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America's Shifting Fascination with Comparative Corporate Governance

Edward B. Rock
University of Pennsylvania Carey Law School

AMERICA'S SHIFTING FASCINATION WITH COMPARATIVE CORPORATE GOVERNANCE

EDWARD B. ROCK*

In the last few years, comparative corporate governance—German and Japanese corporate governance in particular—has been a hot topic in U.S. law reviews and conferences.[1] Some of the best contemporary corporate

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* Professor of Law, University of Pennsylvania Law School. This is a revised version of a lecture I gave to German bankers, corporate lawyers and academics at the Johann Wolfgang Goethe - Universität, Frankfurt am Main, Germany in June 1994.

I am grateful to participants in workshops at the Faculty of Law, Johann Wolfgang Goethe - Universität, Frankfurt am Main, and the Faculty of Law, Hebrew University, Jerusalem, for helpful comments and criticisms. Special thanks to Mark Roe and Richard Buxbaum for helping me (incompletely, I fear) to avoid mischaracterizing their views. All remaining errors are, of course, my own. The interested reader should read the marvelous articles by Professors Roe and Buxbaum and others and form their own judgments. This work was supported by the University of Pennsylvania's Institute for Law and Economics and the Institut für Arbeits-, Wirtschafts- und Zivil Recht, Faculty of Law, Johann Wolfgang Goethe - Universität, Frankfurt am Main.

1. *See, e.g.*, Bernard S. Black & John C. Coffee, Jr., *Hail Brittania?: Institutional Investor Behavior Under Limited Regulation*, 92 MICH. L. REV. 1997 (1994); Richard M. Buxbaum, *Institutional Owners and Corporate Managers: A Comparative Perspective*, 57 BROOK. L. REV. 1 (1991); John C. Coffee, Jr., *Liquidity Versus Control: The Institutional Investor as Corporate Monitor*, 91 COLUM. L. REV. 1277 (1991) (discussing Germany, Japan, Sweden, Canada and the UK); Ronald J. Gilson & Reinier Kraakman, *Investment Companies as Guardian Shareholders: The Place of the MSIC in the Corporate Governance Debate*, 45 STAN. L. REV. 985 (1993) (examining whether a Swedish form of investment company could be useful in American corporate governance); Ronald J. Gilson & Reinier Kraakman, *Reinventing the Outside Director: An Agenda for Institutional Investors*, 43 STAN. L. REV. 863, 876 (1991) [hereinafter Gilson & Kraakman, *Reinventing the Outside Director*]; Ronald J. Gilson & Mark J. Roe, *Understanding the Japanese Keiretsu: Overlaps Between Corporate Governance and Industrial Organization*, 102 YALE L.J. 871 (1993); Martin Lipton & Steven A. Rosenblum, *A New System of Corporate Governance: The Quinquennial Election of Directors*, 58 U. CHI. L. REV. 187, 218-22 (1991) (drawing parallels to the German and Japanese systems); J. Mark Ramseyer, *Takeovers in Japan: Opportunism, Ideology and Corporate Control*, 35 UCLA L. REV. 1 (1987); Mark J. Roe, *A Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 59-62 (1991) (Germany) [hereinafter Roe, *A Political Theory*]; Mark J. Roe, *Some Differences in Corporate Structure in Germany, Japan and the United States*, 102 YALE L.J. 1927 (1993) [hereinafter Roe, *Some Differences*]; Symposium: *The American Corporation and The Institutional Investor: Are There Lessons from Abroad?*, 1988 COLUM. BUS. L. REV. 739.

These articles should be distinguished from the interesting and informative comparative work produced by foreign comparativists, which raise different issues. *See, e.g.*, Werner F. Ebke, *In Search of Alternatives: Comparative Reflections on Corporate Governance and the Independent Auditor's Responsibilities*, 79 NW. U. L. REV. 663 (1984); Klaus J. Hopt, *New Ways in Corporate Governance: European Experiments with Labor Representation on Corporate Boards*, 82 MICH. L. REV. 1338 (1984); Friedrich K. Kübler, *Institutional Owners and Corporate Managers: A German Dilemma*, 57 BROOK.

law scholars have focused on German bank centered corporate governance structures, as well as the Japanese bank centered keiretsu structure,[2] for alternatives to traditional U.S. forms. What is one to make of this development? The intuition that one can fruitfully transplant legal rules or institutions from one system to another is as old as the law itself.[3] The temptation is to try to get something for nothing, or at least at a discount.

In this Article, I want to focus on the specific emergence of the comparativist turn in American corporate law scholarship, to try to appraise the significance of the recent American fascination with German and Japanese corporate governance, and to consider what it tells us about the possible path dependance of corporate law scholarship. Before turning to the comparative scholarship, however, I will first try to put it into context by giving a quick and somewhat idiosyncratic overview of the modern history of corporate law scholarship in the United States.

I. THE BIRTH OF THE MODERN AGE: BERLE AND MEANS

Writing in the depths of the Great Depression, Adolf Berle and Gardiner Means set the course of modern American corporate law scholarship.[4] When one reads their great work, *The Modern Corporation and Private Property*,[5] the contemporary scholar finds its style and much of its content as familiar, as comfortable, as any recently published article. While many of its analyses and prescriptions are dated, it continues to define the field.

In their book, Berle, a law professor, and Means, an economist, set out to map the separation of ownership and control that they took to define the modern publicly held corporation. In Book I,[6] Berle and Means documented in detail the concentration of economic power in the largest corporations, the vast dispersion of ownership[7] and the mechanisms that managers used to maintain control over a corporation that they did not own. In Book

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L. REV. 97 (1991); Christian J. Meier-Schatz, *Corporate Governance and Legal Rules: A Transnational Look at Concepts and Problems of Internal Management Control*, 13 J. CORP. L. 431 (1988).

2. The term Keiretsu describes the Japanese system of cross-shareholding between related corporations. *See generally* Gilson & Roe, *supra* note 1.

3. For a marvelous historical account, see ALAN WATSON, LEGAL TRANSPLANTS (1974).

4. ADOLPH A. BERLE & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (rev. ed. 1991).

5. *Id.* My sense is that this is a book more cited rather than read. If true, it is unfortunate both because of the book's influence on modern scholarship as well as its still substantial merits as corporate law scholarship that bridges economics and legal doctrine.

6. *Id.* at 3-112.

7. In 1929, the largest shareholders of the largest corporations typically owned less than 1%; even the top 20 shareholders, in aggregate, owned no more than 4%.

II,[8] they described the declining legal restrictions on management, including the weakening of shareholder control over the direction of the enterprise,[9] the elimination of state supervision over contributions of capital,[10] the diminution of preemptive rights,[11] and the modifications of restrictions on dividends.[12] These two sections, which comprise the bulk of the book, led Berle and Means to claim that "under such conditions control may be held by the directors or titular managers who can employ the proxy machinery to become a self-perpetuating body, even though as a group they own but a small fraction of the stock outstanding."[13]

Berle and Means left an indelible stamp on American corporate law scholarship in two principal dimensions. First, and probably most significantly, they implicitly and explicitly defined the central *problem* for corporate law to be the separation of ownership and control, and defined the task of corporate law scholarship to be the correction or, at least, mitigation of the negative effects of the separation. Berle and Means argued that the law must protect the shareholders who, because of the separation of ownership and control, will inevitably be passive. Thus, Berle and Means gave American corporate law scholarship a practical, reformist style that persists to this day. As we will see, much of the ensuing sixty years of scholarship has been a search for the appropriate champion of shareholders' interests.

Second, Berle and Means' analysis began with economics and turned to legal and doctrinal issues only after a long empirical analysis. In so doing they implicitly claimed that economics drives corporate law, with respect to the issues that corporate law must address (the reformist point), as well as with respect to the evolution of legal doctrine. The theme of Book II is that the concentration of economic power and the separation of ownership from control led, through some unspecified mechanism, to the relaxation of legal controls over managers.[14] Here, too, Berle and Means' influence on corporate law scholarship has been so fundamental and deep-seated that American corporate law academics can hardly conceive of alternative approaches. Like Berle and Means, almost all corporate law scholars

8. BERLE & MEANS, *supra* note 4, at 119-244.
9. *Id.* at 128-31.
10. *Id.* at 131-33.
11. *Id.* at 133-35.
12. *Id.* at 135-36.
13. *Id.* at 6.
14. *Id.* at 119-244.

respond to the market and focus on the interaction between law and economics.

II. THE 1960S AND 1970S: THE BOARD OF DIRECTORS AS SHAREHOLDERS' CHAMPION

The normative model of the corporation reflected in most corporate statutes, as well as in Berle and Means' work, is that "the business and affairs of the corporation shall be managed by or under the direction of a board of directors."[15] On this model, the shareholders own the corporation and delegate the operation of the corporation to the directors, who then set policy and hire managers to execute that policy.

Berle and Means vigorously argued that the reality of the management-dominated corporation was inconsistent with this normative model. In the management-dominated corporation, managers run the show, choosing directors and operating free of any shareholder scrutiny.

This gap between the normative model and reality animated much of the corporate law scholarship of the period. Some proposed reforms that would bring corporate reality into line with the normative model.[16] Three institutional failings were thought to stand in the way of directors playing the role anticipated by the statute: constraints of time; constraints of information; and constraints of composition.[17] To redress directors' time constraints, a number of scholars proposed the creation of "professional directors," directors who, by virtue of being full-time, would have the time to behave as the normative model suggested.[18] Similarly, other scholars proposed that directors have their own separate staff, in order to give them the information and independent expertise necessary to direct the enterprise.[19]

These proposals—none of which was adopted—faced all of the predictable criticisms. Once a director becomes a full-time director, especially if appointed by the CEO, how does he or she differ from any of the other members of the management group? Would creating a "shadow staff," with responsibility for second guessing management but limited

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15. DEL. CODE ANN. tit. 8, § 141(a) (1991).

16. For a collection of articles that illustrate the populist concerns of scholars of the 1950s, see THE CORPORATION IN MODERN SOCIETY (Edward S. Mason ed., 1959).

17. For a discussion of these constraints, see MELVIN A. EISENBERG, THE STRUCTURE OF THE CORPORATION: A LEGAL ANALYSIS 141-48 (1976).

18. *See id.* at 150-52.

19. *See id.* at 154-56.

responsibility for the results, cause more harm than good? Would it be duplicative and interfere with the running of the company?

During this same period, the Securities Exchange Commission began to study mutual funds, and their distinctive problems. In a series of reports,[20] close attention was paid to governance problems of investment companies, culminating in the 1970 amendments to the Investment Company Act.[21] These amendments introduced a number of governance devices to mitigate the conflict of interest between the fund managers and the shareholders of the funds. Specifically, the Investment Company Act was amended to require that at least forty percent of the directors (or trustees) of an investment company be disinterested.[22] In addition, the Act requires that the advisory contracts between Fund X and Adviser Y be in writing, be approved by a vote of a majority of outstanding shares, and be approved by a majority of the disinterested directors of Fund X.[23] Both amendments were designed to strengthen the board of directors as a counterweight to, and monitor of, fund managers.

At around the same time, Melvin Eisenberg, in a series of articles written in the late 1960s and early 1970s, shifted the debate in an important direction.[24] He argued that the board of the modern, publicly held corporation cannot direct the operation of the enterprise, and none of the reform proposals of the 1960s was likely to permit it to do so. In the modern public corporation, the managers set policy, and no tinkering with

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20. *See, e.g.*, SECURITIES EXCH. COMM'N, REPORT ON THE PUBLIC POLICY IMPLICATIONS OF INVESTMENT COMPANY GROWTH, H.R. REP. NO. 2337, 89th Cong., 2d. Sess. (1966); SECURITIES EXCH. COMM'N, INSTITUTIONAL INVESTOR STUDY REPORT, H.R. Doc. No. 64, 92d Cong., 1st Sess. (1971); WHARTON SCH. OF FIN. AND COMMERCE, A STUDY OF MUTUAL FUNDS, H.R. REP. NO. 2274, 87th Cong., 2d Sess. (1962).

21. Investment Company Amendments Act of 1970, PUB. L. NO. 91-547, 84 Stat. 1413 (codified in scattered subsections of 15 U.S.C. § 80a). Mutual funds have a distinctive organizational form that differs from most other corporations. Mutual funds, or, in the terms used in the relevant statutes, "investment companies," are companies that invest in securities. Investment Company Act § 3(a), 15 U.S.C. § 80a-3(a) (1994). Typically, Fund X will be a corporation organized by Investment Adviser Firm Y which will manage Fund X for a fee that is usually a percentage of assets under management. Having organized Fund X, Adviser Y enters into a management contract with X, which then sells shares of X to the public—sometimes directly, sometimes through brokers. Mutual fund investors are thus shareholders of Fund X, who depend on the performance of Adviser Y for their returns.

22. Investment Company Act § 10(a), 15 U.S.C. § 80a-10(a). If an investment company has a regular broker or a principal underwriter on its board, a majority of the directors must be independent of the broker or underwriter. Investment Company Act § 10(b), 15 U.S.C. § 80a-10(b).

23. Investment Company Act § 15, 15 U.S.C. § 80a-15.

24. These articles were integrated to form Eisenberg's, *The Structure of the Corporation: A Legal Analysis*. EISENBERG, *supra* note 17.

the directors can change this.

So, argued Eisenberg, one needs to change the normative model to give the board a job that it can do. The job that Eisenberg carved out for the board is the now familiar notion that the board should monitor management.[25] He then set out to describe the changes in the structure of corporate governance necessary to permit the board to monitor management, generalizing from the mutual fund analysis.[26]

For directors to monitor managers on behalf of the (passive) shareholders, directors must have sufficient time, information and independence to do so. Otherwise, the new model would be undermined as the old normative model had been. Eisenberg thus argued for the establishment of committees of the board comprised of directors independent of management. Specifically, he proposed that an audit committee should be established, staffed by independent directors charged with the responsibility of hiring and firing the outside auditor, determining the appropriate accounting principles to be used in presenting the corporation's financial reports, and receiving reports from the auditors of any managerial malfeasance.[27] In order to prevent the CEO from packing the board with cronies, or undermining the independence of the board in more subtle ways, Eisenberg proposed that the committee responsible for nominating new directors and current directors for re-election should be comprised of independent directors. Similarly, because compensation of senior management is both critical to providing optimal incentives, and is the area in which conflicts of interest loom largest, the compensation committee should be comprised of independent directors. Finally, because the monitoring of senior management performance and the hiring and firing of senior management are the single most critical functions of the board, the board itself should either be exclusively comprised of independent directors or at least dominated by them.

During this reconceptualization of the board, a number of American corporate law academics, most prominently Alfred Conard and Detlev Vagts, focused American attention on the German two-tier board structure as an institutional alternative and as a suggestive model for reform in the United States.[28] Two of the proposals to address separation of ownership

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25. EISENBERG, *supra* note 17, at 162-68.

26. *Id.* at 56-63.

27. *Id.* at 205-09.

28. Alfred F. Conard, *Company Laws of the European Communities from an American Viewpoint*, *in* THE HARMONIZATION OF EUROPEAN COMPANY LAW 45, 52 (Clive M. Schmitthoff ed., 1973)

and control discussed in the mid-1960s were the appointment of a fiduciary to represent the shareholders[29] and the intervention of various financial intermediaries, particularly pension funds and investment trusts, that would gradually begin to exercise the powers to which their holdings entitle them.[30] Professor Vagts noted that

> [e]ach of the two approaches just suggested has its rough counterpart in German law. The German supervisory council represents a deliberate attempt to furnish the shareholders with a "watchdog" group to represent their interests, and the bankers' depositary vote is an intermediary that has evolved so as to concentrate voting power.[31]

Professor Conard was similarly taken with the German approach:

> The advantages of [the German] system may be more impressive to an American than to others because it is in the United States that the theory of management control was first articulated by Adolph Berle and Gardiner Means, and has been repeated in later studies. . . . Its most obvious advantage is that it provides a separate group of independent observers to decide how well the managers are doing. Because they meet separately from the managers whom they supervise, they are likely to be much more independent than the traditional "outside directors" of American boards, who usually meet only in the presence, and even under the chairmanship, of the inside managers. Moreover, this structure frees them from responsibility for the ordinary management decisions which are the proper business of the full-time executives.[32]

In addition to the two-tier board structure, Conard also focused on other distinctive legal features of the German approach, including co-determination, the existence of a separate legal regime for closely held companies, and the system of share certificates in bearer form and their transfer.[33]

[hereinafter Conrad, *Company Laws*]; Detlev Vagts, *Reforming the "Modern" Corporation: Perspectives from the German*, 80 HARV. L. REV. 23 (1966). *See also* Thomas J. Schoenbaum & Joachim Lieser, *Reform of the Structure of the American Corporation: The "Two Tier" Board Model*, 62 KY. L.J. 91 (1973). *See generally* EISENBERG, *supra* note 17, at 177-85. For later work from the same perspective, see Alfred F. Conard, *The Supervision of Corporate Management: A Comparison of Developments in European Community and United States Law*, 82 MICH. L. REV. 1459 (1984).

29. *See* Vagts, *supra* note 28, at 49 & n.107.

30. *See id.* at 49 & n.108.

31. *Id.* at 49-50.

32. Conard, *Company Laws*, *supra* note 28, at 52.

33. *Id.* at 54-55, 59-62. It is important to note that both Vagts and Conard were acutely aware of the dangers and difficulties of comparative approaches. *Id.* at 53 ("Even assuming that they work quite well in West Germany, one may well ask whether they will be equally effective elsewhere."). *See, e.g.*, Vagts, *supra* note 28, at 25 ("To approach German corporation law with the objective of gaining

III. THE 1980S: THE TAKEOVER ERA

Beginning in the 1980s, with the widespread and dramatic emergence of hostile takeovers in the United States, the focus of corporate law scholarship shifted dramatically away from the Eisenberg approach of focusing on legal and institutional mechanisms for controlling management discretion. In its place, scholars looked to the market, and, in particular, to the so called "market for corporate control" to protect shareholders from managerial abuse.[34]

Corporate control contests, which combined all of the attractions of high stakes poker and war, became the dominant focus of corporate law scholarship during the 1980s. While academics disagreed on the details, they shared a common and fundamental belief that the market for corporate control was the single most important constraint on corporate management and that the law should strive to maximize its effectiveness.[35] This market-based approach continued to dominate academic corporate law

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perspective on the American situation means that one must face head-on the two most difficult issues about any foreign legal institution: (a) How does it work over there? (b) How would it work over here?").

34. The story really begins with an extraordinarily prescient article from 1966 by Henry Manne called *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110 (1965). In this article, Manne argued that a significant cost of an antitrust policy that restricts horizontal mergers is that managers will be insulated from the market discipline imposed by the threat of takeovers. The keystone of Manne's argument was that competitors are the parties most likely to be able to recognize bad management, to be able to reverse it, and to have access to sufficient financing to acquire poorly managed firms. *Id.* a 112-13, 118-19. If this is correct—and it certainly seems to be—then the merger policy pursued by the Department of Justice in the 1960s, which almost entirely prohibited horizontal mergers, increased managerial dominance at the expense of shareholders.

Beginning in 1980, with the election of Ronald Reagan and, more importantly for these purposes, the appointment of William Baxter as head of the Antitrust Division of the Justice Department, U.S. policy on horizontal mergers changed nearly 180 degrees. Suddenly, horizontal mergers, even between large firms with relatively large market shares, were permissible. This brought a large number of eager and high valuing buyers into the market for corporate control and set off a decade long merger boom. In the prototypical 1980s' "bust up" takeover, an acquirer would pay a large premium over prevailing market price for a company. Then the acquirer would sell off pieces to buyers from the same industry, buyers who had previously been excluded from the market.

35. For representative and prominent examples, see the academic debate over whether target management should be passive in the face of a hostile tender offer or whether they should have the limited power to seek competing bids. *Compare* Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161 (1981) and Frank H. Easterbrook & Daniel R. Fischel, *Auctions and Sunk Costs in Tender Offers*, 35 STAN. L. REV. 1 (1982) *with* Lucian A. Bebchuk, *The Case for Facilitating Competing Tender Offers*, 95 HARV. L. REV. 1028 (1982) *and* Ronald J. Gilson, *Seeking Competitive Bids Versus Pure Passivity in Tender Offer Defense*, 35 STAN. L. REV. 51 (1982).

throughout the 1980s and represented a fundamentally different approach than either the Eisenberg institutional reform program or the managerialism of corporate management and the lawyers who typically represented them.

IV. THE 1990S: THE NEW INSTITUTIONALISM

Then the music stopped. In the late 1980s, in the wake of the 1987 market crash, the downfall of Drexel Burnham Lambert, the determination by the U.S. Supreme Court that the anti-takeover statutes passed by many states were constitutional,[36] and the decision of the Delaware Supreme Court in the *Time Warner* case,[37] which was widely interpreted as permitting target managers to "just say no", the age of hostile tender offers died. Suddenly, the shareholders' champion of the 1980s—the market for corporate control—seemed to wither away. Wall Street firms laid off or reassigned takeover lawyers. Takeover artists shifted their attention (at least temporarily) to managing the assets they had acquired. Michael Milken went to jail. And corporate law academics looked for something else to write about.

Like Rip Van Winkle waking from a fifty-year sleep, corporate law academics returned to the Berle and Means paradigm, but the world seemed to have changed. In place of the widely dispersed shareholdings chronicled by Berle and Means, we found that shareholding had become much more concentrated. Now, we had a group of very large and increasingly active institutional investors.[38] Moreover, institutional holdings were (and continue to be) concentrated in relatively few institutions, at least in comparison to the Berle and Means corporation.[39]

Moreover, these institutional investors seemed to have finally found their voice. Some began high profile campaigns against management-imposed

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36. CTS Corp. v. Dynamics Corp. of America, 481 U.S. 69 (1987).

37. Paramount Communications, Inc. v. Time Inc., 571 A.2d 1140 (Del. 1990). It turned out that the *Time-Warner* decision did not protect target managers to the extent anticipated. *See* Paramount Communications, Inc. v. QVC Network, Inc., 637 A.2d 34 (Del. 1994).

38. *See generally* Edward B. Rock, *The Logic and (Uncertain) Significance of Institutional Shareholder Activism*, 79 GEO. L.J. 445 (1991). Between 1950 and 1989, pension funds went from owning less than 1% of equities to holding in excess of 26%. *Id.* at 447. Institutional investors as a group (pension funds, mutual funds, insurance companies, bank-managed funds and charitable and educational endowments) went from holding 8% of equities to more than 45%. *Id.* Of the top 50 U.S. corporations ranked by 1989 stock market value, 45 had institutional ownership in excess of 33% and 25 in excess of 50%, and many with even more. *Id.*

39. The twenty largest pension funds account for about 26% of the total pension fund assets. *Id.* at 447-48.

takeover defenses and scored significant victories.[40] Institutional investors also forced out poorly performing managers.[41]

Also during the early 1990s, Mark Roe began to revisit the political history of American corporate law.[42] In an important series of articles, Roe argued that the fragmentation of American shareholding and the traditional passivity of American shareholders was not the inevitable result of economic growth, as argued by Berle and Means, but was largely the result of a series of political choices. Roe suggested that American populism combined with interest group politics and the structure of American federalism may have led to the fragmentation of the American banking system (with many states confining banks to a single branch), as compared to the national banking systems that characterize Germany and Japan.[43] Likewise, these same forces, Roe argued, may have led to prohibitions on shareholding by insurance companies for most of the twentieth century,[44] as well as regulatory limitations on mutual funds.[45]

Scholars began to write on two different aspects of the same problem. One group of articles focused on the rise of institutional investors. Within this group, there was sharp disagreement over the significance of this change and the extent to which institutional investors were likely to emerge as shareholders' champions. In the optimists' camp, scholars argued that, if only we removed the regulatory barriers to institutional investor activism, the newly energized shareholders would assume their rightful place as shareholders' champions, acting as effective monitors of management.[46] In making this argument, the optimists, of course, were following in the footsteps of Berle and Means in taking the task of corporate law to be the

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40. Rock, *supra* note 38, at 478-90.

41. *Id.*

42. Roe, *A Political Theory*, *supra* note 1; Mark J. Roe, *Foundations of Corporate Finance: The 1906 Pacification of the Insurance Industry*, 93 COLUM. L. REV. 639 (1993) [hereinafter Roe, *Foundations of Corporate Finance*]; Mark J. Roe, *Political and Legal Restraints on Ownership and Control of Public Companies*, 27 J. FIN. ECON. 7 (1990); Mark J. Roe, *Political Elements in the Creation of a Mutual Fund Industry*, 139 U. PA. L. REV. 1469 (1991) [hereinafter Roe, *Political Elements*]. These articles provided the basis for Roe's book, MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE (1994).

43. *See* Roe, *Some Differences*, *supra* note 1.

44. *See* Roe, *Foundations of Corporate Finance*, *supra* note 42.

45. *See* Roe, *Political Elements*, *supra* note 42.

46. Bernard S. Black, *Agents Watching Agents: The Promise of Institutional Investor Voice*, 39 UCLA L. REV. 811 (1992); Bernard S. Black, *Shareholder Passivity Reexamined*, 89 MICH. L. REV. 520 (1990); Gilson & Kraakman, *Reinventing the Outside Director*, *supra* note 1, at 871; Joseph Grundfest, *The Subordination of American Capital*, 27 J. FIN. ECON. 89 (1990).

reformist task of adjusting the law to solve the problem of the separation of ownership and control.

On the other side of the debate, scholars argued that institutional investors are unlikely to fulfill their promise.[47] The critique has followed a number of paths. First, there is little evidence that corporate governance activism increases shareholder returns. Second, to the extent that the rise of institutional investors helps to solve the collective action problem identified by Berle and Means, it does so by means of agents who bring with them all of the agency problems so familiar from the corporate context. The managers of institutional investors, the money managers, face conflicts of interest between their duty to maximize the value of their portfolio, and pressure from corporate management, exerted in a variety of ways. While managers of public employee pension funds—the most prominent institutional investor activists—are relatively immune from pressure from corporate management, they are particularly susceptible to political pressure.[48] Moreover, the incentives facing institutional money managers depart sharply from those of their beneficiaries: The agents, unlike the beneficiaries, benefit from corporate governance activism only if it provides a selective benefit, not if it leads to a systemic improvement. Systemic improvements, while increasing the value of the managed portfolio, also increase the value of the portfolio of competing money managers as well. The lack of incentives is aggravated by the fact that managers of widely diversified funds compete to be the low-cost provider, leaving little to invest in monitoring corporate managers.

Finally, the market and institutional checks on money managers are, in fact, weaker than those on corporate managers. Takeovers are impossible. Capital market checks are non-existent because institutional investors are suppliers rather than purchasers of capital. The market for money managers supplies an uncertain constraint as it is unclear that active monitoring is valued in that market. Finally, product market checks, while in some cases significant, vary from institutional investor to institutional investor, with many beneficiaries locked in. Legal checks are not much better insofar as courts have been even less active in enforcing the duty of loyalty and duty of care than in the corporate context.

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47. *See, e.g.*, Coffee, *supra* note 1; Edward B. Rock, *Controlling the Dark Side of Relational Investing*, 15 CARDOZO L. REV. 987 (1994); Rock, *supra* note 38, at 505; Roberta Romano, *Public Pension Fund Activism in Corporate Governance Reconsidered*, 93 COLUM. L. REV. 795 (1993).

48. Rock, *supra* note 38, at 471-72; Romano, *supra* note 47.

V. PROFESSOR ROE'S NEW COMPARATIVISM

The domestic debate over institutional investors led some scholars to look abroad, to discover the role played by institutional investors in other systems and to analyze the differences in regulatory treatment. Whereas, in the 1960s and 1970s, American legal scholars, like Professors Vagts and Conard, looked to German corporate law for alternative legal/institutional arrangements—principally, the two-tier board and, to a lesser extent, co-determination—attention was now directed to a very different sort of comparative analysis, namely, the analysis of alternative economic governance structures. In particular, U.S. scholars have focused on the relatively prominent role that large banks play in Germany and Japan, as compared to the United States.[49]

In this context, comparative analyses are important for two reasons. First, if governance structures are fundamentally different in other highly industrialized and highly successful market economies, such as Germany and Japan, then perhaps they *could* have been different in the United States. This goes to the question of whether the Berle and Means corporation is an economic inevitability, as they suggested, or is, in large measure, the product of a series of political choices, as Roe argues. Second, and more reformist, if the structures *could have been* different, perhaps they *should* be different. Perhaps America would be better off freeing its shareholders, especially its large banks, so that they can play a role similar to that played by large German and Japanese banks.

On the first claim, the comparative evidence is important and persuasive. As Roe has argued, the fact that governance is organized differently, and apparently successfully in other large industrialized economies undermines any claim of inevitability to the Berle and Means corporation.[50] To the extent that differences in corporate governance correlate with differences in financial regulation, it lends support to Roe's hypothesis that the politics of financial intermediation is a key determinant to corporate structure. In the same context, Roe argues against the claim that Germany and Japan simply lag behind America's financial evolution, and thus against the argument that, in time, finance liquifies and disintermediates. While acknowledging that the boardroom power of the large German and Japanese

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49. *See, e.g.*, Roe, *Some Differences*, *supra* note 1.

50. *See id.* For perceptive critiques of Roe's article, see J. Mark Ramseyer, *Columbia Cartel Launches Bid for Japanese Firms*, 102 YALE L.J. 2005 (1993); Roberta Romano, *A Cautionary Note on Drawing Lessons from Comparative Corporate Law*, 102 YALE L.J. 2021 (1993).

banks is under stress from the increased securitization of debt (which displaces bank lending) and the internationalization of financial markets, banks' stock ownership and control through the proxy system has remained constant or increased.[51]

It is the second, reformist claim that is the most interesting and controversial. In this regard, one should focus again on Mark Roe's work. The promise of the German and Japanese systems, to some American eyes, is that they offer the benefits of close and active supervision, without the costs of the hostile tender offers of the 1980s. Thus, Professor Roe wrote in 1991:

> Certainly concentrated control by financial institutions is imaginable: Japanese and German corporate ownership is quite concentrated; their financial institutions are more actively involved in their companies than are financial institutions in the United States. Daimler-Benz, the automotive concern that is the largest German industrial company, has a 28% shareholder, Deutsche Bank. When managerial infighting recently left the company without clear direction, the bank replaced Daimler-Benz' senior management without the organizational violence of a hostile takeover.[52]

Professor Roe does not make the more dramatic claim that the United States would be better off freeing its banks so that they could play the kind of role played by banks in Germany or Japan. The world, Roe recognizes, is a very complicated place, and the present options depend in significant measure on history (i.e, development is "path-dependent.").[53] But the more dramatic suggestion lurks in the background, sometimes more prominently, sometimes less, and even if Roe does not make the claim, others will. It is this suggestion that I want to consider. What should one make of these comparisons?

There are a number of points that one can make. First, the view of German corporate governance in which the three big banks play an

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51. Roe, *Some Differences*, *supra* note 1, at 1958-62.

52. Roe, *A Political Theory*, *supra* note 1, at 15. For a longer, more detailed, and more cautious assessment, *see* Roe, *Some Differences*, *supra* note 1, at 1977-95. For suggestions that insurers could play a more important role in the U.S., as they do in Germany, except for regulatory restrictions, see Roe, *Foundations of Corporate Finance*, *supra* note 42, at 641-42.

Roe, however, is clearly aware that this alternative monitoring structure may carry significant costs of its own. *See, e.g.*, Roe, *A Political Theory*, *supra* note 1, at 61 ("To be sure, [banks] may not take the stock to monitor, but to force controlled companies to take loans or do deals."). Roe also advocates the use of "comparative studies to learn when the close ties between banks and industry in Japan and Germany are beneficial and when they are detrimental." *Id.* at 62.

53. Roe, *Some Differences*, *supra* note 1, at 1992-93.

important and constructive role as management monitors may be somewhat unrecognizable to the German corporate law community. When I presented this paper in Frankfurt, the lawyers and bankers in the audience found it extraordinary that anyone should think that the system in fact worked this way. In their view, the large banks played a far less significant and far less constructive role.[54] Along these same lines, the effectiveness of the large German banks as monitors of management perhaps looked better a few years ago than today, after the disaster at Metalgesellschaft.[55]

Second, and more provocative, what is one to make of the fact that General Motors' German subsidiary, Opel, is generally considered to be as well-managed as other German car companies? This is a problem for any claim that the United States should free its banks, because G.M. is an oft-cited example of what is so wrong with American corporate governance. How is it that Opel, with such a parent (and no *hausbank*), has been successful? One response is that Opel fits the model because it has a large shareholder, G.M. But that response fails because so do Chevrolet, Oldsmobile and the other poorly performing divisions of G.M. A second response is that the German car market is an oligopoly, and it is easy for managers to look good when there are oligopoly profits. However, this argument, even if true, would prove too much: Daimler-Benz is *likewise* a car company.[56] This, of course, leaves standing Roe's deeper and more fundamental argument against the inevitability of the Berle Means corporation: The fact that Daimler-Benz and General Motors are organized differently at the top proves that alternative governance structures are economically possible.

Third, of course, German fields looked much greener when the United States was stuck in a recession and Germany seemed to be prospering than if things had been the other way around. The tone of comparative corporate scholarship has changed over the last few years as the U.S. economy has

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54. But German audiences may have a different baseline: While banks may seem to play a small role in German boardrooms, their role may still be substantially greater than their role in U.S. boardrooms.

55. In December 1994, Metallgersellschaft, one of Germany's largest industrial conglomerates, nearly collapsed after taking huge losses on derivatives. *See Metallgesellschaft: Germany's Corporate Whodunnit*, ECONOMIST, Feb. 4, 1995, at 71. Some experts blame Deutsche Bank's premature intervention for the fiasco. *Id.*

56. Neither Roe's example of Deutsche Bank's relationship with Daimler-Benz in Roe, *A Political Theory*, *supra* note 1, at 15, nor my counterexample of Opel, is, of course, anything more than anecdotal evidence. As I discuss more below, the success of either could be due to factors other than corporate governance structures.

bounced back and Germany and Japan have lagged, and may change with the business cycle yet again as Germany and Japan pull out of recession.

Fourth, we do not know whether the bank centered structure that has historically characterized Germany and Japan is primarily driven by corporate governance concerns.[57] As Mark Roe and Ronald Gilson have argued,[58] the Japanese keiretsu structure may be as much about establishing an efficient form of industrial organization to support a distinctive relationship between firms and their suppliers/customers, as it is about constraining agency costs.[59] Similarly, an alternative hypothesis about German corporate governance is that the bank's role largely revolves around preserving and expanding its lending activities, with only secondary (or tertiary) attention to corporate governance.

Fifth, what evidence supports the implicit premise that German and Japanese firms are more productive than U.S. firms? The best evidence seems to indicate that this assertion—sometimes taken to be self-evidently true in the U.S.—is false or, at least, unsupported.[60]

Professor Roe explicitly makes a more modest (but still important and controversial) reformist point that avoids many of these criticisms. Roe argues that if comparative work shows that different governance structures are possible between countries, then we should reform domestic law to permit governance structures to compete within the U.S. system.[61] If different governance structures are possible, and if different structures have different advantages and disadvantages in different contexts, then why not let them compete within the U.S. system, and not just in the competition between the United States and Germany or the United States and Japan? On this point, I am in complete agreement with Roe: Where possible, competition among governance structures within the U.S. system should be facilitated. Here, Roe's comparative analysis demonstrating the historical and political contingency of the U.S. structure of corporate governance has significant payoffs in the domestic debate. There is, however, a further question, which I will address in more detail below, over the extent to which competing governance systems are possible within a given corporate

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57. Romano, *supra* note 50, at 2033.

58. *See* Gilson & Roe, *supra* note 1.

59. *Id.*

60. For a review of the evidence, see Romano, *supra* note 50, at 2023-26.

61. *See* Roe, *Some Differences*, *supra* note 1, at 1989-97. A comparison of Roe, *A Political Theory*, *supra* note 1, with Roe, *Some Differences*, *supra* note 1, suggests that Professor Roe may have tempered his reformist impulses in the intervening years.

law.[62]

To the extent that regulations that have outlived their usefulness stand in the way of the exercise of institutional voice, Roe argues, we should at least consider removing such blockages. In this approach, the critical analytical questions become whether particular regulations have, in fact, outlived their usefulness, the extent to which they stand in the way of an expanded role for institutional investors, and the transition costs.

Examples of such regulations are the SEC proxy rules restricting communication among shareholders.[63] Because of the expansive definitions of "proxy" and "solicitation," informal communication among large shareholders on matters of common concern posed a significant legal risk.[64] Cautious shareholders would not proceed without first preclearing all "proxy solicitation" materials with the SEC, an expensive and time consuming process.[65] In reforming the proxy rules to ease the restrictions on communications among shareholders, the SEC eliminated (a few) barriers to the evolution of alternative governance structures without either mandating the adoption of such structures or exposing shareholders to significant dangers.[66]

VI. PROFESSOR BUXBAUM'S COMPARATIVE LEGITIMATION THESIS

I now want to turn to a different contemporary approach to comparative corporate law. If the older comparative approach of Professor Vagts and Conard[67] looked to Germany for potential legal transplants, and if the newer comparative analyses of Professor Roe and others looked to Germany and Japan for alternative economic governance structures, Professor Richard Buxbaum has taken yet a third approach. Among American law professors, no one rivals Professor Buxbaum in "his intimate

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62. *See infra* Part VIII.

63. 17 C.F.R. §§ 240.14a-1 to 240.14b-2 (1995).

64. Rule 14a-1(f) defines a proxy as every "proxy, consent or authorization within the meaning of section 14(a) of the Act." 17 C.F.R. § 14a-1(f) (1995). Solicitation includes "any request for a proxy, . . . [a]ny request to execute or not to execute, or to revoke, a proxy; . . . or . . . [t]he furnishing of a form of proxy or other communication to security holders under circumstances reasonably calculated to result in the procurement, withholding or revocation of proxy." 17 C.F.R. § 14a-1(1).

65. *See generally* Bernard S. Black, *Disclosure, Not Censorship: The Case for Proxy Reform*, 17 J. CORP. L. 49 (1991).

66. *See* Regulation of Communications Among Shareholders, Exchange Act Release No. 31,326, [1992 Transfer Binder] Fed. Sec. L. Rep. (CCH) ¶ 85,051 (Oct. 16, 1992) (describing the changes to rules 14a-1, 14a-2 and 14a-6, 17 C.F.R. §§ 240.14a-1, 240.14a-2 & 240.14a-6 (1993)).

67. *See supra* note 28 and accompanying text.

knowledge and perfect understanding of German law."[68] Like others, Buxbaum found the new prominence of institutional investors an occasion for a comparative perspective.[69]

Buxbaum's comparative corporate law scholarship includes two types of comparative analysis, one fairly conventional, another less so.[70] In the conventional part of his analysis, Buxbaum, relying on the German experience, questions a number of provocative predictions of the future of the American corporation. In response to Michael Jensen's somewhat infamous (and, so far at least, inaccurate) prediction of the eclipse of the publicly held corporation by the LBO association,[71] Buxbaum draws important insight on the limits of private corporate structures from Germany.[72] Similarly, Buxbaum convincingly describes the historical contingency of the German *hausbank* structure, thereby questioning the likelihood or possibility of American evolution towards such an approach.[73]

What distinguishes Buxbaum's comparativism is the less conventional—and more problematic—aspect of his analysis, namely, the way in which he seems to draw on the critical theory of the Frankfurt School[74] as a source of insight into the comparative legitimating roles of institutional investors.

> The old legitimating ideology—the myth of shareholder supremacy—had to be abandoned once institutional shareholdership threatened to make it real; but giving that new ownership a pejorative connotation is at best a defensive tactic, but hardly a legitimating ideology. That can only be found through cooperation with these new institutions that, after all, represent all of us in our capacity as salary and wage earners.
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> In addition—and not in contradiction—the liberal economic premise on which this managerialist version of corporatism would function faces a severe test once ecological imperatives are expected to be operationally satisfied

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68. Kübler, *supra* note 1, at 97.

69. Buxbaum, *supra* note 1.

70. Although I will focus largely Buxbaum's article on institutional investors, *supra* note 1, attention should also be paid to Richard Buxbaum, *Juridification and Legitimation Problems in American Enterprise Law*, in JURIDIFICATION OF SOCIAL SPHERES: A COMPARATIVE ANALYSIS IN THE AREAS OF LABOR, CORPORATE, ANTITRUST AND SOCIAL WELFARE LAW (Gunther Teubner ed., 1987).

71. Michael Jensen, *Eclipse of the Public Corporation*, HARV. BUS. REV., Sept.-Oct. 1989, at 61 (arguing that the publicly held corporation is being replaced by the LBO association).

72. Buxbaum, *supra* note 1, at 26-27.

73. *Id.* at 34-40.

74. For an example of the scholarship of the leading modern figure of the Frankfurt School, see JURGEN HABERMAS, LEGITIMATION CRISIS (Thomas A. McCarthy trans., 1975).

> within its framework. . . . This, more than concern with the negative consequences of exposing corporate decision-making to the short-term mentality of stock and control markets, is what dictates a new respect for a different, longer term vision of corporate behavior. And this vision, unlike the adversarial vision of institutional investors as short-term profligates that underlies the narrow view of short-term versus long-term decision-making immanent in the liberal economy, needs the cooperation of institutional ownership with corporate management to be realized. Further, that cooperative venture now has a unique opportunity to be realized. It can find in the wage-based origin of much of that institutional ownership a unique and perhaps the only enduring legitimation for embarking on the voyage to integrate ecological and efficiency concerns in a new statement of corporate missions and processes.[75]

Buxbaum then turns to an analysis of the conditions necessary for the evolution of a "combined ecologic-economic frame of reference" that will adequately internalize "the social costs inherent in an appropriately long-range view of production and distribution policies that are sound from environmental and social perspectives."[76] Only large institutional intermediaries can accomplish this, and they can only do so if they have:

> mechanisms to express their values to their portfolio firms more directly than is feasible by means of voting or acting in the capital and, especially, the control market (though they need those, too). In the second place, they need mechanisms to formulate these postulated values within their own boundaries before transmitting them to those firms, in order to legitimate their own behavior and decisions.[77]

Buxbaum then turns to German legal/doctrinal structures not for their capacity to provide new mechanisms for solving the Berle and Means problem of separation of ownership and control, but, rather, for their potential to provide legitimating structures in the changing American context. From this perspective, the two favorites of American comparativists—codetermination and the two-tier board structure—become interesting in so far as they provide models through which institutional

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75. Buxbaum, *supra* note 1, at 28-29 (citation omitted). For less comparative approaches to the legitimacy of the American corporation, see JAMES W. HURST, THE LEGITIMACY OF THE BUSINESS CORPORATION IN THE LAW OF THE UNITED STATES 1780-1970 (1970); Robert Chatov, *The Role of Ideology in the American Corporation*, *in* THE CORPORATE DILEMMA: TRADITIONAL VALUES VERSUS CONTEMPORARY PROBLEMS (D. Votaw & S. Sethi eds., 1973); Gerald Frug, *The Ideology of Bureaucracy in American Law*, 97 HARV. L. REV. 1276 (1984).

76. Buxbaum, *supra* note 1, at 29.

77. *Id.* at 30.

investors can legitimate corporate structures and in the extent to which institutional investors can themselves be legitimated through their roles in such structures. The two-tier board, on Buxbaum's analysis, helps provide a mechanism for systematic input by institutional investors. Codetermination is important in helping to undermine the traditional assumption of hostility between labor and capital. Finally, in terms of the legitimation of the institutional investors themselves and the formulation of an appropriate ecologic-economic frame of reference, Buxbaum rejects various forms of pass-through voting, finding "the German experience with employee intermediaries and with their selection [to] be instructive."[78] Buxbaum finds that "the elected business agent of the union, in those sectors which still boast of unions, is the obvious model" of an "intermediate employee institution[] specifically designed to elicit and transmit employee views . . . to the portfolio-voting intermediaries."[79] In this connection, Buxbaum also tentatively supports "fund advisory or managing boards substantially elected by their beneficiaries."[80]

To the Anglo-American sensibility, Buxbaum's approach is problematic for two reasons. First, by immersing himself so deeply in German legal culture, he illustrates another danger faced by comparativists, the problem of "going native." If some comparative analysis is undermined by an insufficient understanding of the foreign system, Buxbaum runs the opposite risk, the risk of becoming incomprehensible to the American corporate law audience. Concepts like "legitimation," however familiar they may be in the German context, are foreign to the Berle and Means tradition of corporate governance scholarship described earlier.

The second problem with Buxbaum's analysis is that it is very difficult to give the concept of "legitimation" non-trivial content, much less to employ it. If "legitimation" means something like *"to make legitimate in the eyes of society,"* then it immediately raises a host of theoretical and empirical questions. Do legal or economic structures lead to a belief in the legitimacy of corporations? What is the mechanism by which legal or economic structures make an institution legitimate in the eyes of society? How do you measure how legitimate an institution is? By public opinion surveys? What is the basis for Buxbaum's assumption that there is a corporate "legitimation crisis" or his speculation that institutional investors can "solve" that crisis? This passing critique, of course, does nothing more

78. Buxbaum, *supra* note 1, at 49-50.
79. *Id.*
80. *Id.* at 52.

than recapitulate the debate over the utility of "legitimation" as a sociological construct.[81]

VII. EVALUATION

What, then, are we to make of the comparativism of Professor Roe or Professor Buxbaum? Return to the observation that Opel, G.M.'s wholly-owned German subsidiary, is generally considered to be a reasonably well-managed German corporation. If the presence or absence of a *hausbank* does not explain the success of Opel, or, by extension, those successful German firms that have a *hausbank*, we must look elsewhere for an explanation.[82]

This leads us to a number of fundamental and rather embarrassing holes at the center of corporate governance scholarship: What is the connection, if any, between corporate governance structures and corporate performance? Even if there is a connection, what is the mechanism that links corporate "law" with corporate performance?

The assumption of sixty years of corporate governance scholarship has been that such a connection exists. Berle and Means assumed that the separation of ownership and control and the resulting powerlessness of shareholders led to worse performance. Eisenberg and the other scholars who reconceptualized the board as a monitor of management seemed to have assumed that a company with a board dominated by independent outside directors would perform better than a company with a management dominated board.[83] Those heralding the hostile takeover boom of the 1980s assumed that a competitive market for corporate control led to more effective management.[84] Those heralding the new prominence of institutional investors in the late 1980s have likewise assumed that companies with large active shareholders will outperform the Berle and Means

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81. For a careful and critical assessment of the utility of the concept of "legitimation" in U.S. legal scholarship, see Alan Hyde, *The Concept of Legitimation in the Sociology of Law*, 1983 WIS. L. REV. 379.

82. On this point, Roe and I largely agree. *See* Roe, *Some Differences*, *supra* note 1, at 1934-35.

83. *See supra* notes 24-27 and accompanying text.

84. While there is substantial evidence that the takeovers of the 1980s benefited shareholders through large premiums, we do not know whether these are one shot gains arising from the influx of new, higher valuing buyers sparked by the relaxation of the restrictions on horizontal mergers, or whether these represent long term reduction in agency costs. For a review of the evidence on shareholder gains, see Roberta Romano, *A Guide to Takeovers: Theory, Evidence, and Regulation*, 9 YALE J. REG. 119 (1992).

managerial firm.[85]

While each of these claims makes some sense—they could be true—the supporting evidence does not exist. While there is a great deal of fragmentary evidence pointing in different directions, we do not have anything approaching convincing evidence, nor any robust theoretical models, on any of the most interesting questions.[86] Do outside directors improve corporate performance? We really do not know.[87] What about concentrated shareholdings? While there is some evidence that firms with concentrated holdings outperform firms with dispersed holdings,[88] we know little about the direction of causation: Do institutional investors improve corporate performance or, rather, do they choose to invest in firms with superior performance?

Likewise, we do not know how corporate law affects corporate behavior. Some sort of direct deterrence (or even "hydraulic") model is implicit in the standard 1980s argument that the threat of hostile takeovers will induce managers, even of non-target firms, to manage better: The pressure of tender offers will push all managers to manage better to keep their jobs. But a direct deterrence model is implausible, because both the likelihood of displacement and the direct costs are relatively small. Moreover, if the direct deterrence model were correct, one would expect a large decline in mangerial performance when Delaware amended its corporation law to permit firms to opt out of directorial liability for breaches of the duty of

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85. *See, e.g.*, Jensen, *supra* note 71.

86. For a very optimistic recent survey of the empirical evidence, see Bernard Black, *The Value of Institutional Investor Monitoring: The Empirical Evidence*, 39 UCLA L. REV. 895 (1992). The most recent work likewise fails to find any robust correlation between governance structures and firm performance, although progress is being made in teasing out the more subtle connections. *See, e.g.*, April Klein, Firm Production and Board Committee Structure, (April 1995) (Stern School of Business (NYU) Working Paper, on file with author); James A. Brickley et al., Corporate Leadership Structure: On the Separation of the Positions of CEO and Chairman of the Board, (August 23, 1995) (working paper, on file with author); David Yermack, Higher Market Valuation of Companies with a Small Board of Directors (July 1995) (Stern School of Business (NYU) Working Paper, on file with author).

87. For a recent survey of research on the connection between outside directors and firm performance, see Sanji Bhagert & Bernard Black, Do Independent Directors Matter? (Jan. 1996) (working paper, on file with author). Whether and how corporate governance affects performance is a very complicated issue. One would need to sort out the extent to which governance structure affects the decisions made, and, when it does, whether and when the effects are positive or negative. A failure, for example, to detect any systematic correlation between governance structure and performance might be the result of governance not affecting the decisions made, or might result from governance leading to better decisions and worse decisions with equal frequency.

88. *Id.*

care.[89] If the principal sanction is reputational, we know little about how this sanction works.[90]

Thus, it is unclear how we explain why G.M.'s German subsidiary performs reasonably well despite its American corporate governance structure and much maligned parent company. The answer puts the whole debate over corporate governance into an important perspective. The three best candidates for explaining Opel's (and Daimler Benz's) performance are likely to be the nature of Europe's automobile markets, the nature of Germany's managerial labor market, and the social norms internalized by German managers. As a general matter, product and labor markets and social norms seem to trump corporate governance structures in determining success or failure by a wide margin.[91]

Consider competitive product markets. Where markets are highly competitive, such as California's high-tech industry in Silicon Valley, the concerns that preoccupy corporate law academics worrying about corporate governance are non-issues. If managers slack off or steal from the firm or build inefficient empires, the firm fails in short order and a firm without such problems takes its place. In other words, highly competitive product markets root out suboptimal governance structures before corporate law needs to pay any attention.

This brings us back, in part, to Henry Manne's point in the article on *Mergers and the Market for Corporate Control*.[92] Competition policy and corporate law are intimately linked. On the one hand, a competition policy that prohibits all horizontal mergers in the interests of maintaining competitive product markets undermines the market for corporate control by removing the most likely acquirers. On the other hand, a competition policy that permits horizontal mergers that create market power undermines the competitiveness of the product markets that hold managers' feet to the fire.

Second, the example of G.M.'s German subsidiary reminds us that social norms play an enormously important role in the management of corporations, as they do in other areas of our social life. Because it is difficult for economic theorists to model norms, those of us who follow the Berle and Means economic approach to corporate law tend to ignore them.

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89. DEL. CODE ANN. tit. 8 § 102b(7) (1991).

90. For an exploration of these issues, see Edward B. Rock, Saints and Sinners: The Peculiar Mechanisms of Delaware Corporate Law (1996) (working paper, on file with author).

91. *See* Roe, *Some Differences*, *supra* note 1, at 1994.

92. Manne, *supra* note 34.

To the extent that German corporate governance works at the level of establishing and promoting norms of conduct for German managers and not on a behaviorist model of stimulus and response—sticks and carrots—the comparative task becomes incomparably more difficult. Unless German managers are motivated by the same things that motivate American managers, there is little reason to believe that the normative structures of German corporate life have very much to say to America. The comparativist's problem, of course, is that there is, in fact, little reason to believe that German managers *are* motivated by the same things as American managers. The vast differences in the level of compensation between the U.S., Germany and Japan suggest just the opposite.[93]

Now return to Professor Buxbaum. Perhaps he is asking a fundamentally different question. The question that has motivated many American corporate law scholars since Berle and Means, and certainly much recent scholarship, has been, at heart, the question of how we can make managers sufficiently accountable so that they will manage the corporation for the shareholders. For Buxbaum, by contrast, the really interesting question is why society permits the establishment and persistence of massive private concentrations of economic and political power over which the political process exercises relatively little control.

This contrast suggests another level on which comparative corporate law can be important, beyond the new comparativist's claims that the contrasting corporate structures of Germany and Japan are evidence that American structures are not inevitable, are not necessarily a product of natural economic selection, but are, rather, the product of a complicated process of social choice—Professor Roe's central thesis. Professor Buxbaum reminds us that the fact—if indeed it is a fact—that other corporate law systems take radically different questions to be fundamental should make us wary of being too confident that the central preoccupations of American corporate law are inevitable or as fundamental as we might initially believe. They, too, may be the historically contingent product of a complicated process of social choice. That is to say, corporate law scholarship, like corporate governance itself, may be path dependent.

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93. *See* GRAEF CRYSTAL, IN SEARCH OF EXCESS: THE COMPENSATION OF AMERICAN EXECUTIVES 204-13 (1991) (showing that German CEOs earn approximately one-quarter of their U.S. counterparts). Differences in compensation are ambiguous. It may be that the differences in compensation policy grow, in part, out of the difference in governance structures, or that both grow out of differences in managerial norms and culture.

VIII. CONCLUSION: PATH DEPENDENCE AND THE DIRECTION OF COMPARATIVE CORPORATE LAW SCHOLARSHIP

The United States, Japan and the countries of Western Europe all have successful advanced industrial economies. Likewise, all have their own distinctive histories: of politics, of economics, and of financial regulation. Examining them today, one finds that the countries have distinctive and distinguishable systems of corporate law. In Delaware, for example, one finds a system of flexible enabling rules. This flexibility is balanced by the ever present judicial scrutiny that operates under a rubric of fiduciary duty and employs rather murky standards. In Germany, mandatory rules play a much greater role with a relatively marginal role for judges. In some countries, pre-emptive rights are mandatory; in others, they are not. In some countries, a bidder who acquires more than a certain percentage of the shares must make a bid for the remainder; in other countries, such is not the case.

The tremendous variety of approaches to corporate law that one sees in a comparative survey, combined with an attention to the specific and distinctive histories of financial regulation, cautions against any straightforward attempt at transplanting. It also pushes comparative law in a fundamentally different direction.

Suppose that one assumes, because of product market competition, for example, that each of the advanced industrial economies has a reasonably adequate body of corporate law. On this assumption, the comparative project provides an opportunity to try to grapple with two fundamental questions of corporate law. First, what problems must a corporate law system, broadly construed, solve in order to be reasonably adequate to an advanced industrial economy? Second, what is the range of alternative legal structures that can respond to those problems, and, perhaps more intriguingly, how do these structures cluster?

Roe's argument for allowing different governance structures to compete within the Untied States is tempting, especially to those of us who consider the engine for the development of improved governance structures to be competition: in product markets, labor markets, capital markets and among states for chartering revenue. One can hardly quarrel with a proposal to open up the choice of governance forms to new entry from abroad.

Here, the range of possibilities is critical. A striking difference between countries like the United States and the United Kingdom, on one side, and Germany and France on the other, is the difference between a strikingly

permissive corporate law combined with active judicial review versus a more restrictive law with less judicial involvement. If, in fact, corporate governance devices, broadly construed, cluster together in identifiable sets, then the range of potential choices may be limited. To the extent that German governance devices—two-tier boards, *hausbanks*, or whatever else seems particularly attractive—presuppose a system of mandatory rules and limited judicial involvement, then the possibility of offering such devices as an option in the very different U.S. system becomes problematic for two reasons. First, such forms may have limited appeal when mixed with the Delaware structure (not itself, of course, a reason not to offer the possibility). More troubling, to the extent that such governance forms depend on structural features of the corporate law system, introducing them into a different structure may have unpredictable negative effects.

Similarly, the notion that the open-textured enabling approach of Delaware corporate law provides an appropriate model for newly emerging market economies in the former Eastern Bloc may founder on the lack of a reliable court system, not to mention the absence of courts with the sophistication of the Delaware Chancery Court.[94] If judicial scrutiny is, in fact, an essential complement to an enabling approach to corporate law, an open question, then one cannot take advantage of its benefits without the appropriate institutional infrastructure.

We know much about corporate law doctrine in different systems. We know a fair bit about how corporate law works in practice in different countries. We know a fair bit about the history of different systems. We know little, however, about the deep structure, or internal logic of corporate law. Indeed, we do not even know whether any such structure exists. Comparative corporate law, at its best, provides an opportunity to search for such an underlying basis.

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94. For a discussion of corporate law in Russia, see Bernard S. Black & Reinier Kraakman, *A Self-Enforcing Model of Corporate Law*, 109 HARV. L. REV. (forthcoming 1996).