Regional Integration and the Diversity of Corporate Governance: Some Lessons of European Integration

Gregory Jackson
Fellow
Research Institute of Economy, Trade and Industry (RIETI), Tokyo

Outline

- Is there a European Model of Corporate Governance?
- Failures of European Harmonization
- Integration and Diversity: A Possibility or Paradox?
- Implications for Corporate Accountability and Asian Integration

Why Corporate Governance?

- “Varieties of Capitalism”: Importance of institutional diversity for comparative institutional advantage
- Corporate Governance is central:
  - Corporations as engines of innovation
  - Impact on national patterns of employment
  - Stability of the financial system
- OECD promotes “global minimum standard,” and yet aims to accommodate diversity

Questions

- How can Asian countries accommodate regional or global standards, and how will these impact their existing institutions?
- This paper will explore these issues by asking: what lessons can be learned from European integration?

A European Model?

- Anglo-American "model" of corporate governance
  - Dispersed ownership
  - Minority shareholder rights, information disclosure, etc.
  - "independent" directors, managerial stock options
  - Market for corporate control
- Yet most Continental European countries differ in important respects from this model…
  - Concentrated ownership: families, banks, industrial groups, state
  - Employee Representation: works councils, board level codetermination
  - Public Interest: British "private association" view contrasts with public interest in the internal governance of firms

Failures of Harmonization

- While Europe differs from the Anglo-American model, no common alternative model guides European Integration
- The origins of national differences are rooted in politics. Different sequences of industrialization and democratization led to different patterns of class conflict, as well as conceptions of public interest.
- Reform pressures via internationalization of markets and “regime competition,” as well as domestic problems

Failures of Harmonization (cont.)

- European Integration is largely liberalization
  - “negative integration”: forms of coordination between national institutional settings
  - company-specific hybrids
- Three Examples
  - European Company Statute
  - European Works Council Directive
  - Takeover Directive

European Company Statute

- Reduce transaction costs, avoid symbolic choice between national “corporate cultures”
- Failure of “Fifth Directive,” inability to export strong German model of codetermination
- Single European Act (1985), principle of “subsidiarity”
- Nice Summit (2000) limits European-level incorporation to multinational firms and requires social partners to negotiate codetermination rules backed by safeguards of national law

Legal Reforms in National Law: Germany

- Financial Market Promotion Acts (1987, 1994, 1997)
  - Liberalized secondary capital markets
  - Implementation of EU Directives on Insider trading, transparency, investment services. Established rule-based Federal Securities Trading Commission
  - Promote stock market by reducing transaction costs of IPOs
- Law on Control and Transparency (1998)
  - Disclosure of large stakes
  - Removed voting rights restrictions, one-share-one-vote
  - Mild restrictions on banks
  - Liberalized uses of corporate equity: buy-backs, stock options
  - Left German Board system relatively intact

Legal Reforms in National Law: Germany

- Accounting Rules
  - NYSE listing of DaimlerBenz
  - Recognition of international standards under domestic tax law
  - DAX30 corporations: 17 IAS, 13 GAP
- Thus while harmonization has failed, Germany has moved a long way to market-oriented reforms or enabled its domestic firms to respond to new capital market pressures

European Works Council Directive

- Successful because it doesn’t interfere with national systems
- Adds on firm-specific institution to represent European workforces in MNCs
- Despite some rights, strength depends strongly on existing national regime
- Different impact in Britain vs. Germany

Takeover Directive

- Absence of open market of corporate control, low incidence of hostile takeovers
- Lack of EU agreement, but increase in activity culminating in Mannesmann takeover by Vodafone
- Difficulty in rules to create a “level playing field” given the dramatic differences in market power
- June 2001 Deadlock: 273 in favor, 273 against, 22 abstentions. German lobby by corporate management and unions against restricting defensive measures

Table 1 Corporate Performance, Selected Averages 2000

	Germany	**United Kingdom**
Real returns to capital		
Price-earnings ratio	17.8	21.5
Dividend yield	2.7%	2.6%
Return on equity	18.2%	20.4%
Market valuation		
Market value (mill. euros)	20,754	42,337
Ratio of market value to turnover	0.51	2.14
Market value per employee (mill. euros)	0.14	0.97
Price-book ratio	2.5	4.6
Sales, profits, employment		
Turnover (mill. euros)	38,122	22,015
Return on sales (EBIT to sales)	9.4%	19.2%
Employees	138,072	60,676

Source: Handelsblatt Europa 500, Handelsblatt June 11, 2001. Averages are calculated from the 19 largest British and 20 largest German industrial firms belonging to the "Europa 500."

Integration and Diversity: A Possibility or Paradox?

- EU Integration means liberalization of markets, not harmonization of underlying institutions
- Comparative Institutional Analysis
  - Examines the linkages between institutions
  - Question of complementarities and tensions

Integration and Diversity (cont.)

- Germany is undergoing “hybridization”
  - Institutional tensions have lead to the erosion of relationship banking
  - Mismatch between growing shareholder-orientation and employee codetermination
  - Heterogeneity of corporate practice within national systems
  - Prospects on an “enlightened shareholder value” model?

Implications for Corporate Accountability in Asia

- Asian regional integration is far less politically developed, difficulties of leadership, greater vulnerability to bilateral U.S. pressure
- Asia has more disparate levels of economic and institutional development, perhaps analogous to Eastern and Central Europe
- But similar types of issues: harmonization vs. negative integration, as well as de facto convergence

The Case of Japan

- Parallels to Germany found in Japan
- Impact of capital markets on domestic banks
- Impact of shareholder pressure on “employee-orientation” of J-firms
- But Japan may have lesser institutional potential for stable hybrid, given the informal nature of institutions giving voice to employees

The Future?

- Uncertainty about best “model”
  - IT revolution, but also need to integrate IT into hybrid products
  - Need to foster comparative institutional advantages, not chase a moving target by imitating other models
- Risks and Social Costs of US/Shareholder/Market Model
  - Market-based governance may also lead to accountability gap, since institutional investors may not monitor sufficiently
  - Managerialism under the guise of a shareholder revolution
  - Shrinking core of stable employment and social closure of the large corporation, rising inequality
  - Corporations less accountable to notion of the public interest
- Political Question: how to establish a “level playing field” for labor?