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Changing Corporate Governance and Competition Policies in the European Union

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Determinants of Technology Licensing

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Abstract:

This paper empirically analyzes technology licensing with the help of a large panel data set of observed licensing transactions involving United States companies across all sectors during the 1990s. The stock of technological knowledge of the licensor, this company's prior licensing experience, the rate of growth of its primary industry, the strength of the intellectual property protection regime in that industry, and the nature of the new technologies produced by the licensor are found to be important determinants of the propensity to sell technology through nonexclusive licenses. The degree of technological/product complexity of the primary industry of the licensor proved a significant explanatory factor of the propensity for exclusive licensing (negative effect) and for cross licensing (positive effect). There are indications of a U-shaped relationship between stocks of technological knowledge and company tendency to sell technology.

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By the fall of 2001 global economic growth had measurably slowed and firms throughout the industrialized world faced falling demand for their products and services. Yet as they searched for ways to address the problem, the globalization of competition continued to escalate, particularly in high-tech industries as, for example, information- and biotechnology and in some service industries such as finance.¹ Technical innovations, production efficiencies, low-cost capital, sophisticated managerial and labor skills and new markets continued to be as much in demand during the downturn as during the high-growth 1990s.

As measured by conventional macro-economic indicators such as growth, manufacturing productivity and unemployment, the European Union (EU) economies had lagged behind the U.S. economy for almost all of the 1990s.² America's economy, except for one year, maintained an average annual growth rate of more than 3% while the average annual EU growth rate was less than that, except for one year. Such performance is usually explained in terms of the traditional European desire for economic stability and social safety as reflected by the widespread acceptance of the welfare states following World War II.³ They are characterized by inflexible economic structures comprised of regulated product-service, capital and labor markets, high taxes, generous public spending and managerial systems that are risk averse. Over time, this had brought about a corporate governance system that sustains and, in turn, is sustained by such economic features and managerial practices.

Yet traditional European companies such as Siemens of Germany, Olivetti of Italy and Renault of France, too mention only a few, had maintained a major presence throughout the world for many decades. They had and continue to offer high quality products effectively marketed, serviced and purchased by loyal customers. Eventually, these traditional companies were joined by other firms such as the cellular-phone manufacturers Nokia of Finland and Ericsson of Sweden that not only compete effectively but also took on the technological leadership of their industry. Moreover, jointly, they also obtained the largest global market-share in the industry (43% in 2000, with Nokia dominating) ahead of America's second-placed Motorola (14.8%).⁴ Another example of a powerful emerging high-tech EU firm is the United Kingdom's Vodafone that through mergers and acquisitions grew into the world's largest network operator by the beginning of the 21st century.

But such successful and globally competitive high-tech EU companies are still the exception rather than the rule. According to a report by the Economic Advisory Group of the EU Commission, of the 100 top companies in the broadly defined high-tech "New Economy" the EU nations are represented by only 6 firms, 3 of them Scandinavian.⁵ Instead of fully restructuring during the 1990s to meet the challenges of the rapidly changing global marketplace, most EU companies tinkered at the edges of efficiency, cutting a few jobs here and selling a division there. As a result, measured by annual revenues earned during the 1990s, of the world's 50 largest high-tech companies 36 were American and only four European.⁶ The strong performance of the American firms is usually ascribed to the flexible U.S. economy and the effective corporate governance system that is an integral part of it.⁷

¹ Globalization is interpreted in numerous different ways nowadays, ranging from the positive to the negative. As understood in this paper it is an economic process referring to the globalization of competition that takes place in an industry and is comprised of the evolving new patterns of cross-border activities of corporations based on trade, international investments and forms of cooperation. It involves the development of new technologies, products and production-processes, markets and marketing techniques and the sourcing of inputs such as raw materials, capital and labor.

² It has been a challenge to economists to explain the excellent performance of the U.S. economy during the 1990s. In time, explanations focused on the average annual productivity increase of 2.5% and the contributions of the information technology industry to the rest of the economy. "ITC Driving U.S. Productivity Gains." [Press Release](#), U.S. Industrial Conference Board, October 29, 2001. The "Annual Economic Report of the President," released in January 2002 made the same point. It should be pointed out, however, that during the 1990s a number of individual EU economies have done well not only in terms of the levels of productivity and GDP per capita, but also in terms of productivity growth. But these relatively successful performers were small states such as Ireland, which led the group. The large nations, generating over 80% of EU GDP as, for example, Germany, the United Kingdom, France, Italy and Spain did not do well.

³ European welfare states provide a broad and deep social safety net that includes, among others, relatively secure employment, generous unemployment and other benefits, regulated working conditions and extensive public pension system benefits, all financed through high taxes.

⁴ [Financial Times, Deutschland](#), October 2, 2001, p.4.

⁵ [Financial Times](#), February 20, 2002, p.15.

⁶ [The Economist](#), September 16, 2000, p. 77.

⁷ Occasionally, the system breaks down, particularly the transparency, disclosure and monitoring aspects. Recent examples include Long-Term Capital Management in 1998 and the Enron Corporation in 2001- 2002.

The Concept of Corporate Governance

There is an extensive literature providing legal and economic definitions of corporate governance systems.⁸ In this paper such systems are understood in a broader sense, consisting of a set of internal and external arrangements and processes that are shaped by the political, economic, legal and social characteristics and values of societies.

The internal arrangements comprise the type and structure of ownership, company objectives, the nature of the internal decision-making processes, the role of share- and other stakeholders, sources of financing, the monitoring, reporting requirements and the managerial incentive system.

The external arrangements consist of the political-institutional features such as the location and distribution of power and the nature of the decision-making processes. They also encompass the economic and, to some extent, the social structures, particularly the degree of competition and flexibility in the product, service, capital and labor markets and the extent of the social safety net. Additional features are the legal and regulatory requirements governing business activities.

Objective and Significance of the Analysis

It is the objective of this paper to provide insight into the evolving EU-wide corporate governance systems and discussing changes in the internal management arrangements while keeping the political-institutional, economic settings and changes in the relevant legal and social features in mind.

The changes are of global importance. With a total population of about 380 million people Germany, France, the United Kingdom, Italy, Sweden, Denmark, the Netherlands, Belgium, Austria, Luxembourg, Finland, Ireland, Spain, Portugal and Greece produce about 25% of annual global output. They have created the Single Market, the world's largest integrated market and carry out more than 16% of global trade, exclusive of internal trade.⁹ EU research institutions, universities and firms contribute to worldwide technological advances, financial institutions move huge amounts of capital across national boundaries and private sector firms are major participants in global foreign direct investment activities.¹⁰

The significance of the changes had been enhanced on January 1, 2002, when the national currencies of the 12 member countries of the Economic and Monetary Union (EMU) of the EU were permanently replaced by a new currency, the euro. In time, the euro will become a major global trade, investment and reserve currency, befitting the EU's growing economic power. Following its introduction, from 6 to 10 nations of the Central- East European, Baltic and Mediterranean regions will most likely be admitted as new members around 2004-2006. This will raise membership from 15 to 21-25, enlarging the size of the internal market to more than 500 million people.¹¹

Germany, with a population of 80 million and a \$ 1,853 trillion GDP in 2001, representing 21% of the total population and 23% of the common GDP, is the EU's largest and most important economy.¹² Moreover, in contrast to other member nations as, for example, the United Kingdom, the Netherlands, Ireland or Spain, its economy continues to strongly reflect the traditional European welfare state features and values. Germany well illustrates the difficulties of restructuring economies and changing the extant corporate governance systems, thus its arrangements and experiences are frequently referred to throughout the paper.

Objectives and Nature of Corporate Governance

The general objective of corporate governance is to align the interests of firms with those of society, to balance entrepreneurship with accountability and to enable companies to earn a rate of return on investment that generates additional capital. Investors are separated from managers through the institution of the joint-stock company or publicly held corporation. Separation upholds the specialization of management functions

⁸ Andrei Schleifer and Robert W. Vishny, *Journal of Finance*, June 1997, pp. 737-783.

⁹ The objectives of the Single Market are the free movement of products, services, capital and labor. To date, these goals have not been fully achieved. The Single Market is a successful work in progress.

¹⁰ Various 1999-2000 *EUROSTAT* reports.

¹¹ The Czech Republic, Poland, Hungary, Slovenia, Estonia and Cyprus are already deeply engaged in entry negotiations. Several other nations have started talks. For a discussion of issues related to corporate governance developments in the transforming economies, see, Alexander Dyck, *Ownership Structure, Legal Protections and Corporate Governance*, Washington D.C.: The World Bank, April 2000.

¹² *International Financial Statistics* (Washington D.C.: International Monetary Fund, 2002.)

and the diversification of risk across the investor- stakeholder base.¹³ Investors and other stakeholders use the governance systems to influence managers to realize their particular goals that may be economic or social or a combination thereof. It is in this sense that corporate governance systems reflect social values.

The attainment of both the general and particular objectives requires safeguards such as transparency and enforceability. Without safeguards, managers could use their position to siphon off economic benefits and thereby weaken long-term corporate performance, reducing investment values. The systematic enforcement of safeguards pertaining to corporate activities and governance issues shapes the business environment and the management ethos of companies. Managers are motivated to obtain financial and other resources on the best possible terms and to use them in the most efficient manner.

It is through the various legal and economic arrangements and processes that investors and other stakeholders establish firms, select, monitor, reward and otherwise influence managers whom they hire to use, safeguard and augment their capital. It is the responsibility of governments to provide transparent political, legal and economic environments to protect individuals, firms and society against the misuse of resources or fraud.

The rapidly expanding globalization of competition and the growing diversity of investor ownership structures, financial products, management methods together with the ongoing differences in how societies and economies are organized and managed, preclude the formulation of a generally accepted corporate governance system. Undoubtedly, international investors and expanding capital markets are gradually bringing about a degree of convergence. Flexibility, transparency and accountability, for example, are by now generally recognized as crucial governance features. But the political, economic, legal and social contexts still vary from country to country or region to region.

Types of Corporate Governance

The corporate governance systems used throughout the world are rooted in either the stock-market based Anglo-Saxon (outsider) or the more traditional bank-based (insider) European and Japanese governance systems.¹⁴ At present, the Anglo-Saxon system is primarily used in the United States and, with modifications in the United Kingdom and Ireland. The European system, with country-to-country variations, is practiced in the other EU nations while different versions of the Japanese system are used throughout the Pacific Basin Region.¹⁵

The main features of the Anglo-Saxon system are dispersed ownership and detailed legal provisions. The rights and responsibilities of investors and other stakeholders are defined by formal rules and applied through legal contracts relying on competitive and transparent market transactions. The primary responsibility of management is to maximize shareholder value. With compensation tied to profits and stock options, managers are under constant pressure to realize this goal. Failure to do so is quickly reflected by declining share prices in the deep and liquid capital markets. The major strength of the system is its flexibility, transparency and accountability, enabling corporate managers to rapidly respond to competitive challenges and shareholder demands. Its disadvantages are the limited influence of stakeholders other than shareholders and the income and wealth gap between managers and workers on the one hand and shareholders and the rest of society on the other hand.

The Japanese corporate governance system is bank- and stakeholder based with the "keiretsu," a unique form of industrial organization, playing a major role. A "keiretsu" is a network of businesses made up of a core company and/or a main bank and associated firms that maintain concentrated cross-ownership arrangements.¹⁶ Its advantage is stability, however, this feature can turn into inflexibility, as seen in Japan since the early 1990s.

¹³For a detailed discussion see, Corporate Governance: Improving Competitiveness and Access to Capital Markets. A Report to the OECD by the Business Sector Advisory Group on Corporate Governance, Paris: Organization for Economic Co-operation and Development, 1998.

¹⁴ For more details see, Paul J.N. Halpern, " Systemic Perspectives on Corporate Governance Systems," in Steven S. Cohen and Gavin Boyd (editors) Corporate Governance and Globalization: Long Range Planning Issues (Northampton, MA,: Edward Elgar Publishing Inc., 2000) pp. 1-58.

¹⁵ The dominant types of corporate government systems have been extensively discussed in the literature. See, for example, Andrei Schleifer and Robert W. Vishny and Steven S. Cohen and Gavin Boyd (editors) cited above. For a discussion of some of the changes in the Pacific Basin Region, see, "The End of Tycoons," The Economist, April 29, 2000, pp.67-69.

¹⁶ In times of high economic growth and corporate profits (1970-1990) the system had worked well because it insured stability in all business relations. But in times of low growth and profits (1991-present,) requiring restructuring and other related corporate changes, the systems stability turns into rigidity. Consequently, the Japanese are currently reviewing the system as part of an overall examination of

The EU Corporate Governance Systems

The corporate governance systems used throughout the EU nations vary. They are rooted in two broad European corporate law traditions; the company- and the enterprise-law based legal systems.¹⁷ In the company-based legal system the emphasis is on the firm as a legal entity and the relationship between it and its investors. In the enterprise-law system the focus is on the enterprise as a real economic and social unit, including the role and relationships of its stakeholders. In the EU, the company - based corporate legal system is used in the United Kingdom and Ireland; the enterprise -based legal arrangements are applied primarily in Germany, the Netherlands and most other member nations.

Concentrated ownership by banks or other firms and complicated stakeholder relations are common features throughout the region. Banks may be major equity owners and lenders at the same time, raising the scepter of moral hazard. Labor unions and/or governments often influence management to achieve political and social goals such as stable employment, sometimes regardless of economic performance. The stakeholder-based consensual decision-making process tends to be opaque and hard to penetrate for outsiders. The use of stock options and other financial incentives tied to profits is limited. Moreover, capital markets do not consistently sanction management for not maximizing shareholder value. The strength of the systems is that it focuses not only on shareholder interests but also considers the goals of other stakeholders. These may include the protection of jobs, a reasonably equitable income and wealth distribution and economic and social stability. Its weakness is limited flexibility, transparency and accountability, particularly by large shareholders. Consequently, firms find it difficult to quickly and decisively respond to changing market conditions, particularly competitive challenges.

Selected Key Features

EU nations vary in size, legal systems, forms of industrial organization and social traditions. Some nations such as Germany, Italy, France, Belgium, Greece, Portugal and Austria reflect the traditional welfare state values. Others as, for example, the United Kingdom, Sweden, Denmark, Finland, the Netherlands, Ireland and Spain have already introduced more competition oriented economic policies that have reduced the scope of the welfare states. Ireland, for example, through sound economic policies has experienced almost 20 years of rapid growth achieving a per capita GNP that is now even with that of the United Kingdom. The different national economies also dominate different industrial niches. Italy, for example, maintains large financial-industrial groups and clusters of family firms, Germany is characterized by mid-sized family owned and large engineering companies while Sweden and Finland by high-tech communications multinational corporations.

As a consequence, the current EU corporate governance systems are a patchwork of arrangements. At one end of the continuum are Germany, France and Italy with concentrated ownership, bank oriented financing system, relatively illiquid capital markets and enterprise-based corporate laws that place moderate emphasis on the monitoring of corporate performance by stock-markets. At the other end are the United Kingdom and Ireland with their dispersed ownership, liquid capital markets and corporate laws that rely heavily on the stock market to monitor the performance of firms. The other member states are in between the two extremes.

Concentrated ownership is widespread, with reasons and structures differing from country to country. Except for the United Kingdom and Ireland, in most nations concentration is seen as supportive of long-term orientation that benefits all stakeholders, including society as a whole. In contrast, widely dispersed ownership is viewed as too focused on short-term objectives such as shareholder value maximization. In Germany, for example, more than 80% of publicly listed companies have a single shareholder, owning more than 25% of equity.¹⁸ Cross-ownership in unrelated companies is prevalent. Other nations with major ownership and voting blocks include Italy, Austria and Belgium. In France, domestic investors own large companies as a matter of government policy, a feature enhanced by the lack of institutional investors. In Italy, banks and holding companies own networks of firms through pyramids of cross-shareholdings. Elsewhere, as, for example, in Sweden several large companies are owned by business dynasties rooted in the late 19th or the early 20th

their economy. Changes, however, are slow in coming. Following the 1997-1998n financial crises, the same is true in the Republic of Korea and other Pacific Basin nations.

¹⁷ For a more detailed discussion see, E. Wymeersch, "Elements of Comparative Corporate Governance in Western Europe," in M. Isaksson and R. Skog (editors.) *Aspects of Corporate Governance* (Stockholm: Juristforlaget, 1994.)

¹⁸ Interview with Dresdner Bank official, Frankfurt, Germany, September 26, 2001.

centuries. It should be noted that in some nations disclosure laws are still not working well thus it is difficult to find out what real ownership structures are.

Other internal features also vary. The Netherlands shares elements of its corporate law with France but uses the two-tiered German corporate management structure that in firms with more than 500 employees comprises a supervisory and a management board. The supervisory board is made up of outside directors sometimes elected by the employees and/or appointed by the labor unions, thereby realizing the objectives of "co-determination," i.e. the involvement of workers in management. It appoints and oversees the management board that runs the day-to-day activities. Unlike under the one-tiered board structure used by French firms, German and Dutch companies thus practice a form of collective leadership. To emphasize this, German firms have "speakers of the boards" rather than "chairmen" as in France. For a number of years, the EU Commission had tried to introduce the German-Dutch system in all member countries. But most of them, in particular the United Kingdom and Ireland had strongly objected to the proposal, thus nothing came of it.

Strong economic growth, following the enforcement of the fiscal austerity measures mandated by the 1993 Maastricht Treaty's convergence requirements and the necessity to stimulate weakening economies in 2000, had prompted several EU governments to change tax laws and to reduce tax burdens.¹⁹ In some countries, the changes promote the restructuring of company ownership arrangements. Germany, for example, introduced radical personal and corporate income tax reforms in 2001. Aggregate taxes were lowered by an amount equal to 2% of GDP. Top individual tax-rates went from 51% to 42% and corporate rates from 52% to 39%. The change that most profoundly affects corporate governance in the long run is the elimination of the capital gains tax on corporate shareholdings in other companies. The measure is giving corporate restructuring a major boost, although there are good reasons not to expect a sudden rush of transactions. Regardless of the tax changes, restructuring of ownership structures has been going on for a while. Moreover, taxes are not the only restructuring consideration; the state of the stock market also matters. As long as Germany's DAX (stock-market index) has not fully recovered from its 2001-2002 decline, companies are not going to engage in a widespread selling of shares. But even with a stronger stock-market, firms are likely to be careful about selling equities that perform better than the DAX index benchmark. Companies are also motivated to hold on to certain shares because sales by parent companies will not be tax-free until 2006. In the meanwhile, corporate spin-offs are treated less favorably than the sale of stakes in other companies.

Another state that had introduced tax changes is France. However, the French reforms were more limited, both in terms of magnitude and scope than the German changes. The top personal income tax rate was reduced by 2% while business income taxes were lowered mainly for small-and medium-sized firms. The chief beneficiaries of the reform are workers at the lowest income levels, which may motivate the unemployed to look for jobs because relative to wages unemployment benefits are now less attractive. While not having a major effect on corporate governance, the reforms in the long run may have a mildly positive impact on the labor markets by somewhat increasing flexibility.

Governance Integration Trends

During the 1990s the EU nations had experienced strong pressures to develop more effective corporate governance systems, tending toward the Anglo-Saxon model as applied in the United States. There were several general reasons for this. First, the example set by the stellar performance of the U.S. economy and American companies. Second, as the globalization of competition spread, investors in general and large institutional investors in particular demanded more uniform and transparent corporate governance standards. To raise investment funds in the international capital markets firms had to meet Anglo-Saxon governance norms. Third, the good economic performance of the EU member states during the second half of the decade, the establishment of the EMU and the introduction of the euro in 12 countries had encouraged cross-border mergers, requiring transparent and flexible transactions. The continual expansion and deepening of the Single Market were additional factors that enhanced the process.

The EU nations' political and cultural establishments and even members of the business communities have frequently expressed reservations about some of the efficiency measures applied by American companies. The member states appear to simultaneously seek efficiency and competitiveness on the one hand and social and economic stability on the other hand. In 1999, Tony Blair, the Prime Minister of the United Kingdom,

¹⁹ To join the EMU, by the end of 1998 prospective member nations had had to meet specific annual budget deficit, public debt, inflation, long- term interest rate and exchange rate targets.

French Premier Lionel Jospin and German Chancellor Gerhard Schroeder had even contemplated the development of a "third way" of structuring and managing economies that would differ from both the traditional European welfare and the American competition-based systems. Introduced with a great deal of fanfare, notions of such a "third way," however, quickly evaporated when they could not agree on what it means. Nonetheless, when the U.S. economy began to slow, the prime ministers and the chancellor together with the other EU heads of states and governments announced that their economies were sufficiently different from that of America not to be affected.

But soon they had had to realize that the world economy was undergoing major changes and that the linkages among the world's industrial economies are tighter than they had assumed. True, many of the EU member states' emerging economic problems could be ascribed to the global slowdown; quite a few of them, however, were homemade. Whereas the American economy had been engaged in creative destruction for most of the 1990s, the EU economies displayed destructive caution.²⁰ Most large companies were managed by well-educated and trained technocrats who had steadily risen through the ranks but had a rather limited understanding of general management and marketing in the era of the globalization of competition. Well managed companies faced a myriad of laws, rules and regulations while the poorly run firms were often saved at taxpayers' expense because of the employment implications. In time, consensual decision-making turned into a veto against change and social and economic stability considerations into the maintenance of established structures. As the potential losses caused by change became politically less and less acceptable, even those who were willing to alter the status quo retreated.

The primarily technologically driven global competitive changes during the 1990s and the 2001-2002 global economic downturn combined with the skyrocketing costs of the traditional welfare states eventually had sobering effects on the political and business leaders throughout the region. They recognized that the frequently discussed but always delayed EU-level political-institutional and structural national economic reforms, including the development of more effective corporate governance systems, could no longer be postponed.²¹ Undoubtedly, the slowdown of the global, U.S. and EU economies and the Enron scandal somewhat reduced the pressures for change. Nonetheless, improving the flexibility and efficiency of the EU economies and revamping the corporate governance systems became major policy objectives of the member nations.

The change process, however, is slow and gradual. It requires a new worldview in general and a different economic value system in particular. Managerial philosophies, organizational structures, competitive strategies and, most of all, labor market structures and practices have to be altered.²² Not surprisingly, across the EU, particularly in Germany and France, a palpable sense of unease has emerged over what is seen as an expanding American led globalization of competition process. While apprehensions are the strongest in Germany and France, other EU nations also express concerns. They believe that shorter working hours and more opportunities to enjoy life are more important than economic efficiency, a higher per capita GDP and a corporate governance system that focuses on shareholder value. Many in the political and cultural establishment believe that the change process threatens to spread American economic and social conditions and values such as pronounced income inequality, individualism and addiction to work, challenging the traditional European way of life. In almost every speech dealing with economic issues, Chancellor Schroeder keeps emphasizing that he does not want "...American conditions in Germany."

Such views, however, are by no means universal. Some politicians, opinion makers in the media and the majority of business executives argue that the establishment members of their respective countries are too self-satisfied and not open to change coming from the outside world.²³ Others point out that the critical views primarily reflect concerns about the future of the traditional welfare states that for decades have provided a

²⁰ It was the Austrian-American economist Joseph Schumpeter who formulated the concept of "creative destruction" as a positive growth force in competition-based market economies.

²¹ Various issues of the *Economist*, *Financial Times*, *The Wall Street Journal* and *Business Week* published during the years 1998, 1999 and 2000. The January 31, 2000 issue (pp. 81-87) of *Business Week*, contains a particularly informative article about the economic changes taking place in the EU nations. See, also EU Commission, Forward Studies Unit, Competition Advisory Group, "Sustainable Competitiveness: Report to the President of the Commission and the Heads of State and Government." (Brussels: EU Commission, September 1999.) Another insightful publication is a working paper by Alexis Jacquemin, "European Competitiveness and Business," (Brussels: EU Commission, Forward Studies Unit, 2000.)

²² Small- and medium-sized family-owned companies are also adjusting to the changing times. The euro has increased pressures on them to obtain equity capital when expanding either domestically or throughout the region, specially when banks reduce lending, as many have done in the recent past.

²³ See, for example, Joseph Joffe, "Agenda Deutschland," *Die Zeit*, March 7, 2002, p.1.

continually increasing standard of living together with economic and social stability. It should be noted that many EU citizens are also practicing wishful thinking. They believe that the economic, technological and social changes that have already arrived or are still looming on the global horizon can be stopped by applying traditional policies, however, effective they may have been in the past. Most people fail to understand that the most effective way to maintain or increase the quality of life in the long run is through productivity growth generated by efficiency improvements, however, painful in the short-run.

A case in point is the view in some countries on cross-border mergers and acquisitions. While the hostile takeover of the large German company Mannesmann by Vodafone of the United Kingdom made German business history, it was not well received by the public in general and the labor unions in particular.²⁴ Fears were expressed that the takeover signaled the victory of America's "jungle capitalism" over the Europe's welfare states, in particular over Germany's "Rhineland" capitalism, a social market economy with a "soft face." in particular. Concerns were expressed that the rules of post-war German labor-corporate management relationships were being re-written from the outside for the benefit of shareholders. Politicians and editorial writers argued that a nation is not just an economic entity, but also a system of social relationships and values that ensure a quality of life desired by citizens.²⁵ As many Germans see it, through power sharing and the traditional principle of consensus seeking, workers and other company stakeholders want to maintain influence over what happens in their lives. It should be mentioned that just about the same time as the Mannesmann takeover, the German government spent \$130 million to rescue the insolvent construction firm, Philip Holzmann. Seen from abroad, the bailout was an anachronism even for a traditional welfare state, sending the wrong signal to international investors. At home, however, Chancellor Schroeder's bailout decision was an instant success, applauded by opposition politicians, bankers, industrialists, the media and average citizens. In March 2002 the firm filed for bankruptcy.

In France the gradual restructuring of some industries that began a few years ago had attracted billions of dollars in investment capital, much of it from U.S. and United Kingdom pension funds. This sparked a series of debates about the relationship between French cultural values and the demands of the international capital markets. French President Jacques Chirac was quoted as complaining that "...French workers were being asked to sacrifice simply to safeguard the investment benefits of Scottish widows and California pensioners."²⁶ It is interesting to note that when in 1999 the partly state-owned car manufacturing company, Renault, eliminated 20,000 jobs at the Japanese car manufacturing company, Nissan, no one in France took notice of the job cuts. On the contrary, French politicians and the media praised the acquisition of a major 37% stake in Nissan by Renault and the subsequent restructuring as a prime example of a successful international expansion and management project by competitive French firms.

Specific Trends

All EU nations, including Germany and even France, are acquiring an Anglo-Saxon corporate governance tinge, albeit to varying degrees and at a differing rates. Tougher disclosure laws are gaining traction, shedding more light on ownership structures. Managers are paying increasing attention to shareholder value as a part of corporate strategies. Cross-border mergers and acquisitions are changing the industrial landscapes while companies switch to more sophisticated profit yardsticks such as "value added," a shareholder value related measure. One of Germany's major banks, the Deutsche Bank has created a powerful new executive committee to streamline decision-making. This places a considerable amount of authority in the hands of the chief executive, an arrangement rather rare in Germany but the norm in US companies. Many of the industrial giants across the region have adopted international accounting standards and in most nations, executives are providing more information about their remuneration, including benefits. And there is a growing tendency to align the interests of top executives more closely with those of shareholders by making share options a part of income.

As pointed out previously, much of the pressure to introduce these Anglo-Saxon governance elements is coming from international shareholders throughout the world who want to see more transparent business transactions in the EU nations. For example, it had been pressure from United Kingdom and other non-German shareholders that forced the management of Mannesmann to accept the controversial hostile takeover bid

²⁴ There were, of course, numerous behind-the-scene battles for company ownership in the past, leading to substantial financial gains by majority and even minority shareholders. The Mannesmann takeover, however, was the first hostile battle for ownership.

²⁵ "The Fifth Power," *Die Zeit*, No.18, April 27, 2000, p.4.

²⁶ *The New York Times*, January 9, 2000, p. 10.

coming from Vodafone. Even though German Chancellor Schroeder publicly deplored the takeover arguing that it was against German business traditions, the management of Mannesmann did not ask for political help. It played and lost by the Anglo-Saxon governance rules

In view of such developments, Germany in 2002 had introduced a new corporate governance code for publicly traded firms, albeit a voluntary one. It was developed by a committee of institutional and private investors, employee representatives, supervisory and management board members, business consultants and academics. Its objective is to make Germany more attractive to international and domestic investors by changing the traditional governance arrangements and practices. These have been strongly criticized by international investors. The criticism included references to inadequate focus on shareholder interests, the two-tiered system of management, particularly the lack of independence of the supervisory board, inadequate transparency and the limited independence of financial statement auditors.

The new code provides more independence to supervisory boards, calls for increased corporate transparency, particularly in the case of hostile takeover attempts and strengthens the role of company auditors. It also proposes that companies regularly publish information concerning executive remuneration. The Association of German Industry and the Association of German Shareholders support the code, although the former expressed strong opposition to the publication of executive pay. It argued that publishing such information violates privacy rights and goes against standard European practices, outside of the United Kingdom where Anglo-Saxon corporate governance norms prevail.

Referring to the collapse of America's Enron as a warning sign, the government emphasized that under a new law publicly traded firms have to declare whether they intend to abide by the voluntary guidelines. While there are no formal sanctions for non-compliance, the government expects EU and international capital markets to pressure firms that choose to ignore the guidelines. The code and the new law are a step in the right direction, but it remains to be seen to what extent they are going to improve the efficiency, effectiveness and, in particular, the transparency of German corporate practices. Considering the changes, it appears that German industry, the financial sector and the government find themselves in a transitional stage in which neither the traditional nor the Anglo-Saxon corporate governance system can be fully relied on.

A nascent shareholder culture is also developing across the region. According to the German Shareholder Institute, in 2000, 35% of Swedes, 33% of Spaniards, 31% of Danes, 30% of the Dutch and 23% of UK citizens, 21% of Greeks, 17% of Germans 13% of the Irish and around 10% of the French were shareholders.²⁷ In comparison, only 25% of Americans and 9% of Japanese owned stocks during the same year. The 2001-2002 global economic downturn has undoubtedly damaged investor confidence and thus reduced share ownership. This may slow the growth of a shareholder culture across the EU but is not likely to turn the clock back. The new generation of working men and women will not be able to retire on the public pension systems alone. They are realistic and do not see stocks as a quick way to riches but want them as an alternative to savings accounts, regardless of the risks involved. Anglo-Saxon ways are also brought into the EU nations by a new generation of managers, many of them with American MBAs, others with backgrounds in international investment banking. They believe in shareholder value maximization, although they know that the EU nations are not likely to accept a no-holds-barred approach to economic competition.

To protect individual shareholder interests, 8 national shareholder associations established "Euroshareholders," in Brussels in 1990. Its objectives include, among others, the EU-wide harmonization of minority shareholder protection systems, increased stock-markets transparency, cross-border proxy voting practices, the enhancement of the concept of shareholder value and the harmonization of corporate governance systems throughout the region. To this end, the organization had published a set of recommendations that are based on the OECD principles of corporate governance issued in 1999.

In January 2002, the European Corporate Governance Institute (ECGI) was established under Belgian law as a non-profit organization to promote the harmonization of EU corporate governance systems. The new institute succeeds the European Corporate Governance Network, financed in the past primarily by the Central Bank of Italy. Through its website, ECGI provides access to corporate governance information and studies produced by international academics, corporations, investor groups, regulators and stock-market authorities across the EU.

Institutional Changes and the Restructuring of Economies

²⁷ Interview with private bank officials in Frankfurt, Germany, October 1, 2001.

The EU-wide political-institutional changes and economic restructuring measures, although not discussed in any length in this paper, include the reform of the Brussels institutional and decision-making structures and the development of a strategic economic plan to move from welfare states to more dynamic economies, increasing the competitiveness of EU firms. A thorough reform of the political-institutional and decision-making systems should lead to more coherent and consistent policy formulation and implementation processes. This, together with the reform of the economic structures and the various laws, rules and regulations could lead to more harmonized corporate governance systems. Conversely, fragmentation and/or delays in updating the EU's political-institutional and decision-making systems and in restructuring the national economies could hinder the formulation of more harmonized corporate governance systems.

Although the EU's economic restructuring process and the harmonization of the corporate governance systems are constrained by overregulated markets and high social costs raising the non-wage component of total labor costs. Most EU nations are still committed to detailed labor laws and high taxes to fund medical, retirement and other social benefits far more generous than those in the United States. The continued inability of governments to reduce such costs constrains productivity, limits economic growth and competitiveness. This endangers the realization of the Lisbon plan objectives and the updating and harmonization of the various corporate governance systems.

Conclusions

The EU's inexorable demographic trends prevent the development of socially acceptable, politically doable and economically efficient pension systems. But the search for the second best i.e. least bad solutions is urgent. The fact that EU governments have not yet even started to look for such solutions may eventually have a very negative impact on the realization of the Lisbon plan and the formulation of more effective corporate governance systems.

The eventual proposals of the constitutional convention together with the number of countries admitted will have important implications for the current EU corporate governance systems already undergoing some changes. If the outcome is going to be a constitution i.e. a federal type EU political-administrative structure, it is likely that a new, unified and comprehensive EU corporate governance system would be established in the future. The existing and new Brussels institutions would receive more authority from the national governments than they already possess. In the name of more integration, they would obtain the power to establish a unified financial market, merge transaction-competition rules, increase the integration of the product-service and labor markets and, in general, to develop new EU-wide laws, governing most corporate activities, including internal management structures and monitoring systems. In doing all of this, they would be expected to observe and protect the traditional European economic and social values.

Such a new, unified and comprehensive EU corporate governance system would have to be adopted by the new member countries, although most of them would probably be given additional time following their admission to meet all rules and regulations.

As mentioned in the introductory part of the paper, EU nations want to improve the efficiency of their economies in general and the global competitiveness of their firms in particular. They agree that to achieve these goals, they have to restructure their economies i.e. create more flexible product-service, capital and labor markets through, among others, more privatization, deregulation, development of new technologies and the promotion of entrepreneurship.

To effectively compete, EU firms have to achieve sustained competitive advantages either through cost leadership, product/service differentiation or through the creation of a market niche in which they serve a particular market segment. Regardless of the specific competitive strategy or a combination thereof, flexibility and the ability to respond quickly are of a decisive importance.

Of the EU nations, Germany has the largest economy with most internationally involved firms. Yet, this powerful economy that is a major influence on the economies of the other member nations is still over-regulated and characterized by a cradle to grave social safety net and a traditionally structured corporate governance system based on consensual decision-making involving a number of stakeholders.

It soon became clear that if labor unions want to remain relevant, they must pursue flexible work skills and not collective political muscle as the key to job security. They also have to negotiate more constructively with management and governments and instead of demanding job security at almost any cost, they must offer retraining and career services to their membership still believe that structural economic and institutional competitive reforms must be introduced to improve the overall performance of their economies and companies once the global economy recovers. Only then will EU corporate managers be able to take full

advantage of their abundant scientific, technical and managerial skills, obtain funds through the most efficient channels of financing and formulate competitive strategies that can challenge the dominant global position of America's high-tech companies. One of the institutional reforms needed is a change in the EU nations' corporate government systems. They also agree that this is not due to a shortage of scientific and management skills and accomplishments. Research centers and firms in the United Kingdom, Scandinavia, France and Germany are engaged in sophisticated explorations in the medical, nuclear and genetic fields, among others. A number of high-tech innovations applied throughout the world were originally made in Europe, only to be commercially first exploited by the more flexible and competitive American companies.

The rapid technological advances in combination with changing product-service and capital markets and more sophisticated cross-border financial flows are changing the ways firms compete. Governments want to obtain the benefits inherent in these changes for their national economies such as, among others, sophisticated know-how, new technologies, lower-cost capital, production efficiencies, large markets and higher paying jobs. To succeed, they must rely primarily on the flexibility and competitiveness of their large, internationally involved private sector firms.

While most unions adjust to changing times, others are reluctant to do so and, as a result, are losing influence. The German metalworkers union, I.G. Metall, with about 8 million members is a case in point. It traditionally set the wage-benchmarks not only for German and EU metalworkers but also for other EU labor unions. But by 2001, its leading role came to an end. A large, chemical workers union established through mergers in recent years is now setting EU-wide wage benchmarks. I.G. Metall, still a powerful wage setting union in Germany, failed to move with the changing times and adjust its strategies.

In spite the high level of average unemployment throughout the EU reaching more than 8% in 2001, governments are unable to introduce labor market reform measures that would lead to either confrontation with the labor unions or burden domestic budgets. However, as discussed previously, the mergers and acquisition directive of the Commission failed. Thus the EU company law is in a flux, for the time being.

It seems that for every EU member nation that takes a step toward economic restructuring, another takes a step backward to protect traditional European economic and social values. Nonetheless, the gradual movement towards a common ground between the Anglo-Saxon shareholder- and the European stakeholder-based corporate governance systems has begun. This is likely to divert attention from the changes required in the short-to medium-term to the pursuit of vague long-range targets.

The old model is partially on the way out but no new predictable rules have yet emerged. The government must take stock and avoid the temptation to look back nostalgically to the time when economic problems were magically solved by consensus. Such an era, if it ever existed, has long since ended.

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