Corporate Governance:
History Without Historians

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The history of corporate governance arrangements, understood as the constitutive processes shaping the relationship between ownership and management of enterprises, is a relatively new field of inquiry for business historians.[1] Indeed, most of the recent historiography has been written by non-historians (especially economists and legal scholars) concerned with tracing the roots of contemporary corporate governance regimes. The historical core of this literature focuses on the origins of dispersed (Anglo-American) and concentrated ownership systems, together with the financial and political factors that shaped different development paths. The arguments advanced by these scholars and the debates they have generated are highly stimulating—if, as we shall see, largely unresolved. They underscore the centrality of corporate governance not only for understanding the historical dynamics of firm performance and economic development, but also for understanding the co-evolution of the corporation with modern ideas of political and legal order.

What follows is a survey of historical arguments on the origins of corporate governance regimes ranging across several disciplines, in particular economics, legal studies, sociology, political science and, in a few cases, business history. The chapter begins by outlining the historical evolution of corporate governance systems in five major countries: the United States, Britain, Germany, France, and Japan. Section 2 then examines the major causal arguments advanced to account for diachronic variations within the country cases as well as synchronic variations between them. It will become clear that the debate is largely unresolved. In particular, problems emerge in attempting to account for the emergence and evolution of the different systems over time.

The chapter concludes with a discussion of what the current literature on the history of corporate governance does not tell us. By this I mean not only what issues remain open or are raised by the existing work. I will also highlight some empirically significant phenomena obscured by the framework of the current debate and suggest some ways that their reintegration may provide greater purchase on the problems of transformation and recomposition thrown up by the debate itself. Here, some insights of an older historical literature on corporate governance will be discussed. A central conclusion is that the entire contemporary debate could benefit from more careful archival scholarship on the development of corporate governance regimes across the major countries.

1. Five Corporate Governance Regimes

Contemporary discussions of corporate governance focus on relations between ownership and management within joint-stock, limited-liability, publicly-held, predominantly large-scale enterprises. This focus centers attention on the balance of power between shareowners and managers, together with the consequences of that balance for enterprise performance . The literature has generated two ideal-typical property systems, based on concentrated and dispersed ownership respectively. The "concentrated ownership system" is "characterized by controlling blockholders, weak securities markets, high private benefits of control, and low disclosure and market transparency standards, with only a modest role played by the market for corporate control, but with a possibly substitutionary monitoring role played by large banks". The "dispersed ownership system" is characterized "by strong securities markets, rigorous disclosure standards, and high market transparency, in which the market for corporate control constitutes the ultimate disciplinary mechanism" (Coffee 2001: 2).

Countries can be organized around the concentrated versus dispersed ownership distinction. But most of the literature also argues that the system of corporate property relations in each country is embedded in a broader set of social, institutional, and power arrangements. In particular, three institutional domains and groups of actors are held to shape the nature of corporate property relations: financial systems (e.g. bank- versus market-driven[2]); the governance role of stakeholders versus stockholders;[3] and the political governance of the economy (e.g. state directed, associational, or market-driven[4]).

As we shall see in section 2, different authors place varying emphases on the degree of integration between the levels of corporate governance, the financial system, stakeholder rights, and political authority. But most use each of these as empirical components in constructing contrasting national models of corporate governance. The following portraits of the US, UK, France, Germany and Japan, therefore, will be structured by their location in relation to these four dimensions.

The United States is typically portrayed in contemporary corporate governance debates as the paradigmatic liberal economy where financing is based on well-developed and highly liquid securities markets, enterprise stock is widely dispersed, managers seek to maximize shareholder value, and the government allows market relations to drive the economy by strongly defending the rules of contract and the rights of property—in particular of minority interests within joint-stock companies. But this system did not always exist in its present form. When unrestricted incorporation and limited liability became available in the mid-nineteenth century, closely-held family firms dominated the corporate form (Roy 1997, Horwitz 1977, Hovenkamp 1991) . This gradually gave way to dispersed ownership during the first half of the twentieth century, as the securities markets grew more robust and managerial control of enterprises solidified (Chandler 1977, O'Sullivan 2000, Navin & Sears 1955).

American banking was very regionally decentralized and fragmented. Much of its activities originally revolved around the financing of trade. Banks played a very small and never more than short-term role in industrial finance in the ninetheenth century. To the extent that they utilized external finance, young American corporations relied on bond issues (Calomiris 1995). There were efforts to construct universal banking arrangements (involving both commercial and investment roles) allowing financial institutions to take equity stakes and intervene more directly in the internal governance of firms (DeLong 1991). But these experiments co-existed with increasingly liquid securities markets and were, finally, legally constrained in the 1930s by the Glass-Steagall Act institutionalizing specialized banking (Kroszner & Rajan 1994).

Stakeholder views, especially in the guise of movements for manager autonomy, competed with stockholder views for much of the mid-twentieth century. Collective bargaining also regulated labor markets in important industrial sectors for much of this period, but stopped well short of union involvement in corporate governance. The government experimented with stronger forms of interventionism and collaboration with corporations and business associations during much of the Progressive and, especially, New Deal eras. But these mechanisms of intervention have been receding since the 1980s (Kaufman & Zacharias 1992, O'Sullivan 2000, Hansmann 1996, Kochan et. al. 1986, Jacoby 1997).

Britain's corporate governance regime is portrayed in contemporary accounts as resembling that of the United States. But the history of British corporate governance is actually quite divergent from that in the US. Indeed, unlike Americans, Britons were very skeptical about limited liability for much of the nineteenth century. Once adopted, moreover, closely-held family firms dominated the joint-stock company form for a much longer period of time than in the US. Not until the 1930s and a subsequent succession of merger waves, did dispersed ownership begin to predominate (Cheffins 2001, 2002, 2004; Toms & Wright 2002; Franks et al. 2004 a&b; Hannah 1982).

Corporate finance in Britain has always been characterized by specialized banking, with a clear distinction between commercial and investment roles. The absence of universal banks, however, does not mean that bank-industry relations were purely arms-length. On the contrary, long-term and often quite intimate relations frequently prevailed between commercial bankers and their clients. Close, performance-monitoring ties were produced and reproduced through cooperatively constructed short-term contracts—loans, overdrafts, etc. But this "relationality" in British banking stopped short of the strong form engaged in by continental universal banks: British banks did not become involved in the transfer of property and never strategically sought ownership stakes in their clients (though stock was sometimes accepted as collateral for loans). Securities markets were significant but often little utilized by domestic firms for much of the early period of industrialization. The London capital market grew significantly in both depth and liquidity over the course of the twentieth century (Ross 1996, Collins 1998, Capie & Collins 1999; Fohlin 1997).

There is ambivalence in British corporate history about stakeholder rights. Labour governments supported unionization and worker rights relative to corporate actors for much of the twentieth century. Moreover, during the mid-twentieth century there were numerous nationalizations after which companies were run in stakeholders' interests , rather than according to strict market criteria (Cheffins 2001, 2002). This stakeholderism has declined since the 1980s, as privatization and merger were accompanied by the dispersal of stockownership and political struggles weakened the labor movement.

France presents in many ways the greatest contrast with the US and British cases, due to the strong role of the state . During the nineteenth and early twentieth centuries, there were very few large corporations in France. Those that did exist were closely held. In large part, these firms financed investment from earnings and engaged with banks only for short-term loans. Relational banking (in the sense of banks holding equity stakes in firms) was rare. Like the British, French banks maintained a specialized divide between commercial and investment functions. Similarly, the securities market was used, particularly in the 1920s, but it was not a significant factor in corporate finance (Fridenson 1997, Levy-Leboyer 1978, Fohlen 1978, Murphy 2004).

But the most distinctive aspect of French development is the state's extremely strong role in enterprise governance , especially after 1945. Beginning around World War I, the French state began to encourage the development of "national champions" in strategic industries—channeling capital to firms and acting as their major customers. After World War II, this role increased as national plans were developed, banks and firms were nationalized, and public influence was exercised both directly and indirectly on the composition of boards and corporate investment strategies. The stock market atrophied and firms became dependent on state- underwritten bank debt (Berger 1981, Zysman 1983, Cohen 1969, Hall 1986). In this context, however, the number of public corporate enterprises proliferated. Given the state's prominent influence, corporate managers directed their enterprises towards stakeholder rather than stockholder interests. Despite the proliferation of large corporations in the postwar period, ownership remained concentrated, not only because of the importance of public enterprises, but also because managers engaged in significant cross-shareholding. The rights of minority holders were not well protected in French corporate law. Since the mid-1980s, following important financial system reforms, a series of major self-dealing scandals involving prominent managers and state officials, and pressures from the European Union to reduce the economic role of the state, French corporations have become more exposed to market pressures. The size and role of the stock market has increased and shareholding has gradually become more dispersed (Hancke 2002, MacClean 1999, Fanto 1995, O'Sullivan 2003).

Even earlier than in the United States, large-scale corporate enterprises played a prominent role in **Germany**'s industrialization (Kocka 1978, Dornseifer & Kocka 1993). Liberalization of incorporation law occurred in 1870 and was then reformed in 1884. Germans enthusiastically took to limited liability and the joint-stock company form—though the former principal was much more broadly embraced than the latter (Jackson 2001, Fohlin 2005). German enthusiasm for the joint stock form was significant even though German law was ambivalent with respect to minority shareholder protections (Schubert & Hommelhoff 1985, Cheffins 2003, Fohlin 2005). In any case, there was space in the German economy, at least prior to World War II, for a variety of corporate governance forms. Closely-held family enterprises have predominated in the German political economy since the beginning of industrialization. But their share of all joint stock companies gradually declined between 1884 and 1933, restabilized after 1945 and began to decline again only in the 1990s. The decline of family ownership before 1933 was also accompanied by a gradual dispersal of shareholdings. But this trend was radically reversed after 1945, as concentrated holdings came to dominate the ownership structures of the 100 largest firms. Cross-shareholding, especially after 1945, became an important form of concentrated ownership (Fohlin 2005, Jackson 2001, Franks & Mayer 2001, Faccio and Lang 2002).

From the beginning of industrialization, German finance was bank-driven and universal banking was the norm (Gerschenkron 1962). Banks extended loans and credits, provided bridging finance, facilitated the transfer of ownership (securities underwriting) and participated in corporate governance through both the exercise of shareholders' proxy votes and direct equity holdings. Despite the existence of these broad capacities, strong bank participation in corporate governance was a dominant feature of the German landscape only during the first few decades after World War II and began to weaken in the 1990s. This is not to say that there was no strong relationality between banks and industry in Germany before World War II. But it was less common than is often believed. Indeed, nineteenth and early twentieth-century firms seldom relied on bank debt for financing and banks seldom took significant equity stakes in their clients (Fohlin 2005, Vitols 2001, Collins 1998). Indeed, recent research suggests that securities comprised a lower percentage of German than British banks' assets prior to World War I – though unlike their British counterparts, German banks tended to take strategic advantage of ownership stakes when they had them (Fohlin 2005). Strikingly, given the breadth of bank capacities, financial institutions lived in apparent harmony with relatively, deep, active, and efficient securities markets prior to 1914 (Gehrig & Fohlin 2004). Political turbulence and shifts in the power of universal banks led to reduced significance for securities markets in the twentieth century, particularly after 1945 (Fohlin 2005, Rajan & Zingales 2003b).

Stakeholders have traditionally played an important role in German corporate governance. When banks held positions of internal influence within German firms, they constituted a stakeholder interest that shaped the character of management calculation. This was always the case among widely held firms and it became more generally true during the first few decades after World War II (Fohlin 2005). Even broader attention to stakeholders was written into the obligations of enterprise management after 1945 by co-determination legislation requiring labor representation on the supervisory boards of all corporations employing a minimum number of people (Jackson

2001, Streeck 1984). The Enterprise managers' obligation to conduct business in the interest of stakeholders not otherwise defined, was also written into the postwar West German constitution (Article 14, Paragraph 2 of the Basic Law -- see Jackson 2001:138).

Except for the twelve-year interlude of centralized National Socialist dictatorship, the German state has been federally organized with highly fragmented authority and a small central bureaucracy oriented toward the protection of market order (as opposed to free markets) and the coordination of public associational debate (Katzenstein 1987). Prior to 1918, this was done quasi-democratically with a systematic bias toward organized property groups (including joint-stock enterprises). During the Weimar Republic, liberal and democratic norms governed the state's relations with associations, but without formally conceding to them any public authority. The liberal democratic Federal Republic formalized many of those concessions of public authority and relied more comfortably on associational governance. Associations representing property owners, employers, and employees play a significant governance role within the German economy, organizing wage determination, the development of training curricula, standards setting, and the organization of political debates regarding industrial and economic policies (Streeck & Yamamura 2001, Jackson 2001, Thelen 2004).

As in France, Britain and the US, there has been a movement, beginning in Germany in the 1990s, toward greater dispersal of holdings, less relationality in banking, more liquidity in securities markets, greater attention to shareholder value, and more emphasis on market solutions to public problems. The full implications of current changes, however, remain ambiguous and uncertain (Streeck & Höpner 2003, Höpner 2001). Intriguingly, Fohlin (2005) points out that current trends suggest a return to the pre-1933 (or even pre-1913) norm in corporate governance .

Corporate governance in **Japan** has a distinctive history, with a caesura in the mid-twentieth century caused by the experiences of imperialism, war, defeat, and occupation. Prior to the militarization of Japan in the 1930s, there were three different patterns of corporate governance. The dominant pattern involved broadly-held joint-stock companies, supported by highly liquid securities markets, headed by professional management directing their companies in the interest of shareholders (Hoshi & Kashyap 2001). Another pattern involved state ownership of enterprise where professional bureaucratic managers pursued public economic development goals (Samuels 1994). A third involved a limited partnership holding company structure where family owners controlled diversified networks of publicly-quoted enterprises, run by professional management known as *zaibatsu* (Morikawa 1992). Interestingly, Japanese corporate law reflected this fragmentation of development paths in that it was both protective of and hostile to minority property interests (Morck and Nakamura 2003:11).

For its part, the financial sector remained very diversified and securities far outweighed bank lending as a source for industrial finance until the 1930s. Banks engaged in specialized arms-length, mostly short-term lending. Relational banking did not exist, though there were some *zaibatsu* banks with very close relationships to *zaibatsu* holdings. But these relationships were not monitoring ones; nor were *zaibatsu* banks the primary sources of finance for the *zaibatsu*. In prewar Japan, professional managers directed enterprises in shareholders' rather than stakeholders' interest —with the exception of state-owned enterprises, which pursued national economic development goals. Thus the state was a significant presence in the prewar Japanese corporate economy, but it did not dominate or even remotely direct vast reaches of the private sector. Beyond its (significant) direct holdings, the state governed the economy by establishing framework rules for private actors (in many cases adopting and adapting foreign models for public education, limited liability, stockownership, law, etc) (Morikawa 1986, Samuels 1994, Hoshi & Kashyap 2001, Morck & Nakamura 2003).

This system was completely transformed in the mid-twentieth century by the turbulent course of military government, war, occupation, and then economic recovery. Key changes occurred on each of the four dimensions relevant to corporate governance. First, the robust securities markets of the prewar era were destroyed by a military government hostile to private economic interests A variety of laws taxing private stockholdings and outlawing dividends, combined with efforts by the state to use banks to direct investment shifted enterprise finance away from securities toward banks. This bank centrality was reproduced in the postwar economy, though the state's role in directing bank lending and corporate investment became more indirect (Hoshi & Kashyap 2001, Vitols 2001, Morck & Nakamura 2003).

The second change was the growth of inter-corporate shareholding. After Japan's defeat , the occupation authorities forced the titular new Japanese government to pass a series of laws disbanding the *zaibatsu*, expropriating their family owners, outlawing holding companies, protecting minority stockholders, and establishing guidelines for accounting transparency, auditing and depreciation (Hoshi and Kashyap 2001, Morck and Nakamura 2003). Such measures, followed by an inflation that devalued the price of existing stock, produced an active market for corporate control, which in turn led managers to purchase substantial shares in related and friendly companies in order to stave off takeovers. Over the course of the 1950s and 1960s, this produced loosely inter-connected *keiretsu* in which related firms owned small amounts of shares in one another. Such holdings were often small, but they summed up to a majority stake in the group by its own members—making it difficult for outsiders to gain a foothold (Okazaki 1995, Sheard 1994).

Banks were crucial players in the governance of these interconnected enterprise groups. Though each group borrowed from a variety of banks, they ultimately relied on a "main bank" to coordinate their financing. Main banks in many ways made the inter-corporate shareholding strategy work as a defense against takeovers, since the new *keiretsu* were not formally directed by a central administration. Main banks could coordinate the strategic development of member firms and mobilize disparate stakes in the event of an outside challenge . They also used their central position as credit givers to monitor *keiretsu* firms and took responsibility for directing restructuring efforts within member enterprises in the event of a crisis (Aoki & Patrick 1994).

The third significant change in the postwar corporate governance regime was the growth of employees as acknowledged stakeholders in Japanese enterprises. The crucial mechanism for this was the "institution" of permanent lifetime employment. Although employment contracts were formally "at will", Japanese courts nonetheless developed case law decisions penalizing large enterprises when they attempted to layoff "regular" employees. As a result, enterprise managers were practically compelled , to manage their firms in the interest of shareholders, bankers, and employees (Jackson 2001, Aoki 1988).

The final significant mid-century transformation in the Japanese corporate governance regime concerned the role of the state. The 1930s military government centrally directed corporate investment through the destruction of the securities market and control of the banks. In the postwar period, government control over banks became more indirect, but nonetheless remained significant. The Ministry of Finance rewarded banks which fostered investment in directions favored by state economic development policies and penalized bank measures that contravened them. This linkage between the public and private sector was reinforced through the effective abolition of the national corporate bond market. With their stock bound up in highly complicated cross shareholdings, postwar Japanese enterprises –unlike their prewar predecessors—were overwhelmingly dependent on the banking system for finance. And the Japanese state was in a very strong position to direct the flow of investment funds from banks (Hoshi & Kashyap 2001).

As in the other cases, this system came under pressure in the 1990s, due to the globalization of financial markets and internal distress in the Japanese economy. As in the other cases, too, the future direction of change is both ambiguous and uncertain (Hoshi & Kashyap 2001).

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The preceding narratives organize the history of corporate governance in all five countries in terms of the categories that have shaped contemporary scholarly discussion. These narratives show how difficult it is to identify countries consistently as stable "dispersed shareholder" or "concentrated shareholder" systems. There is enormous variation and change over time in the way in which the analytical categories of corporate governance studies fit the cases. At best, the US and the UK can be coded as dispersed ownership, or outsider, systems for the post-1980s period, while France, Germany and Japan plausibly approximate concentrated ownership, or insider, systems during the postwar period. Germany differs from France and Japan in that the latter two have a stronger role for the state, while Germany (excepting the Nazi interlude) has an associational regime. The non-Anglo-American countries were substantially stable from the late 1950s through the early 1990s, but before and after that period, the range of variation within each model is considerable.

2: Explaining Variation within and across Cases

The corporate governance literature has generated a number of competing arguments to account for the different regime patterns identified in the previous section. All the explanations have strengths and weaknesses and nearly all involve some sort of historical argument. None, however, completely succeeds in developing an explanation that can account both for the full variation within the national cases as well as the differences in contemporary regime types.

Alfred Chandler is the most prominent business historian in current debates on national variations in corporate governance (Chandler 1977, 1988a & b, 1990). Ironically, Chandler's many writings do not focus primarily on corporate governance. Rather he makes claims about the evolution of governance arrangements as part of his larger explanatory project about the development of the modern corporate enterprise in the United States, Britain, and Germany. For Chandler, governance forms change with the endogenous development of the corporation as an organizational response to the expansion of markets. Specifically, he claims that increasing capital requirements (associated with growth in scale and scope of enterprise) lead to the separation of ownership and control and to the dispersal of ownership.

Chandler presents an ideal-typical development trajectory , driven by technology, management complexity , and market expansion, in which corporate organization evolves through three stages: from personal or family, through financial or entrepreneurial, to managerial enterprises. The nature of corporate governance differs at each stage: families both own and manage enterprises in the first stage, while in the second stage, in response to growing scale and complexity, they begin to cede control to professional managers. Family owners also bring in outside investors, especially bankers, to governing board positions in the firm to cover the costs of expansion. Here management and ownership still remain linked—family owners and their bankers can participate in strategic decision-making as well as monitoring operational management. In the final stage, however, the scale and scope of enterprise become so immense, expensive, and complex that owners (and creditors) become fully detached from any realistic internal monitoring role. Owners become a kind of "rentier" (Chandler 1988a: 361). Ownership thus became progressively dispersed within individual enterprises as managers sought to raise funds from broad sources to sustain expansion and owners diversified their investments. Ultimately for Chandler, the capital requirements generated by increasing enterprise scale led to the dispersal of ownership in securities markets.

Chandler accounts for national differences in corporate governance arrangements by suggesting that open markets and political support for competition allow his ideal model to "naturally" unfold, while smaller, politically limited markets blocked the natural process of corporate development. For him, the fact that the US had already achieved the modern corporate form by the beginning of the twentieth century was a reflection of the size and openness of US markets and America's political commitment to competition. Similarly, the fact that Britain remained mired in the initial "personal" capitalism phase of corporate development, while Germany managed to attain only the intermediate "financial" phase, also reflected the limited size and political and cultural commitments to competition in those domestic markets. Once the barriers to openness and competition were lifted in the post-1945 period, Chandler argues that corporations in both societies began to abandon commitments to family and inter-firm cooperation and move toward the (American) ideal. "The historical story suggests that the modern business enterprise was the more 'natural' response to the technological and marketing imperatives of modern mass urban and industrial societies and that interagency agreements were more of a transitional form" (Chandler 1988b: 399).

Quite apart from the many strengths of the broader Chandlerian view of corporate development, his specific argument about the evolution of governance forms is very weak. Chandler repeatedly assumes that large-scale capital needs led to the dispersion of ownership through the securities markets. But most evidence on corporate expansion in the late nineteenth and early twentieth centuries emphasize that growth in both the US and Europe was typically financed by retained earnings rather than through bank lending or the issuing of securities (O'Sullivan 2000, Fohlin 2005, Feldenkirchen 1991). Moreover, Britain, Germany and Japan had much higher market capitalizations than the US, even as late as 1913 (Rajan & Zingales 2003b). Owners in other words were not forced to dilute their interests in American firms *because* they could not otherwise expand their enterprises. Likewise, British and German (and French and Japanese) owners did not retain controlling stakes in their firms simply *because* their capital needs were not as deep as those of their American competitors. Something else is required to account for the observed differences in governance patterns.

The literature outside business history on corporate governance has supplied a broad array of alternative explanations for why a dispersed ownership system emerged in the United States, and then later in Britain, while more concentrated systems prevailed in France, Germany and Japan. Three types of explanation dominate the current literature: those emphasizing political differences among countries, those emphasizing differences in legal structure, and those emphasizing the power of class or social factions in shaping corporate governance regimes.

Mark Roe (1994, 2002, 2003) argues most prominently for the importance of political factors in the emergence of distinctive corporate governance regimes. He contends that strong political forces favoring stakeholders over private property rights produces concentrated holding systems, while weak political support for stakeholders allows for dispersion. The logic of the argument emphasizes managerial agency costs. When states support stakeholder interests, managers are forced to act against the interests of stock owners. In order to limit the extent to which private stock owner interests are compromised in this way, owners seek large controlling stakes and resist the separation of ownership and control. Such strategies, in turn, strengthen the hand of banks and weaken securities markets. Thus, in countries where stakeholders have political power, owners strategically keep their holdings very concentrated and dispersion is blocked. In societies in which there has been no significant political movement for the defense of stakeholders over private stock owner interests, Roe claims, indirect mechanisms for the control of managerial agency costs can develop—minority protections, transparency rules, independent fiduciary systems for monitoring, active securities markets, and markets for corporate control. Under such conditions, owners can diversify their holdings with less fear that dispersion will allow management to neglect their interests. Corporate growth under such political circumstances can follow the path Chandler suggested, where increasing capital needs are satisfied through the dispersion of ownership in the securities market.

Roe uses this general theory to construct particular historical stories to account for dispersed or concentrated ownership in each of the five countries. For the US case, he suggests that political concern to limit concentrated economic power—particularly that of financial institutions and labor—created a political and economic terrain where there were neither banking interests that could shepherd the development of closely-held large corporations, nor socialist interests that might have sought to place limits on managerial decision- making. In Germany, Japan and France, neither of these two conditions held. Large banks could shepherd the growth of the corporate sector, while labor (in Germany and Japan) and the state (in France) were able to achieve significant stakeholder rights. Responding to different managerial agency costs, Roe argues that US owners allowed shareholdings to become dispersed while political power focused on legal and competitive mechanisms for the indirect control of managerial agency. By contrast, in Germany, France and Japan owners sought to keep their holdings as concentrated as possible in order to control managers. This kept securities markets in those countries weak and improved the position of banks.

There are a number of problems with this elegant argument. First, the German economy between 1884 and 1914 had concentrated ownership and strong banks—but the latter were neither significant holders of corporate equity nor important lenders. They engaged in a broadly diversified array of financial activities, including underwriting new issues in what were at the time comparatively strong securities markets (Rajan & Zingales 2003b; Fohlin 2005). Moreover, legal protection for stock owners was also comparatively strong (Cheffins 2003). Thus, relations between concentrated ownership and strong banks existed long before significant labor stakeholder legislation was imposed on corporations. Indeed, during the first twenty years of joint-stock enterprise in Germany there was a state-imposed ban on socialism and trade unions. The lifting of that law seems neither to have encouraged nor discouraged owners from changing the concentration of their holdings. The number of corporations in the economy steadily increased up to 1914, most remained closely held and relied on retained earnings for expansion, while an ever increasing minority grew to be more widely held (Fohlin 2005). The lack of stakeholder threat and the presence of functioning securities markets did not induce closely held German firms to expand by diluting ownership (or by increasing debt). Roe's explanation of increased concentration under such conditions relies on the assumption that dispersion is the preferred outcome for property owners and will naturally occur with growth, if not constrained. Pre-1914 Germany does not provide anything like unambiguous confirmation of this argument.

Roe's argument about the United States makes a similar assumption—in the absence of political constraints on dispersion, owners will cash out and diversify in the securities market. For Roe, there is an attractive securities market in the United States because the possibility of relational banking was eliminated by political concerns to limit financial power. Roes does not view the relatively modest size of the late nineteenth century securities market and the absence of effective minority holder rights as an obstacle to dispersion. Yet if German owners did not (significantly) exercise the option to cash out when they were constrained neither by banks nor strong limits on the securities market, why did those factors induce American owners to act in the opposite way? Roe can't help us here—at least not without finer-grained historical evidence.

Finally, many have pointed out that Roe has a very difficult time accounting for the British case (Cheffins 2002, Franks et. al 2004 a&b). Britain, like the United States, never developed a tradition of strong (equity-based) relational banking, though there were no legal or political barriers to such practices. During the early twentieth century, despite a functional securities market, and the absence of relational banks and legal protections for stakeholders, British family owners kept their enterprise stakes and did not try to cash out and diversify their holdings. But when they did (gradually) begin to do so, Britain was ruled by a Labour government that energetically nationalized capital and imposed strong welfare measures on private firms. Thus, in Roe's terms, when the potential for the creation of indirect mechanisms to regulate managerial agency costs were perhaps even greater than they were in the United States, British owners did not take advantage. And when stakeholder threats to their interests became most acute, owners increasingly cashed out and allowed holdings to become dispersed. Clearly something other than Roe's argument about politics and managerial agency costs must be deployed to account for the historical emergence of dispersed and concentrated holding systems in many of these cases.

An alternative line of argument has emphasized legal differences among countries in explaining the propensity for either concentrated or dispersed ownership. The most prominent argument that "law matters" has been made by LaPorte, Lopez-de Silanes, Schleifer, and Vishny (LLSV 1997, 1998, 1999, 2000). These economists attribute differences in corporate governance regimes, in particular the dispersion or concentration in holdings and the robustness of markets for external finance, to the extent of legal protection for minority shareholders and creditors. They argue that common-law countries , such as the US and Britain, have very strong protections for minority shareholders and creditors, while civil-law countries, such as Germany, France and Japan, provide far fewer protections to minority shareholders or to creditors. The strength of these protections, and their enforcement, is the mechanism that accounts for the relative dispersion or concentration of holdings—and indeed, the strength and depth of external finance possibilities more generally.

Because minority protection is very weak in Germany, Japan, and especially France, owners have many options for exercising control over minority holders. A market for securities does not develop and deepen in these countries because there is little incentive to take non-controlling stakes in companies, while there is great incentive for owners to protect themselves against unwanted takeover attempts. Similarly, because legal protections for creditors are weak, bond markets do not develop and banks seek close relations with their clients in order to monitor their investments effectively. The logic works in the opposite direction in common law countries, where minority holdings and creditors have stronger protection and hence there is little penalty for taking smaller equity stakes and less reason for bankers to involve themselves directly in enterprise monitoring.

LLVS's argument does a good job of establishing a correlation between legal traditions and corporate governance regimes in the late twentieth century. But the explanatory mechanism they offer becomes questionable in light of the historical evolution of corporate governance in the five major cases considered above. Each of these countries had the same legal traditions throughout its industrial history, yet as we saw, the character of corporate governance (and the density of stockholdings) varied considerably within them over that period. Britain and Japan, in particular, experienced radical shifts in corporate governance arrangements without any significant change in their legal systems—at least not at the level of reliance on common vs. civil law. Indeed, there are many empirical problems with the strong LLVS claim. For example, in the US and the UK dispersion of ownership significantly preceded the passage of strong minority rights protection statutes (Coffee 2001). The lack of legal minority protection seems, therefore, to have been an obstacle to the emergence neither of robust securities markets nor dispersed ownership. Something else must be at work in the evolution of corporate governance regimes than a simple difference in legal tradition and, specifically, the existence of strong legal protections of minority shareholders.

Brian Cheffins (2001, 2002, 2003, 2004) offers an alternative argument to account for the emergence of concentrated versus dispersed holdings systems that also emphasizes legal differences among countries. Cheffins notices the weaknesses both in Roe's political argument and the "law matters" thesis regarding minority protections. He argues that even in the absence of minority protections, dispersion can emerge if antitrust law favors horizontal merger over cooperation and investor sentiment is favorable toward securities, as can be seen from the cases of the early twentieth-century United States and late twentieth-century Britain. In the late nineteenth-century US many industries were characterized by excessive competition and instability. Personal benefits of control were, as a result, very low for owners and they sought to reduce the level of competition (and instability). Since cooperation was legally difficult to achieve, firms thus sought to create market stability through horizontal merger.

In itself, Cheffins points out, such mergers did not require the dispersion of ownership. Block-holding by owners could still have been possible if after the merger the private benefits of control were high enough to divert owners from cashing out their holdings.[5] But in the US case, owners cashed out, Cheffins claims, because there was an enthusiastic market for corporate securities where a multitude of investors competed for stock. By selling into the market, investors could diversify their own investment risks. Cheffins notes that traditional securities markets in the nineteenth-century US were very small and regarded as inappropriate for all but the most specialized investors. The new investor enthusiasm for securities at the end of the century, he suggests, was caused by a general contemporary optimism in the US about the economy's future growth prospects. Such optimism had to do largely with the success of mergers themselves and with the public endorsement of them by prominent intermediaries, such as the Morgan Bank.

In the British case, mergers and investor sentiment took much longer to come together. During the early twentieth century, British mergers created holding companies rather than integrated new enterprises. This, Cheffins claims, allowed owners to retain their private control benefits. Moreover, even though there was investor interest in corporate securities, the market proved to be too unstable and as a result, unattractive to owners as an alternative location for their investments. Only in the 1960s, after laws stabilizing stock issues had quieted owner concerns and renewed equity enthusiasm emerged among investors, did stock begin to disperse in the merger wave that broke over the British economy between 1960 and the late 1980s (see also Franks et. al. 2004a).

The difficulty in the argument concerns the moment when owners judge, after a merger, that cashing out is preferable to continued enjoyment of private control benefits. Cheffins introduces empirical examples in both the US and British cases showing that owners were interested in cashing out and that the happy existence of an enthusiastic market of investors afforded them that possibility. But it is not clear what caused those owners to prefer cashing out over continued private control. Cheffins suggests, logically enough, that continued holding increased owners' investment risk, while cashing out allowed them to spread that risk across the market. But this is only one of a number of ways that owners' investment risk can be diversified —others involve diversification and risk-spreading at the level of the firm and its products. Diversification at that level—which was occurring—could in principle reduce investor risk while affording a higher return than would be possible in a diversified securities portfolio. Why did owners choose cashing out over this alternative option?

Cheffins attempts to meet these questions by looking at the German case, but the (relative) failure of German owners to cash out only deepens the puzzle (Cheffins 2003). Germany did not experience merger waves on the order of those in either the early twentieth-century US or the late twentieth century Britain. Instead, around the same time as the great merger movement in the US, German owners solved the market instability problems that produced merger elsewhere by entering into cartel and syndicate (*Konzern*) arrangements. Such arrangements, which stabilized producer markets, also consolidated owners' private control benefits. Corporate growth could in this way take place without eroding private control benefits relative to diversified securities portfolios.

Cheffins notices that his argument does not sufficiently resolve the puzzle. German owners in syndicates were exposed to the same problem of undiversified investment as owners within newly merged companies in the US and Britain. Why didn't they also cash out? Cheffins notes that it can't be because there were no potential investors in the securities market. The German market for securities was both deep and active—there were continuous new listings throughout the period up to World War I, and, indeed, there was a significant jump in listings that occurred during the period of cartelization. Moreover, he points out that investor protections in Germany were as strong as anywhere at the time. Why, then, did private benefits of control continue to be more attractive to owners than cashing out? Ultimately, Cheffins (following Schumpeter 1939) suggests that there was a cultural norm in Germany, particularly after the passage of the 1896 securities market law, discouraging gambling in the stock market. This norm, he suggests, kept investor enthusiasm for the stock market low and hence restricted owner opportunity to cash out.

But this claim (based on no other historical authority than a passing remark by Schumpeter) has all the markings of an answer advanced because the question would otherwise remain open. It is easy to provide counter examples of late nineteenth and early twentieth-century Germans who, unlike Schumpeter, discerned no norm discouraging speculative trading in the stock market. Georg Simmel's *Philosophie des Geldes* (1900), for example, argued that the modern capitalist economy in Germany was so depersonalized and objectified that it made decisions that ignored human ties and cultural norms not only possible, but increasingly the norm. The point, here, is not to suggest that Simmel is a better authority than Schumpeter, but rather to point out that in the existing state of research the available evidence to support such a cultural argument is very contradictory. For all we know, German holdings stayed concentrated in the pre 1914 period not because there was no potentially enthusiastic market for their holdings, but rather because owners could make satisfactory profits and diversify their risks without selling off their assets. Until we know what was actually happening among German owners, Cheffins's argument linking dispersal to mergers and investor sentiment must be considered unproven.

A final set of arguments seeking to account for cross-national variations in the evolution of corporate governance arrangements, and particularly for the dispersal or non-dispersal of holdings, emphasizes the positive or negative role of well-positioned interest groups or classes. Here there are two prominent arguments in the literature, one by Raghuram Rajan and Luigi Zingales and the other by Mary O'Sullivan.

Like Chandler, Rajan and Zingales's (2003 a &b) argument about variation in corporate governance practices forms part of a larger argument about the historical evolution of financial systems. They claim that openness to trade and cross-border capital flows creates pressure for financial market development: better law (eg., minority protections, clear property rights, reliable enforcement), more transparency, more active and deeper securities markets. Under such conditions, competition from new entrants in domestic industrial and financial markets makes it difficult for large players to protect monopoly rents. Control in many directions--by large banks over credit markets, by large firms over product markets, by banks over firms, or even by owners over corporations-- is undermined, and competitive and dynamic arms-length market relations appear. On the other hand, when openness to trade and capital flows is compromised, then competition is lessened and "incumbent" players—large industrial firms and banks—can exploit their position to restrict the possibilities for new entrants into their markets and keep rents politically inflated. According to Rajan and Zingales, concentrated holdings, relational banking, bank-driven financial systems, etc. all result from structural conditions in which exposure to trade and mobile capital are limited and incumbent self-dealing is therefore successful.

The two economists apply this "political economy of financial development" to the history of twentieth-century financial systems and find that it accounts for many cases. In Japan, the decay of the securities market, the concentration of the banking system, the emergence of the "main bank system" and large-firm cross-shareholding all emerged between the 1930s and 1950s from efforts by the Japanese state and strong incumbent banking and industrial firms to limit domestic competition and centralize capital allocation and investment decisions in the context of restricted capital and trade flows. In a similar way, their structural argument offers a plausible if not always explicit explanation for the significant shift in bank control and shrinkage in the number of firms participating in the German securities market, as well as the capacity of the French state and industrial elites after 1945 to control both the capital market and large firms. In each case, incumbent actors exploited the absence of foreign competition in trade and capital markets to establish control and protect excessive rents. Similarly, as Japan, Germany and France became more exposed to both capital and trade flows during the late twentieth century, incumbent groups' ability to protect their arrangements from the acid of competition declined. In particular, industrial firms, long hostage to financial control by domestic banks, eagerly exploited new financial openness to raise capital in international markets. As a result, all three economies became more open, and their corporate governance structures became more dispersed and arms-length.

Suggestive as this argument is in accounting for the evolution of late twentieth-century financial systems, there are empirical problems in linking financial system development to variations in corporate governance. In particular, Rajan and Zingales's argument has great difficulty accounting for variations in corporate governance structures during the first half of the twentieth century. The authors present data for 1913 showing how surprisingly (from a twenty-first century perspective) financially developed and relatively economically open were both France and Germany. For example, they show that Germany and France had higher ratios of bank deposits to GDP, higher stock market capitalization as a percentage of GDP and higher equity financing to fixed investment ratios in 1913 than did the United States (Rajan & Zingales 2003b: 26-30). Such financial and legal "development", however, did not translate in those cases, as it did in the United States (and as Rajan and Zingales suggest it should) to dispersed holdings and an outside, arms-length system of corporate governance. The persistence of concentrated holdings, despite structural conditions favoring competition and the free flow of capital, apparently has to be explained by something else. Dispersion of ownership, active securities markets and market-based financial systems are the result of more than simply the existence of free movement in goods and money across borders.

Mary O'Sullivan (2000) seeks to explain the dispersion of holdings in the United States by linking possibilities latent within the securities markets to power consolidation strategies on the part of managers. O'Sullivan points out, contra Chandler, that the modern business enterprise in the United States emerged prior to a market for industrial securities. In large part, the market for securities was created to negotiate managerial continuity within such enterprises as original owners retired and also to accommodate the fusion of property rights during the great late nineteenth-century merger wave. In both cases, stock was distributed within a very elite circle of investors. "Of the $6.2 billion of industrial common and preferred stock issued during the peak of the merger movement between 1898 and 1902' she writes, 'only six percent …. was sold to the general public" (O'Sullivan 2000: 75).

O'Sullivan suggests that the elite circle of stock-holders, generally holders of preferred stock, behaved more like creditors than arms-length investors. They also carefully monitored enterprises and, significantly, had the power to challenge management if dividend payments were missed. In reaction to this kind of relational dominance, O'Sullivan claims that managers of these newly public enterprises sought to dilute owners' power and insulate their own organizational authority by issuing common stock to the public, often without any voting rights. Ultimately such practices were outlawed and replaced with clear rules regarding stock voting rights . Yet by that time stock had diffused so broadly that the effect of the new regulations simply legitimized stockholding and fostered even greater diffusion.

On this view, then, the diffusion of ownership in the US did not emerge out of owner/investor diversification strategies to minimize risk—that is, from the structural condition of market openness. Rather, it resulted from systematic management efforts to dilute the power of stock owners through the creation of greater liquidity in the securities market. Dispersion emerged not out of a market logic, but out of an organizational power logic.

O'Sullivan's argument is empirically very powerful for the US case, yet it begs at least as many questions as it answers when placed in comparative perspective. Why were American mangers able to exploit the structural potential of the nascent securities market against relational owners, while German and Japanese managers seem rather to have worked together with major owners to enhance enterprise competitiveness in the context of comparably liquid markets? O'Sullivan's argument does a nice job of showing that the structural condition of market liquidity does not determine owners' investment strategies. But it does not account for (or appear even to notice[6]) the possibility that managerial interests are equally contingent and unconstrained by structure.

This survey demonstrates not only the creativity but also the deep irresolution of the contemporary debate on the historical development of cross-national variations in corporate governance. It remains unclear how to explain the observed patterns of dispersion and concentration in holdings, both across cases and within cases over time. Strikingly, the cases contain far greater heterogeneity in the pattern of holdings, the character of finance, and the role of stakeholders and government than the explanatory theories seem to be able to handle. It's a bit like a boy frantically using all his arms and legs in a fruitless effort to plug holes in a deteriorating dike. Seeming success in one area is contradicted by anomalous development in another.

3. Conclusion: Finding Resolution by Unearthing Possibility

The above analysis suggests that the key problem in trying to explain the origins of cross-national divergence in corporate governance is that the major national cases do not fall neatly into dispersed/outsider and concentrated/insider systems, either over time or cross-sectionally. The five countries surveyed all include examples of dispersion and concentration, arms-length and relational finance, and stockholder and stakeholder governance. The periods when the actual cases resemble pure system types are extremely fleeting—the last fifteen years in the United States and Britain resemble the outsider/dispersed holding model, while France, Germany and Japan (in different ways) resembled the concentrated holding/insider model between 1945 and 1990. Otherwise the cases display remarkable heterogeneity—stakeholderism and relationality in the United States, robust securities markets in pre-1914 Germany, Japan, and France. Moreover, improbable combinations abound—such as the particularly intimate role of German banks within corporations with dispersed ownership and more arms-length ties to closely-held corporations in the pre-1914 period, or the strong stakeholder commitments of diffusely-held American corporations after 1945.

One reason the debate has trouble coping with this heterogeneity is that it is far too wedded to the unitary evolutionary sequence of organizational forms that is postulated in the Chandlerian model of corporate development: family firm, entrepreneurial firm, modern managerial enterprise. Virtually all the historical explanations discussed above cite Chandler for historical authority in their analysis. Even where they reject Chandler's specific causal arguments, they accept his postulated range of organizational possibilities as accurate descriptions of the economic-historical landscape. Within this unitary developmental trajectory, heterogeneity appears either as transitional or as an example of blockage.

But much recent work in business history, economic sociology, political economy, and business economics calls into question this reliance on the Chandlerian paradigm. The alternative literature argues that Chandler's typological framework blends out a broad range of organizational possibilities that are less hierarchical, more cooperative, and driven by bottom-up impulses. On this alternative account, the Chandlerian large-scale joint-stock enterprise is viewed as an historically specific entity that emerged at a specific historical moment (the late nineteenth and early twentieth century) under specific historical conditions, and largely in the United States. The conditions that sustained that corporate form were not present in nineteenth-century America; nor were they completely hegemonic even within the twentieth-century US economy (Berk 1994, Scranton 1997, Lamoreaux et al 2004). Finally, they were very weakly present during much of European or Japanese industrialization (Sabel & Zeitlin 1997, Zeitlin-this volume, Herrigel 1996, Fridenson 1997, Jones 1997); and they no longer seem to pertain in the contemporary global environment (Sabel 2005, Roberts 2004).

This alternative literature shows that where the conditions conducive to the emergence of the Chandlerian corporation were absent (or not hegemonic), alternative organizational forms emerged with different boundaries, value-generation processes, management structures, labor relations, contests for control and possibilities for opportunism, etc. In short, alternative conditions produced very different governance dilemmas and structures within and across organizations. Moreover, the alternative literature argues that the evolution of governance practices within the large-scale Chandlerian enterprise, where and when it emerges, should be seen as co-evolving through encounters, discussions, and processes of experimentation with many other enterprise forms. Exchange, borrowing and imitation across fields and nations expands the range of possibilities available to all actors and provides the material for innovation in governance practice (Zeitlin & Herrigel 2000). From this perspective, heterogeneity in governance forms within a given national economy is not a problem. It is an expression of basic economic process—indeed, it is something that is constantly reproduced by that process itself.

Unfortunately, much like the Chandlerian tradition that it criticizes, this literature tends to focus on a broad array of organizational and relational problems of industrial order rather than on the internal problems of enterprise governance at the heart of the debates discussed above. An alternative literature specifically devoted to the analysis of historical heterogeneity in corporate governance has yet to emerge. The only historical literature that has an explicit concern for the heterogeneity of governance forms in the industrializing economy is nearly a century old. Not surprisingly, German Historical School and British historical economists are most prominent in this older literature, but even American writers a century ago were concerned to systematically catalogue alternative governance arrangements.[7]

One prominent example of this older concern for heterogeneity can be found in a series of articles by Gustav Schmoller on the historical emergence of the corporation (Schmoller 1890 a, b &c). Schmoller surveyed a broad array of arrangements governing relations between owners, managers and stakeholders ranging from manorial and household production systems (*oikos*) and producer cooperatives (*Genossensschaften*, *artels*), to the governance structures in early trading houses and shipping enterprises, guilds, and domestic putting-out systems. Schmoller focused on the ways power was allocated and value generation was controlled in these organizations. In the household economy, power was centralized and hierarchical. Efforts were made from the top of the hierarchy to direct and capture the value generated by the disparate production processes in the household. By contrast, cooperative arrangements avoided hierarchy, coordinated the flow of production collaboratively, and distributed rents across all participants (normally according to an agreed upon formula).

Schmoller explored a wide array of possible variations on each of these governance forms: partnerships, profit-sharing arrangements, collective ownership, etc. In his view, this historical variety served as resources for governance experiments in the industrial economy emerging around him. Schmoller was fascinated by organizational plasticity and the range of possibilities for constituting relations among owners, workers and managers in his own time. And he was acutely aware of the conceptual and practical interchange among organizational fields in the economy, society and politics, as well as the constitution and continuous recomposition of organizational practices in economic life.[8]

One contemporary example of how consideration of alternative governance forms can illuminate peculiarities in the development of large corporate enterprises is a recent book by Koberg (1992) on the emergence of the "society with limited liability" in Germany and France (the GmbH and the SARL) during the late nineteenth and early twentieth centuries. This organizational form was conceived as a mechanism for achieving limited liability without the creation of a joint-stock enterprise. It required a contract and insisted on a very generally specified governance structure. But the intention was to facilitate a broad array of specific forms of governance—cooperative-egalitarian, family-autocratic, profit-sharing, passive participations, etc.—under a limited-liability rubric without requiring the specific governance structures legally mandated of joint-stock companies .

Indeed, Koberg points out that calls for the creation of such a legal form of incorporation came strongly from cooperative enterprises and small and medium-sized family firms. Both required additional capital to grow, but they were not attracted to the specific framework for governance imposed by German joint-stock enterprise law—cooperatives because they resisted hierarchy, and SMEs because they did not want to distribute authority away from the family. Passage of the new law allowed such firms to expand while avoiding becoming joint-stock enterprises. This alternative legal enterprise form was a smashing success both in Germany and, later, in France. The GmbH and SARL forms quickly proliferated and soon massively outnumbered the joint-stock company and the simple partnership as a percentage of total enterprises in both economies. One implication of this study, of course, is that a major factor accounting for the comparatively low numbers of joint-stock enterprises in Germany and France, both in the past and the present, is that there were very attractive alternatives available to expanding companies which allowed them to govern themselves in a more congenial manner.

More of this kind of close historical work on the variety of legal and organizational mechanisms for the governance of industrial enterprise is plainly needed.[9] The existing corporate governance literature, even in its irresolution, has done a great deal to open questions about the range of organizational possibilities in industrial economies both past and present. But it will only be possible to advance the debate if stereotyped national models are put to the side and researchers seek to explore the range of viable possible governance forms through careful, archivally-based historical studies of specific governance practices, across all the major industrial economies.

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[1] Notable exceptions include: Fohlin 1997, 2000, 2005; Lamoreaux 1995, 2004; Lamoreaux & Rosenthal 2004; Lipartito 2004; Dunlavy 2004).

[2] Other relevant distinctions in financial systems are those between specialized and universal banking and arms-length and relational banking. For general discussions see: Rajan 1992, Boot 2000, Mayer 1988; Verdier 2002.

[3] For overviews of this enormous debate, see a defense of stockholder over stakeholder systems, see Hansmann 1996, Blair 1995

[4] Hansemann 1996, Hall & Soskice 2001, Whitely 1999, Rajan & Zingales 2003a&b

[5] He also notes that merger was unnecessary for the dispersion of holdings in the US. Ultimately, for Cheffins, merger is neither necessary nor sufficient as a cause of dispersal. It is an “agent of change” that creates the possibility for owners to cash out.

[6] In her treatment of Germany, O’Sullivan (2000) attributes ownership concentration in Germany to relational bank control over enterprises—a position more recent literature has shown to be inaccurate.

[7] Relevant texts include: Scott 1910-1912, Bauer 1936, Streider 1914, Balderston 1937, Gilman 1889

[8] Some of this spirit, though limited by a preoccupation with the Chandlerian paradigm, made its way into the work of Jürgen Kocka, who has repeatedly shown how the pre-existence of a robust bureaucracy in the Prussian state influenced the development of late nineteenth- century German large enterprises (Kocka 1987, Dornseifer & Kocka 1993). Lipartito (2004) is an interesting genealogical effort on the American side.

[9] See Lamoreaux (1995, 2004) and Lamoreaux & Rosenthal (2004) for interesting efforts in this direction in the US.