The Evolution of the American Corporation and Global Organizational Biodiversity

Ugo Pagano[*]

I. INTRODUCTION

The Evolution of the Modern Corporate Structure has been one of the most influential chapters of *The Modern Corporation and Private Property*.[1] But a limit of Adolf A. Berle and Gardiner C. Means's influential analysis is that it is framed in the American context and cannot be easily generalized to other experiences. Their corporate model arose in a democratic country where "production engineers"[2] commanded more respect than financiers and capitalist dynasties. Other countries evolved along different organizational paths. Different institutional complementarities between labor and financial markets generated "concentrated equilibria" different from the American "dispersed equilibrium." This Article argues that the roots of this divide can be found in the different aristocratic and democratic origins of the two systems, and that organizational biodiversity is still an important feature of the global economy.

The work of Berle and Means included a careful study of the evolution occurring in the United States during the interwar period.[3] Berle and Means described how the corporation evolved as a product of decentralization of powers formerly monopolized by the states.[4] Similar processes

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1. ADOLF A. BERLE, JR. & GARDINER C. MEANS, THE MODERN CORPORATION AND PRIVATE PROPERTY (Harcourt, Brace & World, Inc. rev. ed. 1967) (1932).

2. THORSTEIN VEBLEN, THE ENGINEERS AND THE PRICE SYSTEM 69 (1921) ("These [highly trained and specially gifted experts], technologists, engineers, or whatever name may best suit them, make up the indispensible General Staff of the industrial system; and without their immediate and unremitting guidance and correction the industrial system will not work. It is a mechanically organized structure of technical processes designed, installed and conducted by these production engineers.").

3. *See generally* BERLE & MEANS, *supra* note 1.

4. *Id.*

were at work in other countries as well, and Berle and Means's analysis could be seen as a useful guide for the general evolution of capitalism.[5] But the advent of the new organizational species, which was to become known as the "Berle and Means Public Company," required a complex political process. Thus, the asymmetric political conditions of different countries were bound to have a strong influence on its institutional structure.[6]

As argued by Mark J. Roe, different political conditions, such as social democracy, cause important impacts on corporate-governance systems.[7] Conversely, different corporate-governance systems can generate different political reactions.[8] On one hand, social democracy can be seen as a set of political conditions impeding the separation between ownership and control and the development of the public company.[9] On the other hand, social democracy can also be seen as a reaction to a concentrated family-based corporate-governance system.[10] M. Belloc and I have shown that causation runs both ways: from politics to corporate governance and vice versa.[11]

Politics and corporate governance co-evolve. Initial conditions in history can have a decisive role in shaping a process of cumulative causation—where the political conditions existing when "big business" emerged in a country play a decisive role in the structure of its future

5. *See, e.g.*, FERNAND BRAUDEL, THE PERSPECTIVE OF THE WORLD: CIVILIZATION AND CAPITALISM 15TH–18TH CENTURY (Harper & Row 1984) (1979); BARRINGTON MOORE, JR., SOCIAL ORIGINS OF DICTATORSHIP AND DEMOCRACY (1966); A HISTORY OF CORPORATE GOVERNANCE AROUND THE WORLD: FAMILY BUSINESS GROUPS TO PROFESSIONAL MANAGERS (Randall K. Morck ed., 2005) [hereinafter HISTORY OF CORPORATE GOVERNANCE].

6. For an ample overview of the corporate-governance systems of different countries, see the essays contained in HISTORY OF CORPORATE GOVERNANCE, *supra* note 5. Corporate systems with concentrated ownership are considered in CONCENTRATED CORPORATE OWNERSHIP (Randall K. Morck ed., 2000). Lon Fuller pointed out how the firm involves a decentralization of a public ordering into a private ordering where some transactions are centralized—a point that is particularly evident in the case of the modern corporation. LON L. FULLER, THE MORALITY OF LAW (2d ed. 1969); *see also* Lynn A. Stout, *On the Nature of Corporations*, 2005 U. ILL. L. REV. 253, 253–67. I previously integrated Fuller's approach with the Coasian approach using the Cathedral framework, which was developed by G. Calabresi and A. Douglas Melamed. Ugo Pagano, *Marrying in the Cathedral: A Framework for the Analysis of Corporate Governance*, *in* THE LAW AND ECONOMICS OF CORPORATE GOVERNANCE 264–89 (Alessio M. Paccesed ed., 2010) (citing Guido Calabresi & A. Douglas Melamed, *Property Rules, Liability Rules, and Inalienability: One View of the Cathedral*, 85 HARV. L. REV. 1089 (1972)).

7. MARK J. ROE, POLITICAL DETERMINANTS OF CORPORATE GOVERNANCE: POLITICAL CONTEXT, CORPORATE IMPACT 1–3 (2003).

8. *See id.* at 112–13.

9. Marianna Belloc & Ugo Pagano, *Politics–Business Interaction Paths* 5–6 (CESifo, Working Paper No. 2883, June 2010), *available at* http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1623774.

10. *Id.*

11. *Id.* at 19–20.

institutions of production.[12] Berle and Means considered the evolution of the corporation in a special framework where, at the time of the second Industrial Revolution, a robust democracy already existed.[13] The *democratic roots* of the American system of corporate governance are unique[14] (with the possible exception of Switzerland).[15] In our times, the uniqueness of the American experience is hidden by its dominant role in the world economy.[16] American dominance has turned an exceptional pattern into an apparent norm that other countries are supposed to follow.[17]

If a robust democratic system had already developed by the time of the emergence of large enterprises, then the concentration of economic power in the wealthy would likely have been challenged and limited by democratic political action.[18] But the power of the labor unions was often limited by political constraints put in place by those acting in the interests of employers.[19] In the United States, trade unions turned out to be less popular and powerful than in most other capitalist countries.[20] As a result of these political constraints, neither the employers nor the workers had to balance the concentration of power of the other side. This was a case of a "dispersed equilibrium"—where neither workers nor owners fully organized because a democratic state was in charge and able to limit the power of other centralized organizations. These democratic roots marked the particular setting where the Berle and Means Public Company emerged.

12. *See id.*

13. ALFRED D. CHANDLER, JR., SCALE AND SCOPE: THE DYNAMICS OF INDUSTRIAL CAPITALISM 47–49 (1990). *See generally* BERLE & MEANS, *supra* note 1.

14. Randall K. Morck & Lloyd Steier, *The Global History of Corporate Governance: An Introduction*, *in* HISTORY OF CORPORATE GOVERNANCE, *supra* note 5, at 1–2. Marco Becht and J. Bradford DeLong introduced their interesting paper by considering the two (related) sources of American exceptionalism: "A century ago European academics like Werner Sombart worried why the United States was exceptional, in that it had no socialism. Today we academics worry about a different form of American exceptionalism: why is there so little block holding in the United States?" Marco Becht & J. Bradford DeLong, *Why has There Been So Little Block Holding in America?*, *in* HISTORY OF CORPORATE GOVERNANCE, *supra* note 5, at 613.

15. *See infra* text accompanying note 40.

16. *See* Becht & DeLong, *supra* note 14, at 621–22.

17. *See id.*

18. MARK J. ROE, STRONG MANAGERS, WEAK OWNERS: THE POLITICAL ROOTS OF AMERICAN CORPORATE FINANCE 26–29 (1994).

19. *See, e.g.*, IRVING BERNSTEIN, TURBULENT YEARS: A HISTORY OF THE AMERICAN WORKER 1933–1941 (1969); ROBERT JUSTIN GOLDSTEIN, POLITICAL REPRESSION IN MODERN AMERICA: FROM 1870 TO THE PRESENT (1978); WILLIAM G. ROY, SOCIALIZING AMERICA: THE RISE OF THE LARGE INDUSTRIAL CORPORATION IN AMERICA (1997).

20. *See* Morton Keller, *Regulation of Large Enterprise*, *in* MANAGERIAL HIERARCHIES 161, 170–74 (Alfred D. Chandler, Jr. & Herman Darms eds., 1980).

Most countries have had different evolutionary paths. If a robust democratic system had not emerged before the development of the large capitalist enterprises, then the unchecked, concentrated power of the capitalist dynasties would go well beyond their private wealth.[21] In that case, union and social-democratic power would likely arise as a counterbalance and later be an important ingredient in the democratization of society. The result of that process would be that both workers and employers could find justification for the concentration of their own interests in the high degree of concentration of the other's interests, generating a fairly stable, concentrated equilibrium.

Concentrated equilibria are likely to have *aristocratic roots*[22] in the sense that the existence of dynastic privileges and social exclusion also favor a concentration of workers' interests. Because dynastic and aristocratic privileges were still widespread outside of the United States at the time of the second Industrial Revolution,[23] it is not surprising that a pattern different from the one illustrated by Berle and Means was followed by other capitalist countries.

The Berle and Means Public Companies theory, which built upon Veblen's works on the corporate model, offers a popular counter-narrative to today's history-silent neoclassical approach to understanding corporate governance. Its strength lies in applying the Darwinian evolutionary construct to the development of modern institutions with a focus on the American context. But its limitations are twofold. First, it assumes that the singular American example is sufficient to determine a pattern that can then be applied as a roadmap to other regions. Second, it ignores the critical role of biodiversity to the Darwinian construct, and therefore fails to apply that part of the evolutionary equation to institutions.

This Article builds upon the Berle and Means Public Companies theory by deconstructing these two limitations. It considers the evolutionary paths of several well-documented European systems, and then compares and contrasts the effects of their aristocratic roots to the very different democratic roots present in America. Finally, it argues that "organizational biodiversity" is an important feature of the global economy, just as actual biodiversity is a critical feature of natural ecologies.

Part II of this Article examines how each type of equilibrium forms in response to different political environments and influences the actors within it. Part III discusses the two types of political roots from which modern corporate governance grows: aristocratic roots and democratic

21. *See* MOORE, *supra* note 5, at 20–22.

22. In Part IV, I show that there has been a considerable variety of aristocratic political and social roots.

23. *See, e.g.*, CHANDLER, *supra* note 13; MOORE, *supra* note 5.

roots. Part III also examines examples of corporations modeling themselves after the operating governmental structures and demonstrates that the corporate structures are influenced significantly by their political environments.

Part IV explores how aristocratic roots grow different types of equilibria, expounding on the rich diversity that the aristocratic roots in Europe have produced compared to the unique case of democratic roots in America. Part V counters the assertion that a single Anglo-American model of corporate governance exists between the United States and the United Kingdom, and demonstrates that their similarities grow instead from different roots and that their differences are actually significant. In addition, Part V discusses how corporate and governmental structures can exert coevolutionary pressures on each other. Finally, Part VI discusses the relationship between labor and financial markets.

II. SAFEGUARDS FOR SPECIFICITY AND COLLECTIVE ACTION

In this Part, I discuss the pressure driving equilibrium by analyzing the risks and opportunities available to three key types of actors within the economic system: owners, managers, and workers. Furthermore, I consider how different political environments can influence how equilibrium is reached.

Nobel Prize-winning economist Oliver Williamson observed that labor and financial markets share an important characteristic distinguishing them from intermediate-product markets: in both cases, the individuals make specific investments and, at the same time, face a collective action problem.[24]

Information asymmetries characterize both cases. But according to Williamson, the asymmetric-information problem is more serious in the case of the relationship between shareholders and directors because the latter can easily collude with top management.[25] The integrity of decision-making delegation—the most remarkable advantage of the public company—would be lost if shareholders have to rebalance information asymmetries in a way similar to that characterizing the relationship between the workers and their representatives. Thus, according to Williamson, shareholder democracy can easily degenerate into oligarchy[26]—a

24. Oliver Williamson, Speech at the Corporate Social Responsibility and Corporate Governance International Economic Association (IEA) Research Workshop: Corporate Governance and Managerial Discretion Revisited—The Lens of Contract/Governance Perspective (July 12, 2006).

25. *Id.*

26. *Id.*

point that was forcefully made in Berle and Means's path-breaking contribution.[27]

The difference between the collective action problems faced by workers and shareholders is related to the inseparability between human capital and its owner, which has no counterpart in the case of nonhuman capital. Because of this inseparability, the problem of "absentee ownership" is obviously less severe in the case of human capital. Even the most absent-minded individuals cannot be really absent when their human capital is being used by others! Unsurprisingly, information asymmetries between workers and union leaders are less severe than those occurring between shareholders and directors.

Besides the impossibility of absentee ownership, the human capital of an individual is also characterized by the fact that others cannot own it. For this reason, the ownership of human capital is also characterized by two other restrictions. On one hand, all the human capital of an individual must be concentrated in the hands of that individual. On the other hand, the ownership of different individuals must be dispersed among them. The ownership of shares is therefore potentially more concentrated or dispersed than that of human capital. One does not need to own all the shares of a firm in the same way one owns all the shares of his or her human capital. At the same time, one can be the owner of shares of different firms, whereas in modern societies, it is impossible to own percentages of other human beings.

If we focus our attention only on the concentration of our human capital in one person and the possible dispersion of shares among many individuals, we reach Williamson's conclusion: the collective action of the shareholders is harder to overcome than the collective-action problem of the workers.[28]

But the opposite may also be true. The ownership of capital is not necessarily dispersed; it can be more concentrated than that of labor. From this point of view, shareholders can overcome their collective-action problem more easily than workers. There are many ways in which owners can concentrate their ability to control capital well beyond what would be allowed by their personal wealth. One of them has recently attracted much attention in the literature: the possibility of building wealth through pyramids—structures developed when a firm controls several companies that in turn own several more.[29]

27. BERLE & MEANS, *supra* note 1, at 83.

28. Williamson, *supra* note 24.

29. *See, e.g.*, Randall Morck et al., *Corporate Governance, Economic Entrenchment, and Growth*, 43 J. ECON. LIT. 655, 657 (2005).

Specific assets need to be safeguarded against the possible opportunism of the owners of other assets. Unlike general purpose assets, specific assets cannot easily find alternative employment if they happen to be treated unfairly in their present positions.

Within certain limits, there may be no tradeoffs between employers' and workers' safeguards. For instance, some degree of job security may enhance workers' welfare, productivity, and firm value. Both types of safeguards can contribute to high levels of investment and efficiency. But after a certain limit, a tradeoff among these safeguards will exist. Moreover, in many cases, the safeguards that are necessary to protect the investments of one group of individuals will depend on the level of safeguards that are achieved by the others. Weak or robust safeguards for both capital and labor may be the key ingredients of two self-sustaining equilibria analogous to the high- and low-armament equilibria arising in a standard arms-race game.[30]

Also, nonowning managers need safeguards for their specific investments in human capital. Managers are often required to make "second-order" specific investments to govern the relations arising from the specific investments of other agents.[31] In the case of these specific investments, the general purpose rules and enforcement that govern public markets may be inadequate. Managers are required to set up and rule private orderings that are designed to deal with these specific investments. In turn, their own skills acquire a "second-order specificity" to deal with the specific relations that they structure and run. Thus, managers may require safeguards for their own second-order specific investments.

Suppose that managers try to achieve an "efficiency frontier" where, given a certain level of their own specific investments, the investments of the other individuals (workers and shareholders) are stimulated as much as possible by using appropriate safeguards. Even in these cases, at least along this efficiency frontier, some tradeoffs are likely to arise. If workers have strong safeguards in their jobs, managers may lack the authority to carry out their plans and to safeguard their own specific investments in human capital. Similarly, allowing managers excessive

30. *See* Marianna Belloc & Ugo Pagano, *Co-evolution of Politics and Corporate Governance*, 29 INT'L REV. L. & ECON. 106, 108 (2009). In an arms-race, the incentive to invest in armaments depends on the level of investments in weapons made by the potential enemy. Low-armament and high-armament equilibria are both possible outcomes of this game.

31. See Ugo Pagano, *Public Markets, Private Orderings and Corporate Governance*, 20 INT'L REV. L. & ECON. 453, 470–71 (2000), which stated,

> high "second order" specific investment in the appropriate private orderings were necessary to guarantee a more efficient cooperation [between managers involved in creating GM products]. In other words, the purpose of the merger seems to be an introduction of a system of private governance where some fair exercise of power could decrease the hold-up risks faced by all the agents investing in cospecific human capital.

authority may easily jeopardize workers' specific investments. Certain arrangements—such as allowing shareholders to easily fire or sue the managers—may give strong safeguards for financial investments, but they may discourage the (second-order) specific investments of the managers. If managers have a high degree of job security, then their specific investments in their company may be encouraged, but their security may scare shareholders who find it too difficult to get rid of an opportunistic manager.

Because the ownership of capital can be more concentrated or dispersed than labor power, we cannot a priori say which factor may more easily overcome its collective action problems and eventually gain more safeguards at the expenses of other factors. There is, however, an interesting asymmetry.

The control of capital can be concentrated by ordinary market transactions well beyond the control of labor power and, thanks to devices such as pyramids, the concentration of power made possible by the wealth of the richest families. Thus, in the absence of political constraints, when economies of scale favor large-scale enterprises, the ownership of capital will be easily concentrated in a few hands through the effect of ordinary market contracts. By contrast, labor interests cannot be concentrated by using simple economic transactions. A collective action problem must necessarily be solved. For this reason, the political conditions existing in different countries matter, and those conditions that prevailed at the time of the emergence of big firms are particularly influential with regard to the path of that nation's institutional development.

A strong democracy is likely to find the unilateral concentration of economic wealth in a few dynasties to be unhealthy and will try to set limits on the concentration of economic power. This may also weaken the incentives to build labor organizations that can balance the concentrated interests of the owners. By contrast, if a strong democracy is absent and there is widespread acceptance of dynastic rules, a few families can easily rule large enterprises. In this case, a social-democratic reaction would likely take place after some time, which would result in concentration of the interests of both owners and workers.

If a democracy was already established by the time large enterprises became important for economic development, the concentration of interests of capital owners could be tamed. In this sense, the Berle and Means Corporation required fairly uncommon "political roots," which produced a set of tradeoffs very favorable to managers and tamed the concentration of shareholders' (and eventually workers') interests. In most countries, such a democratic state was missing at the dawn of the growth of big business, and they were bound to follow different institutional paths.

The state has two crucial roles, one as a model for and another as a constraint on corporations. As states decentralized, they lost the monopoly on being a legal person but maintained influence by bestowing their model upon civil society. Each state's model of organization had a crucial role in shaping the nature of the corporations in that particular country. An aristocratic state, ruled by few, was likely to generate relatively more dynastically ruled corporations than a democratic state.

The state was not only a model for the corporations but was also a limiter of the power to incorporate. Without such limits, the power to incorporate allowed the possibility of economic empires of unprecedented dimensions that could easily challenge the state's own power. The Berle and Means Corporation emerged as a particular answer to this challenge. Antimonopoly legislation and the inhibition of pyramids (and of other ways by which partial ownership could multiply their influence) were only some of the tools available to an early democratic state. More important was the emerging principle that "[c]orporations are essentially political constructs"[32] and can "be made subject to those limitations which inhibit state action to protect individual freedom."[33] In this case, it was the model of the democratic state to set limits on the organizations to which it had granted some of its typical privileges.

III. ARISTOCRATIC AND DEMOCRATIC ROOTS OF CORPORATE GOVERNANCE

This Part compares two idealized examples of the *democratic* versus *aristocratic political roots* of modern corporate governance. It also provides examples of corporations modeling themselves after the operating governmental structures and demonstrates that the corporate structures are significantly influenced by their political environments. Though this Part extrapolates from real-life historical processes, it asserts that an analysis of these extreme cases is useful for comparing the actual institutional pattern followed by different countries.

The case of *aristocratic roots* can be schematized as follows. For a long time, society was accustomed to a concentration of political and economic power in the hands of a few families, such as a royal family or an aristocracy. The rule of dynastic succession had been accepted as the legitimate way of transmitting political and economic power, and upward mobility was discouraged. Individuals were supposed to fill the same social roles of their parents, and upwardly mobile individuals were often

32. BERLE & MEANS, *supra* note 1, at xxvi.
33. *Id.* at xviii.

despised.[34] When large firms became the dominant vehicle for economic development, the new industrial aristocracy, which controlled firms beyond even the means of their considerable wealth, was not challenged by an established democratic state. The new industrial giants were embedded in a society where, despite numerous rebellions, dynastic power was still widespread and accepted as legitimate. Capitalist dynasties could increase their power thanks to their own wealth and accumulation of capital, which was allowed by large-scale firms. They could also extend their control beyond their wealth thanks to pyramids and other financial arrangements. Members of the large owning families served as managers of the firms. Small shareholders had no chance to fire these "dynastic" managers, and professional managers were confronted with a socially exclusive group of wealthy individuals who enjoyed a de facto tenure thanks to their family links. Faced with the concentrated interests of capitalist dynasties, workers reacted by concentrating their interests into unions and social-democratic parties.

The story of *democratic roots* can be told in an analogous way. Society's wealth was relatively dispersed and political power was handled through democratic mechanisms, though often with the exclusion of a large majority of society. The rule of dynastic succession had been removed from the political arena, even if it was widespread in the economic arena, which was dominated by small firms. Individuals were not supposed to fill the same social roles as their parents and upwardly mobile individuals commanded high social esteem. When large firms emerged as the most efficient form of organization in many sectors, the extension of dynastic rule to these organizations was met with opposition by a large part of society. Smaller owners were scared of being out-competed by large organizations, minority shareholders were ready to defend their rights, professional managers felt cheated by the role that family connections played in their careers, and most important, politicians who gained office through democratic competition felt threatened by the power of the new industrial aristocracies. Industrial dynasties were not allowed to increase their power beyond the limits of their wealth, and they faced a sharp choice between the advantages of asset diversification and concentrated control. In the absence of dynastically concentrated control, workers' incentive to concentrate their power in unions was also rather weak.

34. According to Ernest Gellner, these social and cultural barriers characterized all ancient agrarian societies. ERNEST GELLNER, NATIONS AND NATIONALISM 29–32 (1983). Industrialization was associated with cultural homogenization and nationalism that allowed individuals to be more horizontally and vertically mobile. *Id.* at 22–23. For a discussion on Gellner's contribution to political economy, see generally Ugo Pagano, *Nationalism, Development and Integration: The Political Economy of Ernest Gellner*, 27 CAMBRIDGE J. ECON . 623 (2003).

In this situation, professional managers could become the rulers of Berle and Means Corporations.

There are several reasons why different political roots could entrench each system of corporate governance. This Article will now focus on two reasons that stem from the analysis contained in the preceding section.

The first reason is considered by Mark Roe's theory that relates concentrated control with social democracy.[35] Even if the growth of strong unions and social democracy was initially stimulated by the preexistence of concentrated, private dynastic power, their formation made the persistence of this power more likely. Once strong unions exist, professional managers are more likely to be captured by the interests of the workers. Shareholders need to concentrate their interests to balance the safeguards and rights that the workers may obtain.

A concentrated equilibrium may arise where both the workers and the majority-block shareholder have strong safeguards, while managers (and often minority shareholders) have weak safeguards. By contrast, a dispersed equilibrium may occur if the concentrated control of the large firms is not allowed to arise. In this case, a fair internal labor market may weaken the incentive to unionize. Thus, even if the weakness of the unions is an effect of the dispersion of ownership, owners can still delegate control to managers because unions are weak. This "disarmament equilibrium" generates the implicit conditions necessary for the high degree of managerial independence that characterize the Berle and Means Corporation.

The second reason why the dispersed and concentrated equilibria may be stable has to do with the "specificity argument" that we have considered in the preceding section.

Different political roots favor safeguards and rights that in turn stimulate particular investments, which biases technology toward developing in a certain direction.[36] Rights and safeguards stimulate specific

35. *See* ROE, *supra* note 7, at 3–5 ("[S]ocial democracies denigrate the modern pro-shareholder tools—such as incentive compensation, hostile takeovers, shareholder wealth maximization norms, etc.—because it is *not* their policy to promote purely shareholder values.").

36. For more information on the relationship between technological characteristics, property rights, and organizational form, see Ugo Pagano, *Bounded Rationality and Institutionalism*, *in* THE EVOLUTION OF ECONOMIC INSTITUTIONS: A CRITICAL READER 19 (Geoffrey M. Hodgson ed., 2007) [hereinafter *Bounded Rationality*]; Ugo Pagano, *Property Rights, Asset Specificity, and the Division of Labour Under Alternative Capitalist Relations*, 15 CAMBRIDGE J. ECON. 315 (1991), *reprinted in* THE ECONOMICS OF INSTITUTIONS (Geoffrey M. Hodgson ed., 1993); Ugo Pagano, *Interlocking Complementarities and Institutional Change*, 7 J. INSTL. ECON. 373 (2011) [hereinafter *Interlocking Complementarities*]. It is estimated that the direction of causation from ownership, organization, and organizational form to technology "turns out to be stronger than the reverse." John S. Earle, Ugo

investments, and sunk costs favor the organization of these vested interests, reinforcing the safeguards and rights that inspired them. Thus, self-reinforcing multiple-organizational equilibria may arise from the interaction between the nature of the factors that are used and the allocation of property rights, and may define different paths of institutional and technological change.

For instance, a concentrated equilibrium creates strong safeguards for the members of the owning family to make specific investments in the firm. And because of the counterbalancing safeguards, workers may also have some similar incentives. By contrast, managers in this equilibrium have weak incentives to make these specific investments.

At the same time, the existence of these specific investments makes both family owners and workers more willing to increase their security in the organization. The opposite argument holds for professional managers, who may not claim appropriate safeguards for their specific skills because in absence of these safeguards, they have invested negligible amounts in firm-specific human capital. The distribution of rights tends to generate complementary technologies, which entrenches the status quo.

Because of these two (and other)[37] mechanisms, aristocratic and democratic roots can entrench corporate-governance systems in a concentrated or dispersed equilibrium.

In this argument, *concentration* and *dispersion* refer to the organization of the interests of owners and workers. In terms of the size of the firms, the implications may be rather different. Indeed, a concentrated equilibrium is likely to be characterized by firms that tend to be smaller than those characterizing a dispersed equilibrium. Even if family dynasties have numerous means to expand their control well beyond the limits set by their wealth, there are still limits to that expansion. In most cases, the only possible way to keep the firm under control is to limit its size and, often, its efficiency. By contrast, as Berle and Means noted, the dispersion of ownership was a *centrifugal force* complementary to, and indeed often necessary for, concentration of power in the hands of a few corporate managers.[38] Impeding the dispersion of ownership could be tantamount to encouraging the concentration of economic power and inefficiently constraining the size of firms.

Pagano & Maria Lesi, *Information Technology, Organizational Form, and Transition to the Market*, 60 J. ECON. BEHAV. & ORG. 471, 472 (2006).

37. *See, e.g.*, Morck et al., *supra* note 29, at 657.

38. BERLE & MEANS, *supra* note 1, at 9 (noting that the dispersion of ownership is complemented by a "centripetal force, tending more and more to concentrate [power] in the hands of a few corporate managers").

IV. The European Model and the American Exception

Most countries have gone through a laborious transition from the feudal order typical of agrarian societies to some form of capitalist organization. At the time of the second Industrial Revolution, when large firms started to become dominant in some sectors, the residual political prestige of the aristocracy and the aristocratic aspirations of the bourgeoisie were still evident in Europe. Only the United States manifested as an important exception to this pattern. In no other country was the Veblenian instinct for workmanship so appreciated relative to pure pecuniary acquisition, and dynastic privileges so despised.[39]

With reference to actual historical experiences, the theoretical scheme considered in the preceding Part involves a striking asymmetry. While the case of aristocratic roots covers many historical cases, the case of democratic roots includes only one important case—the United States. Indeed, there are so many historical cases of aristocratic roots that contrasting a stylized general model of aristocratic roots to the American experience has obvious limitations.

With the exception of the United States and possibly Switzerland,[40] large organizations in all major capitalist economies had aristocratic roots in the specific sense outlined in the preceding Part. At the time of the second Industrial Revolution, aristocratic dynastic succession still had a strong legitimacy in society. Cultural class barriers were strong and accepted, and the aristocracy still had a disproportionate influence in political affairs. Democratization was taking place in most of these countries, but unlike the case of the United States, the process was heavily

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39. Veblen emphasized the contrast between workmanship, pecuniary instincts, and the progressive role of engineers with respect to businessmen and other people that receive their earnings from the trade and ownership of industrial property. VEBLEN, *supra* note 2, at 41–45; *see also* ESSENTIAL WRITINGS OF THORSTEIN VEBLEN (Charles Camic & Geoffrey M. Hodgson eds., 2011); Charles R. T. O'Kelley, *Berle and Veblen: An Intellectual Connection*, 34 SEATTLE U. L. REV. 1317 (2011). Veblen's approach involved the belief that habits of thought and institutional complementarities played an important role in the evolution of society. Charles Camic & Geoffrey M. Hodgson, *Introduction* to ESSENTIAL WRITINGS OF THORSTEIN VEBLEN, *supra*, at 20. For a comparison of the Veblen approach with the neoclassical analysis based on unbounded rational actors, see generally Pagano, *Bounded Rationality*, *supra* note 36.

40. Switzerland also achieved early liberation from feudal relations. *See* JONATHAN STEINBERG, WHY SWITZERLAND? 46 (2d ed. 1996). Swiss feudal ties were traditionally weak. The peasants were difficult to dominate because they were often far from urban centers on Alpine pastures and had good military training (often serving as highly sought-after mercenaries throughout Europe). *Id.* at 17, 21–23. After the defeat of the Sonderbund alliance, formed in 1847 by the conservative and Catholic Cantons, the "Swiss Confederation or, more accurately, some twenty-three leading figures in it, drafted a document so suited to the conditions that the Switzerland of 1849 and of 1847 seem to belong to different eras." *Id.* at 47. Similar to the United States (where the American Civil War terminated the political influence of the slave-owning aristocracy of the South), Swiss big business had democratic roots in the sense that a full-blown post-feudal society had already emerged before the second Industrial Revolution. *See id.* at 55–57.

influenced by the various roles that the landed aristocracy had played in capitalist development.

In his classic book, *Social Origins of Dictatorship and Democracy*, Barrington Moore pointed out that the behavior of the landed aristocracy was rather different in the industrializing European countries.[41] In England, a strong landed aristocracy was the leading factor in the initial phase of modernization.[42] The aristocracy was open to some integration of other wealthy individuals and adopted a positive attitude toward industrialization.[43] The aristocracy was the most important force in the "Puritan Revolution," which eventually led to the establishment of a constitutional monarchy.[44] But because of the flexibility of the British aristocracy, all sorts of dynastic privileges were legitimate during the second Industrial Revolution.[45] Members of the aristocratic families that belonged to the proper aristocratic circles were controlling firms much beyond their financial opportunities, and for those outside of the proper class, a managerial career was rather difficult.[46] On the other side of the social divide, class barriers gave strong incentives for the development of unions and socialist politics. For a long time, a concentrated equilibrium characterized British firms. The following section considers in what sense this equilibrium has disintegrated and whether an "Anglo-American" model of corporate governance can be discerned. For the moment, we can observe that, in spite of—or perhaps because of—the metamorphosis of the British aristocracy, it is appropriate to consider Britain as an evident case of the aristocratic roots of corporate governance.

Whereas the aristocracy became an important, active force in the British economic and political transformation, the French aristocracy continued to rely on traditional feudal privileges.[47] In England, a mutating aristocracy carried out the process of modernization against the King.[48] In France, with the support of an emerging bourgeois class and of a growing centralized bureaucracy, the King imposed modernization on a static aristocracy.[49] French absolutism, not British aristocratic-parliamentary democracy, was the prevailing trend in France before the

41. MOORE, *supra* note 5.
42. *Id.* at 8–9, 13.
43. *Id.* at 29–30.
44. *Id.* at 19–20.
45. *Id.* at 425.
46. *See id.* at 37.
47. *Id.* at 40.
48. *Id.* at 16 ("In England the main dirty work of [destroying the ancient régime] was the symbolic act of beheading Charles I.").
49. *Id.* at 57.

French Revolution. The revolution, in some respects, completed the work of the Bourbons.[50] While the French Revolution gave a democratic turn to the modernization of France, the post-Napoleonic reaction implied that at the time of the second Industrial Revolution, class barriers and aristocratic political privileges were still important in France.[51] In order to get top managerial jobs, proper manners and good family connections mattered more than abilities and hard work. Workers reacted to these class barriers by forming unions and engaging in various rebellious activities.

France and England took different paths to democratization and modernization. But at the time of the second Industrial Revolution, both countries were still characterized by both an aristocracy with pervasive political power and a widespread acceptance of dynastic privilege. In both countries, most individuals were excluded from this system of privileges, which led them to organize into unions and socialist parties. Also, many professional managers had little autonomy and power in their firms because they were beholden to aristocratic interests.

The weight of the aristocracy was even heavier in European countries that industrialized later. In England, the landed aristocracy adopted many entrepreneurial habits; in Germany, it was the entrepreneurs who were taking lessons.[52] "In nineteenth-century Prussia the members of the bourgeoisie who became connected with the aristocracy generally absorbed the latter's habits and outlook."[53] Because of this behavior, by the second half of the nineteenth century, the process of democratization was not only incomplete but it was also very uncertain. Not surprisingly, the resulting German concentrated equilibrium took a much more authoritarian and sometimes tragic path.

In spite of the numerous differences between early- and late-industrializing countries, none of them had a political system capable of taming the power of new industrial dynasties associated with the growth of big business. The challenge to this power would come later, only when the individuals who were excluded from these privileges finally organized their interests.

The only exception[54] to this general pattern was the United States. Since the early beginnings, the British North American colonies had

50. *See id.* at 63.

51. In the restoration period, a Bourbon king reigned again (from 1815 to 1830), and the aristocracy commanded considerable social prestige for a long time thereafter.

52. *See* MOORE, *supra* note 7, at 37.

53. *Id.*

54. In the (rather extreme) words of de Tocqueville, "No great democratic republic has yet existed. It would be an insult to republics to use that name for the oligarchy which ruled France in 1793. Only the United States presents this new phenomenon." ALEXIS DE TOCQUEVILLE, DEMOCRACY IN AMERICA 118 (3d ed. 1994).

been a refuge from aristocratic and ecclesiastical authority. Moreover, by the time of the second Industrial Revolution, the United States had undergone two major democratic revolutions: the American Revolutionary War and the American Civil War. With the major exceptions of the treatment of African-Americans and Native-Americans (and of women's inability to vote or otherwise meaningfully participate in public life at that time), the United States approximated the democratic roots considered previously. From the beginning, the U.S. Constitution was shaped by the idea that only an appropriate system of checks and balances can support individual freedom—in James Madison's words, that "[a]mbition must be made to counteract ambition."[55] "A properly designed state, the Fathers believed, would check interest with interest, class with class, faction with faction, and one branch of government with another in a harmonious system of mutual frustration."[56]

The Founding Fathers were aware that an adequate mechanism of reciprocal guarantees should not rely only on the Constitution. In their view, it was also important that economic power not be concentrated in a few hands. Thomas Jefferson's democracy relied on a society where wealth was diffused among educated farmers[57] and where economic power could not be monopolized. It was as early as 1832 when, in this vein, President Andrew Jackson confronted the power of the Bank of the United States.[58] He vetoed the recharter of the bank and was reelected by running a populist presidential campaign in defense of the "humble members of society" against "exclusive privileges."[59]

The remaining vestiges of European landed aristocracy in the United States, primarily in the form of slaveowners in the South, were further erased by the victory of the Union in the Civil War. The free soil ideology,[60] which advocated the prevention of slavery in the West, offered the material arguments to sustain freedom and widespread small ownership. This ideology, combined with the rhetoric of Abraham Lincoln, generated the unifying feeling of the Union against the pro-slavery states of the South. Lincoln insisted that the new territories should offer "homes for free white people" and that this could not be if slavery was planted with-

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55. RICHARD HOFSTADTER, THE AMERICAN POLITICAL TRADITION: AND THE MEN WHO MADE IT 8 (1948) (quoting THE FEDERALIST NO. 51 (James Madison)).

56. *Id.* at 8–9.

57. *Id.* at 41.

58. *Id.* at 60–61.

59. *Id.* at 60.

60. The idea that the free lands of the West should be available for free people and forbidden for slavery gained impressive momentum before the Civil War and found its most vocal expression in the "Free Soil Party." *See e.g.*, ERIC FONER, FREE SOIL, FREE LABOR, FREE MEN: THE IDEOLOGY OF THE REPUBLICAN PARTY BEFORE THE CIVIL WAR (1970).

in them. "Slave States are places for poor white people to remove from, not to remove to."[61] After the Civil War, no variety of landed aristocracy had a relevant role in the political and economic organization of American society. By the time of the second Industrial Revolution, the distrust for concentrated economic power was already well-rooted in the society of the United States.

At the beginning of the nineteenth century, American society already deeply distrusted attempts to concentrate economic power. At that time, President Theodore Roosevelt could apply antitrust laws against such industry giants as J. P. Morgan and John D. Rockefeller. Passed in 1890, the Sherman Act could be used against both business mergers and workers' unions. For the few first years, it was primarily used against unions. By using antitrust laws, Roosevelt could continue the battle against concentrations of economic power among the privileged few, echoing the confrontation between President Jackson and the Bank of the United States. Theodore Roosevelt, however, was frightened by big business for reasons that were political more than economic in nature. "He was not a small entrepreneur, worrying about being squeezed out, nor an ordinary consumer concerned about rising prices, but a big politician facing a strong rival in the business of achieving power."[62]

Big business was accepted as a necessary development of the second Industrial Revolution. The problem Theodore Roosevelt faced was how to make big business and the growing power of unions compatible with democracy. Theodore Roosevelt believed that the survival of independent political power required that both capital and labor accept the regulation of the state. "Because he feared the great corporations as well as the organized workers and farmers, Theodore Roosevelt came to think of himself as representing the golden mean."[63] Both concentrated powers had to somehow be tamed and dispersed. Yet, in the case of business, the dispersion of owner power was not intended to limit the size of the firm.

Even if with different tones, the American political tradition started by Jefferson and Jackson was continued by President Woodrow Wilson and later by President Franklin Delano Roosevelt. In his 1912 electoral campaign, Wilson clarified why the power of big business should be tamed, maintaining that the real danger was not "the existence of the great individual combinations," but rather the "combination of the com-

61. HOFSTADTER, *supra* note 55, at 111–12 (quoting Abraham Lincoln, Speech in Peoria, Illinois (Oct. 16, 1854)). The viewpoint was that slavery should not be extended to new territories and could unite all the antislavery individuals independent of whether they were abolitionists or "Negrophobes." *Id.* at 112.

62. *Id.* at 222.

63. *Id.* at 217.

binations."[64] "What we have to do—he said—is to disentangle this colossal community of interests . . . to pull apart, and gently but firmly and persistently dissect."[65] The asymmetric nature of this dissection became very clear in the 1914 Clayton Act. Section 6 of the Clayton Act blocked the possibility of applying antitrust law to labor: "The labor of a human being is not a commodity or article of commerce. Nothing contained in the antitrust laws shall be construed to forbid the existence and operation of labor, agricultural, or horticultural organizations, instituted for the purposes of mutual help . . . ."[66] Unlike the Sherman Act, the Clayton Act reinforced the bite of antitrust action against big business. According to § 7 of the Act, the ownership of the stock of one corporation by another was forbidden whenever "the effect of such acquisition, of such stocks or assets, or of the use of such stock by the voting or granting of proxies or otherwise, may be substantially to lessen competition, or to tend to create a monopoly."[67]

The United States Supreme Court has echoed the concerns of Wilson and FDR about allowing businesses to concentrate their power. In the *United States v. E.I. du Pont de Nemours & Co.* antitrust case in 1957, the Court provided a definitive interpretation of the limitations concerning the acquisition of stocks.[68] The Court clarified that anticompetitive circumstances stemming from the acquisition of stock could emerge much later than the moment the acquisition was made.[69] The acquisition of stock could be challenged at any time (*du Pont* was filed many years after the acquisition). Moreover, the threat of limiting competition could arise independent of the good or bad intentions of the corporate agents, and could be applied to both vertical and horizontal acquisition (*du Pont* concerned a vertical acquisition).[70] Even if § 7 had been, in the words of the dissenting Mr. Justice Burton, a "sleeping giant,"[71]

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64. WOODROW WILSON, THE NEW FREEDOM: A CALL FOR THE EMANCIPATION OF THE GENEROUS ENERGIES OF A PEOPLE 187 (1921).

65. *Id.* at 188.

66. 15 U.S.C. § 17 (2006).

67. 15 U.S.C. § 18 (2006).

68. United States v. E.I. du Pont de Nemours & Co., 353 U.S. 586 (1957). The case related to the acquisition of 23% of General Motors by du Pont between 1917 and 1919, a few years after the Clayton Act was passed. *Id.*

69. *Id.* at 597.

70. *Id.* at 590–91, 607.

71. *Id.* at 611 (Burton, J., dissenting). Justice Burton, one of the justices dissenting from the majority decision of the Court, observed:

> The Court's decision is far reaching . . . . [O]ver 40 years after the enactment of the Clayton Act, it now becomes apparent for the first time that § 7 has been a sleeping giant all along. Every corporation which has acquired a stock interest in another corporation after the enactment of the Clayton Act in 1914, and which has had business dealings with that corporation is exposed, retroactively, to the bite of the newly discovered teeth of § 7.

the threat of waking up Wilson's creature contributed to his explicit goal of "gently but firmly and persistently dissect[ing]" the "combinations of combinations."[72]

Indeed, the Act pushed wealthy stockowners toward two extreme choices. One choice was to disperse their stocks and have little control in each one of them. The other option was to concentrate their stock in one business, enjoy the benefits of control, and forsake the advantages of diversification. The first option was often considered to be safer for the offspring of the entrepreneur, while the second was more appropriate for initial innovative entrepreneurship, as well as temporary takeovers of inefficient managerial firms to allow them to be resold on the market. Democratic roots inhibited the possibility of choosing the intermediate solution of diversifying in related business without losing control—a common option in the aristocratic origin countries. In those countries, with the help of political power and financial institutions and with the use of pyramids, a new industrial aristocracy could keep its power and profit by forms of "tunneling."[73]

FDR clearly expressed the antidynastic nature of the American model of corporate governance by denouncing the "economic royalists" who "gathered other people's money" to "impose a new industrial dictatorship," and who had taken unwarranted economic power through the use of devices such as holding companies.[74] He again recognized a coherent line in the American political tradition: "The country is going through a repetition of Jackson's fight with the Bank of the United States—only a far bigger and broader basis."[75] This economic royalism of the very few was leading to a form of "private socialism." Roosevelt believed that only the fragmentation of finance could lead to the kind of dispersed equilibrium considered previously in this Article and avoid the danger of "government socialism." He claimed, "I am against private socialism of concentrated economic power as thoroughly as I am against government socialism. The one is equally as dangerous as the other; and

Id. at 610–11. *See generally* Robert W. Harbeson, *The Clayton Act: Sleeping Giant of Antitrust?*, 48 AM. ECON. REV. 92 (1958) (providing a critical evaluation of the statements that § 7 has been a "sleeping giant").

72. WILSON, *supra* note 64, at 187.

73. In this context, the term "tunneling" refers to the act of transferring value from one pyramid firm to another of the same group. Simon Johnson et al., *Tunneling*, 90 AM. ECON. REV. 22, 22 (2000). Tunneling lifts assets and income from lower to higher firms (that are controlled by the family) and moves losses and liabilities in the opposite direction. *Id.* at 22–23. Morck, Wolfenzon, and Yeung observed that it is analogous to what multinationals do with transfer prices to avoid taxes. Morck et al., *supra* note 29, at 679.

74. ROE, *supra* note 18, at 40.

75. *Id.*

destruction of private socialism is utterly essential to avoid government socialism."[76]

The first Roosevelt administration associated pyramidal business groups with corporate-governance problems, disproportionate market power, and an objectionable concentration of economic power. In the 1930s, the administration explicitly included the double (and multiple) taxation of dividends paid by one firm to another (called "intercorporate dividends") as a part of a package of tax and other policies aimed at eliminating pyramidal business groups in the United States.[77] The program, which was already spelled out in Wilson's Clayton Act, was effective. The destruction of the private socialism made by the pyramidal business groups became an irreversible characteristic of American corporate governance. And in this way the Berle and Means Public Corporation, characterized by the separation of ownership and control, became an exceptional characteristic of its economy. These roots ran deep and could be traced back to the society imagined by Jefferson, a society of educated farmers who believed in religious tolerance and rejected any form of royal or dynastic rule. "Lord and peasant in the making in the modern world"[78] actually came true outside America. But in the United States, the growth of big business was not conditioned on one particular form of aristocratic roots, and the timely fragmentation of finance and ownership eventually led to a dispersed equilibrium before the Second World War.

As anticipated in the preceding Part, this equilibrium was dispersed in terms of ownership but was characterized by the largest firms in the world. Dispersion of ownership and centralized managerial control implied that firms could grow beyond the limitations of the financial (and often political) means of the controlling family. The policies, rooted in the American social and political history, were not against big business but were against the concentrated power of their owners. These policies made the owners smaller and the firms bigger than in the other countries.

V. THE MYTH OF AN ANGLO-SAXON MODEL

This Part critiques the hypothesis that Britain and the United States share a common Anglo-Saxon model of corporate governance, and argues that a more complex biodiversity of capitalism is at play than the traditional Anglo-Saxon versus continental debate considers.

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76. *Id.* at 39 (quoting remarks by Franklin Delano Roosevelt).

77. Randall Morck, *How to Eliminate the Pyramidal Business Groups—The Double Taxation of Inter-Corporate Dividends and Other Incisive Uses of Tax Policy* 9–10 (Nat'l Bureau of Econ. Research, Working Paper No. 10944, 2004), *available at* http://www.nber.org/papers/w10944.

78. This is the subtitle of MOORE, *supra* note 5.

In much economic and political literature, there is a great emphasis on a common Anglo-Saxon or Anglo-American model of corporate governance, which is sharply distinguished from a continental model. In particular, the legal-origins approach has attributed the divide existing between the two groups of countries to the different common law and civil law traditions.[79] But as analyzed in the previous Part, the focus should not be on the legal-origins approach, but rather on the particular aristocratic and democratic political roots of the countries at issue.

Given the variety of aristocratic roots, it is likely that the types of political roots that have characterized Britain have had the effect of pushing it closer to the American model than to other European countries' models. It is enough to mention only a few of the many similarities between the two countries. They share a common history and have a common language, and the British Puritanic Revolution had an important impact on the nature of the "American Soul." Moreover, both countries were defined by the remarkable stability of their early democratic political institutions, even though the British institutions included such aristocratic institutions as the monarchy and House of Lords. But despite these similarities, the different political roots had a strong impact on Britian's development, and its partial and late shift to a model of dispersed equilibrium is consistent with our story.

According to Alfred Chandler, in the last half of the nineteenth century there

> came into being a new economic institution, the managerial business enterprise, and a new subspecies of economic man, the salaried manager. With their coming, the world received a new type of capitalism—one in which the decisions about current operations, employment, output, and the allocation of resources for future operations were made by salaried managers who were not owners of the enterprise.[80]

According to Chandler, while the coming of managerial capitalism made the United States one of the two most important actors of the second Industrial Revolution (the other being Germany), Britain—the main actor of the first Industrial Revolution—became a late industrializer in

79. *See, e.g.*, Rafael La Porta et al., *Law and Finance*, 106 J. POL. ECON. 1113 (1998). An econometric analysis showed that a "coevolution approach" can explain differences in corporate-governance systems better than the legal-origin school. *See* Belloc & Pagano, *supra* note 30, at 106–07 (explaining the coevolution approach); Belloc & Pagano, *supra* note 9, at 9–10 (providing an econometric analysis). The case of England adds a qualitative dimension to this comparison. As discussed in Part V, while we can explain why England's coevolution pattern involved a shift from a concentrated to a dispersed system of corporate governance, the legal-origin approach is incompatible with this double affiliation of the British system.

80. CHANDLER, *supra* note 13, at 2.

many of the new industries.[81] In Britain, the commitment to the model of personal capitalism that had been so successful at the time of the first Industrial Revolution continued. While long-term profits based on long-term growth were a goal about which the managers and major investors of American (and German) managerial firms could agree, the families owning the British firms often preferred to pay out earning in dividends, rather than using them to make the extensive investments required to move into foreign markets or to develop new products in related industries.

"Because [British] firms grew slowly and because they hired only a small numbers of managers, the founders and their families remained influential in the affairs of the enterprise and so affected dividend policy."[82] By contrast, the long-term growth of American firms helped the managers gain strong job rights in their firms. These gains "not only helped to assure tenure for the senior executives, but [they] also enhanced the opportunity for advancement for the more junior managers."[83] British firms did not provide similar opportunities to nonowning managers. The key managerial positions were usually reserved for the owning family. Social and family ties were more important than competence to advance in the managerial ladder. There were few opportunities for junior managers, and no job security similar to those of American firms could be given to senior executives. According to Chandler, the organizational capabilities that were so important for the successful firms of the second Industrial Revolution had stagnated in Britain, and as a result, the nation was no longer the economic leader of the world.[84]

Julian Franks, Colin Mayer, and Stefano Rossi supported but also qualified the account given by Chandler.[85] They argued that at beginning of last century, the dominance of British families was more evident in terms of control than ownership. At that time,

> [t]he observations on the dominance of families in the running of firms are a reflection of their board representation rather than their ownership. Board participation by families became disproportionate to their ownership stakes. There were good reasons for being con-

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81. *Id.* at 250–51.

82. *Id.* at 595.

83. *Id.*

84. *Id.* at 496–98. In this respect, Florence gave a vivid picture of the persistence of the British aristocratic roots in corporate governance. In the 1930s, there was still a massive presence of peers in the directorates of British companies. PHILIP SARGANT FLORENCE, THE LOGIC OF BRITISH AND AMERICAN INDUSTRY: A REALISTIC ANALYSIS OF ECONOMIC STRUCTURE AND GOVERNMENT (1953).

85. Julian Franks et al., *Spending Less Time with the Family*, *in* HISTORY OF CORPORATE GOVERNANCE, *supra* note 5, at 581, 605.

> cerned about this development. The divergence between ownership and control undermined the efficient running of corporations, as documented by Chandler.[86]

But the capital of the families became so diluted that some of the usual "continental" defenses against takeovers emerged. The British corporate-governance system "[f]or a brief period in 1950s and 1960s . . . began to resemble that of Continental Europe."[87] Eventually, the overwhelming political preponderance of the city blocked that solution:

> It was therefore the financial sector that prevented the United Kingdom from drifting into a Continental-style corporate structure with dual-class shares, pyramids, and limitations on take-overs . . . . The financial sector also prevented the corporate sector from erecting the takeover defenses, in particular poison pills, that became common place in the United States.[88]

Britain ended up with a corporate system with a limited family ownership, as well as a financial sector that was much more concentrated and powerful than what existed in the United States. Financial fragmentation remained a distinctive characteristic of the United States.

The divide between American and British corporate governance becomes even wider when one considers the different roles of trade unions and the different systems of social protection in each nation. Because of the aristocratic roots of its industrial society, British workers developed a strong sense of class identity and created very powerful trade unions immediately after the Industrial Revolution.[89] After World War II, while the degree of concentration of ownership was quickly decreasing, British trade unions held their centralized power as well as their political strength. They even had the capability of provoking the fall of a government.[90]

In Britain during the 1960s and 1970s, ownership had become dispersed while unions' power was highly concentrated. This "disequilibrium" was also associated with difficult industrial relations and low productivity, and supports Roe's hypothesis that dispersed ownership may be incompatible with strong unions.[91] This disequilibrium lasted until the 1980s, when Margaret Thatcher weakened the powers of the unions—a policy that Tony Blair did not substantially reverse even after

86. *Id.*

87. *Id.* at 604.

88. *Id.* at 605.

89. EDWARD P. THOMSON, THE MAKING OF THE ENGLISH WORKING CLASS 194 (1963).

90. It happened, for example, in 1974 when the miners' strike caused the end of Edward Heath's government.

91. *See* ROE, *supra* note 7, at 21.

the Labour Party's landslide victory in 1997. In this way, Britain has settled into a "new equilibrium" where a system of partial dispersion of ownership meets a partial weakening of the powers of the unions. This new equilibrium makes Britain the economy closest to the United States in terms of employment protection and ownership dispersion. But the closeness is too recent and the divide between the two countries is still too wide to talk about a unique "Anglo-Saxon" model of corporate governance. At the moment, the aristocratic and democratic roots of the two models continue to be relevant, and the recent economic crisis is putting an unprecedented pressure on the dominance of finance, which has characterized the British system.

VI. THE RELATIONSHIP BETWEEN LABOR AND FINANCIAL MARKETS

The United States and Britain demonstrate only one part of the important relation between the characteristics of labor and financial markets. In general, the greater the level of ownership dispersion in financial markets, the less workers feel the need to be organized and safeguard against their employers and the weaker the level of employment protection.

If we consider the relation between dispersion of ownership and employment protection in all the Organization for Economic Cooperation and Development (OECD) countries, it is clear that the United States and United Kingdom represent one extreme of the inverse relation between these two variables.

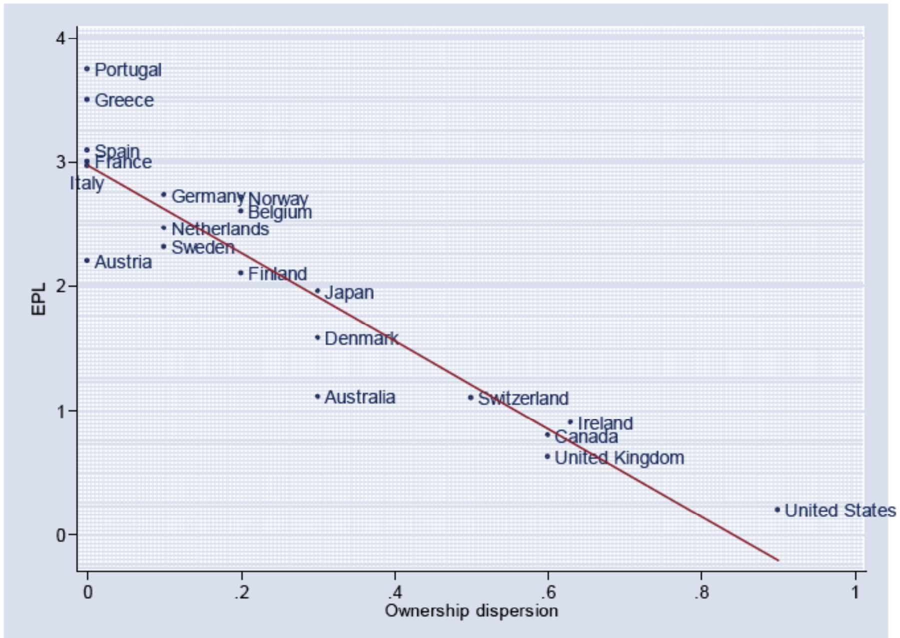

Fig. 1: *Employment protection and ownership dispersion*

Figure 1 plots an index of employment protection against an index of ownership dispersion[92] for a sample of twenty OECD countries. Continental Europe and Japan cluster in the northwest quadrant, with strong employment-protection legislation and concentrated ownership, and with the extreme positions occupied by France, Greece, Italy, Portugal, and Spain.[93] At the other extreme is the United States, with the lowest degree of protection of employees' rights and the highest degree of ownership dispersion. Even though some distance exists between the two, the United Kingdom is the country closest to the United States, with Canada and Ireland occupying similar positions to the United Kingdom.

In this relation, it is likely that causation can flow from the characteristics of labor markets to those of financial markets and vice versa.

92. Given a sample of ten medium-sized firms with stock-market capitalization in 1995, *Ownership* is an index that equals one if there is no controlling shareholder and zero if one does exist. *EPL* stands for employment-protection legislation and is averaged over the period from 1993 to 2002. More detailed information on the variables can be found in Belloc & Pagano, *supra* note 30, at 110–11.

93. Nordic countries like Sweden, which have in the past years had a fairly dynamic economy, occupy the northwestern quadrant. The high ownership concentration of Sweden and its relation to social democracy is discussed by Peter Hogfeldt, *The History and Politics of Corporate Ownership in Sweden*, *in* HISTORY OF CORPORATE GOVERNANCE, *supra* note 5, at 517.

Roe argued that it is mainly labor markets influencing financial markets.[94] He observed that countries with strong social democracies that are characterized by strong employees' rights tend to exhibit a strong and concentrated corporate-ownership structure.[95] In Roe's approach, the separation of ownership and control that characterizes many American large firms is not due to "better" corporate laws that protect minority shareholders, nor is it due to the different legal origins that characterize the different countries.[96] In his view, it is the absence of a social-democratic political pressure that, without strong and present owners, induces managers to collude with employees.[97] Shareholders can diversify their investments only when employees' organizations are weak. Otherwise, only concentrated block holders can be trusted to resist employees' pressure.

Belloc and Pagano stressed the importance of the opposite flow of influence—from financial to labor markets.[98] Dynastic-based concentrated systems of corporate governance may induce social-democratic reactions, whereas workers' organizations have difficulty in doing so because they are weaker in capitalist systems, where management jobs are open to a large section of the population.

Joining together the two directions of causation reveals the possibility that processes of cumulative causation actually hold the answer. Initial political conditions influenced the system of corporate governance and induced workers to organize in centralized organizations, a move that feeds back to the system of corporate governance. Thus, political roots play an important role both in setting these different path-dependent patterns of cumulative causation, and also in explaining why a country occupies a certain point of the regression line. The Berle and Means Public Company turns out to be an exceptional case—the closest one to a purely theoretical case—of a dispersed equilibrium.

VII. CONCLUSION

Before the recent economic crisis, the good performance of the American economy had an effect similar to that of the earlier successes of the Japanese and the West German economies in the 1980s and 1990s. There was a rush to imitate American institutions and, in a particular, the public company. In this case, the pressure to imitate the American model was unusually strong. Some authors claimed that we had reached "the

94. ROE, *supra* note 7, at 52.
95. *Id.* at 49.
96. *See id.*
97. *Id.*
98. Belloc & Pagano, *supra* note 30, at 106.

end of history for corporate law";[99] in other words, an inevitable universal convergence toward the Anglo-Saxon model. Other authors claimed that, for many reasons, the development of corporate ownership and governance systems was likely to be path-dependent, and they focused on the complementarities existing among different domains of the economic system, which makes a global convergence toward a single model unlikely.[100]

The recent economic crisis and the increasing growth of newly industrializing countries, each with their different models of corporate governance, has perhaps put an end to the "end of history theories," attracting instead increasing attention to the institutional multiplicity of corporate-governance systems.

As O'Kelley convincingly argued, Berle and Means's book built on Veblen's work in two important respects: it updated the consequences of absentee ownership, and it followed a similar evolutionary approach.[101] As to absentee ownership, Berle and Means clarified how management interests diverged from those of the predatory-profit motive of absent shareholders, which was Veblen's most important concern.[102] While managers could also follow a self-referential power-enhancing strategy, the road was open to demand the modern corporation serve not only the owners or the control but also those of the other stakeholders[103]—a point that has received increased attention in recent years.[104] Moreover, Berle and Means built on Veblen's (and Darwin's) methodology, applying an evolutionary approach to the emergence of the modern corporation that is grounded on the notion of cumulative causal sequence.[105]

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99. Henry Hansmann & Reinier Kraakman, *The End of History of Corporate Law*, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE LAW 33 (Jeffrey N. Gordon & Mark J. Roe eds., 2004) [hereinafter CONVERGENCE & PERSISTENCE].

100. *See, e.g.*, MASAHIKO AOKI, CORPORATIONS IN EVOLVING DIVERSITY (2001); MASAHIKO AOKI, TOWARDS A COMPARATIVE INSTITUTIONAL ANALYSIS 90 (2001); Lucian Bebchuck & Mark J. Roe, *A Theory of Path Dependence in Corporate Ownership and Governance*, *in* CONVERGENCE & PERSISTENCE, *supra* note 99, at 69; Ugo Pagano, *Legal Positions and Institutional Complementarities*, *in* LEGAL ORDERINGS AND ECONOMIC INSTITUTIONS 54 (Fabrizio Cafaggi et al. eds., 2007); Reinhard Schimdt & Gerald Spindler, *Path Dependence and Complementarity in Corporate Governance*, *in* CONVERGENCE & PERSISTENCE, *supra* note 99; *see also* Ugo Pagano, *Interlocking Complementarities*, *supra* note 36.

101. O'Kelley, *supra* note 39, at 1342.

102. *See id.* at 1342–49.

103. *See id.* at 1349 ("Not surprisingly, Berle's account became the 'bible' of the cadre of young men who moved to Washington with Franklin Roosevelt, intent on finding ways to bring control of the modern corporation under the control of American people.").

104. *See, e.g.*, Katsuhito Iwai, *Persons, Things, and Corporations: The Corporate Personality Controversy and Comparative Corporate Governance*, 47 AM. J. COMP. L. 583 (1999).

105. *See* O'Kelley, *supra* note 39, at 1323. An initial shock causes effects that amplify the shock and creates a regime of cumulative causation. This positive feedback distinguishes cumulative

In both cases, the Berle–Veblen intellectual connections were extremely fruitful. Even now, their joint contributions offer a powerful alternative to the history-silent neo-classical approach. But one must go beyond their evolutionary narrative, which focused mainly on the American corporation. Their Darwinian foundations must involve a multiplicity of evolutionary paths that, in the case of biology, give rise to a plurality of natural histories and species. The notion of cumulative casual sequences implies that initial conditions can have important consequences for the plurality of institutional paths and the possible divergence of their outcome.

This Article has tried to follow this Darwinian insight, showing that democratic and aristocratic roots of corporate governance have had a major impact on the different institutional paths of Europe and the United States. Veblen's mistrust of the goals of absentee owners and his admiration for production engineers were somehow related to the democratic roots of the United States, which contributed to the evolution of the Berle and Means Public Company. The same dispersed ownership (and centralized managerial control) equilibrium did not evolve in Europe. In most cases involving the Old Continent, family dynasties retained control of corporations with minority shareholding and in this way contributed to the generation of social-democratic reactions.

The awareness of the multiplicity of these evolutionary paths is particularly important in the present crisis, which could put severe pressure on the survival of each one of these two species and generate important mutations. An open mind for alternative evolutionary paths is also important for understanding the new corporate species that are emerging in countries like India and China, which may soon have an economic weight that more appropriately represents their share of the world's population. The Veblen–Berle–Means approach can be fruitfully applied to the rich biodiversity of organizations existing in the world economy. Its great analytical power should not be limited to the explanation of the evolution of the American corporation.

causation from the negative feedback on which the standard theory of the convergence of market equilibrium rests.