social market capitalism and its early developments. In other words, the argument here is that each one of these features of the German corporate governance has essentially developed in a simulation of the development of the German capitalist economy.

To illustrate, the first distinguishing feature of German corporate governance is employment representation, which can be traced back to as early as 1848 when the idea of employee participation in managerial decision making was formulated.[103] In 1848, revolutions swept over Europe due to the economic crisis of the 1840s calling for fairness, liberty and democracy.[104] Consequently, the imperial government of Germany, in response to the revolution, opted toward a more liberal form of capitalism by opening free trade markets and appointing prominent liberals to high administrative positions.[105] During this liberal period, many rights were recognised for people including employees' right to strike and form labour unions.[106] However, the belief in market liberalism was soon shaken by the financial crisis of 1873; the government abandoned its free trade policy in 1879 and replaced it with a conservative state-led economy between 1880 and 1918.[107] The imperial government of that time started a large scale process of concentration and became a land of big government, big banks and big industries.[108] It imposed protective import tariffs on most goods and formed large cartels in many industries and as a mitigating policy it introduced protections for unemployment, old age and work injuries.[109] During this period, labour unions

[103] J Bautz Bonanno, ‘Employee Codetermination: Origins in Germany, Present Practice in Europe, and Applicability to the United States’ 14 Harvard Journal on Legislatoin 947, 949

[104] Helge Berger and Mark Spoerer, ‘Economic Crises and the European Revolutions of 1848’ (2001) 61 Journal of Economic History 293, 319

[105] Gerhard Lehmbruch, ‘The Institutional Embedding of Market Economies: the German ‘Model’ and its Impact on Japan’ in Wolfgang Streeck and Kōzō Yamamura (eds), *The Origins of Nonliberal Capitalism: Germany and Japan in Comparison* (1st edn, Cornell University Press 2001), 49

[106] Ibid, 58

[107] Ibid, 50-52

[108] Karl A. Schleunes and others, *Encyclopædia Britannica: Germany: The German Empire 1871–1914* (2020)

[109] Ibid, Philip Manow, ‘Welfare State Builiding and Coordinated Capitalism in Japan and Germany’ in Wolfgang Streeck and Kōzō Yamamura (eds), *The Origins of Nonliberal Capitalism: Germany and Japan in Comparison* (1st edn, Cornell University Press 2001) 110

were supressed at the beginning and then regained their position in 1895 and became very powerful.[110]

Afterwards, In the short period after the First World War and before the Nazi government, the German economy was marked by uncertainty and high levels of unemployment which promoted another wave of revolutions that started in November 1918. These revolutionaries opposed not only the Kaiser's government but also the far-left and the far-right political ideologies that they experienced in the preceding 80 years.[111] During this period, employment representation was declared as the law of the nation, and the theories of the social market model of capitalism matured. In particular, the top three employers of that time signed an agreement with the top three labour unions, namely, the marxist Allgemeiner Deutsche Gewerkschaftsbund (ADGB) and the liberals Christian Catholic and Hirsch-Duncker trade unions. The agreement, which was a reconciliation between the Marxist and liberal unions, gave the unions equal status before employers and the joint task of determining wages and working hours and conditions. A month later, the agreement was declared the law of the land.[112]

Then, the Nazi government from 1933 to 1945 adopted a unique command economy.[113] During the Nazi rule, labour unions were destroyed, cartels flourished, and state contracts peaked.[114] Employment representation, in this period, was eliminated.[115]

After the Second World War, Germany applied the theories of social market capitalism that were developed before the Nazi regime and recognised employees' rights that had been given to them since 1848 with some modifications. Employment representation developed more after the Second World War to give employees, depending on the size of their companies, between 33% and 50% of the seats on the supervisory board; employees'

[110] Gary Wolfes Marks, *Unions in Politics: Britain, Germany, and the United States in the Nineteenth and Early Twentieth Centuries* (1st edn, Princeton University Press 2014) 52-60

[111] Edwin F Beal, ‘Origins of Codetermination’ (1955) 8 Industrial and Labor Relations Review 483, 487

[112] Ibid

[113] Otto Nathan, *Nazi War Finance and Banking: Our Economy in War* (Financial Research Program, National Bureau of Economic Research 1944) 3

[114] Jackson, ‘The Origins of Nonliberal Corporate Governance in Germany and Japan’ (n 49) 136

[115] Gregory Jackson, ‘Creativity in the Evolution of German Codetermination’ in Wolfgang Streeck and Kathleen Ann Thelen (eds), *Beyond Continuity: Institutional Change in Advanced Political Economies* (1st edn, Oxford University Press 2005) 240

representatives were given the right to vote and counsel on matters presented before the board.[116]

Thus, it can be safely argued that indeed employment representation in German corporate governance developed and was shaped in accordance with the social market capitalism development. Employment representation was even eliminated when social market capitalism was brought down during the Nazi administration and then was reinstated after the Second World War along with the adoption of social market capitalism.

The second and third features of German corporate governance are stakeholder-orientated management and the two tier board system. The same argument that this section used for employment representation can be used to give reasons for the presence of stakeholder management and the two-tier board structure in German corporate governance. As discussed previously, German companies were under firm state control, and they only escaped that control in the liberal economic period of 1848 to the late 1870s.[117] During this brief liberal period, the direct government oversight of companies was lifted.[118] However, due to the mistrust in the capital market caused by the financial crisis of 1873, a model that placed an intermediary body between stockholders and a company's management—the supervisory board was introduced.[119] The supervisory board was meant not only to mitigate the influence of the capital market on the management team but also reflect the interest of all stakeholders.[120] This emphasis of the interest of all stakeholders was because of the concern that the shareholders could take any withdrawal of government oversite as a permission to disregard all non-shareholders interest.[121] The stakeholder management and two-tier board continued to reflect the economic policy of their time. During the Nazi rule in Germany and as the economy became a unique type of command system, the Act of 1937 omitted shareholders from the stakeholders of the company and required management

[116] Fauver and Fuerst, 'Does Good Corporate Governance Include Employee Representation? Evidence from German Corporate Boards' (n 43) 674

[117] Klaus J Hopt, 'The German Two-Tier Board (Aufsichtsrat): A German View on Corporate Governance' in Klaus J. Hopt and Eddy Wymeersch (eds), *Comparative Corporate Governance: Essays and Materials* (1st edn, Walter de Gruyter 1997) 6

[118] Ibid

[119] Mark J Loewenstein, 'Stakeholder Protection in Germany and Japan' (2002) 76 Tulane Law Review 1673, 1675

[120] Ibid, 1676

[121] Ibid

to consider the interests of the people and the Nazi regime only.[122] After the Second World War, the stakeholder management was amended again to include all stakeholders and reflect the new social market economy, which called for a free market and social policy.

The fourth feature is the tendency toward insider financing. Unlike companies in the US, German companies rely relatively more on their strong commercial relationships with banks to provide them with external capital at a low cost.[123] The significant role that banks play in financing and monitoring companies in Germany is mainly contributed to the dominance of banks in the German economy. During the conservative period of German capitalism that followed the 1873 crisis, the imperial government of that time started a process of concentration in most industries which led to the creation of large financial institutions.[124] The financial regulations and market structures of that time gave clear preference to banks' domination which was reinforced during the 1930s and 1940s and persists today.[125] Policy-makers in Germany wanted a system that channelled assets into the hands of banks and away from securities markets because they were influenced by social market capitalism's general mistrust of capital markets.[126]

Fifth, concentrated ownership in Germany can also be contributed indirectly to the social market approach to capitalism. Historically, ownership was concentrated everywhere around the world. However, as companies outgrew the financial resources of their founding owners, they were forced to raise capital. In the US and UK, companies tend to raise capital through the issuance of new shares on the stock market, while in Germany, companies opt for the use of bank financing.[127] In Germany, this is a result of the presence of

[122] Mark G Robilotti, 'Codetermination, Stakeholder Rights, and Hostile Takeovers: A Reevaluation of the Evidence from Abroad' (1997) 38 Harvard International Law Journal 536, 550

[123] Jackson, 'The Origins of Nonliberal Corporate Governance in Germany and Japan' (n 49) 121; Sakai and Asaoka, 'The Japanese Corporate Governance System and Firm Performance: Toward Sustainable Growth' (n 49) 3

[124] For more on the subject see: Timothy Guinnane, 'Delegated Monitors, Large and Small: The Development of Germany's Banking System, 1800-1914' (2001) Economic Growth Center Working Paper No 835 <https://www.econstor.eu/bitstream/10419/98270/1/cdp835.pdf> accessed 1 March 2020

[125] Sigurt Vitols, 'The Origins of Bank-Based and Market-Based Financial Systems: Germany, Japan, and the United States' in Wolfgang Streeck and Kōzō Yamamura (eds), *The Origins of Nonliberal Capitalism: Germany and Japan in Comparison* (1st edn, Cornell University Press 2001) 183-184

[126] Jackson, 'The Origins of Nonliberal Corporate Governance in Germany and Japan' (n 49) 130

[127] Ibid, 128

strong financial institutions, which, as explained previously, is the result of social market capitalism. Such presence coupled with unique inter-firm cooperation among German companies placed in a position in which they are relatively in less need for equity financing. Empirical studies even confirm this conclusion and show that there is a strong positive relationship between bank development and bank financing of companies.[128]

Finally, companies in Germany exhibit a higher level of cooperation in many aspects.[129] As explained by Hall and Soskice's work, this cooperation affects monitoring and control systems; how companies gain access to capital, information about other companies' operations, and specific industrial knowledge and technology; and how employees access training and negotiate wages and work conditions.[130] This section argues that such inter-firm cooperation and important element of corporate governance is also the result of the influence of social market capitalism. The ideas that the goods and labour markets must be ordered to produce a socially balanced society and that competition must be mitigated to prevent monopolies have encouraged firms' cooperation. Indeed, social market capitalism has historically a more lenient approach towards cartels and less competitive labour market than free market capitalism which allowed inter-firms cooperation to grow.

5.4.2 The Influence of Free Market Capitalism over the Shareholder Model

Free market capitalism is characterised by the following pillars: right to private ownership; motivation to make a profit; competition among economic units; freedom of choice with respect to consumption, production and investment; determination of prices based on the market; utilisation of labour; and no or limited role for government in the economy. On the other hand, the shareholder model of corporate governance is characterized by shareholder orientated management, dispersed ownership, equity financing, developed capital market, an active market for corporate control, and a powerful management team. This section argues that each one of these feature is influenced directly or indirectly by the free market approach to capitalism.

[128] Asli Demirgüç-Kunt and Vojislav Maksimovic, 'Stock Market Development and Financing Choices of Firms' (1996) 10 World Bank Economic Review 341, 341

[129] Hall and Soskice, 'An Introduction to Varieties of Capitalism' (n 15) 21-27

[130] Ibid

5.4.2.1 Free market Capitalism and Shareholder Primacy Theory

Shareholder primacy theory is one of the theories of corporate governance that has been influenced by two of the most essential characteristics of free market capitalism, the profit motive and private property. The shareholder primacy theory, discussed in the second chapter, is often regarded as central to the field of corporate governance especially in the Anglo-American system. Proponents of this theory believe that maximising shareholder value should be the ultimate goal of corporate managers. They assert that the only or ultimate objective of corporations is to maximise shareholders' value. However, this does not mean that managers should have no regard at all for the interests of other stakeholders. Many shareholder theorists believe that managers should also consider the interests of other stakeholders but as secondary to the shareholders' interests for if they don't it might eventually harm the maximisation of shareholders' wealth.[131] They argue that maximising shareholder value benefits all other stakeholders and creates greater social wealth, as it is the most efficient approach for managing companies.[132] Some of them even argue that managers are the agents of shareholders and must redirect their decisions to serve the interests of their principals because they have a fiduciary duty to them,[133] and because it is the ethical thing to do.[134]

On the other hand, the motivation to make a profit, discussed in Chapter 4, is one of the fundamental features of the free market approach to capitalism, that can be defined as the motivation of the various economic units to act in pursuit of their own self-interests.[135] Every individual in an economic transaction is trying to achieve his or her ultimate goal by prioritising his or her interests over the interests of all others. This is what rational actors do, according to classical economic theory, and it is manifested in property owners selling or renting their properties for the highest feasible price, entrepreneurs trying to maximise their profits while minimising their losses, workers seeking to

[131] James J Brummer, *Corporate Responsibility and Legitimacy: An Interdisciplinary Analysis* (1st edn, Greenwood Press 1991) 103; Andrew Keay, 'Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?' (2010) 7 European Company and Financial Law Review 369, 376

[132] Keay, 'Shareholder Primacy in Corporate Law: Can it Survive? Should it Survive?' (n 131) 390

[133] E Merrick Dodd, 'For Whom Are Corporate Managers Trustees?' (1932) 45 Harvard Law Review 1145, 1145

[134] Alexei M Marcoux, 'A Fiduciary Argument Against Stakeholder Theory' (2003) 13 Business Ethics Quarterly 1, 1

[135] Campbell R. McConnell, Stanley L. Brue and Sean M. Flynn, *Economics: Principles, Problems, and Policies* (20th edn, McGraw-Hill Education 2015) 31

find the highest paying job with the best working conditions, and consumers endeavouring to buy the products they want at the lowest possible price.[136]

Many free market capitalism theorists argue that self-interest is the efficient course that directs economic transactions towards successful exchanges. When people seek to further their own self-interests but cannot obtain what they want without addressing the needs of their counter-party, namely the person or entity that is at the other end of the transaction, they construct the exchange in a state of equilibrium in which both parties are satisfied.[137] Some classical economists even argue that transactions motivated by self-interest not only benefit the parties involved but also society as a whole.[138] By acting selfishly, each individual ends up advancing society as if he or she was guided by an 'invisible hand'.[139] This can be seen in the way in which the profit motive ensures that resources are being allocated efficiently. When the cost of creating something is greater than its value, this is, then, a sign that the energy and capital devoted to making it is misdirected. In other words, trying to make a profit can tell entrepreneurs when an article or service is no longer worth making and when to redirect their resources into another venture in order to ensure that no resources are wasted.[140] Such efficient use of the world's scarce resources is what increases the wealth of societies.

Shareholder primacy theory and free market capitalism are linked. The shareholder primacy theory is essentially a positive response to the classical capitalist calls for fully exercising the rights to private property and prioritising the objective of making profit for businesses. The proponents of the shareholder primacy theory not only support and justify its premise using the same reasoning that is used to defend the profit motive approach in free-market capitalism, but also call for the same thing. As seen from the brief recapitulation above, the shareholder primacy theory is merely an expansion of the profit motive approach in free-market capitalism that extends the idea of profit maximisation to businesses. The choice to maximise profits for shareholders' benefit, however, is largely based on the efficiency arguments that are employed to support the profit motive in free-market capitalism. Both approaches originate from the notions that maximising the profits of a company's shareholders is the most efficient choice for management and that

[136] Ibid, 34
[137] Ibid, 41
[138] Adam Smith, *The Theory of Moral Sentiments*, vol 1 (Wells and Lilly 1817), 249
[139] Ibid
[140] Henry Hazlitt, *Economics in One Lesson: The Shortest and Surest Way to Understand Basic Economics* (1st edn, Three Rivers Press 2010), 105-106

this act of seeking profit is not only beneficial for shareholders but also for all of society. Some proponents of the shareholder primacy theory even specifically quote Adam Smith and build their arguments for shareholder primacy around the invisible hand.[141]

In addition, some shareholder primacy theorists even use the right to private property as a foundation to argue that a company's managers are the agents of its shareholders, to whom they, arguably, owe fiduciary duties and ethical conduct, as the shareholders are regarded, according to many of them, as the owners of the company.[142] They explain that under a capitalist system that recognises private ownership rights and freedom of contract, when a person carries on a business, he or she has no duty to conduct business for the benefit of other people. He or she normally manages a business for his or her own benefit and gain. Similarly, when the business owner appoints an agent to assist in running the business, the situation does not change. The agent must manage the business for the sole benefit of the owner.[143]

5.4.2.2 Free Market Capitalism and Corporate Ownership

Corporate governance models in the US and UK, as Chapter 3 shows, are characterised by dispersed ownership and limited government ownership of companies shares. This thesis argues that such dispersed ownership and limited state holdings exist mainly because of free market capitalism. In particular, the thesis asserts that the relatively adverse competition that free market capitalism promotes is the main reason for the unique diffused ownership structure found in the US and UK. It also argues that the limited role of government in this type of capitalism is the main reason for the relatively low levels of state ownership and, to a lesser degree, the dispersed ownership structure.

In the US, the ownership structure started to become widely dispersed in the second half of the 19th century at the same time as the Second Industrial Revolution, which is usually dated between 1870 and 1914.[144] This phase

[141] See for example, Hugh Alexander Grossman, 'Refining the Role of the Corporation: The Impact of Corporate Social Responsibility on Shareholder Primacy Theory' (2005) 10 Deakin Law Review 572, 574; David Silverstein, 'Managing Corporate Social Responsibility in a Changing Legal Environment' (1987) 25 American Business Law Journal 523, 535

[142] See for example, Dodd, 'For Whom Are Corporate Managers Trustees?' (n 133) 1145

[143] Ibid, 1145-1146

[144] John C Coffee, 'Dispersed Ownership: the Theories, the Evidence, and the Enduring Tension Between 'Lumpers' and 'Splitters'' in Dennis C. Mueller (ed), *The Oxford Handbook of Capitalism* (Oxford University Press 2012) 619

involved an unprecedented development of railroads that allowed people and goods to move more easily and telegraph lines that facilitated rapid communication. The same period also witnessed significant innovations in manufacturing and production technology.[145] These advancements intensified competition; as a result of this severe competition, US businesses experienced an unprecedented wave of mergers.[146] For many firms, mergers were the rational choice in a capitalist system that is unfriendly to cartels and bans price fixing. In fact, the Sherman Antitrust Act of 1890 prohibited price fixing but allowed mergers.[147] Therefore, mergers offered the main technique for businesses to avoid ruinous competition and retain higher profits. The merger wave of this period produced large companies with dispersed ownership. The cases of the US Steel and Standard Oil serve as good examples of the extent of such mergers as these entities acquired most of their competitors in the US.[148] Empirical studies confirm that as a result of these merger activities, the separation of ownership and control reached an advanced level by 1900 and became the new reality of the US corporate ownership structure by 1930. In particular, more than 80% of the largest companies in the US had no controlling shareholder in 1901, while the number of individual investors in the New York Stock Exchange reached 10 million in 1930, increasing from 500,000 in 1900.[149]

This adverse competition among manufacturing companies was matched by another contest among stock exchange markets within the US. In response to this competition, some stock exchanges sought to build a reputation as high-quality stock exchanges that listed only low-risk companies.[150] The New York Stock Exchange, for example, did not accept what is commonly known as penny stocks for listing and insisted that all companies beginning from 1900 publish annual reports and adhere to the rule

[145] Ryan Engelman, ‘The Second Industrial Revolution: 1870-1914’ (*U.S. History Scene*, 2020) <http://ushistoryscene.com/article/second-industrial-revolution/> accessed 10 March 2020

[146] George Bittlingmayer, ‘Did Antitrust Policy Cause the Great Merger Wave?’ (1985) 28 Journal of Law and Economics 77, 77

[147] Coffee, ‘Dispersed Ownership: the Theories, the Evidence, and the Enduring Tension Between 'Lumpers' and 'Splitters'’ (n 144) 625

[148] Ibid

[149] Edward S. Herman, *Corporate Control, Corporate Power: A Twentieth Century Fund Study* (1st edn, Cambridge University Press 1981) 67; Jonathan Baskin, Jonathan Barron Baskin and Paul J. Miranti, *A History of Corporate Finance* (1st edn, Cambridge University Press 1999) 232

[150] Coffee, ‘Dispersed Ownership: the Theories, the Evidence, and the Enduring Tension Between 'Lumpers' and 'Splitters'’ (n 144) 628

of one share, one vote.[151] This strategy encouraged the public to invest in the stock market, resulting in dispersed ownership. For example, US Steel, a company incorporated in 1900 and listed on the New York Stock Exchange, had about 121,000 shareholders as of 1913; Standard Oil of New Jersey, which was 1 part of the 33 parts of the fragmented Standard Oil, had 6,201 investors in 1913.[152]

Similarly, in the UK, dispersed ownership was mainly the result of a matching wave of mergers led mainly by an endorsement of adverse competition by free market capitalism. Businesses in the UK responded to the increased competition that the Second Industrial Revolution induced in a similar fashion to those in the US. Indeed, the intensity of the merger wave of the late 19th and early 20th centuries was unprecedented. On average, 67 companies disappeared in merger transactions each year between 1888 and 1914; during the peak of this wave, 630 companies disappeared in merger transactions in only three years.[153] Thus, it can be concluded that, as in the US, the ownership structure of UK companies became dispersed due to the unique free market capitalism approach to competition.

Moreover, free market capitalism also induced to some degree a dispersed ownership structure in the US and UK through its approach to the role of the government in the market. According to free market capitalism theorists, the role of a government in capitalist economies should be limited to protecting the rights of all its people and to keep an orderly environment that ensures the proper functioning of the markets.[154] The rationale for this is that government interventions inhibit and disturb the efficient working of the free market system.[155] Thus, unlike those under other capitalist forms, governments in countries exhibiting free market capitalism usually refrain from owning any means of production, and this includes owning companies' shares. As a result of this approach, when the Second Industrial Revolution began, many governments in non-free market capitalist systems intervened directly in the market by increasing their ownership in their countries' companies or indirectly

[151] Ibid, 629

[152] R. Michie, *The London and New York Stock Exchanges 1850-1914* (2nd edn, Routledge 2012) 223

[153] Leslie Hannah, *The Rise of the Corporate Economy* (1st edn, Routledge 2006) 23

[154] Sarwat Jahan and Ahmed Saber Mahmud, 'What is Capitalism?' (2015) 52 Finance & Development 44, 44; Des Gasper, 'Capitalism and Human Flourishing? The Strange Story of the Bias to Activity and the neglect of Work' in John B. Davis (ed), *Global Social Economy: Development, Work and Policy* (1st edn, Routledge 2010), 7-9

[155] McConnell, Brue and Flynn, *Economics: Principles, Problems, and Policies* (n 135) 32

through their banking system; Germany serves as an example.[156] However, such involvement was limited in free market capitalism, creating a more appropriate environment for dispersed ownership.

The free market capitalism approach to the role of the government in the market also influences ownership structure in another regard. This thesis argues that the relatively limited state ownership in the US and UK is mainly attributable to free market capitalism, which in turn influences corporate governance. Excessive state ownership of companies does not only disturb the free market system but also affects corporate governance regulations. It creates a conflict of interests inherent in the government's dual role as shareholder and a regulator.[157] Countries that exhibit high levels of state-owned companies have an incentive to change the legal rules to privilege their own interests. This conflict of interest is acute since political parties are induced to abuse it knowing that ordinary citizens, who hold no shares in any company, are often in favour of promoting the state's interests.[158] The cases of Italy, Germany and Brazil are clear examples of how state ownership affected corporate governance rules. At a given time, Italy and Germany changed their legal rules to improve investor protection to maximise their profit from selling state-owned shares to the public, while, in contrast, the Brazilian government deliberately reduced investor protection to increase the control premium it was able to obtain in the private sale of corporate control.[159]

Countries that are influenced by free market capitalism have lower state ownership levels than countries that are influenced, for example, by social market capitalism. This is due to the differences among capitalist systems regarding the role of the government in the economy. The UK, for example, has only 447 fully or partially state-owned companies, while Germany has 15186 state-owned companies.[160] Moreover, while state ownership in the US is close

[156] Albrecht Ritschel, *The Oxford Encyclopedia of Economic History: Modern Germany* (Oxford University Press 2003) 411

[157] Mariana Pargendler, 'State Ownership and Corporate Governance' (2012) 80 Fordham Law Review 2917, 2957

[158] Andrei Shleifer, 'State versus Private Ownership' (1998) 12 Journals of Economic Perspectives 133, 141-142

[159] Pargendler, 'State Ownership and Corporate Governance' (n 157) 2956

[160] For the number of state-owned companies in the UK see, National Audit Office, *Companies in Government* (National Audit Office, Press Office, Briefing Number: 10821-001 2015); For Germany see, Jan Sturesson, Scott McIntyre and Nick C Jones, *State-Owned Enterprises: Catalysts for Public Value Creation* (PWC Public Sector Research Centre 2015) 11

to zero, it is about 5% in Germany.[161] It can also be argued that whenever a country owns a large stake of its companies' shares, this ownership will likely affect its corporate governance rules. In other words, the extent of this likely effect on corporate governance rules depends on the extent to which a country respects the capitalist notion of private property. The temptation to change corporate governance rules to privilege the state interests will increase whenever government ownership of companies increases and will decrease whenever ownership levels decrease, as evident by the cases of Italy, Brazil and Germany that were mentioned previously.

5.4.2.3 Free Market Capitalism and Capital Market

The US and UK are well known for their developed capital markets, equity financing, and relatively active markets for capital control. Economists tend to use the number of listed firms in a stock market to test its development. The higher the number in a country, the more companies that turn to equity finance to promote their businesses, which indicates the development of the country’s stock market. As discussed earlier, the UK had more than 2,150 listed companies as of September 2018, while Germany had only about 450 listed companies as of December 2017, even though it has a larger economy than the UK.[162] Another economic measure for capital market development is the total stock market capitalisation as a percentage of GDP. In 2017, the total domestic market capitalisation of Germany amounted to only 57.13% of GDP, while it exceeded 122% in the UK.[163]

This development of the US and UK capital markets is, in general, a result of their capitalist systems. The free-market approach to capitalism is based on the belief that market forces work themselves out in a competitive environment to reach equilibrium and that the free market has the ability to correct itself. The free-market approach to capitalism promotes deregulation, as competitive markets are self-regulatory, suggesting that these regulations pose a great danger, as they could be used as a governmental instrument that prevents new businesses from entering the market.[164] However, as we live in

[161] Gur Aminadav and Elias Papaioannou, ‘Corporate Control Around the World’ (2016) National Bureau of Economic Research Working Paper No 23010 <https://www.nber.org/papers/w23010> accessed 1 May 2019, 24

[162] For the number of listed companies in the UK see, London Stock Exchange, ‘Companies on London Stock Exchange’ (n 57); For the number of listed companies in Germany see, The World Bank, ‘Listed Domestic Companies: Total’ (n 57)

[163] Siblis Research, ‘Global Market Cap to GNI/GDP Ratios for 28 Countries’ (n 58)

[164] Deepak Lal, *Reviving The Invisible Hand The Case For Classical Liberalism In The Twenty-First Century* (Indian edn, Academic Foundation 2006), 56-59

an imperfect world, market regulations are undesirable but necessary.[165] Such beliefs in the free market system as found in the ideological foundation of the US and UK capitalist model place them among the most decentralised economies and are the main driver for well-developed capital markets.

In illustration, it is helpful to make a brief comparison between the US and UK and other European capital markets. Stock exchanges were founded before the Second Industrial Revolution in the US and across Europe.[166] However, the importance of the stock exchanges in the UK and US signified only in the peak of the Second Industrial Revolution as they provided a means for financing. At the same time, other European stock markets shrank in size.[167] In Germany at that time, for example, the imperial government wanted to have more control over its economy, and it was easier to do so through the banking system.[168] Indeed, the imperial government reformed its Stock Exchange Law of 1896 to make its stock markets unattractive for raising capital in comparison to banks.[169] Stock markets are unpredictable and harder to control than banks, particularly in terms of allocating capital; in contrast, a country has the potential to easily direct capital and guide its economy through a controlled banking system.[170] As a result, capital markets developed more naturally in the decentralised environment of free market capitalism than in continental Europe’s environment of state-guided economies since the practice of controlling the economy never appeared in the US and UK.

On the other hand, equity financing and the active market for corporate control in the US and UK can be partially attributed to this development of their capital markets. In both countries, equity financing is often considered a common method of raising capital. Thus, the US is the largest capital market in the world and the UK is the second in terms of the amount of new capital raised through equity issues.[171] Empirical studies show a positive relationship

[165] Henry C. Wallich and Thomas C. Glaessn, ‘Financial Deregulation in the United States and in Developing Countries’ (III International Conference on the Financial Development of Latin America and the Caribbean, Caracas, 1985) 1

[166] Andreas Martin Fleckner and Klaus J Hopt, ‘Stock Exchange Law: Concept, History, Challenges’ 7 Virginia Law & Business Review 513, 523-533

[167] Coffee, ‘Dispersed Ownership: the Theories, the Evidence, and the Enduring Tension Between 'Lumpers' and 'Splitters'’ (n 144) 627

[168] Ibid

[169] Vitols, ‘The Origins of Bank-Based and Market-Based Financial Systems: Germany, Japan, and the United States’ (n 125) 186

[170] Coffee, ‘Dispersed Ownership: the Theories, the Evidence, and the Enduring Tension Between 'Lumpers' and 'Splitters'’ (n 144) 627

[171] Henderson, Jegadeesh and Weisbach, ‘World Markets for Raising New Capital’ (n 59) 64-66

between stock market development and equity financing in developed countries where the reliance on equity financing increases with further developments of the stock market.[172] Similarly, the relatively active takeover market often contributes to ownership fragmentation or deregulation,[173] but it can also be, to some degree, a result of the development of the capital market. Empirical results show that between 1988 and 2016, 4,487 hostile takeover attempts occurred in the US and 1,834 in the UK, compared to 169 in Germany and 207 in Japan.[174] A large number of takeover attempts, such as in the US and the UK, cannot occur in such volume in undeveloped capital markets. Moreover, whether this unique takeover market is the result of a developed capital market, ownership fragmentation, or deregulation, it can be attributed to the free-market approach to capitalism, as explained in this section.

5.4.2.4 Free Market Capitalism and the Independence of Directors and Managers

The freedom to choose with respect to consumption, production, and investment is one of the key pillars of free market capitalism.[175] Freedom of choice is closely related to the right of private property and refers to the owners' right to choose how to exercise their legal rights over their properties and to the private entrepreneurs' right to obtain and use economic resources to produce and sell their choice of goods and services in any market and in whatever manner they want.[176]

In free market capitalist countries, these rights are extremely valued and respected. As a consequence, the board of directors, as it is the most important decision-making body of a company, is free to use the company's economic resources and make informed, independent and disinterested decisions without or with minimal interference from the government. Indeed, free market capitalist systems often foreground the independence of their companies' directors, providing them absolute freedom to evaluate new and existing business opportunities and make informed business decisions since the freedom of

[172] Demirgüç-Kunt and Maksimovic, ‘Stock Market Development and Financing Choices of Firms’ (n 128) 341

[173] Andrei Shleifer and Robert W Vishny, ‘A Survey of Corporate Governance’ (1997) 52 Journal of Finance 737, 756; Randall Morck, Andrei Shleifer and Robert W. Vishny, ‘Alternative Mechanisms for Corporate Control’ (1989) 79 American Economic Review 842, 852

[174] Nan Zhou and Mauro F Guillén, ‘Institutional Complementarities and Corporate Governance: The Case of Hostile Takeover Attempts’ (2019) 27 Corporate Governance: An International Review 82, 83-84

[175] Jahan and Mahmud, ‘What is Capitalism?’ (n 154) 44

[176] McConnell, Brue and Flynn, *Economics: Principles, Problems, and Policies* (n 135) 33

choice is one the basic functions of capitalism. Thus, it is not surprising that the US and UK are at the top of most charts measuring corporate risk-taking.[177] The freedom of choice, dominating the capitalist thought, is one of the factors that contributed to such measurements' results. Current corporate governance regulations in many free market capitalist countries allow such risk-taking based on the fact that the freedom of choice is one of the core features of capitalism. It is even argued that some corporate governance regulations sometimes promote risk-taking by permitting directors to be compensated in a way that encourages short-termism and excessive risk-taking.[178] These lenient regulations are a result of the influence of free market capitalism on corporate governance theories.

5.4.2.5 Free Market Capitalism and Codes of Corporate Governance

According to the free market approach to capitalism, the role of government in capitalist economies should be limited to protecting the rights of all its people and to keep an orderly environment that ensures the proper functioning of markets.[179] For this particular reason, this approach of capitalism is sometimes called a 'laissez-faire' approach, which means 'to let do' or to allow people to do as they choose without government intervention.[180] The rationale for this is that government interventions inhibit and disturb the efficient working of the market system.[181] Free market capitalism supporters argue that every act of government intervention to cure a negative effect itself raises other negative effects and limits individuals' freedom directly or indirectly.[182]

For this reason, governments influenced by free market capitalism refrain or limit its interference in the business of companies implementing

[177] Kai Li and others, ‘How Does Culture Influence Corporate Risk-Taking?’ (2013) 23 Journal of Corporate Finance 1, 1

[178] Markus K Brunnermeier, ‘Deciphering the 2007-2008 Liquidity and Credit Crunch’ (2008) Princeton University Working Paper <http://www.princeton.edu/~markus/research/papers/liquidity_credit_crunch_WP> accessed 1 September 2018, 7; Anil Kashyap, Raghuram Rajan and Jeremy Stein, ‘Rethinking Capital Regulation’ (2008) Federal Reserve Bank of Kansas City Symposium Working Paper <https://www.kansascityfed.org/media/files/publicat/sympos/2008/kashyaprajanstein031209.pdf> accessed 1 September 2018, 437

[179] Jahan and Mahmud, ‘What is Capitalism?’ (n 154) 44; Gasper, ‘Capitalism and Human Flourishing? The Strange Story of the Bias to Activity and the neglect of Work’ (n 154) 15-16

[180] William A. McEachern, *Economics: A Contemporary Introduction* (7 edn, Thomson South-Western 2006) 40

[181] McConnell, Brue and Flynn, *Economics: Principles, Problems, and Policies* (n 135) 32

[182] Milton Friedman, *Capitalism and Freedom: Fortieth Anniversary Edition* (40th Anniversary edn, University of Chicago Press 2009) 32

contractarian thought that there should be minimal regulation and that the actors should be allowed to employ contract to make up the rules. The structure and governance of companies in these countries are meant to resolve agency problems and manage companies internal affairs, including the relationship among the company's shareholders, directors and employees. Corporate governance codes and regulations that are extended to preserve jobs, protect the economy or consumers are not typical for a free market capitalist system and are seen as a means for intervening in the operation of the free market, which supposedly can work efficiently without governmental intervention. Therefore, in this regard a great variation between countries exists, depending on the type of capitalism a country is adopting. Whenever the capitalist system that is being practised in a country is closer to the free market form of capitalism, as described in Chapter 4, then that country is more likely to refrain from imposing such interventions.

The so called 'co-determination' in Germany is a good example for such interventions only if shareholders, in some sense, are in fact the company's owners. Under the German Co-determination Act, companies are required to allow their employees to participate in the decision-making process.[183] If shareholders are in fact the owners of the company, as argued by shareholder theorists, then this regulation directly contradicts capitalism as it undermines private property rights of shareholders and constitutes, according to many economists, unwelcomed intervention in the operation of the free market.[184] However, that does not mean that Germany has no regard for private property; it only means that this regulation is not in line with the free market capitalist ideology.

Therefore, it is safe to say that capitalism influences the scope of corporate governance regulations. The objective of regulating companies for a country influenced by free market capitalism is managing the internal affairs of a company, including the relationship between the shareholders and the board of directors. However, for other capitalist countries, the objectives will likely go beyond regulating the internal affairs of companies to things such as preserving the economy, environment, local communities, and consumers.

[183] Giuseppe Benelli, Claudio Loderer and Thomas Lys, ‘Labor Participation in Corporate Policy-Making Decisions: West Germany's Experience with Codetermination’ (1987) [University of Chicago Press] 60 Journal of Business 553, 533

[184] Felix FitzRoy and Kornelius Kraft, ‘Co-determination, Efficiency and Productivity’ (2005) 43 British Journal of Industrial Relations 233, 235

5.5 Conclusion

The objective of this chapter was to examine the relationship between corporate governance and capitalism. Specifically, the chapter answers many questions related to this objective, such as: does capitalism affect, or has it affected, corporate governance rules and practices? Do corporate governance rules have an effect on capitalism? How does corporate governance relate to the varieties of capitalism literature? What is the role of the theoretical approaches to capitalism in forming corporate governance rules and practices?

To answer such questions, this chapter first investigated the relationship between companies' behaviour in general and the policies and conditions of capitalist systems, finding that they have a circular, reinforcing relationship as they affect each other. The first two sections clearly show that economic conditions and policies in capitalist countries influence corporate governance greatly and that corporate governance practices contribute to forming capitalist policies as well as positive and negative economic conditions in capitalist countries.

Then, section 3 of the chapter examined the relationship between corporate governance and some models of capitalism as discussed in the varieties of capitalism literature. Based on this section, it can be argued that the relationship between corporate governance and the varieties of capitalism studies becomes more visible when microeconomic factors are employed in order to classify countries' forms of capitalism but less visible when relying more on macroeconomic factors. Hall and Soskice’s and Coates’s analyses are clear examples of the former, and Baumol et al.’s represents the latter. Thus, it can be concluded that in Hall and Soskice’s and Coates’s typologies, corporate governance plays a crucial role in determining the capitalist type of an economy. Moreover, the three studies can give an indication of the importance of corporate governance to each model of capitalism.

Finally, the fourth section of this chapter discussed the relationship between corporate governance models and some theoretical approaches to capitalism—in particular, how the social market and free market approaches to capitalism affect the stakeholder and shareholder models of corporate governance found in different nations. The section found that the two approaches exerted a clear influence on the US and UK shareholder and German stakeholder models of corporate governance.

The four sections of this chapter support the argument that a circular relationship exists between corporate governance and capitalism, namely the former influences the latter and vice versa. This sets the scene for the next chapter, which investigates in its second part the effect of this relationship on the legal transplantation issue.

Chapter 6
The Issue of Legal Transplantation in the Corporate Governance Field: Evaluating Existing Approaches and Examining a New One

6.1 Introduction

This chapter is concerned with two of the thesis' objectives. It will, first, evaluate the current explanations of corporate governance diversity. Then, it will examine the effect of the relationship between corporate governance and capitalism on the legal transplantation of corporate governance rules. It argues that the relationship between corporate governance and capitalism could explain the prevailing divergence in corporate governance. Additionally, it claims that this divergence is better understood in light of this relationship, and that any approach regarding the suitability of legal transplantation in the context of corporate governance that does not take into account the link between the capitalist economy and corporate governance will probably not provide adequate analytical tools to address the problem. However, it was necessary to evaluate the divergence claims that have been made before proceeding to this point. Therefore, this thesis devoted Chapter 2 to identifying what corporate governance is, and Chapter 3 to determining whether corporate governance systems are converging. These two chapters found that most empirical studies support, to a large degree, the divergence theory. Then, the thesis introduced capitalism as a factor that could offer a better explanation for the current state of corporate governance divergence and the thesis devoted three chapters to this purpose, namely Chapters 4, 5, and this chapter. Chapter 4 offers a general background to capitalism and the varieties of capitalism. Next, Chapter 5 examines the relationship between corporate governance and capitalism and uncovers a circular relationship between the two in that they affect each other. Consequently, this chapter explains the limitation of the current explanations of corporate governance diversity and claims that capitalism offers a better one or at least cannot be dismissed in determining what corporate governance in a nation will be. It also illustrates how the various forms of capitalism affect the legal transplantation process of corporate governance practices.

Academics from various fields have been expecting a large scale convergence, arguing that economic globalisation has been bringing with it ever more trans-nationalising tendencies in every aspect of life. They argue that in a world characterised by growing economic and cultural interdependencies, it is questionable whether the law—including corporate governance rules—can remain constrained within the borders of the nation state.[1] It is so much so, that scholars have come to advocate in favour of the globalisation of traditionally statist fields of law, such as constitutional and administrative law.[2] They assert that corporate law around the world has already achieved a high degree of convergence and will eventually fully converge on a single model.[3]

Therefore, during the last three decades, the fields of management, finance, economics, and law have been enriched by a large number of empirical studies on the issue of corporate governance convergence in terms of various governance dimensions to evaluate the validity of these claims. Chapter 3 took advantage of these empirical studies that have been accumulated over the past thirty years in order to develop a generalised evaluation regarding the current state of corporate governance convergence. In particular, Chapter 3 determined whether corporate governance models are converging or not by examining data from four countries: the UK, the U.S, Germany, and Japan. The chapter found that there is only a little empirical evidence supporting the convergence theory and in fact it confirmed that these countries have clearly different governance frameworks and that the major differences among corporate governance models, described in Chapter 2 and in the literature, still persist.

These empirical findings clearly contradict the expectations of both the convergence theorists and some of the divergence theorists. The proponents of the convergence theory predicted that the global revolution of telecommunications, transportation, and international trade would eliminate the differences in corporate governance practices among countries causing them to converge on a single efficient model while many of the proponents of the divergence theory expected globalisation to have no effect on corporate governance systems or even push the governance models towards a greater divergence.[4] The findings clearly do not support the argument that corporate

[1] James A Fanto, 'The Role of Corporate Law in French Corporate Governance' (1988) 31 Cornell International Law Journal 31, 33

[2] See for example, Martin Loughlin and Petra Dobner, *The Twilight of Constitutionalism?* (Oxford University Press New York 2010) xi

[3] Henry Hansmann and Reinier Kraakman, 'The End of History for Corporate Law' (2000-2001) 89 Georgetown Law Journal 439, 439

[4] See for example, Mauro F Guillén, 'Corporate Governance and Globalization: Arguments and Evidence Against Convergence' (1999) University of Pennsylvania Working Paper No S99

governance models have already achieved a high degree of convergence. It, indeed, shows a prevailing divergence.

Therefore, in order to explain the reasons for the current state of divergence, this chapter will, first, discuss the limitations of the current arguments in the divergence literature and then introduce capitalism as an alternative novel explanation. However, it is important to note that this thesis does not argue that the relationship between corporate governance and capitalism is the only cause for corporate governance diversity. It only argues that capitalism is the main reason for this diversity. It also argues that the suitability of legal transplantation in the field of corporate governance is better understood within an analytical framework that takes into account the relationship between corporate governance and capitalism. However, it is accepted that there are other factors, discussed in this chapter, which can also contribute to divergence. Adding the relationship between corporate governance and capitalism to the convergence/divergence discourse improves our understanding of the diversity issue and enables a more accurate evaluation of the suitability of the legal transplantation of corporate governance practices and rules.

6.2 The Limits of the Current Corporate Governance Diversity Explanations

The legal and economic literature offer a number of explanations for the diversity of corporate governance practices across countries. Chapter 3 provides a comprehensive review of the dominant explanations for this diversity. The cultural, legal and political explanations do indeed contribute to the diversity phenomenon. However, it is argued that these explanations are not sufficient to provide a comprehensive answer to the question. This section explains the limits and merits of these explanations. Nevertheless, it is important to note that the superiority of capitalism as an explanation does not derive from the limitation of the other explanations but rather from the strong and unique relationship that exists between corporate governance and capitalism, as depicted in Chapter 5. The limitations of the other explanations,

<http://citeseerx.ist.psu.edu/viewdoc/download?doi=10.1.1.556.8556&rep=rep1&type=pdf> accessed 15 Sep 2017; Douglas M. Branson, 'The Very Uncertain Prospects of Global Convergence in Corporate Governacne' in Thomas Clarke (ed), *Theories of Corporate Governance: The Phiosophical Foundations of Corporate Governance* (Routledge 2001) 349

however, highlight the need for a better and more comprehensive account of this issue.

6.2.1 The Cultural Explanation

As discussed in Chapter 3, Many scholars and practitioners have attributed the differences in corporate governance models to cultural diversity.[5] However, only a few of these people have developed a theory of how cultures contribute to this diversity.[6] One of these scholars is Amir Licht, who describes culture as the mother of all path dependence, arguing that cultural diversity is the lead factor that causes corporate governance systems to be diverse.[7]

Licht relies on cross-cultural psychology in his analysis in order to explain how cultures influence corporate governance models, namely, Hofstede and Schwartz studies.[8] He argues that different corporate governance systems attain different levels of approval around the world, depending on their compliance with the cultural values of a particular country.[9] According to Licht,

[5] See for example, Christophe Volonté, ‘Culture and Corporate Governance: The Influence of Language and Religion in Switzerland’ (2015) 55 Management International Review 77; Ilir Haxhi and Hans Van Ees, ‘Explaining Diversity in the Worldwide Diffusion of Codes of Good Governance’ (2010) 41 Journal of International Business Studies 710; Chuck CY Kwok and Solomon Tadesse, ‘National Culture and Financial Systems’ (2006) 37 Journal of International Business Studies 227; Ruth V Aguilera and Gregory Jackson, ‘The Cross-National Diversity of Corporate Governance: Dimensions and Determinants’ (2003) 28 Academy of Management Review 447

[6] See for example, Jeswald W Salacuse, ‘Corporate Governance, Culture and Convergence: Corporations American Style or with a European Touch?’ (2003) 14 European Business Law Review 471; Charles Hampden-Turner and Alfons Trompenaars, *The Seven Cultures of Capitalism: Value Systems for Creating Wealth in the United States, Japan, Germany, France, Britain, Sweden, and the Netherlands* (1st edn, Doubleday 1993); Shirley J. Daniel, Joshua K. Cieslewicz and Hamid Pourjalali, ‘The Impact of National Economic Culture and Country-Level Institutional Environment on Corporate Governance Practices’ (2012) 52 Management International Review 365

[7] Chapter 3 reviews only Licht’s work for several reasons. First, Licht work can be considered as a representative of other similar works, as this thesis is only concerned about whether and how culture influences corporate governance, and the answers to these two specific questions are essentially very similar across the literature. Second, Licht’s work is related directly to this thesis subject, as it discusses the influence of cultures on corporate governance while most of the other research addresses the topic less directly. Finally, Licht argues that almost every aspect of corporate governance is influenced directly or indirectly by culture while many other scholars study the relationship between culture and only one or two aspects of corporate governance.

[8] Amir N Licht, ‘The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems’ (2001) 26 Delaware Journal of Corporate Law 147, 172

[9] Amir N Licht, Chanan Goldschmidt and Shalom H Schwartz, ‘Culture, Law, and Finance: Cultural Dimensions of Corporate Governance Laws’ (2001) Working

these cultural values possess the ability to influence the choice for a particular corporate governance model from a wide range of options.[10]

Cultural diversity indeed contributes to a limited degree to the variation in corporate governance practices. However, describing it as the mother of all path dependencies or claiming that it has the capacity to be the main cause of the differences in corporate governance models is a part of a cliché, in which people often use culture as a hypothetical explanation of many human behaviours. The enormous complexity of culture makes it difficult to produce a generalised conclusion about its role in a particular context. However, the issue here is whether it is a correct assessment. The cultural analysis in this context contains contradiction and inconsistency, and sometimes selection bias of the empirical data. To illustrate, Licht's utilisation of Hofstede's study to explain corporate governance diversity, discussed in Chapter 3, will be used to identify the limitations of the cultural approach.

The Hofstede study identifies four values and then examines forty countries to observe how each society acts in order to achieve these values.[11] In particular, the study measures how each society acts in respect to the following values: First, individualism versus collectivism, which measures the strength of the relationship of individuals to their communities. A high individualism score in a society implies that its members have weak interpersonal relationship with those outside their core families. In contrast, a high score in collectivism in a society indicates that its members have feelings of loyalty and responsibility to the entire group.[12] Second is power distance, which measures the degree of inequality that may exist in some societies and its acceptance by people. While a high score of power distance in a country means that its citizens accept the unequal distribution of powers, low scores indicates that powers are shared and widely diffused.[13] Third is masculinity versus femininity. In masculine societies, people value and generously reward achievement and heroism, and in feminine societies they value modesty, caring

Paper, SSRN 267190 <https://ssrn.com/abstract=267190> accessed 20 May 2019, 31-32

[10] Licht, 'The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems' (n 8) 189; Amir N Licht, 'Legal Plug-Ins: Cultural Distance, Cross-Listing, and Corporate Governance Reform' (2004) 22 Berkeley Journal of International Law 195, 198

[11] Geert Hofsteds, *Culture's Consequences: International Differences in Work-Related Values* (Abridged edn, Sage Publications 1980), 11

[12] MindTools.com, 'Hofstede's Cultural Dimensions: Understanding Different Countries' (2016) <https://www.mindtools.com/pages/article/newLDR_66.htm> accessed 10 July 2019

[13] Ibid

for the weak and harmony.[14] Finally, high scores in uncertainty avoidance indicate that a society feels uncomfortable in ambiguous circumstances, whereas low scores indicate the acceptance of uncertain situations.[15] Licht uses the dimensions of the above four cultural values to explain corporate governance diversity. However, all four values cannot be used to explain corporate governance diversity without apparent limitations.

First, Licht's study reports, regarding the uncertainty avoidance dimension, that cultures that score highly on uncertainty avoidance are more likely to have lower shares of equity securities in household portfolios because people in such societies tend to avoid the risks associated with equity holding and try to maintain things as they are with a low risk to everyone, which consequently results in concentrated private and state ownership.[16] However, while this hypothesis may be true in countries such as Germany and France, as they have high scores in this dimension, and the US and UK, as they have low scores, it is certainly not supported in many other countries such as China and Japan.[17] China's score in uncertainty avoidance shows a high tolerance for risk-taking as it scores lower than the US and UK's despite the fact that it has higher levels of concentrated ownership and lower shares of equity securities in household portfolios, as shown in Chapter 3.[18] Conversely, while the Japanese score is higher than the French and German scores, they have a relatively greater diffuse ownership structure.[19] Thus, it can be concluded that Licht's use of the uncertainty avoidance dimension is indeed inconsistent.

Moreover, countries that score highly in uncertainty avoidance in Hofstede's table such as Germany and France have surprisingly lower disclosure standards. If a society has high levels of uncertainty avoidance, which means that it is uncomfortable living in ambiguity, it should advocate strict, not lenient, disclosure standards. However, because this result clearly shows that uncertainty avoidance has no effect on the outcome of disclosure standards, Licht intentionally opts for the less obvious conclusion, arguing that societies that score highly in uncertainty avoidance are expected to have lower disclosure standards because they may prefer to suppress transparency to

[14] Licht, 'The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems' (n 8) 173

[15] Ibid

[16] Ibid, 189

[17] Geert Hofsteds, 'Dimension Data Matrix' (*GeertHofstede.com*, 2015) <https://geerthofstede.com/research-and-vsm/dimension-data-matrix/> accessed 7 July 2019

[18] Ibid

[19] Ibid

preserve security and avoid conflict and competition.[20] However, it is generally accepted that the right hypothesis is the one with the least number of assumptions.[21] Lich's hypothesis in this regard contains two assumption, whereas the hypothesis that societies that are uncomfortable living in ambiguity should advocate strict disclosure standards includes only one assumption. Moreover, Corporate disclosure regulations are too narrow to explain the unique status of market competition in Germany and France. It is very unlikely that disclosure standards have any meaningful effect on competition in any country. The requirement to disclose typically does not include revealing any sensitive information that could change a company' competitive position, even in countries such as the US and UK. Thus, choosing not to impose strict disclosure standards to protect competition is meaningless. In other words, if the Germans or French want to achieve a high level of uncertainty avoidance, the rational choice is to impose higher disclosure standards rather than less ones, with the hope that they will affect, to a minimal degree, competition levels.

Second, the power distance dimension also cannot explain, for example, the differences in executive compensation for which Licht argues.[22] Societies that score highly on power distance are expected to have higher executive compensation as they are more accepting of unequal distribution of power practices. However, empirical results challenge this hypothesis. The US score in the power distance dimension is very close to the scores of the UK, Germany and Japan, despite the huge difference that exist between the US and the rest of the world in terms of executive pay rates.[23] Hofstede's study gives the US a score of 40 in the power distance dimension, which indicates a high level of intolerance of the unequal distribution of powers. Similarly, the same study gives Germany and UK a score of 35 and Japan a score of 54 out of possible 100.[24] However, Chapter 3 shows that the US has the highest executive remuneration rates, with a huge gap between it and the rest of the world.

[20] Licht, ‘The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems’ (n 8) 202

[21] 'Occam's razor' is a methodological tool, which dictates that when someone is presented by two or more competing hypothesis, one should choose the hypothesis with the fewest assumptions.

[22] Licht, ‘The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems’ (n 8) 199

[23] Marc Goergen and Luc Renneboog, ‘Managerial Compensation’ (2011) 17 Journal of Corporate Finance 1068, 1071; Anders Melin, ‘Executive Pay’ (*Bloomberg*, 2018) <https://www.bloomberg.com/quicktake/executive-pay> accessed 20 April 2019

[24] Hofsteds, ‘Dimension Data Matrix’ (n 17)

Finally, societies that score high on collectivism or high on femininity are expected to adopt a stakeholder approach to management. This is so because collectivism represents caring for the wider community and femininity represents caring for the weak. Nevertheless, Japan has the lowest score in femininity despite the fact that it applies a stakeholder model of corporate governance, while the femininity scores of the US, UK and Germany are almost the same in spite of their differences in management goals.[25] Similarly, countries' scores on collectivism do not relate to their mode of management. For example, Germany has a very high score in individualism despite the fact that it adopts a stakeholder approach to management.[26]

6.2.2 The Legal Explanation

Another explanation for the diversity of corporate governance systems is offered by Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny.[27] As discussed in Chapter 3, La Porta et al argue that the historical origins of a country’s legal system shape not only its corporate governance but also its law-making, economic nature, and political institutions.[28]

Legal-origin theorists believe that the best way to explain corporate governance differences and understand the process of their reforms is through the legal origin approach.[29] In particular, they devise a two layer argument asserting, first, that the legal protection of shareholders and creditors is the key to understanding the differences in crucial aspects of corporate governance models. This is so because corporate governance, according to La Porta et al, is *“a set of mechanisms through which outside investors protect themselves*

[25] Ibid

[26] Ibid

[27] Rafael La Porta and others, ‘Law and Finance’ (1998) 106 Journal of Political Economy 1113; Rafael La Porta and others, ‘Legal Determinants of External Finance’ (1997) 52 Journal of Finance 1131; Rafael La Porta and others, ‘The Quality of Government’ (1999) 15 Journal of Law, Economics, and Organization 222; Rafael La Porta, Florencio Lopez-De-Silanes and Andrei Shleifer, ‘Corporate Ownership Around the World’ (1999) 54 Journal of Finance 471; Rafael La Porta and others, ‘Investor Protection and Corporate Governance’ (2000) 58 Journal of financial economics 3; Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, ‘The Economic Consequences of Legal Origins’ (2008) 46 Journal of Economic Literature 285; Rafael La Porta, Florencio Lopez-de-Silanes and Andrei Shleifer, ‘Law and Finance After a Decade of Research’ in George M. Constantinides, Milton Harris and Rene M. Stulz (eds), *Handbook of the Economics of Finance*, vol 2 (1st edn, Elsevier 2013)

[28] La Porta, Lopez-de-Silanes and Shleifer, ‘The Economic Consequences of Legal Origins’ (n 27) 291, 301

[29] La Porta and others, ‘Investor Protection and Corporate Governance’ (n 27) 24

against expropriation by insiders”.[30] Thus, the quality of the legal rules that protect investors is an extremely important factor that determine the differences in key elements of corporate governance models such as ownership concentration, corporate finance choices, and the size of stock markets.[31]

Then, they argue that empirical evidence suggests that the quality of the legal rules regarding investors’ protection does not randomly vary across countries. They assert that evidence clearly shows a systematic variation in the quality of investor protection between common law and civil law countries, with the laws of common law countries being more effective in protecting outside investors than the laws in civil law countries.[32] Hence, the authors conclude that the origin of legal systems affect the quality of investor protection rules which in turn affect corporate governance models.[33]

However, although La Porta et al. offer a good explanation of how investor protection rules affect corporate governance practices, they fail to provide adequate reasoning for how the legal origins affect the investor protection rules themselves. They, along with other legal origin theorists, give two accounts of how legal traditions affect investor protection rules. However, neither is sufficient to conclude that the various legal traditions cause the variation in corporate governance models, although the theory itself merits some consideration.

First, correlation does not imply causation. The mere fact that their empirical results show a systemic variation in the quality of investor protection between civil law and common law countries is not enough to conclude that the legal traditions shape corporate governance systems, as one of the other explanations offered in this chapter could be the real reason for this diversity. This is so because La Porta et al. base their argument on the idea that conquest and colonisation are the primary drive for legal development and disregard the fact that conquerors and colonisers do not only impose their legal traditions on their subjects but also their cultural, political and economic orders. Therefore, the systemic variation in their results could be the outcome of the imported cultural, legal, political or capitalist traditions. Indeed, in one of their

[30] Ibid, 4

[31] La Porta and others, ‘Law and Finance’ (n 27) 1145 and 1152

[32] La Porta, Lopez-de-Silanes and Shleifer, ‘The Economic Consequences of Legal Origins’ (n 27) 258-286

[33] See for example, La Porta, Lopez-de-Silanes and Shleifer, ‘Law and Finance After a Decade of Research’ (n 27)

essays, Licht et al. argue that investor protection rules reflect cultural values not legal traditions, accusing La Porta et al. of reverse causality.[34]

Second, legal origin theorists also argue that legal traditions affect investor protection rules through the different judicial practices that exist among the various legal families. According to them, in common law countries rules are usually made by judges based on principles such as fairness and fiduciary duty. Judges regularly rule on unprecedented conduct by insiders and apply these general principles to protect outsiders, even when the conduct has not been detailed in any statute, which place upon insiders an open-ended obligation of fairness to outsiders.[35] In contrast, in civil law countries rules are made by legislators and judges cannot go beyond the statutes and apply such principles.[36] Legal origin theorists claim that these contrasting judicial systems affect the quality of investor protection practices. However, this is not entirely true, because most countries, civil law and common law alike, depend on codes rather than judge-made rules in the area of corporate and bankruptcy laws.[37] The UK Companies Act 2006 is a good example of that. Additionally, many of the codes in civil law countries similarly mandate open-ended obligations and duties on directors. Judges in civil law countries, likewise their counterparts in common law jurisdictions, also rule on unprecedented conduct of insiders based on general principles such as fairness, good faith and, arguably, fiduciary type duties.[38] Thus, corporate directors in common law countries are not the only ones under open-ended obligations to outsiders. Such order of common law and civil law structures raises serious doubt over the extent of the effect of judiciary systems on investor protection rules.

[34] Amir N Licht, Chanan Goldschmidt and Shalom H Schwartz, ‘Culture, Law, and Corporate Governance’ (2005) 25 International Review of Law and Economics 229, 245

[35] La Porta and others, ‘Investor Protection and Corporate Governance’ (n 27) 9

[36] Ibid

[37] Kenneth W. Dam, *The Law-Growth Nexus: The Rule of Law and Economic Development* (1st edn, Brookings Institution Press 2007) 33

[38] See for example article L.123-14-15, L.134-4, and L. 242-6 of the French commercial code Martha Fillastre, Amma Kyeremeh and Miriam Watchorn, ‘French Commercial Code’ (2014) <https://halshs.archives-ouvertes.fr/halshs-01402645/document> ; See also article 93 of the German Stock Corporation Act Norton Rose Fulbright, ‘German Stock Corporation Act (Aktiengesetz)’ (*Norton Rose Fulbright*, 2016) <https://www.nortonrosefulbright.com/-/media/files/nrf/nrfweb/imported/german-stock-corporation-act.pdf> ; Moreover, for an argument that France and Germany have functional equivalents to fiduciary duties see Martin Gelter and Geneviève Helleringer, ‘Fiduciary Principles in European Civil Law Systems’ in Evan J. Criddle, Paul B. Miller and Robert H. Sitkoff (eds), *The Oxford Handbook of Fiduciary Law* (1st edn, Oxford University Press 2019)

Moreover, the use of case law is not exclusive for common law countries, many civil law jurisdictions are embracing the use of legal precedents.

Finally, whereas corporate governance models vary greatly across countries, the legal origin theorists argue that this variation comes only from two sources, the French civil law and English common law. La Porta et al. argue that every country in the world has at some point in their history adopted voluntarily or involuntarily a civil or common law system and that these two origins are responsible for the variation in corporate governance models.[39] However, the fact that corporate governance models are more diverse than the identified legal origins refutes their argument. If the variation in corporate governance models is produced by only two sources, then the results should also be limited to two models, unless there are other factors that contribute to this diversity. The point here is that the legal origin theory cannot alone explain the diversity in corporate governance practices.

6.2.3 The Political Explanation

The political explanation of the diversity in corporate governance systems is developed mainly by Mark Roe.[40] The political theory depends largely on the idea of complementarity and social peace in explaining the models differences and asserts that political pressures can shape national corporate governance systems.[41]

In particular, the theory argues that in countries where social democratic parties play a dominant role, Western and Northern Europe as prime example,

[39] La Porta, Lopez-de-Silanes and Shleifer, ‘Law and Finance After a Decade of Research’ (n 27) 429

[40] Mark J Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (Princeton University Press 1996); Mark J Roe, ‘Political Preconditions to Separating Ownership from Corporate Control’ (2000) 53 Stanford Law Review 539; Mark J. Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (illustrated, reprint edn, Oxford University Press 2006); Mark J. Roe and Massimiliano Vatiero, ‘Corporate Governance and Its Political Economy’ in Jeffrey N. Gordon and Wolf-Georg Ringe (eds), *The Oxford Handbook of Corporate Law and Governance* (1st edn, Oxford University Press 2018); For other scholar's work on the subject see for example, Pepper D Culpepper, *Quiet Politics and Business Power: Corporate Control in Europe and Japan* (1st edn, Cambridge University Press 2010), Ugo Pagano, ‘The Evolution of the American Corporation and Global Organizational Biodiversity’ (2011) 35 Seattle Uinversity Law Review 1271; P.A. Gourevitch, P.A.G.J. Shinn and J. Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance* (1st edn, Princeton University Press 2005)

[41] Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (n 40) 23

companies receive great pressure to favour employees over shareholders.[42] The theory argues that this pressure is what forces policy makers to shape the entire corporate governance system in a certain way in these countries.[43] Germany, for example, settled upon a co-determination system that gives employees half the seats of companies' boards in large companies. This system of co-determination indeed fostered a sort of social peace among employees.[44] However, it triggered a problem. Having employees' representatives and the management team in one board together limits to some degree the freedom of managers in managing their companies. Therefore, in order to give managers the required or wanted freedom, the German policy makers created a two-tier board system, a relatively weak supervisory board for employees and shareholders' representatives and a management board only for managers.[45] However, although this solution produced social peace among managers and employees, it created another problem for shareholders. Since, according to the theory, weaker supervisory boards mean a weaker representation of shareholder interests, corporate ownership structures became concentrated to compensate for this problem. Moreover, in a concentrated ownership system there is no need to align managers-owners interests with large executive compensation schemes, the situation in Anglo-American systems in order to address the agency problem, as large shareholder can provide enough monitoring to make sure that their interests are being considered by management.[46] As a result of this complementary series, the theory concluded that political pressure to favour employees directly or indirectly shaped almost the entire German model of corporate governance.

However, the political theory does not limit itself to Germany or other European countries where social democratic policies are dominant. It argues that its applicability extends to countries where social democratic policies are very weak or do not exist, such as in the US.[47] It further explains that countries cannot be productive unless they realise social peace, and that politicians

[42] Ibid, 24

[43] Lucian Arye Bebchuk and Mark J Roe, ‘A Theory of Path Dependence in Corporate Ownership and Governance’ (1999) Stanford Law Review 127, 169

[44] Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (n 40) 22

[45] Ibid

[46] Ibid, 23

[47] Roe, ‘Political Preconditions to Separating Ownership from Corporate Control’ (n 40) 541

across the world act differently to realise this peace.[48] It asserts that these differences are the cause of corporate governance diversity. For example, the theory argues that the diffused ownership structure in the US is the result of coercive political actions, namely, the prohibition of financial institutions to grow large or own other companies' shares.[49] The advocates of the political theory argue that the American public's mistrust of large concentrated financial powers and the desire of local banks to keep their local monopolies caused the Congress during the nineteenth century to bar banks and other financial institutions from growing large or obtaining other companies' shares, which in turn forced companies to seek capital from the public, causing ownership to be dispersed.[50] They further argue that this political intervention to realise social peace among the American public and local bankers caused another social conflict within companies, namely, the conflict between the dispersed weak owners and strong managers.[51] Solving this internal conflict is what gives the American corporate governance system its unique characteristics, such as high executive compensation, a strong securities market, independent directors, a takeover market, and its one tier board structure. Thus, they conclude that political pressure shapes corporate governance systems even in countries where social democratic policies are not active.[52]

Political actions indeed influence to a limited degree corporate governance practices. However, it is an exaggeration to claim that they are responsible for the diversity in corporate governance models. Politicians themselves are influenced by their own cultural values and can only act within the framework of their legal and capitalist systems. The assumption that they can shape corporate governance systems without any regard to their surrounding environment is simply wrong, especially in democratic countries and even in dictatorships. It is very common for political leaders to announce their intention to change their countries' corporate governance system in a certain way and yet fail to do so. The UK Labour Party's attempts since the 1970s to give employees seats on companies' boards, as well as the Bill introduced into the US Congress by Senator Warren to adopt more of a stakeholder governance, are a couple of many examples of failed political attempts to change certain ingrained aspects of corporate governance

[48] Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (n 40) 22-23

[49] Roe and Vatiero, ‘Corporate Governance and Its Political Economy’ (n 40) 61-64

[50] Ibid, 5

[51] Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (n 40) 3-6

[52] Roe and Vatiero, ‘Corporate Governance and Its Political Economy’ (n 40) 83

systems.[53] Opposition and controversy regarding the efficiency and appropriateness of such amendments often arise to limit the effect of such political conduct. In addition, even when political authorities succeed in changing a certain rule, it will not necessarily be implemented in the manner that was intended by the legislators. As discussed in Chapter 3, the enactment of a rule does not necessarily guarantee its intended application and enforcement.

Moreover, the theory primarily uses the two examples mentioned previously, the German and US cases, to support its argument. Nonetheless, neither example sufficiently demonstrates a link between political actions and corporate governance. First, in the German case, the theory incorrectly assumes that employee representation, which was arguably precipitated by some political actions, caused the two-tier board structure to be formed, which in turn caused the ownership concentration that shaped the entire German corporate governance system. However, Chapter 5 showed that employee representation was not declared the law of the land in Germany until 1918, while the two-tier board system was introduced in 1884.[54] Similarly, ownership concentration in Germany was not caused by the two-tier board structure, the ownership of German companies was concentrated even before its introduction.

Second, in the American case, the assertion that diffused ownership is determined by the political action of shattering financial institutions into small units and banning banks from owning shares in other companies is inaccurate and is challenged by the UK experience. Preventing banks from owning shares in companies is not the reason for the diffused ownership of US companies. In many, if not most, countries, ownership is concentrated even when banks are

[53] Rowena Mason, ‘May Promises Social Reform in Centrist Leadership Pitch’ (*The Guardian*, 11 July 2016) <https://www.theguardian.com/politics/2016/jul/11/theresa-may-tory-leadership-pitch-andrea-leadsom> accessed 6 July 2019; Mark Beatson, ‘Labour's Corporate Governance Three-Card Trick’ (*Chartered Institute of Personnel and Development*, 29 Nov 2018) <https://www.cipd.co.uk/news-views/cipd-voice/issue-16/labour-corporate-governance> accessed 11 Nov 2019; Bob Hancké, ‘Why Stakeholding is Difficult in the UK and What We Can Do About It’ in Janet Williamson, Ciaran Driver and Peter Kenway (eds), *Beyond Shareholder Value: The Reasons and Choices for Corporate Governance Reform* (Trades Union Congress 2013) 50; US 115th Congress, ‘S. 3348 - The Obligations of Certain Large Business Entities in the United States’ (2018) <https://www.congress.gov/bill/115th-congress/senate-bill/3348/text> accessed 6 July 2019

[54] Edwin F Beal, ‘Origins of Codetermination’ (1955) 8 Industrial and Labor Relations Review 483

allowed to own shares in other companies. Typically, ownership and control is in the hand of families and individuals not banks. Thus, the idea that banks would have taken control of companies in the US if they were permitted to own shares is an inaccurate assumption. Furthermore, preventing financial institution from growing large is also not the reason for ownership diffusion. Chapters 5 reported that ownership structure became dispersed in the US between 1870 and 1914. Additionally, many financial institutions of that time were relatively large and had the ability to finance huge projects. J.P. Morgan, for example, financed Brooklyn bridge and the northern pacific railroad in 1880 for 55 million, approximately 1.6 billion in today's money; the US government in 1895 for 62 million, approximately 1.8 billion today; US Steel in 1901 for 492 million, approximately 15 billion today; and the allies in WWI for 500 million, approximately 15 billion today.[55]

Moreover, A close examination of UK corporate governance history shows that the UK has arrived at a similar corporate governance system to that of the US, but without state intervention.[56] Unlike their American counterparts, UK financial institutions were permitted to own shares in other companies as long as they were authorised to do so by their own corporate charters.[57] In fact, during the 1920s and 1930s, the Bank of England encouraged commercial banks to help industrial companies by investing in them.[58] However, this political and legal environment did not prevent UK companies from having diffused ownership.

6.3 Capitalism as an Explanation of Corporate Governance Diversity and a Barrier to Convergence

This thesis argues that capitalism shapes global corporate governance systems and is the main reason for corporate governance diversity. National corporate governance models develop and change according to the capitalist form of the country in which they are practised. The differences and similarities that exist in corporate governance systems are due mainly to the differences and

[55] JPMorganChase.com, 'JPMorgan Chase & Co.: Our History' (2020) <https://www.jpmorganchase.com/corporate/About-JPMC/our-history.htm> accessed 10 March 2020

[56] Brian R Cheffins, 'Does Law Matter? The Separation of Ownership and Control in the United Kingdom' (2001) 30 Journal of Legal Studies 459, 466

[57] Brian R. Cheffins, 'Putting Britain on the Roe Map: The Emergence of the Berle—Means Corporation in the United Kingdom' in Joseph McCahery and others (eds), *Corporate Governance Regimes: Convergence and Diversity* (illustrated, reprint edn, Oxford University Press 2002) 159

[58] Ibid

similarities of capitalist forms. Therefore, any transplantation of a corporate governance rule that does not consider the differences in the capitalist forms between the importing and exporting countries is expected to fail or may not be as productive as hoped for.

However, in order to support the contention that capitalism is the primary reason for corporate governance diversity, it is necessary to demonstrate that the existence of different capitalist forms is the main factor that induced corporate governance practices to develop differently. In addition, in order to find evidence that any legal transplantation of corporate governance practices that does not consider the differences in capitalist forms is expected to fail or be not as productive as hoped for, the thesis must demonstrate that each corporate governance model is compatible only with the capitalist system in which it developed, or with a similar one. Thus, this section is divided into three subsections: the first discusses capitalism as an explanation for the diversity in corporate governance practices, and the second focuses on how capitalism works as a barrier to convergence, detailing how each corporate governance model is compatible only with the capitalist system in which it developed. The third subsection, on the other hand, ties the conclusions of the first two subsections to the other explanations discussed in this chapter.

6.3.1 Capitalism as an Explanation for Corporate Governance Diversity

Based on Chapter 2, it was ascertained that companies around the world face similar governance and agency problems; however, the solutions to such issues are very diverse. This thesis argues that this is because capitalism, due to its unique relationship with corporate governance, induces corporate governance models to adopt different approaches to similar problems. In this section, this argument is elaborated using the analysis from Chapter 5.

Chapter 5 has already examined the relationship between corporate governance models and capitalism. In particular, this unique relationship was researched from four different angles in four sections. The first section studied the relationship between corporate governance and the different economic policies of the various capitalist forms. The second section investigated the relationship between corporate governance practices and the changing economic conditions and policies in capitalist countries. The third explored the relationship between corporate governance and current regional practices of capitalism. Finally, the influence of two theoretical approaches to capitalism on corporate governance practices were also discussed in Chapter 5, specifically: the relationship between the social market approach to capitalism and the

German stakeholder model of corporate governance, and the free market approach to capitalism and the US and UK shareholder model of corporate governance. This is because, as this thesis argues, Germany applies a stakeholder model of corporate governance and a form of social market capitalism, whereas the US and UK apply a shareholder model of governance and are influenced by free market capitalism.

The implication of this relationship between corporate governance and capitalism on corporate governance diversity will be discussed here in four subsections. Each subsection advances a part of Chapter 5's discussion to examine whether capitalism is the reason for corporate governance diversity. However, although the following four subsections make up together the whole diversity argument, each section alone can provide, to some degree, sufficient support for the contention that capitalism is the main reason for corporate governance diversity.

6.3.1.1 The Influence of the Various Capitalist Policies on Corporate Governance Diversity

The first section of Chapter 5 found a unique circular relationship between corporate governance and national capitalist policies, where they both affect each other. However, the effect of the policies of national capitalist economies on companies is more obvious than the effect of companies on them. In particular, policy-makers have a strong, direct impact on companies due to their power and formal hierarchy. They usually have the power to enact new regulation, supply some necessary resources to companies or even bestow formal sanctions on them. Companies constantly have to change their own activities to meet the demand of policy-makers.

Therefore, it is argued that because each country has its unique capitalist policies and because capitalist policies affect corporate governance practices, corporate governance models developed differently. If corporate governance rules were influenced by different capitalist policies, then the resulting models should also be diverse.

6.3.1.2 The Influence of the Various Economic Conditions of Each Capitalist Form on Corporate Governance Diversity

The second section of Chapter 5 found a circular, reinforcing, relationship between the various economic conditions of each national capitalist form and corporate governance practices. The section also asserted that economic conditions, business cycles in particular, are a natural consequence of adopting capitalism and one of its characteristics. Therefore, this section argues that not only is it true that corporate governance practices in capitalist countries change according to new economic conditions, but they also have the capacity to affect them. In particular, it argues that corporate governance practices develop differently around the world because each capitalist country has its own unique economic conditions and experiences global capitalist cycles differently. These different experiences of economic conditions contribute, to a large degree, to corporate governance diversity, and they become the main cause for it when coupled with the effect of the various capitalism theoretical approaches and economic policies of each capitalist form.

The recent 2008 financial crisis is a good example that can illustrate this unique relationship and the argument. Bad corporate governance practices were widely blamed for creating this disastrous economic condition.[59] The accumulated actions of mortgage companies, banks, credit rating agencies, and other financial institutions that resulted from poor corporate governance practices led the US economy and then the rest of the world to the crisis.[60] The 2008 crisis is also a good example for how corporate governance practices change according to new economic conditions. In the wake of the crisis, many scholars and organisations called for better corporate governance practices that could prevent such economic disasters.[61] The OECD, for example, in response to the global financial crisis, launched a programme to address the shortcomings of corporate governance practices in four major areas: executive compensation, board practices, risk management and the exercise of shareholder rights.[62] The UK, US, Germany, and many other countries actually

[59] United Nations Conference on Trade and Development, *Corporate Governance in the Wake of the Financial Crisis* (Unedited edn, United Nations Publication 2010) 2; Grant Kirkpatrick, 'The Corporate Governance Lessons From the Financial Crisis' (2009) 2009 OECD Journal: Financial Market Trends 61, 62; Peter Yeoh, 'Causes of the Global Financial Crisis: Learning from the Competing Insights' (2010) 7 International Journal of Disclosure and Governance 42, 42; US 111th Congress, 'S.1074 - Shareholder Bill of Rights Act of 2009' (2009) <https://www.congress.gov/bill/111th-congress/senate-bill/1074> accessed 4 March 2019; G Fetisov, 'Measures to Overcome the Global Crisis and Establish a Stable Financial and Economic System' (2009) 52 Problems of Economic Transition 20, 20

[60] Bank for International Settlements, *79th Annual Report* (1st edn, Bank for International Settlements 2009) 16- 36; John C Coffee Jr, 'What Went Wrong? An Initial Inquiry Into the Causes of the 2008 Financial Crisis' (2009) 9 Journal of Corporate Law Studies 1, 1-3

[61] See for example, P.M. Vasudev and Susan Watson, *Corporate Governance After the Financial Crisis* (1st edn, Edward Elgar 2012), 1-5; Kirkpatrick, 'The Corporate Governance Lessons From the Financial Crisis' (n 59) 2

[62] Organisation for Economic Co-operation and Development, 'Corporate Governance and the Financial Crisis' (2008)

changed their corporate governance codes and some of their laws to mitigate the apparent negative effects of the crisis and safeguard against future excessive risk-taking during times of sound economic circumstances.[63] Therefore, it can be concluded that indeed economic conditions in capitalist countries have a circular, reinforcing, relationship with corporate governance systems, where they cause change in each other.

Moreover, the example of the 2008 financial crisis can also be used to illustrate the argument that corporate governance practices are not expected to change in the same manner worldwide, since every country has its unique capitalist form and policies and experiences its own particular economic conditions. Although the 2008 crisis originated from the US, its contagious effects spread around the world, causing different impacts on different countries for different reasons, thereby requiring different solutions. The US, for example, handled the issue of managers' excessive risk-taking by empowering shareholders, while Germany handled the same issue by empowering employees. Specifically, the US passed a law that gives shareholders the right to vote on executive compensation, whereas in Germany, this right is now given to the full supervisory board, not exclusively to a special committee, thus ensuring participation of all employees' representatives.[64] Similarly, every other country around the world responded to the crisis differently according to its particular circumstances.

The point is that capitalism, due to its nature of creating cyclical crises, constantly triggers changes in corporate governance practices, and the source

<http://www.oecd.org/daf/ca/corporategovernanceprinciples/corporategovernanceandthefinancialcrisis.htm> accessed 3 March 2019

[63] See for example, Financial Crisis Inquiry Commission, *The Financial Crisis Inquiry Report: The Final Report of the National Commission on the Causes of the Financial and Economic Crisis in the United States Including Dissenting Views* (1st edn, Cosimo, Inc. 2011); Matthias Köhler, 'Corporate Governance and Current Regulation in the German Banking Sector: An Overview and Assessment' (2010) ZEW-Centre for European Economic Research Discussion Paper number 10-200 <ftp://ftp.zew.de/pub/zew-docs/dp/dp10002.pdf> accessed 6 March 2019; Joshua Chircop, 'Corporate Governance After the Financial Crisis: Overview of Some Major Evolutions in the United Kingdom and in Switzerland' (2018) <https://blogs.kcl.ac.uk/kslrcommerciallawblog/2018/01/28/corporate-governance-after-the-financial-crisis-overview-of-some-major-evolutions-in-the-united-kingdom-and-in-switzerland/> accessed 6 March 2019

[64] See article 951 of Dodd-Frank Wall Street Reform and Consumer Protection Act, Pub. L. No. 111-203, 124 Stat. 1376 (2010); and article 4.2.2 of German Corporate Governance Code (as amended on 7 February 2017, convenience translation), published in the Federal Gazette, 24 April 2017

of the change must rationally affect its outcome to some degree.[65] The 2008 crisis is an example of how one capitalist cyclical crisis triggered and influenced a change in corporate governance. The focus of the reforms on, for example, executive compensation was mainly, if not purely, an influence of the crisis, as executive pay packages were identified as one of its causes. Chapter 5 also offered a number of different examples of how capitalist cycles trigger and influence corporate governance change. The failure of the German financial market in 1873, for instance, created widespread mistrust of the market and consequently triggered the formation of the two-tier board system as a solution to distance the management team form market pressure. Hence, it can be concluded that, indeed, the changing nature of capitalism triggers the change in corporate governance and influence it.

6.3.1.3 The Influence of the Regional Forms of Capitalism on Corporate Governance Diversity

Corporate governance practices do not randomly vary across countries. The analysis in Chapter 5 of the relationship between corporate governance and the varieties of capitalism clearly shows a variation in corporate governance models according to the variation in capitalist forms. Hence, it can be concluded that capitalism is the reason for the corporate governance models' diversity as they vary according to capitalist forms. This section, to illustrate this point, uses the prime examples of not only one but the three typologies of capitalism discussed in Chapter 4 to show that corporate governance models vary according to their respective capitalist form. In particular, the section investigates whether or not the two main examples of each capitalist form have similar corporate governance models.

In Chapters 4 and 5, three classifications of capitalism were reviewed: Hall and Soskice, Albert, and Baumol et al.'s typologies. First, Hall and Soskice divide capitalism into two types based on how economic institutions coordinate in five different settings. They use Germany and Japan as the prime examples of the first category, the coordinated market economy, where the various economic institutions work together to achieve the best possible outcomes, and the US and UK as the prime examples of liberal market economies where economic actors rely on the market to coordinate their actions. Similarly,

[65] One of the essential characteristics of capitalism is that it is, by nature, in a constant process of change. "Capitalism by definition means constant change and development, not to mention cyclical crises." Ellen Meiksins Wood, ‘Modernity, Postmodernity or Capitalism?’ (1997) [Taylor & Francis, Ltd.] 4 Review of International Political Economy 539, 549.

Albert's typology divides capitalism into two models based on individualism vs. collectivism and short-termism vs. long-term financial gains. The US and UK are placed under the neo-American category whereas Germany and Japan are considered under the Rhine model of capitalism. Chapter 2 shows that the four countries are also categorised in the legal literature under two models of corporate governance, despite some variations. While Germany and Japan are classified as stakeholder-oriented models, the US and UK corporate governance systems are categorised as shareholder models. Moreover, just like Albert and Hall and Soskice classify all Anglo-Saxon countries under one category of capitalism, many corporate governance scholars make the same classification and list all the Anglo-Saxon countries under the shareholder model of corporate governance.

Finally, the Baumol et al. typology of capitalism is based on the role of the state vs. private entrepreneurs in developing the economy. The typology groups countries into four forms: oligarchic capitalism, state-guided capitalism, big-firm capitalism, and entrepreneurial capitalism. State involvement is at its highest in oligarchic capitalism and decreases gradually in state-guided capitalism and big-firm capitalism to reach its lowest levels in entrepreneurial capitalism. Similarly, state involvement in corporate governance systems vary across countries and have a large influence on corporate governance practices. Hence, some scholars characterise corporate governance systems according to the political involvement of the government in the governance of companies to administrative and economic models of corporate governance.[66] However, since state involvement is often connected with the ownership of shares by the state, government ownership of companies is measured to assess the degree of state involvement in corporate governance. The goal is to confirm the agreement between the four forms of capitalism, described by Baumol et al., and corporate governance models. State ownership should be higher in countries applying the oligarchic form of capitalism and decreases respectively in state-guided capitalism, big firm capitalism and entrepreneurial capitalism.

Aminadav and Papaioannou (2016) report in their study of government control around the world that Uganda, Qatar, UAE, and Russia, the classical

[66] Andrew Keay and Jingchen Zhao, ‘Transforming Corporate Governance in Chinese Corporations: A Journey, Not a Destination’ (2018) 38 Northwestern Journal of International Law & Business 187, 194-195

examples of oligarchic capitalism, have the highest levels of state ownership.[67] They also show that state control decreases respectively in China, the example of state-guided capitalism, Japan, the example of big-firm capitalism, to be close to zero in the US, the prime example of entrepreneurial capitalism.[68] Therefore, it can be concluded that indeed corporate governance practices vary according to the capitalist form in which they are embodied.

6.3.1.4 The Influence of the Theoretical Approaches to Capitalism on Corporate Governance Diversity

The last section of Chapter 5 discusses the influence of two theoretical approaches to capitalism over some corporate governance practices. It does this by illustrating how the social market approach to capitalism affected the German stakeholder model of corporate governance, and how the free market approach shaped the shareholder model of corporate governance. Therefore, this section argues that capitalism is indeed the reason for corporate governance diversity, as it shaped corporate governance's main models.

Chapter 5 shows that the German stakeholder model of corporate governance was not formed as a coincidence nor due to a unique culture of collectivism that welcomes employees' participation and stakeholder management. In fact, Germany has a very high score in individualism despite the fact that it adopts a stakeholder approach to management.[69] It was not also the result of unique legal traditions or political actions as the former lacks any normative support and the latter the capacity to cause diversity in corporate governance. The changes in the German corporate governance that led to its current form are the result of a large number of unique economic conditions, policies and experiences, as argued previously, coupled with the influence of the social market approach to capitalism.

The current form of the German corporate governance was formulated soon after WW II. However, its roots go deep into history. Chapter 5 started tracking back the development of both the social market capitalism and the German corporate governance from the revolution of 1848, that was mainly led by the working class, and the subsequent economic events. These economic events, as argued previously, trigger the change in corporate governance and

[67] Gur Aminadav and Elias Papaioannou, 'Corporate Control Around the World' (2016) National Bureau of Economic Research Working Paper No 23010 <https://www.nber.org/papers/w23010> accessed 1 May 2019, 24

[68] Ibid

[69] Hofsteds, 'Dimension Data Matrix' (n 17)

influence it along with the existing economic policies of the capitalist forms and the various capitalist ideologies.

In the German case, the social market approach to capitalism was mainly driven by a mistrust in the laissez-faire model of free market and a belief in the necessity of having a social order that can intervene in the event of undesirable market outcomes.[70] According to the social market approach theorists, any economic system that does not include social norms and values will eventually erode social bonds and place individuals in a painful isolation leading to disastrous social outcomes.[71] Thus, social market theorists call for a strong state that can apply social policies and design a clear institutional framework within which free and spontaneous market processes take place.[72] Moreover, social market economists condemn classical capitalism for allegedly bringing miserable social conditions to workers.[73] They argue that in classical capitalism, individuals are dependent on impersonal market rules that do not differentiate between the market for goods and the market for labour. Social market economists believe that workers in a labour market that is dominated only by supply and demand cannot cope with it without excessive harm to themselves and society.[74] Chapter 5 shows how such beliefs shaped all the main features of the German corporate governance, namely, employment representation, two tier-board structure, stakeholder oriented management, concentrated ownership, tendency for insider financing and inter-firm cooperation. As a result of the influence of this unique capitalist social market theories, the stakeholder model of corporate governance emerged gradually in its current form in Germany.

Similarly, the US and UK shareholder model of corporate governance is influenced by the free market approach to capitalism. Chapter 5 explained that the shareholder model of corporate governance is essentially a positive

[70] Arne Heise and Özlem Görmez Heise, ‘The Social Market Economy Revisited: The German Variety of Capitalism in Retrospect’ (2013) 1 Izmir Review of Social Sciences 7, 8

[71] Konrad Zweig, ‘The Origins of the German Social Market Economy’ (1980) Adam Smith Institute, Research Paper <https://www.adamsmith.org/s/social-market-economy.pdf> accessed 29 Decmber 2018, 21; Alfred Müller-Armack, ‘The Social Market Economy as an Economic and Social Order’ (1978) 36 Review of Social Economy 325, 327

[72] Flavio Felice and Massimiliano Vatiero, ‘Ordo and European Competition Law’ in Luca Fiorito (ed), *A Research Annual: Research in the History of Economic Thought and Methodology*, vol 32 (1st edn, Emerald Group Publishing Limited 2014) 149

[73] Werner Bonefeld, ‘Human Economy and Social Policy: On Ordo-Liberalism and Political Authority’ (2013) 26 History of the Human Sciences 106, 109

[74] Ibid, 110

response to the free market theorists' basic ideas about the right to private property, self-interest, the role of the government and the objective of making profit. The proponents of the shareholder model not only support and justify its premises using the same reasoning that is used to defend the free market approach to capitalism, but also call for the same thing. In particular, It shows how this approach to capitalism shaped the unique dispersed ownership structure of the US and UK, the shareholder approach to management, stock market development, equity financing and takeover market. Therefore, Chapter 5 argues that the shareholder model of corporate governance is merely an application of the free market approach of capitalism on the modern form of corporation.

6.3.2 Capitalism as a Barrier to Convergence

The analysis in Chapter 5 can also be used to address the contention within this thesis that any transplantation of a corporate governance rule that does not consider the differences in the capitalist forms between the importing and exporting countries is expected to fail or may not be as productive as, perhaps, hoped. Based on the conclusions from Chapter 5 and the previous sections of this chapter, if each form of capitalism has shaped a unique corporate governance model, corporate governance systems vary across the world according to their capitalist form, and corporate governance practices and national capitalist forms have a circular effect, then it is most likely that legal transplantations of corporate governance rules will be affected by this relationship between capitalism and corporate governance. Making such an argument based on these conclusions should be justifiable, but as a matter of confirmation of this argument, this section will demonstrate how each corporate governance model is only completely compatible with the capitalist system in which it was developed.

Scholars often identify a system as being complementary when it constitutes two or more elements with an interchangeable reciprocity relationship whereby one thing supplements or depends on the other.[75] In particular, complementarity systems include two different logics, the logic of similarity and the logic of contrast.[76] Complementarity is considered to be based on the logic of similarity when elements act similarly whenever they are

[75] Wei Liu, Hideyuki Tanaka and Kanta Matsuura, ‘Empirical-Analysis Methodology for Information-Security Investment and Its Application to Reliable Survey of Japanese Firms’ (2008) 3 Information and Media Technologies 464, 465

[76] Nahee Kang and Jeremy Moon, ‘Institutional Complementarity Between Corporate Governance and Corporate Social Responsibility: A Comparative Institutional Analysis of Three Capitalisms’ (2011) 10 Socio-Economic Review 85, 89

found together, and it is considered to be based on the logic of contrast when one element makes up for the deficiencies of the other.[77] Therefore, changes to one complementarity element affect the entire complementarity system.

Corporate governance practices complement capitalism through the logic of similarity, because national differences in corporate governance systems reflect the variation in the forms of capitalism. It was argued previously that national models of corporate governance and the various forms of capitalism develop in the same manner and time, and they affect each other. Therefore, the transfer of a rule from one corporate governance model to another needs to be supported by the same capitalist environment in which it was developed. Moving a corporate governance rule to a completely different capitalist environment not only runs the risk of being incompatible with the borrowing country’s capitalist system but also the risk of impacting its type of capitalism. Moreover, moving additional elements of the donating capitalist form to the receiving capitalist system to resolve the issue of incompatibility will unlikely resolve it, as the new elements themselves will probably be incompatible with the other existing corporate governance and capitalist rules, thereby requiring an unlimited number of changes to fully resolve the incompatibility issue.

For example, employment representation will most likely be incompatible with one of the free market capitalism’s main features: a highly fluid labour market. This is so because it is expected that empowered employees will rationally push towards greater job stability. Therefore, enjoying the benefits of employment representation and fluid labour market within one capitalist system is unlikely. Such transplantation will likely require an unlimited number of changes to resolve the incompatibility issues. The transplanted employment representation rule will most likely change the structure of free market capitalism's labour market, and the new changed labour market will most likely influence some more changes in the goods and services market, and all these changes will also require more new changes to corporate governance, which in turn will cause more changes to the capitalist system to an unstoppable end. Therefore, this thesis asserts that any legal transplantation of a corporate governance practice to a foreign capitalist form, without any consideration given to the differences among capitalist forms, is expected to be discordant

[77] Colin Crouch, ‘Institutions Within Which Real Actors Innovate’ in Wolfgang Streeck and Renate Mayntz (eds), *Die Reformierbarkeit der Demokratie: Innovationen und Blockaden* (1st edn, Campus Verlag 2003) 82-83

and most likely lead to inefficient results due to the complementarity between capitalism forms and corporate governance.

This section will elaborate more on the issue of complementarities between capitalism and the national corporate governance systems. In particular, it will discuss in greater detail how the key aspects of every corporate governance model, such as management objectives, employment representation and citizenship, board structure, ownership concentration, and mode of finance are only compatible in a capitalist environment similar to the one in which they were developed.

6.3.2.1 The Public Company Objective and Capitalism

One of the most important debates in the corporate governance literature concerns the question of what should be the objective of the public company. The importance of this question is due to the fact that its answer dictates to some degree the entire corporate governance system. The debate revolves around two theories: the stakeholder theory and the shareholder primacy theory. However, in practice, the choice for countries of the two theories is not a matter of political or cultural preference. Corporate governance systems differ regarding the public company objective according to the capitalist form of the country in which they are embedded. The stakeholder approach to management is appropriate only in a capitalist system such as the social market economy, whereas the shareholder model of management is suitable only for systems similar to free market capitalism. Therefore, changing the objective of public companies in a system of free market capitalism to serve the interests of all stakeholders, or limiting it in social market economies to maximise shareholder values, runs the risk of incompatibility.

Chapter 4 argued that one of the most essential drivers for social market capitalism is the belief in the necessity to have a social order integrated into the economic policy. This is so because, according to social market theorists, any economic system that does not include social norms and values will eventually erode social bonds and place individuals in painful isolation, leading to disastrous social outcomes.[78] In contrast, the same chapter illustrates how free market capitalism is founded on the belief that government interventions to create a socially balanced society inhibit and disturb the efficient working of the market system and that allowing businesses to act selfishly is the best strategy to realise social peace. Just like these two opposing logics are partly

[78] Zweig, ‘The Origins of the German Social Market Economy’ (n 71) 21; Müller-Armack, ‘The Social Market Economy as an Economic and Social Order’ (n 71) 327

responsible for creating very different economic systems, they are the driving force of the choice between the shareholder and stakeholder approaches to management. Likewise, applying a shareholder approach in a social market economy goes against the foundation of social market capitalism, whereas applying the stakeholder theory in free market capitalism require changes to the logic under which the entire economic system operates.

6.3.2.2 Employment Representation

Chapter 2 showed that one of the key aspects of the German stakeholder model of governance is the so called 'co-determination' system which entitles employees the right to information, consultation, and representation in the company's supervisory board.[79] Under the co-determination system, employees are given between 33% and 50% of the seats on the supervisory board, depending of the size of the company, where their representatives can vote and counsel on the matters presented before the board.[80] In contrast, companies in the shareholder model of corporate governance are typically under no obligation to establish employee representation in any form. Instead, the labour market is highly fluid, which directly discourages apprenticeship schemes and firm-specific vocational training and makes it relatively easy for firms to hire and fire employees.[81]

These characteristics are essentially a reflection of the capitalist system in which they develop. Chapter 4 shows that while free market capitalism prides itself on the idea of enabling workers to freely sell their labour in a free market that is only dominated by supply and demand, social market theorists condemn this practice, arguing that making the right to work a commodity that can be exchanged in a market based only on supply and demand forces workers to accept work in unsatisfactory conditions for minimum wages.[82] Therefore, the aim in social market capitalism is to design a social policy that empowers

[79] Gregory Jackson, ‘Corporate Governance in Germany and Japan: Liberalization Pressures and Responses During the 1990s’ in Kōzō Yamamura and Wolfgang Streeck (eds), *The End of Diversity? Prospects for German and Japanese Capitalism* (1st edn, Cornell University Press 2003), 265

[80] Larry Fauver and Michael E. Fuerst, ‘Does Good Corporate Governance Include Employee Representation? Evidence from German Corporate Boards’ (2006) 82 Journal of Financial Economics 673, 674

[81] Peter A. Hall and David Soskice, ‘An Introduction to Varieties of Capitalism’ in Peter A. Hall and David Soskice (eds), *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (1st edn, Oxford University Press 2001) 44

[82] Karl Marx, *Capital: A Critique of Political Economy*, vol 1 (Frederick Engels ed, Progress Publishers 2015) 507

workers, whereas in free market capitalism the goal is freeing up the labour market.

That being said, having employment representation on companies' boards is not only a reflection of social market capitalism, but also the result of empowering employees. Chapter 5 contends that empowering employees, in the manner social market capitalism is what eventually led to employment representation in the German stakeholder model. In contrast, having employment representation in the shareholder model not only goes against the basic philosophies of free market capitalism, but also against its structure. Whereas workers in social market capitalism secure their rights by regulations and collective bargaining agreements, the labour market in free market capitalism is designed to give the workers the best possible working conditions by enhancing employers’ competition over employees and freeing the market to some degree from regulations. Forcing companies in free market capitalism to have employee representation on companies' boards is simply against this structure and is going to require significant changes to the labour market as explained previously in this section.

6.3.2.3 Corporate Finance

As explained in Chapter 2, corporate governance models are often categorised as either insider or outsider models based on the particular model's dominant method of finance. The US and UK corporate governance systems are considered as outsider models as their companies rely more on equity finance, whereas Germany's corporate governance is considered as an insider model because its companies rely relatively more on banks to provide them with external capital. The differences in the capitalist forms play a crucial role in determining companies’ financing mode across countries; this section argues that the equity financing model is not suitable for economies such as social market capitalism.

Chapter 5 found that countries, depending on their type of capitalism, may prefer bank financing over equity financing to give them more control over their economies. The chapter discussed the situation of the US, UK, and Germany during the Second Industrial Revolution when equity financing started to grow in the US and UK. It explains that in the US and the UK, stock markets were allowed to grow naturally without interventions from the government as the capitalist form of these countries are generally against government interventions in the market. In contrast, Germany empowered its banks and passed some laws to make its stock markets an unattractive means for raising capital. This is because stock markets are unpredictable and harder to control, particularly in terms of allocating capital while, in contrast, a country could easily direct capital and guide its economy through a controlled banking system. The German empire of that time had a state-guided economy and, according to the typology of Baumol et al that was discussed in Chapter 4, modern Germany still does. Therefore, it is unlikely for a country to have the benefits of a state-guided economy and a robust equity market as they are incompatible.

Moreover, companies typically consider three factors before choosing between debt or equity finance, cost, risk and control. The differences in the capitalist forms play a direct role in determining the costs and risks of the financing modes. Chapter 4 explains that, according to Baumol et al.'s typology of capitalism, the US and UK capitalist forms are dominated by a large number of small businesses, which typically face difficulties in securing the required capital from banks and other lending institutions at a low cost. This is so because traditional lending institutions are usually risk averse and small firms, in comparison to large ones, lack assets, history and reputation. Thus, it is more costly for small businesses to get loans from traditional banks. As a result of both the dominance of a large number of small businesses in the US and UK and the higher cost of debt for them, the US and UK markets rely more on equity finance instead of bank loans. Moreover, capitalist forms also play a role in determining the risks of each financing choice. In capitalist forms such as free market capitalism where competition is very high, entrepreneurs may prefer equity finance over debt to lower the risk associated with conducting business in a risky environment.

6.3.2.4 Corporate Ownership

While Chapters 2 and 3 show that the ownership structure is concentrated in Germany and relatively widely dispersed in the US and UK, Chapters 5 and this chapter show that the diffusion and concentration of corporate ownership can be attributed to capitalism. This section argues that the US and UK style of dispersed ownership structure is only compatible with free market capitalism.

Chapter 5 explained that the diffuse ownership of the US and the UK was the result of the unique approach of free market capitalism towards competition. The chapter propounded that business in the US and the UK responded to the increased competition levels that the Second Industrial Revolution induced by a wave of mergers. For many firms, mergers were the rational choice in a capitalist system that is unfriendly to cartels and pan price fixing. In contrast, the chapter also demonstrates that Germany responded to the same situation by creating cartels and supporting universal banks.

Hence, this section argues that diffused ownership is not compatible with social market capitalism and is only appropriate for a system such as free market capitalism. If Germany, for example, wants to have a dispersed ownership in the same manner that the US and the UK had, the country must change not only its approach to competition but also its entire market structure. In comparison to the Second Industrial Revolution, the business world has become even more competitive, and in this competitive world, German companies are relying even more on their inter-firm relations to stay in business. If Germany wants a dispersed ownership in the same manner as the US and UK, it must change its approach to competition and inter-firm cooperation, which is eventually going to lead to changing the entire German market. This is because, typically, no controlling shareholder is willing to give up control without an incentive. The incentive for entrepreneurs in free market capitalism was to avoid ruinous competition by conducting many merger transactions, which eventually resulted in dispersed ownership. Creating such an incentive in Germany requires changing its approach towards inter-firm cooperation which will lead to changing the entire market structure.

6.3.2.5 Board Structure

Chapter 2 describes how the shareholder model of corporate governance is characterised by a single board of directors that is usually dominated by outsiders. On the other hand, companies in the German stakeholder model of corporate governance have two completely distinct boards—a management board consisting entirely of executives and a supervisory board consisting of employee and shareholder representatives. The unique structures of the board in each model are also a reflection of the different capitalist forms and only appropriate in environments similar to the one in which they are embedded.

The two tier board system allows social market capitalism to better implement its social policies into the economy, as the system ensures that management is distanced from shareholders, which gives the managers the opportunity to look after not only the interests of the shareholders but also those of all the other stakeholders. In contrast, in free market capitalism, the society is being taken care of, as Chapter 4 explains, not directly by government interventions in the economy but indirectly by an invisible hand that works best in free markets. This means that there is no need to distance the shareholders from management for the benefit of society. Moreover, it can also be argued that if shareholders are indeed the owners of the company, then having a one tier board in free market capitalism is essential because property rights are the core of this particular form of capitalism, and the one tier board system gives shareholders relatively more property rights over the company because they appoint the entire board of directors.

6.3.3 The Thesis Explanation in Relation to the Other Explanations of Corporate Governance Diversity

Chapter 5 concluded that corporate governance practices have a circular relationship with the various national forms of capitalism where they affect each other. it also examined some regional forms and theoretical approaches of capitalism and concluded that they indeed influence corporate governance practices. This chapter on the other hand, took these conclusions a step further and asserted that capitalism shapes global corporate governance systems and is not only the real reason for corporate governance diversity but also a potential barrier to a successful transplantation of corporate governance rules.

In particular, this chapter argued, firstly, that capitalism is the reason for the diversity because capitalism through its nature of creating cyclical economic crises, it constantly triggers changes in corporate governance practices. Furthermore, these cyclical economic crises influence the change in corporate governance alongside the existing policies of the various capitalist forms and the theoretical approaches of capitalism causing corporate governance practices around the world to develop differently. Nonetheless, it is understandable that when a country changes its regulations in response to such an economic condition, it takes the proper care not to disturb not only its capitalist structure but also its people's cultures, legal traditions, and political ideologies, all of which are the foundations of a nation. For policy-makers, cultures, legal traditions, political ideologies, capitalist frameworks and even religions all equally act as potential ‘red lines’ that restrict them when making any legal reform. However, although cultures, legal traditions and political ideologies restrict the change in corporate governance, they do not trigger it or have the capacity to shape it. Therefore, they cannot be considered the main reason(s) for corporate governance diversity.

The restrictions of cultures are too broad to shape corporate governance practices. Corporate governance is not a socially sensitive subject; thus, it is hard to imagine, for example, that the American or British people would reject, for instance, the stakeholder approach based on cultural grounds. Therefore, politicians often openly propose radical reforms in corporate governance in their political campaigns to gain more supporters without being worried about the implications of such reforms on cultures or legal traditions. The promises of the former UK Prime Minister Theresa May in 2016 to place employees' representatives on boards is a good example of that.[83]

Similarly, the restrictions of legal traditions also cannot be the sole reason for corporate governance diversity. The legal explanation cites the variation in the quality of investor protection rules as the cause of corporate governance diversity, but it does not provide convincing support as to how legal origins affect the quality of investor protection rules. Moreover, the effect of judicial systems on corporate governance rules is posterior to corporate governance practices, as the judiciary reacts to the corporate governance rules that have been enacted, and most countries, civil law and common law alike, depend on codes rather than judge-made rules in the area of corporate law. Hence, the effect of the judicial systems cannot be the reason for the variation in these practices.

The political theory also cannot fully explain corporate governance diversity. Politicians themselves can only act within the framework of their legal and capitalist systems. The assumption that they can shape corporate governance systems without any regard for their surrounding environment is simply wrong, especially in democratic countries, and even in dictatorships. In addition, even when political authorities succeed in changing a certain rule, it will not necessarily be implemented as intended by the legislators. As discussed in Chapter 3, the enactment of a rule does not necessarily guarantee its intended application and enforcement. Every failed execution of a transplanted corporate governance rule is evidence that corporate governance divergence is not due to political inaction.

The point is that if cultures, legal origins, and political ideologies do not usually trigger a change or have the capacity to shape it, then they cannot be the only reason(s) for corporate governance diversity. Capitalism, on the other hand, due its nature of constant change, frequently, if not exclusively, triggers corporate governance reforms and then shapes them according to the influence of the initiating condition, the existing policies of the various capitalist forms and the theoretical approaches of capitalism. The aforementioned 2008 financial crisis confirms this argument. Corporate governance codes across the world have undergone significant changes in the years following the crisis without any noticeable shifts in cultures, legal origins, or political ideologies. This is because the development in corporate governance is essentially a

[83] Mason, 'May Promises Social Reform in Centrist Leadership Pitch' (n 53)

response to the development of capitalism, which develops due to positive and negative economic conditions.[84]

Second, this chapter also argued that capitalism is a barrier to corporate governance convergence. It asserted that any transplantation of a corporate governance rule that does not consider the differences in the capitalist forms between the importing and exporting countries is expected to fail or may not be as productive as hoped for because of the unique complementary relationship between the national forms of capitalism and the various models of corporate governance. This argument sets this thesis's explanation apart from the legal and political ones. Although La Porta et al assert that legal origins are the reason for corporate governance diversity, they do not see it as a barrier to convergence.[85] In fact, they do believe in the superiority of the common law model and call for an active legal transplantation in the field of corporate governance.[86] On the other hand, Roe argues that legal transplantation in the field of corporate governance is indeed problematic; however, not for political reasons, but mainly because of the influence of interest groups. The political theory asserts that corporate governance diversity is more likely to persist mainly because powerful interest groups – namely, powerful managers in the US and employees in Germany – will pressure political leaders to maintain the status quo.[87]

6.4 Is Convergence still Possible ?

As this thesis demonstrates, capitalism is indeed the main reason for corporate governance diversity and a barrier to convergence. However, that does not mean that convergence is impossible. Chapter 3 showed that there are some signs of limited convergence. Therefore, it is not argued that convergence is

[84] It is widely accepted that the 2008 financial crisis is bound to cause some lasting scars on the face of capitalism or even mark a new turning point. See, Luiz Carlos Bresser-Pereira, ‘The Global Financial Crisis and a New Capitalism?’ (2010) 32 Journal of Post Keynesian Economics 499, 499; Luigi Zingales, ‘Capitalism After the Crisis’ (2009) 1 National Affairs 22, 22; Luiz Carlos Bresser-Pereira, ‘The Global Financial Crisis, Neoclassical Economics, and the Neoliberal Years of Capitalism’ (2010) 7 Revue de la Régulation: Capitalisme, Institutions, Pouvoirs 2, 2; Manuchehr Shahrokhi, ‘The Global Financial Crises of 2007–2010 and the Future of Capitalism’ (2011) 22 Global Finance Journal 193, 203-208

[85] Rafael La Porta and others, ‘Legal Origions’ in Stelios Michalopulos and Elias Papaioannou (eds), *The Long Economic and Political Shadow of History*, vol 1 (1st edn, Centre for Economic Policy Research Press 2017) 93

[86] La Porta, Lopez-de-Silanes and Shleifer, ‘Law and Finance After a Decade of Research’ (n 27) 476; La Porta and others, ‘Investor Protection and Corporate Governance’ (n 27) 24

[87] Roe and Vatiero, ‘Corporate Governance and Its Political Economy’ (n 40) 72-75

impossible. It only calls the attention of policy makers to the importance of capitalism in determining the fate of any legal transplantation in the field of corporate governance. It asserts that the appropriateness of convergence depends on the similarities and differences between the importing and exporting capitalist systems. The chances of success increases when the capitalist forms of the importing and exporting countries are similar and decreases when they are different. However, it is important to note that even when legal transplantation occurs between two countries with similar capitalist systems, the transplantation will still be challenged by complementarities, path dependence, interest groups, and the efficiency argument. This is so because this thesis does not argue that corporate governance models are influenced only by one or two types of capitalism, but that every country has a unique model of corporate governance which is influenced by its unique form of capitalism.

6.4.1 Complementarities

This thesis has already argued that corporate governance practices complement capitalism through the logic of similarity which complicate the process of corporate governance convergence. Nonetheless, the complication of corporate governance complementarities does not stop here as they also complement through the logic of contrast with other legal rules and with each other's, which complicate the issue of legal transplantation even more.

Corporate governance rules complement through the logic of contrast with other legal rules such as banking, labour, and tax laws. To illustrate, consider a country that has the most reputable and excellent corporate governance practices. This excellence cannot exist only based on the superiority of its corporate governance code or its corporate law alone. It is often the result of a system of complementary legal rules such as banking, labour, tax, and competition laws.[88] Thus, the individual transplantation of corporate governance rules will not necessarily improve the governance practices of the borrowing country, and may even render the complete corporate system deficient because the new rules do not complement the others that exist already.[89] Moreover, simultaneously importing corporate governance rules as well as those relating to banking, labour, tax, competition

[88] Guillén, 'Corporate Governance and Globalization: Arguments and Evidence Against Convergence' (n 4) 10

[89] Tarun Khanna, Joe Kogan and Krishna Palepu, 'Globalization and Similarities in Corporate Governance: A Cross-Country Analysis' (2006) 88 Review of Economics and Statistics 69, 84

and all other related laws together is exceedingly difficult, if not impossible.[90] This is so because the adoption of a single foreign rule might necessitate an unlimited series of changes to other rules which in turn may initiate an unstoppable chain reaction.

Similarly, through the logic of contrast, certain corporate governance practices complement each other. For instance, the practice of paying high dividends is considered to be efficient in Anglo-American countries, but is thought to be inefficient in Japan. This is so because the payment of high dividends in Anglo-American countries limits agency costs by lowering the discretionary cash available to management, whereas the payment of dividends in Japan, where cross-shareholding is the norm, equates to the movement of discretionary cash from one managerial team to another.[91]

6.4.2 The Efficient Model Argument

One of the most important challenges to convergence is the fact that the efficiency of any system is arguable. Thus, the divergent theorists assert that the idea that corporate governance rules will converge on one efficient model is in reality inconceivable, assuming that countries are indeed looking for the most efficient model.[92] Scholars have been arguing, for example, about the efficiency of each kind of ownership structure since the publication of Berle and Means's influential book in 1932, without reaching any consensus. For many of them, the concentrated ownership structure aggravates the asymmetric information problem and promotes self-dealing and insider trading, while for others it yields better monitoring of management because large block-holders will rationally be willing to incur greater costs in order to monitor management when compared with small shareholders.[93] The point is that scholars vary in their opinions about the best system or even the best features of a system, and if there is no one model that is best, it is impossible to know on what the systems should converge.

[90] Guillén, 'Corporate Governance and Globalization: Arguments and Evidence Against Convergence' (n 4) 10-11

[91] Abdul A. Yoshikawa Toru Rasheed, *The Convergence of Corporate Governance: Promise and Prospects* (1st edn, Palgrave Macmillan 2012) 13

[92] Curtis J Milhaupt, 'Property Rights in Firms' (1998) 84 Virginia Law Review 1145, 1189

[93] William W Bratton and Joseph A McCahery, 'Comparative Corporate Governance and the Theory of the Firm: The Case Against Global Cross Reference' (1999) 38 Colum J Transnat'l L 213, 224-228; Dulal Miah, 'Economic Institutions of Corporate Governance: A Comparative Study between the Bank-based and Market-based Systems' (2015) 5 World Journal of Social Science 36, 36

Another point as to why the idea that corporate governance rules will converge on one efficient model is, in reality, inconceivable is that what is efficient in one country may not be efficient in another.[94] This is so because, as this thesis argues, every capitalist country has its unique form of capitalism and what is efficient for one particular type of capitalist economy may not be efficient for another. For instance, having independent directors on boards is often considered an efficient practice in the U.S. However, when other competitive firms are using their boards to team up personnel with close ties to the government, a common practice in some parts of Asia, focussing on employing independent directors may be a counterproductive strategy.[95] In other words, the added value of appointing government officials on companies' boards vary greatly among countries depending on their form of capitalism. To illustrate, the above given example will be applied to Baumol et al., Coates, and Hall and Soskice's typologies.

In the Baumol typology of capitalism, there are four types of capitalism, state-guided, oligarchic, big-firms, and entrepreneurial capitalism. Having a director with close ties to the government has a great value to companies in state-guided and oligarchic capitalist systems and limited or no added value in big-firm and entrepreneurial capitalisms. This is so because in state-guided capitalisms, as described by Baumol et al., governments typically guide the economy by deciding which industries and even which individual firms should grow.[96] Assuming that such decisions are being taken in absolute objectivity is unrealistic. The possible influence of prominent officials sitting on companies' boards on making such decisions cannot be ruled out. This influence is even clearer in oligarchic capitalisms since the main objective of government officials in these economies is to enrich oligarchic elites coupled with the fact that these economies are typically overwhelmed by corruption. On the other hand, having a director with close ties to the government has limited or no added value in big-firm and entrepreneurial capitalisms because the government interference in these two capitalist systems is very minimal.

Similarly, in the typologies of Hall and Soskice and Coates, the added value of appointing independent directors on companies' boards also vary

[94] John C Coffee Jr, 'Future as History: The Prospects for Global Convergence in Corporate Governance and Its Implications' (1988) 93 Northwestern University Law Review 641, 659

[95] Ibid, 660

[96] William J Baumol, Robert E Litan and Carl J Schramm, *Good Capitalism, Bad Capitalism, and the Economics of Growth and Prosperity* (1st edn, Yale University Press 2007) 67-70

greatly among countries depending on their form of capitalism. As explained in Chapter 4, in both Rhine and coordinated market capitalism, shareholders depend largely on non-market and inside networks to exchange private information and monitor the management team, while in the market-led and liberal market capitalism models, the board of directors and official statements are the primary means for shareholders to monitor management.[97] Therefore, it can be concluded that the value that independent directors add to companies in market-led and liberal market capitalist countries is far greater than the added value of having them in negotiated and coordinated market countries.

6.4.3 Interest Groups

The divergence theorists also argue that even when scholars agree on the efficiency of a particular governance structure, it is not necessarily going to be implemented. Groups that are affected by the proposed reforms will not permit any change that is not in their best interests or against their ideologies.[98] Transplanting a corporate governance rule cannot be equated to transferring a piece of machinery. It was established in Chapter 5 that corporate governance rules in capitalist countries are influenced by the various forms and theoretical approaches of capitalism. Thus, resistance to the adoption of foreign corporate governance practices containing anomalous ideologies and backgrounds should be expected. Historically, interest groups have opposed corporate governance reforms, only because they are not in accordance with their own ideologies and interests. For instance, in the 1950s, interest groups in West German rejected the direct implementation of the Anglo-American model of corporate governance despite considerable American pressure. They were clearly not happy with replacing their traditional ways of conducting and organizing businesses with a foreign model that they believed to be a threat to their own positions and against their ideologies.[99] Consequently, the two major political parties, the Christian Democratic Union and Social Democratic Party, proposed in 1949 two similar economic models for post-war Germany that reflect the common German capitalist ideologies of their time.[100] The aims of the two models were to shape a unique social market capitalism that rejected

[97] Hall and Soskice, ‘An Introduction to Varieties of Capitalism’ (n 81) 23 and 28 ; David Coates, *Models of Capitalism: Growth and Stagnation in the Modern Era* (1st edn, Polity Press 2000) 67

[98] Guillén, ‘Corporate Governance and Globalization: Arguments and Evidence Against Convergence’ (n 4) 16

[99] Marie-Laure Djelic, *Exporting the American Model: The Post-War Transformation of European Business* (1st edn, Oxford University Press on Demand 2001)

[100] Kees Van Kersbergen, *Social Capitalism: A Study of Christian Democracy and the Welfare State* (e-book edn, Routledge 2005) 74-77

the liberal laissez-faire and controlled/planned economy doctrines, and which maintained the capitalist structure of the Weimar Republic, to a large extent.[101]

6.4.4 Path Dependence

It also has been argued that the impact of path dependency on corporate governance practices will prevent any potential convergence in the field. The very essence of the path dependence theory is that the initial starting point of any system matters.[102] For example, the pattern of the ownership structure that a country has at any point in time will affect the ownership pattern it will have in the future. Arguably, even when two countries converge on quite similar economies and legal rules, the differences they had previously in ownership structure will likely persist due to their path of dependence.[103] Another classical example, the current relatively weak role of financial institutions in the US, is viewed as an unequivocal case for path dependency. The American public's mistrust of large concentrated financial powers since the eighteenth century has arguably persisted to shape the current status of the US financial institutions today.[104]

Scholars offer many explanations for this path persistence. They postulate that corporate governance practices result in path dependence owing to the presence of complementarity,[105] interest groups,[106] multiple optima,[107] network externalities,[108] and sunk adaptive costs.[109] The first three reasons of path dependence have been already explained in Chapter 3. The remaining are network externalities and sunk adaptive costs. Network externalities cause path dependence when companies adopt certain corporate governance practices only because they are dominant in their country of operation not because of

[101] Ibid, 75

[102] Licht, 'The Mother of All Path Dependencies: Toward a Cross-Cultural Theory of Corporate Governance Systems' (n 8) 149; Ian Greener, 'Theorising Path-Dependency: How does History Come to Matter in Organisations?' (2002) 40 Journal of Management History 614, 614

[103] Bebchuk and Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance' (n 43) 127

[104] Roe, *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (n 40) ix-x and 92-93

[105] See for example, Reinhard H Schmidt and Gerald Spindler, 'Path Dependence, Corporate Governance and Complementarity' (2002) 5 International Finance 311, 311

[106] See for example, Bebchuk and Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance' (n 43) 127

[107] Schmidt and Spindler, 'Path Dependence, Corporate Governance and Complementarity' (n 105) 315

[108] Bebchuk and Roe, 'A Theory of Path Dependence in Corporate Ownership and Governance' (n 43) 141

[109] Ibid, 139

their efficiency.[110] Sunk adaptive costs become a source of path dependence when the cost of switching to a more efficient system is identified as higher than the potential gains that will result from the change; that is the costs outweigh the benefits and therefore on a cost/benefit analysis it is not worth embracing change. Thus, in such cases, it is rational for a given society to retain the inefficient system.[111]

Chapter 5 shows that the variation in corporate governance practices did not happen as a coincidence. The chapter investigates the origins of corporate governance models and found, for example, signs that the main features of the current German corporate governance system date back to as far as 1848. It also finds a parallel development of both social market capitalism and German corporate governance. The chapter reports that the current forms of social market capitalism and the German corporate governance are the result of, among others, the mixed liberal and social policies that were introduced throughout German history. These mixed policies persisted to shape the current German forms of corporate governance and capitalism.

The current chapter also argued that when an economic condition trigger a change in corporate governance, it influences it along with the existing economic policies and ideologies of the capitalist form. This influence of the existing capitalist policies is one of the sources of path dependence that could affect the change in corporate governance and complicate convergence.

6.5 Conclusion

The objective of this chapter was to evaluate the current explanations of corporate governance diversity and investigate how the relationship between corporate governance and capitalism, that was discussed in Chapter 5, affects the legal transplantation of corporate governance rules and practices. The chapter started by evaluating the dominant explanations for corporate governance diversity. It examined the cultural, legal and political accounts of divergence and found that although they do contribute to the diversity phenomenon, they cannot provide a sufficient explanation for it. It was explained that although cultures, legal traditions and political ideologies restrict the change in corporate governance, they neither trigger it nor have the

[110] Ibid, 141

[111] Mark J Roe, ‘Chaos and Evolution in Law and Economics’ (1996) 109 Harvard Law Review 641, 643

capacity to shape it. Therefore, they cannot be considered the main reason for corporate governance diversity.

The chapter then moved on to link the relationship, found in Chapter 5, between corporate governance and capitalism to the legal transplantation issue. It argued that capitalism is the main reason for the diversity in corporate governance and a challenging obstacle for any attempt of legal transplantation in the field. In particular, it concluded that capitalism is the main reason for the diversity because capitalism, through its nature of creating cyclical economic crises, constantly triggers changes in corporate governance practices. These cyclical economic crises influence the change in corporate governance alongside the existing policies of the various capitalist forms and the theoretical approaches of capitalism, causing corporate governance practices worldwide to develop differently. It also explained how national corporate governance models are compatible only with the capitalist form of the country in which they are practised, concluding that any transplantation of a corporate governance rule that does not take into consideration the differences in the capitalist forms between the importing and exporting countries is expected to fail.

Finally, the chapter raised the question of the possibility of convergence in the future and contended that the appropriateness of convergence depends on the similarities and differences between the importing and exporting capitalist systems. The chances of successful convergence increases when the capitalist forms of the importing and exporting countries are similar and decreases when they are different.

Chapter 7
Conclusion

The principal focus of this thesis was the legal transplantation of corporate governance rules. In particular, this thesis investigated whether the fields of culture, politics, and legal origins provide an adequate answer to the diversity of corporate governance systems and whether they are the only factors to be taken into account in considering the merits of legal transplantation in the field of corporate governance. Furthermore, it examined the relationship between corporate governance and capitalism and how, if at all, does this relationship affect the prosses of corporate governance transplantation.

The overall finding of this research is that although the fields of culture, politics and legal origins have some influence over corporate governance diversity, they do not cause it. On the other hand, the results of this thesis indicate that capitalism not only has the capacity to influence corporate governance models but is also affected by them. Furthermore, the findings suggest that corporate governance models are shaped according to the form of capitalism adopted by the country in which they are embedded and that each corporate governance model is only completely compatible with the capitalist system in which it was developed or a similar one.

This finding suggests that both corporate governance and capitalism may be influenced directly or indirectly by altering the structure of either of them. A change in one system could have a significant impact on the other. Therefore, this thesis informs policy makers and academics of the necessity to carefully evaluate the appropriateness of any proposed legal transplantation, in the field of corporate governance, to their home countries' capitalist environments before proceeding, if at all. Typically, the appropriateness of a convergence between corporate governance models depends on the similarities and differences between the importing and exporting capitalist systems. The chances of success increase when the capitalist forms of the importing and exporting countries are similar and decreases when they are different.

It is not sufficient to simply adopt a corporate governance code of best practice in order to reform a corporate governance system; it is also necessary to adjust the capitalist environment to support the desired improvements in corporate governance practices. However, this remedy itself must be subject to significant evaluation in light of the circular relationship between capitalism and corporate governance. Changes to aspects of corporate governance practices may be ineffective if those changes are not aligned with the underlying values and norms of the national capitalist environment or, even worse, negatively impact the existing capitalist or corporate system. Thus, it is crucial that policy makers and academics approach the issue of legal transplantation in the field of corporate governance with caution.

This concluding chapter elaborates on the main findings of this research, discusses its limitations and makes some suggestions for future research. In particular, the following five sections discuss the current state of corporate governance convergence, the relationship between corporate governance and capitalism, the principal reason for corporate governance diversity, the effect of the relationship between corporate governance and capitalism on the legal transplantation of corporate governance rules, the limitations of the study, and future research.

7.1 The Current State of Corporate Governance Convergence

As some scholars have argued that countries worldwide have already achieved some degree of convergence, it was necessary to investigate such a claim. Being aware of the current state of convergence helped in structuring the entire thesis and enabled a more accurate analysis of the central issue at hand. If corporate governance systems are found to be converging, then all the cultural, legal and political critiques of legal transplantation in the literature would be rendered irrelevant. Therefore, this thesis aimed to utilise the empirical studies accumulated over the past thirty years to develop a generalised conclusion regarding the current state of convergence.

In particular, four indicators of convergence were examined: the ownership structure, the market for corporate control, management pay and foreign direct investments. An examination of all four indicators support the claim that there is only limited evidence that a convergence is actually taking place and indicates there are no major differences between the description of the models presented in the first chapter and the empirical findings. The data presented in this thesis show little change over long time periods, which suggests strong resistance to globalisation in the field of corporate governance.

7.2 The Relationship between Corporate Governance and Capitalism

The effect of capitalism on corporate governance theories and systems/models is an issue that has received no or little attention in either the legal or the economic literature. Thus, Chapter 5 discussed this subject from four different angles and confirmed the strong connection between corporate governance and capitalism from different perspectives.

First, the relationship between corporate governance and economic conditions and policies in capitalist countries was investigated, and a unique circular relationship was found to exist between them whereby they affect each other. Chapter 5 explained that the effect of the policies of national capitalist economies on companies is more obvious than the effect of companies on them. In particular, policymakers have a strong, direct impact on companies due to their power and formal hierarchy. They usually have the power to enact new regulation, supply some necessary resources to companies or even bestow formal sanctions on them. Companies constantly have to change their own activities to meet the demand of policymakers. However, companies also affect national economic policies due to their increasing power. The chapter illustrated that many countries frequently change their national economic policies to attract more businesses. Similarly, the argument was posited that not only is it true that corporate governance practices in capitalist countries change according to new economic conditions, but that they also have the capacity to affect these conditions. A key example is the 2008 financial crisis, which was partly caused by bad corporate governance practices and subsequently caused significant changes in corporate governance regulations.

Subsequently, the chapter discussed the relationship between corporate governance and some regional forms of capitalism that were described in the varieties of capitalism literature, concluding that a connection indeed exists between corporate governance and the varieties of capitalism studies whereby corporate governance affects and is affected by capitalism. However, the effect of corporate governance practices over capitalism becomes more visible when microeconomic factors are employed by these studies to classify countries' forms of capitalism, and less visible when they rely more on macroeconomic factors.

Finally, the chapter examined the relationship between corporate governance and two theoretical approaches to capitalism and confirmed their influence on corporate governance practices. In particular, the chapter illustrated how the social market approach to capitalism has affected the

German stakeholder model of corporate governance and how the free market approach has shaped the shareholder model of corporate governance in the US and UK. Each distinguishing feature of the German corporate governance model is tied to social market capitalism and its early developments, namely, employment representations and citizenship, stakeholder-oriented management, a two-tier board structure, concentrated ownership, the tendency for insider financing, and cooperation among its companies. Equally, the free market approach to capitalism has shaped the main characteristics of the US and UK shareholder model of corporate governance, namely, the shareholder primacy approach of management, dispersed ownership, a reliance on equity financing, a developed capital market, an active market for corporate control, and a powerful management team.

7.3 The Reason for Corporate Governance Diversity

This thesis argued that capitalism shapes global corporate governance systems and is the principal reason for corporate governance diversity. The findings suggest that national corporate governance models develop and change according to the capitalist form of the country in which they are practised. The differences and similarities that exist in corporate governance systems are due mainly to the differences and similarities of capitalist forms. Thus, this thesis concluded that capitalism is the main cause of this diversity. However, the authors of the other explanations examined in this thesis claim that their explanations are the main cause of corporate governance diversity. Therefore, this section, via two subsections, briefly provides general concluding remarks regarding these explanations and explains the process by which it was concluded that capitalism is the principal cause of the diversity issue.

7.3.1 Concluding Remarks Regarding the Other Explanations of Corporate Governance Diversity

For policymakers, cultures, legal traditions, political ideologies, capitalist frameworks and even religions all equally act as restrictions when making any legal reform. However, although cultures, legal traditions and political ideologies restrict the change in corporate governance, they neither trigger it nor have the capacity to shape it. Therefore, they cannot be considered the main reason for corporate governance diversity.

The restrictions of cultures are too broad to shape corporate governance practices. Corporate governance is not a socially sensitive subject; thus, it is hard to imagine, for example, that the Americans or the British would reject the stakeholder approach based on cultural grounds. Therefore, politicians often openly propose radical reforms in corporate governance in their political campaigns to gain more supporters without being worried about the implications of such reforms on cultures or legal traditions.

Similarly, the restrictions of legal traditions also cannot be the reason for corporate governance diversity. The legal explanation cites the variation in the quality of investor protection rules as the cause of corporate governance diversity, but it does not provide convincing support as to how legal origins affect the quality of investor protection rules. Moreover, the effect of judicial systems on corporate governance rules is posterior to corporate governance practices, as the judiciary reacts to the corporate governance rules that have been enacted, and hence it cannot be the reason for the variation in these practices.

The political theory also cannot fully explain corporate governance diversity. Politicians themselves can only act within the framework of their legal and capitalist systems. The assumption that they can shape corporate governance systems without any regard for their surrounding environment is simply incorrect, especially in democratic countries, and even in dictatorships. In addition, even when political authorities succeed in changing a certain rule, it will not necessarily be implemented as the legislators intended. The enactment of a rule does not necessarily guarantee its intended application and enforcement. Every failed execution of a transplanted corporate governance rule is evidence that corporate governance divergence is not due to political inaction.

The key point here is that if cultures, legal origins and political ideologies do not usually trigger a change or have the capacity to shape it, then they cannot be the reason for corporate governance diversity. Capitalism, however, due its nature of constant change, frequently, if not exclusively, triggers corporate governance reforms and then shapes them according to the influence of the initiating condition, the existing policies of the various capitalist forms and the theoretical approaches of capitalism. The 2008 financial crisis supports this argument. Corporate governance codes across the world have undergone significant changes in the years following the crisis without any noticeable shifts in cultures, legal origins or political ideologies. This is because the development in corporate governance is essentially a response to the development of capitalism, which develops due to positive and negative economic conditions.

7.3.2 Capitalism as the Main Reason for Corporate Governance Diversity

This research concluded that capitalism is the main reason for the diversity because capitalism, through its nature of creating cyclical economic crises, constantly triggers changes in corporate governance practices. These cyclical economic crises influence the change in corporate governance alongside the existing policies of the various capitalist forms and the theoretical approaches of capitalism, causing corporate governance practices worldwide to develop differently. The thesis used the analysis in Chapter 5 to address the contention within this research that capitalism is the main reason for corporate governance diversity. In particular, it advances the arguments of each section of Chapter 5 to assert that capitalism is the reason for corporate governance diversity from four different angles.

In the first section of Chapter 5, a unique circular relationship was found between corporate governance and national capitalist policies, whereby they both affect each other. Therefore, because each country has its unique capitalist policies and because capitalist policies affect corporate governance practices, corporate governance models have developed differently. If corporate governance rules were influenced by different capitalist policies, then the resulting models should also be diverse.

In the second section of Chapter 5 a circular, reinforcing, relationship was also found between the various economic conditions of each national capitalist form and corporate governance practices. Therefore, not only is it true that corporate governance practices in capitalist countries change according to new economic conditions, but they also have the capacity to affect them. In particular, it was posited that corporate governance practices develop differently worldwide because each capitalist country has its own unique economic conditions and experiences global capitalist cycles differently. These different experiences of economic conditions contribute, to a large degree, to corporate governance diversity

In the third section of Chapter 5, the relationship between corporate governance and the varieties of capitalism was examined, and a variation in corporate governance models according to the variation in capitalist forms was identified. Corporate governance practices do not randomly vary across countries. Hence, the thesis concluded that capitalism is the reason for the diversity of corporate governance models, because they vary according to the various capitalist forms. To illustrate this point, Chapter 6 used the prime examples of not only one but the three typologies of capitalism discussed in

Chapter 4 to show that corporate governance models vary according to their respective capitalist form. In particular, it investigated whether or not the two main examples of each capitalist form have similar corporate governance models.

Finally, in the last section of Chapter 5 the influence of two theoretical approaches to capitalism over some corporate governance practices were discussed. In particular, the chapter illustrated how the social market approach to capitalism has affected the German stakeholder model of corporate governance, and how the free market approach has shaped the shareholder model of corporate governance. Therefore, Chapter 6 demonstrated that capitalism is indeed the reason for corporate governance diversity, as it has shaped the main models of corporate governance.

7.4 The Effects of the Relationship Between Corporate Governance and Capitalism on the Legal Transplantation of Corporate Governance Rules

The thesis asserted that any transplantation of a corporate governance rule that fails to consider the differences in the capitalist forms between the importing and exporting countries is expected to fail or may not be as productive as is hoped. Based on the conclusions from Chapters 5 and 6, if each form of capitalism has shaped a unique corporate governance model, corporate governance systems vary globally according to their capitalist form, and corporate governance practices and national capitalist forms have a circular effect, then it is most likely that legal transplantations of corporate governance rules will be affected by this relationship between capitalism and corporate governance.

More specifically, each corporate governance model is only completely compatible with the capitalist system in which it was developed. Chapter 6 demonstrated how corporate governance practices complement capitalism through the logic of similarity, because national differences in corporate governance systems reflect the variation in the forms of capitalism. It was argued previously that national models of corporate governance and the various forms of capitalism develop in the same manner and time, and they affect each other. Therefore, the transfer of a rule from one corporate governance model to another must be supported by the same capitalist environment in which it was developed. Moving a corporate governance rule to a completely different capitalist environment not only runs the risk of incompatibility with the borrowing country’s capitalist system but also the risk of impacting its type of capitalism. Moreover, moving additional elements of the donating capitalist form to the receiving capitalist system to resolve the issue of incompatibility will be unlikely to resolve it, as the new elements themselves will most likely be incompatible with other existing corporate governance and capitalist rules, thereby requiring an unlimited number of changes to fully resolve the incompatibility issue.

Therefore, the argument of the thesis is that any legal transplantation of a corporate governance practice to a foreign capitalist form, without any consideration given to the differences among capitalist forms, is likely to be discordant and lead to inefficient results due to the complementarity between capitalism forms and corporate governance.

7.5 Limitations of the Study and Future Research

Without an analysis that takes into consideration the connection between corporate governance and capitalism, one can neither fully understand the structure of the modern corporation nor account for international differences. However, there are limits to this thesis's analysis.

First, the influence of capitalism on corporate governance rules is not equal. Capitalism could shape one corporate governance feature while having no impact at all on another. This thesis only studied the influence of capitalism on the principal features of the US and UK shareholder and German stakeholder models of corporate governance. The findings clearly show that capitalism has a greater impact on corporate governance models compared to any other comparable theories. Unlike the cultural, political and legal origin theories, this analysis asserts that capitalism is linked not only to some corporate governance practices but, arguably, to all the main features of the stakeholder and shareholder models. However, the influence of capitalism on every other corporate governance rule or practice is a subject for future research.

Second, the transferability of each corporate governance rule is different. The appropriateness and ease of transferring a corporate governance rule from one jurisdiction to another depends on, among other factors, the influence level of capitalism on it and its suitability to the capitalist system of the receiving country. Bernard Black conducted a study on this matter yet without taking capitalism into consideration or specifying the receiving country.[1] Further

[1] Bernard S Black, ‘The Legal and Institutional Preconditions for Strong Securities Markets’ (2000) 48 UCLA Law Review 781

research on the transferability of each corporate governance rule is truly needed.

Third, a considerable number of research papers have studied the effect of the various legal traditions, cultures and political ideologies on corporate governance practices.[2] Such research could be conducted based on the relationship between capitalism and corporate governance. This thesis argued that the correlation between corporate governance and capitalism, in general, is stronger than the connection between corporate governance and culture, legal traditions and politics, and that each capitalist form influences corporate governance differently. However, even though it was not possible to include the topics of such research in this thesis, most of this research could benefit from the added value of the findings of this thesis.

Finally, this analysis does not explain what corporate governance form is best. It warns policy makers and academics of the potential risks associated with legal transplantation. Any transferred corporate governance rule runs the risk of being ineffective or negatively impacting the receiving country's capitalist or corporate system.

[2] For cultural studies, see for example, A. Humphries Sarah and Catherine Whelan, 'National Culture and Corporate Governance Codes' (2017) 17 Corporate Governance: The International Journal of Business in Society 152; Wolfgang Breuer and Astrid Juliane Salzmann, 'National Culture and Corporate Governance' in Sabri Boubaker, Bang Dang Nguyen and Duc Khuong Nguyen (eds), *Corporate Governance: Recent Developments and New Trends* (Springer 2012); Rozaini Mohd Haniffa and Terence E. Cooke, 'Culture, Corporate Governance and Disclosure in Malaysian Corporations' (2002) 38 Journal of Accounting Finance and Business Studies 317; For political studies, see, Helen Callaghan, 'Insiders, Outsiders, and the Politics of Corporate Governance: How Ownership Structure Shapes Party Positions in Britain, Germany, and France' (2009) 42 Comparative Political Studies 733; Christopher M Bruner, 'Center-Left Politics and Corporate Governance: What Is the Progressive Agenda' (2018) 2 Brigham Young University Law Review 267; For legal traditions studies, John Armour and others, 'Shareholder Protection and Stock Market Development: An Empirical Test of the Legal Origins Hypothesis' (2009) 6 Journal of Empirical Legal Studies 343; Ole-Kristian Hope, 'Firm-level Disclosures and the Relative Roles of Culture and Legal Origin' (2003) 14 Journal of International Financial Management & Accounting 218; Rafael La Porta, Florencio Lopez-De-Silanes and Andrei Shleifer, 'Government Ownership of Banks' (2002) 57 Journal of Finance 265

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