

# **Toward a comparative perspective on corporate governance and labour management**

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## **ABSTRACT**

While stakeholder models of corporate governance support long-term employment, recent reforms have promoted shareholder-oriented corporate governance worldwide. Will reform cause employment to converge on a market system? This paper presents a comparison of the linkages between corporate governance and employment patterns in 22 countries using the QCA method (Qualitative Comparative Analysis). Case studies of Germany and Japan also show that firms must now cope with capital market pressures, but do so by creative adaptation of their existing national employment institutions. International differences are thus growing smaller, but convergence will not occur in the foreseeable future.

Key words: Corporate Governance; Labour Management; Stakeholder Theory

JEL classification: G30, J51, J53, L21, M12, P16

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## **1. Two families of nations?**

Corporate governance has become increasingly important for students of labour. Recent literature comparing national business systems has illustrated important linkages between finance, management, and industrial relations, as well as politics and law. Most comparisons identify two types of systems—sometimes called market vs. relationship-oriented, or outsider vs. insider regimes. These types reflect strong correlations between national capital market development (e.g. shareholder rights, market capitalisation, ownership dispersion, or merger and acquisition activity), industrial relations (e.g. co-ordination of wage bargaining and employment protection law) and employment (e.g. employee turnover) (Hall and Gingerich 2001; Waldenberger 2003).

Table 1 shows such correlations for 22 OECD countries in the mid-1990s. Market-oriented corporate governance such as ownership dispersion, market capitalisation, private pension funds, and M&A are associated with shorter employment tenure or corporate downsizing. Relational corporate governance coincides with more stable employment. However, these patterns are also correlated with patterns of legal regulation in each country. High ownership dispersion and M&A are associated with shareholders rights, and employee tenure with employment protection law. Since few countries have strong legal rights for both shareholders and employees, it is difficult to tell whether linkages between corporate governance and employment are due to microeconomic factors or due to politics and policy choices.

Table 1 here.

Table 2 shows similar correlations across a pooled sample of listed firms in the same 22 OECD countries. Overall the expected associations exist between ownership, share price volatility or price-book ratios (on the one hand) and rates of downsizing, divestments from capital assets, or average wages (on the other hand). However, the association is weaker among firms than for the country data. One reason is that the relationships are not consistent across countries. No correlation exists between dispersed ownership and downsizing for firms in the US, UK, France or Sweden. Concentrated ownership is associated with fewer employment cuts among Japanese firms, but with more (albeit small) cuts in employment at German firms. One explanation is that the concentration measure picks up “stable shareholders” of corporate groups in Japan, but large blockholders, such as family owners, in Germany. The former tend to support management, whereas the latter may provide a counterweight to employee interests. There is no simple one-to-one relationship between corporate governance and employment.

Table 2 here.

Most Anglo-Saxon countries are relatively homogeneous and market-oriented on most dimensions. Few countries with *strongly* market-oriented corporate governance also have long-term employment. Yet markets themselves come in various shapes and colours. The rise of “managerial capitalism” in the U.S. resulted from the separation of ownership and control in the 1920s, but was followed by a heyday for “welfare capitalism” for US employees in the post-war period (Jacoby 2004). Later the 1980s hostile take-over wave led large conglomerates firms to end diversification strategies and reduce employment. So whereas dispersed ownership first left much autonomy for management, it evolved into a market for corporate control threatening that autonomy. Post-war Japan also had dispersed ownership, but managers built dense networks of stable shareholding to suppress markets for corporate control. This freedom from capital market pressures came to be seen as an important prerequisite of the employee-oriented Japanese firm.

Meanwhile, countries with relational corporate governance and employment are very diverse—equivalent functions may be played by different institutions.<sup>1</sup> For example, ownership may be concentrated relative to the U.S., but large owners have different identities such as families, inter-corporate networks, and banks. Industrial relations may be co-operative relative to market systems, but utilize diverse forms of unionism and labour-management consultation. Employment security may result from legal regulation, firm-specific investments in training, or institutional opportunities for employees to exercise ‘voice’ rather than ‘exit.’ Some countries with stakeholder models also have some market-

oriented characteristics. Japan, the Netherlands, and Sweden have strong shareholder rights or high stock market capitalisation, but maintain co-operative industrial relations and employment security. It is thus doubtful whether these countries belong to a single type.<sup>2</sup>

These differences are important for understanding the major changes underway in capital markets and corporate governance around the world. Since the mid-1990s, corporate governance reform has spread across OECD countries. The European Union (EU) has pushed member countries toward financial market liberalization. Stock markets became more important, and reforms have strengthened investor protection and accounting standards. In countries like Germany or Japan, the influence of banks in corporate finance has declined (Jackson 2003). Cross-border mergers and acquisitions have also risen. These trends may be understood as a *liberalization* that has pushed relational or insider systems of corporate governance to be considerably more market-oriented.

What impact do these changes in corporate governance have on labour management? Will corporate governance reform cause the convergence of employment and industrial relations on a market system? Given the differences among stakeholder models, does, liberalization affect countries in different ways?

In exploring these questions, Section 2 reviews economic theories relating corporate governance and labour management, as well as presents a sociological view on corporate governance as coalitions between investors, employees and management. Section 3 presents a comparative analysis of how corporate governance impacts labour using QCA method

(Qualitative Comparative Analysis based on Ragin 2000). Section 4 presents a comparison of Germany and Japan. The conclusion argues that international differences are growing smaller, but convergence will not occur in the foreseeable future. Firms must now cope with capital market pressures, but often do so by creative adaptation of their existing employment institutions.

## **2. From economic theory to the sociology of coalitions**

The linkages between 'corporate governance' (CG) and 'labour management' (LM) may be analysed in several directions:  $CG \rightarrow LM$ ,  $CG \leftarrow LM$ , or  $CG \leftrightarrow LM$ . Or the interaction of CG and LM may influence firm strategy and performance, or be complementary to other institutions such as welfare state arrangements (Jackson and Vitols 2001).

The linkages between various dimensions of corporate governance and labour management have been conceived in different ways in economic theory. First, transaction cost models suggests that commitment by investors to specific firms supports stable long-term employment, investment in worker training, and co-operative industrial relations (Hall and Soskice 2001). These institutional complementarities support dynamic (X-) efficiency in lower-volume, higher-quality product markets requiring high skills (Streeck 1992a, 1997b). Second, agency theory argues that employee rights increase the agency costs to diffuse shareholders (Jensen and Meckling 1979) and reinforce the advantages of direct control coming from relational finance, which are needed to counter-balance the strength of labour.

For example, Roe (1999: 194) argues that, in countries like Germany, ‘diffuse owners may be unable to create a blockholding balance of power that stockholders would prefer as a counterweight to the employee block.’<sup>3</sup> Third, the economics of information and co-operation stress potential positive-sum aspects. For example, information and disclosure may enhance the prospect of voice for both investors and employees, thereby increasing the accountability of management (Hirschman 1972; Aoki 1988).

Each model may represent only some aspect of economic exchange ( $Z_1, Z_2, Z_n$ ) that have potential trade-offs. Strong labour participation may increase agency costs but lower transaction costs. Take-overs may lower agency costs, but increase transaction costs. Inferences about the overall complementarity between particular institutions remain challenging.<sup>4</sup> Likewise, we cannot tell a priori which dimension will drive overall performance. For example, the relative costs of ‘overinvestment’ by vested managers vs. ‘underinvestment’ due to short-term investors depend on the life cycle of firms, sectors, and economies. Efficiency does not result from a universal “one best way,” but from comparative institutional advantages for different sorts of strategies (Hall and Soskice 2001).

In coping with ambiguous trade-offs, investors, management, and employees may enter into coalitions. This concept of corporate governance as coalition has important roots in economics (Aoki 1984), but also in sociological and political models of the firm (see Cyert and March 1963; Hoepner 2001; Aguilera and Jackson 2003). The literature on coalitions stresses the potential non-unanimity of interests within a group or across countries. For

example, shareholders may hold stakes for strategic purposes or purely financial interests. Employees differ in whether their skill formation and career prospects are firm-specific. Managers may have different interests across countries due to their educational backgrounds, career patterns and incentives schemes. Boardrooms in different countries may require greater degrees of consensus building, delegation, or hierarchy. Whether the interests of stakeholder groups overlap thus depends on the identities of each stakeholder and how their rights and responsibilities are institutionalized within society.

*Class coalitions* may arise when the interests of capital and management oppose the interests of labour, particularly regarding distributional issues. Conflict centres on trade-offs between wages and profits, capital re-investments and dividends, or employment and shareholder returns. Employee ownership or contingent pay may help align employee interests with capital and lessen these conflicts. In the US, class conflict is common because shareholders are mostly finance-driven portfolio investors and management is also rewarded depends upon stock options and external career mobility. In Japan, class conflict is less salient because cross-shareholding and main bank relationships act as strategic and committed investment that is complementary with lifetime employment (Aoki 1994).

*Insider-outsider coalitions* may arise through cross-class alliances centred on stakeholder interests as members of a specific firm. For example, large blockholders may have different interests than minority shareholders. Likewise, as producers at a particular firm, long-term company employees may pursue different interests than non-regular employees, mobile

professionals or craft-type labour. An insider coalition may encompass only labour and management (insiders) in opposition to capital (outsiders) or may include a large blockholder or owner/manager as an insider. Insiders may favour internal diversification ('empire building'), block efforts at restructuring, or erect take-over defences all to the potential disadvantage of outside investors. Japanese corporations have strong insider coalitions among stable shareholders, strong enterprise-based unions and career managers. German corporations are more subject to outside influence through codetermination law and centralized industrial unions.

Finally, *accountability coalitions* concern the common interests of stakeholders to place management under effective checks and balances. Shareholders and employees may form coalitions to remove poorly performing management or to demand higher corporate transparency. Accountability to different stakeholders is not a zero-sum relationship. In Germany, strong labour participation in the supervisory board complements blockholders who actively monitoring management.

### **3. Beyond correlation: studying diversity as institutional configurations**

The importance of different coalitions depends on the institutions in a given country. But studying institutions raises methodological challenges. Due to institutionalized rules and beliefs, some corporate governance characteristics do not vary across firms within a country. Thus, almost all Japanese firms have cross-shareholding, US firms generally use stock options,

and all firms in a given country face the same employment protection law. Thus, using traditional statistical models may be misleading, since an appropriate control group is lacking.

Let us consider one example. Table 3 shows significant differences in the rate of corporate downsizing by country, as well as between firms with dispersed and concentrated ownership. However, Table 4 pools firms across 22 OECD countries and reports the results of a logit model predicting the likelihood of firms making a 10 per cent cut in employment between 1992 and 2001. After controlling for firm performance and industrial sector, country differences persist but the impact of ownership dispersion was no longer significant.<sup>5</sup> This illustration shows the difficulty of separating country effects from the marginal impact of ownership at the firm level.

Tables 3 and 4 about here.

Meanwhile, comparison across countries introduces too many institutional differences that cannot be held constant. The number of OECD countries is small relative to the number of potential explanatory variables – the small N problem (Lijphart 1971; Ragin and Zaret 1983). Explanatory variables may be highly correlated with one another. For example, no countries have strong legal protection for both investors and employees. Moreover, linear models make assumptions about how variables combine based on their marginal effects while holding other factors constant based on their average value. By contrast, theories of institutional

complementarity (Aoki 2001) posit the effects of a variable to be contingent on the presence or absence of another. It may be more realistic to see causation in terms of the conjunction or combination of multiple variables (Ragin 2000). For all these reasons, traditional statistical methods may again be highly misleading. Comparative research is thus often based on case studies with rich empirical detail, but limited generalisation.

In an effort to bridge the gap between cases studies and cross-national correlations, this section briefly analyses the data from Table 1 using the new methodology of qualitative comparative analysis (QCA) based on the logic of fuzzy sets. QCA methods are tools for making inferences about necessary and sufficient conditions for an outcome (Ragin 2000). The empirical indicators from Table 1 were first re-scored between 0 and 1 according to the degree of membership in the conceptual category.<sup>6</sup> A score of 1 represents a case that is ‘fully in’ the category and 0 is ‘fully out.’ 0.5 represents the transition point where a case is ‘neither in, nor out.’ A condition may be considered necessary for an outcome when the membership score in the cause is consistently greater than or equal to membership in the outcome (e.g. all countries with ownership dispersion are members of the group of rich countries). When a sufficient condition is present, membership in the cause will be less than or equal to membership in the outcome (e.g. all rich countries have dispersed ownership). A benchmark proportion is chosen to evaluate the probability that a condition is necessary or sufficient based on the proportion of cases.

Five sets of labour outcomes are examined: employee representation in the board of directors, unionisation rate, the strictness of employment protection law, centralization of collective bargaining, and the rate of corporate downsizing. Tables 5 and 6 report the fuzzy-set tests for whether the presence or absence of corporate governance variables are necessary and sufficient conditions for each of the five labour outcomes. The coefficients show the proportion of cases meeting these conditions. No corporate governance variables were individually necessary or sufficient to produce any employment outcomes.

However, some combinations of corporate governance variables are sufficient to produce labour outcomes.<sup>7</sup> The presence of a condition is indicated with CAPITAL letters, and the absence by lower case letters. The membership score of countries in a given configuration was compared to the membership in the outcome to evaluate the “fit” of the causal conditions to each given case.

Tables 5 and 6 here.

*(a) Employee representation at board level.* One combination of factors proved sufficient for board-level codetermination:

**(a1)** INVESTOR RIGHTS + ACCOUNTING + dispersion + market value  
+ UNION CENTRALIZATION

This pattern fits closely to Norway, Finland and other Scandinavian countries. This configuration links union centralization and low capital market development. Weak capital markets may be interpreted in two ways – as a response to employee strength (as predicted by agency theory) or that because of weak capital markets political opposition to employee rights in the board was limited. Notably, employee representation is positively associated with investor rights and accounting, consistent with an accountability coalition.

*(b) Unionisation.* The configuration with weak dispersion, investor rights and private pension funds proved sufficient for high unionization rates:

**(b1)** dispersion + investor rights + private pension fund development.

Germany, Italy, Belgium, and Austria fit this pattern, but Scandinavian countries fit less well. Britain, Ireland, and Australia also have higher unionization than predicted. Thus, corporate governance seems to have little overall weight in explaining unionization rates.

*(c) Employment protection law.* Many studies have noted the strong correlation of employment protection with corporate governance. The *absence* of strong capital market activity is a *necessary condition* for employment protection law:

**(c1)** market capitalization + m&a + private pensions

One interpretation is that strong capital markets influence the politics of employment protection, or the situation is reverse such that employment protection constrains capital market activity. In either case, this configuration largely reflects the outlying cases of the US

and UK. Several configurations also proved to be sufficient for employment protection, but were a poor fit for countries with strong employment protection. Another interesting finding is that legal rights for shareholders are neither necessary nor sufficient for strong employment protection. For example, Japan and Norway have moderately high investor protection and employment protection law, but an absence of high dispersion and M&A.

*(d) Centralization of collective bargaining.* One configuration proved sufficient for centralization:

**(d1)** OWNERSHIP CONCENTRATION + investor protection + m&a

These conditions had a very high degree of fit for centralized countries such as Belgium, Germany, Austria and Greece, but are also consistent with Sweden and Norway. This result supports the notion that ownership concentration and few legal rights for shareholders facilitate high co-ordination or co-operation among business that, in turn, facilitates multi-employer bargaining (see Hall and Soskice 2001).

*(e) Downsizing.* Capital market pressures are often thought to drive employee downsizing. However, corporate governance factors alone were not necessary or sufficient for downsizing. Many countries fall in the middle having moderate dispersion, but don't have high downsizing rates - specifically, Ireland and Australia, but also to a lesser extent France, Denmark, and the Netherlands. The Netherlands appears to be an interesting case with highly 'marketized' capital but not too marketized labour.

However, downsizing rates cannot be consistently explained by industrial relations. Neither board representation, unionization or employment protection is necessary or sufficient for low downsizing rates. Countries with board representation such as Germany, Austria, Sweden, and Finland do not have particularly low downsizing rates. Countries with low unionization rates such as France and Spain nonetheless have low downsizing rates, whereas Finland and Sweden have strong unions but frequent downsizing. Employment protection law has the strongest relationship, but failed the test as a necessary condition: Japan and Denmark have employment security 'in excess' of the legal index, whereas Spain and Italy have strong employment protection but higher downsizing rates. Downsizing is best explained by combining corporate governance and industrial relations variables as shown by two configurations:

**(e1)** DISPERSED OWNERSHIP + PRIVATE PENSIONS + unionization

**(e2)** PRIVATE PENSIONS + M&A + unionization

Both configurations associate downsizing with low unionization rates together with strong capital market pressure by private pensions plus ownership dispersion or high merger activity.

*(f) Market vs. Relational Types.* An additional analysis was done by looking at the degree to which countries conformed to pure market vs. relational systems by aggregating their membership across several measures (e.g. the degree to which a country has high market capitalisation, high mergers AND high private pensions). The absence of market-oriented corporate governance is a necessary condition for relational employment, but not sufficient to

explain it. However, strongly relational corporate governance is not necessary or sufficient condition for relational employment. This suggests that, at the extreme, market-oriented systems may place a serious constrain on relational employment institutions. Yet more mixed corporate governance systems may be compatible with a variety of employment patterns. Conversely, the absence of relational employment is necessary for strong capital market development, but not sufficient to explain it. This again suggests that vested stakeholder rights impede capital market developments only at the extreme.

In sum, in the extreme case, *strongly* market-oriented corporate governance may indeed prevent a country from developing *strongly* relational employment, and vice-versa. But corporate governance factors alone do not explain the diversity of employment patterns across countries. Nor do employment institutions explain the strength of capital market development or patterns of ownership across countries, as suggested by Roe (2003) or Pagano and Volpin (1999). Rather, corporate governance appears “loosely coupled” to employment in a way that allows a wide range of intermediate cases combining elements of market and relational systems

These findings have several other implications. First, shareholder rights appear quite neutral toward systems of relational employment. In particular, employee participation is compatible with strong investor protections. Second, ownership dispersion itself has no direct link to labour outcomes, but only impacts employment when combined with strong M&A or active private pension funds. Ownership concentration has little direct impact on employment

other than facilitating centralized collective bargaining. Third, the degree of capital market activity by pension funds or through M&A has the strongest direct effect on employment outcomes.

#### **4. National Trajectories: A Brief Comparison of Germany and Japan**

The above analysis confirms the existence of linkages between corporate governance and labour management, especially of strongly market-oriented corporate governance. Yet many countries have mixed or hybrid corporate governance systems that appear compatible with a range of employment and industrial relations patterns. Since the mid-1990s, many OECD countries implemented corporate governance reforms and promoted capital markets. How will financial liberalization and greater attention to “shareholder value” impact labour management?

This section compares recent changes in two very different models of “stakeholder” corporate governance: Germany and Japan. Historically, These corporate governance systems had many similarities: bank finance and monitoring, the absence of hostile takeovers, moderate executive pay, management cultures based on consensus, emphasis on product quality and long-term strategy rather than financial returns, and so on. “Patient” owners and long-term management was thought to be supportive of long-term employment, since short-term returns are sacrificed to build stable relationships. But on the labour side, important differences exist. Germany has industrial unions supplemented by a legally based enterprise

codetermination through works councils and board representation. Meanwhile, Japan has enterprise unionism and a much more informal practice regarding employee consultation in corporate decisions.

In the last decade, corporate governance has begun to change. As European markets integrate, German universal banks have shifted their strategy toward investment banking (Deeg 2001) activities that require them to reduce their large ownership stakes and play a less active role in governance in the boardroom. Ties with Japanese main banks have also weakened, and sparked substantial unwinding of stable cross-shareholdings since the mid-1990s. The erosion of bank power in Japan is, quite unlike Germany, driven by the particular context of post-‘Bubble’ asset deflation, the non-performing loan issue, and changes in accounting which now put banks at greater risk by reporting the current market values of long-term holdings.

Meanwhile ownership by foreign institutional investors is increasingly in large companies. Here direct monitoring by banks is being replaced by indirect monitoring via the market—for most foreign institutional investors exit is more important than voice. One paradoxical consequence is that the discretionary power of top managers may *potentially increase*. Of course, managers also have growing incentives to raise share prices in order to gain external finance. But the sanctioning power of the market may depend upon a “market for corporate control” where takeovers become an important governance instrument. Some indications are

that takeovers are becoming an increasing threat in Germany (see Hoepner and Jackson 2001), but much less so in Japan.

Germany and Japan have also implemented substantial corporate governance reforms (see Jackson 2003). The uses of corporate equity was liberalized to facilitate spin-offs, acquisitions through share swaps, share buy-backs, and stock options as an element of executive compensation. Market-oriented accounting rules have been encouraged. Germany has retained its board system that separates management and monitoring functions into two-tiers. However, several innovations were introduced by a 1998 corporate law reform to better define monitoring functions and promote greater use of committees in the Supervisory Board. Further details were then codified in the recent German Code of Corporate Governance and enforced by a new soft-law comply-or-explain approach. Meanwhile, Japanese boards have lacked any parallel to this two-tiered structure. Reforms aimed to promote the role of outside monitoring by revamping the traditional system of statutory auditors, and finally, in 2002, giving the legal option to adopt a “company with committees” system with outsider board members involved in committees for compensation, nomination and auditing.

Corporate governance is thus becoming more shareholder-oriented. However, management strategies aimed at promoting “shareholder value” interests may provoke a number of conflicts with employees. First, implementing corporate disclosure and market-oriented accounting may reduce company reserves and favour higher distribution of profits to shareholders. Second, investors may demand a business portfolio focused on core

competencies that leads to conflicts with employees over the definition of core business units, divestment or closure of non-core units, and strategies of growth by diversification used to stabilize employment. Third, equity-oriented performance targets create conflicts over performance criteria, time horizons, and disciplining poorly performing units. Fourth, performance-oriented pay may be used to link employee incentives with business unit performance, raising issues of the equity and risks of contingent pay. Managerial stock options may also provoke controversy over income inequality and short-termism. In sum, all these factors create pressure to match employment to market conditions by reducing excess employment, divesting from less profitable businesses and decentralizing bargaining to match wages to productivity.

In Germany and Japan, the strong “voice” of employees has not, in itself, prevented corporate governance reform. Greater checks and balances and better information may enhance the prospects for voice by both investors and employees. Thus, Japanese unions and German works councils have supported selected reforms. In Japanese firms exposed to capital market pressure, strong employee participation via labour-management councils had no positive or negative impact on adopting stronger information disclosure and shareholder rights, and had a positive effect on board reforms (see Miyajima 2004). Rengo also advocates greater disclosure on issues such as executive pay, and better disclosure of pension liabilities. Likewise, German works council members favour greater information disclosure and involvement of the Supervisory Board (Hoepner 2001). Cross-national evidence on board

participation (Section 3) also suggested that stakeholder influence is compatible with coalitions that promote greater corporate accountability.

The impact of shareholder-value strategies on employment in Germany has been studied by several projects at the Max-Planck-Institute for the Study of Societies (see Jackson et al. 2004). Beyer and Hassel (2002) first examined the distribution of net value-added among stakeholders. They found that the adoption of shareholder-value<sup>8</sup> was associated with increasing share of dividends and a lower share for labour. Meanwhile, ownership dispersion positively influenced dividends but had no direct impact on labour. High shareholder value was also associated with a decrease in total employment due to corporate restructuring. Despite strong employment protection law and participation rights of works councils, German corporations engage in more downsizing than Japanese firms (see Table 3). Employment adjustment is still achieved through “benevolent” methods such as early retirement, rather than lay-offs. The German welfare state helps firms and works councils to externalise the costs of adjustment through state sponsored programs. However, this “externalisation” is placing increasing burdens on the welfare state, contributing to very high non-wage labour costs and unemployment. Divestment from business lines is another way of reducing employment. Here works councils may support the independence of core business, while using their influence to promote “good buyers” who offer employment prospects. Meanwhile, the shrinking labour share of value-added is associated with an increase in average compensation for remaining employees.

It is therefore not too surprising that works councils often cooperate with corporate restructuring. Shareholder-value is not leading to direct class conflict so much as a new type of insider-outsider conflict. On the one hand, participation in restructuring involves works councils in the 'co-management' of important decisions and is thus reinforces the co-operative character of German codetermination (Hoepner 2001). On the other hand, the character of codetermination is changing. Codetermination is becoming less of an encompassing and solidaristic political and legal institution guaranteed by law. Rather, the contents and boundaries of codetermination are increasingly 'contractual.' Works councils protect a shrinking core of "good jobs." Works councils thus face a latent conflict between core 'insider' employees and peripheral 'outside' employees whose interests are divided across weaker versus stronger business units.

A similar insider coalition emerges around performance-based pay. Shareholder-value management is strongly associated with adoption of performance-based pay schemes linking salaries to business and/or individual performance (Jackson et al. 2004). Normally wages in German are set by industry-wide collective bargaining that greatly constrain wage differentials between firms. Performance pay has not replaced these existing pay schemes, but come 'on-top' of rates set by centralized industry-level collective bargaining. This again reinforces co-operation among company "insiders." But the new layer of pay schemes nonetheless represents a controlled but *de facto* decentralization of collective bargaining.

Consequently, strengthening such insider coalitions comes at some expense of solidarity across firms and a lesser consideration of societal interests “outside” the firm.

Japan faces many similar pressures, but some different results. As a tentative comparison, the Development Bank of Japan database was used to calculate distribution of net value-added of listed Japanese firms. Unlike Germany, the median labour share rose from around 69% in 1990-93 to just over 79% in 2000-2002 (own calculations, but see also Hyuga 2001).<sup>8</sup> The median dividend share remained steady at around 2.9%. Japanese firms still favour policies of paying stable dividends as a fixed charge on revenue. Matsuura (2001) also finds that Japanese firms cutting employment also cut dividends—very few firms redistributed wealth by reducing employment while raising dividends. The increasing labour share resulted from lower interest payments as bank debt was repaid, as well as fewer taxes due to low profitability.

To examine the impact of corporate governance, bivariate regressions were calculated to examine how corporate ownership influences changes in distributional shares. Foreign ownership had a positive effect on changes in the share of dividends. Meanwhile, changes in the labour share were associated with ownership by financial institutions, other firms and individuals—but negatively related to high ownership dispersion. Although statistically significant, all the effects on changes in the share of value-added were very small and are not reported here.

As in Germany, large Japanese firms reduced total employment but increased their average wages. The largest firms (based on the 99<sup>th</sup> percentile) had over 22,974 employees in 1993, but just 17,417 in 2002 (own calculations, DBJ database). At those same firms, average wage costs increased from just over 20 million to about 23.6 million yen per employee. Table 3 also shows the large increase in downsizing over the last decade, although the level remains very low. Several studies also show that corporate governance characteristics impact the propensity for employment adjustment. For example, Ahmadjian and Robinson (2001) show a positive impact of foreign ownership on downsizing. Meanwhile, strong ties to banks slowed or lessened the likelihood of reducing employment (see also Abe 2002, Matsuura 2001).

Nonetheless, Japanese firms remain committed to a modified form of employment security (see Kato 2001). First, labour market data show that job retention rights show no major decline since the 1980s. Second, recent surveys of top management express continued commitment of long-term employment policies by a vast majority of firms (Miyajima 2004). A 2003 “Survey on the Corporate System and Employment” by the Ministry of Economy, Trade and Industry also suggests that 80% of firms maintain lifetime employment. My preliminary analysis of this data suggests that corporate governance characteristics (e.g. foreign ownership, equity-based performance targets, outside directors) had no influence on the likelihood of maintaining lifetime employment in some form, nor on using layoffs to adjust employment. Third, current strategies for employment adjustment still rely on

intensifying transfers, hiring freezes and early retirement. Outright dismissals of domestic employees are usually avoided.

Given the continued legal supports, restructuring has often reinforced co-operation between management and unions in large firms. Legal protection of employment in Japan remains significant (see Araki 2004). Protection is largely based on case law doctrines of the “abuse of the right to dismiss.” Recent court cases suggest some important loosening of the standards being applied to judge abuse. Yet the 2003 revision of the Labour Standards Law symbolically reaffirmed the case law doctrine as part of statutory law for the first time. Meanwhile, other recent legal changes have supported the participation of labour in restructuring. A key example is the Labour Contract Succession Law of 2000 to guarantee the transfer of employment conditions and collective agreements during mergers or spin-offs.

Corporate restructuring thus seems to occur in ways consistent with a modified notion of stakeholder corporate governance. However, co-operative restructuring also has costs and limits for firms. The less developed Japanese welfare state means that firms cannot easily externalise the costs of adjustment. As firms internalise high adjustment costs, one hypothesis is that restructuring has been slower and damped profitability more than in Germany. The benefits of transfers of employees to related companies may be diminishing as a result of corporate governance reforms that introduced consolidated accounting procedures (Nakata and Takehiro 2001).

Increased corporate restructuring also creates new problems for Japanese unions. Unlike German works councils, Japanese enterprise unions lack legal rights for participation. Participation depends upon informal social norms, as well as maintaining union strength through high membership. The case of NTT shows that Japanese unions may depend upon defending the boundary of the firm or corporate group in order to internalize employment adjustment processes across various business units (Sako and Jackson 2004). Another difference is that the lack of German-style multi-employer wage agreements may mean that enterprise-based unions may also be more willingly to accept direct or indirect forms of pay cuts in order to assure job security. Major firms such as Mitsubishi Materials and Kobe Steel implemented flat-rate cuts, while other firms such as NTT and Keio Electric Railway created new regional subsidiaries with lower wages.

On the issue of performance-based pay, Japanese unions do not face the German problem where performance pay threatens “equal pay for equal work” across firms under centralised collective agreements. A Ministry of Finance survey in 2002 identifies three types of pay systems—50% of firms maintain traditional lifetime-employment and seniority pay, 29% utilise performance-based pay with lifetime employment and 16% utilise performance pay without lifetime employment (Miyajima 2004). For many firms, therefore, performance-based is being implemented in a context of stable internal career patterns. Morishima (2002) suggests that performance pay is not an alternative system, but simply a new element used in existing evaluation systems. Many firms may nonetheless have difficulties introducing merit

pay, given the complexity of evaluating individual performance. Also, performance based pay in Japan thus far appears to be based on individual performance—only 19% of firms surveyed by the Japan Productivity Center for Socio-Economic Development in 2000 used variable pay based on company performance. This may explain my preliminary research finding based on the METI “Survey on the Corporate System and Employment” that shows corporate governance had no effect on the implementation of performance-based systems *per se*, since these often exist alongside traditional employment features. Shareholder-oriented performance targets and outside directors slightly increased the likelihood of employment based entirely on merit without any lifetime employment.

## **5. Conclusion**

The linkages between corporate governance and labour management will remain an exciting subject. National differences still matter. Despite common international trends, convergence on a single model remains far away. Germany and Japan have thus far been able to adapt and modify a strong role of labour in the corporation. The size of the core “stakeholder” model is getting smaller, but is unlikely to disappear. Performance pay is also being used to modify existing wage systems, and firms attempt to adjust levels of employment while maintaining a basic commitment to job security. For better or worse, the legal model of codetermination and strong welfare state has allowed German firms to more

rapidly adapted their stakeholder model toward greater shareholder value than in Japan. But this adaptation comes at a price of greater “social closure” of the corporation.

Both Germany and Japan contrast to cases where labour plays a weaker role in the firm. But corporate governance reforms in France, Spain, and Italy seem to reinforce the weakness of labour (see Gospel and Pendleton 2004). Here labour strength is rooted in centralized collective bargaining and employment protection law, but lacks the institutions for participation in the firm needed to renegotiate the stakeholder relationship. The future success of stakeholder systems depends on finding ways for strong employee ‘voice’ in the firm to be used alongside investor pressure to promote greater corporate accountability. This paper has shown that there is nothing antithetical in extending strong legal rights to both shareholders and employees. For labour management to be complementary to corporate governance, employment should not simply respond quickly to the forces of the capital market. Rather, labour participation may also help constrain the excesses and short-term failures of such markets. It remains to be seen whether organized labour can play a role in promoting an ‘enlightened’ version of shareholder-value that can stress the positive-sum aspects of corporate governance. But the prospects for such a model will have a very real and substantial impact of the welfare of employees around the world.

Table 1 Correlation of corporate governance and labour management in OECD countries in the mid-1990s

	Employee board	Unionization	Employment protection law	Long term employment	Downsizing rate
Corporate governance indicators					
Dispersion <sup>a</sup>	-.18	-.03	-.60*	-.69*	.33
Concentration <sup>b</sup>	.04	.05	.51*	.35	-.33
Family owner <sup>c</sup>	-.21	.03	.35	.09	-.09
Investor rights <sup>d</sup>	-.21	-.13	-.54*	-.52*	.13
Accounting rules <sup>e</sup>	.14	.30	-.58*	-.38	.39
Private pensions <sup>f</sup>	-.23	-.08	-.63*	-.47*	.10
Market cap. <sup>g</sup>	-.34	-.20	-.48*	-.33	.48*
M&A <sup>h</sup>	-.16	.24	-.53*	-.56*	.46*
Bank restrictions <sup>i</sup>	-.30	-.18	-.07	.06	.08
State banks <sup>j</sup>	.29	.06	.52	.32	-.11
Labour indicators					
Employee Board <sup>k</sup>	1	--	--	--	--
Unionisation <sup>l</sup>	.56*	1	--	--	--
EPL <sup>m</sup>	.20	-.06	1	--	--
LTE <sup>n</sup>	.16	-.03	.71*	1	--
Downsizing rate <sup>o</sup>	-.20	.00	-.34	-.40	1

<sup>a</sup> Dispersion = percentage of listed firms with less than 25% of their shares 'closely held'.

<sup>b</sup> Concentration = the average percentage of shares held by the top 3 shareholders.

<sup>c</sup> Family ownership = percentage of top firms with a family owner holding a block of 10% or more.

<sup>d</sup> Investor Protection = index of anti-director rights.

<sup>e</sup> Accounting = strictness of accounting standards.

<sup>f</sup> Private Pensions = assets of pension funds as percentage of GDP.

<sup>g</sup> Market Cap. = stock market capitalisation as percentage of GDP.

<sup>h</sup> M&A = value of mergers and acquisitions as percentage of GDP, average 1990-1995.

<sup>i</sup> Bank restrictions = index of restrictions on banks holding corporate equities.

<sup>j</sup> State banks = assets of state-owned banks as percentage of GDP.

<sup>k</sup> Employee Board = index of representation on corporate board.

<sup>l</sup> Unionization = union membership as percentage of the labour force.

<sup>m</sup> EPL=OECD Index of Employment Protection Legislation.

<sup>n</sup> LTE = Long-term employment, based on average tenure of male employees in years.

<sup>o</sup> Downsizing rate = percentage of firms making a cut of 10% or more in total employment, average 1991-2001.

*Notes* \*Indicates significance at the .05 level.

*Sources:* La Porta, Lopez-de-Silanes, and Schleifer (1999), Barth, Caprio, and Levin (2000), OECD (1997), <http://www.fibv.com>, SDC Platinum Worldwide Merger, Thomson/Worldscope Data and various national sources.

Table 2 Correlation of corporate governance and labour outcomes: firm-level measures for 1992-2001

	Employment Growth <sup>j</sup>	10% employment Cut <sup>k</sup>	5% employment cut <sup>k</sup>	Average wage <sup>l</sup>
Dispersed ownership <sup>a</sup>	0	.04*	.03*	0
% Closely-held shares <sup>b</sup>	.01	-.03*	-.02*	.02*
△ Closely- held shares <sup>c</sup>	-.02*	0	.01*	0
Price volatility <sup>d</sup>	.01	.12*	.10*	-.07*
Price-book ratio <sup>e</sup>	0	-.01	-.02*	-.01
Dividend yield <sup>f</sup>	0	0	.01*	-.01
△ Dividend as % VA <sup>g</sup>	0	.04*	.03*	.01
Sale of stock options <sup>h</sup>	-.01	0	0	.10*
Disposal of fixed assets <sup>i</sup>	-.01	.05*	.05*	.05*

<sup>a</sup> Dispersed ownership = equals 1 if less than 25% of total shares are not closely held.

<sup>b</sup> Closely-held shares = percentage of shares held by insiders or other stable owners based on various national definitions.

<sup>c</sup> △ Closely-held shares = percentage change in percentage of shares held by insiders or stable owners.

<sup>d</sup> Price volatility = index of share price volatility.

<sup>e</sup> Price-book ratio = ratio of total market capitalization to the book value of total assets.

<sup>f</sup> Dividend yield = dividends per share as a percentage of average share price.

<sup>g</sup> △ Dividend as percentage of value-added = percentage change in share of dividends as a percentage of total firm value-added.

<sup>h</sup> Sale of stock options = total value of stock options exercised in U.S. Dollars.

<sup>i</sup> Disposal of fixed assets = total value of fixed assets sold as a percentage of total assets.

<sup>j</sup> Employment growth = annual percentage change in total employees.

<sup>k</sup> Employment cut = equals 1 if negative change in percentage employees was greater than 10% or 5% in a given year.

<sup>l</sup> Average wage = total salary and benefit expense divided by the number of employees.

*Notes:* Own calculations from Thomson/Worldscope Database. This dataset covers all listed firms with over 2,000 employees in 22 OECD countries. Number of observations in the table = 33,094 firm-years. *Source:* Thomson/Worldscope

Table 3 Rates of corporate downsizing for selected countries, 1991-2001

Country	10% cut 2001	10% cut 1991	Average annual rate 1999-2001	Cumulative likelihood for each firm
Australia	.099	.057	.093	.301
Canada	.094	.212	.096	.312
France	.083	.079	.069**	.306
Germany	.093	.099	.101	.402
Italy	.147	.088	.096	.413
Japan	.059	.020	.041**	.213
Korea	.140	.104	.153**	.548
Netherlands	.070	.077	.065*	.351
Spain	.015	.122	.077	.292
Sweden	.154	.276	.095	.384
Switzerland	.131	.096	.091	.426
UK	.179	.164	.129**	.473
US	.206	.092	.106**	.445
Dispersed	--	--	.105**	--
Concentrated	--	--	.082**	--

*Notes.* Sample covers listed corporations with over 2,000 employees. Downsizing is counted as a negative shift in total employment of 10% over a one year period. Cumulative likelihood is calculated as the probability of each firm within the sample undergoing one or more employment cuts within the time period. N=33,094 firm-years.

\* T-test for the difference of means with the overall sample is significant at 0.05

\*\*Significant at 0.01

*Source:* Own calculations from Thomson/Worldscope

Table 4 Logit model of the likelihood of a 10% cut in employment, selected countries in 2001

	Odds ratio	Standard error	z	Significance
Assets (ln)	.9174195	.0368193	-2.15	0.032
ROA (t-1)	.9895516	.0023990	-4.33	0.000
Sales Growth	.9391732	.0036168	-16.30	0.000
Dispersed	1.000280	.1923223	0.00	0.999
Closely-held	.9968440	.0039829	-0.79	0.429
France	.5290478	.1611784	-2.09	0.037
Germany	.5609505	.1637352	-1.98	0.048
Netherlands	.4319714	.2151003	-1.69	0.092
Japan	.3223691	.0620804	-5.88	0.000
UK	1.018149	.1782022	0.10	0.918
Spain	.1444043	.1476633	-1.89	0.058
Italy	1.219077	.4264672	0.57	0.571

*Diagnostics:* n = 3414; LR  $\chi^2 = 546.15$ ;  $\chi^2$  significance = 0.000; Log-likelihood = -1181.966; Pseudo  $R^2 = 0.1877$

*Notes:* The base model includes data from firms in 22 countries. This table reports 7 selected country dummies using the USA as a baseline. Controls for general industrial classification are not reported.

*Source:* Company data taken from Thomson/Worldscope Database. The sample includes all listed firms with over 2,000 employees in each country.

Table 5 Results of fuzzy-set test: necessary conditions

Measure	Cause $\geq$ employee representation	Cause $\geq$ unionisation	Cause $\geq$ employment protection	Cause $\geq$ downsizing	Cause $\geq$ collective bargaining centralization
Ownership					
dispersion	.25	.41	.53	.50	.33
- owner	.50	.59	.79	.50	.44
Investor					
protection	.42	.55	.53	.56	.28
- investor	.58	.59	.68	.61	.50
Accounting rules	.58	.64	.58	.67	.44
- accounting	.25	.36	.37	.33	.11
Private pensions	.33	.36	.37	.50	.33
- pension	.75	.64	.84 (.46)	.67	.50
Market					
capitalization	.42	.41	.37	.44	.28
- market cap	.42	.45	.79	.50	.61
M&A	.42	.45	.42	.67	.28
- m&a	.67	.55	.74	.61	.50

*Note:* The level of significance for all proportions  $> .80$  is listed in parentheses. An adjustment factor of .17 was used in determining membership in each set. The – sign denotes the absence of the particular factor.

Table 6 Results of fuzzy-set test: sufficient conditions

Measure	Cause ≤ employee representation	Cause ≤ unionization	Cause ≤ employment protection	Cause ≤ downsizing
Ownership dispersion	.55	.68	.68	.64
- owner	.50	.50	.68	.55
Investor protection	.41	.64	.59	.50
- investor	.41	.55	.50	.50
Accounting rules	.45	.50	.55	.55
- accounting	.55	.68	.82	.64
Private pensions	.45	.82	.64	.68
- pension	.41	.45	.41	.45
Market capitalisation	.41	.59	.55	.54
- market cap	.41	.55	.50	.45
M&A	.50	.68	.59	.68
- m&a	.41	.64	.45	.50

*Note:* All proportions greater than .80 (using an adjustment factor of .17) and .65 were tested for significance,  $P \leq .05$ . The – sign denotes the absence of the particular factor.

## **Endnotes**

1. On the concept of functional equivalence, see Merton (1949).
2. Indeed many different labels are used such as insider, relationship-oriented, stakeholder, or co-ordinated economies. The quality of such typologies depends on identifying the empirically and theoretically relevant dimensions of variation. A different clustering of countries would result if different variables were included, such as whether unions are organized around industry, occupation / craft, or enterprise lines.
3. German codetermination is sometimes argued to promote poor managerial accountability by dividing the supervisory board into factional benches, diluting the board's overall powers and promoting collusion between management and employees (Roe 1999).
4. See Aoki (2001) on the concept of complementarity. This concept is widely used within discussion of corporate governance to specify the increased returns to an institution in particular combination with another institution.
5. After controlling for various performance variables but no country variables, the odds of downsizing increase by a factor of 1.27 for dispersed firms relative to concentrated firms.
6. This analysis draws on data from another project with Ruth Aguilera on determinants of corporate ownership. Further details on the dataset, coding of membership scores, and the method of analysis can be found in Jackson and Aguilera (2004).
7. Unless otherwise noted, the test for sufficiency required a proportion of positive cases to exceed 80 per cent and achieve a significance of .05. An adjustment of 0.17 (generally equivalent to one degree of membership) was allowed to control for measurement error.
8. Hoepner (2001) developed a shareholder value index based upon several dimensions including information disclosure, equity-oriented management incentives and the use of equity-oriented performance targets for business units.

9. A similar shift can be seen comparing averages during two recession periods 1993-95 and 2001-2002.

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