

Hassel, Anke; Beyer, Jürgen

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The effects of convergence: Internationalisation and the changing distribution of net value added in large German firms

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**The Effects of Convergence:
Internationalisation and the Changing
Distribution of Net Value Added in
Large German Firms**

**Anke Hassel
and
Jürgen Beyer**

01 / 7

Max-Planck-Institut für Gesellschaftsforschung
Paulstrasse 3
50676 Köln
Germany

Telephone 0221 / 27 67 -0
Fax 0221 / 27 67 -555
E-Mail info@mpi-fg-koeln.mpg.de
Website www.mpi-fg-koeln.mpg.de

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Abstract

The paper examines whether and how the increasing internationalisation of firms impacts on the operation of a co-ordinated market economy. Following the tenets of agency theory it assumes that an emerging market for corporate control changes the monitoring mechanisms that oversee management. Since Anglo-American forms of monitoring are usually associated with a higher return for investors compared with Continental European firms, a change in the distribution of the net value added of firms is expected. Using financial data on 59 large German companies, the paper shows that the emerging convergence of German corporate governance practices to Anglo-American standards has had a weak, but significant, impact on the distribution of net value added. This is in contrast to the impact of the internationalisation of firms on product markets, which does not have an effect. Since the market for corporate control is, however, still underdeveloped in Germany, the main effects remain to be seen.

Zusammenfassung

Der Beitrag untersucht, ob und wie die Internationalisierung von Unternehmen das Institutionengefüge einer koordinierten Marktwirtschaft beeinflusst. Annahmen der Prinzipal-Agent-Theorie gehen davon aus, dass die Regulierung der Übernahm Märkte von Unternehmen die Ausschüttung der Nettowertschöpfung eines Unternehmens prägt. Wenn sich deutsche Unternehmen nun in zunehmenden Maße an das angloamerikanische Modell der Corporate Governance annähern, so kann man erwarten, dass ihr Ausschüttungsverhalten sich ebenso verändert. Anhand von Finanzdaten von 59 großen deutschen Unternehmen zeigt der Beitrag, dass die Konvergenz der deutschen Unternehmensführung zu angloamerikanische Praktiken einen schwachen aber signifikanten Einfluss auf die Verteilung der Nettowertschöpfung hat. Im Unterschied dazu finden sich keine Effekte der Internationalisierung von Unternehmen. Da der Übernahmemarkt in Deutschland jedoch noch immer stark unterwickelt ist, bleiben weitere Auswirkungen abzuwarten.

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1 Introduction

In the recent literature of political economy, there has been renewed interest in the functioning and effects of the nationally based institutional configurations of market economies. In particular, major advances have been made in conceptualising the different institutional spheres of national economies and their interaction (Whitley 1999; Amable 2001; Hall/Soskice 2001). Most approaches identify subsets of a number of institutions as the main governing devices of economies: the financial system, the corporate governance system, inter-firm relations, the industrial relations system, and skill creation (Jackson 2001). It is argued that the co-evolution and interaction between these subsystems create the distinct character of national types of capitalism.

However, and despite the renewed interest in national variations, it seems there are signs that those variants of capitalism which deviate from an Anglo-American liberal market economy are on the verge of losing their distinct national traits of institutional embeddedness as a result of economic internationalisation (Jackson 2001a). For scholars in comparative studies who have a strong affinity to non-liberal market economies or merely to the existence of national diversity, this development is to be regretted. On the other hand, the process of convergence is a perfect testing ground for the theoretical claim of the varieties of capitalism approach, namely that institutions in different spheres of the political economy are coupled and that changes in one sphere have implications for the other.

The interdependence between economic institutions is captured in the notion of *institutional complementarities*. Complementary institutions are conceptualised as institutions where the presence or absence of institution affects the efficiency of the other (Soskice 1999: 110; Hall/Soskice 2001: 16). In a static perspective, the notion of institutional complementarity can explain the lock-in phenomenon of a whole set of institutions in one country as compared to another (Aoki 1994). The German corporate governance regime is not only bank-based, but also has weak rights for minority shareholders, a lower rate of return for shareholders and a weakly developed market for corporate control. Moreover, it coincides with a

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system of co-determination and centralised wage bargaining which gives labour a prominent role in the firm's decisions on restructuring and pursuing product market strategies (Streeck 1995: 9).

The notion of institutional complementarity presumes that the mechanisms which link one institution to another can be defined in terms of institutions providing incentives for economic and political actors to behave in a certain way. For instance, the rate of return for shareholders is lower in systems with a weak market for corporate control since management cannot be pressured by shareholders to increase their returns through hostile takeovers. Or one can assume that lower returns for shareholders imply higher rates of retained earnings, which allows a more consensus-oriented approach for restructuring, which is in line with a high degree of employee involvement in the firm. Studies on specific mechanisms linking institutions in different spheres of the political economy are numerous and in many instances have preceded the varieties of capitalism approach.¹

In a dynamic perspective, the notion of institutional complementarities implies that the change in the functioning of one institution should affect the functioning of the other. To use the examples cited above: if a market for corporate control emerges in a previously protected market economy, shareholders should be able to ask for a higher rate of return. Consequently, if shareholders are becoming more demanding, the practice of co-operative methods of economic restructuring involving a high degree of consensus with a firm's employees might be challenged. In the end, one might conclude that an Anglo-American market for corporate control might eventually force companies to adopt an Anglo-American approach towards labour relations.

However, the evolution and success of co-ordinated market economies throughout the 20th century has shown that, during periods of rapid economic and institutional change, institutions can adjust to new economic situations without merely collapsing or converging to a liberal market economy. Firms might have an interest in preserving some of the protective institutions because they know of their advantages (Hall/Soskice 2001: 51). One example here is the stability of centralised wage bargaining systems in many continental European countries (Hassel/Rehder 2001). Another example might be the adoption of new takeover regulation in the EU, where firms might have an interest in a higher degree of

1 Beginning with the literature on corporatism and economic policy in the 1970s, but also found more recently in the work by Michel Albert (1993) on Germany and the Anglo-American countries, Wolfgang Streeck (1992) on Germany, and David Soskice (1994 and 1999) on the Anglo-American and German comparison. For an overview, see Jackson (2001b).

protection from shareholder demands in order to preserve management's room for manoeuvre.

Beyond the mere preservation of existing institutions against pressures for de-regulation, we can also expect that the presumed linkages between institutions might turn out to be more complex when facing a changing economic environment. In corporate governance systems, the monitoring of firms by banks or other blockholders practised in most continental European economies might only be replaced by shareholder monitoring if new regulations on shareholder protection are introduced. In particular, the linkages between different spheres of the political economy, i.e. between the spheres of corporate governance and industrial relations, could turn out to follow different trajectories when faced with adjustment pressure. For instance, employees might be supportive of shareholder demands if they can achieve a more secure status than otherwise in shareholder value companies and, therefore, consensual labour relations might be strengthened rather than weakened (Höpner 2001). Hence, in a dynamic perspective it is very difficult to make sound assumptions on how one institution will adjust to changes to another institution if these institutions are complementary. This is mainly because of the multitude of actors involved who can develop their own strategies to deal with the situation, which might not follow the functionalist logic of economic efficiency and/or shareholders' interests.

In this paper, we will test empirically the impact of economic internationalisation on the operation of German economic institutions. Economic internationalisation has been identified as the major driving force for institutional adjustment in the conduct of industrialised economies. Economic internationalisation expands markets for products, labour and capital beyond national boundaries. Economic internationalisation also implies the increasing intensity of competition not only between companies over sales, but also between governments and national societies over investments and capital. We assume that the degree of internationalisation of firms is company-specific and that we can distinguish between high and low degrees of the internationalisation of firms. We also assume that economic internationalisation can have two dimensions in product markets (the real dimension) and financial internationalisation (Hassel/Höpner et al. 2001). The financial internationalisation of firms is defined and measured as an opening-up of German companies to Anglo-American corporate finance practices. It is thus, by definition, the major sphere where convergence is to be observed.

Following the assumptions of principal agency theory and comparative industrial organisation, we develop a hypothesis on how a higher degree of internationalisation should affect the behaviour of firms towards shareholders and employees. As a tentative quantitative measure for the behaviour of firms, we use the distribution of net value added to the different stakeholders of the firm, which reflects

the different and changing roles of those stakeholders in the firm. We thereby follow the approach of a previous study by de Jong, who was able to show that the distribution of net value added displays significantly different patterns in Continental European and Anglo-American countries. Using a sample of 59 large German firms we test whether a high degree in internationalisation has affected the behaviour of those firms. We will show that financial internationalisation has indeed had certain effects on the relationship between firms and shareholders. These effects are, however, still weak because the process of convergence is in its infancy. We find no effect of internationalisation on the relationship between firms and their employees. This result points to the complex nature of linking institutions in different spheres of economic activities.

The paper is divided into five parts. In the first part the assumptions on mechanisms in corporate governance systems are discussed and hypotheses are developed. The second part reveals the converging tendencies of German corporate governance practices towards Anglo-American standards. In contrast to many authors on globalisation, who do not expect a tendency towards convergence,² we will point out and emphasise the rapid changes in the corporate governance regime in Germany towards Anglo-American practices. The third and fourth parts describe and analyse the data we use. The fifth part discusses the findings.

2 Institutional Complementarities in the German Economy

Firms are embedded in social and economic institutions and are subject to an array of regulations, commercial agreements, employment contracts and social practices. Different types of economic institutions vary from country to country. Their features are not distributed arbitrarily, but form clusters in certain constellations. These clusters have been analysed thoroughly over the years and can be summarised for the German economy vis-à-vis the liberal market economies as follows.³

Compared to Anglo-American market economies, the governance of German firms is defined by two characteristics. Firstly, the relationships between firms and other actors are based on non-market and inter-organisational relationships rather than on competitive market exchanges. Secondly – and closely related to

2 National adaptation to economic internationalisation rather than convergence has become the main thread running through the literature on globalisation. See Jackson (2001a).

3 See on the following also Streeck (1995), Jackson (2001b).

the first characteristic – the position of corporate owners vis-à-vis the firm is weaker while the position of other actors, in particular labour, is stronger.⁴

Non-market and inter-organisational relationships are particularly prominent with regard to corporate ownership. The degree of market capitalisation of German firms is much lower than in Anglo-American countries since only a small part of German companies are traded at the stock exchange. Corporate ownership, therefore, is more concentrated on major blockholders. The lower degree of market capitalisation is connected with a form of corporate finance which relies on long-term bank credit rather than on equity. Banks have tended to hold the shares of companies they finance in order to secure the repayments of credits. In addition, the corporate governance of big companies is characterised by a network of interlocking directorships. The position of minority shareholders is only weakly developed both in terms of their actual role in the company and in terms of their legal rights. Until recently, firms were able to issue shares with non-voting or multiple voting rights. Moreover, banks have used their rights to cast proxy vote on behalf of shares they hold in deposits and have thereby increased their influence at the expense of small shareholders. Dispersed ownership, as opposed to concentrated ownership with the minority shareholders enjoying a stronger legal position, can be seen as an indicator for a higher degree of market relations in the governance of firms.

Because ownership is concentrated rather than dispersed and despite the fact that market capitalisation is low, there has been no active market for corporate control in Germany. Either the vast majority of German companies are not traded at the stock exchange or their shares are in the possession of blockholders, which usually are other companies. Companies are bought and sold largely as a joint strategy by management and owners and not as a disciplinary device used by owners against management when performance is falling short of investors' expectations, as is the case in Anglo-American countries.

The relationship between corporate owners and their firms is not only non-market oriented and based on networks but also diluted by a stronger role of other actors, in particular labour. Workforces can exercise legal rights to co-determination through works councils and supervisory board representation. The legally enshrined position of labour as an actor in the governance of firms enables employees' representatives to engage in a strategic interaction with either management or shareholders to pursue their own agenda. Depending on the issue at stake, labour can play a decisive role in conflicts between management and owners such as hostile takeover attempts (increasing the defence position of manage-

4 See on the characteristics of corporate governance in Germany: Jackson (2001b), Jürgens et al. (2000), Edwards and Fischer (1994), OECD (1995).

ment) or the bailing-out of bankrupt firms (mobilising public support). Since firms are also subjected to regulation via collective agreements and extensive labour protection legislation, the role of labour favours a system which gives incentives to a high cost – high productivity production regime that relies on the negotiated restructuring of firms (Streeck 1995).

Therefore, while in Anglo-American countries the governance of firms concentrates to a large extent on a market-based relationship between owners and management, the governance of German firms embodies a more complex set of actors in a system of network monitoring. These differences have systematic implications for the relationships between the main actors: management, owners and employees.

In Anglo-American countries, corporate owners have a fundamental problem of expropriating the return on their investment. Since the relationship between owners and management is market-driven and does not depend on owners trusting in the fair treatment by management or wider strategic business goals, investors have to strive for a high share of return. Their principal problem is to extract a high enough return from the company so that management is not inclined to overinvest in order to improve its own position (Jensen 1986; La Porta et al. 2000). At the same time, investors in Anglo-American countries also have the means to extract a higher return from a company, not only because their legal position is stronger but also because the market for corporate control forces companies to anticipate and meet shareholders' expectations. Dividends are used as a signalling device for shareholders to indicate a high return on investment.⁵

Since corporate ownership serves to secure either bank credits or to stabilise inter-firm relations in the majority of German companies, rates of return on investment often play a secondary role. Corporate aims are frequently not stated in terms of return on investments, but in the maximisation of growth or sales. Moreover, minority investors do not have the means to enforce higher returns other than to disinvest, because their position is relatively weaker. As an actor, minority shareholders hardly play a role in company policies. As a consequence, we should find higher returns for investors in Anglo-American countries compared to German firms.

Comparative studies on corporate finance and corporate governance have indeed pointed out that dividend payments and rates of return are higher in Anglo-American countries than in Germany (de Jong 1991; Deutsche Bundesbank 1997).

5 Dividends are not the best form of return on investment since they are usually heavily taxed. However, dividend payments are usually highly correlated to the change in share prices so that they can be treated as a proxy for the expected changing value of the company.

Table 1 Rates of Growth and Return in German and US American Companies, 1980s and 1990s

| | Return on sales | | Return on equity | Growth of sales |
|--------|-----------------|-----------|------------------|-----------------|
| | 1979–1988 | 1990–1995 | 1990–1995 | 1979–1988 |
| US | 9.8 | 5.0 | 14.2 | 48.5 |
| German | 4.3 | 2.8 | 12.4 | 79.8 |

Source: De Jong 1991: 11; Bundesbank 1997: 37.

Return on sales were twice as high in US American firms in the 1980s than in German firms according to an empirical study by de Jong (1991: 11), while growth rates were considerably higher in German firms (Table 1). A study by the Deutsche Bundesbank based on data collected by the European Commission found a similar result for the first half of the 1990s. The study also found a distinctly higher return on equity in US American firms (Deutsche Bundesbank 1997: 31). The lower return on equity of German firms is usually reflected in the share price of German companies, which tends to be considerably lower than for Anglo-American firms. In this view, low earnings correspond to the low market value of German firms whereas, in Anglo-American firms, the higher market value of the firms requires higher returns (Höpner/Jackson 2001: 8). Empirical studies have also shown that managers in British companies raise dividend payments in order to ward off the threat of hostile takeovers (Dickerson et al. 1998).

In a more comprehensive view of the firm in market economies, Henk Wouter de Jong has compared the distribution of net value added between Anglo-American companies and Germanic companies and found that Anglo-American companies pay out a significantly higher share of net value added to the government in form of taxes and to their owners in the form of dividends, whereas German companies see higher shares paid to labour and in retained earnings (Table 2).

Corporate governance regimes give general incentives to firms to behave in certain ways. For instance, firms operating in a market-based corporate governance system compete for investors and have to meet the higher return on investment rates of other firms compared to firms in network-based corporate governance systems, regardless of the specific takeover threat. Similarly, all firms operating in a networking-based corporate governance system can rely on weak shareholder demands and will tend to follow a general going rate rather than firm-specific investor demands. The question arises, however, as to what extent the effects of the corporate governance institutions are altered by the specific circumstances of the firm rather than being largely determined by the regime as a whole. With regard to the interaction between the regime and the behaviour of firms, we assume that

Table 2 The Distribution of Net Value Added

| | Labour | Creditors | Government | Retained earnings | Dividends |
|------------------|--------|-----------|------------|-------------------|-----------|
| Anglo-American | 62.2 | 23.5 | 14.3 | 3.2 | 15.0 |
| Germanic | 86.1 | 8.8 | 5.1 | 5.2 | 3.0 |
| Latinic | 80.3 | 14.4 | 5.3 | 3.0 | 4.7 |
| European Average | 79.0 | 13.7 | 7.3 | 3.6 | 6.1 |

Source: De Jong 1997: 17

Note: 82 largest corporations in Europe, averages for 1991–1994, net surplus value in percent of total net value added. The Anglo-American world encompasses Ireland and the UK; Germanic companies are from Germany, Switzerland, the Netherlands and Scandinavia; Latinic companies are from France, Italy and Benelux.

the regime-specific incentives for firms are reinforced by company-specific circumstances. In the empirical study on the link between takeover activity and dividend payments for British firms mentioned above, it could be shown that this relationship is company-specific and not largely determined by the external environment of operating in a market which allows for hostile takeovers compared to an environment where they are absent (Dickerson et al. 1998). From this we should expect that a stronger orientation by German firms to Anglo-American practices, a stronger position of minority shareholders and an emerging market for corporate control would contribute to a higher share of net value added demanded by corporate owners rather than by other actors who participate in the distribution of the net value added of firms. In the next section, we will show how the German corporate sector has taken steps towards an Anglo-American system of corporate governance throughout the 1990s before we present our empirical findings.

3 Changing Corporate Governance Practices in Germany

Since the mid-1990s, rapid changes in corporate governance practices have taken place. These changes consist of three major developments: firstly an increase in the legal protection of minority shareholders, secondly the evolution of more offensive takeover practices and regulation, and thirdly a changing approach by major blockholders – banks and companies – towards cross-shareholding. We will discuss these developments in turn, arguing that the governance of German firms is approaching more of a market-based, and less of a networking-based, model.

The legal protection of investors has been identified in the corporate governance literature as one of the – if not the – most important characteristic of corporate governance systems (La Porta et al. 2000). The legal protection of investors determines the relationship between owners and the management of a firm, and thereby characterises the ability of owners to appropriate their expected returns.

From the mid-1990s onwards, important legal changes aimed to liberalise financial markets in Germany by providing a more transparent framework for the operation of stock trading (Lütz 2000: 21). They included three Laws for the Promotion of the German Financial Market (*Kapitalmarktförderungsgesetze*). These established a supervisory agency for stock trading at the federal level and set up rules of conduct for the participants (Deeg / Lütz 2000).

In 1998 two further corporate laws improved the position of minority shareholders. The Law for Facilitating the Raising of Capital (*Kapitalaufnahmeerleichterungsgesetz*) enabled German companies to issue financial statements based on international accounting standards (IAS or US-GAAP) rather than on German accounting standards (*Handelsgesetzbuch*). Previously, companies could only issue these statements in addition to German accounting statements. For companies that aimed at being listed on foreign stock exchanges and, in particular, the New York stock exchange, this was a major improvement. However, since international accounting practices are much more transparent than German accounting standards, the increasing tendency to apply international accounting standards improves the ability of shareholders to judge the performance of firms.

The other important legal change in 1998 was the Control and Transparency Act (*KonTraG*). The *KonTraG* was a comprehensive piece of legislation that aimed at increasing the transparency of companies in the interest of investors and at improving the control function of supervisory boards. With regard to investors' rights, the law prescribed the principle of "one share – one vote" by banning shares with multiple votes (*Mehrfachstimmrechte*) and limited votes (*Höchststimmrechte*). Moreover, it restricted the use of proxy voting by banks in those cases where the bank itself holds more than 5 percent of the firm's stock. All investors were required to disclose holdings above a margin of 5 percent. For listed companies the law prescribed accounting reports for segments.⁶

At the same time, a market for corporate control started to establish itself. Since the absence of hostile takeovers is more due to the low volume of the stock exchange and concentrated corporate ownership than to legal restrictions, the in-

6 Further important changes consisted in the improvement of stock options for management and the right of companies to repurchase their stocks up to a maximum of 10 percent.

crease in takeover activities is less to do with enabling takeovers by effecting changes in the law. Corporate ownership has not yet changed significantly towards a higher degree of dispersed ownership – the precondition for an active takeover market. Legal regulations on hostile takeovers in the context of the proposed European directive and the German takeover code are largely following changes in the practice rather than preceding it.⁷

In practice, however, the attitudes towards hostile takeovers have changed dramatically over the latter half of the 1990s (Höpner/Jackson 2001). In particular, the case of the hostile takeover of Mannesmann by Vodafone has indicated that corporate actors are reviewing their previous strategies towards the market for corporate control. Compared to previous hostile takeover attempts in Germany, *Hausbanken*, that is banks affiliated to a commercial undertaking, are more hesitant to side with the management of the target firm. Labour and the wider public opinion in the form of politicians have not engaged in taking sides against the hostile takeover. The debates of the expert commission on a German takeover regulation chaired by Chancellor Schröder have showed a high degree of acceptance of the emerging practice of hostile takeovers.⁸

Thirdly, there are clear signs that major blockholders are reconsidering their monitoring approach towards firms. Cross-shareholding and interlocking directorships between firms have developed into a highly complex and tightly knit network of relationships between firms and their managing directors (Beyer 1998; Adams 1999). At the centre of these networks were major financial institutions such as Deutsche Bank and the insurance giant Allianz, which held large portions of corporate stocks in a variety of forms. There are clear signs that banks and other financial enterprises have started to adopt business strategies during the late 1990s that are focused on investment banking and specialist financial services rather than on the monitoring of the German manufacturing sector (Beyer 2001). In recent years, big blockholding firms have considerably decreased their involvement in the monitoring of firms. The traditionally strong role of the representatives of big German banks on the supervisory boards of big German companies has diminished drastically. Between 1992 and 1999 the share of bank representatives as chairmen of supervisory boards fell from 44 percent to 23 percent in 40 large companies in Germany (Höpner 2001). With regard to block holding,

7 Neither the European nor the German takeover regulation has come into force yet. The European directive was adopted by the Council of Ministers on June 4th 2001, whereas the German takeover code has only been prepared by a commission of experts on the subject.

8 This is the case even though the German government later chose to adopt a dissenting view on the European takeover directive as being too friendly towards the bidder.

major disengagement developments are expected in 2002 following the abolition of taxation on profits from the sale of share blocks. This change in corporate taxation was agreed upon by the social-democratic government in 1999.

The combination of these three developments in the German corporate governance sector indicates a major break with past behaviour as affects both the aims of public policy and company behaviour. Public policy is clearly engaged in facilitating and smoothing a transition of the German corporate system towards the adoption of Anglo-American practices, rather than preventing it. Companies, on the other hand, are clearly the engine for this development, taking active steps towards disengaging in cross-shareholding and interlocking directorship, towards more transparency and shareholder value and towards an active position in the corporate market. Obviously, convergence towards Anglo-American practices is not equal to a full-blown adaptation to a market-driven corporate governance regime, and many discrepancies between the governance of German and Anglo-American firms remain.⁹ As a process, convergence is driven not only by the new opportunities of firms in international capital markets, but also by the heightened competition in product markets and an emerging Anglo-American management culture (Höpner 2001). In the following empirical sections of the paper we will test the hypothesis that an increasing adoption of Anglo-American corporate governance standards will also have implications for the distribution of net value added of companies.

4 Data Collection

For the empirical test we will use data collected in the form of a company database by the MPIfG (Hassel/Höpner et al. 2000). The database compiles company data on the 100 largest companies in Germany as defined by the German commission on the concentration of German industry (*Monopolkommission*) in 1986 and 1996. The following research variables were established: internationalisation of firms, shareholder value orientation and the distribution of net value added.

Internationalisation

As we established in an earlier paper, the degree of internationalisation of firms can be seen in two distinct dimensions, a real (or product-market-related) dimension and a financial (or financial-market-related) dimension (Hassel et al. 2001).

9 In particular with regard to the role of the supervisory board in the monitoring of firms.

Both dimensions can be separated theoretically and empirically. Theoretically we have argued that the financial internationalisation of firms is distinct from their real activities and does not follow from a high degree of real internationalisation. The orientation of firms towards international capital markets is independent from their international marketing or manufacturing strategy. Empirically, we have been able to show that there are a number of cases of firms adopting a strategy towards financial internationalisation but not real internationalisation. The real dimension of internationalisation measures the share of foreign-product-oriented activities of a firm and is based on the foreign share of employees, the foreign share of sales and the spread of international activities (number of countries in which the firm operates subsidiaries). The financial dimension measures the degree to which German firms adopt international/Anglo-American corporate governance practices or are controlled by international investors. It is based on the share of foreign owners, the number of foreign stock exchange listings and the use of international accounting practices (IAS/US-GAAP). We have also used dispersed ownership as a measure which indicates a trend towards an Anglo-American corporate governance regime. Dispersed ownership is used as a nominal variable if dispersed ownership was higher than 75 percent and a hostile takeover was possible.

Shareholder value index

The shareholder value orientation of a firm can be seen as an alternative measure of a firm's orientation towards investors' interests. The shareholder value index is based on four indicators: the degree of the information quality of investors' annual reports, the availability of investor relations departments, the degree of shareholder value management in the operative business, and the degree of variability in top management pay. The indicators are mainly based on assessments by analysts and have been combined into one index using factor analysis. This information has been compiled for 40 large firms that are listed in the German stock exchange (Höpner 2001).

Distribution of net value added

The distribution of net value added is calculated on the basis of accounting data from the "Hoppenstedt Verlag" database. Net value added is calculated for the consolidated company as a whole including foreign activities. Banks and insurance companies are excluded from the analysis because the different accounting practices in the financial sector prevent calculations of net value added.¹⁰

10 Net value added was measured as gross performance and miscellaneous revenue minus purchased materials and services, depreciation and miscellaneous expenditure.

The distribution of net value added is calculated for the following stakeholders: creditors (loan repayments and interests), government (tax), owners (dividends), labour (costs for personnel and pension funds) and the firm itself (retained earnings). Retained earnings are calculated as a residual category.

Moreover, outliers are created by firms using a financial technique called “distribute-recapture method” in which companies pay out exceptionally large dividends and simultaneously increase the capital stock by the same amount. This is the case for Daimler-Benz. Another outlier is Metallgesellschaft, a company that was in a deep crisis in the observed period. We had to check if the change in the distribution of net value added is mainly influenced by companies in crisis. It turned out that this is not the case, but Metallgesellschaft and the special year in the Daimler Benz data series are excluded from analysis.

Control variables

Problems in the calculation of net value added arose due to the different accounting methods that firms can choose according to German accounting laws (*Handelsgesetzbuch*): the “cost-of-sales method” and the “total costs of short-term-results accounting”. Unfortunately, the method used has an impact on the distribution of the net value added and had to be controlled for in the data analysis.

Since economic sectors significantly affect net value added, we decided to control for industry. In particular, three sectors turned out to be relevant: the motor industry, the construction industry, and retailing. A further control variable is company size.

5 Data Analysis

Table 3 shows the distribution of net value added in 1992–94 compared to the period 1996–98 as an average for 59 large German companies. The change over time largely supports the assumption of a changing distribution of net value added due to a convergence to Anglo-American practices: the shares of net value added that are paid out as dividends and as taxes to the government have increased, while the share for labour has significantly decreased. It is, however, unclear why the share of retained earnings has also increased significantly, which was not to be expected.

The comparison of these two points in time contains further problems. Data on the distribution of net value added in the 1980s shows a similar distribution as in 1996–98. There are reasons to believe that changes in the distribution vary with the business cycle. During recessions, the share for labour tends to increase particularly in those countries where labour protection legislation is strong. The pe-

Table 3 The Distribution of Net Value Added in Large German Firms, 1992–1994 and 1996–1998 (in % of Net Value Added)

| | Labour | Creditors | Government | Dividends | Retained earnings |
|-------------|--------|-----------|------------|-----------|-------------------|
| 1992–1994 | 85.3 | 5.4 | 5.2 | 2.0 | 2.2 |
| 1996–1998 | 78.4 | 4.3 | 6.8 | 2.8 | 7.8 |
| Change in % | –8.1 | –20.4 | +30.8 | +40.0 | +254.5 |

Note: Sample of 59 companies, net surplus value in percent of total net value added, averages for 1992–1994 and 1996–1998. Own calculations based on Hoppenstedt data base (accounting data in accordance with HGB rules).

riod 1992–94 coincides with the worst recession of the German economy after World War II. We therefore have to take into account a cyclical effect of the economic downturn of the 1990s.¹¹

Bearing this cyclical nature of the data in mind, we can nevertheless test whether we find a significantly different development of net value added in those firms that are more subject to internationalisation or have adopted shareholder-value strategies to a greater degree than others.

The bivariate and multivariate regressions in Tables 4 and 5 test the effect of the internationalisation of firms on the firms' behaviour towards the distribution of net value added. Table 4 shows regression coefficients of bivariate regressions under the statistical control of two variables that control for differences in accounting (the already mentioned difference between “cost-of-sales method” and “total costs method”) or, more accurately, the change between methods. Table 5 presents the result of multivariate regressions. We have included all variables that turned out to be significant in multivariate design, and have controlled in some cases for economic activity.

The results show that the variables measuring “real” internationalisation (the foreign share in employees and sales) are not significant in any case. The internationalisation of product-oriented economic activities are not likely to put pressure on non-liberal market economies per se. This is not too surprising since the majority of large German companies have been internationalised for a long time without changing their behaviour towards their shareholders or employees. German and Japanese companies have long since dominated the export market under extreme competitive pressure without repercussions on corporate governance or labour.

11 Ideally, we would like to extend the time frame in order to control for the business cycle. Owing to changes in accounting regulations, financial data on German firms before 1986 is not consistent with data after 1986. We are therefore confined to the period post 1986.

Table 4 Distribution of Net Value Added, Proxies for Market for Corporate Control, Financial and Real Internationalisation (Bivariate Regression)

| Dependent: Change in the proportion of net value added in percentage points | Labour | Creditors | Government | Dividends | Retained earnings |
|---|-------------------|-------------------|------------------|------------------|-------------------|
| 1996–1998 minus 1992–1994 | | | | | |
| Market for corporate control | | | | | |
| Dispersed ownership > 75% | –6.04 (–1.63) | –2.22* (–2.13) | 1.18 (0.84) | 1.15* (2.21) | 5.74 (1.68) |
| Dispersed ownership > 50% | 0.99 (0.39) | 0.40 (0.54) | –0.41 (–0.42) | 0.18 (0.49) | –1.16 (–0.49) |
| Conglomerate-dummy | –1.22 (–0.47) | 0.90 (1.21) | 1.10 (1.13) | 0.36 (0.98) | –1.30 (–0.54) |
| Financial internationalisation | | | | | |
| “Financial internationalisation” index | –0.94 (–0.54) | 0.62 (0.82) | 0.36 (0.35) | 0.84* (2.36) | –0.99 (–0.62) |
| – International accounting | –0.01 (–0.00) | 0.92 (1.04) | 0.08 (0.07) | 0.91* (2.22) | –2.06 (–0.90) |
| – Listing in foreign stock exchanges | –0.78 (–1.30) | 0.06 (0.27) | 0.16 (0.56) | 0.14 (1.35) | 0.46 (0.83) |
| – Percentage of shares in foreign ownership | –0.03 (–0.44) | 0.03 (0.91) | 0.02 (0.45) | 0.03 (1.68) | –0.05 (–0.75) |
| “Shareholder value” index | –3.57* (–2.28) | 0.07 (0.15) | 1.73** (2.99) | 0.75** (2.85) | 1.05 (0.74) |
| Real internationalisation | | | | | |
| “Real internationalisation” index | –1,74 (–0,78) | –0,75 (–1,61) | 1,72 (1,84) | 0,06 (0,22) | 0,76 (0,39) |
| – Foreign sales as percentage of total sales | –0,09 (–1,34) | –0,00 (0,23) | –0,02 (–0,97) | 0,01 (1,67) | 0,10 (1,64) |
| – Foreign employees as percentage of total employees | –0,11 (–1,71) | –0,03 (–1,91) | 0,04 (1,94) | 0,00 (0,55) | 0,08 (1,50) |
| – Geographical spread of activities | –3,42 (1,27) | –0,38 (0,49) | 0,78 (0,78) | 0,41 (1,05) | 2,65 (1,06) |

Unstandardised coefficients and t-values (in brackets). Two control variables are included in all regressions. They control for differences in accounting methods (“cost-of-sales method” vs. “total cost type of short term results accounting”) respectively change between methods. N ranges between 33 (missings in “shareholder value” index) and 59. Significance levels: * < 0.05, ** < 0.01.

Secondly we can observe that dividends are affected by variables of “financial internationalisation”, in particular the change in accounting practices towards international accounting methods, and by one of the proxies for the market of corporate control, namely dispersed ownership. The effects are significant and point in the expected direction.¹² The interpretation of the effect suggests that those firms which are actively pursuing an Anglo-American approach of corporate governance by changing their accounting practices and which are in dispersed ownership have increased their dividend payments to a significantly higher degree than those that are not. Both variables, the indicator for a market for corporate control and the indicator for an approach towards the international capital market, have an effect on the payment of dividends independent from each other.

Thirdly, we can see that the changing labour share is only affected by the shareholder value index. This is the variable which influenced the distribution of net value added most.

The effects for owners

How important are the changes with regard to the payout of dividends? The increase in the share of net value added between the period of 1992–94 and 1996–98 by 0.8 percentage points is relatively small. This becomes particularly apparent when compared to the share of dividends in net value added in British companies. In British firms, the share paid to owners in the form of dividends amounts to 15 percent of net value added – more than 10 percentage points higher than the share of dividends in German firms. Nevertheless, when we look at the changes in dividends in absolute terms, the increase in dividends is remarkable. Figure 1 shows the change in dividend payments in percentage points of the dividend payments of 1992. From 1992 until 1998, total net value added increases slightly, while the number of employees and the costs for personnel are largely constant. In contrast, dividend payments increase drastically from the mid-1990s onwards. The average sum of dividend payments doubles within less than a decade.

When re-running the bivariate and multivariate regressions on the change of dividends between 1992 and 1998, we find the same effects of Anglo-American corporate governance practices as before, but this time more pronounced. In the bivariate regression, all independent variables are significant with the exception of the dummy variable for conglomerates (see Table 6). In the multivariate analy-

12 The distribution of the variable “dispersed ownership” is skewed, however, since only a few companies (14 in the sample of 59 companies) are in dispersed ownership. This distribution indicates that only very few companies have been exposed to the market for corporate control so far. For the significant negative effect of the variable dispersed ownership on the creditor share and for the significant positive effect on retained earnings – Table 5 – we have not as yet found a satisfying explanation.

Table 5 Distribution of Net Value Added, Proxies for Market for Corporate Control, Financial and Real Internationalisation (Multivariate Regression)

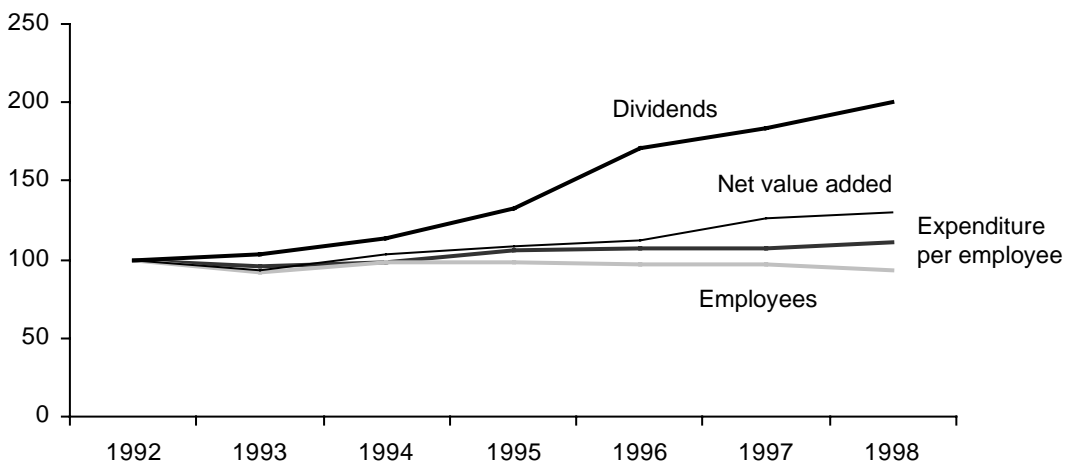
| Dependent: Change in the proportion of net value added in percentage points | Labour | Creditors | Government | Dividends | Retained earnings |
|---|-------------------|--------------------|-----------------|--------------------|--------------------|
| 1996–1998 minus 1992–1994 | | | | | |
| Constant | –2.72 (–1.64) | –0.83** (–2.71) | 0.87 (1.40) | 0.36 (1.66) | 3.80** (3.45) |
| Accounting method (COS vs. TC) | –3.99 (–1.03) | 2.25* (2.43) | 1.12 (0.76) | –1.49* (–2.32) | –4.96 (–1.42) |
| Change in accounting method | –5.44 (–1.35) | 2.85** (3.08) | 0.53 (0.34) | –2.21** (–3.60) | –6.29 (–1.78) |
| Market for corporate control / financial internationalisation | | | | | |
| Dispersed ownership > 75% | – | –2.28** (–3.03) | – | 1.21* (2.20) | 6.89* (2.46) |
| International accounting | – | – | – | 0.76* (2.08) | – |
| “Shareholder value” index | –3.57* (–2.28) | – | 1.49* (2.50) | – | – |
| Economic activity | | | | | |
| “Motor vehicles, trailers and semi trailers“ | – | – | – | – | 19.0** (4.64) |
| “Construction“ | – | 1.73* (2.02) | – | – | –8.52** (–2.71) |
| “Wholesale and retail trade“ | – | – | – | –1.67** (–2.91) | – |
| Model summary | | | | | |
| Df (total) | 32 | 53 | 32 | 47 | 55 |
| F | 5.46 | 4.43 | 4.64 | 4.82 | 7.27 |
| Sign. F | 0.004 | 0.004 | 0.009 | 0.001 | 0.000 |
| R2 | 0.361 | 0.266 | 0.317 | 0.365 | 0.421 |

Multivariate regressions, unstandardised coefficients and t-values (in brackets). Included are two control variables for accounting differences and those independent variables; which turned out to be significant in multivariate design. Significance levels: * < 0.05, ** < 0.01.

sis, the two variables “shareholder value” and “listing in foreign stock exchanges” under the statistical control of company size explains almost 76 percent of the variance in changes in dividend payments.

In addition, we can assume that the legal changes in 1998 towards more transparency and liberalisation of financial markets has an additional impact which is not as yet captured in our analysis. Therefore, we find a number of indicators for an increasing tendency on the part of companies to behave as if they were located in an Anglo-American corporate governance system and alter the pattern of their dividend payments. The effects we can observe in our data are small, but their importance is significant.

Figure 1 Dividends, Number of Employees, Personnel Expenditure per Employee



In addition, we can assume that the legal changes in 1998 towards more transparency and liberalisation of financial markets has an additional impact which is not as yet captured in our analysis. Therefore, we find a number of indicators for an increasing tendency on the part of companies to behave as if they were located in an Anglo-American corporate governance system and alter the pattern of their dividend payments. The effects we can observe in our data are small, but their importance is significant.

The effects for labour

What are the effects for labour? First of all, we have to point out that the increase of the share in net value added for owners has only an indirect effect on the level of the share for employees. In our analysis, we do not find any variable which impacts on both the share of labour and the share of owners simultaneously. While variables measuring the financial internationalisation of the firm have a direct impact on the changes in dividend payments, no variables measuring either real or financial internationalisation of firms seem to have an effect on the share of net value added for labour.

Table 6 The Effect of Internationalisation on the Change in Sum of Dividends in Mio. DM (Correlations and Multivariate Regression)

| Dependent: Change in sum of dividends, absolute values in Mio. DM | Corr. | Multivariate Regression | |
|--|--------|---------------------------------------|--------------------|
| 1996–1998 minus 1992–1994 | | | |
| Market for corporate control | | Model | |
| Dispersed ownership > 75% | 0.51** | Constant | –463.0* (–2.11) |
| Dispersed ownership > 50% | 0.39** | | |
| Conglomerate-dummy | 0.20 | | |
| Financial internationalisation | | Size (log of sales) | 59.0* (2.46) |
| “Financial internationalisation” index | 0.66** | | |
| – International accounting | 0.46** | Shareholder value | 49.4* (2.21) |
| – Listing in foreign stock exchanges | 0.71** | | |
| – Percentage of shares in foreign ownership | 0.49** | Listing in foreign stock exchanges | 20.1** (2.75) |
| “Shareholder value” index | 0.70** | | |
| Real internationalisation | | Model summary | |
| “Real internationalisation” index | –0.19 | Df (total) | 31 |
| – Foreign sales as percentage of total sales | –0.06 | F | 29.31 |
| – Foreign employees as percentage of total employees | –0.11 | Sign. F | 0.000 |
| – Geographical spread of activities | 0.14 | R2 | 0.758 |

Correlation coefficient (Pearson’s r) and unstandardised coefficients and t-values (in brackets) of multivariate regression. Significance levels: * < 0.05, ** < 0.01.

Moreover, Figure 1 shows that expenditure for personnel and the number of employees in absolute terms are nearly constant in the sample of our companies. This shows that the decline in the proportion of the net value added for labour is related to the relative increase in net value added and the stagnating absolute number of employees. The labour side did not lose out during this period in absolute terms, but was not able to participate in the improving business situation of the companies.

As shown above, the ability of the labour share to keep up with the increase in net value added varied with the shareholder value orientation of the company. The more a company pursued shareholder value strategies, the poorer the share of value added for labour. Why do shareholder value companies have a relatively lower share of net value added that is paid to labour than other companies? Since we are talking about share in net value added and not expenditure per employee,

Table 7 The Impact of “Shareholder Value” on the Proportion of Net Value Added for Labour

| “Shareholder value” index | Lower third | | Upper third | |
|------------------------------------|-------------|---------|-------------|--------|
| Number of employees | 125.2 | (+22.0) | 96.5 | (−6.7) |
| Personnel expenditure per employee | 107.2 | (−5.3) | 120.3 | (+7.8) |
| Net value added | 146.9 | (+12.4) | 134.5 | (−0.0) |

Note: Arithmetic mean for the upper and lower third of companies ranked by position on the “shareholder value” index, values of 1998 in percent of 1992. Difference from the total mean in brackets. N = 33 companies.

we can identify several reasons: firstly, shareholder value companies might have a reduction or proportionally lower increase in the number of employees; secondly, shareholder value companies might have a reduction or proportionally lower increase in personnel expenditure; thirdly, they might have a proportionally higher increase in net value added.

Table 7 differentiates between companies with high shareholder value (the upper third on the rank order of the index) and those with low shareholder value (the lower third on the rank order of the index). We see a *reduction* of employees in shareholder value companies, while numbers *rise* in companies with low shareholder value. Change in personnel expenditure per employee in shareholder value companies is *higher* than in other companies and increase in net added value is *lower*. The declining proportion of net value added for labour in shareholder value companies, therefore, has something to do with the decline in the number of employees.

Employees in shareholder value companies do not lose out in pay, but employment levels in shareholder value companies are relatively lower than in other companies. Company insiders are not negatively affected by shareholder value strategies. However, an increase in shareholder value orientation by management is followed by increasing restructuring and productivity increases, which in turn reduce employment levels in those companies. The shareholder value effect is, therefore, more an effect of productivity increase rather than an effect of cost-cutting.

In the US, both the emerging and strengthening of a takeover market and the orientation towards shareholder value have been identified as sources for the downsizing and restructuring of companies. “Top managers downsize the corporations they control, with a particular emphasis on cutting the size of the labour forces they employ, in an attempt to increase the return on equity” (Lazonick/O’Sullivan 2000: 4). The consequences of downsizing for the American labour market

have been far-reaching: growing job insecurity and increasing income inequality were closely associated with shareholder value strategies.

Overall, the employment-cutting effects of company restructuring that are prompted by the convergence towards Anglo-American business practices are likely to have the most profound effect on German industrial relations institutions. If the employment base of the most important German companies continues to shrink, the interplay between big company product-market strategies and labour relations institutions that used to be the backbone of the German production model is likely to be eroded (Hassel 1999). At a wider societal level, further employment losses in high performing companies at the general level reflects the fact that shareholder value strategies are at the advantage of shareholders and core employees alike, while they prove to have a negative effect for fringe employees and society as a whole.

6 Conclusion

In recent years there has been an increasing emphasis on the notion that the institutions embedding a national political economy display characteristics of institutional complementarity. Specific configurations of sets of institutions are not distributed arbitrarily across countries but show systematic patterns which give reasons to assume that even sets of institutions in different spheres of the political economy are linked by specific microeconomic incentive structures.

If this is the case, we should not only find clusters of certain sets of institutions across countries, but also find implications of institutional complementarity in the diachronic development of the firm. In the context of a rapidly changing corporate governance regime in Germany, we assumed that those firms that are approaching the Anglo-American governance system more rapidly than others should behave in a more Anglo-American pattern towards their owners and employees. In firms with a higher degree of financial internationalisation or Anglo-American corporate governance practices, owners should be able to capture a higher share of net value added as paid out in dividends, while labour would tend to lose out.

What we found in an analysis of financial data of 59 large German firms is that the changes in the distribution of net value added between 1992–94 and 1996–98 between different stakeholders can, to some extent, be explained by the increasing orientation of firms towards international financial markets and the increasing importance of a market of corporate control. The effects, we found, were

mainly in the relationship between owners and management and the payout of dividends. The effects were relatively small. On the other hand, the process of the financial internationalisation of German firms only started in the mid-1990s, with the increasing orientation towards international accounting practices, the listing on foreign stock exchanges and the setting-up of active investor relations. Moreover, legal regulations aimed at the liberalisation of equity financing and the facilitation of access of German firms to international capital markets only took effect in the late 1990s (*KonTraG, Kapitalaufnahmeerleichterungsgesetz*). With regard to hostile takeovers, no legal regulation facilitating hostile takeovers has been implemented as yet. Therefore, we should expect that the effects we have captured should become stronger in the future. Compared to the share of net value added that owners of British firms receive, it is still a long way to go for German investors. British firms in the early 1990s paid a share of 15 percent of net value added, while the share for owners in German firms increased from 2 percent to 2.8 percent over a period of 5 years (Table 1). Convergence is still a long way off. Also, cyclical factors play a role in the distribution of net value added that cannot easily be eliminated from the analysis.

Our analysis supports the assumptions of principal agent theory with regard to the relationship between owners and management, namely that the agency problem takes different forms depending on the corporate governance institutions and that each system requires different types of monitoring. In stable corporate governance systems, there is a fit between the ownership structure of companies and the monitoring mechanisms aimed at reducing agency costs.¹³ When moving from a network-based system to a market-based system, these monitoring mechanisms adjust to the changing situation. The changing distribution of net value added and the higher share for investors reflects this development, in particular if legal changes provide further rules on investor protection and transparency.

There is less support for assumptions that these developments will have spillover effects for the relationship between management and employees. We found no effect of increasing internationalisation on the share of labour in net value added. Popular arguments about an increased competitive downward pressure on wages under the impact of internationalisation cannot be supported by our data. The only effect to be found stemmed from the shareholder value orientation of firms and could be traced back to a reduction of the workforce in these firms with expenditure per employee remaining constant.

Moreover, the changes in the corporate governance of firms do not seem to have had any effect on the share of net value added for labour. Whether firms adopted international accounting standards, were listed on foreign stock exchanges or

13 We would like to thank Michel Goyer for pointing this out to us.

were in dispersed ownership did not matter for the share of labour in net value added, whereas it did matter for the share for owners. Several explanations might explain this finding.

Firstly, one could argue that one should expect a time lag between changes in a firm's strategy in the corporate governance sphere and its impact on labour. In Germany, wages are extremely sticky and redundancy protection is strong. Even if firms actively sought to lower the share paid out to labour, it might take a longer period of time to adjust the payout of net value added to labour to an Anglo-American standard.

Secondly, one might conclude that economic institutions in different spheres of the political economy are much more loosely coupled than is assumed in the theory and that the specific national clusters of institutions are more due to historic coincidences than to systematic microeconomic linkages. In other words, patient capital and strong labour participation might have accidentally evolved in parallel in Germany and Japan with no necessary linkage between the two. If this is the case, less patient capital might happily co-exist with strong labour rights.

Thirdly, the relationship between corporate governance and labour relations might be coupled in a more complex form. Changes in the conduct of corporate governance have spill-over effects on other spheres of the political economy albeit in different ways than expected. For instance, the comparatively higher share for labour of net value added in German firms also reflects a higher stock of human capital in those firms compared to Anglo-American firms. If firms now have to deliver a higher return on investments to owners, management might start to bank even more on a high productivity – high consensus orientation with labour in order to be able to deliver to owners, rather than decreasing the share for labour in net value added. Higher productivity might affect the employment of the firm, but not necessarily the pay of those who remain in the firm. The analysis of the impact of shareholder value orientation on labour points in this direction, although no indication has been found that internationalisation has similar effects to shareholder value orientation.

These three explanations are not mutually exclusive but each of them contains some important aspects of the overall picture. Despite the renewed interest in the topic in recent years, the relationship between corporate governance regimes and labour relations is not yet conceptualised thoroughly enough to be able to draw a firm conclusion on the implications of change in one sphere for the conduct of the other. We would, however, tend to give credibility to the last explanation, which draws our attention to a form of economic adjustment that serves the interest of owners while not necessarily having a negative impact on a firm's core workforce.

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