Corporate Governance and Globalization

by

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Biographical Note

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Abstract

Corporate governance is concerned with the institutions that influence how business corporations allocate resources and returns. There is growing interest in pressures on national systems of corporate governance to converge that are allegedly being generated by the process of globalisation, especially the global integration of financial markets. Advocates of the merits of globalisation contend that the trend will lead to a more efficient allocation of capital. Drawing on the examples of the US, Germany, and France, I argue that considerable change has indeed occurred in national governance systems. These changes cannot be understood, however, as the outcome of a market-driven, efficiency enhancing process that is autonomous of political interests. Rather realignments in corporate governance reflect the growing economic and political power of those who have accumulated financial assets, a trend that is closely related to the extent of population ageing and the social arrangements for pension provision in domestic economies as I show in the cases of the US and Germany. Domestic developments in certain national systems of corporate governance, most notably in the US and Britain, have generated international pressures for change in other corporate governance systems. As I illustrate with the case of France, an analysis of the structure of interests in the domestic corporate economy is also an important prerequisite for understanding the effects of these international pressures.

Keywords

Corporate governance; globalisation; shareholder value; institutional investors; pension.

1. Introduction

The question of how corporations should be governed to enhance corporate and economic performance has been widely discussed in the last two decades in the United States and Britain. Until recently, the subject of corporate governance has attracted much less attention on the European Continent, in Asia, and in other parts of the world. By the late 1990s, however, corporate governance had become a major, and highly contentious, issue in all of the advanced economies and, increasingly, in developing countries as well.

International organisations have devoted increasing attention to corporate governance as a topic of global concern. In May 1999, for example, the OECD published its "Principles of Corporate Governance" which it noted "are the first inter-governmental attempt to develop a set of international standards for corporate governance (OECD, 1999)." In June 1999 the OECD and the World Bank signed a memorandum of understanding that created a Global Corporate Governance Forum for the discussion and coordination of global standards of corporate governance. Other multilateral agencies, including the International Monetary Fund (IMF), the Asian Development Bank, and the Asia-Pacific Economic Cooperation organisation, as well as American and British institutional investors, are actively pursuing agendas to bring about reform of corporate governance systems around the world.

Corporate governance is concerned with the institutions that influence how business corporations allocate resources and returns. Specifically, *a system of corporate governance shapes who makes investment decisions in corporations, what types of investments they make, and how returns from investments are distributed* (O'Sullivan, 2000). Contemporary debates about corporate governance largely stem from the recognition of the centrality of corporate enterprises for allocating resources in the economy. In most economies, corporate enterprises play a critical role in shaping economic outcomes through the decisions that they make about investments, employment, trade, and income distribution. That is, the process through which corporate revenues are allocated can have profound effects on the performance of the economy as a whole.

Much of the contemporary debate on corporate governance has focussed on the merits of different national systems for generating favourable outcomes for corporations themselves and the regional and national economies in which they are based. In the 1980s, for example, there was considerable interest in the apparent strengths of the German and Japanese systems of corporate governance, as compared with their US counterpart, for generating economic performance and social cohesion. However, in the 1990s, and especially in the mid- to late-1990s, proponents of the alleged virtues of the US model of corporate governance have largely drowned out other voices.

Lately, in discussions of corporate governance, increased attention has been focussed on pressures on national systems of corporate governance to converge that are allegedly being generated by the process of globalisation, commonly understood as the development of commodity markets to permit the free flow of economic resources from one use to another across national economic borders. In discussions of corporate governance and globalisation, particular attention has been paid to the effects on national systems of corporate governance of the global integration of financial markets.

Advocates of the merits of globalisation contend that the freeing up of capital flows will lead to the more efficient allocation of capital by improving savers' access to investment opportunities and companies' access to financing. If nations are to take advantage of these opportunities, however, they must observe, as the OECD put it, "basic principles of good corporate governance (OECD, 1999, p. 3)." As to what constitutes "good" corporate governance there is little dispute among "globalists": the Anglo-American model of corporate governance that generates pressures on corporate enterprises to "maximise shareholder value" as their primary objective.[1]

That globalisation is and should occur in the realm of corporate governance is one element of a more general argument that holds that the convergence of national economic systems towards a market-oriented ideal is both inevitable and desirable. That perspective is, in turn, based on a theory of the market economy, neoclassical theory, in which the perfection of capital, labour, and product markets is supposed to lead to optimal economic outcomes. For superior economic performance, nothing should inhibit the free flow of economic resources from one use another, and any impediment to that flow is deemed a market imperfection. From this point of view, to the extent that economies will converge towards the American and British economic systems that is true only because these systems are closer than those of most other countries to the market ideal.

There have been important intellectual challenges to the globalisation thesis. A number of international political economy (IPE) scholars argue that the process of integrating markets, especially financial markets, throughout the world cannot be understood as a "purely" economic project because both its origins and outcomes have been highly politicised Cerny, 1993; Chesnais, 1996; Gowan, 1999; Helleiner, 199x; Strange, 1986; 1998a). These scholars emphasise, in particular, the importance of the decision by the US government to withdraw from the Bretton Woods system, and other policy changes that facilitated international capital flows, as well as domestic policy decisions, especially in the US and Britain, that led to the "deregulation" of their financial systems. There are important differences among these scholars in the degree to which they accept that particular states are hegemonic in the process of global financial integration. Some argue that the US dominates global financial markets to a degree that merits its characterisation as an imperialist power in the 1990s; as Peter Gowan put it in his recent book on The Global Gamble: Washington's Faustian Bid for World Dominance, "[t]alk of a *global* financial market, rather than of the increasing influence of the American financial market over other national financial markets, obscures the power dimension of US financial dominance (Gowan, 1999, p. 27)." Other scholars reject the characterisation of the US as hegemon contending that "the transnationalization of finance has developed its own autonomous structural dynamic" and has thus circumscribed the influence of all states including the United States (Cerny, 1993, pp. 3-19). All agree, however, on the political foundations of the process through which national financial markets have become increasingly integrated and, by extension, the pressures that are being brought to bear on national systems of corporate governance to converge.

Another set of critiques emanates from scholars who have contributed to what is known as the "varieties of capitalism" literature. In emphasising the importance of institutional diversity for shaping enterprise behaviour and economic performance, these scholars reject the assumption implicit in the globalisation thesis that there is one best way to organise an economy and, in particular, that the free flow of economic resources through "perfect" capital, labour, and product markets will lead to optimal economic outcomes. The main focus of the varieties of capitalism research has been the analysis of different paths to economic success through the study of historical differences in national and regional institutions and the link between these differences and patterns of economic behaviour and outcomes (Albert, 1991; Dore, 1973; Hall, 1997; Herrigel, 1995; Lazonick, 1990, 1991; Lazonick and O'Sullivan, 1996; Maurice, 1986; Nelson, 1993; Soskice, 1991, 1999; Streeck, 1992, 1995). Recently, some scholars have used the insights that come from these analyses as the basis for grappling directly with the "globalists".

The dominant view that has been expressed by these scholars, although there are disagreements among them, is that to the extent that globalisation affects national governance systems it will do so only through the prism of existing institutional configurations. Since different systems of capitalism will produce different responses to similar pressures, convergence is unlikely to occur. Rather the behaviour and performance of enterprises will continue to differ depending on the institutionalist context in which they are embedded (see, for example, Berger and Dore, 1996; Boyer and Drache, 1996; Hollingsworth, 1998; Whitley, 1998).

Finally a number of empirical challenges to the globalisation thesis have been forthcoming. Some of these are aligned with the varieties of capitalism literature in holding that institutional diversity is a good thing from the perspective of economic performance; others are agnostic or critical of such diversity but nevertheless claim that it persists. These scholars have emphasised persistent variations in, for example, share ownership patterns, takeover activity, and patterns of corporate financing (Shleifer and Vishny, 1997; La Porta, Lopez-de-Silvanes, Shleifer, and Vishny, 1998; Guillén, 1999; Doremus, Keller, Pauly, and

Reich, 1998, pp. 22-58). In his recent paper on “Corporate Governance and Globalization: Arguments and Evidence against Convergence” Mauro Guillén, for example, argues that “[w]hile the conventional wisdom is that corporate governance is (or will be) converging across the world as the result of global pressures, the extant literature has not produced longitudinal evidence documenting such a change (Guillén, 1999, p. 3).” Having himself reviewed the evidence on a number of dimensions of corporate governance systems, Guillen concluded that “[e]xcept for the notable cases of France and to a lesser extent Belgium, the Netherlands and the Scandinavian countries, there are no discernible shifts in stockholding, long-term CEO incentives, hostile takeovers or debt-equity ratios (Guillén, 1999, p. 22).”

In this article I argue that the systems of corporate governance prevalent in the leading industrial economies in the postwar period have evolved substantially in recent years. Moreover, there has been a buildup of tension in these systems that is likely to lead to further change in the foreseeable future. In my empirical discussion, I focus on corporate governance in three countries: the US, Germany, and France. [2]

In Section 2 I compare the evolution of corporate governance in the US and Germany. There are important similarities in the source and impact of recent changes in both countries. Of particular significance has been the postwar accumulation of financial assets by certain groups in the population and the growth of intergenerational dependence. Notwithstanding these common elements, their relative importance, the manner in which they have interacted with the national system of corporate governance, and the responses to these pressures differ considerably across country because of variations in national institutions, especially in financial and pension systems. The analyses of the US and Germany thus underlines the importance of studying the transformation of national politics and economics for understanding the recent evolution of corporate governance in these countries.

To emphasise the importance of domestic developments is not, however, to suggest that we ignore the international sphere in analyses of corporate governance. As I point out in Section 3, national developments have important international repercussions that in turn have further implications for national systems. There is, therefore, a need to complement analyses of evolution within national systems with studies of the interaction between internal realignment of domestic systems of governance and international developments. An analysis of recent developments in the French system of corporate governance is used to highlight the importance and complexity of empirical studies of such interactions.

In Section 4 I argue that, notwithstanding its influence, the globalisation perspective sheds little light the developments in corporate governance discussed in sections 2 and 3. Its deficiencies stem largely from the fact that the theory in which it is rooted has difficulty dealing with the historical reality of the relationship between financial systems and economic development. Particularly problematic, as I shall argue, is the central role assigned to financial markets, especially the stock market, in channelling resources from savers to investors in capitalist economies.

There are also certain problems with contending perspectives for understanding recent developments in corporate governance. In contrast to the globalisation thesis, however, they stem from too narrow an empirical focus rather than fundamental theoretical problems. As a consequence, they are much more easily remediable.

2. The Recent Evolution of National Systems of Corporate Governance

The alignment of the interests of strategic managers of U.S. public corporations with the demands of the stock market is now typically regarded as a defining feature of the market-oriented U.S. system of corporate governance. In historical perspective, however, shareholder influence on the allocation of U.S. corporate resources stands out as a recent phenomenon. For most of this century, salaried managers have exercised control over resource allocation by U.S. corporate enterprises. Shareholders were widely dispersed and had little, if any, direct influence on their actions. In the last quarter of a century the degree to which the US system of corporate governance has changed has been nothing short of dramatic. An analysis of the reasons for the shift in US governance has much to teach us, not only about how change occurs within national systems of corporate governance, but also, given the importance of the

US in the world economy, about the evolution of international pressures for change in corporate governance systems.

The German case is also important not only because, as Europe's largest economy, its development has implications for the rest of the region but also because it is often counterposed to the US case in its internal structure and underlying logic. In Germany in recent decades the institutional foundation of the postwar system of corporate governance have proven to be more enduring than in the United States. None of the elements that characterised that system – extensive intercompany shareholding, close bank-industry relations, and co-determination – have broken down. Nevertheless considerable pressures for change have built up on the system that may well bring about its transformation in the foreseeable future. Of particular importance are the recent changes that have affected perhaps the most distinctive characteristic of German capitalism, the close relations between major German companies and financial enterprises.

2.1 United States

The arguments in support of governing corporations to create shareholder value came into their own in the United States in the 1980s. Until that time the leading corporations in the US tended to retain both the money that they earned and the people that they employed. Retentions in the forms of earnings and capital consumption allowances provided the financial foundations for corporate growth, while the building of managerial organisations to develop and utilise productive resources enabled investments in plant, equipment, and personnel to succeed (O'Sullivan, 2000, ch.s 3 and 4).

Since around 1980, however, most major US corporations have been engaged in a process of restructuring their labour forces in ways that have eroded the quantity of jobs that offer stable employment and good pay in the US economy.[3] Hundreds of thousands of previously stable and well-paid blue-collar jobs that were lost in the recession of 1980-1982 were never subsequently restored. Between 1979 and 1983, the number of people employed in the economy as a whole increased by 377,000 or 0.4 percent while employment in durable goods manufacturing – which supplied most of the well-paid and stable blue-collar jobs – declined by 2,023,000, or 15.9 percent (U.S. Congress, 1992, p. 344). The “boom” years of the mid-1980s saw hundreds of major plant closings. Between 1983 and 1987, 4.6 million workers lost their jobs, of which 40 percent were from the manufacturing sector (Herz, 1990, p. 23; more generally, see Staudohar and Brown, 1987; Patch, 1995). The elimination of these well-paid and stable blue-collar jobs is reflected in the decline of the proportion of the manufacturing labour force that is unionised from 47.4 percent in 1970 to 27.8 percent in 1983 to 18.2 percent in 1994 (U.S. Dept. of Commerce, 1975, p. 375; 1995, p. 444; U.S. Bureau of the Census, 1976, p. 137).

Not only blue-collar workers were affected by the mounting predilection of US corporate managers toward downsizing during the 1980s and 1990s. The “white-collar” recession of the early 1990s saw the elimination of the positions of tens of thousands of professional, administrative, and technical employees – salaried white-collar workers who were considered to be members of "management". Even in this recession, however, it was blue-collar workers who bore the brunt of displacement.

Overall, the incidence of job loss in the first half of the 1990s was even higher than in the 1980s; during the first half of the 1990s, rates of job loss increased to about 14 percent, higher than even the quite substantial rates of about 10 percent in the 1980s. The rate of job loss for 1981-83, a period with a slack labour market, was about 13 percent. As the labour market tightened during the mid-1980s, the job loss rate fell. As the economy went into recession from 1989, the job loss rate increased again to a level similar to the recession of the early 1980s, notwithstanding the fact that the recession of the late 1980s was much milder. Moreover, even as the economy moved into a recovery from 1991, the job loss rate rose to ever higher levels, a trend that continued through 1995, despite an acceleration of economic expansion (Farber, 1997). Indeed, in the boom year of 1998 the number of announced staff cuts by major US corporations was greater than for any other year in the 1990s (Challenger, Gray and Christmas).

While US corporate managers became focused on downsizing their labour forces in the 1980s and 1990s, they also became focused on distributing corporate revenues in ways that supported the price of their companies' stocks. During the 1950s, 1960s, and 1970s, payout ratios – the ratio of dividends to after-tax adjusted corporate profits – varied from a low of 37.2 percent in 1966 (when increases in dividends lagged increased profits) to a high of 53 percent in 1974 (when profits fell by 19 percent while dividends went up by 8 percent). But averaged over any five-year period during these three decades, the payout ratio stayed remarkably stable, never going above 45.9 percent (1970-1974) and never falling below 38.8 percent (1975-1979). The stability is even greater over ten-year periods – 47.9 percent for the 1950s, 42.4 percent for the 1960s and 42.3 percent for the 1970s. These payout ratios were high by international standards, manifesting the extent to which US corporations returned value to stockholders even before the rise of the institutional investor.

Compared with the 1960s and 1970s, an upward shift in corporate payout ratios occurred in the 1980s and 1990s. In 1980, when profits went down by 17 percent (the largest profits decline since the 1930s), dividends rose by 13 percent, and the payout ratio shot up 15 points to 57 percent. Thereafter, from 1980 through 1997, the payout ratio only descended below 45 percent twice, in 1984 and 1985, and even then not because dividends fell but because the increase in dividends did not keep up with the increase in profits. There was no five-year period within the period 1980 to 1997 during which the payout ratio did not average at least 47 percent, and over the 18 years it averaged 50 percent (O'Sullivan, 2000, Table 6.4; U.S. Congress, 1998, p. 43).

Since the mid-1980s, moreover, increases in corporate dividends have not been the only way in which corporations have distributed earnings to stockholders. Prior to the 1980s, during a stock-market boom, companies would often sell shares on the market at inflated prices to pay off debt or to bolster the corporate treasury. In general, although equity issues have never been an important source of funds for investment in the development and utilisation of the productive capabilities of US corporate enterprises, they tended to issue more equities than they repurchased. But during the 1980s, the net equity issues for US corporations became negative in many years, largely as a result of stock repurchases.

In 1985, when total corporate dividends were $84 billion, stock repurchases were $20 billion, boosting the effective payout ratio from under 40 percent, based on dividends only, to 50 percent with the addition of stock repurchases. In the quarter following the stock market crash of 1987, there were 777 announcements by US corporations of new or increased buybacks ("The Buyback Monster," Forbes, November 17, 1997). In 1989, when dividends had risen to $134.4 billion, stock repurchases had increased to over $60 billion, increasing the effective payout ratio to over 81 percent. With close to $70 billion in stock repurchases in 1994, the effective payout ratio was about 66 percent. In 1996, stock repurchases were $116 billion, for an effective payout ratio of 72 percent ("The Hidden Meaning of Stock Buybacks," Fortune, September 1997). Although for any one year the announced buyback plans tend to be lower than actual repurchases, the continuing high levels of announced buyback plans since 1996 suggest that US corporate enterprises continue to favour buybacks as a respectable use for their cash; US corporations announced plans to buy back $177 billion of stock in 1996, $181 billion in 1997, and $207 billion in 1998 (Securities Data Corporation).

Of central importance in encouraging these shifts in US corporate governance was a transformation of the structure of financial institutions and their interaction with the real sector of the U.S. economy that began in the late 1960s and early 1970s. Whilst the causes of this structural transformation are complex and various, the growing financial wealth of U.S. households, as well as changes in the way that they allocated that wealth among different financial instruments, are critical elements of the story. An analysis of household financial assets reveals a dramatic shift in their allocation in recent decades; in particular, pension and mutual funds have registered major increases in their share of household financial assets at the expense of intermediaries such as banks and thrifts. The trend towards a growing reliance of households on pension and mutual funds has increased at an accelerating pace; from 1982 to

1994 pension and mutual funds alone accounted for approximately 67 per cent of the net growth of households total financial assets (Edwards, 1996, pp. 16-27).

Reflecting their growing importance in managing the savings of US households, pension and mutual funds' shares of corporate equities have increased dramatically. As Table 1 shows, pension funds held 24 per cent of U.S. corporate stock in 1997, with private pensions accounting for 13.8 per cent and public pensions for 10.2 per cent, compared with 0.3 per cent in 1945. Over the same period, mutual funds increased their share of U.S. corporate stock from 1.5 per cent to 16.2 per cent. In contrast to the growing importance of institutional investors, the share of corporate stocks held directly by individuals has fallen from 93 per cent in 1945 to 42.7 per cent in 1997. Institutional share ownership is even higher in the largest U.S. corporations than in the population of corporate enterprises as a whole; in 1987, the institutional share of the equity of the top 1,000 U.S. corporations was 46.6 per cent and, by 1995, it had increased to 57.2 per cent (Brancato, 1997, p. 21).

INSERT Table 1 US Corporate Stock held by Households and Institutions, 1952-1996

The importance of institutional investments, especially pension funds and mutual funds,[3] as a repository of financial wealth in the US is related to the process of population ageing underway in that country. That the phenomenon has had such a dramatic effect on financial institutions reflects not so much the demographic trend, however, as the particular form that social provisions for retirement have taken in that country. One important factor is the smaller significance of the government pay-as-you-go pension scheme as a source of pension income in the US relative to a country like Germany; social security accounts for about 40 per cent of the retirement income of US pensioners compared with nearly 70 per cent for German pensioners (Turner and Watanabe, 1995, p. 136). In the decades after World War 2 an extensive system of private pensions was developed to fill the breach at least for the more fortunate Americans.

By 1960, private pensions covered 41 per cent of the US workforce compared with 19 per cent in 1945. By 1979, coverage had risen to 45 per cent of the private sector workforce and half of those covered were union members. By then 83 per cent of union members participated in a pension plan compared with 39 per cent for nonunion workers (OECD, 1993, p. 10; Sass, 1997, p. 179, 139; Freeman, 1985). These figures suggest the vital role that the union movement played in extending coverage of employer pension plans after World War 2. Unions promoted that extension, not only through the direct effect of their negotiations on unionised employers, but also because they raised the benefit hurdle for nonunion workers. As a result, as Sass observes: "Using its right to bargain collectively, labor had created a private social welfare system comparable in coverage to that of corporate employers. Without union pressure, postwar business might never have provided production workers with significant pension benefits. Social Security alone may have satisfied management's basic need for blue-collar pensioning. The federal program had legitimated 65 as the national retirement age, and it guaranteed that all ex-workers, separated voluntarily or otherwise, would not go penniless. Management had little interest in expensive pension programs to develop career commitments among its production workers (Sass, 1997, p. 140)."

As pension funds grew in scale, they increasingly invested their accumulated funds in corporate securities. During the 1950s and 1960s, there had been legal restrictions on the extent to which pension funds could include corporate equities in their investment portfolios. As investors in stocks and bonds, mutual funds thus had advantages over other institutional investors such as life insurance companies and pension funds in generating higher returns on household savings because they were not subject to the same stringent regulations concerning the types of investments that they could make. Moreover, even without the mutual funds as competitors, the inflationary conditions of the 1970s meant that, under current regulations, pension funds and insurance companies could no longer offer households positive real rates of return. The regulatory response was ERISA -- the Employee Retirement Income Security Act (1974) -- that, when amended in 1978, permitted pension funds and insurance companies to invest substantial proportions of their portfolios in corporate equities and other risky securities such as "junk bonds" and venture funds rather than just in high-grade corporate and government securities as had previously been the case.

The stage was now set for institutional investors to become central participants in the hostile takeover movement of the 1980s. An important instrument of the takeover movement was the junk bond -- corporate or government bonds that the bond-rating agencies considered to be below "investment grade". Financial deregulation brought, first, pension funds and insurance companies and, then, savings and loans institutions (S&Ls) into the junk bond market as well. With the liquidity that these investors provided, it became possible to use junk bonds to launch hostile takeovers of even the largest corporations. The result was the emergence of a powerful market for corporate control.

When many S&Ls went bust and when junk-bond markets were thrown into disarray by insider trading scandals and the jailing of Milken, the market maker, institutional investors increasingly turned to corporate equities as a source of higher returns on their portfolios. In 1985, 41.2 per cent of the assets of defined benefit pension portfolios and 38.1 per cent of those of defined contribution portfolios were invested in equities; by the first quarter of 1998 those shares had increased to 53.7 per cent and 47.6 per cent respectively (Quarterly Pension Report, EBRI, September 1998). Institutional investors found other levers than the market for corporate control to influence corporate resource allocation. In particular, from the mid-1980s a number of major institutional investors, led by the California State Public Employees Retirement System (CalPERS), a defined-benefit pension fund for California's public employees, began to take a more aggressive stance vis-à-vis incumbent corporate managers in the proxy process.

An attempted takeover of Texaco by the Bass brothers in 1984, and the company's subsequent buyout of the raiders at a substantial premium to the market price, prompted Unruh to action. California's state pension funds held substantial holdings of Texaco stock and Unruh was distressed that they had no say in Texaco management's decision to compensate one class of shareholders differently from another (Monks and Minow, 1991, pp. 212-213). To remedy what he considered an untenable situation, Unruh promoted a new style of activism by CalPERS and founded the Council of Institutional Investors (CII) to encourage other institutional investors to adopt an activist stance. Most of Unruh's co-founding members of the CII had responsibility for public pension funds and it was these funds, rather than the private pension funds or mutual funds, who were most prominent in the trend towards institutional investor activism.

The early efforts of the CII focussed on knocking down barriers to the market for corporate control through the sponsorship of shareholder resolutions to reduce poison pills, greenmail, golden parachutes, and the application of pressure on corporations to opt out of states' anti-takeover statutes. They were quite successful in their efforts; shareholder support for poison pill rescission proposals, for example, increased from 29.5 per cent in 1987 to nearly 48 per cent in 1989 before dropping off somewhat in the early 1990s. Notwithstanding their success, CalPERS and other institutional investor activists recognised that, by focussing narrowly on anti-takeover provisions, they left corporate managers considerable latitude to fight back. In the late 1980s, therefore, the focus of institutional investor activism widened from anti-takeover devices in particular, to the structure of the shareholder-management relationship in general. CalPERS began publishing, on an annual basis, a list of companies that it would target in its campaigns for "corporate governance" reform. In the early 1990s, CalPERS played a central role in the unprecedented removal of the CEOs of some of these target companies including GM, IBM, Westinghouse, and American Express.

What the above account emphasises is that to the extent that institutional investors have significance in the US system of corporate governance today, it is because they have ridden a wave of structural change in the U.S. economy that has created a large and growing minority of Americans, who, with longer life spans, earlier retirements, and accumulated financial assets, find it in their interests to favour arguments for high returns on corporate equities. In 1995, 40.3 per cent of US households had direct or indirect stock holdings compared with 31.6 per cent as recently as 1989. These holdings accounted for, on average, 41.5 per cent of the financial assets of all U.S. households in 1995, up from 28.6 per cent in 1989 (US Department of Commerce, 1998, p. 532). Moreover, during this period, financial assets were themselves becoming increasingly important as a basis for household wealth, having risen from 27.9 per cent of total household assets in 1989 to 34.1 per cent in 1995 (Kennickell, Starr-McCluer, and Sundén, 1997, p. 12, p. 6).

Notwithstanding the increased reliance on the stock market by US households, the U.S. is a far cry from the picture of a shareholder democracy that some pundits have tried to paint. In 1992 the 0.5 per cent of stock owners with the largest equity portfolios, including both direct and indirect holdings, owned 36.8 per cent of all equity; the top 10 per cent owned 89.4 per cent and the bottom 80 per cent, a paltry 1.8 per cent. Since more than one-third of the gains or losses on corporate stock accrued to the roughly half a million households with the largest equity holdings, and almost 90 per cent of the gains to the richest 10 per cent of households (Poterba and Samwick, 1995, p. 328). If the distribution of equity holdings is highly unequal it is nevertheless true that for many US households, including poorer ones, holdings of stock have become more important as a share of their financial assets.

From the perspective of corporate control, the most important general repercussion of the increased reliance of US households on the stock market to augment their incomes and savings, has been the greatly increased pressure for higher returns on corporate securities that it has engendered. Unlike the days when stockholding in any one company was fragmented among hundreds of thousands of household investors, the collective power of institutional investing now gives wealthholding households greater opportunities to reap high returns. With their ever-increasing holdings of corporate stocks, institutional investors can now put pressure on U.S. corporations to "create shareholder value". In the 1980s and 1990s, so successful have they been in their use of carrots and sticks to further the interests of their constituency, that the "maximisation of shareholder value" has become a veritable mantra on Main Street as well as on Wall Street.

Yet it is important to recognise that, notwithstanding these changes, institutional investors are a long way from controlling corporate resource allocation even in the US. Why? Firstly, the ambitions of most activist institutional investors for transforming the US system of corporate governance are far from radical. Activist institutional investors in the US have tended to take a narrow view of the essence of good corporate governance. CalPERS, for example, focuses primarily on the board of directors and its relationship with corporate management. Moreover, for all the attention that the likes of CalPERs have garnered, they are in a minority when it comes to actively voting the shares that they hold and "jawboning" management and boards of directors about reforming their corporate governance practices. As Table 2 suggests, many institutional investors have focussed their energies on churning their portfolios of shares and thus seem unlikely to have strong incentives to make the commitment required to push for changes in corporate resource allocation. With the growing popularity of indexation as a portfolio strategy for institutional investors, moreover, these incentives would seem likely to be reduced rather than enhanced. Finally, the powerful opposition of corporate management also acts as a constraint on investor activism in the US.

INSERT Table 2 Average Stock Turnover Rates by Type of Institutional Investor

In contrast to the UK, where shareholders tend to be favoured over managers, the system of corporate law that evolved in the US was deeply influenced by the historical reality of the pervasive separation of ownership and control in that country's corporate economy. Contemporary corporate managers have continued to be quite successful at using the protection that the legal system accords them to avoid shareholder interference in their decision making processes. Of particular importance are the rules that determine what subjects can be addressed in a proxy proposal.

Shareholders generally submit proxy proposals under SEC Rule 14a-8. If his proposal is accepted, the shareholder has the right to have it included, together with a 500-word supporting statement, in the proxy statement distributed by the corporation to its shareholders in advance of the annual shareholder meeting. The corporation can exclude a shareholder's proposal from its proxy statements if it violates certain procedural and substantive requirements of the SEC. The most important basis for the exclusion of proposals from a corporation's proxy materials is Commission rule 14a-8(c)(7). The rule permits omission of a proposal that "deals with a matter relating to the conduct of the ordinary business operations of the registrant." The "ordinary business rule" was adopted by the SEC in the early 1950s "to confine the solution of ordinary business problems to the board of directors and place such problems beyond the competence and direction of the shareholders" as the then SEC Chairman explained. He considered that "it is manifestly impracticable in most cases for stockholders to decide management problems at corporate meetings." (Statement of J. Sinclair Armstrong to the Subcommittee on Banking and Currency, 1957, quoted in Whitman, 1997). The ordinary business of a corporation is therefore considered to be the domain of corporate executives rather than shareholders.

Perhaps nowhere is the gap between the rhetoric and reality of shareholder capitalism in the United States today seen as clearly as in the attempts by unions to enter the corporate governance arena in the US. One of the great ironies of the private pension system in the US is that despite the critical role that unions played in encouraging its development unions' control over the allocation of pension monies has been relatively limited. Recently some union leaders have sought to take advantage of the fact that their members represent an important proportion of the ultimate beneficiaries of much of the institutional money in the US capital markets. They hope to leverage what they describe as "labor's capital" or "working capital" to better promote the interests of their constituency. In fact, in the 1990s, unions have become the most important force in institutional investor activism in the US.

The ordinary business provision is, however, an important barrier to unions' attempts to use "labour's capital" as a weapon to force corporate management to discuss issues that pertain to the welfare of US workers. Just how powerful is the ordinary business rule in excluding virtually all of these concerns is evident from the SEC's recent recapitulation of the policy underlying the standards to be applied in making determinations about substantive eligibility under the ordinary business rule:

> The policy underlying the ordinary business exclusion rests on two central considerations. The first relates to the subject matter of the proposal. Certain tasks are

so fundamental to management's ability to run a company on a day-to-day basis that they could not, as a practical matter, be subject to direct shareholder oversight. Examples include the management of the workforce, such as the hiring, promotion, and termination of employees, decisions on production quality and quantity, and the retention of suppliers. However, proposals relating to such matters but focussing on sufficiently significant social policy issues (e.g. significant discrimination matters) generally would not be considered to be excludable, because the proposals would transcend the day-to-day business matters and raise policy issues so significant that it would be appropriate for a shareholder vote.

The second consideration relates to the degree to which the proposal seeks to "micro-manage" the company by probing too deeply into matters of a complex nature upon which shareholders, as a group, would not be in a position to make an informed judgment. This consideration may come into play in a number of circumstances, such as where the proposal involves intricate detail, or seeks to impose specific time-frames or methods for implementing complex policies (SEC, Amendments to Rules on Shareholder Proposals, 17 C.F.R. Part 240, Release No. 34-40018).

The SEC "clarification" amounts to a re-statement of the fact that, notwithstanding the recent resurgence of the ideology of shareholder democracy in the US, the US corporate governance system still enshrines the view that managers have a "right to manage". Without any access to information on "ordinary business", other than to the limited degree to which it is provided in the annual reports and 10-Ks of corporations, institutional investors, whatever their interests, can have little serious influence over the way in which corporations allocate resources.

Senior managers still retain considerable power in the US corporate economy. What has profoundly changed in recent years, however, are their incentives. The growing pressure for financial liquidity in the US economy has provided them with the opportunity to enrich themselves under the mantra of creating value for shareholders. So successful have senior corporate executives been in this endeavour that, to a greater extent than has ever been the case since the rise of the corporate economy, they have separated their fate from that of the rest of the working population. They have achieved real rates of growth in their compensation that leave the rest of the US labour force in the shade. On average, the pay packages of CEOs of large US public corporations increased from 44 times the average factory worker's wages in 1965, already a substantial multiple, to 419 times in 1998 (Business Week, April 19, 1999). It is with the active cooperation of top corporate managers, therefore, that shareholder value had by the 1990s become a firmly entrenched principle of US corporate governance.

This article focuses primarily on financial pressures on systems of corporate governance but it is important to highlight the fact that what made a major shift in the incentives of American corporate managers possible was not just the growing pressures of financial markets in the 1980s and 1990s but also the fact that they were felt at the same time that US corporations faced unprecedented productive challenges. In the 1960s and 1970s, the principle of retain and reinvest common to US corporations at the time began running into problems for two reasons, one having to do with the growth of the corporation and the other having to do with the rise of new competitors. Through internal growth and mergers and acquisitions, corporations grew too big with too many divisions in too many different types of businesses. The central offices of these corporations were too far from the actual processes that developed and utilised productive resources to make informed investment decisions about how corporate resources and returns should be allocated to enable strategies based on retain and reinvest to succeed. The massive expansion of corporations that had occurred during the 1960s resulted in poor performance in the 1970s, an outcome that was exacerbated by an unstable macroeconomic environment and by the rise of new international competition, especially from Japan (Lazonick and O'Sullivan 1997c; O'Sullivan, 2000, ch. 4).

The overextension of US corporate enterprises helped to foster the strategic segmentation of top managers from their organisations. At the same time, the innovative capabilities of international competitors made it harder to sustain the employment of corporate labour forces, unless the productive capabilities of many if not most of these employees could be radically transformed. Under these conditions, US corporate managers faced a strategic crossroads: they could find new ways to generate productivity gains on the basis of retain and reinvest, or they could capitulate to the new competitive environment through corporate downsizing. Over a period of almost two decades, company after company succumbed to the latter option as more and more top managers were swept up in the trend to align their own interests with external financial interests rather than with the interests of the productive organisations over which they exercised control. As they shifted their interests, corporate managers invoked the serious productive challenges that US corporations faced to legitimate their claims that the old system of retain and reinvest could not be sustained.

Shareholder value advocates gave legitimacy to corporate executives efforts' to turn their success as organisation men into substantial holdings of corporate stock. However, these executives have retained enough control over corporate decision making to structure the so-called "pay-for-performance" relationship on their own terms. For all the pious talk of the importance of bearing risk commensurate with returns, most stock options awarded to executives have constant exercise prices. If the stock price rises significantly above that exercise price, the executives are rewarded even though the rising price may have nothing to do with CEO actions and may simply reflect a strong bull market (as has been the case in recent years) and/ or a sectoral boom. As <u>Fortune</u> magazine put it in a recent article on "pork in executive compensation": "that old cliché about 'bull market genius" explains a lot of what is going on – Wall Streeters who are being in the right place at the right time, corporate executives who are pocketing above-average salaries while their companies underperform their peers (<u>Fortune</u>, September 7, 1998, p. 63)." There have been calls for relative performance evaluation for executives to ensure that they are compensated only for the stock market performance of companies that they manage. For example, it has been suggested that the exercise price be tied to indexes such as the S&P 500 and/ or to a price index for similar companies. Yet, it is generally academics who get most exercised about these "subtleties". Institutional investors, with a few notable exceptions like the State of Wisconsin Investment Board, have expressed only muted interest in whether or not there is any economic justification for CEO pay packages. While the party continues for them, it seems that they have little interest in crossing swords with the other revellers.

2.2 Germany

As recently as the late 1980s confidence in the ability of the "Rhenish system of capitalism" to deliver economic performance without sacrificing social cohesion was running at an all-time high. From the early 1990s, however, as Germany wrestled with the challenges and costs of reunification, and then plunged into its worst recession since World War II, talk of the strengths of German capitalism was replaced by anxious discussion of the viability of *Industriestandort Deutschland* (Germany as an industrial location). Employers warned that German companies would be forced to relocate production abroad if drastic reforms of corporate structures, and, indeed, the foundations of the social market economy, were not undertaken to ensure closer attention to the bottom line. Senior German managers seemed to be increasingly influenced by what was happening overseas, especially in the US corporate economy. Indeed, companies such as Daimler-Benz and Deutsche Bank, formerly seen as synonymous with the distinctive German postwar system of managerial capitalism, have emerged at the forefront of a shareholder value movement in Germany in the mid- to late-1990s.

Yet there were also many signs of business as usual in the German corporate sector. Within German companies, even those that are most strident in proclaiming their conversion to shareholder value, corporate resource allocation processes are only beginning to be overhauled to accord with its logic. Among serious proponents of shareholder value, moreover, there is a certain scepticism that German managers know what they mean and mean what they say, when they speak of the merits of shareholder value for enhancing corporate performance. Nor has the recent rhetoric of German managers gone unchallenged at home. Prominent labour representatives have publicly expressed their disquiet with talk of shareholder value and the ideology of casino capitalism of which, they allege, it is a harbinger.

For all of these reasons, many students of the German corporate economy, are sanguine about the possibility of the managerial rhetoric of shareholder value taking hold in Germany. And it is certainly true that the institutional foundations of the postwar system of corporate governance in Germany have until recently proven to be more enduring than in the US. Nevertheless various pressures have built up on the German system of corporate governance that raise questions about its sustainability in its current form. Many of these pressures are the result of structural changes in the German financial sector that are creating systematic pressures in Germany for higher returns on financial assets. As in the US these changes are rooted in the rising level of savings generated by the country's postwar economic success and an evolution in the way these savings are allocated. They have, however, assumed a substantially different institutional form in Germany than in the US.

The Federal government controlled interest rates after the war, thus limiting interest-rate competition in Germany not only among different sectors of the banking industry, but also from savings instruments provided by other financial enterprises. The objective of this restriction was to stabilize the banking system and thus protect depositors; its effect was seen in the channelling of the vast majority of German savings through the banks; although the formation of monetary assets was limited during the 1950s, about 75 per cent of these assets were channelled into the banking sector (Francke and Hudson, 1984, p. 76).

As their incomes expanded, Germans were able to save more, and the success of public campaigns and state subsidies to promote saving led to the emergence of higher aggregate saving rates in Germany than in the US by the 1960s. Automatic wage deposits for workers helped mass consumer banking to become the major source of expansion in the banking business in the 1960s. Once restrictions on branch banking were removed in 1958, competition in the banking sector occurred primarily through the expansion of branch networks (Francke and Hudson, 1984; Deeg, 1991). In 1970, as Table 3 shows, claims against banks accounted for more than half of the financial assets of German households, and over three-quarters of these bank deposits were in savings accounts. In the 1950s and 1960s competition for the rapidly growing funds of German savers took place primarily among the savings banks, the private banks and the cooperative banks. In 1970 the savings banks dominated the market with 58.8 per cent of total savings deposits; the credit cooperatives followed with 18.2 per cent and then came the private banks with 17.3 per cent (Oberbeck and Baethge, 1989, p. 285).

INSERT Table 3 Structure of Financial Assets of Private Households

During the 1970s, investors began to move out of bank deposits and into higher-yielding savings instruments. As Table 3 shows, the proportion of financial assets held as bank deposits fell from 52.4 per cent to 40.7 per cent between 1970 and 1992. There was a further decline in the mid-1990s to 35.4 per cent by the end of 1998. Insurance investments increased from 13.3 per cent of private financial assets in 1970 to 18.5 per cent in 1992 with a further increase to 21.7 per cent by 1998. Especially in the 1990s, stocks and mutual funds showed substantial growth; by the end of 1998 they accounted for 10.7 per cent and 9.7 per cent respectively of household financial assets.

The changes in the structure of German household financial assets are considerable in historical perspective. Competing for savings has provided German financial enterprises with strong incentives to pursue higher yields on financial assets in the German economy. Germany has one of the most extensive banking networks in the world and all three sectors of the banking industry -- the savings banks, the cooperative banks, and the private banks (incl. the big banks) -- have been active participants in "the battle over the piggy bank" that has been underway in Germany in recent decades (Oberbeck and Baethge, 1989, p. 287). Arguably, it is the large private banks -- Deutsche Bank, Dresdner and Commerzbank -- the alleged "patient capitalists" of the German economy – that have particularly strong incentives to push for higher returns on financial assets. They have less to lose than the savings and cooperative banks (with a combined total of 80 percent of savings deposits) through the disintermediation that has already resulted and will continue to result from the widespread introduction of market-based savings instruments (Deutsche Bundesbank, 1991). Moreover, with their access to high-income Germans through their retail networks, and their experience in securities markets at home and abroad, they are well positioned to exploit the profit potential of this business. Reflecting these incentives they have been particularly active in the introduction of these new savings instruments and in attempting to promote an "equity culture" in Germany. The major insurance companies, like Allianz and Munich Re, have also become formidable competitors for the savings of German people. They have been eyeing the business opportunities in asset management that are growing as competition for yields heats up in Germany.

The incentives of these financial enterprises to stimulate demands for higher financial returns in Germany have been reinforced by similar trends towards heightened competition in all segments of their business. A major overhaul of the regulatory framework of the German financial markets that has been underway since the mid-1980s has facilitated and fostered greater competition (Deeg, 1996; Story, 1997). Margins have thus become very tight in all sectors of German banking and financial enterprises have been looking to new business opportunities to compensate. Asset management is one such opportunity. For the major German banks, investment banking is another.

In the late 1980s and early 1990s, the Big Banks, especially Deutsche Bank and Dresdner Bank, seemed confident that they could compensate for slimmer margins in their domestic business by turning themselves into global investment banks. They have encountered serious setbacks in the pursuit of that strategy but they are heavily committed to it. As a result of their expansion in investment banking the big banks have reduced their dependence on interest income compared with other sectors of the banking industry in Germany; 63.9 per cent of the total operating surplus of the big banks came from interest in 1998 compared with 79 per cent for cooperative banks and 81.9 per cent for savings banks. However, the growth of commission businesses has not stopped the deterioration of their operating results; the operating profit of the big banks declined from 0.69 per cent of their average volume of business in 1996 to 0.47 per cent in 1998 (Deutsche Bundesbank, July 1999). The level of competition in German finance is likely to increase still further as the big banks and other German financial enterprises struggle with each other and with foreign competitors to regain business and profits in the German market. If the European Commission succeeds in its attempts to sever the ties between the savings and cooperative banks and the public sector, competition will become even more intense ("Monti to challenge Berlin," Financial Times, October 22, 1999).

Given the business conditions that the big banks face, to assume that they can be characterised as "patient capitalists" seems particularly misguided in the 1990s. Indeed, it has arguably long been a misnomer. The big banks have never been shy about advancing their profit interests and have done well from their postwar acquiescence in a system that provided German enterprise with financial commitment largely because of restrictions on competition, both among savings instruments and in the securities markets (O'Sullivan, 2000, ch.s 7 and 8). As Germans have grown wealthier and competition for their savings has intensified, however, the banks increasingly see their interests as being better achieved by promoting financial liquidity rather than financial commitment.

One important symptom of change, with direct implications for the German system of corporate governance is the evolution of German financial enterprises' attitudes towards their industrial holdings. The big banks have been quietly reducing these shareholdings for some time; the number of companies in which banks held at least ten per cent of the shares (directly or indirectly) fell from 129 in 1976 to 86 in 1986 and the number on which they controlled a blocking minority of more than 25 percent fell from 86 to 45 (Deeg, 1991, p. 201). In the 1990s, the reduction of big banks' industrial holdings has gained apace. The major commercial banks, especially Deutsche Bank, have made no secret of the fact that they would like to receive higher returns from these holdings either by managing them more actively or by selling them. Until recently, the German tax system has put a brake on the latter option; a major capital gains tax liability would accrue on most of these holdings because they have been held by the banks for so long. As the banks have come under increasing financial pressures in their own businesses, however, that barrier has no longer proven prohibitive.

In 1997 Deutsche Bank reduced to zero its stakes in a number of important German companies including AMB, Bayersiche Vereinsbank, and Karstadt, and substantially reduced its stakes in other leading companies like Continental and Metallgesellschaft. Apparently, the premia paid for these shares was sufficiently high to compensate Deutsche Bank for the tax liability incurred on the transaction. In December 1998, the bank issued euro-denominated bonds, exchangeable into Allianz ordinary shares. The hugely successful issue allowed Deutsche Bank to sell off some of its holdings of Allianz shares – its stake in Allianz was reduced from 10 to 8.3 per cent in the process – at a substantial premium and to defer the tax liability until the bonds are exchanged. Later the same month, in what is regarded as a prelude to the pursuit of a more shareholder-value oriented strategy in the management of its share portfolio, Deutsche Bank announced that it would move its remaining stakes in other German companies into a group of newly-formed, tax-efficient, asset management subsidiaries. Other major German financial enterprises have been following Deutsche's lead. In February 1998, for example, Allianz issued an exchangeable bond to monetise approximately half of its stake in Deutsche Bank. Dresdner has announced that it is moving its portfolio of shareholdings into an asset management subsidiary that will be managed at arm's length from the rest of the bank.

The importance of these transactions to the banks and insurance companies is readily seen in the impact they had on profitability. Notwithstanding the desultory operating performance recorded by the big banks in 1998, for example, they managed to reverse a strong downward trend in their net profitability – their after-tax return on capital was 19.24 per cent in 1998 compared with 5.44 per cent in 1997, 7.79 per cent in 1996, 8.17 per cent in 1995, and 8.12 per cent in 1994. They did so by recording a massive amount of extraordinary income, to the tune of more than 3 times their operating result in 1998, as a result of sales of some of their participating interests and the transfer of a large proportion of the others to autonomous partnerships (Deutsche Bundesbank, Monthly Report, July 1999). Given the competitive conditions facing the leading financial enterprises in Germany we can only expect that they will continue to pursue strategies that are considerably different from their historical orientation. It is not beyond the bounds of possibility, therefore, that the banks and insurance companies will unwind most of their shareholdings, at least to the extent that they are unrelated to their core business interests.

One can but speculate about the effect that such a change might have on German corporate governance. German banks, despite all the attention that their industrial shareholdings garner, held only 10.3 per cent of the shares of German companies at the end of 1998 (down from 11.2 per cent at the end of 1996). Yet mutual funds in the US held only 10.2 per cent of US corporate stock in 1996. It is therefore likely that effects on the German corporate economy would be significant if the banks transferred ownership of the shares that they hold or if they managed them in a more aggressive manner. The likely effect of such changes also depends on what happens to the remaining 90 per cent of German shares and in particular on the level of support that a stronger shareholder-value orientation finds among other shareholders. In the past, cross-shareholdings among non-financial enterprises in the German economy have acted as an important buffer against interference from outsiders but the importance of these holdings has declined rapidly in recent years; at the end of 1998 non-financial enterprises held 30.5 per cent of all German shares, down from 37.6 per cent at the end of 1996. The shares released from the cross-shareholding network seem to have been bought up by foreign investors (whose holdings of German shares increased from 11.7 per cent to 15.6 per cent during the same period) and investment funds who increased their ownership of German shares from 9.1 per cent to 12.9 per cent (Deutsche Bundesbank, *Gesamtwirtschaftliche Finanzierungsrechnung*).

The above account underlines the fact that there are clear signs of changes in the incentives and behaviour of at least one group of actors who have the potential to transform a critical element of the postwar German system of corporate governance. And change is not confined to the banks. Major German corporations are singing to the tune of shareholder value to a degree considered unimaginable as recently as the early 1990s, and they display a growing propensity to adopt innovations from executive stock options to stock buybacks that until recently were regarded as anathema in German business circles. The recent success of the *Neuer Markt* has substantially increased the number of listed companies in Germany and it is "widely expected that the going public trend will continue since thousands of mid-size companies suffer from a deteriorating equity position and face a succession crisis from company founder to non-familial management (Deeg, 1996, p. 12)". The appetite of German households for equities has also been increasing in recent years; the proportion of Germans owning shares increased from 5.4 per cent in the early 1990s to 7.6 per cent in 1995 and then again to 8.8 per cent in 1997 (Deutsche Bank Bulletin, January 9, 1995, p. 9; Economist, December 6, 1997). The financial assets of institutional investors have also increased substantially from 36.5 per cent of GDP in 1990 to 57.5 per cent in 1997.

It is important, however, not to overstate the degree to which change has penetrated to the heart of the German system of governance. It is still the case today that most companies in Germany, including some of her most successful enterprises, have nothing at all to do with the stock market. Furthermore, notwithstanding changes in the structure of German savings in recent decades, equity holdings as a percentage of private financial assets remain low in international comparison (Deutsche Bank Bulletin, January 9, 1995, p. 9). The German financial system has generated nothing approaching the vast liquid funds under management by US financial institutions whose assets increased from 123.8 per cent of GDP in 1990 to 202.8 per cent in 1997. The difference in absolute terms is even more striking; in 1997, for example, institutional investors in the United States held financial assets of approximately US$15,868bn compared with US$1,202bn for their German counterparts (OECD, 1998, p. 20).

Pension funds account for a substantial proportion of the difference and if there is one area in which substantial change could induce a systemic shift in corporate governance in Germany it is the pension system. The financial assets of German pension funds were, at 2.9 per cent in 1997, negligible compared with their American counterparts which had comparable holdings of 72.5 per cent of GDP. There has been a significant increase since 1960 in personal provision for pensions in Germany with most of it channelled through insurance companies. If we add the holdings of insurance companies, an important channel for private pension provision in Germany, we get a somewhat different picture (34.8 per cent of GDP in Germany versus 115.6 per cent in the US) but the relatively vast scale of US funds under management by institutional investors for pension purposes is still not in question (OECD, 1998). In Germany, moreover, there are restrictions on the proportions of the assets of pension funds and insurance companies that can be held in different types of financial instruments which has limited the pressures for higher yields on equities from this source. For example, the limit for EU equities is 30 per cent (increased from a maximum of 5 per cent in 1990); it is 6 per cent for non-EU equities; in 1994, German pension funds put about 72 per cent of their assets in domestic bonds and only 9 per cent in equities (Queisser, 1996, p. 14).

The most important reason for the differences between the Germany and the US in accumulated pension funds under management is the relative importance of the state pension system in Germany. As a pay-as-you-go system, the German government pension system generates no reservoir of surplus funds to be allocated. Instead, almost 75 per cent of the financing for the system comes from employee and employer contributions on the basis of earnings up to a ceiling of 1.8 times the average gross earnings of all insured individuals; the remainder is paid by the federal government out of general revenues (World Bank, 1994, p. 361).

Since 1960 there has been a steady increase in the contribution rate required to finance the pay-as-you-go pension system; it has risen from 14 per cent in 1960 to 20.3 per cent in 1997 (Deutsche Bundesbank, September 1997, p. 42). A further increase in the contribution rate to 21 per cent in 1998 was forestalled only by the emergency measure agreed in April 1997 to raise VAT by one point to 16 per cent. The levy is expected to rise still further in the decades to come as growing life expectancy and a decline in fertility contribute to a “double ageing” process in Germany. The OECD has forecast that by 2040 pension costs in Germany will amount to an enormous 18 per cent of GDP (OECD, 1996).

Demographic trends are not, however, the only source of increased pressure on the financing of the German pension system. They are compounded by labour market pressures. All major OECD countries have experienced a strong decline in labour supply by the elderly but the German participation rate for older people is now among the lowest of the major OECD countries. It is just over half that of the comparable US figure and much lower than the Japanese rate. Some scholars have attributed the striking German trend to the structure of the state pension system which provides generous incentives to retire and, until recently, did not decrease with age in a manner which was actuarially “fair” (Börsch-Supan, 1991). The low average retirement age also reflects the use of early retirement as a means of contracting enterprise workforces; in 1994, for example, only 29 per cent of new pension benefits awarded were paid to those retiring at "normal" retirement age (Queisser, 1996, p. 18; see also Abraham and Houseman, 1993). The extensive use of early retirement increases the pressures on the pension system beyond what the growing old age dependency ratio alone would imply.

How the German government deals with the problem of supporting more and more people in old age will have critical implications for the sustainability of financial commitment in the German economy. The growing concerns that have been expressed in Germany about the funding of pensions suggest that if the pressures for higher yields in Germany, especially from corporations, is to get a major push in the near future it will come from changes in the pension system. To date the initiatives undertaken by the government to improve the funding situation in the state pension scheme have focussed on making adjustments within the framework of the pay-as-you-go pension system but the financial pressures on the system have increased and the proposed solutions are becoming more radical.

A Pension Reform Commission established by the former Kohl government recommended a move to funded employer pensions along US and British lines but these proposals were not translated into reform prior to the government’s losing office. The legislative framework for a new personal pension vehicle was introduced by the Third Financial Market Promotion Act that took effect in mid-1998. These pension funds were not, however, accorded any tax incentives making them very little different in practice from ordinary mutual funds (“Pinning Hopes on Pension Reform”, Euroweek, April 1998). The SPD and the Greens made the issue of pension reform a central part of their election campaigns in September 1998. One proposal that received considerable attention was the imposition of an energy tax to fund state pension obligations. Since taking office, however, it has proven difficult for the Red-Green coalition to agree on the appropriate direction for reform. Gerhard Schroeder's government has put a brake on the cutbacks to the state pension that were due to take effect in January 1999 but as yet no concrete proposals have been made about pension reform (Pensions and Investment, 2 November 1998, p. 16).

The difference in pension funds under management in Germany compared with the US is also greatly affected by the way in which German employers fund the pensions that they provide to employees. Employer pensions were originally introduced as elements in the compensation packages offered to key workers to keep them with specific companies, mainly larger companies, when labor markets became tight from the mid-1950s. In more recent periods of relatively high unemployment, some German companies have reduced these benefits. Moreover, changes in German pension law in 1974, that allowed workers to transfer their pensions from one company to another, have reduced the effectiveness of this device for retaining workers. Nevertheless, these pensions still represent a significant accumulation of pension liabilities in the German economy; in 1993 the total pension obligations of companies amounted to c. DM 460.6 billion (Queisser, 1996, p. 12).

In the early 1990s, as Table 4 shows, about one-fifth of employer pension assets was in private pension funds (*Pensionskassen*). Employers and employees generally make contributions to these funds and the investment behaviour of these funds is regulated by the life insurance laws (Turner and Watanabe, 1995). Some employer pensions are funded by direct insurance (*Direktversicherungen*) through life insurance companies. Support funds (*Unterstützungskassen*) are another significant channel for employer pensions. These funds are legal entities that are financed by allocations of resources from the employer company but are legally separate from it. The funds are generally lent back to the employer company as an interest-bearing loan (Turner and Watanabe, 1995, p. 97). As Table 4 shows, these three channels together comprise just over 40 per cent of employer pension assets in Germany.

INSERT Table 4 Allocation of Employer Pension Assets in Germany

The remainder, nearly 60 per cent of the funds earmarked for the payment of company pensions, remain in the company as book reserves. As a company builds up its pension reserves (*Pensionrückstellung*), the increases in its pension liabilities are tax-deductible. Since enterprises are permitted to invest the funds allocated to pension obligations in the normal course of their businesses, this system in effect affords them a tax-effective means of borrowing from their employees; company pension funds were used to finance almost 5 per cent of the net investment of German producing enterprises in the period from 1980-1989 and thus represented a more important source of finance for industrial enterprises than equity issues (Edwards and Fischer, 1994, p. 54). For large manufacturing A.G.s, provisions for pensions were even more important, accounting for nearly 15 per cent of their net investment in the period 1970-85 (Edwards & Fischer, 1994, p. 128). Major German A.G.s have enormous pension reserves on their balance sheets; as Hauck put it, "Siemens has over DM 14 bn of pension reserves and can be compared in this respect with a good medium-sized life insurance company (Hauck, 1994, p. 557)". Although the importance of book reserves has fallen since 1981 from 67 per cent of all occupational pension assets and, correspondingly, direct insurance has increased its share from under 5 per cent in 1981 (Queisser, 1996, p. p. 14), the accumulation of book reserves nevertheless remains the prevalent practice with regard to German employer pensions.

There are some signs that employer pensions may be moved out of company financing into market-based instruments. In early 1996 Deutsche Bank purchased equities to the value of $330 million -- nearly 15 per cent of its pension book reserve -- and allocated them to a pension fund managed by an asset-management subsidiary. In late 1997 Deutsche Shell AG announced that it would create a DM2bn fund in an attempt to generate higher returns from its pension assets. The company expects to earn an average annual return of 7 per cent on investments in stocks and bonds compared with the current rate of 3 per cent that it is generating from holding the funds in cash.

The implications of any major move by the state or employers towards market financing of pensions would have profound implications for the German financial system. According to Josef Wertschulte, a director of Bayerische Hypotheken- und Wechsel-Bank, "[p]ension funds could total between DM1,600 bn and DM2,000bn in 10 years if the right legal and tax conditions were created. This would double the size of the present equity market (Financial Times, February 17, 1997, p.20)." Not surprisingly the German financial community can hardly contain their excitement at the prospect! Deutsche Bank, for example, has been leading the campaign to induce reserves off company balance sheets into pension funds controlled by professional asset managers. In 1996, Deutsche Bank Research published a report that called for a shift "From Pension Reserves to Pension Funds" that provoked much discussion and controversy in Germany. At the end of 1997, the German banking association submitted draft legislation on employer pension funds that called for the management of pension funds by external money managers as well as favourable tax treatment for externally funded pension provision.

It is by no means assured that there will be a major shift to the funding of pensions through the equity markets. The political opposition in Germany to such a move would likely be enormous. The issue is not, however, solely dependent on domestic politics. What happens to pension provision in Germany will also depend on policy initiatives by the European Union. In its attempts to promote the mobility of capital and labour across European borders, the European Commission has for some time identified retirement provision as one of the key obstacles to achieving this objective. With a view to removing this obstacle, the European Commission developed a draft pension funds directive in the early 1990s that was designed to allow the cross-border sale of pension products and to remove restrictions on cross-border investments by these funds but it was forced to withdraw the proposed directive in the face of opposition from some of the member states. In 1995 the debate was reopened, however, when Mario Monti, the European Commissioner in charge of financial services, issued a Green Paper on "Supplementary Pensions in the Single Market". The objectives laid out in this document were very similar to the withdrawn draft directive. In May 1999 the Commission issued a blueprint for pension reform, “Towards a Single Market for Supplementary Pensions”, which called for the liberalisation of the EU pension fund market and reported that substantial progress had been made in gaining consensus among member states about the regulatory changes that such a development would require. Major companies, especially in the financial sector, have been exerting pressure on the European Commission to develop a directive along these lines for pension funds but they have also been threatening to take the issue to the European Court of Justice if the Commission does not comply with their demands. However it comes about, change along these lines seems likely in the current political climate in Europe.

The above account underlines the fact that Germany has not witnessed as dramatic a transformation in its system of corporate governance as the US. The critical institutional supports for its postwar system of governance remain largely intact. However, there have been important developments in the financial sphere that call into question the future viability of the German postwar system because of changes in the abilities and incentives of key actors in the postwar system, especially the major financial enterprises, that they have induced. My analysis suggests that systemic change is unlikely to occur without greater structural change in the financial sector and that the most likely impetus for such change would be an overhaul of the pension system. There are substantial pressures on the existing German system given the demographic profile of the population and the propensity to use early retirement as a tool to manage the labour market. To the extent that there is a major push to individualisation of pension provision with the greater resort to the financial markets, and the equity markets in particular, that such a strategy would almost inevitably entail, one important effect would undoubtedly be stronger pressures on corporations to generate higher yields for their shareholders.

To the extent that these pressures develop, the productive challenges that German enterprises face may prove complementary in bringing about a transformation of the German system of governance. Business elites are pointing to strong international competition from other parts of the world, especially Asia but also from Eastern Europe, as a rationale for unwinding elements of the postwar German model. As corporate enterprises struggle to deal with these challenges the relationship between senior German managers and the rest of the corporate organisation is an important one to watch. To the extent that they become increasingly segmented from the people that they manage, share prices will undoubtedly become more and more important as an incentive either for their personal gains through stock options or for their empire building through mergers and acquisitions. As compared with their US counterparts, however, the ability of top managers in Germany to go off in their own direction is constrained by the role ascribed to workers in the German system of corporate governance. If German managers try to follow their American counterparts down the path to shareholder value, they will therefore have to contend with a politically powerful labour movement that has a voice in for whom and how corporations should be run.

3. Understanding the Recent Evolution of Corporate Governance

In the foregoing discussion I have emphasised certain similarities in the source of recent pressures for change in both the US and German systems of corporate governance. Of particular importance was the postwar accumulation of financial assets by certain groups in the population as well as the rise in intergenerational dependence that resulted from population ageing and, especially in Germany, the growth of early retirement. These two countries are not alone in experiencing these pressures. Similar tensions are apparent in other economies in which some or all of the following features are apparent: substantial accumulations of financial assets, broad-based expectations of a period of paid retirement at the end of people's working lives, and a rise in intergenerational dependence due to population ageing and early retirement. In France, Japan and Italy, for example, various combinations of these factors have created momentum for reform of corporate governance systems.

As the comparison of the US and Germany also reveals, however, the nature of these pressures varies considerably across countries, as does their impact, as a result of national institutional diversity, especially in financial and pension systems. Without an analysis of the development of these, and other, national institutions, the pressures on corporate governance systems and the responses to them cannot be understood. An analysis of the productive pressures confronting national systems of corporate governance has not been undertaken here but would provide further support for the same conclusion. Different countries display distinct productive strengths and frailties that are closely related to their institutional formations. These patterns have had an important effect on the timing and seriousness of the vulnerability of their leading corporate enterprises to competitive challenges and, relatedly, the susceptibility of their extant systems of corporate governance to challenges for reform from within the domestic economy (O'Sullivan, 2000, chs. 5 and 8). In particular, as I have noted, an understanding of the social organisation of corporate economies as productive entities is an important source of insight in analysing the incentives and abilities of top managers to buy into pressures from the financial sphere to transform the extant system of corporate governance.

As important, and arguably less understood, than the dynamics of corporate governance at the national level is the interaction between the evolution of national systems of corporate governance and the international economy. Given the importance of US institutional investors in international securities markets it is of particular importance that we understand the relationship between the internal re-alignment of the US system of corporate governance and international developments. There is certainly a perception in the popular press, and among many academics, that US investors (and their British counterparts) now exercise considerable influence over corporate resource allocation in continental Europe, Japan as well as many developing countries. However, while the general impression may well be accurate, we know little about the mechanisms through which control by foreign institutional investors is exercised and therefore about the true extent of that control. A brief look at the data that is available on the role of institutional investors in international capital markets highlights the complexity of the task.

The domestic bias in the allocation of assets by institutional investors has long been recognised by students of international finance. Far from being an exception to the general rule, US institutions in fact reveal stronger preferences for domestic securities than their counterparts in other advanced economies like Britain, the Netherlands, Switzerland, and Japan. As Table 5 shows, in 1996 only 10.4 per cent of securities held by US pension funds were issued by nonresidents as compared with 29.2 per cent, 30.6 per cent, 18.6 per cent, and 14.9 per cent for their British, Dutch, Swiss, and Japanese counterparts respectively. The comparative home equity bias of US mutual funds is even stronger; they are more reliant on domestic securities than the mutual funds of any other country shown in Table 5.

Table 5 Institutional Investors' Holdings of Securities issued by Nonresidents, 1987-96

The internationalisation of US institutional investment has, however, increased rapidly in the 1990s. As Figure 1 shows, US international assets have grown substantially in recent years. Portfolio investments have increased in importance in the international asset position of the US rising from 20.9 per cent in 1992 to 33.1 per cent in 1998. The share of equities in portfolio investments has risen from 61 per cent in 1992 to 71.5 per cent in 1998. As a result, equities as a proportion of total US international assets have increased from 12.8 per cent in 1992 to 23.7 per cent in 1998. The growth in US holdings of foreign equity experienced a setback in the third quarter of 1998 as US investors fled the Asian financial crisis but the downturn in the rate of growth seems to have been a temporary phenomenon.

Figure 1 International Asset Position of the United States, 1992-1998

US institutional investors are largely responsible for these trends. The most recent figures available show that the largest 25 US pension fund holders of international equity, for example, have steadily increased the proportion of their total assets that they allocate to foreign equities from 4.8 per cent in 1991 to 11.2 per cent in 1996. The trend seems to have been sustained since then; CalPERS, for example, held 19.2 per cent of its total assets in foreign equities in July 1999 (with plans to increase it to 20 per cent) compared with 16.9 per cent in September 1996 (for CalPERS current asset allocation, see http://www.calpers.ca.gov/invest/asset/asset.htm;).

In addition to the recent trend towards a greater internationalisation of US institutional assets their sheer size, and continued growth, means that they have an importance in international markets that goes beyond what their proportional investment in international equities might suggest. In 1997 the financial assets of US institutional investors were approximately half of the OECD total and were 6 times those of Britain (in 1996), 10.5 times those of France, and 11.5 times the German total (OECD, 1998, p. 20). Moreover, that US institutions have traditionally invested more of their funds in equities than their counterparts in most other OECD countries, with the notable exception of Britain, has given them a particularly heavy weight on international equity markets (see Table 6). In 1996 US foreign equity securities amounted to US$1,002.9 billion compared with US$ 404.7 billion for the UK, US$156.9 billion for Germany (1995), US$154.9 billion for Japan, and US$65.2 billion for France (IMF, 1999).[4] More recent figures are available for the US and Britain; both countries' foreign equity assets have increased substantially but their relative positions remain close to where they were in 1996; the US held 2.41 times more foreign equities than Britain in 1998 compared with 2.48 in 1996.

There is no question that US investors dominate international equity markets today, although British institutional investors are clearly important players too. Nevertheless the continued dominance of the US should not be taken for granted. Not only are the assets of institutional investors growing in countries other than the US and Britain, the distinctiveness of these countries in their reliance on equities is fading to some degree as institutional investors in other countries have displayed a marked tendency in the mid- to late-1990s to invest proportionately more of their assets in equities; for example, between 1992 and 1997 the proportion of institutional investors' assets invested in equities increased from 19 per cent to 30 per cent in France and from 27 per cent to 40 per cent in Sweden (OECD, 1998, pp. 32-34).

INSERT Table 6 Portfolio Composition of Institutional Investors*

It is perhaps premature to attempt to assess what the future holds for the role of US institutional investors in international capital markets since there are, as yet, no easy answers to the question of how important they are today. In 1998 US holdings of foreign equities amounted to approximately 11.6 per cent the total market capitalisation of stock markets outside of the US down from 13.7 per cent in 1997 (author's calculations based on IMF, 1999 and Féderation Internationale des Bourses de Valeurs, 1998). These figures confirm the general impression that US investors exercise substantial weight in world capital markets. What is not clear is how and the extent to which they bring their weight to bear on corporate economies outside of the US.

The example of the French corporate economy is illustrative. The level of penetration by foreign investors in the French stock market has increased dramatically in recent years, from 10 per cent of stock exchange capitalisation in 1985 to approximately 35 per cent in 1998-1999 (Banque de France, 1999, Table 31, p. 167). The foreign penetration of domestic equity markets is now considerably higher in France than in other major industrial economies; foreign ownership of corporate equities was 11 per cent in Japan, 9 per cent in Great Britain, 6 per cent in the US in 1997 (Morin, 2000, p.33) and 15.6 per cent in Germany at the end of 1998 (Deutsche Bundesbank, 1999). The level of foreign penetration is particularly high among the top 40 French listed companies (the CAC 40) with more than half of them having 40 per cent or more of their shares in the hands of foreign investors (<u>Le Revenu Français</u>, 23 January, 1998; Morin, 2000; "Le nouveau capitalisme français," <u>Le Monde: Dossier Documents</u>, March 1999, no. 274, p. 1).

News of these trends has generated great hyperbole in contemporary discussions of corporate governance in France. Most of the attention has been focussed on American, and to a lesser extent, British institutional investors. In an article called "Les 10 Commandements du Nouveau Capitalisme"[5], for example, <u>Le Nouvel Observateur</u> began "Qui possède aujourd'hui les plus grandes entreprises françaises? Les retraités américains! Avec l'épargne accumulée sur leurs fonds de pension, ils se sont offert des actions de Pechiney, Usinor ou Rhône-Poulenc."[6] The article goes on to say that these pension funds now dictate their laws to French enterprises: "Ces fonds de pension ont en effet des exigences. Ou plutôt, une exigence: de la valeur, encore de la valeur, toujours de la valeur. C'est-á-dire, plus d'argent pour les actionnaires, donc plus de rentabilité pour les capitaux investis dans l'entreprise. Cela peut sembler évident, mais jusqu'á maintenant le capitalisme européen – et notamment le capitalisme français – avait vécu a l'abri de cette contrainte (Le Nouvel Observateur, 27 August – 2 September 1998, pp. 52-54)."[7] In a similar vein, Le Nouvel Economiste, in an article called "Les patrons dans l'étau", (Bosses in the vice), declared: "A l'instar de leurs pairs américains et brittaniques depuis de nombreuses années, les patrons des entreprises françaises sont à leur tour soumis au diktat de la valeur actionnariale, la célèbre *shareholder value* anglo-saxonne"[8] (Le Nouvel Economiste, 27 March 1998, p. 37). Nor is talk of a revolution in French business practices confined to the popular press. Many French academics believe that foreign institutional investors have spurred major change in the French corporate economy. In a recent paper, "A Transformation in the French Model of Shareholding and Management," François Morin, a long-time student of the French corporate economy, argued that "Directly inspired by the American 'shareholder value' model, the largest French groups are going through a managerial revolution, whose consequences are only now beginning to become apparent, most noticeably in the new way in which the French stock exchange operates (Morin, 2000, p. 3; see also Morin, 1998)."

In discussions of the implications of growing levels of foreign penetration in the French corporate economy the power of US and British institutional investors to influence, indeed to transform, French business practices is widely accepted. The degree to which French business elites have learned to talk in terms of shareholder value is certainly striking. What is not at all clear, however, is who is driving these changes. There are a number of factors that complicate the simple picture of a French business elite besieged by the representatives of pensioners in Iowa and Minnesota!

Firstly, notwithstanding the attention paid to American and British institutional investors, it should be recognised that many of the foreigners who hold French shares fit into neither of these categories. Some foreign shareholders are companies in related businesses who have taken strategic stakes in French corporations apparently to develop their core business interests. Many of these strategic investors are companies domiciled in other continental European countries. Estimates of the percentage of shares held by foreign institutional investors are much lower than the overall figure for foreign penetration in the French equity market of 35 per cent. Morin has estimated that at the end of 1997 foreign mutual funds held 19.81 per cent of Alcatel, 14.56 per cent of BNP, 12.11 per cent of Elf, 11.31 per cent of Société Générale, 10.13 per cent of Générale des Eaux, 8.94 per cent of Paribas, 8.64 per cent of Suez Lyonnaise, 8.61 per cent of AGF, and 7.42 per cent of AXA-UAP (Morin, 1998, p. 31). Most foreign institutional investors hold relatively small shares in French companies, around 1 per cent or less, with a few notable exceptions. As Table 7 shows, Fidelity and Templeton have sometimes taken larger stakes, as in one or two instances, has Capital Group, Franklin Mutual, and Janus. Although the ability of foreign investors to impose their will on French corporate executives is often taken for granted the question that an analysis of foreign shareholdings in French companies raises is whether there is sufficient agreement and scope for coordinated action among foreign investors, even US and British institutional investors, to induce a major change in resource allocation by French corporates.

INSERT Table 7 Holdings of Selected US Institutional Investors in Leading French Companies

On the basis of extensive interviews with senior French corporate executives Morin argues that there are a number of critical issues on which institutional investors do agree. As a result they can present a united front in dealing with French corporate executives. He suggests that these “precepts of shareholder value” include a focus on one core business, the divestiture of non-core activities, the unwinding of cross-shareholdings, and the use of stock buybacks, which are all intended to ensure that institutional investors "earn" a return on their investments that is as good or better than their comparable investment opportunities (Morin, 1998, idem., 2000). Morin's results are not entirely persuasive, however, precisely because he relies so heavily on the testimony of French elites. It is entirely plausible that they have their own incentives to present a picture of a united front of institutional investors pressuring them to act in particular ways in order to legitimate actions that they themselves want to take. Indeed, Morin goes on to say that "the general feeling among the company bosses has softened somewhat with regard to the penetration by pension funds. Many think that it is not necessary to paint a diabolical picture of this movement, which is a way of modernising the French capitalist system (Morin, 2000, p. 26)."

If French executives have used the presence of foreign institutional investors as a cover for their rationalising decisions they have been quite effective in finding scapegoats. For example, in September 1999 when Michelin announced the layoff of 7,500 workers at the same time that the company reported increased profits, a large number of articles appeared in the French press denouncing the pressures that US pension funds were bringing to bear on French jobs (see, for example, "Versailles, Florida; De la politique-specatacle, il ne reste plus que le spectacle," Le Monde, September 20, 1999). So concerned were the managers of CalPERS and Temploton in France that they publically responded to these criticisms and declared that they would not be "les boucs emissaires lorsque des entreprises, comme Michelin en France recemment, decident de rationaliser leur production ou announcent des plans de licenciements ("Les fonds americains se defendant d'etre des speculateurs a court terme," L'Echo, October 14, 1999)."[9]

What makes the idea that French senior executives may be, at least to some extent, complicit in driving the shareholder value movement, is the fact that it is difficult to find the levers that institutional investors could use to impose their will on French corporations (even if there was agreement as to what their objectives should be). Of course the standard reply is that if French executives resist pressures to deliver higher returns to shareholders, institutional investors will not invest in their shares and French corporations will find themselves short of capital. Common though that assumption is, it is entirely mistaken. The markets for corporate stocks are predominantly secondary markets. That shares are exchanged on them has no direct implications for the financing of productive investment. Nor is it clear why major French corporations need to raise cash through these markets to finance their investments. From 1980 to 1995 French enterprises reduced their debt to such an extent that they went from being the most debt-laden to the financially-strongest firms in the G5. Their internal capacity to fund their productive investments has exceeded 100 per cent since the early 1990s.

Why then do French executives care about their stock price to a degree that they are willing to succumb to what is widely seen as a foreign ideology? One answer is that the lure of having a highly-valued stock that can serve as a merger currency or a deterrent against undesirable bidders provides French executives with strong incentives to dance to the tune of shareholder value or at least appear to do so. Merger activity in France has been rising for some time and has reached unprecedented levels in the 1990s. Cross-border merger activity has also exploded and French companies have featured prominently as sellers and purchasers. Since shares are increasingly the currency of exchange, getting the stock valuation up is a critical means of maintaining control in domestic and international corporate restructuring.

A second reason for French executives' pursuit of shareholder is more prosaic than their battles for global dominance. As Renaud Saluer, the head of Fidelity's Paris office noted with some irony: "Les standards anglo-saxons s'imposent peu à peu. Le système des stock-options aide également les dirigeants à voir ou est leur intérêt! ("Fidelity exige la transparence," Le Revenu Français, 23 January, 1998, p. 12)."[10] French corporations have been quicker than their continental European counterparts to embrace stock options for senior corporate managers. As L'Expansion, a weekly French business magazine, put it: "il y a au moins un domaine dans lequel nos patrons n'ont rien à envier à leurs homologues européens, voire à certains Anglo-Saxons: celui des stock-options. L'apprentissage a été d'une rapidité saisissante!"[11] The magazine, not noted for its social critique, goes on to argue that "S'il n'est pas question de décrier un mécanisme totalement légitime qui permet à des managers de faire fortune, il est sans doute temps de s'interroger sur le contrôle de ces plans de stock-options.

Qui doit en profiter? Toujours selon notre classement, seulement 1% des 2,76 millions de salariés des sociétés du CAC40 en bénéficient. La démocratie des actionnaires doit aussi trouver sa place dans l'entreprise. Quelles conditions d'attribution? L'opacité qui règne sur les modalités a de quoi laisser perplexes les soi-disant tenants de corporate governance. Comme par hasard, de grandes entreprises en ébullition ont vu fleurir des plans de stock-options considérables juste avant l'annonce de rapprochements ou d'acquisitions (L'Expansion, October ?, 1999)."[12]

To the extent that French corporate executives feel compelled to respond to the demands of institutional investors it would seem that it is at least to some extent because they have chosen a particular path to business success and personal wealth. Moreover, that they have been so willing to embrace these types of behaviour is in many ways predictable from an understanding of the postwar system of corporate governance in France and the social organisation of the corporate economy more generally. Of particular importance is the traditional relationship between senior executives and the rest of the organisation in French corporations.

Many senior French corporate executives like to describe the economy over which they preside as one which attaches a high value to the contributions not just of shareholders but of a variety of stakeholders. The Viénot Report, published in 1995, captured this view well when it stated: "In Anglo-Saxon countries the emphasis is for the most part placed on the objective of maximising share values, whilst on the European continent and in France in particular the emphasis is placed more on the human assets and resources of the company (Reference)." There is, however, considerable scepticism among more disinterested observers about the extent to which such lofty ideals are put into practice in French corporations. The institutions that regulate French management-labour relations are quite different from those that are operative in, for example, Germany. Overall French workers have much less of a say in the governance of corporate enterprises than is the case for their German counterparts. As Joel Rogers and Wolfgang Streeck put it, "[o]verall, 'social dialogue' in French firms is often formalistic and superficial, without much effect on management decisions." Thus French executives are much less constrained in their ability to segment themselves from the fortunes of other employees of the corporation than is the case in Germany. To the extent that restrictions will be placed on their actions, such as the award of stock options, it is likely to come not from the system of corporate governance but from the government.

Furthermore, the common practice of appointing Présidents Directeurs Généraux (PDGs) from the state sector, combined with the significant persistence of large family-owned enterprises in France, means that managerial personnel cannot have the expectation that a career of loyalty to the enterprise will result in promotion to its apex. A recent study of the 200 largest French enterprises found that a mere 4 per cent of them was run by a "company man". As a result those who run the major corporations in France tend, as a general rule, to have little detailed knowledge of the specific capabilities for developing and utilising resources in the enterprises that they run. As a result they display a marked propensity towards strategies that rely on external growth rather than internal development (Bauer and Bénédicte Bertin-Mourot, 1995).

These comments on the French system of corporate governance reinforce the emphasis placed, in the discussion of the US and Germany, on the importance of studying domestic re-alignments for understanding developments in national systems of corporate governance. But they also underline the need to understand domestic changes in order to analyse the effects of international pressures on corporate governance systems. Domestic interests, especially corporate executives but also enterprises in certain sectors of the financial industry, often have their own reasons for portraying international pressures as constraints on their actions. To understand what is fact and fiction in these accounts there is a need, therefore, to understand the nature of these interests and how they have evolved.

4. The Limits of Existing Debates

There are serious limits to the globalisation thesis for understanding the developments in corporate governance discussed in the previous sections. The globalisation argument with respect to corporate governance generally relies on the contention that greater capital mobility will lead to a more efficient allocation of capital in the world economy. In a world in which capital is mobile German, French, Japanese, and other enterprises will have to ensure that investing in their corporate stock offers a competitive rate of return to foreign and domestic investors. If not capital will move elsewhere. Given that US and British corporations provide high returns to shareholders the implication of being competitive on international equity markets is that other countries must go further down the path towards a corporate governance system that, as in the US and Britain, promotes the interests of shareholders as the number one priority, or risk undermining their productive capabilities because of a shortage of investment capital.

These types of arguments have been and continue to be enormously influential among policy makers, journalists, and mainstream economists. In the wake of the Asian financial crisis however, some of the cracks in their underlying logic have begun to receive some attention. Perhaps the most striking example of “the Emperor has no clothes” thesis has been advanced by Jagdish Bhagwati, a Professor of Economics at Columbia University and an ardent supporter of market liberalisation, in an article called “The Capital Myth”. He argued that the mainstream view that “a world of full capital mobility continues to be inevitable and immensely desirable” is just a myth: “freeing up trade is good, why not also let capital move freely move across borders? But the claims of enormous benefits from free capital mobility are not persuasive. Substantial gains have been asserted not demonstrated… the myth to the contrary has been created by what one might christen the Wall Street-Treasury complex (Bhagwati, 1998, p. ?).” He concluded that it was time “to shift the burden of proof from those who oppose to those who favor liberated capital (Bhagwati, 1998, p. ?).”

So where is the proof that higher levels of international capital flows have any beneficial effect on real investment in the economies to which they go? Most of what is described as portfolio investment involves exchanges of securities on secondary markets that have no direct implications for the productive economy at all. Moreover, even foreign direct investment, which many economists (including Bhagwati) believe to be more desirable from the point of view of the real economy, has become more like portfolio capital flows in recent years as the importance of cross-border asset swapping has grown. In 1997 FDI grew by 29.4 per cent to reach $US464 billion and in 1998 it increased by a further 38.7 per cent to reach US$644 billion. Cross-border mergers and acquisitions grew even faster, by 45.2 per cent in 1997 and by 73.9 per cent in 1998. As a result these transactions accounted for 50.9 per cent of FDI in 1997 and 63.8 per cent in 1998 (UNCTAD, 1999). As in the case of portfolio investment M&A activity has no necessary implications for productive investment. In the aftermath of an acquisition, the acquiring company may make substantial investments in the acquired company but levels of M&A activity tell us nothing about the extent to which this is happening and they are certainly not a measure of such real investment. Moreover, the record of performance for M&A activity within countries is sufficiently negative that there are no grounds for assuming, *a priori*, that such investment, even if it occurs, will generate improved economic performance.

The supposed merits of international capital mobility may have been subject to more contestation recently but what concerns most critics is the volatility of international capital markets that portfolio flows are alleged to induce. The more fundamental question of whether these flows play the role assigned to them in economic theory as suppliers of capital for investment continues to attract insufficient scholarly attention. Furthermore, what is still not widely recognised is that what Bhagwati calls the "capital myth" at the international level is merely an extrapolation of the problems encountered by mainstream economic theory in explaining the relationship between financial institutions and economic development within nations.

Nowhere are the deficiencies of the conventional view more striking than in the case of the stock market. It is commonly assumed that the stock market is an important institution for channelling finance from savers to investors but in none of the leading industrial economies of the 20th century was the provision of capital through the stock market the central element in the process of economic development. Retained earnings -- undistributed profits and capital consumption allowances -- have always provided, and continue to provide, the financial resources that are the foundations of investments in productive capabilities that made innovation and economic development possible (Lazonick and O'Sullivan, 1997a and 1997b).[13] Even, or perhaps especially in the so-called equity based system of the US, corporate retentions and corporate debt, not equity issues, have been the main sources of funds for business investment throughout the twentieth century (Ciccolo and Baum, 1985; Corbett and Jenkinson, 1996). As capital markets have become more liquid in the 1980s and 1990s US corporations have, in fact, become net purchasers of their own stock as they invest massive amounts of money in buybacks (O'Sullivan, 2000, ch. 6).

Even when equity has been issued it has not necessarily played a role in funding investment in new productive assets. New corporate equity issues have often been used, not to finance investment, but to transfer financial claims over existing assets or to restructure corporate balance sheets. The ownership transfer may be an initial public offering (IPO), in which case share ownership is transferred from the original owner-entrepreneurs and their venture-capital partners to public stockholders. High levels of IPO activity, therefore, do not necessarily indicate that households and institutional investors are funding a wave of innovative investment. Rather, in absorbing IPOs, these entrepreneurs are paying the entrepreneurs who built the businesses for a claim on the enterprise's future earnings, based on investments in productive capabilities that have already been made. Whether any of the money realised from an IPO ends up committed to new innovative investment strategies, either in the issuing company or some other new venture, is at the discretion of those who control corporate resource allocation in the newly public enterprise and the original owner-entrepreneurs whose shares have been liquidated in part or full. It is not inherent in the IPO itself.

The ownership transfer may also occur for the purpose of one company acquiring another company. Typically, the acquiring company issues new stock of its corporation to exchange for the existing stock of the acquired company, the stock of which is then retired. In the aftermath of the acquisition, the acquiring company may make substantial investments in the acquired company, but once again the equity issue does not provide the source of such investment financing. Funds raised through equity issues may also be used to restructure the corporate balance sheet but here again the new equity issue does not necessarily lead to an increase in innovative investment.

For all the talk of the merits of efficient stock markets for economic growth therefore, evidence is lacking that the stock market performs its assumed function as a crucial conduit of resources from savers to investors. Nor are there strong theoretical grounds for the widespread assumption that the stock market should play such a role. In a paper provocatively entitled "Stock Market Efficiency and Economic Efficiency: Is there a Connection?' Dow and Gorton underline the point: "There is a large body of research on welfare economics, and an equally large one on efficient markets theory. However, there has been relatively little work linking these two literatures. By and large welfare economists have not studied corporate control or asset pricing, while efficient-markets researchers have taken for granted that informational efficiency implies economic efficiency (Dow and Gorton, 1997, p. 1090)" Assumptions about these markets are based largely on extrapolations from theories of markets for apples and oranges. As Dow and Gorton point out, however, the fact that capital markets play only a limited role in the direct allocation of capital means that such extrapolations are not warranted. In particular, given the extent to which financing for investment comes from sources other than the equity markets it is not at all clear that improvements in the capacity of these markets to impound information have any effect on allocative efficiency. It should also be pointed out that when the stock market is engaged in the direct allocation of capital, as it is to some degree through the initial public offering (IPO) market, it is not at all clear that its capacity to allocate resources to investment has anything at all to do with efficiency in the sense in which financial economists mean it. In fact, the IPO market has been shown by a number of academic studies to be particularly prone to bubbles and fads (see the review in Heisler, 1994, pp. 88-89) and, as such, to be a far cry from the efficient capital market of financial orthodoxy.

The weak conceptual and empirical underpinnings of the globalisation argument, at least if we interpret it as an economic argument, make it unsuitable as the basis on which to interpret recent developments in corporate governance systems. If there are problems with the thesis of economic globalisation for understanding the contemporary process of change underway in corporate governance systems the leading challenges to that thesis have deficiencies of their own. However, in contrast to the globalisation argument, whose problems stem from the very core of its theoretical framework, the shortcomings of the other relevant literature are largely a matter of empirical focus. They are, as a consequence, more easily remediable.

The IPE literature is, with its emphasis on political processes, much closer to the reality of what has been happening in national and international financial markets than the globalisation accounts. In light of my empirical discussion its weakness is that it places too much weight on policy shifts – especially the rise of neoliberalism in the US and Britain – to account for the growing propensity of national economies to deregulate their financial sectors. Too little attention is paid to the structural shifts in domestic economies that I have described, including the accumulation of financial assets by large groups in the population as well as the rise of intergenerational dependence, to explain changes in the relationship between the financial sector and the real economy.

The lack of an explicit analysis of these issues makes it difficult to explain the success of neoliberals and groups deemed to be their natural allies, such as multinational companies and financiers, in pushing through policy changes to advance their interests in national and international arenas. Helleiner captures the puzzles that the IPE literature encounters when he observes that: "it is striking that in none of the liberalization decisions in the 1970s and 1980s was the kind of controversy generated among the general public that regularly emerges concerning liberalization decisions in the trade sector." He suggests that "[t]he highly technical and seemingly complex nature of international financial issues appears to give these groups a high degree of autonomy to influence state behaviour in this area (Helleiner, 1995, p. 194)". That may be part of it but it surely is also related to the fact that political support for higher returns on financial assets is not confined to neoliberal radicals and business and financial elites.

A more sophisticated understanding of interest group formation around key policy changes must be rooted in an analysis of the shift in economic interests that took place in many advanced economies from the 1970s onward. Indeed, without such an analysis it is difficult to explain why ostensibly neoliberal policies were pushed through by leaders with an apparently different political orientation as happened in the realm of US financial deregulation. Some authors have recognised that an important evolution of economic interests did occur and is important for explaining general trends in policy. In addressing the question of why the US state has allowed financial markets to become so dominant, for example, Peter Gowan emphasises the links between the regulators of financial markets and big speculators, the dependence of politicians on financial operators for campaign funds and the fact that "the strategic social groups within American society have themselves been captured by the institutional dynamics of the financial markets (Gowan, 2000, p. 55)." However, he does not develop the latter argument in any detail.

An explanation of why it was that "strategic social groups" in the US were captured by the logic of financial markets is clearly important for understanding the policy changes that occurred in that country although it hardly needs to be pointed out that it is by no means sufficient. Such an explanation might also shed light on the likelihood of something similar happening in other countries and, as a result, the degree to which one might expect them to introduce similar policy changes. That the IPE literature has not managed to provide good explanations for the timing and content of policy contagion from the US and the UK to other countries is undoubtedly in part because it has not focussed sufficiently on structural change within these economies and the evolution of domestic interests that it produced.

Like the IPE literature, "varieties of capitalism" studies tend to be closer to the contemporary reality than globalisation arguments and if there is a general approach that informs the analysis presented herein it is that one. One important general weakness of the varieties of capitalism literature, however, is a lack of attention to the interaction of different national systems of capitalism. As Fred Block has argued the varieties of capitalism literature "needs to be pushed forward by reconceptualising international capitalism as a constructed system, that is to insist that both within societies and as an international system, capitalist arrangements are not natural but need to be constantly constructed and reconstructed (Block, 2000)." A second weakness, although one that is found only in the work of some authors, is a tendency, especially in reaction to the globalisation thesis, to emphasise persistent diversity across national economic and governance systems to the point where important changes going on within them are understated or even ignored (for tendencies in this direction, see Hollingsworth, 1998; Whitley, 1998).

Finally, there are the empirical critiques of the globalisation thesis. There is certainly something to be said for an injection of sobriety into a debate that has more than its fair share of extreme, unsubstantiated empirical claims. Yet many of the empirical critiques do seem to be in danger of ignoring the forest for the trees. In a review of three such studies, published shortly before her recent death, Susan Strange put her finger on the problem: "To sum up, all that these three books say about the overselling of globalisation by firms and by observers may be true. But the litmus test that none of them really apply is whether there is, or is not, change (Strange, 1998b, p. 710)." She went on to say "Sure, it takes more than one swallow to make a summer. But the moral for researchers may be to pay more attention to the newspapers and less attention to out-of-date and inappropriate statistics (Strange, 1998b, p. 710)."

Certainly data on corporate governance systems poses a particular problem in terms of its timeliness. Share ownership breakdowns, for example, are typically only available with a few years delay. Yet changes in ownership structure can occur quite rapidly as the cases of France and Germany show. The main problem with empirical work on globalisation, however, is not so much its reliance on data that is often outdated as its focus on outcomes. As the case of the US illustrates, the processes that lead to a shift in governance regimes take decades to unfold. There is thus more insight to be gained about change in corporate governance systems by asking whether the structures that supported old systems of corporate governance continue to be viable. It is only in that way that change can be identified and understood as it is happening rather than after the fact.

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Tables

Table 1 U. S. Corporate Stock Held by Households and Institutions, 1952-1996
percent, except for total value (billions of dollars)

Year	Total Value	House-hold	Foreign	Insurers	Private Pension	Public pension	Mutual funds	All fin-ancials*
1945	118	93.0	2.3	2.4	0.3	0.0	1.5	4.3
1950	143	90.2	2.0	3.3	0.8	0.0	3.2	7.4
1955	282	88.1	2.3	3.2	2.2	0.1	3.4	9.2
1960	420	85.6	2.2	3.0	3.9	0.1	4.7	12.1
1965	735	83.8	2.0	2.9	5.6	0.3	5.0	14.0
1970	841	68.0	3.2	3.3	8.0	1.2	5.2	28.5
1975	846	59.0	3.9	4.9	12.8	2.9	4.7	36.7
1980	1,514	59.6	4.9	5.2	14.8	2.9	3.1	35.2
1985	2,319	48.6	5.9	5.6	21.3	5.2	5.1	44.9
1990	3,537	51.2	6.9	4.6	15.9	8.3	7.1	41.5
1995	8,331	48.6	6.3	5.4	14.2	9.0	12.8	44.3
1996	10,062	45.7	6.5	5.5	14.1	9.5	15.0	46.9
1997	12,776	42.7	7.2	5.7	13.8	10.2	16.2	49.3

* Insurers, pensions, mutual funds, bank personal trusts, and other.
Source: Board of Governors, Federal Reserve, Flow of Funds Accounts, Flows and Outstandings, various years.

Table 2 Average Stock Turnover Rates by Type of Institutional Investor

Type of Funds	**1993**	**1995**
Corporate Pension	33.2%	24.8%
Public Pension	13.3%	20.7%
Mutual Funds	48.2%	42.3%
Money Managers	56.7%	59.2%
Insurance Companies	53.6%	46.4%
Banks	24.3%	25.3%

Source: Based on Brancato, 1997, p. 27

Table 3 Structure of Financial Assets of Private Households
% of total private financial assets

Assets	**1970**	**1992**	**1993 Unified Germany**	**1998**
Bank Deposits	52.4	40.7	41.7	35.4
Cash and Sight Deposits	10.6	8.0	8.8	8.6
Time Deposits	1.8	8.0	12.6	6.3
Savings Deposits	39.1	19.4	20.3	20.5
Savings Certificates	0.9	5.3	---	---
Savings and Loan Deposits	7.6	3.7	3.5	3.1
Insurance (1)	13.3	18.5	19.8	21.7
Fixed-Income Securities (2)	7.7	20.9	15.9	13.1
Stocks (3)	11.3	5.2	5.4	10.7
Investment Fund Certs			6.3	9.7
Other Receivables (4)	7.7	11.0	7.4	6.3

(1) incl. life insurance and pensions
(2) incl. bond fund shares
(3) incl. stock fund shares

(4) incl. pension claims within the company
Source: Deutsche Bank Research Bulletin, January 9, 1995, p.7; Deutsche Bundesbank, Gesamtwirtschaftliche Finanzierungsrechnung; dies., Kapitalmarktstatistik).

Table 4 Allocation of Employer Pension Assets in Germany
% of total, 1996
Total volume, DEM 515bn

Type of plan	**% of total pension assets**
Book reserves	57
Private fund	22
Direct insurance	13
Support fund	8
Total	100

Source: Deutsche Bank, Research Bulletin, No. 2, 1998, p. 35

Table 5 Institutional Investors' Holdings of Securities issued by Non-residents, 1987-1996

Pension Funds	**1987**	**1990**	**1992**	**1994**	**1996**
France	--	--	2.0	5.0	4.4*
Germany	--	4.5	4.3	7.0	7.7
Italy	--	--	4.0	5.0	--
Japan	14.3	16.0	14.4	10.8	14.9
Netherlands	12.8	15.8	17.1	22.0	30.2
Sweden	--	--	--	11.0	14.8
Switzerland	4.0	4.2	6.0	13.0	18.6
Britain	14.0	20.0	24.0	27.0	29.2
United States	2.5	3.5	4.3	8.1	10.4

Mutual Funds	**1987**	**1990**	**1992**	**1994**	**1996**
France	--	--	--	--	--
Germany	25.2	35.4	29.6	23.0	20.2*
Italy	9.2	11.2	22.4	28.1	24.0*
Japan	--	7.9	9.9	--	--
Netherlands	--	--	--	--	--
Sweden	--	5.4	12.4	15.7	16.8*
Switzerland	57.6	60.3	65.3	69.5	67.2
Britain	26.7	31.0	35.2	36.4	34.5*
United States	--	6.6	10.1	--	--

Life-Insurance Co.s	**1987**	**1990**	**1992**	**1994**	**1996**
France	--	--	--	--	--
Germany	--	1.0	--	--	4.0*
Italy	--	--	--	--	--
Japan	--	13.5	11.4	6.7	6.9*
Netherlands	4.6	3.9	5.3	7.8	--
Sweden	1.5	5.4	7.8	10.4	12.7*
Switzerland	--	--	--	--	--
Britain	8.8	10.7	12.4	13.5	14.2*
United States	3.0	3.6	3.7	5.4	5.8

-- Not available
- 1995 figures

Source: Blommestein, H., and Funke, N., 1998, p. 39.

Table 6 Portfolio Composition of Institutional Investors*

Country	Bonds	Loans	Shares	Other
France	60	4	30	7
Germany	42	34	19	5
Italy	68	---	14	17
Japan	32	22	19	27
Sweden	54	4	40	2
UK	16	1	67	16
US	34	9	45	11

* calculation of composition is based on portfolio values in national currencies
Source: OECD, 1998. Institutional Investors, Statistical Yearbook, pp. 32-34

Table 7 Holdings of Selected US Institutional Investors in Leading French Companies
% of total capital

	U.S. Institutional Investors			All Foreign Investors
Company	**CalPERS**	**Fidelity**	**Templeton**	
AGF	0.20	0.09	0.20	42.0
Alcatel-Alsthom	0.30	10.04	1.90	22.0
AXA-UAP	0.36	0.26	1.06	37.0
BNP	0.24	0.15	4.90	35.0
Bouygues	0.21	0.05	-	30.0
Canal Plus	0.20	1.31	-	37.3
Elf	0.26	0.43	2.10	51.0
Générale des E.	0.41	0.07	-	42.0
Havas	0.21	0.04	-	15.0
Paribas	0.21	0.18	-	38.0
Saint-Gobain	0.36	0.06	0.17	35.0
Société Générale	0.39	0.68	-	45.0
Suez-Lyonnaise	0.53	0.13	2.50	39.0
Total	0.33	5.14	1.50	50.0

Source: “Le Nouveau Capitalisme Français,” Le Monde, March 1999, p. 1 (originally from the Banque de France).

[1] The OECD tones down that contention somewhat by saying that “[t]here is no single model of good corporate governance.” In the very next sentence, however, it notes that “At the same time, work carried out in Member countries and within the OECD has identified some common elements that underlie good corporate governance.” What are these elements? Of the principles put forward by the OECD the most significant are those that refer to the treatment of shareholders and stakeholders. With regard to the former, the OECD advises that “the corporate governance framework should protect shareholders’ rights” and “ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have an opportunity to obtain effective redress for violation of their rights (OECD, 1999, pp. 5, 6).” In contrast, “[t]he corporate governance framework should recognise the rights of stakeholders as established by law and encourage active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises (OECD, 1999, p. 7)." Shareholders are assumed to have rights, that the OECD lays out in some detail, that are deemed legitimate across countries and over time. The corporate governance framework should actively protect these rights. In contrast, “the corporate governance framework should assure that the rights of stakeholders *that are protected by law* are respected (OECD, 1999, p. 7, emphasis added).” The asymmetric treatment is clear. Whatever the OECD would like to pretend about

its international standards of corporate governance, they clearly resonate more with the contemporary Anglo-American systems of corporate governance than they do with others.

[2] In describing the evolution of corporate governance systems in the US and Germany I emphasise developments in the financial sector of both of these economies that have implications for the viability of their systems of corporate governance. Pressures from the productive sphere have also been important in influencing corporate governance in both of these countries, especially the US. I have discussed these pressures elsewhere (O'Sullivan, 2000) but I treat them in a cursory fashion herein due to space constraints.

[3] A substantial proportion of the recent upsurge in the share of mutual funds, moreover, is attributable to their growing popularity for pension provision; at the end of 1996, retirement plan assets represented 35 per cent of all mutual fund assets (Investment Company Institute, 1998).

[4] More recent figures are available only for the US and Britain. Both countries' foreign equity position has increased substantially but their relative positions remain close to where they were in 1996; the US held 2.4 times more foreign equities than Britain in 1998 compared with 2.48 in 1996.

[5] The 10 Commandments of the New Capitalism

[6] Who owns the largest French enterprises today? American pensioners! With the savings accumulated in their pension funds, they treated themselves to the shares of Pechiney, Usinor, or Rhône-Poulenc.

[7] Indeed these pension funds have their demands. Or rather, one demand: value, value again, always value. In other words, more money for the shareholder and therefore higher profitability on the capital invested in the company. That may seem straightforward but until now European capitalist – and especially French capitalism – has been sheltered from that constraint.

[8] As has been the case for their American and British counterparts for many years, French employers are in their turn subject to the dictate of shareholder value, the celebrated anglo-saxon shareholder value.

[9] the scapegoats when companies, as in the recent case of Michelin, decide to rationalise their production or announce layoffs.

[10] The Anglo-Saxon standards are asserting themselves little by little. And the system of stock options helps executives to see where their interests lie.

[11] There is at least one domain in which our bosses have nothing to begrudge their European counterparts and even some Anglo-Saxon managers: that is stock options. The apprenticeship occurred with a striking rapidity.

[12] If it is not a question of denouncing a completely legitimate mechanism that allows managers to make fortunes, it is undoubtedly time to raise questions about the control of stock option plans. Who ought to profit from them? According to our analysis, only 1 per cent of the 2.76 million wage-earners in the CAC40 benefit from them. Shareholder democracy should also find its place in the enterprise. What are the conditions under which stock options are awarded? The opacity around their terms and conditions leave even the so-called supporters of corporate governance perplexed. As if by accident, large enterprises in turmoil have seen a flowering of substantial stock option plans just before the announcement of mergers or acquisitions.

[13] The contribution of internal funds to net sources of finance of non-financial enterprises during the period 1970-1989 has recently been estimated as 80.6% for Germany, 69.3% for Japan, 97.3% for the UK, and 91.3% for the USA (Corbett and Jenkinson, 1996).