VARIETIES OF CAPITALISM AND THE LEARNING FIRM: CORPORATE GOVERNANCE AND LABOUR IN THE CONTEXT OF CONTEMPORARY DEVELOPMENTS IN EUROPEAN AND GERMAN COMPANY LAW

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by

Peer Zumbansen
Canada Research Chair in the Transnational and Comparative Law of Corporate Governance
Osgoode Hall Law School, York University
4700 Keele St., Toronto, ON, Canada M3J 1P3
Email: pzumbansen@osgoode.yorku.ca

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Abstract
Research in corporate governance and in labour law has been characterized by a disjuncture in the way that scholars in each field are addressing organizational questions related to the business enterprise. While labour has eventually begun to shift perspectives from aspirations to direct employee involvement in firm management, as has been the case in Germany, to a combination of 'exit' and 'voice' strategies involving pension fund management and securities litigation, it remains to be seen whether this new stream will unfold as a viable challenge to an otherwise exclusionary shareholder value paradigm. At the same time, recent suggestions made by Delaware Chancery Court Vice Chancellor Strine, to dare think about potentially shared commitments between management and labour – and UCLA's Stephen Bainbridge's response – underline the viability – and, the contestedness – of attempts at moving the corporate governance debate beyond the confines of corporate law *proper*.

While such a wider view had already famously been encouraged by Dean Clarke in his 1986 treatise on Corporate Law (p. 32), mainstream corporate law does not seem to have endorsed this perspective. This paper takes the questionable divide between management and labour within the framework of a limiting corporate governance concept as starting point to explore the institutional dynamics of the corporation, hereby building on the theory of the innovative enterprise, as developed by management theorists Mary O'Sullivan and William Lazonick. Largely due to the sustained distance between corporate and labour law scholars, neither group has effectively addressed their common blind spot: a better understanding of the business enterprise itself. In midst of an unceasing flow of affirmations of the finance paradigm of the corporation on the one hand and 'voice' strategies by labour on the other, it seems to fall to management theorists to draw lessons from the continuing co-existence of different forms of market organization, in which companies appear to thrive. Exploring the conundrum of 'risky' business decisions within the firm, management theorists have been arguing for the need to adopt a more sophisticated organizational perspective on companies operating on locally, regionally and transnationally shaped, often highly volatile market segments. Research by comparative political economists has revealed a high degree of connectivity between corporate governance and economic performance without, however, arriving at such favourable results only for shareholder value regimes. Such findings support the view that corporate governance regimes are embedded in differently shaped regulatory frameworks, characterized by distinct institutions, both formal and informal, and enforcement processes. As a result of these findings, arguments to disassociate issues of corporate governance from those of the firm's (social) responsibility [CSR] have been losing ground. Instead, CSR can be taken to be an essential part of

understanding a particular business enterprise. It is the merging of a comparative political economy perspective on the corporation with one on the organizational features, structures and processes of the corporation, which can help us better understand the distribution of power and knowledge within the 'learning firm'.

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INTRODUCTION

The role of the employee in the corporation is manifold. Starting with their carrying out of various functions, determined by the superiors, employees often play a much more differentiated role in the functioning of an organization. It's obvious then that the form of the organization—a small, middle-sized firm, or a large, publicly traded corporation with operations around the world—has a direct impact on the role of the employee. This first observation is important if we want to avoid pursuing the question "what role for employees in the corporation" in a one-size-fits-all manner. The size, structure, and embeddedness of the corporation, as recently highlighted again by Sanford Jacoby[1], are directly related to our assessment of the role and involvement of employees in the organization. In turn, the shape of the organization is driven by developments in the political economy, of which a corporate, labour law and industrial relations regime each forms a part. This regulatory framework is increasingly less a domestic affair. The increased liquidity of funds available for the financing of corporate operations worldwide has been undercutting, informing, and pushing domestic policy developments. It is thus no surprise that our view on who are the 'leading political economies' shifts with the particular regimes' aptness and capacity to adapt to the changing structures of world markets. Two interim conclusions follow: 1) corporate governance forms part of a larger regulatory framework which is constantly under pressure of being adapted on the domestic and, increasingly, the transnational level to the capabilities of global investors and capital flows, 2) any assessment of the involvement and role of employees in the firm has to be made with this complex background and framework in mind.

The following observations provide a few examples in support of the two above statements. The first section will address the current state of research into employee involvement in the firm from a comparative perspective and argue how issues of employee involvement are being shaped by contemporary developments in corporate governance. The next section will study in more detail the case of German co-determination in order to show how a long-held misconception is applied to what is and what is not 'bad' co-determination in German companies. It will also place this discussion in the context of current EU law making in the area of corporate governance (II). The third section, then, will suggest an alternative perspective on employee involvement in the firm, one foremost informed by insights provided by management studies, organizational science and by scholars of historical political economy. These scholars suggest a much more complex understanding of the firm, where managerial success and economic performance depends on a set of institutional features inside and outside of the firm, such as a vivid communication, for one

between different levels of employees and, secondly, between the firm and societal knowledge actors. Couched in a vivid culture of incentive structures, adaptation techniques, which enhance collaborative efforts, experimenting and learning, the corporation can thus be seen as an integral part of a highly differentiated knowledge society.

I. The Political Economy of Corporate Governance

Research into the role and involvement of employees in the contemporary business corporation, be it for a small scale, domestically or regionally operating enterprise, or for the large, multinational corporation, reflects the larger trends in corporate governance and business organization. We can differentiate between a human resources approach and a co-determination or, control approach. The latter has been the much-discussed model of German corporate governance, about which we will speak later in more detail. The former can be found, expressed in a very strong form in Japanese corporate law, and in a weaker form, in the United States corporate form. Co-determination comprises different forms of employee involvement in the management of the company. In contrast, a model focusing on human resources, can unfold without granting workers substantive input into management issues of the firm. Japanese Corporate Governance was hailed all throughout the 1980s as a model nurturing stable employments, skills training and intra-firm mobility. The Human Resources manager would regularly be part of the firm's managerial cohort, given that the well-being and sustaining of stable employment relations ranked high on the Japanese corporate governance agenda. By comparison, in the United States, HR has not been considered a crucial or vital element of corporate governance. HR managers regularly took second or third place after strategic and, more recently, financial management personnel. The US model can probably best be understood as a 'market model', while for the Japanese one the label 'organizational model' appears most suitable.[2] There is certainly a whole host of elements and issues connected with such a characterization and this should already indicate that any such label hardly captures the complexity of how decisions are taken in and for the business enterprise. Even less can such labels fully illustrate the wealth of elements conducive to sustained economic success. It is here, where business historians, corporate law economics and corporate governance scholars[3] have much to say to all those, who perhaps too quickly assume the triumph of a certain organizational paradigm.[4]

As can be observed over the last 15 years, the German co-determination and the Japanese human resources model have come under pressure. Foremost, global financial liquidity and ever shorter periods at which a company's economic performance is being assessed, seem to leave little room for the long-term

orientation that both German[5] and Japanese[6] firms have long been endorsing. This development has been taken by many to reflect on a fundamental convergence of corporate governance regimes. To explore the validity and the lessons from such a finding, we need to place these contentions in the context of comparative assessments of legal structures and their larger institutional, political, economic and cultural environment.

A) *Le regard d'autrui*: Comparative Perspectives on Company Law

The alleged convergence of corporate governance regimes around the world has been on the mind of investors, policy makers and scholars for some years now.[7] In fact, whether such a convergence is actually taking place has at the same time been contested from many participants in the debate.[8] The trickiness of such assessments of a moving target is certainly also felt by such a keen observer as The Economist, who in a recent survey on 'European Business' swayed between dismissal of the European way of doing things on the one hand and Europe's promise to pull through on the other.[9] Vice Chancellor Leo Strine, Jr., noted an abundance of 'tired features' in the 'so-called corporate governance debate. "Exaggeration is the norm; conversation the exception."[10]

At the outset of any assessment of converging regulatory regimes should lie an appreciation of what it is that is allegedly converging. In other words, we need to be clear on what we mean by corporate governance and which aspects of it we currently see changing. Secondly, we need to be mindful that identifying and evaluating current developments necessitates a comparison of not only different systems' formal rules and codifications, but also their customs and business practices. In other words, we need to compare the law on the books and the law in action. The latter, certainly in the area of corporate governance, constitutes a wide-ranging variety of informal rules, standards, codes of conduct and understandings of relevant business communities. While these form an integral part of a vibrant legal and economic environment, they are much harder to identify and ascertain by an outside observer.

In this light, I would like to suggest that we attempt our comparison of existing corporate governance regimes through a combination of traditional modes of comparative law, that is its instruments, norms and their functionality on the one hand[11], and the political economy of corporate governance, that is the mix of formal and informal, of hard and soft laws, rules, standards and practices on the other.[12] This combination will allow us to appreciate the real changes that are taking place in different corporate law regimes around the world. In addition, such a perspective will allow us to gain a deeper understanding of the currently unfolding trends of convergence and divergence among corporate

governance regimes in regional markets and regulatory spaces such as the EU. Here, for example, the particular history of corporate law harmonization cannot be properly understood without such a 'deeper reading' of the hard-soft forms of corporate law development that are characterizing contemporary changes in the existing regulatory regimes.[13]

The European scene for corporate law making, then, is a remarkable laboratory for the study of multilevel and multi-polar law making in a politically and culturally contested arena, where different historically grown and embedded political economies are colliding.[14] Such a combined perspective is needed in particular at a time, where the experimental, decentralized and informalized law-making character in the EU has been inspiring scholars to imagine the EU as a space of innovative regulation within a decentralized polyarchy, allowing for and consciously promoting dialogue and, arguably difference.[15] Such inquiries into new forms of regulatory dialogue, decentralized law-making constitute an important and laudable challenge to traditional modes of centralized or, top-down law-making and, as such, complement concurrent explorations in other fields in a valuable way.[16] At the same time, their coincidence with far-reaching assessments of regulatory and normative convergence, even in such fields with a notably high degree of historically grown, national diversity is problematic insofar as the conflation of alleged trends of convergence and phenomena of decentralized, 'privatized' law-making[17] too easily does away with the institutional framework in which these trends are unfolding. As recently demonstrated by Simon Deakin, the particular regulatory and normative scope of a legal field deserve a close investigation in terms of the field's institutional structure, its history and the driving forces that are shaping it.[18] Such an investigation takes a closer look at how trends of convergence are unfolding, which institutional structures are emerging and how their processes in turn shape the theoretical assessment of new forms of norm-creation. As will be argued in more detail later, the complex arrangement of law-makers on the European, domestic and transnational level in the area of corporate law invites precisely this close inquiry into the way this multi-polar regulatory regime increasingly substitutes other, often more transparent modes of law-making. Before looking at these developments in more detail, however, we should provide a working definition of the regulatory/normative field we are concerned with in the following.

B) WHAT IS CORPORATE GOVERNANCE?

Confusion over the potential impact of the alleged convergence in different corporate governance regimes is what lies at the heart of what we mean by 'Corporate Governance'. The law of corporate governance, commonly

conceived as “company law”, “corporate law” or, “business associations”, is embedded in a larger regulatory scene that also comprises fields such as securities regulation, labour law, industrial relations, and insolvency law. In order to trace the particular characteristics of distinct national systems of corporate governance, it is essential to cast light on the historical, socio-economic and legal developments that have contributed to national variation. While there is an important body of literature underlining the relevance of historical trajectories and associated competitive advantages to national differences (the so-called *Varieties of Capitalism* school[19]), there is a wide agreement that these distinct national systems are under severe and growing pressure towards convergence. The privatization of public welfare systems and the increased tendency to base pension and retirement financing on the capital market[20] have coincided with a worldwide competition for stock market investments.[21] As a consequence, the capacity of traditional *stakeholder*-oriented systems of corporate governance to provide the transparency and management control that is necessary for success in the global competition for investments is increasingly contested.[22]

Beyond the disputes over the merits of “shareholder primacy”, however, lies the essential question: the nature of the business corporation itself.[23] Beyond the ongoing struggle between shareholder and stakeholder oriented concepts of corporate governance[24] lies a wide field of research concerning the organizational design of today’s corporation as a complex and innovative institution of social learning.[25] The involvement of workers within the firm is not an issue that can be solely understood against the background of established and hotly contested models of co-determination.[26] Rather, the role of workers in the firm can itself be explained only with regard to the ways in which the firm is organized to generate, channel and process fragmented knowledge and innovative capacity.[27] The association of workers’ involvement with a firm’s social[28], *intellectual* and *innovative* capital certainly differs from the hitherto held perception that workers involvement in corporate governance is merely an inefficient check on shareholder power. In fact, switching from a conflict model, which opposes shareholders against employees, to one of cooperation and integration of viewpoints, capacities and processes, opens up a new perspective on workers’ involvement. This perspective is directed at the productive input of workers’ knowledge for a more efficient governance of the firm. The latter differs from the much-discussed and often not sufficiently understood form of co-determination, as it exists for example in German supervisory boards.[29] In these, half of the board’s members are employee representatives. This has led many observers to a harsh dismissal of this powerful influence of workers. The fact remains, however, that the chairman of

the supervisory board, regularly a shareholder representative, holds the deciding vote. The confusion about the parity of powers in the supervisory board is legendary. While the fact of the chairman's deciding vote alone should put overly troubled minds to rest about the purportedly counter-productive effects of co-determined supervisory boards of large German enterprises, even recent empirical evidence from German companies indeed seems to suggest that many managers recognize benefits from the – still – existing system.[30]

In contrast, the other form of co-determination, which has always existed in the shadow of the internationally discussed and scrutinized board co-determination, concerns so-called Works Councils. These can be formed in all companies with at least 5 employees, if at least 3 have been with the firm for six months.

Works councils are constituted only by employees and are elected by secret ballot. They are understood as being a counterpart to management and play a crucial role in the firing process, seeking together with management to maintain socially justifiable criteria when selecting personnel to be laid off. This form of worker involvement, from an international perspective, has existed in a quiet, neglected corner of the otherwise heated corporate governance debate. While the law clearly attributes a relatively prominent role to works councils, their institutional success has been varied.[31] Only recently, works councils have acquired a more positively regarded currency. One of the reasons for this development was the 1994 introduction of so-called European Works Councils.[32] Their success has been ambiguous at best, assessments ranging from doubts over unions pursuing their local interests through the newly established EWCs[33] over critical evaluations of the less-empowered EWCs when compared to the German *Betriebsräte*[34] to a sceptical rejection of EWCs as yet another mosaic stone in an already losing battle for organized labour interests.[35] While these developments unfolded on the European level, domestically works councils increasingly became entangled in pressure systems created by firm management on the one hand and trade unions on the other. While the latter eventually conceded so-called opening clauses which would allow variations to the collective agreement to be stipulated on the firm level, management has taken this opportunity in recent years to forcefully push employees to enter into unfavourable agreements in exchange for, say, job security. Effectively, works councils can now often be seen to accept agreements that contain standards, which are well below the threshold contained in collective agreements. Trade unions themselves find themselves facing the dilemma that their protest would potentially drive more of their already weakening members away.[36]

Taking a step back, however, from this labour interests perspective, we can identify a set of other considerations relating to the works councils. Here, then, another reason for the increased attention received by works councils can be seen in the overwhelming pressure on firms to improve their competitiveness (inseparable from their organizational structure), the firms' location and the applicable laws governing salaries, production and social costs. In this context, works councils are increasingly being recognized as essential *fora* for the much-needed negotiation between management and employees in developing and realizing the most cost-effective solutions for the firm's future.[37] A crucial aspect, then, is that at the same time as the influence of trade unions is diminishing, works councils might be seen as enforcing their demise, instead of being able to work against it. In this light, works councils can be seen to be entering a pact with the devil. Where agreements between management and employees are pursued as part of industrial restructuring strategies on the part of management in highly competitive industries can be reached on the level of the firm[38], the larger framework of workers representation in a coordinated market economy becomes questionable. In reality, management can exercise a large degree of pressure on works councils by connecting demands on lower wages, longer working hours and so on with threats of relocation, plant closure and the like – all that in exchange for job security, for the time being.[39]

This problematic interaction between management and works council certainly does not invite a very optimistic view on management-employee relations. To be sure, not the fact that there is such interaction is problematic. But it is the reduction of the works council to a transmission belt to communicate the management's will to the employee constituency. In this scenario, chances might remain unused for a resource-based, fruitful and sustained collaboration between the different power levels within the corporation.

This last aspect is important. As indicated, there is a second reason for the recent interest in works councils. In fact, this reason provides a much more positive perspective on the interaction among the different powers within the firm. Organizational science scholars and management theorists have been emphasizing the economic gains, which can result from a close cooperation between management and the firm's work force. The value of workers' input in refining, strengthening and consolidating the firm's performance is increasingly recognized, in traditionally organized firms and also to a certain degree in more loosely organized, unbundled or networked firms. The latter has been described by organization and labour scholars as the final deadly blow delivered to workers rights, given that organizing becomes more difficult as the firm becomes more decentralized, as the organizational structure becomes more opaque and as employment relations become more precarious. The combination

of corporate organization of the 21st Century firm and the flexibilization of work constitutes the dark side of the Culture of the New Capitalism.[40] At the same time, the very volatility of corporate organization in a networked economy must not necessarily only lead to a further erosion of workers' power within a firm. More sophisticated studies of management and organization theorists show that management in many cases relies on a healthy and functioning relationship with their employees, especially where high profile and fast-changing organizational patterns require capacities of adaptation and of responsiveness.[41]

In an interim observation, we can say that co-determination exists in two forms, one concerning quasi-parity of shareholder and employee representatives on the supervisory board of large stock corporations, and the other one as works councils in small to large firms. The first form has regularly been attracting a lot of international attention and recently strong criticism as constituting a so-called "competitive disadvantage" in the global race for investment. And yet, a closer look at the voting structures in the board, together with the deliberation practices long followed by corporate actors in Germany, reveals – as we saw above – the myth behind the much-discussed German *Social Model*, of which co-determination has always been seen as a central pillar.[42] The latter model, located in works councils, has only more recently stepped forward to play a remarkably differentiated role. On the one hand, works councils have become the site for the implementation of management policy concerning restructuring, plant relocation and closing. On the other, works councils could come to be seen as potentially important players in tapping, structuring and realizing knowledge and capacity pools that exist within the firm. The latter, more positive perspective on workers involvement in the firm provides a friendly contrast to the before-mentioned development.

II. THE GLOBAL AND THE LOCAL: SPACES AND PLACES OF CONVERGENCE AND DIVERGENCE

The following section will place these observations into the context of the contemporary corporate law-making environment in the EU and in Germany (in particular with a view to the complementing of official rules with unofficial ones such as soft norms, recommendations and codes of conduct). But, before this it is necessary to briefly allude to the larger conceptual framework in which these developments have been taking place. Today, contemporary global developments demand the attention of domestic law reformers in the areas of corporate law or securities regulation. There are different ways, in which

national governments or, in the case of the EU, regional law makers, have been reacting to international developments. The post-Cold War opening of formerly closed markets along with the large-scale restructuring of publicly financed services and infrastructures and their replacement by privatisation and deregulation have fundamentally altered the playing field for business corporations, investors, and interest groups as well as for domestic and transnational regulators.

1) END OF HISTORY I

Francis Fukuyama 1992: End of History

Michel Albert 1991: Capitalisme contra Capitalisme

2) END OF HISTORY II

Hall/Soskice 2001: Varieties of Capitalism

Hansmann/Kraakman 2001: End of History in Corporate Law

Table 1: The End(s) of History

To trace how these global developments translate in a domestic and a regional context, the ensuing subsection will take a closer look both at the EU company law scene and at the corporate law reform process currently taking place in Germany.

A) GERMANY'S COMPANY LAW REFORM AND CHANGING REGULATORY LANDSCAPES

The 1980s/1990s in Germany were a period of difficult bargaining between pro-Shareholder government and deeply entrenched stakeholders, unions and lobby groups. With the end of social-democratic government in 1982, the Christian-Democratic/Liberal majority took power in 1983. In 1998 then, at the end of Christian-Democratic rule, finally, there occurs the first major Corporate Law Reform Legislation since the 1960s. The Law on Corporate Control and Transparency (KonTraG) introduced a number of elements designed to improve German Corporate Governance, long criticized for the less developed disclosure rules and, importantly, for its already mentioned two-tier board, where worker representatives have half of the seats on the Supervisory board – but as we saw - not half of the votes, as the Chairman, a shareholder representative, has a deciding vote.

The KonTraG left this structure untouched, it also left untouched the high number of seats of the Supervisory board, and thereby failed to satisfy longstanding demands to change the German system and to make the

Supervisory Board more effective.[43] The German debate concerning the reform of the Supervisory Board has not lost in intensity, and has indeed received renewed input from a combination of forces both on the domestic and the transnational and European level.

Domestic corporate law reform discussions such as that in Germany[44] or in other countries[45] take place in light of a European and global debate over competition for mobile capital and how corporate law systems might accommodate companies' needs to tap into these capital markets without boundaries.[46] At the same time, the debate takes place against the background of a complex European integration process in which the political and cultural outcome remains unsettled.[47]

It is obvious that within the EU, the *Varieties of Capitalism* approach is of great significance, for it explicitly addresses the embedded, historically grown socio-political and cultural systems of the Member States.[48] How difficult it would be to achieve any harmonization of company law standards in Europe given the high degree of diversity of existing company law regimes, was strongly evidenced by the decades-long struggle over the European Company, originally initiated already in the 1970s, and adopted after many compromises in 2001.[49] Another example of the European Varieties of Capitalism in the field is the almost 15 year long fight over a European Takeover Directive. This was concluded only in 2004, resulting in a directive that contains so many opting out clauses, that the question has been asked whether it has led to any harmonization at all.[50]

International attention is usually attracted by the noise, which surrounds the larger developments, such as European Directives or the Corporate Governance standards promulgated by an international body such as the OECD (Organization of Economic Cooperation and Development) or by domestic legislators (such as the U.S. Sarbanes Oxley Act in 2002). Yet, attention is less focused around the dramatically more complex forms of law reform that take place on other levels, which are not so easily discernable by the outside spectator. Examples of such reforms can be highlighted from within the myriad ways in which Member States move to implement European Law into their domestic legal orders. While there are straightforward and easy ways to track reforms, as for example when a Member State passes a law that appears to translate a European Directive into its domestic legal framework, in reality such law making processes take place much differently within hotly contested fields. In short, it takes place in many unofficial, harder to trace ways, as the landscape of norm making in corporate law (as in many other areas) has been changing dramatically. The emergence of privately made best practice guidelines, codes

of conduct and corporate governance codes has led to a far-reaching change of the relevant regulatory landscape in which companies operate today.[51] But many of its features and elements are not and, arguably, cannot be truthfully represented and documented in the official legislation. The proliferation of private, semi- and quasi-public lawmakers in the field of corporate and securities law has altered the regulatory landscape so that it has become much harder to develop a political critique of the processes as they unfold. This is, in corporate law, expressed by corporate governance codes and best practice recommendations, as it is in labour law by codes of conduct, which purport to provide for a comprehensive regulation of employment relationships.[52] To be sure, the shift away from traditional forms of lawmaking and the embrace of a myriad ways of norm creation (often summarized as "governance") has had as one of its consequences a highly problematic removal of many of the regulatory changes from the political debate. In many cases, 'demands' of the market are offered as sufficient justifications for legal change, effectively moved outside of the political arena of deliberation and contestation.

Illustrating this point are the deep-reaching changes to that element of German Corporate Governance, which seems to be at the core of the End of History critique of Germany's need for reform on the one hand and of Mark Roe's characterization of 'social democratic' corporate governance on the other.[53] The here-found depiction of the allegedly social democratic origins, nature and preservation of workers' co-determination on company boards may, however, blind our view on the much more nuanced, ambiguous and multi-directional lines along which corporate governance has been evolving.

So, indeed, one of the most discussed features of German company law – co-determination – has indeed been attracting scathing criticism from the press, both from lobbyists who fear the negative signal co-determination sends to prospective, and much needed, international investors and from scholars.[54] Even the national lawyers' meeting in the fall of 2006 put co-determination on the agenda and openly explored its possible demise.[55] These developments strongly suggest that even in Germany, one of the heartlands of Michel Albert's Rhenish capitalism[56], there is a shift towards a more shareholder driven corporate governance regime.[57]

However, what the bird's eye view of the observer fails to capture is the altogether ambivalent process – both politically and institutionally – which characterizes German company law reform. Here the point is, that the legal reform agenda is driven by an intricate and, for German traditions, seemingly unprecedented combination of official and unofficial law making.[58] The presently pursued reform agenda is the result of federal law making and the

work of an expert commission, which was initiated by the government in 2000.[59] That commission resulted in the issuance of detailed marching orders, recommendations and demands for the legislator as to how to adapt the German company law system to the 'needs of global financial markets'.[60] On the other hand, the commission also suggested the creation of a follow-on commission to draft a code of best practices, the so-called German Corporate Governance Code.[61] An early discussion regarding the Code's legal nature quietly subsided.[62] A comprehensive law reform in corporate law, which was initiated by the Social Democratic government at the time, seems to turn the dearly held cliché of Germany's stakeholder capitalism company law regime on its head. The first and the second commissions, in preparing the legislative design and the collection of best practice guidelines, ingeniously managed to adopt allegedly universal models and terms through which they prepared the field for the major overhaul. But while everybody expected, that this would mean the abolition of co-determination, change occurred in much more subtle, but clearly not less dramatic ways. The government did not openly attack co-determination while the semi-political, quasi-public expert body, the commission, silently and effectively worked toward its deconstruction. Certainly, the recommendations pertaining to the isolation of the inter-shareholder dialogue from that of the stakeholders (the employees and union representatives)[63] must be seen within the context of the fallout from the post-*Centros*, *Ueberseering* and *Inspire Art* within the European company law scene.[64] That scene, as regards the disembedded operationability of the incorporation theory for European companies seeing a dramatic mobility increase of companies, is still in search of the best legislative fix.[65]

This change in the German approach, which has led to a larger role for unofficial, indirect forms of law-making[66] has important lessons to offer for our current and future appreciation of the European company law scene. It is here where we would still harbour hopes as to the preservation not only of difference with regard to the long-standing legal and socio-economic cultures in the Member States, but also to the preservation of an open eye for the forms in which law reform has been taking place in recent years, across the globe.

B) 'THE EUROPEAN COMPANY LAW SCENE': OVERCOMING DIVERSITY?

The current European Company law scene is characterized by an interesting tension between different trends and dynamics. When European scholars assessed the prospects of company law in Europe a couple of decades ago, no one doubted its centrality in the making of a more integrated market, both

economically and politically.[67] A few decades down the road, the picture looks much different. What began with high hopes for harmonized and unified corporate law rules among the EC Member States, eventually resulted in a series of increasingly long and exhausting law making initiatives, the success of which in many cases depended or was prevented by national resistance politics. While in the area of company law the European legislator made considerably little progress[68], this was not the case for capital markets law, where various regulations came out of Brussels. With regard to the diversity of company laws in Europe, this was for a long time and, indeed, until very recently, seen as a particular feature and characteristic aspect of the European company law scene. While it made consensusfinding difficult in areas where change was recognized as being desirable, these obstacles made everyone sensitive to the existing variations in corporate law regimes and culture. The latter was, among Europeans, always seen with a grain of salt – while it reflected on the diversity within Europe, it was also seen as a problem with regard to corporate mobility in Europe and the attractiveness of European firms for international investors.

This diversity has recently come to be seen in a different light. Reform attempts in the last years have regularly included eloquent references, and reverences, to the existing diversity. At the same time, a number of developments suggest that the time for diversity might have come. For one, the Commission has taken several steps toward reinvigorating law reform in this area. These have grown out of the lengthy adoption process for two recent company law directives, one concerning corporate takeovers, the other one relating to the creation of a European Company Statute.[69] Both were examples of drawn-out, tiresome and complex negotiation struggles, one of which occupied lawmakers for some 30 years, the other one almost half of that. In gearing up for a safe adoption of the Takeover Directive, the Commission initiated an expert committee process, out of which grew, in quick succession, two of the first comprehensive reports on the law relating to takeovers and on the state of European company law in general.[70] These reports did not remain alone for long. On both the European as well as on the Member State level, we are seeing a plethora of committee reports, expert findings, recommendations, and self-regulatory codes. For the commission, this has lead to a certain differentiation of its law making agenda and methodology. Realizing the political obstacles in the way of harmonization in specific core areas (e.g. board composition), the turn to soft law, benchmarking and self-regulation promises a viable alternative.

But, there is another development, which has a great impact on the shaping of the European company law scene. The already mentioned case law by the ECJ has dramatically altered the framework in which European managers are thinking about where to incorporate. The Court's rejection of national

governments' attempts at preventing foreign European companies to form subsidiaries in another European state has also put Member State law makers under increased pressure to revisit their existing company law regimes. Hence, following the case law in *Centros* (1999), *Ueberseering* (2002) and *Inspire Art* (2003), national governments all throughout Europe have begun to make far-reaching changes to their applicable company law rules to render their legal framework attractive under incorporation considerations.[71]

It is against this two-fold background that we have to assess the current European company law scene. The debate concerning the degree to which the ECJ's jurisprudence might have initiated a U.S. style process of regulatory competition, is still ongoing.[72] At the same time, the shape and structure of company law in Europe seems to be driven to a large part by the already mentioned, myriad forms of soft law and indirect regulation, which have come to the fore in recent years.[73] Suffice it to point to the multilevel nature of these processes on the EU and the domestic, member state level to show how this levelled structure is eventually much more complicated due to the fact, that the relevant norms grow out of reports, codes and other forms of soft law. This makes a straight-forward assessment of the changes in the law dependent on the changes on the ground. In other words, without a better view on how codes are implemented, how firms are actually responding to various suggestions of indirect and voluntary regulation, there can hardly be a satisfying evaluation of the changing company law scene.[74] What really matters in this respect, however, is that without a proper assessment of the changes 'on the ground' we will fail to appreciate how these many soft and indirect forms of norm-making, the many ways in which companies have been marketing their commitment to specific corporate governance or corporate social responsibility standards, are reflective of an important shift in law making.

While the noted cases of national resistance to company law harmonization put the political nature of corporate law in the spotlight, the space is rather dimly lit, when it comes to soft law and self-regulation. Ironically, these norms are regularly not presented as law at all, because they do not have their origin in the state nor are they equipped with the traditional enforcement instruments that we know from state-made laws. Given their apparent distance from the state – and their proximity to the market – soft laws are understood as private norms, without any real footing in the political sphere of the state's law making arena.[75] It is this removal of indirect corporate law regulation from the political sphere, which provokes the question, whose interests are really served in the long run in this scenario. Given that a certain lobbying group succeeds in dominating the market for ideas with a certain concept for a while, what happens if the market begins to shift? Not only does the formerly successful

concept allegedly lose the support from other market actors, but meanwhile the effect on dependent personnel, employees, creditors and others involved with the firm, might suffer from a change in corporate organization. We might just think this a natural effect of market actors' self-regulation and accept them as collateral. We might also, however, stop to think whether self-regulation can adequately capture and channel all of the involved stakeholders' concerns in the different features of the firm's organization and governance. In other words, where we pursue corporate law reform and realize the need to overcome political deadlock that arises from path dependent, deeply embedded, politically, legally, culturally backed regulatory regimes, we would be well advised not to dismiss these features of embeddedness and the role of the law in this context.

What should be seen as the most pressing of challenges in this regard is how to reconnect our ongoing assessment of the fast changing and continuously evolving modes of transnational governance in the EU[76] and generally[77] with a critical inquiry into national law-making trajectories and the justifications offered in their support. One of the institutions engaged in a complex, interwoven process of negotiation facilitation and promotion of best practices is the European Corporate Governance Forum[78], established in pursuance to a recommendation of the Winter II group in their November 2002 report on European Company Law.[79] The Expert Commission made it clear that such a structure, while facilitating a process and eventual results which would themselves be 'voluntary and non-binding', would be necessary in order to effectively work towards an improvement of corporate governance regimes.[80] In fact, what we can observe to be arising from the European Corporate Governance Forum's work in recent times is a far-reaching of policy recommendations and lawmaking proposals, which are portrayed as resulting from a quasi-natural process of almost technical content.[81] 'Good corporate governance' has emerged as the regularly used formula to express the plethora of considerations, which have informed the deliberations among the Forum members. In light of the alluded-to contestations of a convergence of corporate governance regimes and the ongoing explorations into the different elements of corporate governance we are asked to further assess the merits of regulatory competition[82] and the apparent triumph of a finance perspective on the corporation.[83]

III. THE LEARNING FIRM

This paper began by taking a perspective on the role of the employee in the firm. This focus helped in illustrating the current regulatory framework for workers involvement in firm management. Moreover, a study of contemporary developments in corporate governance revealed that a discussion of codetermination forms but a part of a much larger reflection process on corporate governance rules. While there has been a long-standing debate as to the substantive goals of corporate law regulation[84], this discussion has been rendered intricately more complex due to the fact that not only the perspectives on corporate law have been multiplied, enriched and widespread, making corporate law the 'hottest game in town'.[85] Another reason why corporate law is increasingly been recognized as a very promising field in terms of research and reform potential[86], has also to do with the field's fascinating and challenging regulatory dimensions. The proliferation of lawmaking arenas in the area of corporate law on the domestic, transnational and international level constitutes a prime challenge to traditional understandings of domestic bodies of corporate law with an occasional comparative glance to the right or the left of one's borders. Instead, corporate law has advanced to being one of the most highly researched fields in terms of doctrinal, comparative, economic, organizational, historical and political approaches.[87] The immense impact of these changes will before long become noticed and translated into core corporate law curricula as well. The changing forms of lawmaking and the ensuing, multi-jurisdictional competition between official and in-official, soft and hard norms in corporate regulation constitute a formidably complex landscape, the exploration of which has only just begun.

The focus on management and employees, however, was taken to open the door to an analysis of the corporation, which would not limit its inquiry to traditional elements of monitoring management, even if that included occasional assessments of, for example, the German two-tier board and worker codetermination in supervisory boards.[88] Instead, the moving of employees into the present corporate governance spotlight aimed at eventually gaining a better picture of what constitutes 'good' corporate governance on the organizational level. It is this level, which is often neglected in corporate law scholarship, which remains for the most part within a rights paradigm of the corporation.[89] While the combination of structural analysis of the assigned rights of those invested in the corporation with a particular view on the economic results of a particular regime has the advantage to illuminate the tensions among different economic interests within and around the corporation[90], it appears to fall short of capturing the processes and institutional dimensions of the firm in operation.[91]

Without a better understanding of the processes within the firm that result from an institutional interaction within and outside the firm's boundaries it is hard to imagine one would ever be in a position to make reasonable assessments about the connection between corporate governance and economic performance. The picture changes, however, if the concept of corporate governance is redefined by drawing on the wider institutional perspective alluded to before. Where Varieties of Capitalism scholars have importantly advanced our understanding of the market structures that are conducive to and interacting with particular governance strategies and structures, this perspective must be complemented in two ways. One is the integration of a regulatory theory approach to an understanding of corporate governance developments. Given the proliferation of norm producers, localities and spheres for corporate rule making, any assessment of corporate governance developments must take this regulatory dimension into account.

The second complementing perspective is directed at the structures of the corporation itself. The two models that we have learned to identify as being situated at opposite sides of the table are the nexus-of-contracts conception of the corporation here[92], the corporation as social/political/organic entity on the other.[93] A recent articulation of the corporation as a 'social institution' was provided by Vice Chancellor, Leo Strine, Jr, who argued that "both management and labour are likely to view a public corporation as something more than a nexus of contracts, as more akin to a social institution that, albeit having the ultimate goal of producing profits for stockholders, also durably serves and exemplifies other societal values. In particular, both management and labour recoil at the notion that a corporation's worth can be summed entirely by the current price the equity markets place on its stock, much less that the immediate demands of the stock market should thwart the long-term pursuit of corporate growth."[94] An intimate expert of U.S. corporate governance politics with an ear close to the ground, Strine aptly identifies the blind spots in the reigning and raging 'corporate governance industry' made up of 'public pension fund administrators, proxy advisory and corporate governance ratings organizations, corporate law scholars, and business journalists'.[95] Strine directs his critique at the heart of the dominant school of thought, which contends that the Berle & Means challenge of overcoming the separation of ownership and control still stands. In contrast, Strine argues that given the high concentration of stocks in institutional investors, the Berle & Means equation has been reversed, now in favour of stockholders. But, who are those? The reality of stock market based old-age pension makes, for one, of most employees, if 'forced', capitalists. Yet, they hardly 'own' anything directly. The owners are large institutional investors, intermediaries between employees and the firm.[96]

At the heart of Strine's critique, then, is his concern with an unceasing flow of literature demanding shareholder empowerment against management, that stands in bizarre contrast to the disassociation of employees' ownership from exercising long-term focused, pension-oriented rights vis-à-vis 'their' corporation. He finds it, thus, particularly troubling that much of the current corporate responsibility and corporate governance efforts are made without the awareness that they eventually serve to empower not those with long-term interests in the viability of the corporation, but rather intermediaries with not-so-often clearly demarcated interests, which might frequently be directed towards high short-term returns than long-term sustained performance. Immediately contested[97], Strine's suggestions focus on appropriate means of shareholder empowerment precisely with the goal of identifying long-term orientations of a firm's strategic outfit in order to disclose to stockholders in greater detail where a company stands and where its dominating investors intend to take it.[98] Instead of 'feeding the market beast' as in before the market meltdown in Enron and Worldcom, efforts should be made at improving disclosure rules which would "enable managers to focus more on sustainable, long-term corporate growth and less on the market's short-term expectations."[99] Interestingly enough, it is the critic of Strine's common sense and shared interests approach, who returns the analysis to a atomized interest pluralism model, which allows him to purportedly dismiss Strine's contentions of such shared interests. Claiming that the degree of diversity among the different corporate stakeholders effectively defeated any contention of shared values between the firm's constituencies, Bainbridge evades the central challenge that Strine formulated, namely, to recognize that both management and employees share a basic interest in the sustained success of a business enterprise. Regrettably, for the time being, Bainbridge dismisses this claim, without pursuing the idea further what it would mean for our understanding of a firm's constituencies and the firm itself, if we adopted a more wholesome approach to the firm and its stakeholders.

In the following, I want to suggest an alternative perspective on the corporation. For that I put forward the thesis that neither the contractual and the interest pluralism paradigms of the corporation can fully illuminate the internal workings of the firm, in particular, neither approach can adequately identify nor assess the processes by which knowledge is generated, disseminated and executed within the corporation, in other words, which processes in fact precede and inform any decision made by corporate management. While the contract model of the corporation remains confined to explaining corporate decision-making with regard to agreements among the firm's stakeholders even in cases of so-called 'incomplete contracts'[100], the interest pluralist model of the corporation tends to one-sidedly focus on identifiable interests of specific

stakeholders of the firm[101] - this appears to be true also in the most recent Strine-Bainbridge dialogue. In contrast, a possibly more promising perspective on the firm's institutional nature in making decisions possible could start with the premise that the elements shaping corporate decisions are never in a static, foreseeable or fully determinable state. Rather, corporate decision-making by necessity involves high-risk assessment of uncertain development trajectories, market strategies and product conceptualizations. The complexity of the field to be assessed by management must be reflected in the way in which we speak about the regulation of corporate activity. From this perspective, then, the firm itself moves into the centre of attention. In other words, corporate governance with the claim to effectively address the core challenges of governing a corporation must take the particular features of a firm's decision-making processes into consideration.

Accordingly, it is this second complementary perspective that the remainder of the paper will unfold in more detail. The key to understanding the contemporary corporation in the political economy of the de-territorialized knowledge economy is to focus on its capacity to remain innovative.[102] The firm's capacity to engage in innovative production depends on its ability to constantly grow, adapt and learn. This it can do by letting go of traditional modes of command and control, and, instead, embracing an ironical, distancing, reflecting and *post-heroic* attitude to corporate governance and management.[103] Our urgently-sought definition of corporate responsibilities, its public duties and obligations to society at large, especially in an era of scandalous corporate crime, depends entirely on our understanding of the firm itself. It is here where we recognize the relevance for our theme of the fierce battle between shareholder-value oriented systems of corporate control and those that place a higher emphasis on workers' voice, participation, industrial relations, and a wider consideration of the firm's stakeholders.[104] Whether we lay our emphasis on the shareholder or on the stakeholder dimension of the firm will have a significant impact on our assignment of duties and obligations to the firm.[105] This is particularly relevant with regard to disclosure. Where corporate governance reform is predominantly concerned with shareholders, the emphasis is likely to remain placed – at least for the time being – on improvements in the financial auditing schemes. In contrast, were our focus on an improved environmental accountability of the firm, we would indeed direct our initiatives at other areas in corporate organization. Environmental internal auditing, in fact, constitutes a prime example of the latter developments in environmental, corporate self-regulation.[106] Restated thus, the question of the firm's responsibilities cannot be separated from our foundational understanding of the firm.

However, this perspective on the connection between the *political economy of the firm* and the firm's environmental (or wider social) responsibilities, fails to account for our remaining lack of knowledge of the corporation *itself*. Today's large, publicly held and globally operating firms escape clear definitions, both with regard to their core activities or 'competences'[107] and their organizational structure. Increasingly, firms have become unbounded, borderless and virtual, with activities that span multiple areas of industry, manufacture or soft products. Echoing many of the challenges that we identified for the state today in a complex society, the firm constitutes a highly complex organization that operates in a volatile regulatory and competitive environment. We should thus reject both overly simplistic categorizations of the firm as either shareholder or stakeholder oriented, for the firm of the 21st Century challenges our learned ways of organizing social behaviour. Shifting the CSR debate away from the control-oriented images of the corporation is an essential step in beginning to understand the question of the firm's social responsibilities. Instead, the firm must be viewed within a complex web made up of the socio-economic framework, the embeddedness of the corporation, the internal organization of corporate governance, and the organizational experiments of a constantly evolving, dynamic, multipolar business enterprise. While the latter two dimensions describe the corporation as a communicative, self-referential being, the first dimension speaks of the embeddedness of the firm, its socio-economic and political place in a dramatically changing local and global environment. With the corporation increasingly assuming formerly public functions (welfare, pensions, medical care), we must reconsider our understanding of the firm's allegedly exclusive private character. While it has become increasingly difficult to assign the label public or private to social activities, this certainly also extends to our conception of the business corporation. Understanding the firm is the first step towards understanding the challenge of corporate social responsibility.

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