

Draft : not for quotation or attribution without
author's permission Copyright 2004.

“Explaining Corporate Governance Systems:

Alternative Approaches

Peter Gourevitch

UCSD

“Workshop on Corporate Governance”

AMSTERDAM RESEARCH CENTRE FOR
CORPORATE GOVERNANCE REGULATION
VRIJE UNIVERSITEIT AMSTERDAM
Inaugural Workshop
Amsterdam, 17 – 18 December 2004

Note: This paper relies heavily on co-authored work with James P Shinn in a manuscript: *Political Power and Corporate Control: The New Global Politics of Corporate Governance*, Princeton University Press, forthcoming.

Why do corporate governance systems vary around the world? Awareness of this variance is relatively recent – only a decade or so – in the academic literature on corporate governance, though references to variance among countries and over time can be found in a few historical and comparative treatments. With that awareness has come a vigorous debate about explanation. This paper explores how several research traditions deal with explanation of divergence among corporate governance models. We can identify three very broad research strands, with substantial debate within each.

What is to be explained?: the dominant way of characterizing the dependent variable is shareholder concentration (blockholding) vs. shareholder diffusion. These are crude proxies for the dichotomy between “stakeholder “ and “shareholder” models: in the former, owners of stocks share with suppliers, workers, local communities and interest in the firm as a system distribution wide benefits to all its members; in the latter, the claims of shareholders are primary. Blockholding (concentration of ownership) overlaps with stakeholding, though in principle one could have blockholding without stakeholding.¹

Measurements of diffusion/blockholding show considerable variance around the world. The US and UK rank at the highly diffuse end, Chile at the other end, with a great range of variance in between. (Table below from Gourevitch/Shinn, forthcoming 2005).

A. Table 2.1: Ownership Concentration
Concentration Country

4.1	Japan
5	China
15	United States
20	Netherlands
23.6	United Kingdom
24.6	Ireland
27	New Zealand
27.5	Australia
27.5	Canada
31.8	South Korea
37.5	Denmark
38.6	Norway
42.6	Malaysia
43	India
44.8	Singapore
45.5	Taiwan
46.4	Philippines
46.9	Sweden
48.1	Switzerland
48.8	Finland

49	Venezuela
51.5	Belgium
51.9	Thailand
52	South Africa
52.8	Austria
55	Israel
55.8	Spain
58	Turkey
59.6	Italy
60.3	Portugal
63	Brazil
64.6	Germany
64.8	France
66	Mexico
67.3	Indonesia
71.5	Hong Kong
72.5	Argentina
75	Greece
90	Chile

Note: The full table of concentration from which Table 2.1 is drawn is reproduced in the data appendix.

Sources: Claessens et al. "Diversification and Efficiency," "Expropriation of Minority Shareholders," 2,980 public corporations in 9 countries; Barca and Becht 2001; Faccio and Lang 2002, 5232 listed firms; La Porta, Lopez-De-Silanes, Shleifer 1999, 20 largest firms for "large", 10 largest „small% firms for large; Korea = Hasung Jang, "Corporate Restructuring in Korea

after the Economic Crisis,” *Joint U.S.-Korea Academic Studies*, Table 10; Chile = Fernando Lefort and Eduardo Walker, “Ownership and Capital Structure of Chilean Conglomerates: Facts and Hypotheses for Governance,” *Revista ABANTE* 3 (1999): 3-27; China = Cyril Lin, “Public Vices in Public Places: Challenges in Corporate Governance Development in China,” In *The History of Corporate Governance Around the World: Family Business Groups to Professional Mangers*. Randall Morck, ed. Chicago: University of Chicago Press.
<http://www.nber.org/books/corp-owner03/index.html>.

What explains that divergence? We can identify three very broad research approaches : *law and economics*; *political processes*; and *economic sociology*. The three overlap in some ways, contain substantial internal disagreement, and some writers cross boundaries. But it is perhaps more useful here to emphasize the distinctions rather than the overlap -- each “strand” of work has its own “center of gravity” of concerns and preoccupations? The Law and Economics school stresses the incentives of actors as shaped by laws concerning the organization of the firm, securities regulation, finance: where minority shareholder protection is provided by law, we find diffusion. The dominant tradition in explaining the type of regulation and the degree of shareholder protections has been “legal family” – common vs. civil law.

The politics tradition stresses a wider range of policies and a different “politics.” On the policy side, it is not just corporate and securities law that matter, but a set of interacting policies --- labor market, price and wage setting, education and training, trade unions, anti-trust, economic openness – which shape the firm. This line of reasoning is familiar in the Hall-Soskice *Varieties of Capitalism*, the Regulation School in France, Max Planck and WZB in Germany, and is suggested by Mark Roe in Law. The explanation for divergence in corporate governance turns on the politics which sustains one form of “patterned capitalism” rather than another (the neo liberalism of

Thatcher-Reagan or the OME's of Germany and Austria, or the version of Scandinavia). Politics is in turn a product of political parties, elections, interest groups, ideologies, class, and political institutions.

The third approach rests in economic sociology: the firm, like other institutions in society, is embedded in a system of social roles: norms, practices, institutions, relationships which define the possible and the permitted. The social practices shape all the processes which the law/economics and politics school examine. Variance across countries expresses differences in their "national scripts."

Let us examine these different approaches in greater detail.

Law and Economics. This approach sees corporate governance systems as a rational response to a set of economic incentives that deal with the problem of managerial agency costs. The relevant players in the firm – managers, owners, investors, and workers – are pursuing a strategy of optimizing their utility function for control of the firm's cash flow. Institutions, rules and "private bonding" arrangements shape those incentives. According to the logic of this approach, then, variation in corporate governance outcomes reflects some variance in incentives across countries.

But which incentives? In recent years, attention has focused on "minority shareholder protection" (MSP), an expanded version of "quality of corporate law" (QCL). Investors seek protection from moral hazard: the ability of managers to take advantage of owners, and of insiders to exploit minority shareholders. The essence of the governance problem lies in the incomplete contacts between owners and managers.² (Shleifer and Vishny) Without protections for minority shareholders, investment will

be low and shareholding will be concentrated in blocks. Where MSP is strong, financially markets are deeper, investment is higher, and shareholding is more diffuse.

Table 3.1 Minority Shareholder Protections Index

Country	Information	Oversight	Control	Incentive	Total MSP	
US	86	100	100	100	97	US
Singapore	89	71	80	97	84	SIN
Canada	83	71	100	78	83	CAN
UK	81	60	100	53	74	UK
Australia	75	71	80	59	71	AUS
Hong Kong	85	14	100	81	70	HK
Ireland	69	71	80	59	70	IRE
Malaysia	84	36	80	69	67	MAL
South Africa	73	43	100	41	64	SAF
Chile	35	14	100	66	54	CHIL
France	64	37	60	47	52	FRA
New Zealand	56	71	80	0	52	NZ
Argentina	48	0	80	72	50	ARG
Spain	57	14	80	50	50	SPN
Israel	74	29	60	31	48	ISR
Norway	66	29	80	16	48	NOR
Sweden	67	36	60	22	46	SWD
Finland	60	36	60	16	43	FIN
Venezuela	49	14	20	81	41	VEN

India	50	7	100	0	39	IND
Switzerland	59	36	40	16	38	SWT
Japan	66	0	80	0	37	JPN
South Korea	65	21	40	22	37	SK
Denmark	44	43	40	16	36	DEN
Netherlands	57	0	40	47	36	NED
Philippines	74	7	60	0	35	PHL
Taiwan	74	7	60	0	35	TAI
Belgium	43	32	0	59	34	BEL
Germany	44	29	20	41	33	GER
Thailand	78	7	40	6	33	THA
Brazil	27	0	60	41	32	BRZ
Austria	40	36	40	6	30	AUT
Greece	53	14	40	0	27	GRC
Mexico	59	14	20	9	26	MEX
Portugal	43	0	60	0	26	POR
Italy	69	7	20	0	24	ITAL
Turkey	51	0	40	0	23	TURK
Indonesia	45	0	40	0	21	INDO
China	25	0	20	0	11	CHIN

This table is from Gourevitch and Shinn, forthcoming 2005. Sources: Accounting from LLSV, "Investor Protection and Corporate Governance," based on Center for International Financial Analysis and Research, 1990; Disclosure from LLSV, "What Works in Securities Laws", 2002; Oversight NED estimates for Belgium, France, Germany, Netherlands, Portugal, UK, and US

from Davis Global Advisors, “Leading Corporate Governance Indicators”, 2002, p.41; Japan from Tokyo Stock Exchange, Survey on Directors, 2001; China from Stoyan Tenev and Chang, “Corporate Governance in China”, 2001; Korea from Hasung Jang; Turkey from Hakan Orbay, Sabanci Universitesi; Latin American countries from various papers [cite them, mostly ABANTE; South Africa paper; SEA estimates; other European countries from discussions with Towers & Perrin and Mercer.

LLSV are the most well known developers of this line of reasoning. They measure QCL and more recently elements of MSP and its connection to shareholder diffusion and concentration . The tables here ,from Gourevitch and Shinn Table on MSP and on diffusion/blockholding is constructed from several indicators among them LLSV: it shows the difference in MSP found in countries around the world and on concentration/ diffusion. Note that there are two issues here: does MSP predict corporate governance as measured by shareholder diffusion and second, does that in turn predict growth rates and financial market deepening? The corporate governance debate focuses largely on the first, though the motive for being interested in it is connected to the second.

The policy implications of this approach are clear: the diffusion model is best, MSP is the way to get it, thus countries should provide MSP to produce growth. The very big impact of LLSV has been to focus attention on institutional protections of shareholder as the driver of governance patterns – thus of incentives defined by public policy in the realm of investor protections.

Disputes within the family: Within a law and economics camp , there are several lines of conflict: the private bonding school which challenges the importance or need for regulation, and an historical school which wonders about the sequencing of the

argument (which came first, shareholders or shareholder protections). (There are also challenges to the centrality of QCL and MSP as to whether they are in fact the real driver of incentives for diffusion / concentration --- notably Mark Roe's stress on labor power and product market competition - but this blurs into the next category, the political process school).

The private bonding school thinks that shareholder protections can be provided by "private means" --- stock exchange regulations, bond rating agencies, stock analysts, and other mechanisms of "commitment" and obligation. Law is unnecessary, and moreover, possibly harmful. . . Generally private bonding scholars think regulations cost too much in expense, inhibiting experimentation, and give false confidence.

Recent historical work provides interesting evidence for private bonding mechanisms: shareholder diffusion *precedes* not follows formal protections in the law.³ Reconstruction of cases in the UK and the US suggest that mergers produced some degree of diffuse shareholding, with private commitments, sustained by personal ties, to support them. Stock markets began demanding forms of protections through their listing requirements. Firms began selling shares for the classic reasons (diversification of risk by the owners, raising capital by the firms) As shareholding grew, that group of people pressed the state for protections.

Roe's critique by contrast is that MSP and QCL are not the drivers of diffusion / concentration practices.⁴ The correlations between MSP and diffusion have omitted variable bias. Diffusion is strongest in countries with: vigorous product market competition (thus low trade barriers and strong anti trust), weak labor market

protection, high income inequality and weak trade unions . Competition drives down the “surplus” firms have vulnerable to agency problems. Labor strength creates a power block in the firm that induces owners to retain share blocks, so that they can bargain more effectively. (That line of reasoning is connected to the “Varieties of Capitalism” literature, on which more below).

Further arguments among law and economics scholars have to do with issues about specialized vs. general law and specialized regulation. Is tort law sufficient or is protection better with a specialized body of corporate and securities law? If the latter, a new fork in disagreement: can courts do the job if they have the right laws, or can a dedicated regulator do a better job? Glaeser, Shleifer and colleagues examine what regulators can do in an interesting paper contrasting the experience of (Czech republic which used law, with Poland that used an SEC type regulator.)

Can diffuse shareholders effectively overcome collective action problems to monitor effectively their “agents” , the Board of Directors they presumably elect? Scholars agree about this and about what reforms could make a difference. Jensen, one of the founders of the law and economics approach, and many others voice concern that the system does not work. Can it be fixed and how? Romano⁵ writes critically of Sarbanes Oxley, as pushing the wrong reforms, but also that regulation is costly and ineffective. Bebchuck explores ways of helping shareholders overcome the barriers to exerting influence on the board through voting arrangements Black and Coffee explore how financial institutions can serve the role of “institutional investors” simulating the benefits of blockholding, and examine what incentives might stimulating more

surveillance of governance problems by such institutions, and why the ones in the UK seem more active than those in the US.

Does competition among securities markets produce a race to the top (presumably high quality shareholder protections) or to the bottom (favoring managers)? This has been vigorously debated in the US and is of considerable importance in the current context of international competition among securities markets (Coffee). The US debate turns on the evaluating the impact of Delaware's role in the US Federal system. Romano argues competition favors shareholders as states provide quality protections in order to attract incorporation. Bebchuck argues the opposite: states do not in fact seek incorporation, but respond rather to the lobbying of firms within their states who want protection from takeovers, thus for poison pills. The disagreement turns on assumptions of the utility function of politicians: do they respond to owners in their states (well organized) or to shareholders (diffuse, not well-organized, and responsible for incorporation, which confers few benefits to each state thus not worth the investment to seek it. Roe recently suggests that Federal legislation is overriding the historical state role in corporate governance. ⁶

At the global level, this logic suggests that firms will seek to incorporate where the rules are favorable to capital, and capital will be increasingly defined by minority shareholders in institutional investors. Possibly that may be the case, but many other forces enter into the regulatory politics that produce or favor one type of regulatory regime over another, on which more below.

Another interesting issue in law and economics concerns the difference among tort law, specialized corporate and securities law and a dedicated regulator – not just does law matter, but which law: A muscular tort law – one with clear standards, strong penalties and an efficient bar – should, some argue provide sufficient force to inhibit abuse. Tort law, about punishing wrongs, includes concepts of fiduciary responsibility. Case law can articulate the standards as they apply to corporate governance. Strong penalties are seen as effective deterrents.⁷

The opposing view argues that tort law cannot be clear enough to provide effective supervision of malfeasance in corporate governance. A special set of law is needed to deal with the defects of private ordering. With unclear standards, protections are weak, punishment sporadic and thus an ineffective deterrent. A clearer body of law – most broadly, MSP minority shareholder protections – can produce enforcement both from public authorities and from private ones.⁸ With clear law, public authorities can bring cases against managers or other abusers. At the same time, private actors can use the information provided by MSP to sue other private actors. Together these are more effective than either alone. Incentivizing private actors and providing them with information empowers more monitoring than public authorities can do on their own. Public authorities can work to overcome collective action limits on private action. Both the public and private routes are key elements of the ability of law to control agency problems.

Another fork in the argument is between law and regulation. Are there things a regulatory body can do which a set of laws alone will not? Glaeser et. al. argue the

private bonding argument rests “on the possibility of effective judicial enforcement of complicated contracts. Judges must be able, and more importantly willing, to read complicated contracts, verify whether the events triggering particular clauses have actually occurred, and interpret broad and ambiguous language.”⁹ But what incentive do judges actually have to undertake the work this involves? “Indeed, even when contracts are restricted by statutes, the courts may not have the resources or incentives to verify whether or how particular statutes apply. ... These requirements on the judges apply as strongly to the judicial enforcement of laws, where the interpretation and application of particular statutes requires significant investment.”¹⁰

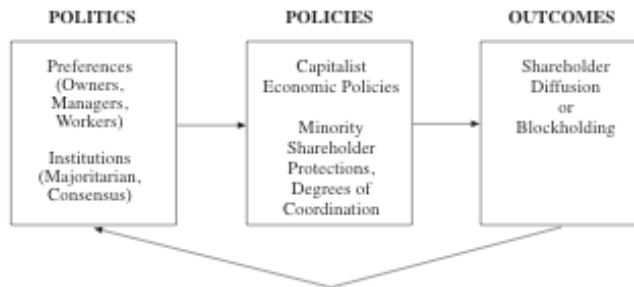
Regulatory bodies can overcome these obstacles to the effective use of legislation and courts. Properly structured, regulators have incentives to investigate, study, examine and enforce. “.. reducing the costs of the investment in information by law enforcers can improve enforcement efficiency.”¹¹ This logic inspired Judge Landis’ design of the SEC in the 1930s: a regulator to do what civil suits would not, but also giving incentives to reputational intermediaries to provide information which could then be used by the Regulator, and by civil action.¹² (Note: the preceding pages rely on Chapter 3 of Gourevitch and Shinn, forthcoming).

All of these debates revolve around the issue of regulation. Writers disagree on which regulations work best, at what cost and what level – but most authors in law and economics agree that the core set of rules deals with corporate and securities law: it is these that drive outcomes in corporate governance; variance across countries reflects variance in law and regulation on that set of laws.

Political Explanations:

The Politics school of corporate governance critiques the law and economics approach in two ways: First, it critiques the conceptualization of the “intervening variables” – which laws matter (corporate and securities law are insufficient, as there are other important policy and regulatory arenas); second it critiques law/economics school for the absence of clear explanation of the laws and regulations themselves – what explains the content of the rules, particularly what is the role of political variables in shaping policies. The politics school is especially critical of the “legal family” school that seems so influential in the law and economic interpretation.

The diagram below from Gourevitch /Shinn expresses a simple version of a political model. Preferences refracted through institutions create the policies, laws and regulations which in turn produce outcomes in corporate governance. Divergence in preferences and institutions generate different laws and regulations which in turn generates divergence in corporate governance outcomes.

Figure 2.1 Causal Schema (From Gourevitch Shinn chapter two)

Let us begin in the middle: the intervening variables (the dependent variable remains patterns of corporate governance.) The law and economics tradition focuses on corporate and securities law (traditionally on QCL—quality of corporate law) but this has now evolved to a broader measure of MSP --- Minority Shareholder Protections. Critics of that approach argue that the MSP interpretation focuses too much on the agency problem of owners monitoring managers without putting that problem in the context of other forces which shape the firm. Roe for example notes that corporate governance correlates highly with degrees of product market competition, labor market protections, income inequality, and trade union strength. Diffusion is strongest in countries with: vigorous product market competition (thus low trade barriers and

strong anti trust), weak labor market protection, high income inequality and weak trade unions . Competition drives down the “surplus” firms have vulnerable to agency problems. Labor strength creates a power block in the firm that induces owners to retain share blocks, so that they can bargain more effectively.

Hall and Soskice broaden the relevant set of policies that matter. They include education and training systems (articulated by one of the founders of this approach, Streeck), wage and price determination mechanisms, social welfare systems, central banking. The “Varieties of Capitalism “ approach rests on the idea of “institutional complementarities,” to how the pieces of the political economy fit together, so that one practice reinforce another. Economies tend toward one pole or another ---CME vs. LME to Hall and Soskice, while other authors argue the existence of a third model (a French statist model) or note differences within the models (Scandinavian vs. German CME’s).¹³

The task of explaining corporate governance must carry a bigger burden: not only must it account for corporate and securities law (the degree of Minority Shareholder Protection) but it must also account for the pattern of institutional complementarities – what Gourevitch and Shinn label “degrees of coordination” – the cluster of laws and regulations which generate these patterns of capitalist practices.

Here political science has several useful modes of attack: partisan politics, class conflict, interest group strength, political institutions. Political arguments critique the law and economics conceptualization of the players: it is not only managers and owners as conceived by the incomplete contract theorists, but also workers, and by

extension other social and economic categories (suppliers, distributors, professionals). To resolve conflicts inside the firm, labor, owners and managers seek to mobilize help outside the firm to prevail in political struggles over regulation. Several arguments have been developed to model these political alignments: Owners vs. Manager and workers, Managers and Workers vs. Owners, and Workers and Owners vs Managers.

Table 2.3 Political Coalitions and Governance Outcomes

Coalitional Lineup	Winner	Model Name	Predicted Outcome
Pair A: Class Conflict			
Owners + Managers vs. Workers	Owners + Managers	Investor	Diffusion
Owners + Managers vs. Workers	Workers	Labor	Blockholding
Pair B: Sectoral			
Owners vs. Managers + Workers	Managers + Workers	Social Bargain	Blockholding
Owners vs. Managers + Workers	Owners	Oligarchy	Blockholding
Pair C: Property and Voice			

Owners + Workers vs.
Managers

Owners + Workers

Transparency

Diffusion

Owners + Workers vs.
Managers

Managers

Managerism

Diffusion

(see Table XXX from Gourevitch and Shinn,chapter two).

We begin with the actors within the firm identified by finance theory – owners, managers, and workers – and the preferences for corporate governance practices of each group.¹⁴ These preferences can be combined in several possible ways.

The three actors contend with each other over the resources of the firm, each with a varying set of claims against the firm’s revenue and profit stream. Each set of actors has a range of preferences that set up a range of trade offs, thus of possible alignments with the other players.

Workers seek good wages, job stability in the face of lay-offs, even at the expense of profitability; and protection of their pension claims on the firm . They are in conflict with managers and owners over wages and with managers over agency costs that benefit only them. They may be relatively indifferent to expropriation costs that help one set of shareholders at the expense of other shareholders – but they will oppose them – unless self-dealing by a blockholder threatens the financial viability of the firm thus jobs and its ability to cover its pension claims.

Managers seek income, job security, and managerial autonomy. They will want high payments of various kinds, from salary to options, and the greatest autonomy in directing the resources of the firm – which also gives them the greatest leeway to shirk.

They dislike expropriation costs at the expense of the firm , for reasons similar to those of workers. Thus they have common interests with workers against some kinds of owner action, and common interests with owners against worker claims.

Owners prefer to minimize all the forms of agency costs paid to Managers and Workers, fearing that each of these is able to divert resources from profits, requiring the firm to pay above market prices to these groups. Owners may be concentrated or diffused. Concentrated owners incur a portfolio risk of exposure to a single firm, compared to diffuse owners who can spread out the risk of their equity investment over a variety of firms and assets. On the other hand, blockholders can help themselves to a variety of expropriation costs at the expense of minority shareholders. Diffuse owners don't share in expropriation costs; they focus on getting the best risk-adjusted rate of return on their investment, and a diversified equity portfolio. Some subset of owners may have common interests with workers against the expropriation claims of blockholders, while in other situations, blockholders may make common cause with managers and workers.

We see three possible alignments. Each group can make a bargain with another. This requires resolution of the internal struggle within each – which cleavage principle dominates? Or more accurately, each group can divide, one faction going in one direction, another faction the other. This helps us understand “coalitional potential”, the possible alliances combinations of the intra firm players as they move outside to politics. Which one coalesces in a given country, and which side wins, cannot be understood only by knowing the preferences. In order to translate these preferences

into real coalitions, however, we must understand the forces at work that decide which coalitions will coalesce. Here we explore three coalitional patterns: Class Conflict, Sectoral Conflict, Transparency Alignment.

Class conflict, left vs. right; Mark Roe developed one of the first overtly political interpretations of corporate governance in looking at a classic line of reasoning in political economy --- left vs. right , or the partisan manifestation of class conflict. Patterns of policy are produced by the balance of power between left and right. Where the left is strong, we get policies that support blockholding and the ancillary package of labor employment protections and income equality. Where the right is strong we get policies that support shareholder diffusion, weak employment and income inequality. Roe argues this affect on corporate governance is independent of the degree of MSP : that is, even where shareholder protection is relatively strong , as in Scandinavia, we find blockholding because strong labor inhibits diffusion.

Sectoral conflict: labor-manager-blockholder bargains: Another way of interpreting the political cleavages looks at cross class alliances and conflicts. Roe's statistics contrast left governments vs. right governments; his carefully done country case studies suggest a somewhat different pattern: countries differ on the extent to which bargains are struck across the class divided. The CME/Blockholder/stakeholder outcome reflects arrangements made among certain subsets of managers, workers and some kinds of owners to preserve a system in which they share power and benefits: the firm is protected , and all those who work and invest in it are able to retain their jobs, be this the workers or the managers, and the owners to be sheltered from hostile takeovers and

instability. This contrasts with the diffuse shareholder model where the fluidity of asset mobility is protected; the rights of the external shareholder to the cash flow of the firm, to reduce “the agency costs of cash flow “ (the firm retaining its earnings) and to exit.

Policy outcomes reflect in this way, cross class bargains. Pagano and Volpin model a bargain in favor of blockholding as an accommodation among managers, workers and inside owners against a regime of external capital holders. What Roe labels as Social Democracy, are often bargains of this kind involving labor with management and capital : Christian Democracy in Germany and Italy look like this. So does the coalitional foundations of the bargains in Scandinavia which involve farmers as well in “red-green” alliances.

Transparency coalitions: The class and sector alignments are quite familiar to students of political economy, as they appear in the literature on trade disputes (tariffs), social policy and other issue areas. Less familiar is a third coalitional alignment: the link of labor to minority shareholders against managers and insider capital. Labor pushes for transparency (via Minority shareholder protections) as way of monitoring managers (an argument development by Hoepner concerning Germany) and to defend pension investments (Gourevitch /Shinn; Hoepner/Cioffi).¹⁵ Examples can be found in Germany : the social Democrats and Free Democrats aligned to push through various reforms facing opposition from the Christian Democrats , the defenders of the Rhenish model of CMEs. In the US and the UK, we find labor related pension funds (CalPERS , Hermes, and TIAA/CREF) as leaders in the effort to push for strong shareholder protections in the regulatory process, and who challenge managers in the boardrooms

Political Institutions: We have identified the alternative coalitional line-ups that support one or another regulatory policy posture leading to alternative governance outcomes. What explains the triumph of one coalition over another? Political resources and leadership to be sure – Tiberghien¹⁶ is developing a political leadership model using cases studies of France, Japan and Korea. Resources and leadership matter, but are hard to operationalize across countries. What can be measured more readily are political institutions: structures influence the aggregation of preferences – they increase or decrease the chances of one or other coalition winning. Pagano and Volpin for example have a forthcoming paper ¹⁷that looks at electoral systems ---- Proportional representation favors blockholding, single member once past the post favors diffusion models. Gourevitch and Hawes explore this ideas as well.¹⁸

Following such writers as Lijphart, Beck, etc. ¹⁹ Gourevitch and Shinn incorporates electoral laws into a broader , increasingly used typology of political systems – Majoritarian and Consensus. High levels of MSP and a liberal production regime will, we predict, correlate with Majoritarian political institutions. Low levels of MSP and an organized or regulated production regime will correlate with Consensus institutions.

Majoritarian systems magnify the impact of small shifts of votes, thus allow large swings of policy; consensus systems reduce the impact of vote shifts by giving leverage to a wide range of players through coalitions, thus have lesser swings of policy. Consensus systems have many “veto-players”, Majoritarian ones have few. In a Consensus system, a wide range of opinion has to be included in decisions. The

coalition nature of the government assures this, as all participants in the cabinet have to agree to important decisions. In a Majoritarian system, large blocks of opinion can be overridden by a narrow majority, thus small shifts of votes can have big consequences. In Lijphart's classification, the United Kingdom is at the closest to a pure Majoritarian model, where a single party controls a cabinet that controls the legislature.²⁰ Consensus systems (in Scandinavia, Austria) also have cabinet dominance over the legislature, but within the context of a multiparty system. The connection between institutions and outcomes emerges clearly by examining the impact of electoral rules. Electoral rules have a big impact on how preferences are articulated and represented.²¹ Single member districts, with victory to the plurality winner, reward coalition formation before an election. Groups of varying opinions have an incentive to combine forces so as to get the plurality need for victory.

Conversely, proportional representation systems reward the articulation of divergent preferences at the time of election. It is after the election that combinations or coalitions are formed. The electoral system is not the only logic at work – there are some strong cleavage lines of preference, such as religion or multiple cleavages in the population that don't follow this logic, but it does have substantial force.

Gourevitch and Shinn adapt the measures of Lijphart, Beck and others into a particular measure of Consensus systems exploring "veto point."²² A high score on Political cohesion means Consensus systems. A Low score produces majoritarian systems. We then correlate countries against blockholding.

Predicting the Effects of Consensus/Majoritarian Politics

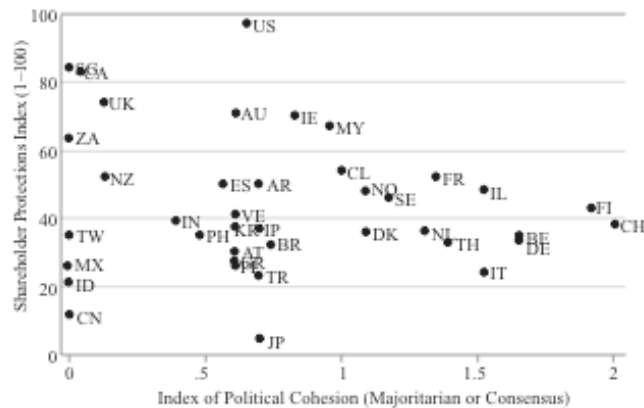
Our expectation is that in established democracies:

- Consensus systems favor Corporatist coalitions and correlate positively with blockholding and negatively with minority shareholder protections.
- Majoritarian systems inhibit Corporatist coalitions, thus correlate negatively with blockholding and positively with shareholder protections.

On the other hand, we predict that in authoritarian regimes or weak democracies:

- Strong governments, with few veto players, have high capacity for policy change and predation, thus correlate positively with blockholding, even if they correlate positively with shareholder protections.
- Weak governments, with many veto players, are ineffective in responding to crises, also frightening investors, thus correlate positively with blockholding.

We find substantial support for these expectations – see chapter 4 of Gourevitch and Shinn. The results are summarized in the chart below.

Figure 4.3 Political Cohesion and Shareholder Protections

Summing up: Political arguments seek to explain the regulations and laws that shape corporate governance: these are a combination of Minority Shareholder Protections and degrees of coordination, the regulations that shape a type of market economy –LME vs. CME. We have examined several arguments of that type --- alternative theories of coalitions and some theories institutions. The Politics arguments differ from the dominant Law and Economics school in two ways: first, a wider range of policies are in play than MSP and second, a broader view of politics. Law and Economics relies heavily on a weak line of reasoning about politics –

that the regulations derive from legal family: civil vs. common law – once selected, at some historical moment, countries are trapped. Because of its influence we examine it here.

Legal Family: Civil Versus Common Law—where are politics? (adapted from chapter 4 of Gourevitch and Shinn).

The most widely known explanation of country divergence on corporate governance policy is the legal family school, developed by La Porta, Lopez-de-Silanes, Shleifer and Vishny (LLSV). We have already referred to their important work on measuring aspects of MSP. That work makes two vital contributions to our enterprise. First it measures the variance in corporate governance outcomes around the world – it establishes a vital dependent variable and weakens ideas of convergence. Second, it argues the importance of law , regulations and policies in shaping those outcomes. It helps establish the importance of one of our two intervening variables, MSP, (and in recent work on labor, our other intervening variable, production regimes).

LLSV then make another move, on which we differ: to explain the provision of MSP, or its absence, they turn to the concept of “legal family” – the distinction between “common” and “civil” legal systems. This is a familiar distinction in legal scholarship, generating a lot of research considering the impact of the difference on various outcomes. LLSV see a causal connection with corporate governance, namely that common law countries are more likely to have diffusion shareholding models, and while civil law countries have blockholder ones. The driving mechanism is MSP. Shareholder protection is more likely to be found in common law countries, and less likely in civil law countries. We alert the reader again to the QCL /MSP distinction. The

first round of LLSV work examined the narrower QCL, not the fuller MSP. For this discussion about legal family, the distinction does not matter; we will take up the impact of the difference in the next chapter.

//Table 4.4 near here//

This table from LLSV sorts countries into legal family, measures the concentration of ownership among the three largest shareholder, and notes their mean and median. It also measures the per capita market capitalization among the countries.

The force of the relationship lies in the contrast between English common law and French civil law. The French examples include all its former colonies, mostly in Africa and those of the former Spanish empire, mostly in South America. The English group includes its former colonies, scattered around the world, comprises both the countries of English-European settlement and the colonies of conquest in Asia and Africa. Note that civil law by itself has variance with the grouping: Scandinavian Civil law has high share holder protection, as does Germany, but both have blockholding.

What mechanism explains these results? LLSV have suggested several mechanisms at work. For example, LLSV suggest (as one candidate) judicial explanation, the notion that judges in common-law countries, have stronger fiduciary duty principles than do civil judges applying general principles farther removed from specific cases.²³ Common law judges rely on precedent and experience in a “smell test” thus they have more leeway and are more inclined to be

Table 4.4 Legal Family and Corporate Governance

	<i>Mean</i>	<i>Median</i>	<i>Market cap</i>
<i>Legal family</i>			
<i>Common law</i>			
English origin average	.43	.42	6,586
<i>Civil law</i>			
French-origin average	.54	.55	1,844
German-origin average	.34	.33	8,057
Scandinavian–origin average	.46	.45	4,521

Source: LLSV, “Law and Finance,” *Journal of Political Economy* 106, 6 (1998):1113---55, table 7, pp 36 ff.

permissive. As civil law is more detailed, it specifies and prohibits, rather than permit and encourage. Civil-law countries may be more involved in regulating business than are common-law ones. The civil code is a toolbox, inclined to regulate and restrict – thus when situations arise, the countries regulate.²⁴ These inhibit the develop of free and open capital markets, and the bonding mechanisms that began the process of shareholder diffusion. It allows the state to interfere with business activities and inhibits the free play of the market in ways that would encourage the diffusion model.

Recent work by Djankov, et. al. suggest a “torts” model of what happens. Legal protections, like those we have called MSP, facilitate two channels of enforcement.²⁵ One channel works through public authorities, using their powers to bring suit against wrong doers. The other channel allows private individuals to sue, using the information provided by MSP. This mechanisms economizes on the public resources. It uses a market of enforcement by allowing individuals to work through the judicial system.²⁶

Outcomes Without Explanations

While the Legal family school provides an intriguing stylized fact that compels attention – the correlation between MSP and legal family, it is not in our view convincing. If civil law is more regulatory, why does that regulation appear to favor blockholding rather than supply effective shareholder protection? A regulatory system could be a strong MSP one. The fact of higher regulation does not establish by itself the content thereof.

If the mechanism is judicial discretion, LLSV themselves note judges could apply their discretion in different ways to protect insiders as much as outsiders, or to bar all intervention. It is therefore not enough “to focus on judicial power; a political and historical analysis of judicial objectives is required.”²⁷ Common law countries can pass legislation that suffocates markets, and civil law countries can pass laws that protect MSP if they so chose. Common law Britain became more interventionist under a Labor government in 1945, while civil law France became less regulatory after 1985. Common law countries can have effective rule of law, or weak rule where the common law legacy does not protect against extensive political interference with markets and courts — Pakistan for example, and several countries in Africa.

Legal tradition can evolve in different directions, depending on the politics that shapes legislation and enforcement. LLSV note that while it may be true that “political factors affect corporate governance through channels other than the law itself[,] . . . the law remains a crucial channel through which politics affects corporate governance.”²⁸ Indeed, law is a channel, but this confirms the point about the centrality of politics: politics picks the law and shapes its enforcement.

Pistor and colleagues note the importance of the transplantation effect : how law moved from one country to another — thus how common and civil law moved from France and the UK to their former colonies or related empires , turns on local conditions. We interpret the “transplant” effect as an argument calling attention to politics — the way in which receiving societies want to use the legal family legacy, thus on local politics, institutions, and cultures.²⁹

Laws come from politics: Law and regulation come from politics. If Pakistan has weak shareholder protection and thus blockholding, while the UK has the opposite, the difference lies in the political use of their common law tradition. This is the implication of Glaeser and Sheifer's comparison of regulation with courts as enforcers in "Coase vs. the Coasians." The choice of regulator (Poland) rather than courts (Czech Republic) was a political one, not explicable by legal family.³⁰ Similarly, they place politics at the center of the evolution of the US system: the United States turned to regulation because 19th century courts were deeply corrupted by big lobbies, especially the railroads. Both these examples, the United States and the European ones, contradict the legal family argument: holding constant it's Common Law tradition, the United States has gone through a periods of poor shareholder protection, and good ones. Contemporary scandals suggest just how variable the system really is.

What changes over time within countries of any legal tradition is politics and political processes. Is Legal family in fact a political interpretation.? Only in the initial move to pick a legal family. At some point decision makers selected a legal tradition—voluntarily in some cases, through coercion (colonialism) in others. At that moment we could say there was a political process that influenced corporate governance. But a weakness of the Legal Family school is that political processes disappear after that single moment. How it comes about that certain laws are enacted and enforced to give higher or lower protections disappears from the analysis. Judges seem to make decisions because of the logic of the tradition, but this too is insulated in analysis from politics. LLSV do study laws and regulations—extensively, again a major

contribution – but they offer no account of why and when these laws are passed or enforced. It all flows from legal family, thus a single political act in a distant past.

Legal family interpretations seem to leave countries trapped in their initial founding moment. It cannot explain “the great reversals”³¹ the changes that have taken place within one country over time. It has odd policy implications: does it mean no civil law country can develop effective MSP? If not, then legal family cannot be so decisive in its impact.

The legal family approach has provoked a number of critics. Roe has done of the most direct statistical confrontations, pitting his three political variables -- -- partisan location of governments (left vs. . right), labor employment protection , and income inequality³² -- against legal family and finding the evidence supports the political variables. Pagano and Volpin as noted find electoral system does better, while Gourevitch and Shinn stress political institutions more broadly. Pistor and colleagues show the “transplant” effect refracts legal family through a variety of local political conditions.

Legal family is thus not a political model – it is single formal event and can't incorporate political processes that generate the policies that shape corporate governance.

Economic Sociology

(This section below is drawn from Gourevitch and Shinn, chapter 4).

A substantial body of research on market economies has been generated by economic sociology in recent years, informative for our enterprise. These researchers share our desire to locate economic practices and behaviors in social processes. Work in this tradition include studies of: changes in corporate forms,³³ the influence of investors in the breakup of conglomerates in the 1980s,³⁴ the diffusion of poison pill and anti-take over laws,³⁵ the role of law firms in the development of high technology industry in Silicon Valley,³⁶ decision-making processes in firms (on GM); the implementation of legislation, the emergence of the Chief Financial officer in American firms,³⁷ shareholder activism as a social movement,³⁸ the role of networks in developing and enforcing norms,³⁹ labor market and labor training in shaping production systems,⁴⁰ international corporate governance patterns,⁴¹ the diffusion of corporate governance structures,⁴² and the role of legitimacy versus efficiency in the spread of governance codes.⁴³

This work contributes substantially to our understanding of the processes that shape firms and the actors in them. It challenges a pure “efficiency” account of economic life, conforming to deductively derived principles of optimality, wholly autonomous from the society in which it takes place. Economic activities are “embedded,” sociology argues. They emerge out the same process by which social practice arises in realms such family, ethnicity, religion, education, and social structure. . Behavior and practice derive from social forces and processes, such as political dynamics and social emulation and the interaction of the economy with other social

sub-systems, such as the state, bureaucracy, political and other organization. Ensminger shows how norms, social structure and institutions fuse to make markets. ⁴⁴

A growing number of people across several disciplines see this point about “embedded “ economies. Some specialists in law and finance and corporate governance have been examining the role of interest groups, electoral systems and political institutions, social structures, the media, human capital issues. Rajan and Zingales, Kroszner, Perotti and van Thadden, Pagano and Volpin, are all economists working on finance and governance writing in this vein. Other economists have been exploring political institutions and interest groups more generally, (Grossman and Helpman, Persson and Tabellini), while others examine the interaction of social structures and path dependence on the evolution of institutions (North; Acemoglu, Johnson, et. al).

Conversely, many sociologists studying the economy explore the impact of incentives and utilitarian calculations on economic behavior. As examples Davis, Dobbin, Useem all note the way changes in anti-trust policy by the Reagan administration and the development of financial institutions following important legislation helped set loose processes that undermined the conglomerates that had emerged in WW II. Streek’s work on labor and training systems, Dobbin on railroad building in the US, France and the UK, Aguilera and Jackson on corporate governance, all pay careful attention to the incentives of actors, but seek to embed them in a social context. Sociologists contribute important quantitative work on ownership patterns, on connections across firms among directors and the diffusion of practices across firms.

“There is now a large literature documenting the role of board interlocks in the spread of governance practices such as adopting a poison pill (Davis and Greve, 1997), creating an investor relations office (Rao and Sivakumar, 1999), making particular types of acquisitions (Haunschild, 1993), and others.”⁴⁵ Davis and McAdam examine the politics of shareholder activism and locate it in the framework of “social movements.”⁴⁶

But while there is often substantial overlap, there are differences in emphasis among the disciplines of sociology, economics and political science and in some places those differences are substantial. We see disagreements on two key points. If regulations and policy matter, and these shape economic action, rather than arise from some independent economic calculus, what explains the content of policy and regulation? In this book we stress politics and political processes. Many economic sociologists also point to political processes and resource mobilization, but quite frequently they subordinate politics as a sub-system of a larger society and social action. This is an old quarrel among the social sciences going back at least to Parsons, Durkheim, Weber, Marx, Mill and even before them to Aristotle and Plato. By that approach, the political processes themselves reflect some more fundamental social process, a mixture of value systems, family, culture and institutions. We do not make an effort to resolve boundary issues among politics and other social processes, but only to point out the difference in emphasis. Our goal is to clarify just where political choices are operative.

The second disagreement has to do with incentives and interests. Do economic incentives sufficiently capture the richness of the motivations of economic actors? Many

sociologists challenge this. Drawing on the work of John Meyer and others, Dobbin writes in a major literature survey "Sociology's core insight is that individuals behave according to scripts that are tied to social roles."⁴⁷ Individuals, and firms, construct a world out of these scripts. They negotiate an understanding built out of incentives to be sure, but interpreted through past experience, cultures, frames of understanding. It is not possible to model "interests" and incentives, therefore, without knowing the scripts that give meaning and motive to them. Dore questions the adequacy of "allocative efficiency" in explaining behavior: "overall output maximization is achieved less by allocative efficiency than by productive efficiency which involves organizational learning and willing cooperation."⁴⁸ "Incentives and their efficacy cannot be discussed without reference to the latent patterns of motivation that the incentive devices assume to exist and presume to appeal to. Is it indeed true that the prospect of material gain and the threat of legally enforced sanctions to which the above incentive mechanisms relate are the only relevant motives? "It requires only a small amount of reflection", Margaret Blair has written recently, "to realize that financial incentives and enforceable legal constraints cannot possibly be what holds most cooperative relationships together. They simply do not bind tightly enough. Most business relationships involve, and indeed require, a substantial amount of voluntary cooperation and trust among participants in the enterprise."⁴⁹

Shareholder value, a core concept in the "nexus of contracts" approach, is for these sociology theorists "constructed." It "... is intrinsically impossible, given human nature, to calculate the intrinsic value of a share")⁵⁰ and " 'Security analysts have

enormous difficulty in performing their basic function of forecasting earnings prospects for the companies they follow...Financial forecasting appears to be a science that makes astrology respectable'”, in practice can only mean intersubjective agreement, and intersubjective agreement is embodied in the price assigned by the stock market.”⁵¹ Firms are engaged in “impression management,”⁵² They do things that correspond to the models various constituencies hold of best practice. “ The announcement of a new long-term incentive plan for executives on a proxy statement produces a significantly higher stock price increase when described in terms of incentive alignment than the same plan described as a means to attract and retain qualified executives “ even if there is no change in operating performance. “⁵³ “....governance reforms are themselves rhetorical performances, intended to persuade activists and other players in the financial markets of the corporation’s fitness for investment. Creating ‘the kind of firm, governance structure, and securities the customers in capital markets want’ involves marketing through rhetoric, from the letter to the shareholders in the annual report, to how diversified the corporation portrays its operations on the income statement, to the choice of directors.”⁵⁴ The concepts signaling and status help explain firm behavior in this context.

“What is important to recognize is that standards that apply {for evaluating change in governance} do not concern whether the theory is true (this governance structure will create earnings growth into the future), but whether it is persuasive (this governance structure is rhetorically plausible). Truth in this case is in principle unknowable: the vast body of recent research on corporate governance provides no

consistent support for any particular “best practice” that has worked well in the past, much less insight into what will work well in the future. The relevant question, however, is not is the defendant “really” guilty, but how did the jury vote.”⁵⁵

“Corporations are *legal fictions*.... In the sophisticated version of contractarianism, shareholders are as much a legal fiction as the corporation itself. It just happens that they are, by hypothesis, part of a social welfare-maximizing genre of corporate governance. As Allen (1992) puts it, this conception of the corporation ‘is not premised on the conclusion that shareholders do “own” the corporation in any ultimate sense, only on the view that it can be better for all of us if we act as if they do.’ As a corporate genre, the contractarian approach is as distinctive to the US as Faulkner and Hemingway. The emphasis on voluntarism and individual liberty, and the suspicion of viewing the corporation as a social entity with obligations to constituencies other than shareholders, are recurrent themes in American law and economics.”⁵⁶ “....custom among law and economics scholars – if not the law itself – treats the shareholders as the sole owners and legitimate ‘stakeholders’ of the corporation, and this notion has achieved the status of doxology among American corporate managers.”⁵⁷

The sociologists note divergence in judgments on whether concentrated or diverse ownership is beneficial. Davis and Useem cite Rajan and Zingales, “ The opacity and collusive practices that sustain a relationship-based system entrench incumbents at the expense of potential new entrants.”⁵⁸ Moreover, economies characterized by concentrated wealth in the hands of ‘old money’ families grow more slowly than economies without such families, again suggesting a political entrenchment that limits

economic adaptability.⁵⁹ Recent research in financial economics thus suggests that social welfare is enhanced by a strong independent state and undermined by concentrated inherited wealth and power. The implications are ironic. Whereas Berle and Means feared that dispersed ownership would create a class of managers with control over large corporations but little accountability to shareholders, the late twentieth-century assessment suggests that *concentrated* ownership leads to cronyism, political favoritism, and weak economic growth. The irony runs deep. 'Managerialist' firms in the US pursue shareholder value with little regard for other stakeholders, while firms with concentrated ownership elsewhere in the world cannot help but attend to other stakeholders. Yet the explicit ignoring of other stakeholders may ultimately yield more favorable benefits for them."⁶⁰

The importance of scripts and ideology surely matters. Finance theorists like Zingales note that alternative theories of the firm lead to varying views of value, governance, and finance.⁶¹ By implication, the choice of theory is a construct. Some political scientists have been applying the concepts of scripts and discourse to political economy: Schmidt on European economic policymaking, Katzenstein and economic regionalism, Sinclair on bond rating agencies are but some examples. March and Olson write about the logic of appropriateness and the logic of consequences in a noted volume on international relations. Suzanne Berger stresses the element of choice in how firms, and countries, select strategies for dealing with common pressures of international competition. Hancké stresses the leeway managers had in devising

solutions to the new situation they confronted; policy and economic shifts changed the parameters, but firms and their leaders picked among alternative paths.⁶²

Here the politics school differs from the sociological approach (or a subset of each). The political school stresses incentives and interests in shaping policies and the response to them. MSP and the rules of the production system *do* influence behavior. On that the politics school agrees with the finance economists, the legal family school and our economic sociology colleagues who study the impact of policies upon economic behavior. The disagreement in emphasis is in explaining the origins of those rules (politics vs not legal family, or the “autonomous” economy pure and simple), and on which rules matter (tort law alone, or MSP and /or rules of the production system.) the politics school agrees with Roe, the *Varieties of Capitalism* authors, some of the sociologists, and some of the finance economists in saying that the broader set of rules matter. Where the politics approach disagrees, at least in emphasis, is on the inadequacy of an incentive model (viz the economists) and the sufficiency or separateness of “scripts” (viz) the sociologists.

The politics school stresses change within countries over time over their regulatory regime and its practices. To the extent the idea of “national script” explains behavior, does it explain change by a country over time. Ideas about Confucian patterns or the French model, or the American one, do not capture the way those countries changed. Some economic sociologists have written extensively about the self-interest of various actors in bringing about change: the financial analysts who made money encouraging conglomerates, then in breaking them up. The swirl of competing

interests both makes a case for “scripts” – in confusing situations, one’s “priors” are a guide to action – and against them – in confusion, actors advance their particularistic goals. Either way, some abstract concept of optimum efficiency has substantial weaknesses as an explanation.

Conclusion: Three broad families of interpretation have been set out here. Each has generated substantial scholarship on corporate governance patterns and practices. The interaction among them is often limited, as each school refers internally to its colleagues and often does not cut across boundaries. Just how to integrate these alternative arguments remains an open theme for the future. There are advantages to specialization, to each school working out the logic of its inquiry, and then comparing. That seems better than assembling all the pieces into a collage or a laundry list of factors.

Politics of course enters the equation of interpretation. Corporate governance goes to the heart of power in market economies. It links deeply with income distribution, job security, social services, employment and competition. Analysis overlaps with evaluation. Many see convergence: investors demand strong transparency and MSP; in a world competing for international capital, investors will get what they want and so convergence will occur. Writers on the left condemn this as bad for workers; conservatives applaud it. Both see the same causal mechanism (the power of capital) but evaluate it differently.

Reality and rhetoric make it hard at times to evaluate what changes are really taking place. Shareholder value rhetoric sweeps the world, companies open offices of shareholder relations, everyone adopts codes of governance that sound alike, resonating with OECD principles, those of CalPERS, Hermes, TIAA-Cref, etc. But what actually happens in these countries. In many places with codes, law has changed little, and enforcement even less. In companies with shareholder relations offices, have practices really changed much – do the managers respond to what shareholders want, or is the PR better?

Important distinctions get neglected: the talk about the power of financial institutions sweeping the world overlooks important differences among them. CalPERS and Hermes for example are quite pro active on corporate governance issues, while Merrill Lynch and Fidelity are not, at least not publicly. The latter have conflicts of interest that may inhibit them from being pro active, while public employee funds with union representatives on the boards do not have those conflicts of interest. We know little about these institutional differences. As private pension funds grow in importance, it makes a big differences just how the financial institutions of pension funds are actually structured and controlled ---the pension fund and the governance systems interact in important ways.

Corporate governance expresses rules ,regulations, preferences, cultures and politics. These vary considerably round the world. Indeed in may be that having different systems can be a comparative advantage – so that systems can differ as they specialize in one form of activity rather than another. The jury is still out.

¹ Ronald Dore, *Stock market capitalism/welfare capitalism*; Michel Albert, *Capitalism against Capitalism*, and many other authors explore these distinctions.

² Shleifer and Vishny, 1996.

³ See work by Cheffins, Meyer and Franck, Morck and NBER papers being edited by Morck.

⁴ Mark Roe, *Political Determinants of Corporate Governance*, Oxford 2003.

⁵ Roberta Romano, NBER paper on Sarbanes Oxley, 2004; Lucien Bebchuck several papers.

⁶ Mark Roe, Harvard Law 2004, Coffee, 2002 paper.

⁷ Gary Becker "Crime and Punishment: An Economic Approach," *Journal of Political Economy*, 76 (1968): 169-217; Richard A. Posner, *Economic Analysis of Law*, (Boston: Little & Brown, 1972), chapter 7; John Coffee, "No Soul to Damn: No Body to Kick: An Unscandalized Inquiry into the Problems of Corporate Punishment," *Michigan Law Review*, 79 (1981): 386-459.

⁸ La Porta, Lopez-di-Silanes, and Shleifer 2004 unpublished manuscript.

⁹ Glaeser et. al. 2001, p. 854.

¹⁰ Ibid, p. 854.

¹¹ Ibid, p. 855.

¹² La Porta, Lopez-di-Silanes, and Shleifer 2004 unpublished manuscript.

¹³ See for example Vivien Schmidt work, the French regulation school, and others.

¹⁴ The basic formulation looks of the agency problem looks at owners and managers only, on the grounds that there is no problem of incomplete contract with workers. Concern with "human capital" undermines that distinction, and thus we include workers. See Zingales 2000.

¹⁵ Gourevitch/shinn forthcoming; Hoepner and Callaghan, APSA 2004, Hoepner and Cioffi, APSA 2004 and European Studies meeting 2004.

¹⁶ Yves Tiberghien, Stanford thesis, and papers. 2002, and following.

¹⁷ Pagano and Volpin, forthcoming, *American economic review*. 2005 forthcoming

¹⁸ Gourevitch and Hawes, *Regulation*, 2002, Robert Boyer, editor, Presses des Science Po, Paris.

¹⁹ See Lijpart 1999; Thorsten Beck, George Clarke, Alberto Groff, Philip Keefer, and Patrick Walsh, "New Tools in Comparative Political Economy: The Database of Political Institutions," *World Bank Economic Review*, 15 (2001): 165-176; Matthew S. Shugart and John M. Carey, *Presidents and Assemblies: Constitutional Design and Electoral Dynamics*, (New York: Cambridge University Press, 1992); See Chapter 9 for development of this classification scheme.

²⁰ Lijphart 1999, p. 10-21 for specification of the arch-typical Majoritarian (Westminster) system.

²¹ Electoral laws play an important role in shaping the system. Cox 1997.

²² From Gourevitch and Shinn: In analyzing these systems, researchers focus on the way institutions define the capacity to block or to pass legislation, thus to exercise a “veto.” While different terms are used to articulate this concept, we focus on veto “points” rather than two common alternatives, veto “gates” and veto players.” Majoritarian systems have fewer veto players than consensus ones, thus governments are able to make important decisions on a narrower base of support. Because Consensus systems contain more veto points, governments depend on a broader base of support. We would expect therefore narrower policy swings in Consensus systems, compared to Majoritarian, on the same swing of votes in an election.

This is, we note, an argument about continuity as well as about creation. Once a policy is adopted in Consensus systems, it is likely to be kept. Consensus systems may make it harder to get things adopted in the first place.²² Alternatively, Majoritarian systems are indeed be able to make decisions, but they may be of a substantively different kind: consumer oriented rather than producer, as Rogowski suggests. We explore the second of these ideas: that institutions influence not whether a decision is made, but what coalition wins, thus what the content of the decision may be.

Measuring Institutional Difference

To quantify the countries in our sample in terms of Consensus or Majoritarian politics, we use an Index of Political Cohesion derived from and modified from the Beck *et. al.* World Bank database of political indicators (DPI). In our index, 0 equals a unified presidential or single party Parliamentary government; 1 equals a divided Presidential government, two- party coalition Parliamentary government, or minority party Parliamentary government; and 2 equals a multi-party coalition Parliamentary government, measured over a longitudinal range of x years. Since the number of veto players can change with each election, these scores are the average across all the years available e in the DPI.

²³ La Porta et al 2000; John Coffee, “Privatization and Corporate Governance: The Lessons from Securities Market Failure,” *The Journal of Corporation Law*, 25 (1999): 1-39; Simon Johnson, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, “Tunneling,” *The American Economic Review*, Papers and Proceedings of the One Hundred Twelfth Annual Meeting of the American Economic Association, 90 (2000): 22-27.

²⁴ Juan C. Botero, Simeon Djankov, Rafael La Porta, Florencio Lopez-de-Silanes, and Andrei Shleifer, “The Regulation of Labor,” *The Quarterly Journal of Economics*, 119 (2004): (pages forthcoming)

²⁵ Botero et. al, forthcoming.

²⁶ Mathew D. McCubbins, and Thomas Schwartz, “Congressional Oversight Overlooked: Police Patrols versus Fire Alarms,” *American Journal of Political Science*, 28 (1984): 165-179.

²⁷ *Id.* at 12. From the Seventeenth century onward, for example, the British Crown lost influence over the courts to Parliament and the property owners who dominated it, so common law evolved

to protect property against the Crown. John Brewer, *The Sinews of Power: War, Money, and the English State, 1688-1783*, (New York: Knopf, 1989); Barrington Moore, *Social Origins of Dictatorship and Democracy: Lord and Peasant in the Making of the Modern World*, (Boston: Beacon Press, 1966). While many observers classify the English state as weak in comparison to highly bureaucratized French and Prussian examples, Brewer argues that the English state was in fact stronger because Parliamentary supervision of the executive reassured social groups the state was being used as they desired, and not at the monarch's whim. See also North and Weingast 1989, (showing that England paid lower interest rates on loans because investors had confidence in a supervised executive).

²⁸ La Porta et al. 2000.

²⁹ Daniel Berkowitz, Katharina Pistor, and Jean-Francois Richard, "Economic Development, Legality, and the Transplant Effect," *European Economic Review*, 47: (2003): 165-195.

³⁰ Glaser et al. 2001.

³¹ Rajan and Zingales, the great reversals.. and Saving Capitalism from Capitalists.

³² Roe *Political Determinants*.

³³ Neil Fligstein, *The Architecture of Markets: An Economic Sociology of Twenty-First Century Capitalist Societies*, (Princeton: Princeton University Press, 2001).

³⁴ Neil Fligstein and Linda Markowitz, "Financial Reorganization of American Corporations in the 1980s," in *Sociology and the Public Agenda*, William J. Wilson, ed., (Newbury Park, CA: Sage Publications, 1993); Gerald Davis, Kristina Diekmann, and Catherine Tinsley, "The Decline and Fall of the Conglomerate Firm in the 1980s: The De-Institutionalization of an Organizational Form," *American Sociological Review*, 59 (1994): 547-570; Michael Useem, *Executive Defense: Shareholder Power and Corporate Reorganization*, (Cambridge: Harvard University Press, 1993); Useem 1996.

³⁵ Gerald F. Davis, and Michael Useem, "Top Management, Company Directors, and Corporate Control," in *Handbook of Strategy and Management*, Andrew Pettigrew, Howard Thomas, and Richard Whittington, eds., (London: Sage, 2002); Gerald F. Davis, and Gregory E. Robbins, 2001 "The Fate of the Conglomerate Firm in the United States," in *How Institutions Change*, Walter W. Powell and Daniel L. Jones, eds., (Chicago: University of Chicago Press, forthcoming); Tracy A. Thomson, and Gerald F. Davis, "The Politics of Corporate Control and the Future of Shareholder Activism in the United States," *Corporate Governance* 5 (1997): 152-159; Gerald F. Davis, "Agents without Principles? The Spread of the Poison Pill through the Intercorporate Network," *Administrative Science Quarterly*, 36 (1991): 583-613; Davis, "Networks and Corporate Control: Comparing Agency Theory and Interorganizational Explanations for the Diffusion of the Poison Pill," in *Academy of Management Best Papers Proceedings 1991*: 173-177; Davis, "The Significance of Board Interlocks for Corporate Governance," *Corporate Governance*, 4 (1996): 154-159; John Meyer and Brian Rowan, "Institutionalized Organizations: Formal Structure as Myth and Ceremony," *American Journal of Sociology*, 83 (1977): 340-363.

³⁶ Mark C. Suchman, *On Advice of Counsel: Law Firms and Venture Capital Funds as Information Intermediaries in the Structuration of Silicon Valley*, Ph.D. dissertation, Stanford University Department of Sociology; Mark C. Suchman and Mia L. Cahill, "The Hired Gun as Facilitator: Lawyers and the Suppression of Business Disputes in Silicon Valley," *Law and Society Inquiry*, 21 (1996): 679-712.

³⁷ Dirk Zorn, Frank Dobbin, Julian Dierkes, and Man-Shan Kwok, "Managing Investors: How Financial Markets Reshaped the American Firm," in *The Sociology of Financial Markets*, Karin Knorr Celina and Alex Poole eds., (Oxford: Oxford University Press, forthcoming).

³⁸ Gerald F. Davis, and Douglas McAdam, "Corporations, Classes, and Social Movements," in *Research in Organizational Behavior 22*, Barry Straw and Robert I. Sutton, eds., (Oxford: Elsevier Science, 2000).

³⁹ Davis *Networks and Corporate Control*.

⁴⁰ Wolfgang Streek, *Industrial relations in West Germany: A Case Study of the Car Industry*, (London: Heinemann, 1984).

⁴¹ Ruth Aguilera and Gregory Jackson, "Institutional Changes in European Corporate Governance," *Economic Sociology*. 3 (2002): 17-26; Aguilera and Jackson, "The Cross-National Diversity of Corporate Governance: Dimensions and Determinants," *Academy of Management Review*, 28 (2003): 447-465; Ruth Aguilera and Michal Federowicz, eds., *Corporate Governance in a Changing Economic and Political Environment: Trajectories of Institutional Change on the European Continent*, (London: Palgrave Macmillan, 2003).

⁴² Marie-Laure Djelic, *Exporting the American Model: The Postwar Transformation of European Business*, (Oxford: Oxford University Press, 2001); Marie-Laure Djelic and Sigrud Quack, eds., *Globalization and Institutions: Redefining the Rules of the Economic Game*, (Cheltenham, U.K.: Edward Elgar, 2003); Mauro Guillen, "Corporate Governance and Globalization: Is there a Convergence Across Countries?" *Advances in International Comparative Management*, 13 (2000): 175-204.

⁴³ Alvaro Cuervo-Cazurra and Ruth Aguilera, "The Worldwide Diffusion of Codes of Good Governance," in *Corporate Governance and Firm Organization*, Anna Grandori, ed., (Oxford: Oxford University Press, 2004); Peer Fiss and Edward Zajac, "Corporate Governance and Contested Terrain: The Rise of the Shareholder Value Orientation in Germany," *Administrative Science Quarterly*, (Forthcoming).

⁴⁴ Jan Ensminger, *Making a Market: The Institutional Transformation of an African Society*, (New York: Cambridge University Press, 1992).

⁴⁵ Davis and Useem 2002.

⁴⁶ Davis McAdam 2000.

⁴⁷ Frank Dobbin, ed., *The New Economic Sociology: A Reader*, (Princeton: Princeton University Press, 2004), p 4.

⁴⁸ Ronald Dore, "Pros and Cons of Insider Governance," *REITI Working Paper*, 2004, "...within all societies *individuals* differ in their propensity to be cooperative, trusting and trustworthy, absent strong material incentives to be so. (That is to say human beings are capable of "natural inclination" trust--though differing in the extent to which they have it--and not just the "calculative trust" which transaction economists consider (a) universal because rational, and (b) the only kind of trust worth bothering with)...

But over and above those individual differences, there is also considerable *national* variation in *modal* patterns of such inclinations--variations in the social norms about trusting and cooperation which are subscribed to by the average individual and which hence provide the motivational resources which can make the incentives implicit in institutional arrangements work."....

"Organisational tinkering in the name of reforming corporate governance interacts with, and can sometimes reinforce changes in social structures and class interest, as well as,

increasingly, changes in the international environment and the society's degree of exposure to that environment. But in the long run what really changes corporate governance (reverting to this paper's opening definition of corporate governance as being about the distribution of power) is the social structural changes themselves.

⁴⁹ Margaret M. Blair, "Post-Enron reflections on comparative corporate governance", *Journal of Interdisciplinary Economics*, 14 (2003): 113-124.

⁵⁰ Burton G. Malkiel, *A Random Walk Down Wall Street: The Time-Tested Strategy for Successful Investing*, Sixth Edition, (New York: W.W. Norton & Co., 1996) p. 103.

⁵¹ Malkiel 1996, p. 169.

⁵² Edward J. Zajac and James D. Westphal, "The Costs and Benefits of Managerial Incentives and Monitoring in Large U.S. Corporations: When is More not Better?" *Strategic Management Journal*, 15 (1994): 121-142, cited by Davis and Robbins 2001, P. ??VERIFY DATE AND PAGE ; See also Edward J. Zajac and James D. Westphal, "The Social Construction of Market Value: Institutionalization and Learning Perspectives on Stock Market Reactions," *American Sociological Review*, 69 (2004): 433-457.

⁵³ James D. Westphal and Edward J. Zajac, "Symbolic Management of Stockholders: Corporate Governance Reforms and Shareholder Reactions," *Administrative Science Quarterly*, 43 (1998): 127-153, cited by Davis and Useem 2002, p. 250.

⁵⁴ Davis and Useem 2002, p. 293.

⁵⁵ Davis and Useem 2002.

⁵⁶ Davis and Useem 2002, p. 250

⁵⁷ Davis and Useem 2002..

⁵⁸ Davis and Useem 2002, p 250.

⁵⁹ Morck, et al., forthcoming.

⁶⁰ Davis and Useem 2002, p. 251.

⁶¹ Zingales 2000.

⁶² Vivien Schmidt, "The Politics of Adjustment in France and Britain: When Does Discourse Matter? *Journal of European Public Policy*, 8 (2001): 247-264; Schmidt, "Does Discourse Matter in the Politics of Welfare State Adjustment? *Comparative Political Studies*, 35 (2002): 168-193; Peter Katzenstein and xx Shiraishi, *Remaking Asia: Americanization and Japanization* (provisional title, forthcoming) ; James G. March and Johan P. Olsen, "The Institutional Dynamics of International Political Orders," *International Organization*, 52 (1998): 943-969; Suzanne Berger, *The First Globalization: Lessons from the French*, (Paris: Seuil, 2003); Bob Hancké, *Large Firms and Institutional Change: Industrial Renewal and Economic Restructuring in France*, (Oxford: Oxford University Press, 2002).