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Capital unbound? The transformation of European corporate governance

Martin Rhodes and Bastiaan van Apeldoorn

ABSTRACT This article represents a first attempt to analyse the forces at work in the transformation of European corporate space, at both the national and supranational levels. In doing so, it consciously combines a comparative with an international political economy perspective and argues against analyses which minimize the role of domestic institutions and understand the contemporary transformation of European capitalism solely in terms of globalization-driven, neo-liberal convergence. After discussing the existing variety of Europe's national capitalisms, we argue that a number of mechanisms are inducing change – competitive pressures on producers; the liberalization and integration of financial markets; the growing role of international actors; and the equally potent role of non-economic domestic actors in internalizing external pressures. We analyse their effects in three critical areas: corporate governance, especially in terms of the balance of power between 'stakeholders' and shareholders; the relationship between the 'public' and 'private'; and the balance between capital and labour in the 'networked' (and especially the 'Germanic') systems.

Despite these common pressures, we argue that although the differences between national systems will be modified in a market-liberal direction, this will not result in convergence for the following reasons. Domestically, élites will not promote change to a degree where it will undermine their own power and positions; path dependence and the lock-in effects of historical development create formidable pressures for continuity; and competitiveness will depend on the adjustment rather than abandonment of those structures and policies which have delivered efficiency in the past. As far as external pressures are concerned, international competition and the implementation of European monetary union are as likely to reinforce existing relationships as they are to break them down, while the creation of a new regulatory environment for European capitalism linking supranational with national rules still permits considerable scope for diversity.

KEY WORDS Capitalism (Anglo-American and 'network'); corporate governance; economic convergence; globalization.

When Europe's leaders met at Maastricht in 1991, the last thing they intended was that monetary union should be a vehicle for spreading Anglo-Saxon capitalism. But that will be the most dramatic effect of the single currency . . . There will be more equities and corporate bonds. And as it grows, the capital market will exert its influence on all other sectors of the European economy. It

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> will increase the pressure on companies to perform. Pursuit of shareholder value, hostile take-overs and better corporate governance – all will become increasingly prominent features of the European landscape.
>
> (*Financial Times*, 'The Lex Column', 30 March 1998)

INTRODUCTION

The above quotation is typical of the excitement and anticipation with which the mainly 'Anglo-Saxon' financial press awaits the full implementation of the European single market and monetary union. In combination with the irresistible forces of globalization, these final phases of European integration are expected to rein in the powers of national governments to set taxes, establish labour relations and influence the framework of corporate governance at will. Already restrained by the capacity of firms to shift production, tax burdens and corporate identity on a global scale, in a fully integrated European economy, national jurisdictions will become increasingly standardized as they compete for international investment. A strong stream of academic analysis agrees with this popular prognosis: advocates of the 'strong globalization' thesis like Teeple (1995: 5) argue that 'the neo-liberal agenda is the social and political counterpart to the globalization of production, distribution and exchange', marking an epochal change in the development of capitalism from one dominated by national capital tied to the nation state to one dominated by global capital escaping national regulation and control.

But for those familiar with another stream of political economy – one which takes a comparative approach and highlights the character and origins of national distinctiveness – the idea that capital is finally 'unbound', and will produce a process of transnational convergence on an 'Anglo-Saxon' or 'neo-liberal' model, is counter-intuitive. Zysman (1994), for instance, argues that 'historically rooted trajectories of growth' created by national institutional networks are not susceptible to rapid transformation or demise. Fligstein and Freeland (1995) characterize these trajectories in terms of the timing of entry into industrialization and the institutionalization of that process; the role of states in regulating property rights and rules of co-operation and competition; and the social organization of national élites. They further argue that, together, these combinations of institutions and rules create 'stable organization fields' and national systems that are resistant to convergence. There is, then, a puzzle: on the one hand we have a view of sweeping transformation, but on the other a picture of relative calm. Both cannot be correct.

This article sets out to tackle this conundrum. After examining the diversity of European 'capitalisms' below, we consider the arguments and evidence concerning their contemporary transformation. We first examine the institutions, rules and organizations of West European capitalism by focusing on 'corporate governance', construed broadly to include not just the regulation of the activities of firms but the web of relations that surround their operation, between 'stakeholders', shareholders, employees and the state. We then seek to develop a tentative understanding of the forces – both domestic and international – that may be changing these systems of governance and suggest a thesis of partial transformation in formerly stable systems. But there is also the question of what kind of socio-economic order, or 'model of capitalism', is emerging within the supranational regime of the European Union (EU). Rather than creating a pan-European, neo-liberal regime, we argue that, alongside other forms of internationalization, the creation of the single European market integrates elements of 'Anglo-Saxon' corporate governance and economic organization with established national institutions, norms and rules, thereby allowing for continued national diversity within a framework of 'embedded neo-liberalism'.

CAPITALISM VERSUS CAPITALISM IN WESTERN EUROPE

The diversity of West European capitalisms

Various attempts have been made to categorize capitalist systems, providing important insights into institutional distinctions and the way they affect the functioning and performance of firms. Albert (1993) draws a distinction between 'Atlantic' (Thatcherite/neo-American) and 'Rhenish' (German or Rhineland) capitalism. While the former prioritizes individual success and short-term financial profits, the latter promotes collective achievement, consensus and long-term results. The principal differences derive from contrasts in corporate governance: while the key characteristics of the Atlantic model are arm's-length relations between sources of finance and firms, the supremacy of shareholder interests and few restrictions on predatory behaviour (via mergers and acquisitions), those of the 'Rhenish' model derive from the concept of 'stakeholder' capitalism – i.e. the location of the firm and its management within a network of interests, including banks and workers. Although Vitols (1997) warns against romanticizing the German company as a 'stakeholder community', the purpose of corporate governance is often a much more 'collective' one than in the Anglo-American systems, given the stability of contractual relationships and widespread antipathy to 'hostile' takeover activity – although not, it should be noted, to the accumulation of 'hostile stakes', as in Germany where companies, with the assistance of banks, frequently use this method to gain control of competitors (Jenkinson and Ljungqvist 1997).

We cannot adequately present here the different characteristics of these systems, or acknowledge the important differences that exist within these broad 'capitalist families'. Tables 1 and 2 therefore summarize the characteristics of these systems, the first outlining the 'external' environment of firms, the second the system of 'corporate governance'.

As Gourevitch (1996) argues, the microstructures of industries and firms are shaped by regulatory policies which structure incentives to use different organizational forms. These, in turn, have a substantial effect on the efficiency of economies. In this respect, we can attribute 'advantages' and 'disadvantages' to the characteristics of these different models. In the *Anglo-Saxon, market-oriented systems*, advantages are thought to derive from the dynamism imparted by the external threat to poorly performing managers from hostile take-overs and the incentives provided by performance-related compensation. The sovereignty of shareholders is assumed to provide another check on management since the large

Table 1 Characteristics of market and network-oriented systems: external environment

Institutional context	*Market-oriented* *Anglo-Saxon*	*Network-oriented* *Germanic*	*Latin*
Role of the state	Shift towards a minimal state since the 1980s	A regulatory rather than interventionist state	Extensive public ownership (now declining)
Co-operation between social partners	Conflictual until the 1980s; now minimal contact (Ireland maintains corporatism)	Extensive at the national level till late 1960s. Revived in the 1980s/1990s	Social pacts in Italy and Portugal in 1980s/1990s; problematic in Spain and Greece
Labour organization	Union membership high till 1980s; fragmented organization	Union membership density high; strong centralized unions	Union density generally low: significant decline outside public sector
Education and training	Fragmented training system; poor skills provision	High level of participation in vocational and professional training	Lower levels of participation in fragmented training systems
Labour market flexibility	Poor internal flexibility owing to poor skills; high external flexibility	High skills allow internal flexibility, external flexibility more restricted	Lower internal flexibility (lower skills); external flexibility also restricted
National innovation system	Low levels of R&D; weak regional innovation support system	Higher levels of R&D; regionalized innovation support systems	France excepted, R&D national and regional support weak
Finance for innovative small firms	Explosion of venture capital companies, but regionally concentrated	Venture capital weak; access to regional banks for small firm finance	Venture capital weak; access to regional banks for small firm finance

shareholders can, in principle, replace it (although if managers are also the largest shareholders, this constraint is clearly reduced). These systems may also have a comparative advantage in fast-moving consumer markets (e.g. retailing and banking) or more high-risk areas of innovation such as pharmaceuticals and biotechnology (see Vitols 1997), while in Europe, Britain may be establishing some comparative advantage with its higher level of labour market flexibility. These advantages may be offset, however, by the lower levels of education and skills in the British workforce, certainly by comparison with Germany, and, although to a lesser

Table 2 Characteristics of market and network-oriented systems: corporate governance

Corporate features	*Market-oriented* *Anglo-Saxon*	*Network-oriented* *Germanic*	*Latin*
Employee influence	Limited; Japanese FDI promotes shop-floor collaboration, 1980s/1990s	Extensive through works councils on organization of work and training	Strong shop-floor influence until early 1980s; now minimal
Role of banks	Banks play a minimal role in corporate ownership	Universal banks play an important role in corporate finance and control	Bank holdings and participation in France and Spain only
Role of stock exchange	Strong role in corporate finance; 70 per cent of top 100 companies in UK listed	Publicly listed corporate firms limited; stock exchanges small	Stock exchanges relatively undeveloped; closed ownership
Shareholder sovereignty	Widely dispersed share ownership; dividends prioritized	Number of freely traded shares limited; dividends less prioritized	Shareholder sovereignty recognized but shareholders' rights restricted
Family-controlled firms	General separation of equity ownership and management control	Family ownership important in small and medium-sized firms	Family ownership and control extensive, exercised through holdings
Market for corporate control	Scope for hostile take-overs 'corrects' management failure	Take-overs restricted; managers under direct stakeholder influence	Take-overs restricted; little external challenge to management
Management boards	One-tier board system: includes executive and non-executive managers	Two-tier board system: supervisory and executive responsibilities separate	Administrative board combines supervisory and executive duties
Managerial labour market	Incentives (e.g. stock options) align management with shareholders	Performance-linked compensation limited: 'equality' important	Incentives more important (e.g. stock options in France)

Sources: Rhodes and van Apeldoorn (1997: 174–5); Moerland (1995a, 1995b); De Jong 1995.

extent, France; by the absence of long-term contractual relationships with suppliers of capital and workers which may encourage short-term, quick profit-oriented strategies; by the faster pace of mergers and acquisitions – frequently of a 'hostile' character – which may distract management from long-term corporate strategy, without necessarily adding to firm productivity or viability;[1] and by the priority given to 'shareholder value' at the expense of employees which means not just lower employee remuneration as a proportion of net value added, but also less institutionalized and, arguably, less productive industrial relations.

The *network-oriented systems* of the European continent also have advantages and disadvantages, and here the Germanic and Latin systems need to be distinguished. For while the former provides a generally productive environment for firms – with high levels of education and research and development (R&D) support and patient capital – the latter are much less well endowed in all these respects. Among the advantages attributed to Germanic network-oriented, 'contractual' governance are: the benefits of close and long-term relationships between firms and strategic capital suppliers (banks with board representation are thought to monitor managerial behaviour in a more constructive way than the Anglo-Saxon 'market' for corporate control, but the stability of long-term shareholdings in providing 'patient' capital is probably more important); a better institutionalized and similarly longer-term relationship between management and employees; and an advantage in market sectors which require 'depth competencies' (e.g. high-quality mechanical engineering, long-term relationship banking) (Vitols 1997).

More negatively, these systems are proving less successful in new sectors requiring greater flexibility in organization, labour relations and financial supply (e.g. venture capital for high-technology 'start-ups'); the strong 'insider' role of capital suppliers (the famous *Hausbanken* in the German case) may create an information gap to the disadvantage of 'outsider' smaller investors, compounded by a traditional lack of transparency in corporate governance (Moerland 1995a); and the absence of an active external market for corporate control means that managerial failure may not be corrected, especially where managers have been least subject to shareholder influence and where ownership has been separated from control by complex cross-shareholdings and pyramidal groups. The latter is especially true of the Latin countries where covert and cosy relationships are often consolidated by membership of a relatively closed élite (e.g. the network of graduates of the prestigious French École Nationale d'Administration in France and the restricted club – *salotto buono* – of leaders of the largest Italian companies and financial organizations) and where the role of banks as monitors has certainly been less important: France and Italy are neither bank-centred nor market-oriented, given the absence in both countries of strong and independent financial intermediaries (France is, after Italy, the country where the ownership share of financial institutions is lowest, owing in part to legal obstacles to bank equity ownership) (Goldstein 1996; Sarcinelli 1997).

GLOBALIZATION AND SYSTEM TRANSFORMATION

Given the continued diversity of West European capitalisms, the argument that globalization has swept away the national distinctiveness of both firms and their national systems of innovation and support is untenable. We broadly agree with the analysis of Forsyth and Notermans and their colleagues (1997) which suggests that the shift to a disinflationary macroeconomic policy regime and deregulation of the financial sector cannot be explained primarily by the globalization of business and financial markets in the 1970s and 1980s, but has had more to do with the need to forestall a cumulative inflationary dynamic across the industrial nations. Their argument that the liberalization of financial regulation has not led to convergence in national financial systems is also well taken. Nevertheless, as we argue below, important tensions are now emerging between national systems and the 'extra-national' sphere of multinationals and global finance and within national systems between the protagonists of liberalizing change and the defenders of the status quo. Bit by bit, globalization – and the new domestic pressures and coalitions it generates – are beginning to transform the traditional relationships between governments, banks, companies and unions that have underpinned national socio-economic orders, even if 'convergence' may not be the end result.

While Gill (1995) links globalization to neo-liberalism in arguing that the impact of the latter will vary 'according to the size, economic strength, form of state and civil society, and prevailing national and regional institutional capabilities, as well as the degree of integration into global capital and money markets' (1995: 415), Boyer (1996) and Gourevitch (1996) have suggested more precise ways of understanding the mechanisms behind such change. For Boyer, diverse systems may find 'by chance or necessity' solutions to common problems; or international consulting firms, international bodies or multinationals may diffuse the same business principles and economic policies across national borders, while also defining or enforcing the rules of the game within a given international regime. Gourevitch mentions the internalization of external pressures, internally generated pressure, producer-led reform, and the role of the bureaucracy and political parties. Adapting the insights of all three approaches, we argue that several dynamics are at work in which domestic and international forces interact in destabilizing traditional 'contractual' relations:

- competitive pressures on producers who consequently seek to modify their domestic contexts, depending on whether they prioritize local or global markets;
- the liberalization and integration of financial markets, which has also modified the behaviour of banks, making them in certain cases the advocates of further, liberalizing domestic change;
- the growing role of international actors – multinationals, investment banks, pension funds, international authorities – in advocating domestic regulatory change in countries where they are active;
- and the equally potent role of non-economic domestic actors (politicians, bureaucrats and technocrats) in internalizing external pressures.

Below we examine the combined impact of these forces in three critical areas where a significant shift in power between actors is occurring:

- in corporate governance, especially in terms of the balance of power between 'stakeholders' and shareholders;
- in the relationship between and respective weight of the 'public and the private' in these systems;
- and in the balance between capital and labour in the 'networked' (and especially the 'Germanic') firm.

'Stakeholders' versus 'shareholders' in corporate governance

Fligstein and Freeland (1995: 36) have argued that 'while the American industrial structure is firmly in the grasp of the finance conception of control, the rest of the world has steadfastly resisted importing such a notion of governance . . . in large part because of state and élite resistance.' While they are correct to emphasize the resistance of European countries to the wholesale adoption of Anglo-American practice, this should not blind us to the fact that the nature of their capitalist élites is changing, making them much more amenable than hitherto to the finance conception of control – and especially the associated notion of 'shareholder value'.

Recent evidence suggests that network systems will increasingly accommodate the 'Anglo-Saxon' characteristic of channelling capital flows to corporations through investment funds, pension funds and insurance companies, while managers will identify more closely with stock price behaviour as more companies seek stock market quotation and managers' remuneration is tied more closely to performance (e.g. through stock options). Funded pensions are spreading as continental countries find them a solution to the demographic problem of an ever-climbing ratio of retirees to the employed and they will take their 'Anglo-Saxon' values with them. While the Anglo-Saxon market for corporate control seems to be becoming less ferocious (as corporate raiding, hostile take-overs and asset stripping lose favour), management in 'network' countries is becoming increasingly subject to the influence of shareholders, the result of a combination of growing shareholder pressure and new EU regulations (see below). This has important implications not just for the balance between 'stakeholder' and shareholder power in the network systems but also for the behaviour of companies.

German companies are leading the way in adopting both the rhetoric and practice of 'shareholder value' – in large part because their continued expansion requires access to international capital: as Viag chairman Georg Obermeier has stated, 'We need international capital markets and therefore we inevitably need to meet international standards' (which means greater transparency through the use of global accounting standards and an end to cross-subsidization and the use of hidden reserves to disguise bad earnings figures) and 'less social consensus, although it is important, and more value added. This is the trend change in Germany' (*Financial Times*, 14 January 1998). Thus, large German companies (Deutsche Bank and Daimler Benz) have introduced stock option schemes for senior management,[2] while others are also modifying their internal rules regarding the rights of shareholders and transparency: Continental has abolished the rule limiting voting rights to 5 per cent or more of equity capital, while Bayer has raised the return on shareholders' funds from 14 to 20 per cent. Deutsche Bank has introduced International Accounting Standard (IAS) accounting and Veba, the energy and telecommunications group, has shifted to Generally Accepted Accounting Standards (GAAP) (Marsh 1996). In both France and Germany, one of the consequences of the growing number of Anglo-Saxon institutional investors on shareholder rosters means that managers are increasingly oriented towards restructuring and a more aggressive exploitation of market opportunities.

This last point alerts us to the fact that, while the increasingly international reach of these companies clearly plays a role in their transformation, so too does the penetration of their domestic markets by foreign actors with a different set of corporate values. Germany, France, Italy and the other continental economies have all witnessed an increase in the domestic presence of foreign – especially American – investors, attracted by the opening up of European markets and the lucrative business generated by privatization programmes. While the nature of privatization differs from country to country (in some, like France and Italy, companies are often secured from foreign take-over by continued government stakes or shareholder pacts between core investors), its net effect has been to undermine traditional relationships. As Schmidt (1997) notes in the French case, privatization has helped to ensure the internationalization of French capital through the participation of foreign firms in the hard core of investors and on the boards of directors. Foreign financial services companies have also expanded in the European market, bringing more aggressive business methods with them and influencing the business practices of European companies, given that, until recently, financial intermediaries in most European countries have been as hidebound and conservative as their stock markets. American business culture is being spread throughout Europe by the growing presence of US institutional investors, consultancy firms and credit agencies like Standard & Poors – which exercise considerable influence over the direction and nature of investment – not to mention the arrival of a new generation of executives trained in US business schools or with formative career years in US companies.[3] Goldman Sachs, for example, is becoming a major operator, if not *the* major operator, in mergers and acquisitions (M&A) in a number of European countries. In France, in 1996, it beat the Parisian company Lazard Frères into second place in the French M&A business league (Jack 1997) and has also been a key player on the protagonists' side in recent hostile take-over bids. In Germany (where M&A activity has accelerated in recent years) (Müller-Stewens and Schäfer 1997), Goldman Sachs has close links with Daimler Benz and Deutsche Bank and played a key role in Krupp Hoesch's debt-financed bid for Thyssen in 1996, which, though it failed (owing to widespread antipathy towards such practices), led to the negotiated merger of these groups in 1997. Both steel groups are now striving for a clearly defined return on capital – 12.5 per cent for Thyssen, 15 per cent for Krupp – and have been downsizing (US style) to achieve it (*Financial Times*, 5 November 1997).

As already mentioned above, one obvious way that the foreign lobby is influencing corporate governance is by encouraging the spread of shareholder sovereignty in the 'network' systems. Lobbying by domestic shareholder groups for greater management transparency and responsiveness (German investment funds have been particularly active) has been backed by foreign shareholders and fund managers frustrated by the interlocking élite relationships that still dominate these systems.[4] More generally, the shift towards greater reliance on equity markets and the desirability of international alliances are forcing even the most secretive private companies to become more open. Even in Italy, where corporate culture is at its most opaque, companies are being forced to become more transparent: attempts by companies like Fiat to forge the international alliances they need to grow are forcing them to consider transformation from family-owned conglomerates to public ones; in 1996, Olivetti was forced to report quarterly figures in response to a 1996 shareholders' revolt that also toppled chairman Carlo De Benedetti. As one observer has commented, alongside the dismantling of the Italian public sector, a combination of both internal and external pressures is forcing the 'privatization' of the Italian private sector (Betts 1997). As discussed below, politicians and technocrats are also gradually responding to these pressures, introducing new legislation to open up the club-like character of continental corporate control.

The changing balance between public and private sector power

The privatization of state-owned firms and utilities and the parallel liberalization of previously closely controlled markets are turning previously mixed economies into regulated market economies, implying a considerable boost in the scale and power of once public but now private sector companies. One result has been the emergence of a major cleavage between private sector actors who have embraced the new world of the liberalized market and those companies which retain a public sector character and a more 'social' orientation. Political struggles along this divide promise to become one of the major determinants of the future shape of national capitalisms in western Europe.

Take France, for example, where large parts of the extensive public industrial and financial sector (built up by the Socialist government in the early 1980s) are now being privatized. While certain large corporations will remain under state control – especially non-commercial financial institutions such as the mutual banks, the Caisse d'Épargne savings bank network, Crédit Agricole and the Post Office – the way that they operate may have to change substantially as the result of an onslaught by the expanding commercial sector on their special lending rights and subsidies. Long seen as a central part of a 'socially oriented' banking system, these institutions are now seen as the source of 'competitive distortions'. Private sector French banks have increasingly attacked the allegedly unfair way that the state has repeatedly bailed out Crédit Lyonnais, the highly loss-making French public sector bank (which has received FF49 billion of aid to date). And backed by the powerful Jean-Claude Trichet, the governor of the Bank of France and head of the state regulatory Banking Commission, they and their political allies have been waging war on the 'uncompetitive practices' of those financial institutions which remain protected by the state. The Caisse d'Épargne is a key target (for it is not obliged to pay dividends on its shares and has exclusive rights to offer the *Livret A*, a tax-exempt savings product), as are Crédit Mutuel (which exclusively runs the *Livret Bleu*, a state-run savings account which has higher than market rates) and Crédit Agricole which has a monopoly right to collect deposits from notaries in rural areas. The commercial banks claim that this special status distorts competition and enables the savings bank network to undercut them and reduce their interest rates to uncompetitive levels.

Meanwhile, in Germany a similar cleavage has opened up between the private sector banks (grouped in the German Banking Association) and public sector banks, again over allegedly unfair competition. An example is the accusation levelled against WestLB and five other *Länder*-backed public sector banks (*Landesbanken*) for receiving capital injections in the form of housing development funds (and – at least in the case of WestLB – for operating internationally in the same way as the large German universal banks), using their triple A rating (gained because of their *Länder*-guaranteed status) to borrow and lend at lower rates of interest (Kregel 1997). However, both Bonn and the *Länder* also regard public banks as important agents of regional policy, while the *Landesbanken* are deeply embedded in local political and economic structures and play a critical role in the network of regional and local savings banks (*Sparkassen*). While the large commercial banks (especially the 'Big Three' – Deutsche Bank, Dresdner Bank and Commerz Bank) have sought to be more competitive, both domestically and internationally, have reduced the size of their equity stakes in non-financial companies, and have set out to become global players by buying 'Anglo-American' investment banks (Deutsche Bank-Morgan Grenfell, Dresdner-Kleinwort Benson), the savings and co-operative banks play a major role in underpinning the financial strength and adaptability of Germany's *Mittelstand* of medium-sized firms, creating a dual system of industrial finance (see Deeg 1997).

In both countries, the European Commission has been drawn into the dispute. In December 1997, French mutual banks were put under investigation by the Commission after complaints by commercial rivals about distortions in the financial sector: the probe is focusing on the Crédit Mutuel *Livret Bleu* operations and Crédit Agricole. In the German case, Helmut Kohl's attempts to secure special protection for the German public bank network in the Amsterdam Treaty led to a compromise in which the local authority-linked financial infrastructure system will remain safe (as long as it does not infringe competition policy guidelines), but a more general ring-fencing of the sector was refused. As a result, the Commission is now probing the activities of WestLB.

The changing balance of power in industrial relations

The potential effect of globalization on employee influence and solidarity in the 'networked' (and especially 'Germanic' firm) is far-reaching. Quite apart from the issue of non-wage labour cost competition – with all that this implies for wider issues of social welfare policy – there is the pressure that the changing nature of the global corporation will place on the tradition of social consensus. First, German employers – like their counterparts in other 'organized' capitalist countries such as

Denmark and Sweden – have been decentralizing bargaining to the level of the firm to tailor costs more precisely to its needs. Solidarity among workers may consequently be diminished. In addition, as 'networked' firms 'go global' and embrace new methods of business organization and new forms of finance, the traditionally greater share of net value added they distributed to workers in the past will be challenged by the growing power of institutional shareholders – both domestic (including newly liberated pension funds) and foreign: until now, for Europe as a whole, the wage share in value added has been stable, generally reflecting the rise and fall in the business cycle (high at the troughs, low at the peaks), and significantly higher than in the Anglo-American systems (Young 1997).

Moreover, even if it does not actually relocate all parts of its production, conception and design process, the increasingly internationalized firm can use its locational power (i.e. the threat of exit) to modify contractual relations at home, making it potentially a major agent in eroding the differences between 'shareholder' and the 'stakeholder' economies. German firms – including Daimler Benz, Bosch, BMW as well as multinationals with a wider scope such as Ford and GM Europe – have increasingly used locational threats to weaken the power of unions and force concession bargaining (see Mueller 1996).[5] German companies and unions are now agreeing patterns of flexible working that were unthinkable just five years ago, and many of these are reached locally with company works' councils, thereby circumventing national accords. But the national union IG Metall is also sometimes involved. This was the case in a recent example of concession bargaining from Osram, the German light bulb manufacturer which is part of the Siemens group. A deal with the union was forced after the company threatened to shift production from Augsburg to Bari in southern Italy, where labour costs are some 40 per cent lower. In the productivity deal that saved the plant for Augsburg, the union agreed that the new production line there would be kept running for 160 hours a week, 18 hours longer than the previous maximum for the plant. Ford's loss-making German operations have struck a deal with 34,000 employees, whereby it saves $120 million and gains greater flexibility in organizing work levels in return for keeping jobs and investment in Germany and compensates for a drop in overall take-home pay with more time off. Following a 1997 deal in the chemical industry, companies can cut wages by up to 10 per cent in a downturn in return for not laying off workers (*Financial Times*, 17 June 1997).

More generally, certain employers' associations and large companies are testing both the will of the government and of labour in key areas of labour regulation. In September 1996, Daimler Benz, Siemens and Mannesmann cut sick pay unilaterally by 20 per cent, provoking widespread labour unrest (although many other large companies opposed this action as destructive to what they still see as the broadly positive German system of consensual industrial relations). In August 1996, Werner Stumfe, the head of Gesamtmetall (which represents 8,500 German engineering companies), launched an attack on the influence of trade unions on management boards in large German companies, arguing that it prevented competitive restructuring and was deterring foreign investment. Gesamtmetall renewed its attack in November 1997 and called for a new system of working hours, more profit-related pay, special treatment for loss-making companies, greater all-round flexibility in collective sector-wide wage bargaining and the introduction of varied working time arrangements. In January 1998, Hans Olaf Henkel, the head of the German Industry Federation, also attacked centralized wage bargaining and advised companies to start breaking their wage contracts.

THE TRIUMPH OF ANGLO-SAXON CAPITALISM?

Globalization – and the new domestic pressures and coalitions that it generates – are thus beginning to transform the traditional relationships between government, banks, companies and unions that have underpinned national socio-economic orders. But in none of these areas is a clear process of neo-liberal convergence occurring. We argue that there are several reasons why neo-liberal convergence is not occurring and is very unlikely in the future.

- first, there is a power argument: in the same way that the rhetoric and practice of Anglo-American corporate governance are being adopted to bolster the power of certain élites, those same élites will resist any changes that might go too far in undermining their own positions, as will those who will clearly lose from the modification of traditional rules and norms;
- second, there is an argument about path dependence and the lock-in effects of historical development which, as discussed by Fligstein and Freeland (1995), create formidable pressures for continuity.
- third, there is an efficiency argument: as argued by Gourevitch (1996), the efficiency and competitiveness of economies are linked to the microstructures of industries and firms whose incentives to use different organizational forms are shaped by particular national regulatory policies: continued competitiveness will depend on the adjustment rather than abandonment of those structures and policies.

Two further reasons stem from the external environment:

- external pressures (international competition, the shift to a new macropolicy regime under European monetary union) are as likely to reinforce existing relationships as they are to break them down (we argue that this is most clearly the case with social partnership and corporatism);
- and finally – the subject of our final section – the creation of a new regulatory environment for European capitalism which links supernational and national rules is one in which considerable scope for national variety is allowed.

Beginning with 'shareholder' value: while the rhetoric and practice of a new style of 'corporate governance' are becoming important in the network systems, there is widespread resistance to the full-scale adoption of Anglo-Saxon rules and norms and to the unravelling of traditional 'contractual' relations. Numerous examples of such resistance can be found, especially in Germany, including opposition to hostile take-over bids, as with the widespread chorus of disapproval voiced by national and local politicians, business and labour representatives to the abortive Krupp Hoesch bid for Thyssen in 1996; and the joint 1996 position paper presented by a broad business coalition opposed to an agenda for reform promoted by the opposition SPD (including measures to reduce the influence of large private banks via shareholdings in non-banks and the exercise of proxy powers, and the anti-competitive practice of cross-shareholdings with competing companies) (Vitols and Woolcock 1997). To the continued importance of stable, long-term shareholdership in the German system and of the large banks in the insider system of corporate control (see Deeg 1997), one can add the centrality of large and powerful actors, such as the Italian investment bank Mediobanca, or the financial groups Paribas and Indo Suez in France, in governing the tight network of relations that span their countries' cross- and circular shareholdings and interlocking boards. These are key features of these systems and a major defence against outsider influence and far-reaching corporate change – even if in recent years these linkages have been unravelling, owing to the turbulence created by privatization and the greater independence of those companies with foreign partners. But in neither France nor Italy does this amount to their abandonment, nor does it suggest a radical shift towards Anglo-Saxon corporate governance.

But under the aegis of pro-reform élites, an onslaught *is* occurring on the worst abuses of power which can result from the 'club-like' character of continental capitalism. New codes of governance influenced by Anglo-Saxon practice have been introduced in the wake of the 1995 Viénot Committee of the French employers' federation, the CNPF (and parallel proposals from the Senate's Marini Committee), and the 1995 take-over code drawn up by the Advisory Committee of the Deutsche Börse AG. These have been influenced in part by the recommendations of the 1994 Cadbury Report in the UK, which became semi-compulsory for British listed companies, and concern the rights of minority shareholders and the monitoring of accounts and remuneration packages. In Spain, the new conservative government set up a commission in 1997 to overhaul that country's arcane and opaque corporate governance system, while in Italy legislation designed by the Treasury's Draghi committee is revising the rules of Italian capitalism and challenging the old interlocked vested interests of family firms and financial holding companies. Again, policies to open up the corporation and elevate shareholders' interests to a higher level will not necessarily overturn the existing system or align it with Anglo-Saxon practice. But one of the key elements of continental capitalism – the closed, backroom conduct of corporate affairs – is clearly under siege.

Second, although there has been an onslaught on 'public purpose' banking in Germany and France, for example, led by increasingly internationalized and market-oriented finance capital, it seems likely that a new equilibrium will be found, in part because of the willingness of the European Commission to protect the local financial infrastructure of the network systems that has a 'social purpose', but also because of the obvious efficacy of these forms of finance for small and medium-sized firms. Here, the power and efficiency arguments go hand in hand with path dependency to explain continuity. It is true that the international and domestic financial environment has been transformed by the emergence of global markets in short-term securities and cross-border equity trade, by rapid innovation in new financial instruments like derivatives (swaps, futures and options), and by the appearance of actors with transnational investments (insurance companies, mutual investment funds and pension funds). In response, national authorities have had to surrender traditional control over banking and financial markets, and monetary instruments like credit control, and replace them with regulatory frameworks that permit international capital flows. Once cosy relations between central banks and domestic financial communities are being undermined. But, on the other hand, as Vitols (1997: 249) notes, the importance of institutional interdependence is preventing these changes from generating full financial system convergence, for different types of production regime make varying demands for varying types of capital; while companies that rely on cheaper labour and less new equipment are less likely to require long-term debt capital than those relying on greater quantities of new equipment and long-term planning, the greater stability of industrial organization in these latter companies (owing, for example, to tighter forms of labour market regulation) may also produce stability in industrial finance.

This brings us back to industrial relations. Although the long-term linkages between productive systems and financial systems will not necessarily cement in place a similar linkage between productive systems and labour relations, it does seem that both path-dependence and the efficiency argument will ensure that employers will not rush to abandon arrangements that have served them well in the past. Indeed, in the German case, the posturing and rhetoric of certain companies and employer organizations have simply hastened arrival at a new compromise rather than precipitating a crisis. While there has been a perceptible shift in the balance of power between capital and labour, neither the destruction of co-operative labour relations nor the abandonment of social partnership is imminent: on the contrary, as elsewhere, new forms of social partnership will prove essential for macro-economic policy innovation and micro-economic adjustment. Thus, other corporate leaders in Germany have lined up alongside trade unions to defend the merits of centralized wage bargaining (although most insist that the system needs reform to ensure its survival) and, together, German employers and trade unions are likely to find a more flexible version of the present system. Dieter Hundt, the president of the BDA (the German employers' federation), has said that his organization is working towards a 'sensible reform' and wants its members to stick by their wage agreements; meanwhile, IG Metall leader Klaus Zwickel says that a raft of different agreements could be concluded centrally and then companies could choose from those 'building blocks' according to their needs (*Financial Times*, 29 January 1998).

This type of reform would introduce into the German system the kind of centrally negotiated bargaining flexibility that is being adopted in many European industrial relations systems. Contrary to common prediction, these have actually preserved in most cases either the principal elements of their centralized bargaining systems (e.g. Finland, Denmark, Norway and Austria) or (as in the case of the Netherlands since the mid-1980s) have revived and made corporatist policy-making and wage regulation more flexible. Only Sweden has seen a radical departure from its previously centralized model (arguably owing more to the conflict between employers and unions over new labour laws and wage earner funds from the late 1970s than any globalization effect), while incomes policies and wider corporatist bargains are now well established in Portugal, Italy and Ireland.

The persistence or modification of social partnership can be attributed to the fact that pressures for the dismantling of contractual social relations have been accompanied by equally powerful pressures for their preservation. On the one hand, decentralization in formerly centralized industrial relations systems has been induced by the introduction by multinationals of ‘alien’ elements into national bargaining arenas and by cross-class ‘flexibility’ alliances between employers and workers in export sectors, while employers in all systems are searching for greater company and plant-level flexibility. The creation of the single market and movement towards monetary union are also placing new pressures on wage-cost competition, given constraints on competitive devaluation. But there are also pressures in favour of centralization – as well as high levels of national (and European) employment protection. For also in response to competitive pressures, the diffusion of new forms of ‘best practice’ management and work organization implies the creation or maintenance of co-operative labour relations and a high-trust firm environment. Well-designed systems of labour market rules remain essential in this context, while both cost competitiveness and stability require a means of preventing wage drift and inflationary pressures. This has focused the attention of governments on revitalizing incomes policies. Rather than disrupting these forms of concertation, the movement to full monetary union is likely to lock the bargaining partners even more closely together (Rhodes 1998).

THE EUROPEAN DIMENSION: A CONVERGENT OR FRAGMENTED CORPORATE SPACE?

On the basis of the above, we argue that globalization is not demanding a global neo-liberal order, nor for that matter is market integration in Europe demanding the destruction of national distinctiveness. For globalization and market integration not only involve the state as an agent in the process of opening borders, liberalizing markets and promoting the flow of finance and trade, but also, of necessity, in channelling, constraining and legitimizing market power. The spread of market ideology (neo-liberalism) hits its functional limits when the dependence of the market on national institutions is revealed. Quite apart from ideological resistance, at that point a purely neo-liberal strategy becomes dysfunctional; for the effective functioning of market mechanisms still requires purposive state intervention – and in many countries social concertation and corporatism – in *re*regulating the domains of welfare, taxation, innovation, employment and education.

In the European context, there has been a convergence of philosophy and strategy among the EU’s most powerful business and political actors on what we call ‘embedded neo-liberalism’ (see Apeldoorn 1998), the result of a conflict between three incompatible views of state–market relations in the 1970s and 1980s: *pan-European social democracy*, promoted by social democratic political forces and the European trade union movement as a strategy to protect the European ‘social model’ – the mixed economy and extensive social protection – against globalization;

neo-liberalism, as the ideological outlook of global financial capital (based primarily in the City of London), but also of some (mainly British) multinationals, according to which the European region must be exposed to what are seen as the beneficial forces of globalization; and *neo-mercantilism*, oriented instead towards a strong regional economy through industrial policy and the promotion of Euro-champions (if necessary protected by European tariff walls) as a bulwark against global competition. *Embedded neo-liberalism* (most clearly advocated by the German multinationals) is premised on a strong belief in the free market and supports neo-liberal policies of deregulation and flexibilization, but recognizes that the market must be embedded in a regulatory framework fostering both competitive business and social consensus.

By the early 1990s, Europe's most powerful businesses, grouped in the European Roundtable of Industrialists, had overcome their earlier division between neo-liberals and neo-mercantilists, and advocated an 'embedded neo-liberal' compromise. At the same time, politicians across Europe were moving towards a compromise of their own in introducing a social component (albeit a rather weak one) into the European constitutional settlement at Maastricht, as well as stressing the need to preserve national prerogatives via the subsidiarity clause. For this reason, the Maastricht compromise represented neither a triumph for Thatcherite neo-liberalism nor the construction of a neo-mercantilist Europe, but rather a complex synthesis. Monetary union – the central part of the treaty – and its convergence criteria most clearly reflect the neo-liberal orthodoxy. But aspects of the Rhenish 'network' model can be found in the Maastricht chapters on 'Trans-European {infrastructure} Networks' and 'Research and Technological Development' (reflecting a German-style industrial policy or *Ordnungspolitik*) and in the appended Social Protocol and Agreement which sets out procedures for bargaining between European trade unions and employers.

One of the reasons for the acknowledgement of subsidiarity at Maastricht was the battle waged in the 1980s and early 1990s over attempts to introduce a uniform system of corporate governance – part and parcel, in fact, of the broader conflict outlined above. Harmonization had been advocated from various quarters, but the most powerful arguments were either based on the need for lower transaction costs via standardization or on the need simultaneously to avoid a convergence spiral (triggered by corporations moving their headquarters to countries with more lenient governance systems) and remove the *de facto* entry barriers to capital created by continued differences in rules on take-overs and share ownership (see Schaede 1995). But, in fact, the directives regulating European corporate space have either been blocked by national disagreements over surrendering national sovereignty or have been issued in a form which allows a degree of national diversity. Moreover, there remain many gaps in the European regulatory framework preventing a full liberalization of financial services and cross-border investment.

The existence of national disagreement on the constitution of a European corporate space should not surprise us since, as Fligstein and Mara-Drita (1996) argue, the regulation of property rights and competition is more central to the state's claim on sovereignty than rules of exchange, and it is the liberalization of the latter rather than the former in the single market project that has gained the greatest degree of élite consent. Moreover, many of the directives which affect this area of sovereignty have been poorly conceived, translating particular national models into draft European legislation: thus, while the UK model was adopted for proposals on take-over rules (the Thirteenth Company Law Directive), the Germanic two-tier board structure strongly influenced the EU draft on internal governance mechanisms (the Fifth Directive), provoking predictable rejections from élites in both the Anglo-Saxon and network economies (Schaede 1995). Similarly, both the proposal for a European Company Statue and the Tenth Company Law Directive on cross-border mergers remain blocked – mainly because of disputes over their employee participation components but also because, like the Fifth and Thirteenth Directives, they ignore the fundamental interdependence between corporate law and corporate finance in national systems (Berglöf 1997).

In the case of the Company Statute, the struggle between a pure neo-liberal and an embedded neo-liberal view of the market continues, for, true to their global orientation, the large British multinationals are opposed to a European statute altogether, advocating a mix of national and international governance, and a harmonization of rules for company behaviour through the International Accountancy Standards Committee. The latter view may ultimately prevail. For attempts to reduce the diversity of accounting standards within the EU via the Fourth Directive on Company Accounts (1979) and the Seventh Directive on Consolidated Accounting (1983) produced little in the way of harmonization and the adoption of mutual recognition seems to have reduced the priority given to it. As recent German developments suggest, as national standards decline within the EU they are more likely to be replaced by international IAS or US GAAP rules than European standards (Leftwich 1997). In February 1998, the German government introduced a bill to regulate a *de facto* reality and allow quoted companies to use international accounting standards as part of its plan to broaden its country's capital markets.

Alongside the other institutional and political impediments outlined above, regulatory gaps and inconsistencies prevent the adoption or imposition of a single European capitalist model – neo-liberal or otherwise. Finance again provides a clear example. The first step towards the creation of a free European financial area began in 1988 with the Capital Movements Directive. As in other sectors, rather than a shift in governance to the European level, a two-tier structure has been created. While the Commission is responsible for removing national barriers and controls, the main policy instruments – and responsibility for domestic market regulation – remain with the member states. The governing principle here is mutual recognition rather than harmonization. Under the Second Banking Directive of 1989, for example, banks of one country can offer a full range of services in another. But while a financial institution must comply with the market rules of the country in which it operates, responsibility for regulating that institution lies with its home country. Moreover, a full surrender of national influence is unlikely in the near future. Some countries enjoy derogations, preventing access to various parts of their financial sectors, while tax differences affecting many financial products remain extensive and most directives allow governments to apply local conduct-of-business rules to foreign firms.

In financial services – an area of regulation with far-reaching consequences for European corporate governance – EU directives have already altered business conduct by introducing new standards of capital adequacy and risk assessment and increasing transparency. Old practices – insider trading, the monopoly status of traditional brokers, unregulated 'gentleman's' agreements on conduct – have been swept away, and parochial stock exchange activities have been revolutionized by organizational change, computerization and, in the German case, a centralization of securities, futures and options trading and a privatization of the Frankfurt exchange. The 1996 Investment Services Directive (ISD) and its sibling, the Capital Adequacy Directive (CAD), set new minimum standards for markets and traders and will help to remove some of the vestiges of 'nationalism' from Europe's stock markets. But as with the Capital Movements and Second Banking Directives, scope for some national diversity is maintained. While it is no longer possible for governments and stock exchanges to prevent competition across their borders – for investment firms regulated in their own countries can acquire a 'passport' to operate in others and trade on foreign exchanges using remote access – host countries cannot take away the passport of 'visiting' companies (which may have been awarded in a country with more relaxed standards) and capital adequacy standards will remain diverse, given that a *minimum* rather than a uniform level is required.

At the same time, governments may continue to protect their home markets in numerous ways, as evidenced by the problems of insurance companies in gaining access to Germany and mortgage issuers in penetrating France. The regional differences between Europe's personal insurance markets are still too great for any real cross-border synergies in the insurance market, while European monetary union on its own will fall short of providing the economic and legislative harmonization required to sell life assurance and pensions across borders: in some countries (e.g. Belgium) one can only claim back tax on life policies when they have been bought from local suppliers – a privilege enshrined in law by the European Court of Justice in the early 1990s. Equally, VAT rules are still unharmonized (in part because of the difficulties in bringing corporate tax rates together) and bankruptcy laws remain nationally specific. The 1985 Undertaking for Collective Investment in Transferable Securities Directive does not prevent countries from protecting their home financial services markets, by restricting pension funds products, for example, to resident fund managers (a market which the UK is currently campaigning to liberalize). Equity markets are still fragmented by a maze of different rules and regulations: thus in Denmark, Sweden, France and the UK, it is not possible for companies from another member state to launch a public offering using a prospectus drawn up in accordance with the EU's Prospectus Directive (*Financial Times*, 26 January 1998). In sum, Europe is set to remain a regulatory mosaic, regardless of the greater uniformity that is also being created by pan-European rules.

CONCLUSION

Whether embedded neo-liberalism will prove to be a stable *European* model of capitalism remains to be seen. What seems clear, however, is that the EU will not recapture the public governance that is being eroded at the national level, since European integration will continue to be primarily a process of *market* integration. This supremacy of the market is 'softened', however, in so far as the single market is still embedded at the national level by old institutions as well as by new European institutions although the former are clearly still more important. In this respect, the embeddedness of neo-liberal Europe is located primarily at the national level in terms both of economic organization and social legitimacy.

If the Anglo-Saxon model of finance gains more ground on the European continent once European monetary union sweeps away the remaining national barriers to economic integration, the 'strong globalization' thesis may then prove correct in predicting that the social and political structures of European national capitalisms may also be eroded and move towards the more minimal provisions of market-oriented systems. Nevertheless, as we have explained, there are good reasons to expect that systems of corporate governance will converge only at the margins, while the external support networks of the Germanic – and, to a lesser extent, the Latin – firms will be remodelled rather than abandoned. This is because these systems still gain competitive advantage from their 'network' resources and because the complex relationships that underpin them are highly resistant to radical change. That said, the stability of these systems will ultimately depend on the outcome of the political struggles between stakeholders and shareholders, companies and their employees, and private and publicly oriented capital, and on their ability to accommodate the forces of global capitalism without also abandoning their own institutions of national economic governance.

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NOTES

1 To quote Young (1997: 48–9): 'output per employee in the entire manufacturing sector has risen by about 7 per cent more in Europe than it has in the USA during the past decade . . . {this} raises the issue of what restructuring is about if the USA does it, Europe does not do it, and Europe has the higher labour productivity growth.'

2 It is worth noting that another 'network' system – Japan – is travelling a similar path in terms of executive remuneration. The Japanese parliament removed the legal obstacles to stock options in 1997.

3 There has recently been a proliferation of such people in the new structure created by the merger of Mercedes Benz and Daimler Benz in January 1997.

4 To date, however, the tactics used by large US pension funds in the USA to shake up management in the companies where they invest have not been widely employed in Europe: it was expected that Calpers (the California Public Employees' Retirement Funds), which has large holdings in both the UK and France, would adopt such tactics there but so far it has behaved much more cautiously. Calpers has, however, lobbied actively to support changes in French and British corporate governance systems.

5 Similar developments have occurred in other European countries, including, most notably, Sweden, where the relocation debate has been as vigorous as in Germany. Here

the problem seems to be less labour costs and corporate tax rates (which are low) than very high personal tax rates, which makes it hard for companies like Ericsson and Astra to retain and attract personnel for their large R&D operations. Ericsson has been threatening for some time to transfer the headquarters of its transport and cable networks business from Stockholm to the UK.

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