Book Review

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Corporate Governance, Competition, and Political Parties
by Roger M. Barker
Published 2010
by Oxford University Press, Inc.
Great Clarendon Street, Oxford, OX26DP, UK, 327pp
ISBN: 978-0-19-957681-4

For a substantial period of the 20th century, the European corporate ownership has been dominated by the incumbent block-holders, with a relatively insignificant role for minority shareholders and institutional investors. In general, the European corporate strategy was focused primarily on the achievement of social stability, rather than maximisation of shareholder value.

However, over the past two decades, thus starting in early 1990s, a major shift in the strategic approach occurred, where the emphasis moved from social stability towards a more Anglo-American-type objective, that of enhancing value for corporate shareholders. This shift, paradoxically, took place at a time when the political spectrum started leaning more favourably toward political parties displaying a more left-oriented mentality.

This book provides an analysis of this apparent paradox through the examination of the interaction between economic factors and political preferences of political parties in several leading European countries.

The key hypothesis presented in this book is that the European corporate governance regime has shifted in a ‘pro-shareholder direction’ mainly due to the distinctive interaction between political partisanship and product market competition. The author, Dr. Roger M. Barker, brings a significant level of expertise in the area of corporate governance. He acted as the corporate governance advisor for the European Union Economic and Social Committee in Brussels, which is a member of the European Confederation of Directors’ Association.

2 Corporate governance: philosophy and practice

The book commences with an introduction of the relationship between political partisanship and the ‘puzzle’ of corporate governance change in Europe. This relationship is analysed from the perspective of the overwhelming march of globalisation and its triumph against local and/or regional economic development, as the mid 20th century managerial capitalism is gradually, albeit forcefully, replaced by an overarching global financial capitalism.

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In Chapter 1, the author describes the support of the left-leaning political parties to the economic maximisation of shareholder value that occurred in a perceived dissonance and apparent departure from the traditional goals of the 'left', which are generally better aligned with social values, such as increased income levels, employment security and income equality. This support, argues the author, occurred primarily due to an environment of increased competition, thus diminishing economic rents. A case is made that in such circumstances 'the left' would increasingly favour a shift towards a shareholder orientation, while 'conservative' political parties would tend to retain a preference for the status quo. Here, the corporate governance area seems to play a key role as it can introduce regulation that could either encourage or stifle the potential economic benefits accruing to shareholders. In this sense, the analysis asserts that corporate governance played a determining role in identifying a substantial number of economic and political outcomes including levels of economic growth and efficiency (Carlin and Mayer, 2003; Mueller, 2005).

One of the key underpinnings of the economic environment analysed by the author is the fact that the European economic model has, traditionally, operated within a framework of incentives designed to preclude corporations from engaging into short term earnings and profit maximisation strategies. However, the past couple of decades are experiencing a rebalancing of corporate governance regulations in favour of minority shareholders, this occurring in a rather stark contrast with post World War II regulation, which exhibited a far more social orientation.

Such rebalancing has been accompanied by the introduction of several internal control mechanisms, such as boards and audit committees which were meant to promote 'best practices' codes of conduct. The author further describes these transformational processes in several European countries such as Germany, France, Spain, Sweden, and so on. Also, a comparison of corporate governance ratings for large European companies from 16 European nations is performed. In addition, a thorough description of main mechanisms for corporate protection against hostile takeovers, such as the poison pill for example, is presented. The chapter concludes with the idea that corporate governance in European nations displays a convergent characteristic, where most regulation seems to now become more uniform, particularly when it comes to the protection of shareholder rights and profit maximisation.

Chapter 2 introduces two very interesting propositions; first – that economies where substantial economic rents are available to the incumbent participants, no discernible relationship will exist between political partisanship and corporate governance outcomes; and second – that in economies where economic rents are low, due to the increased market competition, a distinct relationship does tend to occur where 'the left' tends to be more aligned with a pro-shareholder model of corporate governance. Thus, it is argued, party politics seem to matter most in economies exhibiting competitive market conditions.

According to Schleifer and Vishny (1997) 'corporate governance deals with the way in which suppliers of finance to economic enterprises assure themselves of getting a return on their investment'. The author then describes two distinct models of corporate governance:

1 the block-holder model

2 the shareholder model.

The book refers to (Gourevitch and Shinn 2005) which summarises the key characteristics of these two models (see Table 2.1).

Moreover, this chapter details the relationship between corporate governance and economic trends, as well as the interaction between political partisanship and product market competition. Here, and interesting insight is offered by Katzenstein (1985, p.47), where it is argued that smaller European countries, which have a significant involvement into the world markets, do tend to restrict the competitiveness of their domestic markets through the implementation of rigorous corporate governance mechanisms. Therefore, it looks like product market competition is further restricted in these smaller European nations due to their involvement in mitigating the potentially harmful domestic effects of high levels of economic openness.

Furthermore, the author argues that the absence of regulatory safeguards will lead to a desire on behalf of block-holders to further exploit their position of control in order to expropriate resources from minority shareholders via a variety of mechanisms at their disposal. Such mechanisms could encompass acts such as choosing the management based on non-meritocratic or dynastic considerations, or requiring managers to pursue a business strategy based on personal objectives rather than profit or value maximisation. In some cases, argues the author, the block-holder's control rights may actually facilitate their ability to engage in illegal insider trading or even worse, to actually undertake outright theft of the company's assets. As the block-holders represent the incumbent or dominant majority in several sectors of European economies, it looks quite plausible that they will continue to shun efforts by the regulators to introduce new policies and laws that would safeguard the rights of minority shareholders.

This leads us to the conclusion of chapter two where the author launches the idea that there is in fact a very strong relationship between political partisanship and increased levels of corporate governance regulation, thus a higher level of rules and guidelines meant to prevent corporate abuses on behalf of the economic enterprises.

Chapter 3 contains a literature review of alternative approaches to corporate governance models by analysing relevant studies in Legal Issues, Economics, Sociology, and Political Science. Here, comparative patterns of distinct corporate governance models are explained. Furthermore, the chapter is concerned with economic, legal, political, and sociological approaches to corporate governance. The chapter concludes with the idea that the introduction of the European Union's Single Market Program (SMP) exerted a substantial influence on the actual level of competitiveness for the European product markets. Also, it is argued that a greater level of competition represents a key precondition and a substantial driver for corporate governance change.

The analysis of economic approaches vis-à-vis corporate governance is characterised by a focus on the role of the market-determined incentives in driving corporate governance outcomes. Here the author cites a conclusion reached by Frank Knight in *Risk, Uncertainty and Profit*, where Knight argued that owners, rather than shareholders, should fulfill the central role in the governance of the firm in a capitalist economy. Such argument is supported by the assertion that the owner is the only stakeholder whose economic return is directly dependent on the corporate efficiency; therefore, their control of the economic enterprise represents the most socially desirable corporate governance outcome. Relinquishing the control of the firm to other actors, even though they may be shareholders, would be subject to significant issues of moral hazard according to Knight. However, subsequent economic literature such as Jensen and Meckling (1976), argue that the job of rational economic agents is in fact to identify a system of corporate governance

that is best suited at minimising agency costs and at balancing the rights of block-holders versus those of minority shareholders.

The chapter continues with an analysis of legal approaches to corporate governance, where it is concluded that the legal and the regulatory environment represent an essential determinant of corporate governance outcomes. This; however, seem to contrast with the implicit assumption of the economic theory of the firm – that corporate governance outcomes will be determined by the private behaviour of independent economic agents in response to divers economic incentives. According to Shleifer and Wolfenzon (2002), the law will be inextricably important in shaping the incentives of rational economic actors, and thus determining the nature of firm-level corporate governance behaviour. It is further argued that a middle of the road path, whereby both economic incentives and legislative measures are implemented, would likely represent the best compromise in order to accomplish a balanced regime of corporate governance.

In the section examining the 'political approaches to corporate governance' the author analyses how differing distributional political coalitions lead to differing corporate governance outcomes. In this sense a more detailed study was performed by Peter Gourevitch and James Shinn in *Political Power and Corporate Control* (2005).

Chapter 3 concludes with the study of two additional perspectives, one relating to 'sociological approaches' to corporate governance, while the other talking about the relationship between corporate governance and 'nondomestic factors'. Here, the author reaches the conclusion that the influence of the European Union on national models of corporate governance may have been the greatest through directives and policy initiatives not directly addressed at corporate governance, rather through parallel measures, such as the introduction of the EU Single Market Programme, which ended up exerting a significant amount of influence on the competitiveness of the European product markets.

Chapter 4 is concerned with the measurement of change in corporate governance in several European countries, and analyses how ownership concentration, private equity investments and equity-share dispersement tend to impact the corporate governance models in those respective countries. Moreover, the chapter presents a substantial analysis of the La Porta, Lopes-de-Silanes, Schlieifer and Vishny (LLSV) paper on Corporate Governance and The Determination of The AntiDirector Rights Index.

This chapter explains the measurement of ownership concentration relative to corporate governance ratings and corporate governance behaviour. Ownership concentration is a measure that permits a comparison of countries' corporate governance structures based on the ownership framework of their economic sectors. Since high levels of ownership concentration tend to imply that economic corporations are dominated by block-holders, the author concludes that some countries, which exhibit such elevated levels of ownership concentration, continue to retain a block-holder-oriented model of corporate governance. A comparison among 15 European countries plus the USA is performed and the final conclusion is that the USA ranks lowest in terms of ownership concentration with an ownership concentration of 15% (as of early 1990), thus quite favourable towards a shareholder corporate governance model, while at the other end of the spectrum lays Greece with an ownership concentration of 75%. Therefore, based on the author's arguments, we can conclude that Greece shows distinct evidence of a definite block-holder oriented corporate governance structure.

In addition, this chapter analyses the issue of equity share, and it is argued that the relative size of an economy's equity market may potentially be driven by country-specific institutional factors, which may be unrelated to the corporate governance structure.

Tables 4.2 details the European private equity investment as a percentage of the GDP in 14 European countries, while Table 4.3 defines the descriptive statistics for equity share for the same countries. Furthermore, Figure 4.2 shows the value traded for equity shares for several European countries from 1975 to 2003.

In the second part of the chapter, we learn about specific measures of corporate governance, and a particular emphasis is placed on LLSV's index of shareholder protection. Currently, the most widely utilised measure of *de jure* regulation in the corporate governance literature is the antidirector rights index developed by LLSV. This index seeks to measure the extent to which the legal framework in forty-nine developed economies tends to restrain the capacity of insiders to divert corporate wealth to themselves, at the expense of minority shareholder. This index was originally developed by LLSV in an attempt to provide a cross-sectional snapshot of the situation during the early 1990s. However, the series has later been updated and transformed into a time series, which now covers the period of 1993 to 2002.

In conclusion, the author argue that proxies based on LLSV's antidirector rights index should not be construed as tenable representations of corporate governance regulation on a time-series cross-sectional basis despite their perceived ubiquity and utilisation in the corporate governance literature.

Chapter 5 deals primarily with the specific issue of measurement of product market competition. Several metrics are considered, such as real share-price levels, concentration indices, profit margins, and the Organization for European Cooperation and Development (OECD) indices of product market competition. All these indices are summarised in Tables 5.7 and 5.8, where key statistical values for 16 European countries (the sample) are exhibited, with data going back to 1975. An added-value data for the USA is included in this comparison too.

This chapter is extremely interesting as it uncovers a significant amount of detail for each one of the metrics enumerated above. Figure 5.1 provides an excellent comparison of markups in manufacturing versus non-manufacturing sectors for all European countries included in the data sample. The final conclusion in this chapter relates to the fact that, out of all the countries included in the data sample, Greece and France retained a relatively uncompetitive market structure, while other countries such as Denmark, Germany, the Netherlands and Sweden have accomplished a substantial level of market liberalisation, thus they reached far more competitive structures.

Chapters 6 and 7 present a panel-data econometric analysis of corporate governance change, complemented by an analysis testing the robustness of the dynamic modelling. Both these chapters employ advanced econometric and statistical techniques, through the utilisation of distinct variables related to corporate governance change within diverse empirical contexts.

Some of the variables employed here are:

- equity share
- value traded
- international equity issuance
- 'left' government
- 'conservative' government
- pension system

- GDP growth
- interest rates
- population.

It seems that all these variables have been carefully chosen for their highly important significance in analysing the data for the countries included in the data set.

The empirical research here analyses all these variables in the context of 'the sample' – the 16 European countries we talked about earlier. The existing methodology describes the empirical model; and all regression results are exhibited in Tables 6.9, 6.9, 6.10, 6.11, 6.12, and 6.13. A graphic display and interpretation of all the variables can be found in Figures 6.1 through 7.12.

Chapter 8 presents a further, in depth, analysis through a methodological approach involving a qualitative comparison of specific events and experiences in a small number of countries. This particular methodology is described by Lijphart (1971) as the 'comparative method', which seems to be complementary to the 'statistical' method, where a large number of countries tend to be analysed through quantitative techniques (King et al., 1994). Furthermore, this chapter introduces a 'rationale' for case studies, which, in the context of this particular book, is primarily motivated by a desire to benefit from some of the relative strengths the case study methodology exhibit in comparison with other analytical approaches. This particular way of tackling the problem – analysing it from different methodological perspectives – seems to be consistent with the recommendation of Gerring (2004, p.353), where it is stated that "if both Case Study and Cross-Unit methods would add substantial value to the final result, then both methods ought to be pursued; perhaps not in equal measure, but at least with equal diligence and respect". The author argues that the case study technique offers an opportunity for a more detailed understanding of the processes by which differing levels of economic rents translate into changes in the corporate governance preferences of relevant social actors in individual country settings.

Chapter 9 displays the case study evidence through the utilisation of two distinct approaches. First method is a longitudinal case study of a particular country which has experienced significant changes in the level of product market competition over time; while the second method relates to an evaluation of the experiences of two countries that, concomitantly, exhibited different levels of product market competition when their respective corporate governance structures were analysed and compared. In Chapter 9, the author presents the case of Germany and the paradigm shift from 'block-holding' to 'hybrid' corporate governance regimes. Moreover, it is argued that change in the competitive landscape of incumbent block-holders has overlapped with a significant period of Left government, where a substantial shift towards a pro-shareholder direction has occurred. The chapter further discusses the distinctive nature of the post-war political and economic environments in Germany, as well as the corporate governance models associated with that specific timeframe. In addition, a description of economic rents and the German corporate strategy is presented. Here, an emphasis is placed on the challenges encountered by the German management, which had to continuously cope with the highest labour costs of any industrialised country in the world. Despite Germany's excellent record in terms of productivity and productivity growth, the extremely high labour costs in the overall German economic environment proved to be one of the most problematic issues local corporations had to deal with. Nonetheless, numerous local firms

tended to adapt to this situation fairly rapidly through the implementation of more aggressive means of rationalising their operation; such as Mergers, Divestitures, and Acquisitions. Table 9.1 details the number of mergers and acquisition that occurred in Germany between 1980 and 1998.

A representative sample of this shifting corporate behaviour is illustrated by Tony Edwards in his case study of the Volkswagen corporation, which, prior to 1990, operated mainly as a classic example of block-holder corporation, but which has later transitioned toward more of a shareholder environment.

This chapter concludes with an analysis of the role the 'politics' are playing in the German corporate governance structures and by explaining all the changes that had occurred in corporate governance for corporation from the German economic landscape. In this sense, the author seems to conclude that a new social equilibrium was reached between social, political, and economic participants and that such equilibrium has been conducive and engendered a development of a 'hybrid' regime of corporate governance, where elements of the shareholder and the block-holder models ended up being combined and utilised.

Chapter ten details a very similar analysis as the one performed in Chapter 9, only this time the emphasis is placed primarily on the Italian political and economic environments. The main structural differences identified by the author in comparison with the analysis performed in the preceding chapter, seems to be related to the fact that there is no intention to trace the changing corporate governance preferences of the political actors and their constituencies over time, as in the form of either a historical or longitudinal case studies. The objective here instead, is to offer a cross-sectional comparison with the German experience of corporate governance reform of the late 1990s. This chapter also describes the post-war Italian corporate governance framework through a thorough description of the regional reforms instituted mainly by the Romano Prodi government of Italy in the late 1990s.

The chapter then concludes by arguing that higher levels of competition remain a key precondition for the realisation of a greater outsider orientation, and thus an increased alignment with a shareholder model, in the actual corporate governance behaviour of Italian corporations. Table 10.1 details the average ownership concentration of the thirty largest Italian corporations for the period 1996 through 2005. The final thought of the chapter relates to the fact that a meaningful relationship exists between substantial economic rents and the Italian corporate governance structure.

Chapter 11 offers structural conclusions over the entire book and takes the reader through a brief synthesis of each prior chapter, as well as the overall purpose of the book and what it tried to convey in terms of academic and intellectual value-added to the field of corporate governance, particularly from the unique viewpoint of a European perspective.

The chapter also describes the emphasis placed on the macro-comparative statistical approach within the empirical analysis conducted in earlier chapters. With the qualitative research taking a rather secondary role to the quantitative one, the author definitely displays a predilection toward a high level of statistical and data-drives analyses. It is more than apparent that the central focus of this book revolves around the need to identify the specific determinants of change that led to a paradigm shift in European corporate governance models, where such shift took place in a unilateral direction from the entrenched block-holder model during the post-war era toward a shareholder friendly model prevalent over the past quarter century. This shift underscores the towering

importance the shareholder model is now enjoying in the European corporate environment, and the prevalence with which this model is currently instituted across the newly developed economic union. It is also apparent that such shift started to arise in late 1980 and has become a full blown phenomenon today. This transition was also accompanied by a rise power and influence for the left-leaning political structures, which have, in the mean time, become more aligned with, and more permissive to, a shareholder-oriented corporate governance framework. In addition, the book describes and analyses the inherent challenges encountered during the transition from a block-holder-oriented corporate governance model toward a shareholder-friendly one. It is more than apparent that such challenges tended to be far more significant in European economies where the environment was dominated by the incumbent block-holder-oriented models. A final conclusion for the book is that, despite the fact that the corporate governance landscape is in the midst of a period of considerable change; the 'firm' still remains the fundamental building-block of a modern economy. In this sense, a good balance needs to be struck between a firm's need for relative independence and thus a commitment toward a 'laissez faire' attitude, and the societal requirement that corporate governance will continue to embody the principles of social responsibility, thus to reflect a set of rules, guidelines, and regulations, meant to prevent corporations from perpetrating potentially damaging actions to the detriment of the society at large. That is why, the inter-linkages between politics and corporations, within a rapidly evolving economic landscape, seem to now play a more important role than ever.

From the perspective of the reviewer of this highly informative book, the analysis carried out throughout the publication represents a wonderful example of the dedication, the passion and the great deal of knowledge the author brought into acquiring and investigating all the collected data. In the end, corporate governance models, frameworks, and structures will unquestionably continue to evolve and to be aligned with the particular needs of specific groups of interest. Whether such groups of interest will have the ability to ultimately influence the political landscape or vice-versa, this is a question that remains to be answered in the near future.

3 Conclusions

I strongly recommend this book for corporate executives and for researchers interested in the field of corporate governance and corporate social responsibility.

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