

**HORSE, COW, SHEEP, OR ‘THING-IN-ITSELF’? THE COGNITIVE
ORIGINS OF CORPORATE GOVERNANCE IN SWITZERLAND,
GERMANY, AND THE US, 1910s-1930s**

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Abstract

This paper investigates the origins of the shareholder-orientated corporate governance (CG) model of the US and the stakeholder-orientated model prevailing in continental Europe (exemplified by Switzerland and Germany) for most of the 20th century. We reject the most common theories, which explain cross-national differences in CG models either as the result of a natural evolution, different legal origins, social democratic political power, or openness to trade. We show instead that – starting from fairly similar corporate governance structures in the US and continental European countries during the late 19th century – the crucial period for the emergence of two different corporate governance models was the period from the 1910s to the 1930s. We stress in particular the importance that legal experts and the ideas that they produced played in this process. In fact, during this period, the increasing size of firms and the professionalisation of their management led to new problems, which increasingly challenged existing corporate governance structures and the related individualistic theory of the firm. The diagnoses of this situation and possible remedies formulated by legal scholars informed political decision-makers in times of uncertainty and contributed, in important ways to shaping the different ‘paths’, which the different countries went down subsequently. While the scholarly debates in all three countries were surprisingly similar, different solutions were finally institutionalised due to differences in the political context.

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‘The real, central theme of history is not what happened but what people felt about it when it was happening’

(George M. Young. *Portrait of an Age*. 1936)

1. Introduction

At the beginning of the 1930s, Adolf A. Berle and Gardiner C. Means (1933: 66; originally published in 1932) characterised the relationship between the shareholder and the corporation in the following way: *‘It is often said that the owner of a horse is responsible. If the horse lives he must feed it. If the horse dies, he must bury it. No such responsibility attaches to a share of stock.’* Eugen Schmalenbach – one of the founding fathers of management theory in Germany – wrote a few years earlier that the joint stock corporation resembled a dairy cow, which the shareholders must treat with care in order to be able to milk it as long as possible (Schmalenbach 1926: 91). An influential Swiss lawyer, Fritz Fick, stated in 1920 that between the two extremes of shareholder orientation or the complete rejection of shareholder interests, there could be a better world where the sheep (i.e. the companies) could safely graze on green meadows, guarded by good shepherds and vigorous sheep-dogs, to be shorn ‘for the benefit of the collectivity’ (Fick 1920: 336).

The metaphors of the horse, the cow and the sheep highlight a nowadays largely acknowledged fundamental difference between the Anglo-Saxon and the continental European systems of corporate governance,¹ i.e. the definition of rights and responsibilities of the shareholder towards the company. More precisely, the metaphors express two different legal theories of the company. One – associated with continental Europe – sees shareholders as having certain responsibilities towards the company, while the other one – the US conception – considers that shareholders are free to pursue purely selfish, financial interests. This difference is at the very heart of the commonly accepted difference according to which the creation of wealth for the owners is the only legitimate goal in US companies, whereas European companies were generally perceived during as something more than just a ‘money-making machine’ for their owners (Streeck & Höpner 2003).

This opposition between the US and the European perspectives is usually summarised as shareholder- vs. stakeholder view of the firm. It extends not only to the theory of the firm but is reflected in different aspects of corporate governance regimes and notably concerning the prevailing ownership structure: Stakeholder systems are associated with concentrated ownership structures and control by blockholders, while shareholder systems are characterised by a large number of genuine public companies without dominant shareholder (see notably La Porta et al. 1998).

Different theories attempt to explain this difference between corporate governance systems in continental European and in Anglo-Saxon countries referring to a natural evolution, different legal origins, social democratic political power, or openness to trade (see section 2). In this paper, we contest these explanations by providing an analysis of the ‘cognitive origins’ of national corporate governance systems. We argue that, corporate governance structures on both shores of the Atlantic were not fundamentally different up until the early 20th century. Only during the first decades of the 20th century did the two systems start to grow increasingly distinct, with minority shareholder interests being regarded as legitimate in the USA, while largely considered to be negligible in continental European countries like Germany or Switzerland. We argue that this development is the result of a ‘sequence of events’ in which cognitive aspects played an important role. More precisely, the emergence of the large stock corporation during the last decades of the 19th century led to a new situation which challenged the existing legal framework governing stock corporations as well as traditional beliefs concerning the purpose of the firm and the rights and responsibilities of its participants. Legal scholars and economists analysed the nature of the changes and formulated remedies in order to adapt existing legal rules to the new situation. In the interwar period, such diagnoses and remedies had an increasing impact on the legislator as the political turmoil and the repeated economic crises opened up an opportunity window in which ‘path-departing’ change became possible. While the debates among scholars in the three countries under analysis were surprisingly similar, the outcomes of the sequences of changes – scholarly diagnosis of problems and proposing of remedies, political processes and institutionalisation of particular remedies – varied from one country to the other. In fact, the solution that was finally adopted depended on the different political contexts, in the sense that certain ideas were backed by a ‘winning coalition’ in the political arena, while others were discarded.

In order to show the relations between diagnosis, formulation of remedies, and institutionalisation of certain ideas in a given country's company law, we analyse the two paradigmatic cases for the shareholder and the stakeholder model respectively, i.e. the US and the German cases. In addition, we include the Swiss case in our comparison. Switzerland constitutes an interesting case as the Swiss and German corporate governance systems are commonly seen to be fairly similar, but their establishment took place in very different contexts. The Swiss case serves hence to illustrate how very different national configurations and processes may still lead to surprisingly similar results.

The paper is structured as follows: Part 2 discusses different explanations of cross-national diversity in corporate governance and sets out our theoretical approach to the role of ideas in institutional change. In part 3 we show that the corporate governance systems in the three countries were not fundamentally different during the 19th century; in both regions family-owned companies prevailed, the stock corporation was considered to serve the interests of the individual shareholder, and stock markets were vigorous. Towards the end of the 19th century, these features started to change fundamentally in all three countries as companies grew bigger. Part 4 discusses how this evolution was perceived and analysed in the three countries and what remedies legal scholars and economists proposed. Part 5 discusses the political processes which ultimately led to the prevailing of the individualistic view of the corporation (i.e. the shareholder approach) in the US and to the supra-individualistic view (i.e. the stakeholder approach) in the two European cases. Part 6 concludes.

2. Varieties of Corporate Governance and the Role of Ideas

Scholarship in the field of corporate governance usually distinguishes between two different corporate governance models: an Anglo-Saxon shareholder-orientated model, which is characterised by dispersed share ownership, high levels of legal minority shareholder protections, and a market-based financial system; and a continental European system where ownership is concentrated, legal minority shareholder protections are weak, and large (universal) banks with close ties to non-financial companies play a central role in corporate finance and governance (Hall & Soskice 2001).

Much of the recent corporate governance literature aims to explain this fundamental difference between the Anglo-American shareholder-orientated and the continental European stakeholder-orientated corporate governance systems. Herrigel (2007) identifies four different types of explanations, which he summarizes as the 'first wave' of corporate governance research: the 'natural

order' view, the political explanation, the 'legal origins' thesis, and the 'interest group' explanation.

The 'natural order' argument derives from Alfred Chandler's (1990) work and states in a nutshell that the dispersion of ownership is the result of the growth of companies at the end of the 19th century through consecutive new share issues, which increasingly diluted the traditional blockholders' stakes and made employed managers the central actors in the firms. On this account, the shareholder-orientated system, which is associated with dispersed ownership structures, emerged in countries where growth opportunities are not hampered by political, legal, and cultural factors (Herrigel 2007: 477).

The second explanation, the political one, is mainly associated with Roe's (1994, 2003) work and argues that concentrated ownership structures will persist in countries where political forces, which favour interests of other stakeholders than shareholders – such as Social Democrats – are strong. This will lead to political decisions that are disadvantageous to shareholders and to pressure on managers to neglect shareholder interests by pursuing risk-adverse strategies (Roe 2003: 30). In reaction, historical blockholders will hold on to their large stakes so as to be able to counter the political demands that press down on managers. According to Roe (2003), countries where 'Social Democrats' are strong will hence not evolve into a dispersed ownership model.

The third explanation is the 'legal origins' argument associated with the Law and Finance school and in particular with La Porta et al.'s (1997 and subsequent works) work on minority shareholder protection around the world. La Porta et al.'s (1997) argue that the difference in corporate governance structures is due to the level of legal minority shareholder protection, with dispersed ownership occurring in countries where minority shareholders' interests are well protected. This is the case, so the argument runs, in common law systems that focus much on the protection of property rights in general and that of minority shareholders in particular. In civil law systems, on the other hand, minority shareholders have fewer legal protections and blockholding as a compensatory mechanism for lacking legal protection will prevail.

Finally, a fourth kind of explanation focuses on interest groups and the impact of openness to trade on corporate governance structures (see Herrigel 2007: 480). Rajan and Zingales (2003) have argued that dispersion of ownership will emerge in countries that are open to capital and trade flows. In fact, openness to trade creates strong competition between incumbent monopolists and new entrants. As new actors enter the market, monopolists will ultimately lose their

power. This is true, on this account, not only at the level of competition between companies, but even inside a given company, where blockholders will fail to keep the control due to new entrants and dispersion will hence occur.

However, all these explanations of the ‘first wave’ of corporate governance research – as Herrigel (2007) terms it – have considerable limitations, because they are unable to explain either some ‘crucial cases’, or within-case variance in corporate governance structures over time (Herrigel 2007: 481). Yet he points out that a ‘new wave’ of truly historical corporate governance research has emerged recently. Studies of this strand of literature differ from the above-mentioned general explanations in – for our study – two important ways: firstly, they take history seriously in that they explore archival and other historical materials without attempting to fit these materials into a pre-existing theoretical framework (Herrigel 2007: 482). This new – partly inductive – approach allows the ‘new wave’ researcher to ‘get the historical facts right’ and to contribute to a proper understanding of each case, rather than bending them in order to make them fit with one’s theoretical claims. Secondly, as a result of the attention to historical detail, the studies of the ‘new wave’ stress much more the ‘[...] complexity, variety, process, and recombinatory change over time within cases [...]’ (Herrigel 2007: 482), while the above-mentioned general theories of corporate governance explain difference across cases, but rarely within a case over time.

The truly historical approach of the ‘new wave’ of corporate governance research has indeed made a necessary and very substantial contribution to the discipline. However, the risk exists that the attention to historical detail leads us to over-emphasize the particularities of individual cases and overlook theoretically informed, fundamental differences between different countries’ corporate governance systems. Herrigel (2007: 481) considers – rightly – that the countries around the world do not divide neatly into two categories of corporate governance models, but that each country is characterized by considerable heterogeneity in corporate governance structures and constitutes thus ‘mixed cases’ rather than a pure form of either model. This is undoubtedly true: there are German companies with dispersed ownership as well as US companies with a large blockholder. Yet, the existence of heterogeneity should not lead us to overlook fundamental differences between different countries. In fact, while several recent studies have convincingly argued that corporate governance structures in continental Europe and the US were not fundamentally different before the First World War (see below), during the second half of 20th century, two very different approaches prevailed in the two regions (see e.g. Streeck & Höpner 2003). This can be illustrated for instance by the considerable

political struggles over the organisation of companies in many European countries that took place during the last two decades of the 20th century and was triggered by the arrival in Europe of Anglo-American corporate governance practices and ideas (see for these more recent political debates e.g. Cioffi & Höpner 2006). Therefore, we cannot ignore the fundamental difference between the two regions and little is gained from considering each and every country as a ‘mixed case’. Rather, we have to ask: when and why did these differences emerge?

Moreover, while Herrigel (2007) criticizes the ‘first wave’ mainly on the grounds of empirical evidence and suggests ways in which methodological limitations of these studies‘’ may be remedied, he does not address their theoretical flaws. In fact, the lack of a proper historical analysis, which is indeed a major limitation of the above mentioned theories of corporate governance, reflects flawed theoretical assumptions inherent to these theories. All these approaches are – implicitly – based on a model of action that conceives of actors’ preferences as exogenous and stable. Therefore, these theories take for granted certain preferences that are associated with certain groups of actors: managers will always attempt to increase private benefits of control, while shareholders are interested in maximizing the value of their holdings.

We adopt a different view, which is based on the insight from historical institutionalism that actors’ preferences are formed in a historical process and are contextual rather than exogenous and stable (see notably Hall 2005). This underlines the importance of analysing the historical processes that led to the emergence of a given institutional setting and of empirically identifying the collective actors that mattered and what their preferences were (see Thelen 1999).

In particular, we underscore that cognitive aspects, i.e. ideas or beliefs, which allow actors to make sense of the reality and to define what their ‘interests’ are, played an important role in this process of preference formation.

Arguments referring to ideas in order to account for differences between corporate governance regimes are not entirely new. In fact, Roe’s (1994) analysis of the origin of the US financial system explicitly includes an ideational – or ideological – aspect (see also Lehmbuch 2001, Roe 2003). Roe considers that populist anti-bank ideology played, besides interest group politics, a major role in the US in the adoption of the financial sector regulations of the New Deal era, which had a major influence on the ownership structure of stock corporations. However, Roe explicitly conceives of ideas as a

‘background variable’ and claims that the cultural aversion in the US against concentration of economic power influenced the political process in the sense that policies had to be in line with the public opinion and with certain politicians’ constituencies (Roe 1994). While such broad cultural factors may indeed have played a certain role, we qualify this view as it allows only for a very limited leeway for ‘agency’ and underestimates the importance of ideas.

Recent scholarship in historical institutionalism has indeed criticized previous cognitive approaches precisely because they define interests and ideas as clearly distinct from each other and because they put (too) much emphasis on the role that ideas play to *justify* pre-existing material interests. Newer cognitive approaches consider ideas and interests to be intrinsically related: Ideas are not just a ‘justification’ for certain ‘material interests’ – although they may be in some instances – but play a central role in the processes by which political actors define what their interests are in the first place (Blyth 2002). In fact, actors need certain beliefs, ideas, or ‘causal theories’ in order to define what their interests are. Therefore, actors’ preferences do not precede ideas, but are formed in reference to a certain set of ideas.

This is not to say, however, that political power relations and support for ideas is irrelevant. In fact, as Gourevitch (1986: 17) put it: ‘Ideas for solving economic problems are plentiful, but if an idea is to prevail as the actual policy of a particular government, it must obtain support from those who have political power’. This is true independently of the fact if this support is obtained because those who have power use the ideas as justification for a certain course of action, or if the ideas affect in a more profound way what these actors believe their interests to be.

In this paper we propose to analyse the emergence of different corporate governance models in Switzerland, Germany and the US, using a theory of institutional change that takes into account the process of preference formation and acknowledges the role of ideas in this process. We also analyse the political context and the power relations between different actors in order to understand, which ideas ultimately prevailed.

The historical institutionalist approach in political science has attributed ideas an important role in institutional change early on (see notably Skocpol & Weir 1985, Gourevitch 1986, Hall 1989). Following this approach, we consider that a corporate governance system is underpinned by a cognitive construct akin to what Hall has termed a ‘policy paradigm’ (Hall 1993). A policy paradigm is defined as a ‘system of ideas’ or an ‘interpretative framework’ ‘[...] that

specifies not only the goals of policy and the kind of instruments that can be used to attain them, but also the very nature of the problems they are meant to be addressing' (Hall 1993: 279ff). While Hall (1992) applied this concept to policy fields, a corporate governance model has a comparable cognitive underpinning: it implies a fundamental hierarchy of goals or values, ideas about what the fundamental problem is and about instruments that allow one to achieve these goals. Thus, a difference in the 'paradigm' of the company underlying the two above-mentioned corporate governance systems is generally acknowledged but largely understudied. In fact, different perceptions of the role of outside investors and of the goal of the firm go together with the two models (Deakin & Slinger 1997: 124-151): In continental Europe, minority shareholder interests were during long time considered to be negligible or at least subordinate to more general goals (e.g. 'the public interest') or other stakeholders' interests.² The prevailing legal conception of the company was therefore a super-individualistic one, which sees the company as more than just an aggregate of its shareholders. In the US system, on the other hand, the interests of the atomized individual shareholder are central and shareholders have even been proclaimed the only constituency with a legitimate claim to the residual profits of the firm (Jensen & Meckling 1976), hence the designation of this system as 'shareholder model', which was based on an individualistic view of the firm.³ This difference can be interpreted as a difference in the fundamental 'hierarchy of goals' or 'values' of the company (shareholder primacy vs. primacy of the corporate interest). Based on the fundamental hierarchy of values, corporate governance paradigms also imply different perceptions of what the fundamental problem in the stock corporation is: for example holding managers accountable in order to reduce 'agency costs', or insuring that shareholders' greedy behaviour does not jeopardize the existence of the company. Furthermore, a given corporate governance paradigm implies different instruments to achieve the fundamental goal. The shareholder paradigm for instance uses performance related pay schemes in order to align shareholder and manager interests, while 'insider-systems' often use instruments such as opacity in accounting, in order to increase managerial autonomy from market forces.

One of Hall's claims is that the different levels of such a 'belief system' resist change to different degrees: it is much harder to make actors abandon the fundamental hierarchy of values they adhere to than instrumental beliefs about how to achieve a given goal. In the first case, Hall speaks of a third order change (or 'paradigm shift'), while the latter case constitutes a second order change. First order changes, on the other hand, consist in adapting measures that go together with a given instrument, e.g. changes in the number of years that

employees are prevented from selling shares they have obtained as part of a performance related pay scheme. Such first order changes are easier to achieve (Hall 1993: 278-279).

In this paper we argue that the emergence of two different models of corporate governance in the US, on the one hand, and Germany and Switzerland, on the other, can be interpreted as the result of historical processes that took place during the 1910s and the 1930s and led in the two latter countries to a 'paradigm shift' away from 'shareholder primacy' towards a super-individualistic conception of the firm, while in the former case only a 'second order change' took place, i.e. the original goal of shareholder protection was not abandoned during this period, but new instruments to achieve this goal were designed.

The importance of ideas for the definition of actors' preferences and the central role they play in the construction of a 'corporate governance paradigm' also suggests that the 'producers' of such ideas are important actors in processes of institutional change. This is particularly true for scientific experts. Klages considers that in recent corporate governance reforms in Germany, legal experts '[...] provide the legislator with legal ideas which cannot only be deployed to justify political reforms in legal terms but which can also shape policy-makers' perception of problems they try to solve and the goals which need to be pursued.' (Klages 2007: 8-9).

Therefore, we analyse, in this paper the role that legal experts and the ideas they produced played in the changes from 19th century corporate governance structures in the US, Switzerland and Germany to the ones that marked the 20th century. We argue that the modern corporate governance systems were the result of new ideas that were developed by legal experts in order to make sense of the changing characteristics of the stock corporation. While the legal debates were remarkably similar in both regions, different remedies were ultimately institutionalised on both shores of the Atlantic, paving the way to increasing divergence over the subsequent decades.

3. A Common Ground to Start with: Owner-controlled Companies and Shareholder-orientated Laws in the 19th Century

In this section we show that the corporate governance systems of the late 19th century in continental European countries and the US were not as different from each other as the dichotomic view, which prevails today, would suggest.

This concerns the economic and financial structure of the corporation as well as the legal framework.

Windolf (2005) shows that the US and Germany shared several features concerning the role of banks, networks of interlocking directorates, and cross-shareholdings between companies (see also Davis and Mizruchi 1999, Vitols 2006). Close interrelations between banks and industrial firms and an important influence of banks over non-financial firms existed in both regions. This can be illustrated by the proximity of Rudolf Hilferding's (1968 [1910]) analysis of the '*Finanzkapital*' in Germany and Louis Brandeis's (1995 [1914]) 'Other People's Money', which both observed a trend towards monopoly capitalism' and criticised excessive influence of banks over industrial companies. Mizruchi (2004:3) considers indeed that the period from 1895 up to about 1920 constituted the 'era of finance capital' in the US when large trusts emerged, which were controlled by groups of financiers and industrialists – i.e. by the owners – such as J. P. Morgan and J. D. Rockefeller, which controlled powerful investment banks and insurance companies. The role of US banks, such as J.P. Morgan, and of the emerging German and Swiss universal banks were not fundamentally different at that point.⁴

Concerning the ownership structure of companies, Lazonick and O'Sullivan (1996) show that in both country clusters, the so-called coordinated market economies (CME) of continental Europe and the Anglo-Saxon liberal market economies (LME), blockholding by the founding families prevailed during the 19th century. Similarly, Hannah (2007) has shown that large US corporations were, around 1900, dominated by plutocratic family owners rather than being characterised by dispersed ownership.

Concerning the level of development of capital markets – according to the Law and Finance school one of the distinguishing features between the shareholder and stakeholder models (see e.g. La Porta et al. 1998) – Rajan and Zingales (2003), Roe (2006) and Hannah (2007) show that European countries did not have underdeveloped capital markets as compared to the US or other Anglo-Saxon countries. In particular, Germany had well developed equity markets before the First World War (Nowak 2001, O'Sullivan 2007, Fohlin 2007a). The figures reported by Rajan and Zingales's (2003: 15, table 3) for instance show that total market capitalisation over GDP was in 1913 58% for Switzerland, 44% for Germany and 39% for the US. Only after World War II did this pattern change: by 1970 the respective figures for market capitalisation were 50% for Switzerland, 16% for Germany, and 66% for the US.

In short, during the latter half of the 19th century, European and US corporate governance structures were not significantly different; If anything, Switzerland and Germany were more market- or shareholder-orientated than the US, as their equity markets were more developed.

This situation is also reflected at the level of the legal conception of the company. At the end of the 19th century, most lawyers and the legislators on both sides of the Atlantic agreed that the goal of private firms was to serve the interests of shareholders and adhered therefore to an individualistic view of the firm. In both the quasi-public corporations and in privately held companies, shareholders were considered as the only stakeholder group with a legitimate claim on the firm's resources (cf. Chandler 1977, Dunlavy 1998 and 2004, Hannah 2007, Jackson 2001). As a result, protecting the shareholders was at the core of corporate laws in all three countries although the instruments that were used to achieve this goal varied.

In Switzerland, the legal framework of corporate governance was mainly based on the Stock Corporation Law of 1881.⁵ The first Swiss law was largely inspired by the German law of 1870, but the two countries' regulatory framework evolved into divergent directions thereafter. Thus, while the new German law of 1884 constituted a step towards more detailed regulation (see below), the Swiss Stock Corporation Law was very liberal in its formal characteristics in the sense that few aspects were regulated on a mandatory basis, much leeway was left to the interpretation of the rules by the judge, and the organisation of the corporation was largely left to the self-regulation by economic actors. This led contemporary observers to conclude that the Swiss law of 1881 was closer to the British model than to the German one concerning the general spirit of the law (Klein 2004 [1904]: 19-21, Von Waldkirch 1904, cf. for more details David et al. forthcoming). At the level of its content, however, the Swiss law of the late 19th century was – like the German law – based on a 'hierarchy of values' in which the minority shareholders were placed on top. This is most clearly expressed by the fact that the annual meeting of shareholders was explicitly defined as the supreme organ of the corporation, which could withdraw any competence from the board. As we will show below, this initial shareholder orientation of the Swiss law started to be put into question only during the first decades of the 20th century.

While the idea prevailed in Switzerland that shareholders could protect their interests on the basis of self-regulation, the German legislator increasingly attempted to protect the shareholders by relying on compulsory and detailed legal rules. The need for explicit shareholder protection became first apparent

with the stock exchange crisis of 1873 (the *Gründerkrise*). The circumstances of this crash led Rudolf von Ihering, an influential legal expert in Germany, to an analysis of the problems which resembles closely what we would today call the ‘agency theory’. He proposed – consequently – legal action in favour of shareholders (von Ihering 1904 [1877]; see below section 3.2). As a consequence of fraudulent activities and the failure of numerous companies, shareholder protection became even a priority for the German legislator. As a result, the company law of 1884 was clearly orientated towards the protection of minority shareholders (see Schubert and Hommelhoff 1985). The main measure to achieve this was the compulsory separation between the supervisory board and the management board for all public limited companies (Bähr 2003). Interestingly enough, measures favouring shareholders – and hence the functioning of financial markets – were at the time even supported by the large universal banks, which are nowadays typically seen as a constituting element of the ‘stakeholder system’ and per definition opposed to shareholder-orientated laws (Fohlin 2007b).

The law of 1884 led the influential Austrian legal scholar,⁶ Franz Klein to vehemently criticise the excessive protection of minority shareholders. He argued that strong minority shareholder protection would prevent firms from growing and left their managers without the necessary autonomy:

‘It is a legislation born out of mistrust, soaked with suspicion, directed against abuse. Its lodestar is the protection of the shareholder with a slight inclination towards the small shareholder, protection against the organs of the corporation and against the exploitation of the corporation by its organs or by third persons.’
(Klein 2005 [1904]: 12, our translation)

Lehmbruch (2001: 46) considers that the late 1870s constituted a watershed in the history of the German variety of capitalism as a formerly ‘liberal developmentalist’ dominant discourse among experts and public officials started to be replaced by the discourse of the ‘socially embedded capitalism’, as exemplified by the positive attitude towards cartels (Lehmbruch 2001). Concerning corporate governance, we also observe a certain change in the approach towards the regulation of corporations following the *Gründerkrise*, since the crisis had shown the risks of leaving too much leeway to company insiders. However, we argue that this reorientation was not yet decisive in the emergence of the German stakeholder system as it did not yet constitute a ‘paradigm shift’. In fact, the stock corporation law reform of 1884 led to the abandoning of the formerly liberal regulatory approach, where much leeway

was given to market forces and self-regulation and little state intervention existed, but not of the underlying goal, that is, protecting shareholders. Therefore, this change affected the *means* not the *goal* of the law and constitutes hence a ‘second order-’ not a ‘first order change’ in Hall’s (1993) terminology. Thus, the law of 1884 explicitly aimed to enhance investor protection through detailed and constraining legal rules and it aimed at discouraging small investors from investing in shares by fixing the minimal par value of shares at 1000 Mark (Jackson 2001). The legal reforms of the late 19th century in Germany reflect a loss of the belief in the self-regulatory capacity of market forces, not an abandoning of the underlying idea of shareholder primacy. The same can be said of the Stock Exchange Law of 1897, which also put the protection of minority shareholders at the centre by outlawing certain types of speculative trading activities which were considered to be harmful for minority shareholders (Fohlin 2007a).

While in continental Europe, company law was regulated at the level of the central state, it was in the domain of the member states in the US. New Jersey was the first state to adopt a modern – i.e. a norm-based not a concession-based – corporate law on US American soil in 1896 (Roe 1999, Cary 1974). This law – like the Delaware code adopted shortly after and largely inspired by the NJ law – did not attribute any particular priority to the protection of minority shareholders; not more, anyway, than the European laws of the time. Rather, the NJ and Delaware laws aimed clearly at attracting large trusts to incorporate in their respective states and were therefore very permissive towards trusts, but they were also often criticised for their orientation towards the interests of the managers rather than the interests of shareholders (e.g. Cary 1974).⁷

The jurisprudence of the late 19th and early 20th centuries, which played a particularly important role in the US common law system, does not show an unambiguous orientation towards the interests of minority shareholders either. Thus, the Supreme Court ruled in 1886 in the famous *Santa Clara Co. vs. Southern Pacific Railroad* case that the Fourteenth Amendment of the US constitution, which aimed at guaranteeing rights to freed slaves, was also applicable to corporations who were therefore declared as ‘persons deserving the law’s due process’ (Horwitz 1985: 174). This ruling has been interpreted as defining the corporation as a legal personality, with rights and interests which were not necessarily identical to shareholder interests. Yet, Horwitz (1985) shows that the underlying reasoning of Justice Field reveals that the Supreme Court still adhered to the individualistic view, arguing that constitutional protections apply to companies not because they extend ‘[...] to the name under which different persons are united, but to the individuals composing the union.

The courts will always look through the name to see and protect those whom the name represents' (Santa Clara 1883: 402/3, quoted in Avi-Yonah & Sivan 2007: 161). Also, two years after Santa Clara, Justice Field made it even clearer in *Pembina Consolidated Silver Mining & Milling Co. v. Pennsylvania*, that 'corporations are merely associations of individuals united for a special purpose' (Pembina: 189, quoted in Avi-Yonah & Sivan 2007: 162).

During the late 19th century this aggregate view did, however, by no means prevail in jurisprudence, but competed with super-individualistic views, some cases referring to different legal conceptions in a rather inconsistent manner (Avi-Yonah & Sivan 2007). The dominant theory of the company appears in fact to have more and more been marked since the 1880s by the idea of the company as a 'legal personality' with rights and interests of its own. Avi-Yonah and Sivan (2007: 164) even consider that by the mid-1920s the super-individualistic 'real entity' view prevailed in the legal theory.

While there is indeed some evidence indicating an increasing influence of the 'real entity' view, which also fitted best the 'economic reality' of ever larger companies controlled by managers, our analysis shows that the debate was far from being settled, either in jurisprudence or in legal scholarship by the mid-1920. Other authors, too, contradict Avi-Yonah and Sivan's (2007) view, considering instead that the shareholder-supremacy view ultimately prevailed in US jurisprudence. In fact, the *Dodge v. Ford Motor* case of 1919, in which the Supreme Court obliged Henry Ford to give priority to the interests of (minority) shareholders instead of customers and employees, has been interpreted as a landmark ruling paving the way towards shareholder primacy (cf. Baums and Scott 2003). Yet, again, this ruling was ambiguous and left room for the consideration of stakeholder interests as well (this was notably Dodd's (1932) view).

Be that as it may, it is safe to say that around 1900 there is no evidence for the nowadays so familiar distinction between continental European stakeholder orientation and US shareholder orientation, but both regions appear to have quite similar corporate governance structures and legal conceptions of the firm. The question becomes hence: when and why did the two different systems emerge? In the following sections, we argue that the explanation lies in diverging answers to similar economic transformations during the first decades of the 20th century.

4. Diagnoses and Remedies: The Emergence of the Super-individualistic Theory of the Firm

Avi-Yonah and Sivan (2007: 154-5) argue that debates about the legal conception of the firm have taken place in a cyclical manner, following certain economic transformations, throughout the history of the corporation as a legal form. Thus, the spread of the ‘limited liability’ and of a norm-based system of incorporation had already during the early 19th century given rise to debates over the nature of the firm. In this paper, we focus on what Avi-Yonah and Sivan (2007) call the ‘third transformation’, i.e. the rise of large companies with numerous shareholders and publicly traded shares. In fact, during the second half of the 19th century, many companies, which had been founded as a personal form of organisation with an owner-entrepreneur as only investor, changed into ever larger organisations where professional managers were increasingly independent from the control by the owners and where a new type of investors emerged, i.e. external minority shareholders.

This situation was famously analysed for the US by Adolf A. Berle and Gardiner C. Means (1933 [1932]) in their book on the modern corporation and the separation of ownership and control, but was by no means limited to the US. In continental Europe, and notably in Germany and Switzerland, the phenomenon was perceived as well and widely debated as the ‘*Strukturwandel der AG*’ (‘structural change of the stock corporation’; see e.g. Rathenau 1917a and Passow 1930). In all three countries, a new type of shareholders, which did not exist in the owner-managed companies on which the legal theories of the 19th century were based, i.e. a purely financially interested minority shareholder, had emerged by the early 20th century. Moreover, more and more firms were not managed by their founders any more, but by professional managers. While the new investors were passive and had little influence on the decision-making within company, the professional managers became more powerful. As in the US, German and Swiss scholars observed an increasing distance between shareholders and managers and analysed the problems that were likely to emerge from such an evolution.

To be sure, the extent to which ownership was really dispersed at any given point in time in the different countries remains subject to debate up to today. In fact, Burch (1972) critically reassessed Berle and Means’ (1932) calculations and finds that they had overestimated the extent of dispersion. Also, in Germany and Switzerland, public companies with truly dispersed ownership structures remained a minority throughout the 20th century, and blockholding by families or other companies prevailed (see for Germany notably Höpner & Krempel

2003, for Switzerland Windolf & Nollert 2001). However, independently from its actual extent of this evolution, contemporary legal scholars, economic actors and politicians *perceived* it as a fundamental change in the nature of the stock corporation with far-reaching repercussions for company law and the economy as a whole.

We will show that it is this perceived transformation of the stock corporation during the late 19th century that triggered a sequence of changes between the 1910s up to the 1930s, which would ultimately lead to the institutionalisation of two fundamentally different approaches to corporate governance in the three countries: The increasing size of companies and emergence of small shareholders led legal scholars to search for remedies for problems linked to the new situation. The economic crises of the 1920s and the Great Depression opened up an opportunity window for the transfer of these legal ideas into the political arena and ultimately the institutionalisation of a certain theory of the firm. In other words, the two distinct corporate governance systems that emerged during this critical period ultimately resulted from the fact that different, even contradictory, answers to a similar problem – i.e. what governance structures are appropriate to govern the ever larger corporations and what rights and duties does a stock corporation have? – were ultimately embraced by policy-makers in the two regions.

It may well be that several choices away from a shareholder-orientated organisation of corporate governance were made in Germany and Switzerland already during the late 19th century (cf. the positive attitude towards cartels). Conversely, the US adopted already at the end of the 19th century anti-trust and anti-concentration policies notably concerning the banking sector, which favoured dispersed ownership and influenced the subsequent development in important ways. These differences had important implications for the evolution of corporate governance structures notably because equity ownership by private households and equity-finance of companies was encouraged in the US, while it was hampered by certain political decisions in Switzerland and Germany. However, these different approaches towards financial markets and big business in the two regions were not yet linked to a fundamental difference concerning the theory of the firm. Only during the period from the 1910s up to the 1930s did different approaches to questions of corporate governance emerge and it was during this period that different views were explicitly debated and finally codified for the first time. Therefore, the early 20th century was a crucial era for the definition of institutional regimes of corporate governance precisely since different ‘events’ led to a questioning of the ‘nature and role of the firm and its key actors’ (Biondi 2007: 4).

In the following sub-sections we discuss the debates that have taken place in each one of the three countries in order to show, how the conception of the company and the orientation of corporate governance gradually evolved into the direction which is nowadays associated with the two models.

4.1 Switzerland: The ‘Corporate Interest’ as a Qualification of Shareholder Interests

During the reform of the Swiss Stock Corporation Law of 1881, which took place between 1911 and 1936, the above mentioned evolutions of the nature of the stock corporation led to a debate about how the legal framework of corporate governance should be adapted to the new situation. It is in this context that the super-individualistic conception of the stock corporation emerged in Switzerland. Two legal scholars had a crucial influence in this respect: August Egger and Walther Hug.

In practice, the ‘liberal’ character of the Swiss company law of 1881 and the leeway it left for actors to interpret the rules, had increasingly been used to curtail the rights of minority shareholders. Yet, the reaction of most legal experts in Switzerland was not to demand the reinforcement of shareholder rights, but rather to promote the institutionalisation of this new ‘insider orientation’, which was often seen as a ‘natural’ evolution of the capitalist system. In fact, during the reform work, a growing consensus among lawyers and businessmen emerged that the individualistic view of the firm was obsolete, i.e. that in addition to shareholder interests, other interests, and most notably the ‘corporate interest’ (*Unternehmensinteresse*)⁸ should also be protected. This legal concept was going to become a central element of the Swiss corporate governance system, as it was considered to be the only criteria by which the legality of decisions of the corporate bodies’ could be judged (see Bär 1966, Nenniger 1974).

This shift in the goal of the reform in Switzerland away from shareholder protection towards the protection of the super-individualistic ‘corporate interest’ is remarkable because when the reform was kicked off in 1911, no fundamental change in the orientation of the legal framework of corporate governance was intended (Lüpold 2008). The first draft law of 1919 was even explicitly orientated towards better shareholder protections, attempting to adapt the 19th century shareholder protection to large quasi-public firms (Huber 1919).

A change set in during the inter-war period. The law professor August Egger (1925) was one of the first to maintain that the focus on shareholder protection in the 19th century laws was outdated and had to be replaced by the protection of

the company. Egger argued, referring notably to von Ihering and Klein (see Egger 1925: 4-5), that the modern company law should first and foremost enable the growth of the companies, which implied giving managers and directors the necessary instruments to finance and manage the firm in full autonomy. Egger (1925: 7-8) argued that the shareholder orientation

‘[...] was certainly part of the early age of the most recent economic evolution, but it was one-sided to consider company law mostly as a legislation aimed at protecting shareholders. One should primarily aim at the promotion and the protection of the company – in principle this is also the best way to preserve shareholder and creditor interests.’ (our translation)

Egger’s view soon gained support among legal scholars, the business elite and politicians. This shift was also linked to an increasingly negative attitude towards minority shareholders among the Swiss business elite. This view can be illustrated by the one-liner ‘*Les actionnaires sont ou des lions ou des moutons, mais toujours des bêtes*’ (literally ‘shareholders are either lions or sheep, but always animals’⁹), which the lawyer Fritz Fick (1920: 336) quoted to convey the prevailing attitude among the Swiss business elite towards shareholders. Fick (1920: 336) – adhering to this view – concluded that only loyal shareholders (the ‘sheep’) had a legitimate interest in the firm, whereas the greedy speculators (the ‘lions’) did not. As a result, many Swiss lawyers, businessmen and politicians considered that opportunistic behaviour by managers was the lesser evil than opportunistic behaviour by minority shareholders, as the former had a genuine interest in the survival of the company whereas the latter did not.

Some years later, law professor Walther Hug further developed Egger’s ideas. Hug (1934: 83-84) considered that the typical corporate governance conflict in Switzerland was between small shareholders and blockholders rather than between managers and shareholders, i.e. – in modern terms – it was a ‘horizontal’ rather than a ‘vertical corporate governance problem’ (cf. Roe 2005). Hug did hence not deny problems of minority shareholder protection, but he still formulated remedies which heavily drew on Egger’s work, i.e. he did not attach much importance to the protection of minority shareholders. Like Egger, Hug wanted to maintain the ‘liberal’ character of the Swiss company law – in the sense that legal should be sparse and leave room for interpretation by economic actors – and rejected the German way of protecting shareholders by detailed and constraining rules. Even though it had been precisely this ‘liberal’ character of the old Swiss company law that had allowed a shift of power from

the general meeting to the management, Hug relied on the responsibility of the managers and directors rather than on detailed legal rules. Hug alluded to the famous above-mentioned quote by Franz Klein when he described the character of the Swiss company law:

‘It is not based on a legislation born out of mistrust and soaked with suspicion, but on a law that is based on honesty, respectability and reliability of the personality of the entrepreneur.’ (Hug 1934: 17f., our translation)

This quote reflects a central element of the Swiss corporate governance model as it emerged from the transformation of the late 19th century, i.e. a positive perception of managers. In fact, managers were seen as neutral ‘arbiters’ who balance the interests of different groups of actors against each other, rather than an interest group in their own right. The guiding principle for managers to fulfil this task should be the ‘corporate interest’. For Hug, this was the only way to reconcile the interests of all stakeholders:

‘If one envisages the overall interest of the shareholders, it results with imperative necessity that the advancement and the safeguarding of the company have to precede the momentary interests of the individual shareholders. [...] The advancement and the safeguarding of the company demand a strong and secured position of the management and the board of directors.’ (Hug 1934: 35-36, our translation).

To sum up, Egger and Hug saw the protection of the ‘corporate interest’ as a way to reconcile the interests of blockholders and small shareholders. Shareholder interests were hence not entirely neglected, but only the interest of long-term investors (*Daueraktionäre*) were compatible with the corporate interest and hence legitimate, the interests of short-term investors (*Spekulanten*) were not. This resembles closely Rathenau’s (1917b) assumption that the interest of shareholders – rightly defined – converged with the interest of the company and that, consequently, minority shareholder protection was superfluous.

Yet, while Egger did not mention Rathenau in his work, Hug (1934) explicitly distanced himself from Rathenau. In fact, Hug rejected the new German transpersonal ‘theory of the enterprise-in-itself’, developed by German lawyers around 1930 and often – wrongly – attributed to Walter Rathenau (see section 3.2). Hug argued that the corporation could not be an ‘end in itself’, but he

accepted the fundamental super-individualistic principle of the German theory because it constituted a way to reconcile the interests of blockholders and small shareholders. Interestingly enough, even though Hug had spent some time at US universities, the preoccupation with the German developments turned out to be more influential for his work. While he cites different German scholars in his book, he did not even mention Berle and Means.

Egger's and Hug's way of defining the 'corporate interest' was, however, contested, as some lawyers defended the German theory of the 'enterprise-in-itself'. The main advocate of this theory in Switzerland was Hans Fehr, professor at the University of Bern. Fehr was one of the first authors to introduce the 'stakeholder idea' into the Swiss debate. Interestingly enough, he quoted mainly US sources in support of his theory. Thus, Fehr (1928: 121-124) cited John D. Rockefeller jr. and Henry Ford who both had argued that in the interests of workers should be considered in the exercise of property rights. Fehr considered this to be a form of 'socialist capitalism'. He also cited the then US Secretary of Commerce Herbert Hoover who considered that the current age was one of transition from an individualistic period towards a more 'collectivist period' of collaboration and economic democracy (Fehr 1928: 124-125). Another scholar who defended this view was one of Fehr's students, Kurt Kohli. His doctoral dissertation (Kohli 1936) is one of the few truly 'Rathenau'ian works in Switzerland. However, the 'theory of the enterprise-in-itself' did not have much success in Switzerland vis-à-vis the competing view of the 'corporate interest' defended by Egger and Hug. Especially, it did not have an impact on political decision-makers (Riechers 1996). This shows that Switzerland – despite close commercial and cultural ties with its large neighbour Germany – developed its own models, based in part on a selective and autonomous adaptation of foreign models and theories.

The dominant legal discourse in Switzerland attributed shareholders hence some responsibility towards the firm (i.e. being loyal and providing patient capital), which constitutes an inversion of the 'hierarchy of goals' associated with the 19th century conception of the company. In stead of pursuing 'shareholder primacy', the new conception put the management as neutral arbiter between harmful private interests on top of the hierarchy in the company. As we will show below, this view was institutionalised for the first time in the Swiss Stock Corporation Law of 1936 and was subsequently to become a central feature of the traditional Swiss insider-orientated corporate governance system.

4.2 Germany: The Rathenau'ian 'Theory of the Enterprise-in-itself' and the Decline of Shareholder Protection

An alternative to the traditional individualistic shareholder-orientated view of the firm emerged in Germany during the same period as in Switzerland. This view put into question the shareholder-orientation of the existing German company law and was based on a negative view of the shareholder as 'stupid and impertinent'.¹⁰

As noted above, during the late 19th century leading German company lawyers defended a shareholder-orientated view of the company. Rudolf von Ihering 1904 [1877] for instance saw the managers as the problem, and the corporation was mainly an instrument used by managers to cheat on investors:

'The position of the administrator [i.e. of the manager] implies a large temptation. [...]. No thief is in so good a position to steal as the administrator of other people's goods, and no cheater can so easily commit a roguery and cover it up.' (von Ihering 1904 [1877]: 172 [223], our translation).

As we have shown above, this view had clearly influenced the German legislation of the late 19th century. However, the position of the minority shareholder became even more precarious with the structural change of the stock corporation. Like most European countries and the US, Germany had experienced, since the mid-19th century, a trend towards ever larger companies and an increasing concentration of industrial activity which led to the emergence of large groups or conglomerates (*Konzerne*). This evolution sparked off a debate about the 'structural transformation' (*Strukturwandel*) of the stock corporation and became the subject of one of the committees that dealt with company law reform during the Republic of Weimar (Enquête-Ausschuss 1928, see also Passow 1930). One lawyer described the problems related to *Strukturwandel* as follows:

'The structural transformation of the corporation, caused by the formation of conglomerates, has in particular led to an increase of managerial power without sufficient checks and balances and, at the same time, to a weakening of the legal position of the general meeting and to a reduction of disclosure.' (Rosendorff 1932: 11, our translation).

During the Weimar Republic, certain lawyers (and journalists) criticized the instruments on which insiders' power was based, most notably shares with

multiple voting rights, and asked for a company law reform in order to strengthen shareholder rights (Laux 1998: 158-192). Yet, like in Switzerland, despite the increasing vulnerability of minority shareholders within the firm, a competing super-individualistic view to the original shareholder-orientated view soon emerged and the interests of individual shareholders were increasingly qualified.

One of the most influential authors concerning the development of this new approach was the businessman, lawyer and politician Walter Rathenau. Rathenau described the phenomenon of the emergence of large, quasi-public firms which were dominated by professional managers as ‘substitution of the fundamental purpose’ (*Substitution des Grundes*), that is, the transformation of the stock corporation’s internal organisation and purpose away from the owner-controlled family business towards a quasi-public institution (Rathenau 1917b: 11-12). One consequence of this structural transformation was described in Rathenau’s text of 1915 ‘Von kommenden Dingen’ (‘In Days to Come’; Rathenau 1917a) as the ‘depersonalisation of property’. In this text Rathenau described the modern shareholder as a ‘nexus of different property rights’ – i.e., the modern shareholder owned shares of different firms of which he merely knew the name and towards which he showed no particular interest or attachment (Rathenau 1917a: 141f.). This had two implications:

‘The depersonalisation of property means at the same time an objectification of the thing. The property rights are fragmented and flexible to such an extent that the enterprise obtains a proper life – just as if it did not belong to anybody – an objective existence, like it was embodied by state and church [...] in earlier times. This situation appears in the process of the life of the enterprise as a shift of focus; the top levels of a hierarchy of officials become the centre [...].’ (Rathenau 1917a: 142, our translation).

Rathenau’s analysis was strongly influenced by his own experience as manager and director of many large firms, in particular the AEG (*Allgemeine Electricitäts Gesellschaft*), and went together with a very negative perception of external shareholders. Rathenau (1917b: 28) considered in fact that the loyal, long-term investors (*Anlageaktionäre*) at AEG accepted the managements ‘retain and reinvest’ policy of large parts of the profits. Small shareholders, however, wanted to exploit the firm in order to get high dividends and increasing share prices. He even accused some of these small shareholders to be spies for rival firms (Rathenau 1917b: 28). More generally, Rathenau

observed an increasing passivity of purely financially interested shareholders, which explains the above-mentioned ‘depersonalisation’ of share ownership. This predominantly negative view of small, anonymous, external investors became more and more accepted in Germany during and after the First World War. The observation by economist Eugen Schmalenbach, mentioned in the introduction of this paper, expresses precisely this view:

‘The shareholders, if they are not closely connected to the firm, do not treat the firm like a cow, which has to give milk; [...] they treat it like the wandering gatherer of berries treats a wood: they take everything away, the ripe and the unripe, because it is not known who will harvest the future fruits. The normal shareholder does not intend to stay forever and tends to depletion.’ (Schmalenbach 1926: 91, our translation).

Not the increasing vulnerability of minority shareholders, but the protection of the company from self-interested behaviour by increasingly materially-interested shareholders was therefore perceived as the main problem in Germany. This led among other things to the formulation of the theory that the shareholder had a duty of loyalty (*Treuepflicht*) towards the firm (Laux 1998: 193-228), which constitutes the inversion of the original view that the firm had to serve shareholder interests.

Given the negative perception of shareholders, Rathenau’s conclusion was that managers needed to have a large autonomy to protect the ‘enterprise interest’ against greedy investors. More precisely, the managers of the firms should have the discretion to create as many reserves as possible, and to defend this policy of retaining and reinvesting against speculators. Moreover, as companies’ size and hence their importance for the ‘public’ increased, managers became responsible not only for ‘their’ company, but for the interest of the nation as a whole and started to play an important role notably for national defence. They should, therefore, not consider themselves as trustees of the shareholders (Rathenau 1917b: 60).

Rathenau’s negative view of shareholders had as a corollary an idealistic view of managers, which explains why increasing managerial autonomy was not perceived as a problem. In fact, Rathenau saw the actions of managers in the new context as being guided by a sense of duty or ‘public servant idealism’ (*Beamtenidealismus*), i.e. they acted unselfishly in the interest of their company and took pride in its flourishing; a view that comes close to the modern stewardship theory. The perception of the professional manager that prevailed

in Germany – but also in Switzerland – was hence that of a technocratic administrator who was driven by an uninterested ‘universalistic ethos’ to favour the interests of his organisation and the society at large (see Lehmbruch 2001: 54). In that sense, managers were not perceived as an interest group, or a source of ‘agency costs’, but rather as a neutral arbiter between interests. In Rathenau’s work, this idealistic view of managers and their comparison to the public administration seems to translate his admiration for the Prussian state tradition (Lehmbruch 2001: 69). More generally, the fact that the concepts of ‘administration’ and ‘bureaucracy’ were at the time primarily positively connoted signifying the rational and unemotional – technocratic – organisation, has favoured the demand for increasing managerial autonomy.

In Weimar Germany, after Rathenau’s death in 1922, his ideas were little by little transformed into a theory, for which the lawyer Fritz Haussmann (1928) coined the term ‘theory of the enterprise-in-itself’, a term Rathenau himself had not used. While other lawyers – such as Oskar Netter (1932) – criticised this interpretation of Rathenau’s work, the theory of the ‘enterprise-in-itself’ still became influential in Germany.

In a nutshell, the ‘theory of the enterprise-in-itself’ is a transpersonal view of the company stating that the particular interests of all shareholder and stakeholder groups were subordinated and at the same time encompassed by the ‘enterprise interest’ (*Unternehmensinteresse*) (Laux 1998, Riechers 1996). Contrary to the Swiss doctrine of the ‘corporate interest’, the ‘enterprise interest’ was not defined as the sum of the interests of the individuals or stakeholders that composed it, but the ‘enterprise-in-itself’ was defined as a transpersonal, quasi-organic entity with interests and a life of its own. In other words, the company was perceived as something remotely comparable to the ‘thing-in-itself’ in the Kantian phenomenology, i.e. an object whose true nature cannot be perceived or understood by the observer (see Schluep 1955 for this explanation.)¹¹

In short, the evolution of companies in Germany since the late 19th century was clearly perceived in the same way as in Switzerland: ever larger companies and changing preferences and capacities of shareholders required a reorientation of the legal instruments that had governed stock corporations during the 19th century. Like in Switzerland, the firm was increasingly seen as an institution serving multiple goals and not only those of individual shareholders. In parallel, shareholders were increasingly exposed to exploitation by blockholders and managers. Yet, shareholders were also increasingly perceived in a negative way as their only interest appeared to be material and they constituted a potential

menace to the company in times of war and economic crises. Therefore, the key corporate governance problem as it was perceived by most Swiss and German scholars from the 1920s onwards was not how to hold managers accountable, but how to prevent outside shareholders from plundering the firm.

The solutions for the new situation in both countries were hence based on the idea to subordinate the selfish financial interests of shareholders to a broader super-individualistic ‘corporate’ or ‘enterprise interest’. This implied that minority shareholder interests were legitimate only if they did not contradict the interests of the firm as defined by the managers.

In the next section, we show that the US debates show striking similarities with the debates in Germany and Switzerland.

4.3 United States: Berle, Means and the Continuing Need for Shareholder Protection

As noted above, Avi-Yonah and Sivan (2007) show that starting in the late 19th century, the definition of the nature of the company became an increasingly debated issue in US jurisprudence, due notably to the increasing size of companies. During that period, three different legal conceptions of the firm – the real entity theory, the artificial entity theory and the ‘aggregate view’ competed (see above endnote 3). Avi-Yonah and Sivan (2007) consider that the debate had been decided by the mid-1920s in favour of the ‘real entity view’ – which sees the stock corporation as an independent unit controlled by managers – and that the debate had stopped after the publication of an influential article by John Dewey in 1926 (Dewey 1926).

We disagree with this view. Certainly, the late 19th century had seen the emergence of an important debate about the relation between the state and the company, which was spurred by the introduction of a norm-based system of incorporation and touched issues such as taxation. In this context, the view emerged that the company was more than an ‘artificial entity’ – that is, a mere extension of the state – and had a legal personality of its own, which was a necessary condition for the emergence of the ‘super-individualistic view’ of the company. Yet, during the early 20th century a new issue was increasingly perceived as the main problem, i.e. the relationship between shareholders and managers rather than between the company and the state. This issue is obviously linked to the question of the legal personality of the company, as shareholders responsibilities are in part determined by this issue. Yet, the relations between managers and shareholders were not settled with the attribution of legal personality to the stock corporation. Therefore, the debates

over the nature of the company went on in the US during the first decades of the 20th century. Max Radin's (1932) article on 'The Endless Problem of Corporate Personality' shows indeed that the debate was far from being over at that point. Also, E. Merrick Dodd (1932: 1145-6) spoke still in 1932 of the '[...] widely prevalent theory that the corporate entity is a fiction [...]', i.e. a mere aggregate of its members rather than a 'real entity'.

In fact, a debate comparable to the *Strukturwandel* discussion in Germany and Switzerland took place approximately at the same time in the US. This debate was spurred by the famous findings of the Adolf A. Berle and Gardiner C. Means (1933[1932]) concerning the separation of ownership and control in large US companies during the first decades of the 20th century. Berle and Means (1933) found that in many American firms, a situation had emerged where a large number of shareholders bore the financial risk, but had no significant influence in the firm, whereas the managers had the power but did not bear any financial risk. However, shareholders were not considered in Berle and Means' (1933) analysis as pure victims of this evolution, but contributed to it by their increasing lack of interest in the companies' in which they held shares. In fact, ownership had become 'passive' in the course of the American 'corporate revolution' – as they called the rise of giant public corporations – in the sense that not only did ever smaller shareholders have less potential influence, but also did they care less about the companies. As a result, Berle and Means considered that the original conception of the shareholder, the one of the 19th century, was outdated:

'The shift of powers from the individual to the controlling management combined with the shift from the interests of the individual to those of the group have so changed the position of the stockholder that the current conception with regard to him must be radically revised.' (Berle & Means 1933: 278).

They considered that the shareholder was not a partner for the company any more but only a supplier of capital with no particular interest or responsibility towards the firm whose stock he decided to buy. The horse metaphor quoted in the introduction reflects this view. This evolution has fundamentally changed the nature of the corporation to the point that '[i]t was apparent to any thoughtful observer that the American corporation had ceased to be a private business device and had become an institution.' (Berle & Means 1933: V).

The parallels with Rathenau's analysis are conspicuous. Interestingly enough, Berle and Means quote Rathenau's text on the depersonalisation of property in large German firms (see Berle&Means 1933: 352).

Following Rathenau, Berle and Means concluded that the 'modern corporation' was potentially the dominant institution of the modern world, as powerful as the church or states had been in earlier times (Berle&Means 1933: 356-357). As a result, there were increasingly forceful claims for corporate power to be used in favour of the public interests or of stakeholders other than shareholders.

Berle and Means (1933: 354-356) saw three possible answers to these calls for the inclusion of stakeholder interests: First, the managers could continue to act as trustees of the shareholders and manage the firm in the sole interests of the owners. Second, unlimited powers could be given to managers which would mean to accept that managers were the new central group in the firms. Berle and Means (1933: 355) explicitly stated that '[i]f these were the only alternatives, the former would appear to be the lesser of two evils'. They explicitly rejected hence the 'managerialist' or 'real entity' view, which had become a central element of corporate governance models in Switzerland and Germany. Yet, Berle and Means saw a third alternative, which was a stakeholder system, in which shareholders voluntarily agreed that their interests were not the only legitimate ones. This was the outcome which Berle and Means ideally privileged, but considered to be unrealistic. They were hence by no means the partisans of 'shareholder primacy' as which they are often perceived today, but considered shareholder orientation to be the 'lesser of two evils' in absence of any practical solution for instituting a public interest orientation of the firm. Indeed, Bratton and Wachter (2007) show that while Berle's – who was the more influential of the two – 1931 article on 'Corporate Powers as Powers in Trust' was clearly part of an early phase where he defended a pure shareholder primacy view, he soon changed towards what Bratton and Wachter call a 'corporatist' view that sees the firm as being bound by public objectives. Moore and Reberioux (2007: 358) make a similar argument stating that Berle and Means did not aim at reducing the separation between ownership and control, but at exploiting it for the benefit of the society at large. Indeed, Berle's 'corporatist turn' took place during his collaboration with Gardiner C. Means and has influenced – at least parts of – their book on the 'Modern Corporation and Private Property'.

Yet, contrary to most Swiss and German scholars, Berle was, throughout his career, strongly opposed to excessive managerial power as he perceived these 'princes of property', in a very negative way (Bratton & Wachter 2007). It is

this negative perception of managers rather than a shareholder primacy view that opposed him during the 1930s to other contemporary US lawyers as can be illustrated in the famous dispute in the Harvard Law Review in 1932 between Berle and Harvard law professor E. Merrick Dodd. The debate was kicked off by the publication of an article by Dodd attacking Berle's 1931 article on 'Corporate Powers as Powers in Trust'. Dodd attacked Berle's shareholder primacy view and defended a stakeholder approach instead (Macintosh 1999). More precisely, Dodd rejected Berle's idea that '[...] managerial powers are held in trust for stockholders as sole beneficiaries of the corporate enterprise' (Dodd 1932: 62). In his view, shareholder interests should not be primordial, as the corporation had to fulfil '[...] a social service as well as a profit-making function' (Dodd 1932: 62). For him, the dispersed shareholders were too far away from the firm to understand the necessity of the 'social service'; managers were not:

'That stockholders who have no contact with business other than to derive dividends from it should become imbued with a professional spirit of public service is hardly thinkable. If incorporated business is to become professionalized, it is to the managers, not to the owners, that we must look for the accomplishment of that result.' (Dodd 1932: 66).

Moreover, Dodd contested the traditional view that the 'distinct legal entity' of the corporation was a fiction resulting from the 'mysterious act of incorporation' and held instead that the legal personality of the corporation was real (i.e. he privileged the 'real entity theory' over the 'aggregate theory' of the firm). This resembles very much Rathenau's argument who also considered the company had become a 'thing in itself', which is much more than a legal fiction.

Different reasons explain why Berle defended – despite his 'corporatist turn' after 1932 – shareholder interests in the debate with Dodd. Firstly, Dodd's attack aimed at Berle's 1931 article on 'Corporate Powers as Powers in Trust' and was written before 'The Modern Corporation' was published. While Berle's views had considerably evolved between the publication of this article and the publication of 'The Modern Corporation' in the autumn of 1932, he could obviously not completely renounce to his opinion of just a year earlier.

Secondly, Dodd's ideas were influenced by the 'business commonwealth' idea that had emerged as an answer to the Great Depression, which in turn was the major issue dominating the debates over the nature of the firm at that point. The advocates of the 'business commonwealth' promoted the establishment of a

corporatist type of economy based on self-regulation of the business community in the public interest (Bratton & Wachter 2007: 32). This approach was notably favoured by very influential managers such as Owen D. Young and Gerard Swope chairman and president of General Electrics respectively. It was based on a super-individualistic view of the firm, rejecting shareholder primacy. Young – a potential Democratic presidential candidate for the 1932 election – had for instance declared in 1929 that he felt as a ‘trustee of an institution’ and its stakeholders rather than as an ‘attorney for the investor’ (quoted in Dodd 1932: 66-67). Swope, in turn, had developed a crisis plan – the so-called ‘Swope Plan’ – according to which ‘organized industry’ should recognize stakeholder interests on the basis of self-regulation rather than wait until the state would force them to do so (Dodd 1932: 67, Swope 1932). Berle, however, was – due to his distrust of managers – strongly opposed to the idea of a ‘business commonwealth’.

Thirdly, the extent of ordinary people’s savings invested in shares, made in Berle’s view of shareholder interests a matter of the welfare of the general public (Bratton&Wachter 2007: 38). Berle, argued that the millions of Americans who had invested their savings in corporate stock needed protection. In fact, he estimated that about half of total US household savings were ‘passive property’, i.e. held by minority shareholders (Berle 1932: 79). Therefore, as Bratton and Wachter (2007: 25, note 126) put it: ‘While Berle had few good words for absolutist corporate administrators, he had a soft spot for shareholders, whom he identified with ordinary working people who needed to collect their dividend checks to make ends meet’.

Yet, Berle also considered that – as a result of the passivity of their ownership – shareholders’ ‘moral right’ to demand compensation for their ownership had to be limited (Berle 1932: 79). Shareholders’ claims were hence by no means the only legitimate claims on the firms’ assets and maximising their interest was not the only objective of the stock corporation. Berle considered that eventually the super-individualistic view should prevail over the individualistic view of the firm:

‘It remains only for the claims of the community to be put forward with clarity and force. [...]. When a convincing system of community obligations is worked out and is generally accepted, in that moment the passive property right of today must yield before the larger interests of society.’ (Berle 1932: 356).

Yet, in his view, the managers and directors of the large corporations did not recognize their social responsibility and there was no mechanism, which would allow the legislator to enforce it (Berle 1932: 77). In such a situation, Berle feared the problems linked to a stakeholder approach, in which the management would be attributed the role of an arbiter between individual interests in the name of the corporate interest.

‘The legal doctrine that the judgement of the directors must prevail as to the best interests of the enterprise, is in fact tantamount to saying that in any given instance the interests of the individual may be sacrificed to the economic exigencies of the enterprise as whole, the interpretation of the board of directors as to what constitutes an economic exigency being practically final.’ (Berle 1932: 277-278).

Berle rejected hence – provisionally – the real entity theory of the firm as the guiding principle for corporate governance rules and refused to give unlimited power to managers with ‘[...] a pious wish that something nice will come out of it all’ (Berle 1932: 78). The only solution for the time being was, in his view, to put the accent on the protection of individual shareholders’ rights.

While Berle later considered that history had proven Dodd to be right (Berle 1954), he clearly was the political winner of the debate in the 1930s as his views were those that were to become influential with the New Deal administration (see below section 5.3).

4.4 Summary: The Emergence of the Super-individualistic Conception of the Firm

To sum up, the diagnosis that Berle and Means made of the US economy during the early 20th century was not far from Rathenau’s or from Swiss scholars’ analysis of the situation – they saw the modern corporation as an ‘institution’ with a responsibility for stakeholder- or the public interest (i.e. in Frederic Maitland’s terms a ‘right-and-duty-bearing unit’) rather than a private money-making device, and it was doubtful whether the passive shareholders’ selfish and purely financial interests should prevail over other stakeholders’ and the general public’s interests. Scholars in all three countries saw the evolution towards ever larger corporations and the parallel decreasing influence of (dispersed) owners over the firm as a ‘natural’ evolution, which would or should in the end lead to idealistic managers who guide the firm in the interest of the multiple stakeholders’ and the public’s interests.¹²

Rathenau had concluded from his analysis that due to the separation of ownership and control, shareholders had lost their rights and their position as central stakeholder group; Swiss scholars considered that the managers were well placed to guarantee the protection of the ‘corporate interest’ from selfish, private interests; Berle and Means on the other hand concluded from a similar diagnosis that, at the contrary, this separation demanded better investor protection. Broad cultural explanations may explain part of this divergence: Roe (1994) showed that US ‘public opinion’ was generally hostile to too powerful organisations, which has certainly influenced the analysis of the problem. The economic history of the US is indeed considerably influenced by a certain popular and political aversion for ‘big business’. This is expressed already in the state of New York’s General Incorporation Statute of 1811 which defined a maximal – not a minimal – capital for companies and demanded companies to be dissolved after a certain period.¹³

In continental Europe, on the other hand, more paternalistic views may have been easier to defend. Also, in Germany, the Prussian tradition of a strong state and bureaucratic organisation may have favoured a predominantly positive view of the increasing size and the – consequential – bureaucratisation of the companies.

However, as we have shown in this section, the shareholder approach in the US was neither undisputed nor dominant from the outset. Strong tendencies towards a super-individualistic view of the firm existed with the ‘business commonwealth’ and other corporatist ideas. On the other hand, voices demanding efficient minority shareholder protections existed in Weimar Germany and Switzerland as well. Hence, none of the three countries were destined to develop a particular type of corporate governance. In all three countries different theories existed and were debated, and only the analysis of the political processes that led to the institutionalisation of different approaches can explain why one path was ultimately chosen rather than another. The next section analyses briefly these political processes, which led during the 1930s to the institutionalisation of the different approaches, paving the way to the nowadays usual distinction between continental European and Anglo-American corporate governance systems.

5. Legal Ideas and Politics: The Institutionalisation of Divergent Conceptions of the Firm

It is no coincidence that in all three countries the institutional foundations of corporate governance regimes started to take shape during the period from 1910 to the 1930s. In all three cases, the structural transformation of the joint stock corporation fell into a period of great political and economic instability and crisis. This situation shook existing beliefs and favoured reform programs and policies that broke with existing norms and values. Theoretically, Hall (1993) shows that existing ‘policy paradigms’ become shaky as the underlying ‘causal theories’ fail to explain new events. In such cases, disagreements and debates among experts increase.

In this section we argue that this is what happened – in different forms and to different degrees – in all three countries during the period under analysis.

One major limitation of ‘cognitive approaches’ is to measure empirically the impact that ideas have on actors’ behaviour and on political decisions and to isolate ideas from material interests. Nevertheless, a brief historical account of major legal changes in the three countries during the crucial period of the 1910s to 1930s make a considerable influence of certain ideas – notably through the participation of certain experts in the political processes of corporate governance reform – at least plausible.

5.1. Switzerland: Centre-right dominance and managerial autonomy

As we have seen, starting in the 1920s, legal theory in Switzerland converged relatively quickly on a super-individualistic stakeholder system. This was in large part due to August Egger’s and Walther Hug’s works establishing the doctrine of the ‘corporate interest’, which was to become the dominant legal doctrine in Switzerland for the largest part of the 20th century (Binder 1988). In fact, the concept of the ‘corporate interest’ has been a central element of Swiss corporate governance at least up until the 1990s and the view that the stock corporation could be compared to a ‘sheep’ which had to be protected from external shareholders was common sense (Schnyder 2008). A central factor which explains the prevailing of this doctrine from the 1930s up until the 1990s lies in the fact that this doctrine was firmly rooted in the Stock Corporation Law of 1937, which was the result of the reform of the 1881 law and elaborated between 1911 and 1936. In fact, while during the 1910s and 1920s there was some support among the business elite for measures favouring external shareholders, this attitude waned during the 1920s and the 1930s. The new Law of 1937 constituted very clearly an institutionalisation of the insider paradigm and ended the shareholder-orientation of the Swiss corporate governance system

notably through the legalisation of hidden reserves and restrictions to the transfer of registered shares (a procedure called *Vinkulierung*).

During the reform works of the 1881 law, the new, super-individualistic concept was fed into the decision-making process by legal experts who had a direct influence on the elaboration of the new law. For instance, Egger was personally involved in a preparatory committee of experts charged with the elaboration of the new law (EJPD 1926). The legal experts' support alone would of course not have been sufficient in order to make the institutionalisation of this new conception possible. Yet, the economic and political situation of the 1920s and 1930s led to a more general acceptance of the super-individualistic view also among managers and politicians and made ultimately its institutionalisation possible.

Besides the broader economic evolutions discussed above, the most important contextual factor which has favoured the institutionalisation of the super-individualistic view were the economic crises of the inter-war period (in Switzerland mainly 1921-1922 and 1931-1936). The link with the economic crises is suggested in a ruling of the Federal Tribunal – Switzerland's Supreme Court – of 1928 concerning the use of priority shares (ATF 51 II 427; quoted in Schluep 1955: 411). In this and in several other rulings, the court observed a

‘[...] trend in modern Stock Corporation Law, which is not unilaterally orientated towards the protection of the interests of shareholders and creditors, but first and foremost towards the protection of the stock company itself, in the sense of the facilitation of its creation, the safeguarding of its assets, the protection of its liberty of movement and its existence in hard times, through the provision of ways and means for the perpetuation or recovery of its productivity, which is all based on the idea that the flourishing of the enterprise also best serves the interests of its members’. (our translation)

This is also the view of Hans Fehr who wrote in 1934:

‘The protection of the enterprise is more and more forcefully demanded by legal experts and economic actors. The often so petty and selfish interest of the shareholder has to give way to the corporate interest’ (quoted in Schluep 1955: 413-414, our translation)

Indeed it seems plausible that in a period when the number of bankruptcies and the unemployment rate soared, shareholders' individual interests appeared less important than the 'corporate interest'.

In this context, the institutionalisation of the 'insider paradigm' happened quickly once the business elite adhered to this approach. The reform process clearly shows the important break with the traditional approach which took place during the 1920s.¹⁴ The first two reform proposals of 1915 and 1919 were still orientated towards the aim of increasing protection of minority shareholders and increasing transparency (see Lüpold 2008 chap. 2.3; David et al. forthcoming). These goals were at the time also supported by important economic actors, as transparency was considered to be a necessary protection against foreign influence in Swiss firms (*'Überfremdung'*). This also led to the adoption in 1919 of a new article in the Stock Corporation Law (art. 655) by way of a governmental ordinance demanding the publication of companies' balance sheets. This measure was actively supported by the peak organisation of the Swiss economy, the Swiss Federation of Industry and Trade (*Vorort*), and by other business associations (Lüpold 2004).

However, during the early 1920s, the orientation of the reform changed considerably. The reform proposal of 1923 dropped virtually all measures aiming at increasing transparency and constituted therefore a first step towards the institutionalisation of the 'corporate interest' as the supreme goal of the company law (Lüpold 2008).

The reorientation of the reform towards a super-individualistic view implied a strengthening of the management and the board of directors vis-à-vis the shareholders and the AGM. This view was even maintained during the economic recovery after 1922, as a new threat had appeared, i.e. the risk of hostile takeovers by foreign companies. The need to privilege the interest of the companies in times of crisis as well as the threat of foreign takeovers were arguments, which were shared not only by the business elite, but also by centre-right MPs. The crisis of 1921/22 constituted in fact an important turning point, which saw the support of the business elite for more transparency and shareholder protection erode (Lüpold 2008).

The bourgeois majority in parliament, which debated the reform between 1931 and 1936, readily accepted the new orientation of the draft laws based on the theory of the 'corporate interest'. The only opposition came from the Social Democrats and from some far-right MP's who, under the impression of the Great Depression, forcefully demanded better transparency standards and

control over management (Lüpold 2008). Yet, the power relations in the parliament were such that the bourgeois centre-right parties had no troubles imposing their view. As an example, in the lower house, even after the introduction of the proportional voting procedure for general elections in 1919, the centre-right Free Democratic Party (FDP), which was close to the business elite, still constituted the largest party. The first elections under the proportional voting procedure in October 1919 the FDP obtained 33.3% of the seats; 21.7% went to the Catholic conservatives; the Farmer, Trade and Citizens Party (BGB) obtained 25 seats 13.2%. Adding to this the nine seats of the Liberals, the ‘bourgeois bloc’ controlled 73% of the seats in the lower chamber of parliament against 21.7% for the Social Democrats (figures based on Gruner et al. 1970).

Concretely, this situation led to the institutionalisation of traditional instruments of insider-domination over the company, which had developed in corporate practice without legal basis in the very lax law of 1881. Thus, an art. 663 al. 2 was introduced in the Stock Corporation Law of 1936, which allowed the management to create hidden reserves and which would become one of the main pillars of insider-control in Switzerland. This article explicitly refers to the long-term prosperity of the company as main reasons for the creation of hidden reserves; a view, which clearly has its roots in the doctrine of the ‘corporate interest’. Even besides the question of hidden reserves, the parliament clearly favoured opacity over transparency in accounting. As an example, the bourgeois majority in parliament decided to cancel art. 655 of the old CO demanding the publication of annual accounts, which had been introduced by the Federal Government in 1919.

Other new provisions which show the increasing insider-orientation of the Swiss Stock Corporation Law of 1936 as compared to the law of 1881 include the legalisation of the *Vinkulierung* procedure, by which the management could refuse any buyer of registered stock without mentioning a reason (art. 686 al.1 and al. 2 CO 1936); and the legalisation of voting right distortions (art. 693 al.1 and al.2 CO 1936). Minority shareholder protection diminished hence considerably with the revised Swiss company law of 1936. At the same time, there were only very few provisions concerning other stakeholders – such as employees – and most rules that were introduced in 1936 aimed – in accordance with the super-individualistic theory of the company – clearly at enlarging the autonomy of managers and blockholders.

5.2 Germany: Political break-down and new claims

In Germany, the emergence of the super-individualistic view of the company and its institutionalisation spanned over three very different periods in German

history: The last decades of the '*Kaiserreich*', the Republic of Weimar, and the first years of the NS Regime. During each of these periods different factors made that the new super-individualistic conception of the company gained the support of important groups of actors.

While all laws up until the 1897 Stock Exchange Law place the stress on the protection of shareholders, the First World War has contributed to the increasing receptivity of German politicians for super-individualistic approaches by submitting private interests to the national interest. In fact, while at the beginning of the War, there was still opposition to the subordination of the private economy to the war effort, this opposition waned during the War and led ultimately to the acceptance of the superior national interest by German entrepreneurs (Lehmbruch 2001). Therefore, the War disqualified the priority of private individual interests. This view did not disappear after the War. It is even explicitly expressed in the constitution of the Republic of Weimar, which obliged property to serve the common good.¹⁵

The war had also furthered the idea of a need for cooperation among 'social partners'. This trend continued after the breakdown of the monarchy and the establishment of the first German republic. In fact, the establishment of a parliamentary democracy allowed for the first time to integrate into the political process formerly marginal 'sub-cultures', namely Catholics and labour (Lehmbruch 2001: 71; see also Balderston 2002). Both introduced new ideas and new claims concerning economic policy, which had a considerable impact on the German economy, and notably on the organisation of the firm. Thus, the Social-Catholic ideas of subsidiarity and corporatism favoured some degree of cooperation among social-partners. In parallel, the establishment of social insurances at the end of the 19th century, which were co-managed by workers and employees through parity organs, led Social Democrats to claim the extension of this type of co-management to the firm level. This led ultimately to the establishing of the first form of co-determination in Germany through the adoption of the Law on Works Councils (*Betriebsrätegesetz*) of 1920 (Lehmbruch 2001: 59; see also Teuteberg 1981).

Although the emerging 'social partnership' of the Weimar years was soon to break down, it still left its legacy in the form of co-determination arrangements and cooperative forms of interaction between different stakeholders, which would re-emerge soon after the end of the NS dictatorship.

The super-individualistic view of the firm matched this societal and political evolution very well as it provided a rationale for the inclusion of new legitimate claims and of the qualification of individual shareholders' interests.

Another factor, which favoured the qualification of individual shareholders private interests was – like in Switzerland – the context of economic crisis during the Weimar years and the beginning of the NS dictatorship. Nussbaum (1931: 492) stated that

‘[...] the theory of the ‘enterprise-in-itself’ could never have emerged in a time of a flourishing economy and of bustling issuing activity. It is typically the product of an age of decay and consolidation – a company law philosophy of decay’ (our translation)

The economic crises of the 1920s and the Great Depression furthered the view that the survival of the company had to have absolute priority vis-à-vis private shareholder interests. An additional factor was that after the end of the First World War and during the period of (hyper-) inflation, numerous German firms faced a danger of hostile takeovers by foreign competitors. In this context, anonymous outside investors were increasingly seen as a potential threat to the company and spurred the perception that German companies had to protect themselves against this danger of *Überfremdung*¹⁶ from outside shareholders. Therefore, like in Switzerland, the impact of the new ideas on legal rules was favoured by this economic and political instability, which made major reforms possible.

A Stock Corporation Law reform was initiated in 1924 during the Republic of Weimar, but was brought to an end only in 1937 under the National Socialists. When the company law reform was initiated in 1924, no precise goal was defined and several directions for the reform were proposed. During the reform works of the Republic of Weimar, the traditional individualistic shareholder-orientation was maintained despite the increasing convergence of the legal doctrine on the theory of the ‘enterprise-in-itself’. The two draft laws of 1930 and 1931 elaborated by the officials of the Ministry of Justice as well as the amendment to company law passed as an emergency decree (*Notverordnung*) by Chancellor Heinrich Brüning in 1931 were still clearly influenced by the traditional approach aiming to protect shareholders. As an example, the *Notverordnung* introduced a compulsory external auditing body and increased levels of disclosure and transparency (Bähr 2003). Yet, little by little the hierarchy of goals between shareholder primacy and a stakeholder approach started to be inverted during the reform works of the Weimar years. Thus, the

idea that the shareholder had a fiduciary duty (*Treuepflicht*) towards the company increasingly won support, which was in line with the above-mentioned idea of ‘ownership has responsibilities’ (Laux 1998: 223-228). Accordingly, a ‘general provision’ (*Generalklausel*) was proposed which prescribed that shareholders must not harm the interests of the company (Laux 1998). This is obviously at the opposite of the role of shareholders implied by Berle and Means’ (1933) horse metaphor – where no duty whatsoever went together with the ownership of shares – and constituted a reversal of the fundamental ‘hierarchy of goals’ underlying German company law.

The arrival in power by the NS Regime in 1933 sealed the victory of the super-individualistic view over the individualistic conception. The emerging super-individualistic stakeholder view of the firm was compatible with the collectivist NS ideology as it detached the firm from its owners and legitimised the pursuit of goals different from the private interests of individual shareholders. This also allowed the NS legislator to reconcile the interests of the anti-capitalist wing of the NSDAP – that was opposed to the idea of a capital company with limited personal liability and pleaded for the transformation of capital companies into business partnerships – with the interests of the business elite who opposed the abolishing of the joint stock corporation as a legal form (Bähr 2003, Schubert 1986). Re-orienting the reform towards a super-individualistic goal, allowed the legislator to attenuate the individualistic orientation of the joint stock company without taking too extreme measures. In fact, the influence of the business elite – and notably the managers of the largest companies – on the Stock Corporation Law reform was considerable as they participated in the preparatory committee of the new law, thus preventing Nazi ideologues from fully controlling the formulation of the terms of the reform (Bähr 2003). As an example, the two-tier board structure was not put into question in spite of the fact that the NS idea of the ‘*Führerprinzip*’ would have justified the abolishing of control mechanisms constraining the leeway of the so-called ‘*Betriebsführer*’, i.e. the general manager. The super-individualistic view served hence as a means to assure the support of both the anti-capitalist wing of the NSDAP and the business elite. Yet, compared to most lawyers writing during the Weimar years, a new meaning was given to the super-individualistic approach in the sense that the ‘enterprise interest’ was equated with the interest of the ‘German people’ represented by the NS state. This conception is closer to what Biondi et al. (2007) call the ‘artificial entity view’ of the firm (the company as a mere extension of the state that is subject to its policy goals) than to the ‘real entity view’.

Yet, this theoretical view was not implemented in the law of 1937 in any pure form, but elements of the traditional system, as it emerged during the late 19th century and the Weimar years persisted in the law. Thus, the stakeholder approach that emerged after the First World War and that implied a certain consideration of workers' interests was not completely eliminated by the Nazi legislator. Paragraph 70 of the new Stock Corporation Law of 1937 for instance obliged the management to take into account the interests of the nation *and* of the workers (Schlegelberger 1937: 305). This is a strong case for a certain path dependence in institutional change as it shows that even radical regime changes, such as the arrival in power of the NSDAP, do not necessarily lead to a complete overhaul of the pre-existing system, but rather to an amalgamation of old and new elements.

Although the Nazi period and the Second World War constituted a caesura in German history, the fundamental reorientation that the Stock Corporation Law had experienced during the period from the 1910s to the 1930s was going to have a lasting influence on German corporate governance. In fact, the fundamental elements of the new approach would survive even the breakdown of 1945, and several ideas which were developed by Rathenau during the First World War and elements that had first emerged under the Republic of Weimar, re-emerged after the Second World War. The most important example in this respect is the progressive reintroduction of forms of employee co-determination, first at the shop floor level through the reactivation in 1947 of the *Betriebsrätegesetz* of 1920; later through board level co-determination (cf. *Montanmitbestimmungsgesetz* of 1951). Therefore, like in Switzerland, the period from the mid-1910s until the late 1930s was a crucial period for the establishment of the corporate governance model which was to become the system that we nowadays associate with post-war Germany.

5.3 United States: Shareholder protection through federal financial market regulation

While in both Switzerland and Germany corporate governance rules for large firms codified at the federal level mainly in the stock corporation law and the stock exchange laws, the US legal framework of corporate governance is divided between state-level company laws and federal securities regulations. Also, jurisprudence played a more prominent role in the US common law system than it did in the two other cases.

The company laws of New Jersey and Delaware stick out as the most important sources for corporate governance rules in the US during the period under analysis as most large companies were incorporated in these states. As

mentioned above, both New Jersey and Delaware have often been criticised to be at the origin of a ‘race to the bottom’ attempting to attract new companies that would incorporate in their state by increasing the leeway for managers and curtailing shareholders’ rights. Justice Louis Brandeis was probably one of the first to evoke the idea of a ‘race to the bottom’ in the ruling *Liggett v. Lee* of 1933 (see also the article by William L. Cary (1974), former chairman of the SEC). As an example, Delaware introduced in the late 1920s, just before the stock market crash of 1929, an act which allowed companies to restrict some important shareholder protections and introduced so-called ‘blank stock’ whose terms could be defined by the board without the shareholder meeting’s assent. This act was clearly orientated towards insiders’ interests and slashed by Adolf A. Berle as giving insiders the power of confiscation (Roe 2003: 611).

The Great Depression, however, led to the emergence of more interventionist economic policies in order to protect the ‘public interest’ from the dynamics of capitalism. Several solutions to the Great depression were discussed in the political arena, most of which were marked by a profound distrust towards unhampered markets and proposed increasing state regulation (Bratton & Wachter 2007: 14). Interestingly, contrary to the Swiss and German cases, the shareholders were not considered to be the ‘villains’ in the US and far-reaching managerial autonomy was not seen as the solution. Even business men adhering to the ‘business commonwealth’ idea, for instance GE manager Swope, asked for state intervention in order to restrict competition and for vigorous investor protections, mainly better accounting and disclosure standards. In fact, Swope considered shareholder protection and high levels of transparency as essential for an efficient functioning of markets.¹⁷ Hence, in the US, even managers supported only to a limited extent the claim for increasing autonomy of managers and the subordination of shareholders’ individual interests to the ‘corporate interest’ that prevailed in Germany and Switzerland.

Yet, the above-mentioned controversy between Dodd and Berle clearly shows that the individualistic view of the firm had by no means prevailed at that point in scholarly debates. It was only due to the political context that Berle and Means’ pro-shareholder views ultimately prevailed at the federal level. One major factor explaining the influence of their ideas is linked to the election of Franklin D. Roosevelt as the president of the US. His New Deal Program (1934-1941) provided Berle and Means with the necessary political influence in order to put their ideas into practice. In fact, both of them worked as advisers for the New Deal administration for some time. Especially Berle, who was starting in early 1932 – together with fellow Columbia professors Raymond Moley and Rexford Tugwell – at the core of FDR’s first ‘Brains Trust’, influenced FDR’s

policies directly (Bratton & Wachter 2007). Thus, the New Deal answer to the economic crisis of the 1930s was clearly inspired by Berle and Means' work and did not only address the immediate effects of the crisis but was also meant to remedy the long-term consequences of the increasing size of companies and of the 'separation of ownership and control'. This can be illustrated by a quote from FDR's Commonwealth Club Address of September 23, 1932, which was presumably penned by Adolf A. Berle himself (Lloyd 2006: 8):

'Recently a careful study was made of the concentration of business in the United States. It showed that our economic life was dominated by some six hundred odd corporations who controlled two-thirds of American industry. [...] More striking still, it appeared that if the process of concentration goes on at the same rate, at the end of another century we shall have all American industry controlled by a dozen corporations, and run by perhaps a hundred men. Put plainly, we are steering a steady course toward economic oligarchy, if we are not there already.' (quoted in Lloyd 2006: 121-122)

Berle and Means' remedies fitted into the critical perspective on big business and concentration of economic power in the aftermath of the 1929 stock market crash. More precisely, Berle's distrust towards managerial power was in line with Roosevelt's own increasing opposition towards the managerial elite. While Roosevelt's first term in office was not characterised by any particular anti-business policies, he increasingly started to ally with labour rather than with business and to challenge the power of 'big business' during the second half of the 1930s (Blyth 2002). Thus, the National Labour Relations Act of 1935 (the Wagner Act) altered industrial relations in favour of labour and FDR established an anti-trust committee (Blyth 2002: 85). At the latest from 1937 until the outbreak of the war, the tensions between Roosevelt's administration and business were indeed strong.

While Roosevelt's anti-monopoly policies were not directly linked to Berle's ideas, but rather to a revival among certain experts of the FDR administration of Wilson's and Brandeis' progressive 'New Freedom' ideas, Berle's anti-managerial stance found the necessary political support in Roosevelt's administration. One could speculate over the impact of Berle and Means' work on federal law had Herbert Hoover – whose position in the shareholder vs. stakeholder debate we mentioned above – been re-elected in 1932.

The New Deal Administration introduced new instruments of shareholder protection in domains where the states had neglected MSP for opportunistic (i.e.

fiscal) reasons. The instrument which served the Government to this end was mainly federal securities regulations, which were, tellingly, called at the time 'Federal corporation law' (Cary 1974, Fleischer 1965). The most important regulation of the New Deal era concerning corporate governance was certainly the Securities Exchange Act (SEA) of 1934. This act took the proxy voting procedure out of states' hands and regulated the issue at the federal level in favour of shareholders. The SEA also outlawed insider-trading, which was not the case of the Delaware law, and established the Securities and Exchange Commission (SEC).

Apart from increasing disclosure and control over listed firms, New Deal legislation also restricted directly the control instruments which served in continental Europe the insiders to control 'their' company. Thus, the stakes held by banks were dissolved and the rise of new blockholders discouraged (Roe 2003). Furthermore, the Public Utility Holding Company Act of 1935 limited the possibilities to use pyramidal holding company structures in order to exercise control over a firm. According to Roe (2003: 609) the Federal Government regulated thus little by little all 'big issues' of corporate governance – mainly through securities and antitrust regulations – and left only 'minor issues' to the states. US federal law – contrary to state laws – was hence clearly shareholder-orientated as early as the 1930s and laid the foundations for a shareholder-orientated corporate governance system.

The change of political power at the Federal level in 1933 was therefore a crucial element for the impact of Berle and Means' ideas. It was through the New Deal legislation – as imperfect and inefficient in terms of MSP as it might have been in reality – that a certain pro-shareholder counter power to state laws emerged. The protection of minority shareholders was hence introduced into US federal law, precisely at a moment when such a shareholder-orientation was abandoned in Germany and Switzerland in favour of a – at the time more modern – super-individualistic view of the company.

Of course, at the state level, the law did not follow the same path as federal financial market regulations. At the contrary, the US clearly became a case of 'managerialism' during the following decades (see the famous analysis by James Burnham 1972 [1941]) and 'investor capitalism' emerged in actual fact only during the 1980s (Jackson 2001). Yet, the shareholder-orientated policies of the SEC constituted an important counter-weight to state-level insider-orientated laws and practices. No such counter-weight existed in Germany and Switzerland. The basis for an effective protection of shareholder rights was hence much stronger in the US, than in continental Europe, and minority

shareholders were not considered as ‘nuisance’ as they were in the two European cases. It is therefore no coincidence that ideas and concepts such as the agency theory, shareholder value, and value based management, which started to emerge during the 1970s at the latest, are the product of US scholarship.

6. Conclusion

In this paper we have shown that the corporate governance structures were not fundamentally different in the US, Germany, and Switzerland during the 19th century. Therefore, the prevailing of a shareholder-orientated system in the US and a stakeholder-orientated one in the continental European cases was not a ‘natural attribute’ of the two regions, but the result of a historical process that set in towards the end of the 19th century. This process was triggered by the emergence of ever larger companies in which the distance between owners and managers was perceived to increase. This evolution led lawyers and economists to consider 19th century investor protection rules, which were based on the owner-entrepreneur and not on passive minority shareholders, as outdated. It is in this context that the super-individualistic conception of the firm emerged and led, during the period from 1910 up to the 1930s, to the institutionalisation of fundamentally different conceptions of the stock corporation in the US and the two European countries.

In theoretical terms, the discrepancy between the societal reality and the existing beliefs concerning the functioning of the company increased, which led political and economic actors to redefine their beliefs and preferences and to support institutional changes. The ideas that legal experts produced played a crucial role in this process of redefinition of beliefs. In fact, the emergence of two different corporate governance models in Switzerland, Germany and the US can be best understood as the result of a process by which different answers to the question what a stock corporation is (horse, cow, or sheep?) and what it should do emerged in both areas and were ultimately institutionalised due to particular political contexts.

One central factor explaining the different paths in the two regions concerns the perception of minority shareholders. This difference was certainly also linked to different choices during the late 19th century. Thus, regulations like the Glass-Steagall Act aimed at curtailing the power of large financial institutions and thus favoured alternative source of corporate finance to bank loans and encouraged private share ownership (Roe 1994). As a result, the US had, by the 1920s, already a fairly wide-spread equity culture, which did not exist in

Germany and Switzerland. In Switzerland and Germany, on the other hand, the development of large universal banks was virtually unhampered by regulations. As a result, banks acquired a dominant position in the financial system, and shareholding by ‘small savers’ was discouraged.

Due to these choices, minority shareholders were respectable American citizens and constituted a considerable part of politicians’ constituencies in the US, while they were considered in Switzerland and Germany to be – at best – ‘stupid and impertinent’ – but more likely they were rascals who either wished to drain the company from all its money, or to obtain information for (foreign) competitors. Obviously, politicians in Switzerland and Germany had no incentive to engage in a struggle to obtain legal protection for investors thus defined. This difference in the perception of shareholders and in their societal importance ultimately led to different positions of shareholders within the hierarchy of the firm (see for a similar argument Riechers 1996: 185).

Our analysis does hence not contradict accounts, which explain the emergence of a dispersed ownership structure in the US and of concentrated ownership in Europe through political choices concerning the regulation of the financial sectors at the end of the 19th century (see notably for the US case Roe 1994). Yet, these choices did not yet reflect fundamentally different conceptions of the stock corporation and of rights and responsibilities of different stakeholders. Only with the development of diverging legal conceptions of the firm during the first decades of the 20th century did the three countries corporate governance approach start to diverge, as a paradigm shift away from shareholder primacy towards a super-individualistic view took place in Germany and Switzerland, but not in the US. These divergent paths were cemented with their institutionalisation in the company and securities laws of the 1930s.

Certainly, one should not see the influence of different legal scholars in terms of absolutes. Yet, neither of the three countries would have developed their characteristic corporate governance model without concrete legal theories such as the ones developed by Hug, Rathenau and Berle. In fact, in none of the three countries was the future dominant theory of the firm undisputed and hence ‘natural’. Like in Europe, a super-individualistic stakeholder-view had considerable support in the US during the early 20th century. However, due to particular historical circumstances (Great Depression, election of FDR), it was not Dodd’s, but Berle’s vision, which ultimately obtained the necessary political support for its institutionalisation in ‘Federal corporation law’. Conversely, several factors favoured the institutionalisation of Rathenau’s, Hug’s and Egger’s ideas in Switzerland and Germany. Interestingly, very different reasons

led different actors to support similar ideas not only across countries, but even within one country over time (e.g. the support for a super-individualistic view by Catholics and the NSDAP in Germany). In this context it is also important to note that in all three countries, the corporate governance rules emerged over long periods of time, spanning sometimes over very different eras of a country's history. Each era left its mark on the rules, which were rarely completely removed by the successive generations. Each national system has hence its inbuilt contradictions due to incomplete transformations of existing rules (e.g. the relics of shareholder protection in Nazi Germany's Stock corporation law of 1937) and due to the existence different levels of policy making (e.g. the US state-level pro-manager rules vs. federal level pro-shareholder rules).

Our findings have also a contemporary relevance. In fact, the 'shareholder view' had become increasingly powerful since the 1970s and the victory of the shareholder model over the stakeholder model in Europe seemed inevitable some years ago (Hansmann & Kraakman 2004). Yet, recent political debates about the behaviour of certain types of investors (notably hedge funds and private equity firms) and the increasing interest for corporate social responsibility (CSR), show that the history of corporate law is not ending just yet and the problem of the 'corporate personality' seems just as endless as in 1932. Indeed, the recent 'locust debate' in Germany (see Seifert & Voth 2006), for instance, shows that the 'traditional' view of shareholders has – despite a 'contractual turn' during the 1990s – not completely disappeared from political discourse and scholarly debate and could eventually be re-activated. The recent financial crisis and the criticism of the 'American model' that it has triggered, can be expected to contribute to this swing-back of the pendulum. Our study suggests, in any case, that the perception of what a corporation is and what aims it should pursue is never undisputed and – depending on what political forces adopt a given view – not necessarily irreversible. Different countries are hence not 'stuck' on a given path forever.

Notes

¹ In this paper, we define corporate governance as the legal rules and the practices which determine the authority structure within the firm. Despite the anachronistic nature of the term, it is – thus defined – a useful analytical concept for the analysis of historical phenomena (cf. Bähr 2003, Lüpold 2008).

² Note that the term stakeholder is not a historical term (Freeman 1984).

³ In this paper we distinguish the individualistic view of the company from the super-individualistic view. The former considers the company merely as an association of shareholders and shareholder interests hence as being the only legitimate interests. Super-individualistic views see the company as more than the sum of the shareholders' interests. This terminology is handy, but at times somewhat imprecise. Thus, an 'individualistic view' does not necessarily preclude viewing the firm as a 'legal personality', but it gives absolute priority to the owners' interests ('shareholder primacy'). Also, the super-individualistic view comes in different forms. Avi-Yonah and Sivan (2007: 155), for instance, distinguish the 'real entity view', which sees the company as a managerial controlled entity with interests of its own and the 'artificial entity view', which sees the company as a mere extension of the state.

⁴ Mark Roe's (1994) analysis qualifies this interpretation of the 1890s to 1920 somewhat, suggesting that owners in the US were not as strong during the late 19th century as is commonly assumed.

⁵ The first banking law was adopted only in 1934, and Federal financial market regulations were non-existent up to the mid-1990s.

⁶ It should be noted that the German-speaking world of legal scholarship at the beginning of the 20th century was very permeable concerning national frontiers. German, Swiss, and Austrian scholars interacted in important ways.

⁷ While the 'race-to-the-bottom-thesis' of shareholder protection standards due to federalist competition is strongly debated (Roe 2003), the first laws of NJ and Delaware clearly privileged managers' interests over shareholders' interests.

⁸ The term '*Unternehmensinteresse*' (literally enterprise interest) is the same term that was used in Germany as well. In order to distinguish the two different concepts, which did not mean exactly the same thing, we translate the Swiss concept as 'corporate interest' while we use the term 'enterprise interest' to translate the German concept. This is obviously rather imprecise, but during the phase we are interested in here, a debate among legal scholars about differences between terms like corporation, firm, and company is remarkably absent and many scholars – including Rathenau – use the terms interchangeably.

⁹ Note that in French 'bête' can mean either 'animal', or 'stupid'.

¹⁰ The one-liner ‘Shareholders are stupid and impertinent. Stupid because they invest their money in shares, and impertinent because they demand a dividend for their stupidity’ is usually attributed to the German banker Carl Fürstenberg.

¹¹ In Kant’s phenomenology the ‘thing-in-itself’ (*Ding an sich*) designates the *noumenon*, i.e. the thing as it is independently of the mind and of perception, while the phenomenon designates the ‘thing’ as it is perceived by the observer.

¹² It is interesting to note that socialist thinkers – such as Rudolf Hilferding – notably in Germany adhered to a similar interpretation of the capitalist evolution, seeing the emergence of the huge *Konzerne* as a new phase of capitalism, which would eventually lead to the dissolution of the capitalist system (see Höpner 2005).

¹³ Thanks to Katharina Pistor for pointing this out to us.

¹⁴ The relevant archival sources of the company law reform of 1911 – 1936 in Switzerland (Swiss Federal Archive: E 4110(A) 1000/800) are analysed in Lüpold 2008.

¹⁵ cf. art. 153 of the Weimar Constitution of August 11, 1919, which stated: ‘*Eigentum verpflichtet. Sein Gebrauch soll zugleich Dienst sein für das Gemeine Beste*’. (‘Ownership has responsibilities. Its use shall be at the same time a service for the common good’ (our translation)).

Source: <http://www.documentarchiv.de/wr/wrv.html> (18.2.2008).

¹⁶ Literally ‘over-foreignisation’. The term designates excessive foreign influence and was coined in Switzerland during the 1920s but frequently used in Germany as well; see Kury (2003).

¹⁷ See *Time Magazine*, Sept. 28, 1931. Source:

<http://www.time.com/time/magazine/article/0,9171,742325,00.htm>
(18.8.2008).

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