CHANGES IN CORPORATE GOVERNANCE OF GERMAN CORPORATIONS: CONVERGENCE TO THE ANGLO-AMERICAN MODEL?

ESRC Centre for Business Research, University of Cambridge
Working Paper No. 259

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March 2003

This Working Paper forms part of the CBR Research Programme on Corporate Governance: www.cbr.cam.ac.uk/research/programme2

Abstract

This paper examines the many changes which have transformed the German system of corporate governance during the last seven odd years. It concludes that it is in the process of converging towards the Anglo-American system and that this has fundamentally affected the way strategic decisions are made in firms. Large, internationally oriented companies are particularly affected. But the notion of shareholder value and its many behavioural effects are gradually spreading also to other parts of the economy. Consequently, the distinctive logic, which had underpinned the German variety of capitalism during most of the post-war period, is eroding. This transformation is affecting also labour and industrial relations in negative ways. The argument is empirically substantiated with data about recent trends in capital markets, banks and firms.

The paper theoretically examines institutional change, focussing on the notions of system logic and institutional complementarity. It examines both external sources of change and internal powerful actors who promote the process of transformation. The notion of hybridisation of the German business system is examined but is rejected in favour of a trend towards convergence. Convergence is not seen as a functional necessity, nor is it viewed as inevitable.

JEL Codes: B52, G30, J50, P52

Keywords: Corporate governance, capital markets, German variety of capitalism, institutional change.

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I. Introduction

After the collapse of state socialism in 1990, the focus of debate in the social sciences came to rest on differences within the capitalist world between different models of capitalist organisation. Just ten years on, the debate has shifted further, and there are now being voiced both triumphant claims and fears that one model of capitalism – that of competitive or liberal market capitalism - is displacing all others. The fundamental and long-established differences between what has come to be known as organised or co-ordinated market economies and competitive or liberal market economies are said to be in the process of erosion.

This new debate has focused on changes in capital markets, corporate financing and their implications for corporate governance - institutions widely held to be cornerstones of models of capitalism (O'Sullivan 2000; Deeg 2001). Corporate governance may be loosely defined as all those rules and arrangements structuring the exercise of control over company assets and the pattern of interaction between different stakeholders within the firm. Because forms of corporate governance are inherently connected with the allocation of power and resources and with a distribution of surplus they structure most other relationships within firms and the wider political economy, shaping its whole logic. Hence, there is strong concern, particularly but not only on the part of labour, with the consequences of any processes of change for the redistribution of surplus and control to various stakeholders in the firm.

Transformation of corporate governance in recent years has been most pronounced in coordinated market economies, and the impetus for and advocacy of change have come chiefly from the US (O'Sullivan 2000) and also from the UK. As Germany long has been portrayed as the paradigm case of coordinated capitalism (Deeg 2001), with many built-in institutional obstacles to erosion, debate around the German case is of particular interest. If the hitherto very cohesive German system can be shown to be in the process of fundamental change, then other continental European business systems also are vulnerable.

The processes of change which can be empirically observed have initiated a fresh debate on institutional transformation and how it might best be conceptualised. In particular, it is being debated whether the changes in

corporate governance signal radical system transformation and a process of convergence, or whether they can be absorbed into the existing institutions of a coordinated market economy by processes of institutional adaptation and/or conversion (Thelen 2000). Four positions may be distinguished in this debate: an argument for system transformation and convergence; claims for system persistence, albeit with partial adjustment of the old model; and third, a diagnosis of the emergence of a hybrid model of capitalism. Partly overlapping with the third is a fourth position which posits functional conversion for one important institutional constellation within the German model.

This paper seeks to further clarify the extent and exact nature of current transformations in the German system of corporate governance and political economy, as well as identify sources of change. I shall make the deeply contentious claim that convergence is, indeed, beginning to occur. Convergence has been variously defined, and in this paper it means one-sided adaptation of the 'coordinated market economy' model to that of the 'liberal market economy'. It is being recognised that existing German institutions will mediate the impact of the 'liberal market economy' model . Hence it is not being envisaged that convergence will result in the creation of a German model, identical in all its features to Anglo-American capitalism. Nevertheless, the transformation of the underlying system logic is viewed as initiating fundamental and far-reaching changes in all institutional sub-systems.

My argument is not based on the functionalist assumption that convergence is occurring because 'liberal market' economies have shown themselves to perform in a superior way and that imitation by the less efficient is compelling. As Mary O'Sullivan has shown historical analysis of the evolution of systems of corporate governance and their impact on performance casts serious doubts on such claims. Hence I make no assumption that convergence is desirable and inevitable. On the contrary, it will be shown that convergence is connected with far-reaching consequences which will be highly negative for at least one important stakeholder – labour. I shall suggest that it is reversible, if there is sufficient political will.

The paper offers both an in-depth theoretical analysis and empirical substantiation of institutional change. To this purpose, it will provide first, a discussion of institutional change in general and convergence, in particular and, second, an outline and evaluation of changes in the German system of corporate governance, placing them in their broader institutional context.

Change in patterns of corporate governance is a highly complex process, going far beyond changes in regulation of the capital market and the adoption of new

company codes of good practice. A convincing evaluation of the degree and nature of transformation has to go further and deal with its multiple real consequences for various stakeholders at the level of the firm. It cannot rely on the protestations of managers that they continue to have the interest of labour at heart but, instead, has to examine managerial behaviour, instigated by changes in corporate governance. Such a study has to deal with any fundamental changes in company strategy and structure and with the new configuration of intra-firm relations initiated by them.

Evidence for such an in-depth assessment will be drawn from my own study of German companies in one important industry – chemicals/pharmaceuticals and from a range of secondary sources. Among the latter, I owe a particular debt to the excellent study by Steffen Becker (1999).(The industry is one of the most important in terms of its contribution to GDP and to R&D activity, and it also is a major employer).

The paper is structured as follows. Section II outlines the theoretical framework adopted. It presents a brief outline of two models of corporate governance found in the literature . This is followed by a more sustained conceptualisation of the nature of institutional reproduction and change, with a special focus on the notions of institutional logic, coherence/complementarity and hybridisation. Section III, the empirical core of the paper, first introduces a brief historical sketch of the German model of corporate governance up to the mid-1990s to enable an assessment of change. This will be followed in section III.2 by an analysis of the changes in formal and informal institutional arrangements at the levels of both the financial system and of the firm. It evaluates the consequences of change for various corporate stakeholders, as well as their opportunities to influence the direction of change or mediate its impact. Section III.3 dwells on persistence of institutional arrangements at both levels and enduring divergence of the German model from the Anglo-American one. Section III.4 considers the balance of persistence and change and then critically examines claims about hybridisation of the German business system. In section III.5, it is concluded that the concept of convergence more aptly characterises emergent tendencies of change and that we may expect acceleration of the transformation process in the coming decades. The Conclusion debates the import of the findings offered in part III for the debate on convergence versus divergence, in the context of the theoretical understanding of institutional change detailed in section II. Finally, the paper draws out the consequences of convergence for the German variety of capitalism and the role of labour within it.

II Theoretical Considerations

II.1 Approaches to corporate governance

There are two major approaches to corporate governance. The first approach, current in mainstream economics, is only concerned with the relationship between financiers of firms – mainly shareholders and banks (principals) - and their agents (managers) and with formal and informal rules and procedures structuring it. The key goal of corporate governance here is to ensure a maximum return to investors. The development of a market for corporate control , through the threat of takeover, both structures the ex ante incentives of managers to fulfil this goal, as well as disciplining managers if they are under-performing or diverting too large a share of net value to themselves. The second approach, more common outside economics, is the stakeholder approach which focuses on the entire network of formal and informal relations which determines how control is exercised within corporations and how the risks and returns are distributed between the various stakeholders. In addition to owners of capital and managers, employees are the most prominent. The principle embodied in this form of corporate governance is that companies should be required to serve a number of groups, rather than treat the interests of shareholders as overriding all others. The interests of labour here are foremost, and both their right to an equitable share of surplus and their entitlement to industrial participation are emphasised (e.g. Streeck 2001). .

These two systems of corporate governance then may be mapped onto two different modes of exerting control (Mayer 2000). The first is equated with outsider and arms' length control, connected with dispersed share ownership and the prevalence of institutional investors. The second notion, dwelling on the whole network of control, occurs when share ownership is more concentrated and owners of significant portions of ownership are able to exercise insider control. Concentrated holdings may be held by family owners, banks or other non-financial firms.

In both types of systems, managerial performance is monitored and poorly performing managers are disciplined, but the way in which these two types of control are exercised differs decisively between outsider and insider control. In the insider system, control is exercised through board membership and legal rights of appointment and dismissal. It is said to be more direct and active, whereas in the outsider system control is indirect and exerted through the market for corporate control and the threat of take-over. Whereas the insider system is associated with management goals of stability and growth and longer-term returns to significant owners, the outsider system implies the goals of

liquidity of capital markets and of opportunities for short-term maximisation of returns on capital invested.

This paper starts by adopting the second notion of corporate governance which has been prevalent in Germany until the mid-1990s. I then proceed to investigate whether and to what degree it is giving way to the first type in current debates on this topic.

II.2 Analysis of institutional persistence and change.

Theoretical analyses of varieties of capitalism conducted during the last decade or so have differed in the degree to which they have systematically considered institutional change. Works published during the 1990s, such as Whitley 1992 and 1999, Lane 1995; Hollingsworth and Boyer 1997, Berger and Dore 1997, Kitschelt et al 1999, and even Hall and Soskice 2001, have predominantly focused on institutional reproduction or persistence. In this, they have been influenced both by the notion of what constitutes system transformation and by an emphasis on system coherence (Whitley 1992 and Lane 1995) or interlocking complementarity of institutional ensembles (Hall and Soskice 2001). Institutional complementarity is said to exist when the presence or absence of one institution affects the efficiency of the other (Hall and Soskice 2001: 16), and the link between institutional complexes are specific incentive structures. These are seen to inhibit radical or fundamental socio-economic change and instead promote institutional reproduction.

Both the notion of institutional coherence and of institutional complementarity are derived from the assumption that there is an institutional logic expressed in concrete practices and organisational arrangements which influences what social roles, relationships and strategies are conceivable, efficacious and legitimate (Biggart and Guillen 1999: 725). Additionally, organising logics are held to be 'repositories of distinctive capabilities that allow firms ….to pursue some activities in the global economy more successfully than others' (Biggart and Guillen 1999). The relationships and roles researched in the empirical part of their paper centres on relationships of control and identifies the categories of actors favoured by them in a number of political economies. Biggart and Guillen's sociological institutionalism views institutional logics as sense-making constructs and focuses on taken-for granted organisational arrangements. Hall and Soskice 2001, in contrast, committed to a 'rational actor' institutionalist perspective, are concerned above all with incentive structures and efficiency goals. Both these approaches, envisaging a system logic, internal coherence/complementarity and system reproduction have

suggested that underlying logics are changed only with great difficulty and have therefore implied that only extreme external shocks are able to effect system transformation. Although change is not ruled out entirely, ‘within system’ incremental change has been theoretically privileged.

More recently, in the face of empirically observable, wide-ranging change in core institutional arrangements, analysts have begun to question three interconnected assumptions of the above approaches: 1. That system change necessarily has to be of the radical big-bang nature: 2. that it can be brought about only by external shocks (Mahoney 2001; Deeg 2001; Thelen 2000); and 3. whether institutional complementarity really is as strong as believed by the earlier approaches, or whether discrete institutions may change independently from the rest (Thelen 2000; Lane 2000; Becker 2001; Deeg 2001; Hoepner 2001; Vitols, 2001; Streeck 2001; Beyer and Hassel 2002; Morgan and Kubo 2002). These writers implicitly or explicitly dwell instead on more evolutionary and cumulative change. They place great importance also on the influence of internal actors in bringing about radical change. Most important, they do not assume system coherence but posit hybridisation of systems, or identify buffers which prevent change in one part of the system, affecting other parts (Morgan and Kubo 2001). Although these recent critics have elaborated a much more sophisticated and valid notion of institutional change they do not go far enough and mistake a temporary phenomenon for the final outcome. Hence they are unable to do full justice to an understanding of processes of change currently observable in coordinated market economies.

This paper will further explore some of the assumptions underlying both sets of arguments and, in doing so, adopt an institutionalist approach, combining elements of the ‘rational actor’ and the more sociological variant of New Institutionalism. It will agree with more recent analysts that transformation can result from cumulative change and that a consideration of internal actors is vital when trying to understand the process of change. I also accept their claim that institutional ensembles may change independently from each other and that, for a short time, systems may contain opposed logics. At the same time, I agree with Biggart and Guillen 1999; Whitley (1999) and Hall and Soskice (2001) that there is an inherent strain for system coherence or complementarity, based on an underlying institutional logic, which cannot be disrupted in the longer run if the system is to prosper. In contrast to the second set of analysts, the paper therefore concludes that hybridisation can only be unstable and temporary. Top managers cannot make strategic decisions based on a market logic in one arena and resort to an opposed logic in another arena of decision-making. Instead, it will be argued that, in the longer term, we must expect either a return to the old path or the adoption of a new one. As adoption of an entirely new path rarely

occurs, convergence to the currently hegemonic Anglo-American model is the more likely outcome. I will provide evidence that the general movement is towards convergence, as well as a careful specification of what the concept does and does not entail.

Two further issues need to be dealt with. First, how does one know whether institutional innovation, resulting from evolutionary and cumulative change, is within-system or bounded change or whether it has led to the adoption of a new path and a more fundamental system change. How does one distinguish one type of change from another? System change has occurred when a new logic has replaced the old one, i.e. when it is accepted by most influential actors in the political economy. It is being assumed that the system of corporate governance, which defines relations of control within firms, as well as pinpointing the main stakeholders, is crucial to the definition of the institutional logic linking all parts of the system.

Second, how does system change differ from hybridisation? Hybridisation usually implies that complementarity no longer exists and that different parts of the system are dominated by different logics. Thus, to illustrate, the logic of the liberal market economy may be accepted by actors in the capital market and in large listed firms, but not by unlisted large companies or by small and medium-sized firms and their banks (Deeg 2001). Or, alternatively, the new logic may dictate strategy in product markets but not in firm-internal systems of co-determination (Hoepner and Jackson 2001).

To sum up this section, it has been argued that transformation of core institutional arrangements of the German political economy has been more striking than reproduction and that it is necessary to arrive at a theoretical understanding of this momentous process. It has been suggested that hybridisation generally is an unstable temporary phenomenon. If a cumulative change in a central institution, i.e. the financial system, has fundamentally changed the logic which governs relations within that system, and is supported by powerful actors both within firms and the political system, hybridisation does not usually endure. The power and/or legitimacy of internal champions of change will lead to a spill-over into other parts of the system, even into those more remote from the stock market. Complementarity eventually will be restored. Hybridisation, however, may be more enduring if it is supported by some powerful internal actors and effective buffers between different spheres of the economy are erected (see Morgan and Kubo 2002 on Japan). These theoretical claims will be substantiated in the empirical part of this paper focussing on contemporary changes in the system of corporate governance (Part III.2 to III.4). First though a short description of the German system of

corporate governance during the post-war period and up to the middle 1990s will be outlined. This will identify the institutional logic and coherence of that system, as well as provide a base line against which more recent transformation may be assessed.

III Review of Empirical Evidence

III.1 Historical sketch of the German financial system and form of corporate governance.

Throughout the post-war period, until the mid-1990s, the German financial system and mode of corporate governance showed a high degree of stability, distinguishing it, for example, from the French system (Morin 2000). It has often been described as being diametrically opposed to the system of outsider control, prevalent in Britain (Lane 1992 and 1995; Mayer 2000; Heinze 2001) and in the US (O'Sullivan 2000).

Among sources of capital for German firms, retained earnings has been the most significant, leaving firms highly autonomous (Deutsche Bundesbank 1997: 37, quoted by Becker, p. 31). Bank debt was low, and issuing of shares through listing on the stock market was common only among a small proportion of the largest firms. Due to a number of reasons, the stock market remained underdeveloped and insignificant both for domestic and foreign investors. Hence stock market capitalisation has been low in comparison with Britain, the US and even Japan. Thus, during the period of 1982 to 1991, stock market capitalisation stood at only 20 per cent of GDP, compared with 75 per cent in the UK (Mayer 2000: 1). Ownership in German firms has been relatively concentrated, and family ownership is still significant even in some very large firms. Cross ownership of non-financial firms has been more pronounced and interlocking directorships have been highly developed (Windolf 2002). For all these reasons, hostile take-over was almost unknown. Although historically banks have been important insiders in German firms, occupying a high proportion of seats on supervisory boards, their ownership stakes during recent decades have not been high. Their importance as insider controllers has been upheld primarily by their ability to cast proxy votes on behalf of the many smaller investors whose shares they administer. Important rights of control have been vested in the supervisory board, which is independent from the management board and on which seats are held in varying proportions by representatives of owners and of employees. Relatively effective employee co-determination has been a distinctive feature of the system of governance.

Such a system of corporate governance has implications for a wider range of stakeholders. Hence top managers in this system are said to be less autonomous than their British counterparts (Vitols et al 1997), being more accountable to both large owners, banks, employees and even the local community. Decision-making is more consensus-oriented and may even be described as more collective.

There has, however, been a relatively low constraint to deliver very high returns to shareholders, and instead stability of the firm, market growth, together with adequate profits, have been management goals. Managers usually made their career in a given industry and advanced to top positions within the internal labour market. These circumstances have enabled managers to pursue strategies, oriented towards longer-term returns, and this orientation has shaped the German practice of skill development and the production paradigm of diversified quality production. Employees possess legally guaranteed rights of control, and they have exercised them to safeguard their skills, their employment security and an equitable distribution of surplus between various stakeholders. The pay gap between top managerial staff and other employees has been far less pronounced than, for example, in Britain and the USA (Crouch and Streeck 1997). The other side of the coin is that financial control of organisational subunits has been relatively lax, financial transparency of companies low, and small investors have had no means to safeguard adequate returns on their investment.

The underlying logic, informing all parts of the German political economy, has been shaped by a network type of control, aiming for stability and growth, rather than short-term high returns on investment. This network has included employees as important stakeholders in the firm, entitled to a fair share of surplus and to co-decision-making in areas directly affecting their current and future well-being.

III.2 Recent institutional changes in the German capital market and system of corporate governance.

III.2.1 Sources of change

This network system of corporate governance has begun to change during the second half of the 1990s. The external impetus for change has come from three main sources. There usually is considerable interdependence between them, but each source of change also can be effective in isolation. Many analyses of changes in the German model of capitalism have focused only on the transformation of the capital markets (e.g Heinze 2001) or deny the marked

interaction in the influence on firms of internationalised capital and goods markets (e.g.Beyer and Hassel 2002: 12). Only a consideration of all three sources and a recognition of their mutually reinforcing impact, however, is able to capture the full force for change.

The first source of change has been liberalization of international capital markets and the greater readiness of hitherto 'national' capital to seek out the most profitable opportunities for both accessing and investing capital wherever this may be in the world. This has entailed the modernisation of capital markets in continental Europe and the spread of the Anglo-American model of organising them, as well as the greater participation of firms from coordinated market economies in the stock markets of liberal market economies. . The impact of the US/UK model of organising capital markets has entailed an introduction of new actors to those markets - foreign investment funds - and has established enhanced legitimacy for and wide acceptance of their primary goal – improved shareholder value. This, in turn, has put pressures on listed firms to restructure their operations in line with fund managers' expectations, particularly to increase financial transparency. A prominent aspect of this is a demand for reduction of product diversity and for concentration on what is considered core business. Failure to de-diversify is sanctioned by the so-called conglomerate discount on the share prices of non-compliant firms. Greater pressure for enhanced profits and dividends has forced managers to turn previously integrated organisational sub-units into independent profit centres. Capital market actors thus clearly have introduced the logic of the market into firms and have been able to influence managers' strategic decision-making.

Intensified competition in product markets has been the second source of change. Greater competitive pressure has made it important to attain sufficient size and market influence to prevail against international competitors and thus has exerted pressure for capital concentration, through merger and acquisition. This, in turn, may precipitate listing on stock markets. (An example is the Merck KgaA pharmaceutical company which, although in majority family ownership, listed a proportion of its shares in 19996). Competitiveness on international markets also has been shaped by product innovation. The much increased speed of innovation and the greatly enhanced cost of research and development to achieve it, have created further pressures for capital concentration and reliance on the stock market to achieve it.

A third source of change in corporate governance has been the development of new cultural and/or ideological orientations, shaped by three processes of cultural diffusion. Here the reference is to the concept of shareholder value and associated motivations, cognitions and scenarios for action. These have been

widely propagated by consultancy firms which often are of Anglo-American origin. They also have been absorbed through participation in new programmes of management education, particularly the MBA, and, last, during extended spells of direct exposure to Anglo-American business environments when managing German subsidiaries in these two countries. The management practice of measuring performance through application of precise financial indicators, fundamental to the concept of shareholder value, has become widely adopted by and legitimate among higher German managers (Becker 2001). They are regarded as modern management approaches, the adoption of which enhances managerial reputation.

All these external pressures, it will be shown below, have not simply been imposed on unwilling financial and non-financial firms. Core and powerful economic actors have begun to identify their own interests with those of capital market actors and to actively promote internal change. Political actors have given them important legislative support and have not stepped in to prevent hostile take-over, as became evident in the recent takeover of Mannesmann by Vodafone. (For details, see Hoepner and Jackson 2001). However, the current and previous social democratic governments have been sending out conflicting messages. The new Takeover Law, in force since 1 January 2002, permits the target management to put in place anti-takeover defences, provided these have either received support from 75 per cent of shareholders or have been authorised in advance by the supervisory board (Deakin et al 2002). The government also has adopted a very pro-labour stance on the issue of labour market reform, insisting that reforms can only be introduced in a consensual manner. There is as yet no indication as to how these conflicting stances are to be reconciled.

III.2.2 Changes in capital markets

Wide-ranging changes in German capital markets have been effected by both important market actors and by government changes in legislation. A long list of changes from the mid 1990s onwards (for an exhaustive list, see Hoepner 2001) by 1998 had led to the modernization of the organisation and regulation of the German stock market and to the establishment of a centralised capital market on the US/UK model. Particularly significant steps were: the weakening of the regional decentralization of stock markets and the creation of a unified market in Frankfurt, to become the privatised Deutsche Boerse; the creation, in 1994, of a federal authority for market supervision; the establishment of legal rules and conventions, creating greater transparency in firm structures and actions; safeguarding of the rights of minority owners; the removal of hurdles to hostile takeover; the creation of the initially successful Neuer Markt for smaller, technology-intensive firms, which caused a wider diffusion and

acceptance of the market principle both among smaller firms and small German investors; and some curtailment of banks' influence on company supervisory boards through some limitation of the rule on proxy voting and the number of chairmanships individual bankers can hold.

Other government legislation fuelled the expansion and influence of the stock market on firms. Among these were the authorisation of stock options as part of managers' reward package, in order to realign incentives; the legalisation of share buy-back; the introduction of a semi-voluntary company code to encourage greater transparency and accountability of firms to investors.

The most far-reaching piece of legislation, however, passed in 2000 and to be implemented in 2002, is the exemption from tax payments of gains from sales of blocks of shares, previously tied up in cross holdings. It is expected that this law, encouraging investors' withdrawal from long-term share-holdings in under-performing companies, will unravel the German system of cross shareholding. It is likely to dissolve the large block holdings and destroy the network character of corporate control. This, in turn, will constrain companies to become more reliant on stock markets. The greater dispersion of holdings then will provide investment opportunities for outsiders, thus making firms more vulnerable to takeovers. As non-financial firms are the most significant owners of other non-financial firms this would knock out the basis of the current German system of insider control and put into question the long-termism that patient capital has permitted.

All these measures also have changed the role of banks, both in capital markets and within firms. Banks have begun to recognise that their business in large firms had been diminishing (Becker 2001; Deeg 2001) and, simultaneously, that more money could be made in underwriting and the lucrative market for company buying and selling. Deutsche Bank has led the way in transforming itself and entering investment banking on the Anglo-American model, and several other banks have since followed this move. Banks' partial disengagement from insider control is evident in their reduced representation on company supervisory boards (Luetz 2000) and, more dramatically from a significant surrender of chairmanships. Thus, between 1992 and 1999, banks' share of chairmanships fell from 44 to 23 per cent in the largest forty companies (Hoepner 2001:). They now have slightly less control over proxy votes (Deeg 2001). Together, these developments indicate their reduced willingness and capacity for insider monitoring. Deutsche Bank and Allianz – between them the most significant owners of large listed companies - have made it clear that they intend to restructure their holdings in accordance with profit levels (Heinze 2001). Many banks already put greater emphasis on short-

and middle-term increases in share values of the companies in their ownership portfolio (Becker 2001: 316).

III.2.3 Changes within firms

The number of companies listed on the stock market has increased very slightly as has listing on foreign markets, and the proportion of shares owned by foreign institutional investors increased from 4 per cent in 1990 to 13 per cent in 1998 (Deeg 2001: 27, footnote 39). Also the degree of dispersion of share ownership has risen slightly. Those companies already quoted undertook a number of changes, significantly affecting corporate governance, organisational structures and strategies and the relations with other stakeholders. However, the number listed has remained small and of those quoted, only a minority – around 10 per cent – significantly changed their ownership structure and became exposed to takeover (Heinze 2001). A market for corporate control, it is widely agreed, has not yet developed. But the market is nevertheless shaping many managers' expectations and interests, and external monitoring of listed companies is prevalent. Together, these are sufficient to have exerted a significant effect on internal strategic decision-making. Many companies not exposed to shareholder pressures have adopted elements of the notion of shareholder value to legitimate restructuring and a greater performance orientation. Even firms still in substantial or total family ownership, such as Boehringer Ingelheim and Merck KGaA, now work with financial indicators and targets, as well as using managerial incentives, normally found only in listed and/or widely held companies.

Hence the influence of the stock market on managerial attitudes, goals and strategies of chemical/pharmaceutical companies has been pervasive, affecting both listed and unlisted internationally oriented companies. Although there is little evidence that investment funds are exerting strong direct external control over managers, the indirect influence of the stock market, via the movement of share prices, has been considerable. The listed companies are now more subject to external monitoring and have responded to such monitoring to varying degrees. This is evident not only in a greater cultivation of investor relations, the adoption of international accounting standards and the issuing of quarterly reports (Beyer and Hassel 2001). It is additionally expressed in more fundamental changes of strategy and structure, relating to enterprise goals, such as mode of growth, selection of product portfolio, incentive structures and system of payment (Becker 2001; Hoepner 2001). The following examples from one industry will illustrate what I believe to be a more general trend.

As firm size is becoming more crucial to survival in global markets, more firms have had to dilute owner control and become listed to raise the additional capital needed for expansion (e.g. Merck KGaA and Fresenius) or to swap shares in mergers. Concern with the movement of company share price then motivates managers to introduce various strategy changes, welcomed and rewarded by capital market actors. Some or all of the following changes in strategy have been implemented by companies in the chemical/pharmaceutical industry: introduction of sometimes ambitious targets for growth in turnover and profits (most large companies in the industry); changes in organisational structure to enable better control of performance by both top managements and capital market actors, as well as to facilitate listing of organisational sub-units (Hoechst, Bayer and Fresenius); introduction of share options or equivalent schemes to align managerial incentives with those of investors (all major companies in the industry); introduction of reward systems for employees, tied to the company's or business unit's performance (all large companies in the industry); some reduction of product diversity to enhance transparency and a greater shift to the more profitable pharmaceuticals segment (executed most consequentially by Hoechst/Aventis and more hesitantly by most of the other companies) (Company Annual Reports 2001/02; Becker 2001).

Unlisted firms and those still substantially under family control have responded to a lesser degree. But they nevertheless have been compelled to make partial adjustments as they operate in the same competitive environment as the companies, exposed to stock market control. Some also have found it convenient to refer to shareholder value notions to push through measures to enhance employee performance or to justify restructuring and job cutting. Thus Boehringer Ingelheim, still wholly family-owned, nevertheless has introduced changes in organisational structure which force managers to take more responsibility for their unit's performance and has introduced 'shareholder value' indicators for purposes of internal control. Additionally, the company has introduced a functional equivalent to a share option scheme, in order to attract and retain high calibre top managers (Becker 2001: 299). Merck KgaA, although over 70 per cent family-owned, has introduced share options for the same reason (ibid: 310).

Many of the younger managers, often with US training or experience , in any case are less committed to the German company structure and culture. Financial and business specialists are now more likely to be selected for promotion to management boards (Hoepner 2001; Baecker 2001), necessarily causing partial displacement of the traditionally strongly entrenched production-oriented engineers. (The radical restructuring of Hoechst, for example, in line with shareholder demands, was master-minded by just such a financial specialist –

Juergen Dormann). Career patterns of higher managers also are becoming more similar to those of their Anglo-American counterparts, as evidenced in the dramatic decline in the average time in post during the 1990s (Hoepner 2001) – a feature more conducive to adopting a strong stance on raising short-term profitability. More generally, the new generation of German top managers recognises the importance of financial indicators and targets as bases for strategic decision-making (Becker 2001: 274). In sum, important aspects of managerial strategies have been decisively shaped by changes in corporate governance, even if there is still resistance on some aspects and different firms have adapted at different speeds and to different degrees.

All these changes in strategy, structure and reward systems have impacted on employees and on organised labour, i.e. company co-determination systems and industrial relations at industry level. Negative repercussions for employee stakeholders have been various. The famed German employment security has been eroded in some large shareholder value companies. Selling off or closing of sub-units and large-scale job cutting have become prevalent. Such firms now spend a higher share of net value generated on dividends and a lower proportion on labour (Beyer and Hassel 2002: 15, reporting on a survey of the 59 largest German companies). They have not reduced spending on labour but have cut the level of employment and thus have intensified labour for remaining employees (ibid). In 'shareholder value' companies, a greater proportion of employees' pay is now variable (Kurdelbusch 2001), creating further insecurity, as well as undermining labour solidarity. Company-wide representation and the solidarity it affords have been weakened by linking pay more strongly to performance of individual company sub-units. A much increased focus by employees on the profitability and survival of their employing company also has made employee representatives less willing to cooperate with unions to achieve wider industry goals (Hoepner 2001: 27). At the same time, labour has not been fundamentally opposed to the imposition of shareholder value, and it has even seen some of the new developments, such as greater company financial transparency, as being very much in its own interest (ibid). Hence organised labour, particularly at the company level, appears to be coopted into a more neo-liberal model.

III. 3 Persistence of the German model

The story told so far has provided a one-sided picture. Many features of the old system of corporate governance persist, and convergence to and divergence from the Anglo-American model exist side by side in a complex mixture. An assessment of the degree of persistence has to bear in mind, however, that

German companies have only achieved financial internationalisation since the late 1990s.

The most glaring example of persistence of the old financial system is that German firms have not been rushing to become listed, and the German stock market, in comparative perspective, remains strongly undercapitalised. Hence only the large flagship companies, and not all of those, are subject to stock market pressure, and family ownership of even very large companies persists. Companies become listed much later in their life cycle and at a much higher size threshold than in the UK (Mayer 2000: 1). Individual shareholding, although increased, remains low by international standards and thus retards the development of a shareholder psychology. Recent adverse developments in the capital markets, particularly the collapse of the Neuer Markt, have called forth a renewed scepticism about financial markets.

Among listed companies, ownership concentration, sustained often by cross ownership of shares, remains significant. Average size of voting blocks of nearly 50 per cent may be opposed to blocks of less than ten per cent for UK companies (Mayer 2000: 2). This continues to obstruct the development of an outsider system of control and of a market for corporate control. The influence of foreign investment funds – the most insistent claimants for shareholder value - has been significant in only a small proportion of cases – about ten per cent of large listed companies.

Also there has been no change in company law, and the system of codetermination is still intact. Employee stakeholders still retain some degree of influence, if not control, within the enterprise, even if intensified competition often makes it difficult to voice their demands. The two-tier board, designed for insider control, also remains in place.

III.4 Balance of change and persistence: hybridisation?

The discussion under III.2 has shown that the German system of corporate governance has experienced far-reaching change in its underlying logic, indicating significant convergence with the Anglo-American system. But, at the same time, it shows stubborn resistance to change on some central features of corporate governance. Most analysts nevertheless agree that the German financial system of corporate governance has converged to the Anglo-American model, but they do not wish to go as far as positing convergence for the whole political economy or variety of capitalism. Instead, these analysts are suggesting that other institutional configurations are persisting or merely are adapting in incremental ways. Hence these scholars prefer to conceptualise current

transformations as a process of hybridisation (Deeg 2001; Vitols 2001 ; Streeck 2001; Beyer and Hassel 2002) or, more obscurely, posit the occurrence of hybrid convergence (Hoepner 2001). Such conclusions capture important aspects of the process of institutional transformation at the beginning of the 21st century. One important variant of the hybridisation thesis is that radical transformation in one institutional configuration calls forth adaptive functional conversion in other parts of the political economy. Such conversion, according to Thelen (2000: 105), occurs when exogenous shocks empower new actors who harness existing organisational forms in the service of new ends. Diagnoses of hybridisation have taken different forms, and three different arguments in support of hybridisation will be examined critically in the following. They will be analysed both for their internal theoretical coherence and for their plausibility in the light of empirical developments.

For some of these authors, advocacy of hybridisation is based on the belief that the great internal diversity of the German economy creates highly diverse contingencies for firms and hence, despite some common pressures, precludes convergent development (Deeg 2001; Vitols 2001; Becker 2001). The focus is particularly on diversity in terms of sector, size and type of firm, as well as degree of exposure to global pressures. A second argument advanced against convergence points to diversity in managerial perceptions, cognitive focal points and evaluations of contingent circumstances, regarded as at least in part endogenous to the institutions which govern managerial actors' rationality. This, in turn, is deemed to preserve diversity in strategy and hence in forms of corporate governance and other institutional constellations (Becker 2001). A third variant of the hybridisation thesis is that the system of codetermination and democratic participation of labour is both so well entrenched and of such centrality to the German production paradigm of diversified quality production that management will find a way to combine the logic of the capital market with the logic of an employee stakeholder system (Hoepner 2001; Hoepner and Jackson 2001; Streeck 2001; Beyer and Hassel 2002). Evoking Thelen's (2000) concept of functional conversion, it is being suggested (Hoepner 2001) that institutionalised practices of co-determination have become transformed, in order to re-establish complementarity with the system of corporate governance. In the process, they have changed from being an institutional structure to negotiate on issues of a 'class' type to one mainly supporting the company goal of enhanced efficiency.

How persuasive are these various hybridisation theses? Becker (2001) and Vitols (2001), in support of the first hybridisation thesis, cite the differing product strategies, organisational forms and cultures of large companies even in the same industry – chemical/ pharmaceutical – and contrast what they see as

the highly divergent paths taken by Hoechst/Aventis, Bayer and BASF. This argument about diversity between firms, in my view, underestimates the pressure for isomorphic adaptation which emanates from the business press and the example of the large flagship companies. Additionally, it wrongly suggests that transformation of the German political economy could only occur if all economic actors were to adopt the 'shareholder value' model to the same degree.

A close analysis of recent developments of the three chemical/pharmaceutical giants, however, shows that Hoechst was merely the first to choose a strategy of de-diversification and radical organisational and legal restructuring in 1996/97. Bayer and BASF, although originally much more wedded to the retention of a diverse product portfolio and a traditional integrated organisational structure, have begun to embark on a similar, albeit still less radical path. Bayer retains chemicals for the time being, but the proportion of pharmaceuticals in the portfolio is being systematically increased. In 2002, the company began to restructure itself into a holding company, with legally independent subsidiaries – a pattern highly reminiscent of the Hoechst model. The push to proceed in this way clearly came from the capital market. According to the company's web site, this new structure gives greater transparency for internal resource allocation, for the capital market and for stockholders (Bayer web site, 13.8.2002). It may well be a preparation for the planned acquisition of pharmaceutical companies, to further increase the focus on this business area, favoured by the capital market. Both Bayer and Hoechst/Aventis, on Hoepner's index of shareholder value orientation, are ranked very highly, and Bayer even tops Hoechst/Aventis in the ranking list It is only in the area of gaining focus on core competences that the Bayer has moved more slowly. BASF, too, has sought to gain more focus, albeit in a different direction from Hoechst. In 2000, it shed its business in pharmaceuticals to concentrate on chemicals. (Its subsidiary Knoll, which had the largest part of the pharmaceutical operations, was sold to Abbott Laboratories). Thus, the three companies have not adopted identical strategies, but they are clearly changing in the same direction, albeit at different speeds.

Most other large German chemical/pharmaceutical companies have been engaged in strategic and organisational adjustments oriented towards capital market actors. Some have engaged in organisational restructuring affording greater internal and external transparency, others have down-graded geographical divisions (Landesgesellschaften) in favour of product-based business units. All have become more performance-oriented and have set relatively high profit targets to signal to capital market actors that they are concerned to raise shareholder value. According to Becker (2001), 'in all

enterprises, there occurred during the 1990s, an upgrading of financial controlling, closely allied to centralisation of strategic management and the granting of operational independence to operative units, all allied to the use of performance indicators and targets as bases for decision-making (ibid: 273-74). It is only in the area of greater focus on core competences that most German chemical-pharmaceutical companies have stalled and are holding on to a more diversified product portfolio for reasons of risk distribution.

Nor is diversity as pronounced when we move to other industries or descend in the size scale of firms. Although the pharmaceutical industry is among the most highly internationalised ones there now exists hardly any industry sheltered from competitive pressures in international markets for capital and goods and services. Even industries with a low export propensity are exposed to international pressures from inward investors and, if listed, are not immune from takeover. The studies by Hoepner (2001) and Zugehoer (2001) well illustrate that the shareholder value orientation is prevalent also in other industries.

Furthermore, competitive pressures affect both large and medium-sized firms, albeit to different degrees. Firms in both size classes have to find funds to increase their size or to increase investment in R&D, in order to stay ahead in the international competitive race. Nor are smaller firms totally exempt from pressures as large firms have to pass on cost pressures to their smaller suppliers. The existence, until recently, of the Neuer Markt, too, has familiarised smaller firms with market practices and values. Pressures on non-commercial savings banks to become more profit-oriented, too, in the longer run will force them to pass these on to their SME clients, especially after the planned demise of the privileges currently still enjoyed by savings banks (Lane and Quack 2000)..

Turning to the second argument, managers do indeed differ in the extent to which they acknowledge and accept the new pressures for greater transparency and shareholder value. But their perceptions, interests and motivations have been changing, together with the changing institutions and business culture. They are increasingly being shaped by the ideology of shareholder value. Associated goals and practices, such as monitoring profitability with numerical targets, are not seen in ideological terms, but as being part of modern management practice, likely to raise reputation. Hence some managers have embraced the new ideology with alacrity as, for example, the chief executive of Hoechst, others have done so more partially (the previous CEO of Bayer) or more reluctantly (the previous CEO of Merck) when the adverse consequences of non-compliance for stock price became obvious. In 2000, the Aventis share surpassed that of Bayer in value by nearly 100 per cent although Bayer had

been, if anything, more profitable than Aventis/Hoechst during most of the 1990s. But it was being punished by the so-called conglomerate discount, whereas Hoechst/Aventis was rewarded for conforming to all demands of capital market actors (Becker 2001: 137-140, 145). Merck's chief executive – a member of one of the owning families - publicly railed against stock market actors' demands and tried to pursue a strategy of maximum stability of earnings for the owning families. Merck's share price, despite good overall performance, consequently did poorly. This chief executive has now been replaced by a more compliant professional manager, and the share price has risen accordingly (ibid). The new pressures for enhanced performance and more transparent organisation, exerted on managers of large listed companies, have to be passed on to both their subordinates and their business partners and thus gradually will diffuse throughout the economy.

The claim by Hoepner and Jackson (2001) that 'shareholder value and co-determination do get along fine' exemplifies one position among the third set of arguments for hybridisation. The authors are referring to the fact that many works councils have undergone functional conversion and are now seeing their main function as supporting management goals of enhancing efficiency and competitiveness (ibid). The argument by Hoepner and Jackson (2001) that this institution is persisting, despite the changed logic of the system of corporate governance, does not convince. The goals of co-determination, it is true, therefore are no longer in opposition to those of corporate governance, but the reverse relation does not hold. Adherence to the shareholder value principle by management means putting investors first, and many of the activities undertaken to satisfy investors go counter to employees' interests, as already detailed in section III.2. What persists is only an institutional shell, emptied of all the old ideological content which allowed bodies of codetermination to execute checks on and provide a counterweight to the power of capital. The collapse of any real chances for co-determination and its substitution with a co-management stance would be better described by the term 'loss of function', than by the grand label of 'functional conversion'.

Up to now, the system of co-determination and the stakeholder company have, indeed, been deeply entrenched in contemporary German political culture, and it has appeared unlikely that any government would change the co-determination laws. But it now appears that the institution is no longer sacrosanct. The Commission which drafted the new corporate governance code is planning to introduce a new measure, designed to weaken the system of co-determination. This would permit companies which have more than half their employees overseas to opt out of being bound by co-determination (Financial Times, 8.

November 2002: 9). Many of the big companies already have achieved or could easily achieve this 'overseas' employment target.

Even if such legal change were not to occur, the institution of co-determination already has been weakened from within. There no longer exists a link between the incentive structure underpinning corporate governance and that shaping industrial and labour relations. If the whole logic of the system of corporate governance has left or is in the process of leaving the path of stakeholder capitalism, then the continued existence of an empty institutional shell will not stand in the way of convergence.

A stronger argument in favour of a hybrid outsider/insider system of control is advanced by Streeck (2001) and Beyer and Hassel (2002). Echoing the view of Biggart and Guillen (19991) that a certain system logic 'breeds' certain capabilities, conducive to cultivation of particular market niches, they rightly point to the indispensability to the German production paradigm of high levels of human capital development and consensual decision-making. They further strengthen their claims by pointing to empirical evidence that, to date, wage levels have not fallen and commitment to a high-skill economy has not noticeably weakened.

Beyer and Hassel (2002) further claim that investors have not shown themselves opposed to the expensive training system and may recognise that this system enables German firms to deliver higher value. They therefore conclude that institutional investors might be willing to forego short-term profit maximisation in favour of longer-term gains. Beyer and Hassel (2002) thus are citing the arguments of 'enlightened shareholder value' and refer to the professed willingness of some fund managers to support the 'high road' to simultaneous gain both for shareholders and other stakeholders. But unfortunately, at the time of writing, these professed enlightened goals hardly have been put to the test. Research done in the UK on implicit contracts in the negotiation of takeover conditions established that, though legal and regulatory provisions permit directors to temper the pursuit of shareholders' interests with those of employees, in a situation of conflict of interests shareholders' short-term financial interests usually prevailed over those of employees (Deakin et al 2002: 14, 24).

Furthermore, although many managers and policy makers will no doubt wish to preserve the venerable paradigm of 'diversified quality production', powerful constraints for profit maximisation will make this a much more problematic endeavour than is recognised by Beyer and Hassel (2002). Their argument attributes more subtle behaviour to investors than is possible in an arms' length

market environment where resources usually flow to producers who are likely to guarantee the highest returns. Furthermore, their assumption that patience by stock holders will necessarily be rewarded by higher future yields from German producers is dubious. Although diversified quality production has served the German economy well it has never delivered above average returns of the magnitude which, for example, has induced venture capitalists to take a long-term perspective in high-technology sectors. Nor is there evidence that the government would intervene to shore up the expensive German system of human resources development.

The various points made above seriously question whether the various theses on hybridisation and/or functional conversion will continue to be useful for the analysis of developmental trends in the German variety of capitalism. The next section therefore will pose the case for convergence. To do so, I will identify the underlying pressures which will eventually destabilise the hybrid system and initiate more complete convergence, as well as pinpoint the developments which already indicate such a progressive trend.

III.5 Pressures for system convergence

As pointed out by Deeg (2001), the changes in the capital market now are so well established that they have become irreversible. They have created a new logic for corporate governance which will prove compelling in the longer run. This is all the more the case because these changes have been accepted and promoted by powerful internal actors – German commercial banks and the insurance company Allianz. The gains from the switch to outsider control have amply compensated the large commercial banks for the progressive attenuation of insider control, and their interests now are firmly aligned with a stock market oriented economy (Becker 2001).

Their enduringly powerful position in the German political economy makes it most likely that these financial institutions have been instrumental in nudging the Schroeder government towards support for system change. This has been evident in the reluctance to intervene to save Mannesmann from takeover (Heinze 2001). But more important, the introduction of the socalled Eichel law, which encourages the unravelling of the system of cross shareholding by non-financial companies, has been passed without much debate. As the law only takes effect in 2002, nothing definite can be said on its impact at this moment in time. But it appears highly likely that the vast opportunities for gain, entailed by withdrawing poorly performing ownership stakes for utilisation in more lucrative investments, will be seized by both financial and non-financial firms. Indeed, both Deutsche Bank and Allianz already have signalled their intention

to follow this course of action (Heinze 2001). Such a development would further transform the system of corporate governance, leading to de-concentration of capital holdings, much increased stock market listing, new openings for foreign investment funds and hence to a market for corporate control. This would deal the death knell to the old-entrenched German system of cross shareholding and the system of insider control it has been upholding.

Pressures for convergence have come not only from capital market actors, but the ideology and practice of shareholder value also have been more or less enthusiastically embraced by a significant group of company managers – those making strategic decisions in internationalised firms. Their positive stance towards the concept of shareholder value has been brought about by changes both in business culture and by new powerful incentive structures. Processes of cultural diffusion have wrought changes in what is considered legitimate business behaviour and what serves to enhance managerial reputation. Changes in incentive structures mean that strategic managers' interests are better served by a transformation of the German model of corporate governance.

Although this transformation is not in the longer-run interest of labour, in the short run employees have not necessarily been averse to the new model as share ownership has been made widely available to employees at all levels of the firm (Becker 2001; Hoepner 2001). This might at least partly explain the low degree of opposition from labour against the change in corporate governance introduced. The growing conflict between the goals of company-based industrial relations actors and unionists (Hoepner 2001), together with a pronounced weakening of organised labour during the last decade or so, also explains wide-spread acquiescence.

Another powerful impetus for convergence, discussed in detail by O'Sullivan (2000) and hence not covered in this paper, comes from the crisis of the German pensions system and the increased likelihood of developing private schemes ensuring higher liquidity of funds. Such a development would boost the importance of pension funds as prominent stock market actors on the Anglo-America model and enlarge the German stock market.

Last, pressures for convergence have existed for only a relatively short period of time, gaining momentum only during the late 1990s. If they have been able to unleash fundamental change in so many areas in this short time span we must expect that many hitherto persistent features of the German variety of capitalism will be swept away during the coming decade.

IV Conclusions

The preceding theoretical analysis and empirical description of changes in the German model of corporate governance since the mid-1990s has considered both the nature and the outcomes of change. It has attempted to make evident the complexity of the change process and has explored the conditions which have to be fulfilled in order to diagnose either system reproduction or system convergence. There has been a particular focus on how to conceptualise the role which the notions of institutional logic and of institutional coherence or complementarity play in our understanding of change, and the discussion also has problematised the notion of hybridisation.

I have explored whether the outcome or direction of change in the German case can best be conceptualised as persistence of the model of coordinated market capitalism, as imminent convergence to the model of 'liberal market' capitalism, or whether the current state of affairs is best typified as a hybrid model, incorporating elements from both varieties of capitalism.

The virtual consensus of previous analyses of the transformations in Germany has been that, despite much persistence of traditional 'coordinated market' features, change in the core area of corporate governance has been fundamental and that a new logic is in the process of establishing itself. Change has proceeded too far and is supported by too many powerful 'within system' actors to be reversible. However, in contrast to previous analysts, this paper has concluded that the typification of this process of change as hybridisation is unhelpful. It can at most depict a temporary unstable stage of development. The new logic of corporate governance is beginning to feed through into other sections of the economy - beyond the larger listed and highly internationalised firms - and to other institutional sub-systems, particularly to labour relations and utilisation and development of human resources. In this way, it eventually will lead to convergence with the Anglo-American model. Further development in the direction of convergence is not simply attributed to external constraints, but is shown to be receiving support from powerful actors within the German economy, particularly from large banks and insurance companies and from many of the large internationally oriented and listed German companies, but also from some politicians. Such internal support is explained in terms of change in both cultural orientations and incentive structures of these actors. Evidence in support of an emergent tendency towards convergence is drawn from an analysis of managerial behaviour in the vital area of strategic decision-making.

The paper has **not** argued that the German variety of capitalism already has converged towards the Anglo-American type. It has merely identified a developmental tendency and predicts an intensification of this tendency in the coming decades. My focus on convergence has not been based on any functionalist assumption of a necessity to imitate the most successful economic model but on the belief that it would be dangerous to underestimate or ignore such tendencies. An important precipitating event here will be the implementation of the Eichel law and the likely dissolution of the cross shareholding system which has been at the very heart of the German variety of capitalism for more than a century. Such convergence will not entail the copying of all details of the model of liberal market capitalism, but the embracing of the underlying logic of shareholder value nevertheless will have a powerful transformative impact. on all relations within and between firms. A system of corporate governance does not have a determining impact but also depends to some degree on the values of those most centrally involved in its implementation and on the nature of the environment in which they have to operate (Deakin et al 2001). This implies that shareholder value might be implemented in a manner more congruent with German institutionalised practices. Such implementation will, however, fall short of hybridisation and would be better described as a softening of the hard edges of the 'liberal market' model .

Occurrence of convergence to liberal market capitalism is not merely of theoretical interest. It will have far-reaching practical consequences, to the detriment of employees and organised labour, as well as increasing the level of social inequality in German society. It is, therefore, important to ask whether there are any powerful or influential supporters within Germany of the *status quo* who might be able to erect buffers between the capital market and labour and industrial relations.

Here the arguments of Hoepner (2001) and Beyer and Hassel (2002) carry particular weight. They point out that the production paradigm of diversified quality production is indispensable to German international competitiveness and that it is premised on cooperative labour relations. The latter involves the continuation of active participation by labour in shaping company strategy and adherence to the high-wage/high skill model. The question thus becomes whether the proven importance of viewing labour as a stakeholder would result in the adoption of a model which can satisfy both international investors and labour.

Hoepner (2001) and Beyer and Hassel (2002) plead for the evolution of a new stable system, combining two different logics which may nevertheless establish

complementarity. I am, however, sceptical of the claim that the combination of two opposed logics can result in the establishment of complementarity and a stable system. My pessimism about evolving a new complementarity is based on two arguments. First, even the German managers who would like to preserve the old system and its values may either succumb to the powerful incentives of the 'shareholder value' idea and become seduced by the new opportunities for material enrichment they offer. Or they will be constrained to implement the shareholder value concept, even if they do not welcome it. Last, functional conversion of the institutions of co-determination is not likely to save them as meaningful industrial relations entities. Although the structures may persist, their rationale will be changed fundamentally. They will no longer be an avenue through which labour may exert a significant amount of insider control - the feature which has long endowed the German variety of capitalism with its distinctive character. Although the legal shell may remain in place for a while, the new capital market regulations and their pressures on top managers to conform to investors' demands will transform co-determination mechanisms from encouraging labour participation in strategic decision-making to merely endorsing such management decisions.

But the future is never as closed as my pessimistic prognosis makes it appear, and events may occur to halt or reverse the convergence process. Given the strength of cultural values and social institutional embeddedness of the 'Rhine' model, there may yet emerge a coalition of industrial managers, representatives of labour and politicians working for a new, as yet inchoate compromise solution. The present government owes its re-election to union support, and both cautious labour market reform and the 2002 Takeover Law are indicative of a stance trying to protect the old system. .
At the present time, however, the emergence of such a macro level coalition cannot be detected. - political leaders still send out mixed messages and confusing signals. At the micro level, continually shifting shorter-term alliances between investors, managers and labour are more notable (Hoepner 2001: 27).

Alternatively, powerful external shocks and a sea change in the international business environment could reverse the convergence process. The 'Enron' syndrome has dented the faith in the US system of corporate governance, but it has not completely undermined it. The passing of the Sarbanes-Oxley Act, moreover, has already begun to restore investor confidence. The only chance for a halting or reversal of the convergence process lies in a strong de-legitimation of the Anglo-American system of corporate governance. This might come about through the occurrence of deep world economic recession and the inability of the US economy to find a way out of it.

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