Corporate Governance in a Global Environment: The Search for the Best of All Worlds

Timothy L. Fort

Cindy A. Schipani

Follow this and additional works at: https://scholarship.law.vanderbilt.edu/vjtl

Part of the Commercial Law Commons

Recommended Citation
Timothy L. Fort and Cindy A. Schipani, Corporate Governance in a Global Environment: The Search for the Best of All Worlds, 33 Vanderbilt Law Review 829 (2021)
Available at: https://scholarship.law.vanderbilt.edu/vjtl/vol33/iss4/2

This Article is brought to you for free and open access by Scholarship@Vanderbilt Law. It has been accepted for inclusion in Vanderbilt Journal of Transnational Law by an authorized editor of Scholarship@Vanderbilt Law. For more information, please contact mark.j.williams@vanderbilt.edu.
Corporate Governance in a Global Environment: The Search for the Best of All Worlds

Timothy L. Fort**
Cindy A. Schipani***

ABSTRACT

This Article reflects on the various visions of corporate governance. Initially, the Article reviews the contractarian and communitarian theories of the corporation. The communitarian theory views the corporation as a separate entity, with social responsibilities not only to the shareholders but to the firm's other stakeholders and society at large. On the other hand, the contractarian approach considers the firm's shareholders as the primary constituency to whom management is accountable. Voluntary contracting and market forces align the interests of management and shareholders.

The Article next analyzes salient features of corporate governance in the United States, Japan, and Germany. The United States provides an example of a country heavily rooted in a contractarian, shareholder-primacy approach, whereas Japan and Germany traditionally have appeared to be more aligned with communitarian ideals. Recent events suggest that these traditional distinctions are changing, with the resulting entities suggesting a convergence between the two models.

The Authors propose a model that examines business as a mediating institution—that is, as corporate communities that compete in a marketplace as well as support the moral dispositions of their employees and shareholders. The result of this model is an entity that provides the freedom and...

* Copyright 2000, Timothy L. Fort and Cindy A. Schipani. All rights reserved. The authors would like to gratefully acknowledge the valuable research assistance of Brian Broughman and Rachel Tausend.

** Assistant Professor, University of Michigan; Ph.D., Northwestern University, 1995; J.D., Northwestern University Law School, 1983; M.A., University of Notre Dame, 1984; B.A., University of Notre Dame, 1980.

*** Professor, University of Michigan; J.D., University of Chicago, 1982; B.A., Michigan State University, 1979.
flexibility of a contractarian model while also being attentive to communitarian sentiments.

**TABLE OF CONTENTS**

I. CORPORATE GOVERNANCE: EFFICIENCY AND EQUITY ... 832
   A. Communitarianism ........................................................ 833
   B. Contractarianism .......................................................... 836

II. COMPARATIVE CORPORATE GOVERNANCE ....................... 838
   A. Features of Corporate Governance ............................. 842
      1. Goals of the Corporation ........................................... 842
      2. Ownership Structure ................................................. 846
      3. Board Composition ................................................ 850
      4. Managerial Labor Markets .......................................... 853
      5. Executive Compensation ........................................... 853
   B. Benefits and Shortcomings of the Various Approaches ...... 855

III. A BLENDED MODEL: BUSINESS AS A MEDIATING INSTITUTION ............................................. 858
   A. Business as Mediating Institution:
      An Overview ............................................................. 860
   B. Blended Model ............................................................. 864
   C. Governance Prongs ..................................................... 866
      1. Economizing and Property .......................................... 866
      2. Power-Aggrandizement—Subsidiarity .............................. 869
      3. Ecologizing Values—Communication ............................... 871
   D. Impact on Comparative Criteria ................................. 873
      1. The Goals of the Corporation ...................................... 873
      2. Ownership Structure and Composition of Board of Directors ........................................... 874
      3. Managerial Labor Markets and Executive Compensation .... 875

IV. CONCLUSION ................................................................. 876

The point is that capitalism, albeit on another level and not in such trivial forms, is struggling with the same problems as communism. . . . It is well-known, for instance, that enormous private multinational corporations are curiously like socialist states; with industrialization, centralization, specialization, monopolization, and finally with automation and computerization, the elements of depersonalization and the loss of meaning in work become more and more profound everywhere . . . IBM certainly works better than the Skoda plant, but that doesn’t alter the fact that both companies have long since lost their human dimension and have turned man into a little cog in their machinery, utterly separated from what, and for
Capitalism has an enviable record of creating wealth, opportunity, and technological advances. No other economic system in human history has produced an equivalent standard of living. Yet apart from the important issues that environmentalists have raised and that the passion of protests in Seattle\(^2\) and Davos\(^3\) has shown, there is an unease associated with capitalism, an unease captured by Vaclav Havel, the President of the Czech Republic, in the opening quote. On the one hand, to compare the dreariness of an Eastern European plant with the clean efficiency of a U.S. technology firm, even one as large as IBM, is absurd. On the other hand, Havel expresses unease about human beings losing a sense of their personhood in the midst of a centralized, controlling, corporate megastructure. Although people in free market capitalism undoubtedly have vastly superior freedom to choose what companies they work for, the logic of efficiency and bureaucracy requires them to adopt roles that can change persons into cogs.

This problem has not gone unnoticed. Indeed, it is a central concern of “communitarianism.” Communitarians worry that human beings lose a sense of their social identity in free market economics, a free market where a contractarian approach to business relationships dominates.\(^4\) As a result, a substantial portion of the twentieth century featured debates among American corporate theorists as to whether a corporation should be considered a natural entity with responsibilities for its stakeholders or a web resulting from a nexus of contracts among

---

self-interested individuals who measure the success of the firm through profitability.\textsuperscript{5} In addition, the meaning of the purpose of the firm is a question raised in comparative literature, where Japan and Germany are seen as emblematic of countries with communitarian corporate governance structures, in contrast to the United States and the United Kingdom, which feature contractarian models.\textsuperscript{6}

This Article explores the divide between communitarian and contractarian corporate governance structures by comparing the governance structures of the United States, Japan, and Germany. Section I briefly reviews the communitarian and contractarian schools of thought. Section II provides the comparative foundation, analyzing salient features of corporate governance in the United States, Japan, and Germany. With this background, Section III then attempts to address the problem Havel raised by engaging in a thought experiment about what a blended model, a model combining features of contractarianism and communitarianism, might look like. The proposed model is one that considers businesses as mediating institutions—that is, as corporate communities that compete in the marketplace as well as support the moral dispositions of their employees and shareholders. Section IV contains concluding remarks.

I. CORPORATE GOVERNANCE: EFFICIENCY AND EQUITY

Corporate governance can be described as the top management process that manages and mediates value creation for, and value transference among, various corporate claimants in a context that ensures accountability to these claimants.\textsuperscript{7} This definition of corporate governance emphasizes the roles of both

\textsuperscript{5} For general background on the debate, see Michael Bradley et al., The Purposes and Accountability of the Corporation in Contemporary Society: Corporate Governance at a Crossroads, 62 LAW & CONTEMP. PROBS. 9, 33-47 (1999). For views on the corporation as a natural entity, see Thomas Lee Hazen, The Corporate Persona, Contract (and Market) Failure, and Moral Values, 69 N.C. L. REV. 273 (1991); David Millon, New Directions in Corporate Law: Communitarians, Contractarians, and the Crisis in Corporate Law, 50 WASH. & LEE L. REV. 1373 (1993); David Millon, Theories of the Corporation, 1990 DUKE L.J. 201 [hereinafter Millon, Theories of the Corporation]. For arguments from the law and economics literature depicting the corporation as a nexus of contracts, see generally Armen A. Alchian & Harold Demsetz, Production, Information Costs, and Economic Organization, 62 AM. ECON. REV. 777 (1972); Ronald Coase, The Nature of the Firm, 4 ECONOMICA 386 (1937) (emphasizing the nature of the firm as a center of contracts to reduce the transaction costs of business); Michael C. Jensen & William H. Meckling, Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 J. FIN. ECON. 305 (1976).

\textsuperscript{6} E.g., Bradley et al., supra note 5, at 61.

\textsuperscript{7} Id. at 10-11.
claimants and accountability. Claimants include shareholders, employees, customers, creditors, suppliers, competitors, and even society at large. Including accountability in the definition of governance reflects the principle that good governance is a two-way street. Just as the corporation is responsible to its stakeholders for governance, governance practices determine how the stakeholders monitor and control the firm. At the heart of good governance, therefore, are methods for dealing with both efficiency and equity.

The corporate governance models that the United States, Japan, and Germany follow reflect two dichotomous schools of thought regarding the roles and purposes of the corporation in modern society. At one extreme are contractarians, who view the corporation as a nexus of contracts whose sole purpose is to serve the shareholders. At the other extreme are communitarians, who consider the corporation a separate legal entity with responsibilities not only to shareholders, but also to other stakeholders and to society at large. The United States provides an example of a country heavily rooted in a contractarian, shareholder-primacy approach, whereas Japan and Germany traditionally have appeared to be more aligned with communitarian ideals. Upon closer examination, however, shifts in the corporate governance systems of Japan and Germany suggest a trend in these largely communitarian-based countries toward a more shareholder-based approach. At the same time, commentators have recommended that the United States consider the virtues of systems that "encourage, if not command, corporations to take into account the interests of workers and other nonshareholder constituencies when making strategic decisions."  

A. Communitarianism

The communitarian theory views the corporation as a separate entity, independently capable of doing harm and good. As such, the corporation has social responsibilities not only to shareholders but also to the firm's other stakeholders and to


9. Bradley et al., supra note 5, at 41-47.
society at large. Under this paradigm, non-shareholder constituencies receive legislative protections. However, difficulty arises when these separate interests begin to conflict, as it becomes difficult, if not impossible, for management to consider the needs of every possible stakeholder, and no clear delineation exists in the social, political, or economic realm to help management make choices.

One of the most positive features of a more communitarian paradigm is lifetime employment, which gives employees a greater incentive to develop and supply firm-specific human capital and encourages stronger employee loyalty. It may facilitate team efforts, and lifetime employees may be more willing to make concessions in times of financial distress.

The more concentrated, relatively permanent ownership structure of corporations in communitarian regimes such as Japan and Germany offers additional advantages. Large shareholder involvement means shareholders can intervene quickly when a crisis hits. Block ownership facilitates a great deal of mutual monitoring and could lower the cost of equity capital. Under a communitarian regime, banks may facilitate the governance process because they have a great deal of access to inside information, can lower the cost of debt, and resolve financial distress much more informally than in a contractarian regime.

Communitarian systems, however, are not without costs. The most serious long-term competitive issue for communitarian countries such as Japan and Germany may be the bias in their systems against start-ups, research and development, and human-capital-intensive industries. The average age of a listed firm in the United States is fourteen years for the NYSE and thirteen for NASDAQ. For the German stock exchange, the average age is about fifty-five years. In the United States, 40% of the companies listed on the stock exchange are less than ten years old; in Japan this figure is 0.7%. The OECD has concluded that compared to the United States, both Japan and Germany have a comparative disadvantage in the high-technology

10. Id. at 67.
12. Id.
sectors. For example, neither Japan nor Germany has a true U.S.-style venture capital industry.

The bank-centered nature of businesses in communitarian regimes has related consequences. Banks have a bias against risk that manifests itself in a bias against start-ups. Banks focus on assets that can be collateralized, creating a bias against intangible investments, including research and development. This may lead to excessive hedging and excessive investment in insurance.

Communitarian infrastructures often are characterized by inflexibility in a number of areas, including sourcing strategies, labor markets, and corporate restructurings. Communitarian companies are less likely to be able to move quickly to meet competitive challenges from the global product market arena. Globalization strategies may be hindered because of a vertical chain of relationships. These relationships may not be portable across borders due to differences in legal regimes. Intercorporate holdings pose similar problems for firms considering a global strategy.

Labor markets also show the inflexibility of communitarian infrastructures. For example, in 1996, the average German manufacturer paid approximately $32 per hour of employee work, while Japanese manufacturers paid approximately $21 per hour. In the United States, the rate was approximately $17.70 per hour. Inflexible labor markets contributed to high unemployment rates in Europe in the 1990s, whereas unemployment has steadily declined in the United States over the past two decades.

---

14. OECD ECONOMIC SURVEYS: GERMANY, supra note 11, at 102.
17. Id. at 883.
19. Id.
20. See generally Org. for Econ. Cooperation & Dev., The OECD Jobs Study: Evidence and Explanations, Part I: Labour Market Trends and Underlying Forces of Change (1994). From 1980 through 1996, the unemployment rate in the United States decreased from 7.1% to 5.4%. BUREAU OF THE CENSUS, U.S. DEPT OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES 1997, at 845 tbls. 1360, 1361 [hereinafter BUREAU OF THE CENSUS]. During the same period, the unemployment rate increased from 2.8% to 9.0% in West Germany and from 2.0% to 3.4% in Japan. Id.
Communitarianism is thus under strain in a world where capital flows internationally, human-capital-intensive technologies have become the norm, and organizational boundaries are more nebulous. The strain comes from the nature of the corporate strategies that communitarian styles of governance engender, such as excessive risk avoidance, overinvestment in capacity, brand and product proliferation, excessive hedging, absence of external controls, and insufficient attention to shareholder wealth creation. Nonetheless, even if the future shuns communitarian governance, it need not shun socially responsible corporations that exemplify communitarian values.

B. Contractarianism

Contractarians consider the firm's shareholders as the primary constituency of concern to management. Because they view corporations as a nexus of contracts, they tend to prefer to rely on voluntary contracting and market forces to align the interests of managers and shareholders. Other stakeholders are presumed to have the knowledge and means to make Coasian bargains with those persons managing the corporation. Integral to this approach to corporate governance are the various market forces, including the capital market, the product market, the managerial labor market and, perhaps most importantly, the market for corporate control. Market forces will discipline management to act in the interest of the shareholders, the residual claimants. The market will penalize inefficient contracting. Also imperative to this schematic are a public policy regime and a legal regime facilitating freedom of contract.

The problem with the contractarian approach, however, is the inevitable lack of perfect market conditions. Instead, the environment includes disputes due to ambiguities in language, unforeseen circumstances, information asymmetries, transaction costs, and unfortunately, outright fraud. Even greater problems arise when contracts are attempted in a global environment in which different legal regimes may make contracting inefficient and property rights unenforceable.

The problems of communitarianism and contractarianism reach their zenith when their models are applied at large-scale levels. For communitarians, as Havel implies, the creation of large bureaucratic structures typically does not mean that

22. Coase introduced the theory that firms consist of a nexus of contracts designed to minimize transaction costs. Coase, supra note 5, at 386.
institutions are operated for the benefit of all constituents, but rather for the benefit of the elites that control centralized power. As the last decade has shown in Japan and Germany, the communitarian design can dampen creativity, initiative, and adaptiveness. Although the rhetoric of communitarianism is one that values solidarity, empathy, integrity, and responsibility, the linkage of these virtues to vast nation-states, and to large corporations, undermines communitarian virtues themselves both by reducing their competitiveness vis-à-vis the rest of the world and, more subtly, by undermining the internal dynamics of the community itself.

For contractarians, the focus on efficiency and access to capital makes the manipulation of employees necessary. Employees easily become known as "labor inputs" and thereby become depersonalized in a way like, although not to the same degree as, the depersonalization of socialist states. The need for treating employees as "labor inputs" or "cogs" is why Havel says the issues facing IBM and old socialist factories are the same. In both, human beings adopt a role at work that can restrict rather than enhance their ability to approach work in a way meaningful to them. In short, corporations can be alienating and sometimes resemble socialist (or feudal) states uninterested in human beings because economic criteria are simply too narrow.

Moreover, commentators have noted that the contemporary world is bureaucratic. A decision made by a corporate manager, for example, "disguises and conceals rather than illuminates and it depends for its power on its success at disguise and concealment." In a bureaucratic system, people do not ask ultimate questions because they assume that they cannot ultimately adjudicate among various moral traditions. Instead they rely upon a process which will generate choices and allow them to determine autonomously what particular option maximizes individual self-interest. This is precisely the basis of free-market economics. Free-market economics is based not on

---

23. Of course, similar problems were even more dramatically evidenced by former (and current) socialist states.

24. The efficiencies of scale and thirst for power are inimical to individual meaning-making. Indeed, it is this problem that gives rise to Alasdair MacIntyre's repeated condemnation of bureaucracy as concealing critical assumptions about meaning. See generally ALASDAIR MACINTYRE, AFTER VIRTUE: A STUDY IN MORAL THEORY (1981); ALASDAIR MACINTYRE, DEPENDENT RATIONAL ANIMALS: WHY HUMAN BEINGS NEED THE VIRTUES (1999); ALASDAIR MACINTYRE, WHOSE JUSTICE? WHICH RATIONALITY? (1988).

25. MACINTYRE, AFTER VIRTUE: A STUDY IN MORAL THEORY, supra note 24, at 24-26.

26. Id. at 103.
determining the "good" of a product, but on how to efficiently produce a product that meets market demand.

Consumer choice, legal regulation, and competition determine what products are acceptable. The manager does not ask ultimate questions, because asking such questions simply is not his job as an agent. The model depends upon the power of managerial efficiency and the ability to conceal the fact that deep values are at stake in corporate affairs. This Article focuses on the development of a corporate governance structure that blends a contractarian model that values transparency, efficiency, and initiative with a communitarian model that values empathy, solidarity, integrity, and identity. Put another way, the proposed blended model seeks to create corporate communities that can compete aggressively with other corporations in a global marketplace.

II. COMPARATIVE CORPORATE GOVERNANCE

What differentiates the governance structures of the United States, Japan, and Germany are the roles the various stakeholders play in monitoring and controlling the firm. For example, in the United States, the primary stakeholder has been the shareholder, whereas in Japan and Germany, labor historically also has had a relatively strong voice. None of these countries, however, take an all-or-nothing approach. Rather, some of the more communitarian features of Japan and Germany are finding their way into U.S. governance practices27 as the more contractarian features of the United States are gradually being incorporated into Japanese and German practices.28

The structure that typifies U.S. capitalism traditionally has been differentiated from both Japan and Germany in the way it configures the factors that create accountabilities. In focusing on the well-being of the shareholder, the U.S. governance system has emphasized efficiency, with impressive results. A market designed to provide information transparently to a wide range of investors has been able to generate effective discipline for managers to run efficient operations.

The contractarian governance model prevalent in the United States in large part may be the result of the greater reliance U.S. corporations place on external capital markets to provide corporate funding. Investors in such markets are concerned with

27. For example, see infra note 67 for a listing of more than 40 states that have adopted statutes permitting corporate directors to consider the interests of non-shareholder constituencies in making various corporate decisions.

returns on their investments and they demand efficiently run businesses. This has resulted in a much larger equity market with relatively liquid funds. More than 9,000 firms are listed on the three major stock exchanges in the United States: the New York Stock Exchange, the American Stock Exchange, and NASDAQ.29 In contrast, Japan lists only 1,800 firms,30 while in Germany fewer than 700 firms are listed in the equity markets, although there are 500,000 German corporations.31 Listed firms account for only about 20% of the corporate revenue in Germany,32 and stock market capitalization as a percentage of GDP is less than 40%, compared to 57% in Japan and 136% in the United States.33

The liquidity provided by American markets also makes possible contested ownership of corporations themselves. In recent years, the United States has accounted for more than half of all merger and acquisition activity worldwide.34 The combination of liquidity and potential competition provides further incentives to executives to manage their businesses efficiently, lest they lose control.

In contrast, the market for corporate control is relatively inactive in Japan. Between 1985 and 1989, mergers and acquisitions accounted for just over three percent of the total market capitalization, and all were friendly transactions.35 The words used to describe takeovers in Japan include "miurisuru" (to sell one's body), "baishu" (bribery), and "nottori" (hijack), suggesting a cultural aversion to takeovers.36 Anti-takeover defenses such as poison pills and golden parachutes are rarely found in corporate charters or by-laws. Cross-shareholding is used as an anti-takeover device, although it is limited by Japanese law. Cross-shareholding by subsidiaries in their

29. THE LGT GUIDE TO WORLD EQUITY MARKETS 500 (Jacqueline Grosch ed., 1997).
30. Id. at 266.
31. OECD ECONOMIC SURVEYS: GERMANY, supra note 11, at 87.
32. Id.
34. THE MERGER YEARBOOK: U.S./INTERNATIONAL EDITION 15, 22-23 (Securities Data Publ'g 1999).
parents is prohibited, and the Japanese Commercial Code restricts voting by companies with large cross-shareholdings.\(^{37}\)

The market for corporate control in Germany is also poorly developed. Between 1985 and 1989, only 2.3% of the market value of listed stocks was involved in mergers and acquisitions, compared with more than 40% in the United States.\(^{38}\) Corporate combinations tend to be friendly, arranged deals, rather than hostile takeovers or leveraged buyouts.\(^{39}\) While there are informal guidelines, there is no commonly accepted formal German takeover law, and anti-takeover provisions, poison pills, and golden parachutes have not been introduced.\(^{40}\)

Disclosure rules also distinguish the United States from Germany and Japan, in part due to the dependency of U.S. corporations on the stock market for external financing. For example, the Organization for Economic Cooperation and Development (OECD) has collected survey data to rate corporations on their disclosure based on three standards: “full disclosure,” “partial disclosure,” or “not implemented.” Two-thirds of U.S. firms surveyed met the full disclosure standard, with the remaining one-third meeting the partial disclosure standard.\(^{41}\) In contrast, in Japan, only one percent of the firms met the standard of full disclosure, while in Germany, no firms met the full disclosure standard.\(^{42}\) The high level of disclosure in the United States is likely due in large part to the Securities and Exchange Act of 1934, which mandates disclosure of corporate activity and delegates power to regulate proxy communications to the Securities and Exchange Commission (SEC).\(^{43}\)

Rather than focus on the protection of creditors, employees, or other stakeholders, U.S. accounting rules emphasize the provision of accurate economic information to potential investors and shareholders.\(^{44}\) For example, U.S. securities are evaluated at

\(^{37}\) Roy C. Smith, Restructuring Japanese Financial Institutions, WASH. Q., Summer 1999, at 181 (discussing cross-shareholding and its effect on merger and acquisition activity). See also Rafael La Porta et al., Corporate Ownership Around the World, J. Fin., Apr. 1999, at 470 (noting that firms are typically controlled by families or the state except in economies with effective shareholder protection).

\(^{38}\) PROWSE, supra note 35, at 47 tbl. 12.

\(^{39}\) Between World War II and 1993, there were only four hostile takeovers in Germany. JULIAN FRANKS & COLIN MAYER, GERMAN CAPITAL MARKETS, CORPORATE CONTROL, AND THE OBSTACLES TO HOSTILE TAKEOvers: LESSONS FROM THREE CASE STUDIES 1 (London Business School Working Paper, 1993).

\(^{40}\) Bradley et al., supra note 5, at 56. See also PROWSE, supra note 35, at 46-55 (discussing the market for corporate control and the importance of transnational corporate control mechanisms).

\(^{41}\) PROWSE, supra note 35, at 28-29.

\(^{42}\) Id.


\(^{44}\) FUKAO, supra note 13, at 119.
market price rather than historical cost.\textsuperscript{45} In Germany, marketable securities are carried at historical cost, and tangible fixed assets are carried at cost, less depreciation, resulting in an understatement of true asset values.\textsuperscript{46}

Despite the emphasis on shareholder wealth, few people see the current U.S. style of corporate governance as blindly profit-oriented at the expense of the community. While employees suffered greatly at the hands of corporate downsizing in the 1980s, such pain generally was not associated with the takeovers of the 1990s. Further, employees can use stock ownership to protect themselves and force management to consider their interests as part of the fiduciary duty to shareholders. According to a recent study by the National Center for Employee Ownership (NCEO), employees now control more than 8% of total corporate equity in the United States,\textsuperscript{47} compared with 1% to 2% ten years ago.\textsuperscript{48} The NCEO estimated that as of August 1997 employees owned $663 billion of the estimated $8 trillion in corporate equity: $213 billion through employee stock ownership plans, $250 billion through 401(k) and profit sharing plans, and $200 billion through broadly granted stock options and other broad ownership plans.\textsuperscript{49} The growth and impact of employee ownership is illustrated by the July 1994 acquisition of 55% of United Airlines by the pilots and machinists unions in exchange for $4.9 billion worth of salary and other concessions.\textsuperscript{50} Five years later, the company is operating profitably, and the unions have realized a profit of several billion dollars.\textsuperscript{51} Therefore, it is no coincidence that the attitude of labor toward management also has become less confrontational. Despite some high-profile strikes, such as the United Parcel Service strike in August 1997\textsuperscript{52} and the General Motors strike in June 1998,\textsuperscript{53} the number of

\textsuperscript{45} Id.
\textsuperscript{46} Id. German tax laws generally explain this choice of accounting rules. Id. at 120-21.
\textsuperscript{48} National Center for Employee Ownership, ESOPs, Stock Options, and 401(k) Plans Now Control 8.3% of Corporate Equity, at http://www.nceo.org/library/control_eq.html (last visited Sept. 19, 2000).
\textsuperscript{49} Id.
\textsuperscript{50} Adam Bryant, After 7 Years, Employees Win United Airlines, N.Y. TIMES, July 13, 1994, at A1.
\textsuperscript{52} Steven Greenhouse, High Stakes for 2 Titans, N.Y. TIMES, Aug. 5, 1997, at A1.
major strikes in the United States reached a record low of 17 in 1999, idling a total of 73,000 workers for an average of 16 days per strike.\textsuperscript{54}

Recent events suggest that the traditional distinctions between the U.S., Japanese, and German systems may be changing. The Tokyo Stock Exchange recently has ruled that in filing their results, all listed companies must disclose their efforts to improve corporate governance.\textsuperscript{55} Increasing pressure for transparency and corporate accountability has led to the implementation of significant accounting reforms over the past year.\textsuperscript{56} In Germany, landmark legislation was passed last spring to authorize share option schemes and share buybacks, curb voting restrictions, and allow companies to use more liberal, non-German accounting standards.\textsuperscript{57} New financial disclosure rules also have been suggested,\textsuperscript{58} and insider trading laws have been introduced.\textsuperscript{59}

With the apparent convergence toward a more open, transparent, and liquid external market, it is worthwhile to compare the corporate governance features of the United States, Japan, and Germany in an attempt to pull from each approach the best practices that might be included in a blended model. The next part of this Article compares the corporate governance features of the United States, Japan and Germany along the following lines: (1) goals of the corporation, (2) ownership structure, (3) board composition, (4) managerial labor markets, and (5) executive compensation.

\textbf{A. Features of Corporate Governance}

1. Goals of the Corporation

In the United States, federal law has not been involved in the internal workings of the corporation and has not weighed in with a corporate purpose. Instead, corporate law has primarily been

\textsuperscript{54} Business Headlines, DAYTON DAILY NEWS, Feb. 25, 2000, at 2E (quoting statistics from the U.S. Dep't of Labor related to strikes of 1,000 or more workers).
\textsuperscript{55} No Country for Old Men, ECONOMIST, May 1, 1999, at 60, 61.
\textsuperscript{58} OECD ECONOMIC SURVEYS: GERMANY, supra note 11, at 120.
\textsuperscript{59} See FUKAO, supra note 13, at 118-19.
the province of the states. Historically, legislatures only granted corporate status to organizations that would benefit the public generally, such as municipalities and public utilities. Through the dynamics of nineteenth century industrialization, the rise of the influence of Adam Smith's "invisible hand" theory of social benefits from self-interested economic acts, and the populist reforms that swept the nation after the presidential election of Andrew Jackson, the granting of corporate charters became a ministerial rather than a legislative act. This move undermined the cronyism that accompanied legislative grants of corporate charters, but it also minimized the public purposes for which a corporation had to be accountable. Thus, historically, even in the United States, there was a tension between the public and private accountabilities of the corporation, a tension that has raised its head throughout U.S. corporate legal history.

Nevertheless, for the past one hundred years or so, a corporation has been able to be formed for no more specific purpose than to "engage in any lawful act or activity for which corporations may be organized . . ." In 1919, the Michigan Supreme Court decided in favor of private accountability to the shareholders. Dodge v. Ford Motor Co., 170 N.W. 668, 684-85 (Mich. 1919). In the early 1930s, two highly respected legal theorists, Professor Adolf A. Berle of Columbia Law School and Professor E. Merrick Dodd of Harvard, took up the debate in their classic series of articles. See A. A. Berle, Jr., Corporate Powers as Powers in Trust, 44 HARV. L. REV. 1049 (1931); E. Merrick Dodd, Jr., For Whom Are Corporate Managers Trustees?, 45 HARV. L. REV. 1145 (1932); A. A. Berle, Jr., For Whom Corporate Managers Are Trustees: A Note, 45 HARV. L. REV. 1365 (1932); E. Merrick Dodd, Jr., Is Effective Enforcement of the Fiduciary Duties of Corporate Managers Practicable?, 2 U. CHI. L. REV. 194 (1935). For a more modern view of the debate, see A. A. Sommer, Jr., Whom Should the Corporation Serve? The Berle-Dodd Debate Revisited Sixty Years Later, 16 DEL. J. CORP. L. 33 (1991).

The Revised Model Business Corporation Act similarly provides that "[e]very corporation incorporated under this Act has the purpose of engaging in any lawful business unless a more limited purpose is set forth in the articles of incorporation." REVISED MODEL BUS. CORP. ACT § 3.01 (1984).

---

60. See Michael J. Phillips, Corporate Moral Personhood and Three Conceptions of the Corporation, 2 BUS. ETHICS Q. 435, 437 (1992) (citing Chief Justice John Marshall in Trustees of Dartmouth Coll. v. Woodward, 17 U.S. (4 Wheat.) 518 (1819)). See also Louis K. Liggett Co. v. Lee, 288 U.S. 517, 549 (1933) (Brandeis, J., dissenting) ("[T]here was a sense of some insidious menace inherent in large aggregations of capital, particularly when held by corporations. So, at first, the corporate privilege was granted sparingly; and only when the grant seemed necessary in order to procure for the community some specific benefit otherwise unattainable."); Millon, Theories of the Corporation, supra note 5, at 207 (noting that the corporation of the mid-nineteenth century was usually chartered for a public function).


62. Id.


Supreme Court made it clear that "[a] business corporation is organized and carried on primarily for the profit of the stockholders." The American Law Institute also asserts that a corporation's primary objective should be "corporate profit and shareholder gain." The adoption of other constituency statutes by most states, however, has changed long-standing conceptions of corporate purpose. Previously, shareholder primacy was based upon, and ensured by, the directors' exclusive duty to shareholders. Other constituency statutes alter the nature of the directors' fiduciary duties by allowing, and in some circumstances requiring, consideration of non-capital stakeholders.

This change is not as fundamental as it may appear, however, because Delaware, the place of incorporation for

---

66. 1 AM. LAW INST., PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS §2.01(a) (1994).
67. The following statutes permit directors to consider the interests of non-shareholder constituencies in any appropriate context: CONN. GEN. STAT. ANN. § 33-756(d) (West 1997) (mandating consideration of non-shareholder constituencies); PLA. STAT. ANN. § 607.0830(3) (West Supp. 2000); GA. CODE ANN. § 14-2-202(b)(5) (Supp. 2000); HAW. REV. STAT. ANN. § 415-35(b) (Michie Supp. 1999); IDAHO CODE § 30-1702 (1999); 805 ILL. COMP. STAT. ANN. 5/8.85 (West 1999); IND. CODE ANN. § 23-1-35-1(d) (Michie 1999); ME. REV. STAT. ANN. tit. 13-A, § 716 (West Supp. 1999); MASS. GEN. LAWS ANN. ch. 156B, § 65 (West Supp. 2000); MINN. STAT. ANN. § 302A.251(5) (West Supp. 2000); MISS. CODE ANN. § 79-4-8.30(f) (1999); NEV. REV. STAT. ANN. § 78.138(4) (Michie 1999); N.J. STAT. ANN. § 14A:6-1(2) (West 2000); N.M. STAT. ANN. § 53-11-35(D) (Michie 1993); N.Y. BUS. CORP. LAW § 717(b) (McKinney Supp. 2000); N.D. CENT. CODE § 10-19.1-50(6) (Supp. 1999); OHIO REV. CODE ANN. § 1701.59(E) (West Supp. 2000); OR. REV. STAT. § 60.357(5) (Supp. 1998); 15 PA. CONS. STAT. ANN. § 515(a) (West 1995); WIS. STAT. ANN. § 180.0827 (West 1992); WYO. STAT. ANN. § 17-16-830(e) (Lexis 1999). The following statutes permit directors to consider the interests of non-shareholder constituencies in the context of transactions for corporate control: ALA. CODE § 10-2B-11.03(c) (1999); ARIZ. REV. STAT. ANN. § 10-1202(c) (West 1996) (sale of assets); ARK. CODE ANN. § 4-27-1202(C) (Michie 1996) (sale of assets); COLO. REV. STAT. ANN. §§ 7-106-105(7) (reverse splitting of shares), 7-111-103(3), 7-114-102(3) (West 1997) (authorization of dissolution after issuance of shares); IOWA CODE ANN. § 491.101B (West 1999); KY. REV. STAT. ANN. §§ 271B.11-030(3), 271B.12-020(3) (Michie 1989) (sale of assets); LA. REV. STAT. ANN. § 12-92(G) (West 1994); MO. ANN. STAT. § 351.347 (West 1991); MONT. CODE ANN. §§ 35-1-815(3), -823(3) (1999) (sale of assets); N.H. REV. STAT. ANN. §§ 293-A:11.03(c), 293-A:12.02(c) (Supp. 1999) (sale of assets); N.C. GEN. STAT. §§ 55-11-03(c), -12-02(c) (1999) (sale of assets); R.I. GEN. LAWS §§ 7-5.2-8(a) (1999); S.C. CODE ANN. §§ 33-11-103(c), -12-102(c) (Law. Co-op. 1990) (sale of assets); S.D. CODED LAWS §§ 47-33-4 (Lexis 2000); TENN. CODE ANN. § 48-103-204 (1995); TEX. BUS. CORP. ACT ANN. art. 5.03(c) (West Supp. 1999); UTAH CODE ANN. § 16-10A-1103(3) (1999); VT. STAT. ANN. tit. 11A, §§ 11.03(c), 12.02(c) (1997) (sale of assets); VA. CODE ANN. §§ 13.1-718(C), -724(C) (Michie 1999) (sale of assets); WASH. REV. CODE ANN. §§ 23B.11.030(3), 23B.12.020(3) (West 1994) (sale of assets). The following states and territories do not have specific legislation regarding consideration of the interests of non-shareholder constituencies: Alaska, California, Delaware, District of Columbia, Kansas, Maryland, Michigan, Nebraska, Oklahoma, Puerto Rico, Virgin Islands, and West Virginia.
approximately 300,000 U.S. corporations, has not adopted legislation allowing or mandating directors to consider the interests of non-shareholder constituencies. In addition, although there have not yet been efforts to repeal the statutes, they have been heavily critiqued as nothing more than a shield used to expand the discretion given to directors, making the board less accountable to all stakeholders. Another school of thought argues that constituency statutes "simply ratify preexisting corporate law" and therefore will not produce social change.

Traditionally, Japanese corporations have operated to benefit a small group of owners rather than to maximize shareholder value. The corporate governance system emphasizes the protection of employee and creditor interests as much or more than shareholder interests. Management has had few direct incentives to enhance shareholder value.

German law clearly defines the goals of German corporations. In 1937, the German government adopted a new business corporations statute, consolidating nearly fifty years of corporate laws and amendments. The law reads: "The managing board is, on its own responsibility, to manage the corporation as the good of the enterprise and its retinue, and the common weal of folk and realm demand." The law also provides that if a company endangers public welfare and does not take corrective action, it can be dissolved by an act of State.

72. Bradley et al., supra note 5, at 50-60.
74. Bradley et al., supra note 5, at 52.
76. Id. at 40.
77. Id. at 41.
Although this statute thus contains the first non-shareholder constituency clause, it is equally noteworthy for its omission of shareholders from the constituencies to be considered in management decisions. The statute did not specifically mention shareholders until it was revised in 1965. Still, German corporate law clearly shows that managers must operate the firm for the benefit of multiple stakeholders, not just shareholders. The propagandist language used throughout the 1937 Act was common to Nazi propaganda of the Interwar Period urging Germans to sacrifice personal interests in the name of the Reich. However, modern Germany clearly demonstrates that this scheme of corporate governance does not inevitably lead down the road to statism, collectivism, and the destruction of individual entrepreneurialism.

The foregoing history of the German statute foreshadows a central claim of this paper, to be developed in Section III. To the extent that the German structure is an example of a communitarian regime that attempts to link an individual to a megastructure, it can pose serious risks of coercion and excessive sacrifice of individual needs to those of the community. Human beings authentically develop the sentiments that communitarianism champions—for example, empathy, solidarity, and commitment to the common good—in much smaller "mediating institutions," not in large communities where such sentiments often are rhetorical fig leaves covering coercive leadership.

2. Ownership Structure

In the last twenty-five years, the role of the institutional investor in U.S. corporations has grown dramatically. In 1996, public mutual funds and other similar investments accounted for almost fifty percent of all equity in U.S. corporations. Pension funds hold close to twenty-five percent of U.S. shares. U.S. households own slightly more than fifty percent of all outstanding

---

78. Bradley et al., supra note 5, at 52.
79. OECD ECONOMIC SURVEYS: GERMANY, supra note 11, at 84. See also Stefan Wagstyl, Crumbs from the Table, FIN. TIMES, Sept. 25, 1996, at 27 (noting that the German language does not include a phrase for the words "shareholder value").
80. See generally ROBERT NISBET, THE QUEST FOR COMMUNITY: A STUDY IN THE ETHICS OF ORDER AND FREEDOM (1990) (examining the quest for community as the "dominant social tendency" of the twentieth century).
81. BUREAU OF THE CENSUS, supra note 20, at 524 tbl. 808.
82. Id. See also Stephen L. Nesbitt, Long-Term Rewards from Shareholder Activism: A Study of the "CalPERS Effect", J. APPLIED CORP. FIN., Winter 1994, at 75 (noting that the 50 largest pension funds own approximately 10% of outstanding U.S. shares).
domestic shares, representing more than double the percentage owned by German or Japanese households.\textsuperscript{83} Share ownership by banks and other U.S. corporations is small relative to other developed nations.\textsuperscript{84}

Traditionally, Japan's industrial organization system has been defined by the \emph{keiretsu}, groups of networked firms with stable, reciprocal, minority interests in each other.\textsuperscript{85} Typically, the firms in a \emph{keiretsu} are separate, independent, joint-stock companies that have implicit and relational contracts with each other on such matters as ownership, governance, and commercial contacts.\textsuperscript{86} \emph{Keiretsu} can be either vertical or horizontal. Vertical \emph{keiretsu} are networks consisting of a loose collection of firms from the supplier to the distributor chain.\textsuperscript{87} Horizontal \emph{keiretsu} are networks consisting of a loose collection of businesses in similar product markets.\textsuperscript{88} A large main bank that conducts business with all of the member firms and holds minority equity positions in each of the firms usually will be a member of a horizontal \emph{keiretsu}.\textsuperscript{89} Relative to the total number of joint-stock companies, the number of \emph{keiretsu} in Japan is small. Collectively, however, \emph{keiretsu} firms represent approximately 25% of the total sales in the Japanese corporate sector and close to 50% of the value of all listed stock in Japan.\textsuperscript{90}

History provides a good illustration of how a \emph{keiretsu} operates. In 1974 Mazda Motors faced bankruptcy when sales of its rotary-engine cars plummeted as a result of the oil crisis.\textsuperscript{91} Mazda was a member of the Sumitomo \emph{keiretsu}, and the group's chief bank, Sumitomo Trust, was a major lender and shareholder

\begin{itemize}
  \item \textsuperscript{83} OECD ECONOMIC SURVEYS: GERMANY, supra note 11, at 88 tbl. 23.
  \item \textsuperscript{84} Id.
  \item \textsuperscript{86} Bradley et al., supra note 5, at 57.
  \item \textsuperscript{87} Gilson & Roe, supra note 85, at 894.
  \item \textsuperscript{88} Id.
  \item \textsuperscript{89} See Paul Sheard, The Main Bank System and Corporate Monitoring and Control in Japan, 11 J. ECON. BEHAV. & ORG. 399, 401-02 (1989).
  \item \textsuperscript{90} ROBERT W. LIGHTFOOT & W. CARL KESTER, NOTE ON CORPORATE GOVERNANCE SYSTEMS: THE UNITED STATES, JAPAN, AND GERMANY 6 (Harvard Business School, Note 9-292-012, 1991).
  \item \textsuperscript{91} Mary Ann Maskery, Safety Net: Web of Ownership Between Banks, Auto Industry Keeps Companies Alive, AUTOMOTIVE NEWS, Aug. 6, 1990, at 1, 28.
\end{itemize}
in the car company.\textsuperscript{92} Sumitomo Trust took the lead in reorganizing Mazda, dispatching seven directors and forcing it to adopt new production techniques.\textsuperscript{93} The other members of the \textit{keiretsu} switched their automobile purchases to Mazda, the parts suppliers reduced prices, and lenders provided the necessary credit.\textsuperscript{94} As a result, Mazda survived without requiring any layoffs, although management and workers received smaller bonuses.\textsuperscript{95} Taken alone, none of the Sumitomo \textit{keiretsu} members' decisions to save Mazda made economic sense. Whether the decisions taken together made economic sense remains a much-debated question.\textsuperscript{96} The example, however, illustrates the degree of sacrifice members of a \textit{keiretsu} are willing to undertake to prevent one of its members and that member's stakeholders from experiencing the pains of market change—pains that U.S. management would argue ensures efficiency. Many people contend that the painful downsizing of U.S. corporations in the 1980s is at least in part responsible for the current U.S. economic boom and, similarly, that Japan's refusal to accept such pain has created its current economic crisis.\textsuperscript{97}

Evidence suggests that many of the \textit{keiretsu} bonds are now beginning to soften or break. For example, parts procurement in the auto industry has long been viewed as a model of Japanese vertical \textit{keiretsu}, but Japanese automakers purchased $15.5 billion of U.S.-made parts in 1993, a six-fold jump since 1986.\textsuperscript{98} In 1994, Japanese car companies did business with 1,245 companies, compared with only 298 in 1987.\textsuperscript{99} Purchasing companies, pressured by global competition, have sought lower-cost suppliers outside of their \textit{keiretsu} networks.\textsuperscript{100} The merger of the Industrial Bank of Japan (IBJ), Fuji Bank, and Dai-Ichi Kangyo Bank (DKB) announced in the fall of 1999, and any further banking consolidation, will undoubtedly have a significant

\textsuperscript{92} Id. at 28.
\textsuperscript{94} Id. at 230.
\textsuperscript{95} Id. at 238-39.
\textsuperscript{96} See id. at 257-63.
\textsuperscript{97} E.g., Brenton R. Schlender, \textit{Japan's New Realism: Don't Count This Superpower Out}, FORTUNE, Oct. 31, 1994, at 117, 118 (noting the emergence of a pragmatic "New Realism" among Japanese businesses in an effort to remain competitive).
\textsuperscript{99} Id.
\textsuperscript{100} James B. Treece, \textit{Nissan Untethers Suppliers—and Itself}, AUTOMOTIVE NEWS, Apr. 12, 1999, at 26V.
impact on the *keiretsu* system. The most likely effect will be the dilution of the major *keiretsu* groups’ power and influence. In addition, banks involved in the mergers may have to divest at least part of their stakes in related industrial companies in order to comply with Japanese law.

Frequently, in Japan, a small group of four or five banks will control between 20% and 25% of a company’s stock. Thus, despite a prohibition on Japanese banks holding more than 5 percent of a single firm’s stock, banks may be the only shareholders who can easily influence a firm’s management. In practice, however, bank shareholders often will not intervene in firm management unless the firm performs poorly. The largest bank shareholder is also usually the largest debtholder.

The role of banks in financing has been decreasing in the past decade. Historically, Japan’s legal and regulatory regime was heavily biased against non-bank forms of finance; however, since the mid-1980s, these restrictions gradually have been relaxed. Cross-shareholding is declining, as companies recognize that it may no longer have practical value and in fact may even create obligations that are not good for business in the long-term. Between 1992 and 1998, company cross-shareholding decreased from a high of 52% to 45%

The ownership structure of equity in Germany also differs substantially from that in the United States. Ownership in Germany is concentrated and controlled in large part by banks. Banks own approximately 14% of shares of German corporations, while other German corporations own approximately 40%. Bank ownership is high in Germany partly because a substantial portion of equity in Germany is in the form of bearer stock and left on deposit with banks. Banks may vote the shares on
deposit by proxy unless the depositors explicitly instruct the bank not to do so.\textsuperscript{112}

However, there are signs of change here as well. For example, banks are being encouraged to divest their corporate shareholdings and to reduce their lending exposures to individual companies.\textsuperscript{113} In addition, new laws require German investors to disclose the details of their share ownership of greater than five percent in a company,\textsuperscript{114} and foreign ownership in German corporations has increased as a result of relaxed foreign share ownership rules.\textsuperscript{115}

3. Board Composition

In the United States, shareholders typically elect directors at annual shareholder meetings. Similarly, shareholders have the power to remove directors either with or without cause, unless the articles of incorporation or by-laws limit this power to removal for cause only.\textsuperscript{116} Labor is rarely involved in the corporate governance system. In the majority of U.S. corporations, several directors will be named from outside of the company.\textsuperscript{117} The role of the board of directors is to monitor a management team that it hires to carry out the day-to-day operations of the company.

Japan, like the United States, uses a single-tier board structure.\textsuperscript{118} Traditionally, Japanese boards have been large, increasing with the size of the firm.\textsuperscript{119} One of the primary reasons for the large board size is that company managers received directorships as rewards for loyalty and long service.\textsuperscript{120} Some of the largest Japanese firms have had more than fifty directors.\textsuperscript{121} Another traditional characteristic of Japanese boards has been a domination by older men, nearly all of whom

\begin{itemize}
\item \textsuperscript{112} \textit{Id.}
\item \textsuperscript{113} OECD \textsc{Economic Surveys: Germany}, supra note 11, at 120.
\item \textsuperscript{114} \textit{Unhappy Families}, \textsc{Economist}, Feb. 10, 1996, at 23, 25.
\item \textsuperscript{115} \textit{See} Edward Carr, \textit{A Fortress Against Change}, \textsc{Economist}, Nov. 23, 1996, at 3, 5 (noting the "transatlantic attitudes" of many managers due to the increased globalization of capital markets).
\item \textsuperscript{116} \textsc{Del. Code. Ann. tit. 8, § 141(k)} (1991); \textsc{Revised Model Bus. Corp. Act} § 8.08 (1984).
\item \textsuperscript{117} \textsc{James C. Abegglen & George Stalk, Jr., Kaisha: The Japanese Corporation} 183 (1985); \textsc{Fukao, supra note 13, at 98}.
\item \textsuperscript{118} \textsc{Prowse, supra note 35, at 42}.
\item \textsuperscript{119} \textsc{No Country for Old Men, supra note 55, at 61}.
\item \textsuperscript{120} \textit{Id.}
\item \textsuperscript{121} \textit{Id.}
\end{itemize}
are insiders of the company.\textsuperscript{122} Most typically, board members will be current or former senior and middle management.\textsuperscript{123}

However, signs of sweeping change exist within the Japanese boardroom. For example, in April 1999, Nissan announced a reduction in its board size from thirty-seven to ten, with a younger average age and three new directors from Renault, the French car maker which purchased a 36.8\% stake in the company.\textsuperscript{124} Sony was one of the first Japanese companies to reform its board, reducing the size from forty to ten in 1997 and including three independent, non-executive directors.\textsuperscript{125} Following the changes commenced by Sony and Nissan, nearly two hundred other companies, including trading houses, leasing companies, insurers, and supermarket chains, have announced plans to shrink their boards.\textsuperscript{126} Reasons for the reductions range from simple cost cutting to, as in Sony’s case, deliberate efforts to remove day-to-day managers and enable the board to focus on hard strategic decisions.\textsuperscript{127}

Some Japanese firms have retained large boards but shifted management decisions to other forums. For example, Matsushita is now run by a group management committee which meets weekly and consists of four board members who bring in other managers as needed.\textsuperscript{128} This enables the company to make much faster decisions than the traditional approval method.\textsuperscript{129} Other companies similarly have shifted away from consensus decision-making to a more top-down management system. Mitsubishi now has a single management committee, composed of the heads of its previous multiple committees system.\textsuperscript{130} In addition to shrinking their boards, Japanese companies have discussed importing outsiders to their decidedly inward looking boards. The Keizai Doyukai, an association of corporate

\begin{itemize}
\item[122.] Id.
\item[123.] Almost 78\% of Japanese directors are promoted from among employees. FUKAO, \textit{supra} note 13, at 14. A recent article in \textit{The Economist} opened by noting how Japanese company men could empathize with a young Japanese politician in a popular \textit{manga} (comic book) series who exclaimed, “Damn these old bastards,” in reference to the aging Japanese company men who are thwarting the radical change sought by Japan’s younger businessmen and politicians. \textit{No Country for Old Men, supra} note 55, at 60.
\item[124.] \textit{No Country for Old Men, supra} note 55, at 61.
\item[125.] Id.
\item[126.] Id.
\item[127.] \textit{From Squares to Pyramids, \textit{Economist}}, Nov. 27, 1999, at 7 (Survey: Business in Japan).
\item[128.] See generally \textit{No Country for Old Men, supra} note 55, at 61.
\item[129.] Id.
\item[130.] Id.
\end{itemize}
executives, has recommended that at least ten percent of board directors come from outside the company.\textsuperscript{131} The system used in Germany is significantly different from that in either the United States or Japan. In large German firms, employees select half of the board of directors.\textsuperscript{132} Some commentators speculate that this practice—known as codetermination—traditionally influenced firm management and stockholders to limit the flow of information to the board and otherwise minimize its functions.\textsuperscript{133}

Modern German companies manifest the codetermination philosophy through a two-tier board structure. Large firms with over five hundred employees are required to have this structure, which divides the oversight role into two functions.\textsuperscript{134} A supervisory board performs the strategic oversight role, while a management board performs the operational and day-to-day management oversight role.\textsuperscript{135} There can be no membership overlaps between the two boards and membership overlaps between boards of different corporations are restricted and rare.\textsuperscript{136} In firms with over 2,000 employees, employees of the firm must comprise half of the supervisory board; shareholder representatives make up the other half.\textsuperscript{137} Typically, the supervisory board chairperson is a shareholder and has the tie-breaking vote.\textsuperscript{138} Supervisory boards also may include representatives of firms with whom the corporation has vertical relationships, such as suppliers and customers.\textsuperscript{139} The supervisory board appoints and oversees the management board.\textsuperscript{140} The management board is comprised largely of the

\begin{itemize}
\item \textsuperscript{131} \textit{Id.}
\item \textsuperscript{132} Gilson & Roe, supra note 104, at 535.
\item \textsuperscript{133} Mark J. Roe, \textit{German Codetermination and German Securities Markets}, 1998 COLUM. BUS. L. REV. 167, 171-173.
\item \textsuperscript{134} Bradley et al., supra note 5, at 52.
\item \textsuperscript{135} \textit{Id.}
\item \textsuperscript{136} \textit{Id.} at 52-53.
\item \textsuperscript{137} OECD ECONOMIC SURVEYS: GERMANY, supra note 11, at 86. In companies with fewer than 2,000 employees, the ratio of employee to non-employee representation is one-to-two. \textit{Id.}
\item \textsuperscript{138} \textit{Id.} For more details about German boards, see Prowse, supra note 35. See also Fukao, supra note 13, at 100-01; Alfred F. Conard, \textit{Corporate Constituencies in Western Europe}, 21 STETSON L. REV. 73 (1991); Jonathan R. Macey & Geoffrey P. Miller, \textit{Corporate Governance and Commercial Banking: A Comparative Examination of Germany, Japan, and the United States}, 48 STAN. L. REV. 73 (1995); Mark J. Roe, \textit{German "Populism" and the Large Public Corporation}, 14 INT'L REV. L. & ECON. 187 (1994); Mark J. Roe, \textit{Some Differences in Corporate Structure in Germany, Japan, and the United States}, 102 YALE L.J. 1927 (1993); Vagts, supra note 75.
\item \textsuperscript{139} Klaus J. Hopt, \textit{Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe}, 14 INT'L REV. L. & ECON. 203, 205 (1994).
\item \textsuperscript{140} Bradley et al., supra note 5, at 53.
\end{itemize}
firm’s senior management. Consequently, board members tend to possess technical skills related to the firm’s products, as well as substantial firm- and industry-specific knowledge. The German board structure thus functions to explicitly represent the interests of non-shareholder constituents and ensures that major strategic decisions cannot be made without the consent of employees and their representatives.

4. Managerial Labor Markets

While the United States has an active market for managerial labor, inter-corporate mobility is limited in Japan and Germany. Historically, employees in these countries have tended to stay with one company for most of their careers. In Japan this has been due primarily to the practice of “lifetime” employment, which causes closure of the external labor market. Employees have been encouraged to remain at firms because they traditionally have been provided much greater levels of responsibility, discretion, benefits, and guarantees by their employers than comparable U.S. corporations provide. An early retirement age of fifty-five years also has contributed to Japan’s limited managerial labor market. In Germany, limited inter-corporate movement may be due to extensive apprenticeships and training that build firm-specific human capital.

5. Executive Compensation

In the past few years, U.S. newspapers and magazines have headlined rising U.S. executive compensation levels. Last year, the average U.S. Chief Executive Officer’s (CEO’s) total pay was 442% higher than in 1990. The pay increases largely have been due to the growing use of stock options, a measure initially introduced to better align executive and shareholder interests by rewarding CEOs for driving up stock prices. The recent bull
market has made stock options especially lucrative. As a result, in 1998 the average total pay for a U.S. CEO was 419 times greater than the average pay of a blue-collar worker.\textsuperscript{148} This compares with a multiple of fifteen to twenty times in Japan and Germany.\textsuperscript{149}

Stock options were behind the huge differential between the compensation levels of the heads of Chrysler and Daimler-Benz at the time of the 1998 merger of the U.S. and German companies. While Bob Eaton and Jurgen Schrempp had similar salaries, in the $1-2 million range, Eaton's total pay was seven times that of his counterpart, largely because he received a $1.2 million performance-share payment and $10 million in options.\textsuperscript{150} In 1988, the average CEO who was a member of the Financial Executives Institute received four times his or her base salary in stock options.\textsuperscript{151}

Outside of the United States, stock options are infrequently used as compensation, and when they are used, it is to a much lesser degree.\textsuperscript{152} This may in part be due to complicated laws and cultural conditions in other countries. Stock options were illegal in Japan until 1997.\textsuperscript{153} Now, in order for a U.S. multinational with more than fifty employees to issue stock options, it must go through a cumbersome annual notification process with the Japanese Ministry of Finance.\textsuperscript{154}

The Japanese culture traditionally has supported an egalitarian pay structure. Directors' pay has been low and fixed.\textsuperscript{155} Although change to pay arrangements has been slow, recently some large companies have announced plans to give more weight to individual performance rather than length of service.\textsuperscript{156} This shift is likely to be buttressed by government-initiated reform. For example, the Japanese government recently

\begin{thebibliography}{99}

\bibitem{148} Id. at 78.

\bibitem{149} Cynthia G. Wagner, Soaring CEO Salaries, FUTURIST, Nov. 1999, at 9.

\bibitem{150} Shirley Fung, How Should We Pay Them? ACROSS THE BOARD, June 1999, at 37.

\bibitem{151} The Financial Executives Institute is an Arthur Andersen entity composed of 88% U.S. and 12% Canadian companies. Id. at 38.

\bibitem{152} For example, out of a sample of 119 large Japanese firms, none used stock options for top executive compensation. Steven N. Kaplan, Top Executive Rewards and Firm Performance: A Comparison of Japan and the United States, 102 J. Pol. Econ. 510, 535 tbl. 4 (1994). In contrast, all of the 111 large U.S. corporations included in the sample used stock options to compensate their top executives. Id.


\bibitem{154} Fung, supra note 150, at 38.

\bibitem{155} From Squares to Pyramids, supra note 127, at 8.


\end{thebibliography}
has announced plans to further deregulate the banking, securities, foreign exchange, and insurance sectors by 2001.157

In Germany, stock options became legal in 1998.158 However, the response of German Daimler-Chrysler shareholders to the compensation discrepancy between Eaton and Schrempp suggests significant cultural resistance to stock option programs.159 Few major German companies have introduced stock option schemes.160 Instead, management compensation is usually in the form of fixed salaries and bonuses.

B. Benefits and Shortcomings of the Various Approaches

Shareholder primacy, though slightly amended, is still the rule in the United States. However, with a greater swath of the population owning shares and companies' unsurprising realization that bad community relations hurt profits, the adoption of communitarian values in this still very contractarian regime is understandable. Although a contractarian regime produces more wealth, it also allows a community of shareholders to reinvest that wealth as they see fit—a very American twist on the centralized control of corporate social conscience exercised by Germany and Japan.

The benefits of free markets, transparency, and efficiency provide opportunities for large organizations that can take advantage of efficiencies of scale in intra-organizational synergies and in increasing market share. Obtaining those benefits, however, risks simultaneously turning the human beings who work in large corporations into mere labor inputs. To use Havel's term, it makes them "cogs."161 Two conditions particularly threaten this kind of alienation. One condition is the extent to which workers, whether managers or line-workers, have a sense of ownership of their jobs and with such ownership, a right as citizens of the corporation to participate in the governance of the


158. Structural and Regulatory Developments in OECD Countries, supra note 57, at 17; Who Wants to Be a Billionaire?, supra note 153, at 15.

159. See supra notes 57-59 and accompanying text.


161. HAVEL, supra note 1, at xx.
The second condition is the extent to which the corporation acts as a social construct where important relationships are formed among those who work there.

The heart of the problem is that the anonymity of markets and the anonymity of large corporate bureaucracies tend to overwhelm the individuals working in them. Contemporary governance structures tend to make individuals into what Havel feared: cogs. While efficiency is a good value, it must be balanced with work employees value. Ironically, although purporting to provide a social connection to work, communitarian regimes have similar problems of alienation when they attempt to provide "community" in megastructures.

The German system, for instance, is not immune to its own creation of elites in opposition to a full-fledged participatory notion of corporate governance. To be sure, employees do have a greater potential role in shaping German corporate behavior. To the extent such a voice can be raised, the German system has a mechanism to broaden corporate concern beyond that of monetary goals. Yet an insular group of creditors and investors like that created in the German system could be even more dangerous to social concerns because of the lack of

162. This notion of ownership is akin to a property-like interest in one’s work. The property notion, of course, has long been linked to work. John Locke “introduced the notion that the origin of material property lies in labor . . . [p]roperty comes into existence when an individual applies labor to objects belonging to no one.” RICHARD PIPES, PROPERTY AND FREEDOM 35-36 (1999). Locke held that the mixing of labor with property created a property interest in the resulting product and that the protection of property rights was the raison d’etre for government. Id. at 37. Abraham Lincoln concurred that labor is prior to, and independent of, capital:

[C]apital is the fruit of labor, and could never have existed if labor had not first existed . . . [L]abor is the superior . . . of capital . . . . They do not deny that there is, and probably always will be, a relation between labor and capital. The error, as they hold, is in assuming that the whole labor of the world exists within that relation.


164. Thomas J. André, Jr., Some Reflections on German Corporate Governance: A Glimpse at German Supervisory Boards, 70 TUL. L. REV. 1819 (1996). One frequent criticism of the German model is that the shareholder representative component of the supervisory boards of German companies tends to be dominated by representatives of a few large German banks, with a small number of other individuals—many of whom also have close business or professional relationships to the company on whose board they sit. The implicit suggestion in the criticism is that the interrelationships among these individuals may sometimes be too close to allow effective monitoring of corporate management. Id. at 1822.
accountability. Centralized control of information and a lack of U.S.-style sensitivity to pluralistic concerns could make a German board less concerned with a broad range of stakeholder issues. To the extent the U.S. system requires significantly enhanced disclosure to the public and investors, it counteracts the elitism of the German model. Thus, a model that, like the German model, allows key stakeholders, such as employees, to have a vote may be an improvement for the protection of their stakeholder interests, but to avoid a new set of cronyism, governance decisions should also be transparent, as U.S. governance requires.

Two important lessons can be gleaned from the German situation. First, a mechanism for enhancing stakeholder concerns can be designed in the form of an oversight board. Second, in doing so, it is important not to simply create another "in-group" which can dominate corporate policy. If an oversight board is to be designed, it must be small enough to be practical, yet diverse enough to function as a proxy for pluralistic interests. Joined with the transparency of the U.S. system, such a board would have the benefit of a protected group of stakeholders—the employees—subject to the review of other stakeholders.

Many of the same benefits and criticisms of the German model also apply to Japan. The Japanese model highlights the view of corporate life as a social one. Perhaps more accurately, the Japanese model is more a family model. It is not surprising, then, that Japanese employees see the corporation as a social entity as well as an economic one. The reasoning connects with a normative framework in Japan that is more relational than what we might expect to acknowledge in the United States. In Japanese thinking, "a person becomes a full person only through a social network, and an independent person without a social network is, even if it is possible, a deviation or negation of its original form." The social network is part of a person's life, but the relationships also continue after death.

In this relational context, some argue that the task of ethics "is to define the structure and the mechanism of this relationship that already exist in our social life through customs and

165. Bradley et al., supra note 5, at 62.
167. Id. at 5.
168. Id.
Rather than beginning with a Western notion of self-consciousness regarding one's autonomy, the Japanese structure "starts with the two-person community, the smallest unit of human relationships."170 This two-person community may be that of husband-wife or parent-child, but can also include a relationship between friends.171 The kinds of trust involved in these relationships differ according to the relationship itself.

There are three kinds of Japanese social relationships. In the first context, there is a close-knit relationship, such as family and intimate friends, where the presumption of mutual basic trust is beyond reasonable doubt. In the second context, one has a relationship akin to neighbors and casual acquaintances, where mutual trust is reasonable. In the third context, there are no reasonable presumptions of trust; people are strangers.172 The third stage is analogous to what the law considers to be arms-length transactions.

For the Japanese philosopher, Mitsuhiro Umezu, the kinds of relationships people have and the rules associated with those relationships differ.173 He is critical of the Western approach of analyzing business relationships in an arms-length way.174 The arms-length approach may be a helpful model for negotiating with strangers, but the nature of the relationship and the moral principles governing that relationship are much different in the community where one works. In that work community, one at least has the opportunity for bonding in the form of casual acquaintance and neighbor and possibly even more intimately as close friend and colleague. Umezu's approach suggests that between the notions of individualism and communitarianism associated with megastructures—Germany or IBM, there may be models where communitarian sentiments can flourish in a contractarian global setting.

III. A Blended Model: Business as a Mediating Institution

The U.S. governance model offers advantages of freedom and transparency, the German governance model provides notions of citizenship and participation, and the Japanese model offers a sense of communal identity. Each offers advantages, but each

169. Id. at 6 (following the Japanese philosopher Watsuji).
170. Id.
171. Id. at 9.
172. Id. at 10-11 (arguing that the West tends not to make distinctions between these three contexts).
173. Id.
174. Id. at 11.
also threatens to overwhelm the human beings working for such a megastructure. Considering “business as a mediating institution” (BMI) may provide a framework for blending these three factors. This Section engages in a thought experiment of what a blended model might look like. In conducting this thought experiment, the result should provide the freedom and flexibility of a contractarian model while also being attentive to communitarian sentiments. This section has four key parts.

The first part provides an overview of BMI distilled by current scholarship to date. This part particularly emphasizes the logic and moral epistemology behind why small groups must be formed within a megastructure in order to foster communitarian sentiments. The groups, existing as a collective, have strong contractarian positions from which to engage the outside world.

The second part sketches the idea of a blended model that acts as its own self-reinforcing model for governance. In this model, regulation of corporate activities comes more from a system of checks and balances that empowers those within the organization to have an effective voice than from relying on outside regulation. In particular, the voices activated are those of employees, who are believed to be a special class of stakeholders, along with shareholders.

The third part describes three main pillars of the blended governance model, with attention to the specific structures that ought to be built to achieve the self-regulating system of checks and balances we advocate. These pillars include economizing, power-aggrandizing, and ecologizing, natural forces that exist in all aspects of life. In erecting these pillars, the lessons of comparative governance strategies become critically important.

The fourth part assesses what kind of an impact this model may have on the five comparative criteria set out in Section II. That is, it analyzes how this blended model would account for the goals of the corporation, ownership structure, board composition, managerial labor markets, and executive compensation.

A. Business as Mediating Institution: An Overview

Mediating institutions are those institutions standing between individuals and the larger society.\footnote{Fort, Business, supra note 175, at 150.} Within these structures human beings obtain their moral knowledge and personal identity. Traditional mediating institutions include family, religious institutions, neighborhoods, and voluntary associations. These associations are typically rather small and consequently allow for—indeed make inevitable—face-to-face interactions with others. Because of these face-to-face interactions, an individual’s actions make a difference. Unlike bureaucratic structures, where an individual’s actions can become lost in a megastructure’s maze,\footnote{See supra note 24 and accompanying text (noting Alasdair Maclntyre’s condemnation of bureaucracy).} in a mediating institution the actor witnesses the impact on another person. That knowledge, together with the peer pressure from others in the institution, influences a person to take into account the effect of actions on others. The individual’s conscience is thereby formed, and the community provides a monitoring and nurturing function for moral behavior.

For example, sociologist Robert Jackall describes a central problem of contemporary, large corporations; separating individuals from the consequences of their actions.\footnote{ROBERT JACKALL, MORAL MAZES: THE WORLD OF CORPORATE MANAGERS 127-28 (1988).} In a large corporation, individuals often cannot see the difference it makes to shortchange quality or even to embezzle, because they will not get caught. Moreover, others have written about the “moral muteness of managers.”\footnote{Frederick B. Bird & James A. Waters, The Moral Muteness of Managers, CAL. MGMT. REV., Fall 1989, at 73.} Frederick Bird studied managers and found that even those who did care about ethical behavior often were silent about it because it did not seem tough enough for hard economic assessment of business strategy or because introducing moral behavior produced “notoriously indeterminate” discussion.\footnote{Id. at 76-79.}

In contrast, it is difficult in a small group, such as a family, neighborhood, or voluntary organization, for individuals to avoid the consequences of their actions. In such organizations, usually either moral values are agreed upon in advance so that accountability criteria are clear or the members of the group know each other well enough to be able to confront each other.
In addition to the traditional forms of mediating institutions, much of a person’s conscious life will be involved with work. Because so much time is spent working, perhaps more so now than has been spent in previous eras of human history, there is a need to consider the extent to which businesses also should be mediating institutions.

Some have attempted to apply the concept of mediating institutions to the free market. Unfortunately, in doing so, they take a phrase, “mediating institution,” and use it without regard to the moral forming content resulting from a small community which nourishes ethical behavior through face-to-face interactions. Richard Madden provides a classic description of the corporation and weds that description to the mediating analogy when he writes that the corporation provides jobs and benefits to employees and various other economic benefits to suppliers, investors, customers, and charities.

The corporation mediates the relationship between the individual and the amorphous ambiguity of life by providing the monetary return so that individuals can have financial security, owners can realize profit, and charities can be funded. Virtually nothing is said about obtaining identity except that identity is characterized by the ability of the individuals to choose what they can do with this monetary return. Madden is clear that ethical virtues are necessary for the proper functioning of business, but he also argues that size “has relatively little to do with whether or not an organization can serve as a mediating structure.” If, however, others are correct in describing these structures as “the people-sized institutions, the mediating institutions where people ‘act as neighbors,'” then the large corporation can rarely be called a mediating institution.

The classical description of the corporation lacks the communal element necessary to provide meaning and identity. Of course, the corporation, even as a megastructure, can very well foster the common good by satisfying customers, making a return for investors, creating new wealth and jobs, generating upward mobility, promoting invention and ingenuity, promoting progress in arts and sciences, and diversifying the interests of the

181. Fort, Business, supra note 175, at 155-60.
183. Id. at 112-15.
184. Id. at 110.
186. E.g., Madden, supra note 182, at 107.
republic, but such goods are not goods of creating meaning and identity. Nor are such institutions necessarily communities that foster virtue and solidarity. Thus, although some may wish to characterize businesses as mediating institutions, businesses do not necessarily nourish solidarity, compassion, empathy, and respect for others. Saying that businesses are not necessarily mediating institutions does not mean, however, that they cannot become mediating institutions.

Considering business as a mediating institution provides a sense of individual empowerment and responsibility and an account of human nature that takes seriously the hardwired nature of human beings as social creatures formed by their moral communities. Because it takes the issue of size seriously, considering business as a mediating institution does not suggest that corporations are responsible to all facets of the community, but instead suggests that business should take itself as a community seriously.

Indeed, at the heart of communitarian sentiment is the belief that the community’s common good is connected to the individual. This belief requires stakeholder confidence in the community. American constitutional history provides an example of the relationship between the size of the community and the confidence of its members in it. To draw from U.S. constitutional history, some have argued that both the Federalists and the Anti-Federalists agreed that in a democracy, obtaining and maintaining the confidence of the people were critical because, without it, authority would have to resort to “force and the coercion of the sword.”

At bottom, this Anti-Federalist concern for the people’s “confidence” in lawful authority rests on a keen appreciation for the fact that popular government is, to some extent, a subjective phenomenon: a collective state-of-mind expressed in popular political culture. It depends on people believing that government acts for them, that it follows their wishes and can be controlled by them; it depends on people believing that government is, in a word, theirs. Perceptions matter because they affect how people behave, how they deal with the government and its laws—and so how the government deals with them. People who have confidence in their rulers, who believe that representatives are properly responsible to the needs and desires of constituents, are more likely to obey whatever laws the government enacts.

Id. at 30-31 (citation omitted).
Obtaining this confidence, according to the Anti-Federalists, was dependent upon personal interaction between representative and citizen. The Anti-Federalists believed in a relationship between the governed and governor that was fairly rich. The relationship was not based on a particular interest, but had the character of a more complex relationship among people within their community.

In small electoral units, leaders had to mix with the people and even prostrate themselves before votes. As wild as some of these campaigns may have been, the leaders got to know voters and vice versa. This style of politics, however, was doomed by the constitutional opponents who saw "that representatives who were not known personally and could not mix with voters would lose the confidence of the people. Distancing politicians from politics, they understood, would come with a cost."

Eventually, James Madison and Thomas Jefferson formed the first political party as a response to this problem. The reliance on parties, which are sometimes classified as a kind of mediating institution, has also been noted by organizational theorist and business ethicist Michael Keeley. Keeley notes that the founders' solution for avoiding the religious and other warfare of the centuries leading to the American Revolution was to place governance in the hands of the people.

Furthermore, Keeley contends that although an Aristotelian view of ethics, such as that expressed by the Anti-Federalists and contemporary business ethicists who rely on virtue and communitarianism, is not bad, it may not be enough to prevent "abuses of power by bosses or cynical reactions by workers." According to Keeley, more emphasis is needed on governance structures.

190. Id. at 35.
191. Id. at 62.
192. Id. at 76.
193. Id. at 85.
196. Id. at 246.
197. Id. at 248.
198. Id. Keeley writes:

Perhaps managers shouldn't treat employees differently than other stakeholders if they want employees to act like other stakeholders: like individual utility-maximizers in the marketplace. But managers, in claiming authority over employees, expect them to act differently. No one else is expected to care very much about the organization or its good. Managers don't expect customers to put the good of the organization above
Employees, like shareholders, are a special class of stakeholders. Keeley concludes his view of the challenges for twenty-first century business by saying the challenge is "to devise more popular theories of the corporation, to close the gap between governing fiction and reality in the workplace." This Article now turns to a discussion of this kind of model, with special attention on participatory form of governance.

B. Blended Model

Because reliance on coercion and ideology will inevitably require the excessive sacrifice of the individual for the common good, people must rely on "legitimate institutions" that balance the importance of individual human beings with communal goods. Those institutions recognize the importance of small groups combined with property protection and individual rights. In short, a balanced corporation would be one where participants within the organization have the requisite voice and power to have economic and non-economic concerns expressed and integrated into their business communities. Put another way, in such structures there is a sense of partnership among the participants because of a rich feedback loop.

As noted above, the most tangible mediating institution is a family, which is the most basic community. Yet, "[f]amily members do not ordinarily experience themselves as part of this family structure. Every human being sees herself as a unit, a whole, interacting with other units." In order to preserve the reality of autonomy with the reality of one's networked identity, family therapist Salvador Minuchin uses the term "holon" to describe the idea of holos, meaning whole, and the suffix on, which suggests a particle or part such as a proton or neutron.

their own interests. They don't expect this of investors. They don't really expect it of temps. Generally, it's only expected of full-time employees. It seems reasonable for employees, in return, to expect some say in the larger goods they are supposed to place before their own.

Id. at 251.

199. Id. at 252.


201. Id. Anthropologist Roy Rappaport calls this kind of institution a "cybernetic form." This denotes "a structure or form" providing "negative feedback, such that deviations of the states of components of the loop from reference values initiate processes tending to return those states to their reference values." ROY A. RAPPAPORT, ECOLOGY, MEANING, AND RELIGION 76 (1979).


203. Id. at 13.
Holons belong to the whole of the family, but are also part of other wholes as well. In such systems, a feedback loop is necessary in order to grow and maintain a state of dynamic equilibrium. By analogy, the basis of a corporation acting as a mediating institution provides a way for individuals to act within the mediating unit while simultaneously being linked to other systems. The enhanced opportunity to actually communicate with others in a "human-sized" setting fosters interaction and empathy. This interactive engagement develops communitarian sentiments of affection and empathy.

In family businesses – which are unique combinations of two kinds of mediating institutions – an important way to develop a notion of community spirit is the unsurprising, and often unpracticed, solution to listen, "establish two-way performance evaluations," and "encourage open communication in the family." In short, one central way of creating a system which functions in a state of balance is to engage the most relevant stakeholders in the system unit. In fact, a leading proposal for a self-enforcing model of corporate law suggests "direct participants in the corporate enterprise (shareholders, directors, and managers), rather than indirect participants (judges, regulators, legal and accounting professionals, and the financial press)."

Yet, shareholders are not enough. Employees are also a special class of stakeholders, and as two scholars of corporate culture note, "[l]ike families, villages, schools, and clubs, businesses rest on patterns of social interaction that sustain them over time or are their undoing. They are built on shared interests and mutual obligations and thrive on cooperation and friendships." Corporations are the loci for a good deal of other social interaction that is directly related to the financial success of the corporation itself. To be a self-enforcing model attuned to the realities of the workplace, corporate governance should be configured to foster an active engagement of shareholders and

204. Id. at 14-15.
206. Id. at 334.
employees. While involving all stakeholders in corporate governance may create too many masters,210 reinforce managerial authority,211 and risk gridlock,212 a limited set of stakeholders—shareholders and employees—would significantly diversify the voices heard in corporate governance. These parties could act as proxies for the concerns of other stakeholders because employees are also members of the community at large. Adding employees to the corporate governance structure gives a voice to both empathy and efficiency.

C. Governance Prongs

In his influential book on business ethics,213 William Frederick provides significant evidence from nature that there are three recurring values in all elements of life. The first is economizing, which is the basic activity of converting raw materials into useful resources.214 The second is power-aggrandizing, which is the quest for status and power that occurs in all life forms to some degree.215 The third is ecologizing, which refers to the linkages between members of species and species themselves that create the diverse web of life that supports long-term survival.216 This tri-partite structure relates to a characterization of various aspects of political economy in terms of the political, economic, and cultural/moral sectors217 and is a helpful model to utilize when considering business as a mediating institution.218

1. Economizing and Property

Economizing is a priority of any corporation. As Frederick describes it, economizing acts as a culture’s metabolism, converting raw materials into useful products and services.219 To do so in an adaptive way places a priority on efficiency. To the

210. E.g., ROBERT CHARLES CLARK, CORPORATE LAW § 1.2.4 (1986).
212. E.g., Hanks, supra note 69, at 111.
214. Id. at 30.
215. Id. at 57-78.
216. Id. at 134-67.
218. Timothy L. Fort, How Relationality Shapes Business and its Ethics, 16 J. BUS. ETHICS 1381 (1997) (providing a rationale for how these naturalistic forces are present in corporate settings).
extent corporations can maximize the value they produce in relation to the cost incurred by their effort, they are rewarded with profit and a higher market valuation. The optimal goals of this process of efficiency are the survival and growth of the organization. As a result, efficiency and the transparency that makes corporations efficient—through vibrant and liquid capital markets—promotes a valuable adaptability.

One key governance step, then, is to encourage the open markets that the United States is known for. Indeed, as indicated in Section II, this is already occurring in other countries. They see the efficiency and competitiveness that an open, transparent system provides and the obvious economic rewards associated with it. Strong disclosure laws, accounting principles that value assets according to their market value, liquidity of markets, and free transferability of shares all promote this kind of corporate efficiency. In short, corporations ought to be accountable for their economic performance, and these legal regimes foster that accountability.

In addition to overall efficiency, there is the dimension of how each significant stakeholder can maximize its own economic utilities. The open market mechanisms of the previous paragraphs go a long way to achieve this for shareholders. We have already argued that employees are a special group of stakeholders. One traditional way of assuring that individuals have the ability to control their own work is to emphasize the property interest they have in their work.

Anthropologists and historians have noted cultures that recognize property rights in songs and rituals and today, of course, we recognize property rights in patents and copyrights. Similarly, following John Locke's logic linking an individual's work to a property interest in his work and Abraham Lincoln's emphasis on the priority of labor over capital, the notion of property rights could be enhanced in an individual's work. Property rights enable individuals to feel more like they have an ability to influence the factors that affect their lives. Mediating institutions have this kind of influence; the individual is not simply at the mercy of an amorphous "society," but instead is a

220. See generally Roberta Romano, A Guide to Takeovers: Theory, Evidence, and Regulation, 9 YALE J. ON REG. 119, 119 (1992) (examining the empirical evidence on the effectiveness of preventing corporate takeovers "as if they were non-value-maximizing wealth transfers").
221. PIPES, supra note 162, at 80.
222. Id.
224. Lincoln, supra note 162, at 478.
constitutive part of that community with an influence on it. In particular, by strengthening the right of employees to vote in their corporate community, they become citizens of their corporate community. This could be done in the following ways, the list of which is meant to be suggestive rather than exhaustive.

One way to encourage property rights in employment would be for employees within various divisions or teams to state what their norms are and should be. Without that, the members of the organization do not relate to each other as human beings, but as interests, stereotypes, and ciphers. By engaging in the development of aims or norms, or by simply telling stories, the individual presents a richer revelation of his person. In addition to the norms required by laws, such as the Federal Sentencing Guidelines, the members of these smaller communities-within-a-corporation at least should have the ability to vote for the norms that govern the behavior within their group and to put it in writing. For instance, subgroups can meet to determine what values they believe their subgroup should respect. Evidence suggests that the list of values may not be as diverse as one might think, but there is a psychological difference created by contributing to the norms by which one is governed rather than by being told those rules. The ownership one has in those rules acts as a ratification of the rules themselves. Because small groups can also lurch toward tribalism, writing down the rule further acts as a transparent protection against the kind of oppression that a small group can perpetrate.

This kind of ownership over one's direct work experience is akin to models of workplace engagement that quality theorists advocate. The heart of their argument is two-fold: (1) that refined statistical measures are necessary in order to properly understand whether a product or service is being produced in a high-quality way, and (2) that to make things in a high-quality way, one must directly engage the person working on the product to contribute his ideas of how the product can be improved.

Similarly, another way to provide this kind of citizenship voting, matched with property, is to expand the use of Employee Stock Ownership Plans (ESOPS). ESOPS link efficient work with a direct property right. With the traditional property interest—in

---

this case, a share of stock—comes a right to vote for items such as the corporate board of directors, provided that the employee does not simply transfer the right to vote to someone else. Indeed, a greater set of incentives for the utilization of ESOPs could accomplish a significant portion of this first pillar’s objectives.

2. Power-Aggrandizement—Subsidiarity

As the framers of the Constitution knew, owning property itself provides an important check against unbridled executive power. They knew this because of evidence that individual property rights neutralized royal power in England. The foregoing proposal relative to property rights thus has implications for checks against executive power as well. Beyond this, however, the notion of subsidiarity checks excessive centralized power. Sociologist Robert Nisbet argues that centralized government’s chief opponents were mediating institutions. These institutions—families, guilds, churches, and voluntary associations—command allegiance from members at the expense of loyalty to megastructures. Rather than allowing such groups to form on the rallying point of alienation, it would seem more constructive to nourish them within a context of corporate and global good.

In corporate terms, some significant degree of autonomy should be given to subunits within the corporation. The “team” concept of contemporary management does this, although turnover makes equating “team” and “community” dangerous. J. Irwin Miller, longtime CEO of Cummins Engines, required that no plant have more than five thousand workers. Beyond this number, he thought, one could not generate a unifying culture. Thus, a second check designed to create a system in which corporate governance fosters impartial treatment of its members and inspires its members to commune to a common good is that of creating mediating institutions within the corporate structure.

First, as already suggested, the mediating institutions within the corporation can establish their “aims.” It is important to

230. See supra notes 47-50 and accompanying text.
231. PIPES, supra note 162, at 121-58.
232. See generally NISBET, supra note 80.
233. Id.
establish clear aims in order to force psychological attention to the multiplicity of goods that human beings possess and value.\textsuperscript{236} Without concrete expression of those goals, it is difficult for any organization to attend to the multiplicity of values that its members may bring to the workplace. Instead, a default to efficiency and only efficiency may replace the members' values. As has already been noted, however, this emphasis on efficiency may not fully account for all interpersonal dynamics within the firm.

A mediating institution either could ask its members to nominate, discuss, and vote on what values it holds important, or it could tell stories about what is meaningful to individual members of the group. These techniques elicit the moral goods of the constituents which can become aims to which members aspire and hold each other accountable in addition to—not instead of—the traditional corporate aim of profitability. It is theoretically possible that these aims could be destructive. A group could aim, for instance, to abuse minorities. This Article's proposal, however, is made with the expectation of a regulatory environment in which there will be limits on such activity and with transparency of those aims so that groups are accountable for their actions.

In between communal moral aims and the capacity (through property rights and voting) to influence corporate policy lie the various layers of corporate bureaucracy. It is important to link the notions described herein so such a bureaucracy does not eliminate them. Institutional economists argue that consensus decision-making is inefficient.\textsuperscript{237} Instead, they argue for hierarchies, so that there are clear lines of power and authority.\textsuperscript{238} These are similar to what anthropologists call simultaneous hierarchies.\textsuperscript{239} In legal terms, this economic argument for hierarchical control of corporate decisions makes the master-servant aspect of agency law one that characterizes employer-employee relationships.\textsuperscript{240}

Another model is that of sequential hierarchies. In these structures, small (mediating) groups elect a representative to articulate the group's consensual decisions with other small
groups "up-the-ladder." This process continues so that every decision is made within a small group where there is face-to-face interaction. Often, the representative of the initial group changes according to the issue, so a group having multiple leaders reinforces that consensus. These varying representatives are known as "sodalities" and they serve to keep each separate mediating institution open to the views of others. Having such a process keeps the mediating institution open to the views of others, thereby helping to preserve its adaptability. These structures require the face-to-face interaction necessary for the development of moral empathy and provide a structure to make clear the moral aims that exist within the corporation in addition to its economic aims.

In short, the creation of vibrant subgroups creates communities where empathy, commitment to the common good, and concern for the welfare of a variety of stakeholders take place. These kinds of subgroups can be integrated within the corporation itself. The authority of these groups does not necessitate capitulation of strategic thinking to full-fledged workplace democracy, but it does provide an opportunity for individuals to maximize their influence on those things that matter to the workers directly.

3. Ecologizing Values—Communication

Mediating institutions within corporations, equipped with a kind of property right, link personal moral identity with corporate policy and bring to corporate discussions the variety of human goods and experience that exist within any organization. Some have argued that communication serves as the central natural law principle. Similarly, this construct is a mechanism for configuring institutions so that communication can be more fully developed. Although not all intractable moral disputes are simply a matter of needing a good chat, open communication is a powerful tool. Not only can it reveal inconsistencies and commonalities allowing people to find ways to work together, the very commitment to communicate is a validation of human respect and dignity. Indeed, revival of civic republicanism, during the 1980s, scholars argued that the commitment to dialogue was

241. See Johnson, supra note 239, at 392-98.
242. Id.
243. Id.
244. E.g., LON L. FULLER, THE MORALITY OF LAW 186 (1964).
a central tool to transform self-interested individuals into citizens concerned with the common good.\textsuperscript{245}

In corporate terms, the importance of open communication among constituents can be demonstrated by a recent study, which suggests ways to handle downsizing. For instance, to mitigate the “downside” of downsizing, a four-step process is often recommended.\textsuperscript{246} The process is one that can be considered a way to enhance a sense of partnership, even in situations where one is being removed from the partnership.

In step one, the decision to downsize is made only as a last resort where it is necessary as part of a long-term vision for the company.\textsuperscript{247} In step two, actually planning the decision, a cross-functional team that has insights into constituent needs and can speak on behalf of stakeholders should be formed.\textsuperscript{248} This team should identify all the affected constituents, use experts (such as outplacement companies or government training programs) to assist downsized workers, train managers how to communicate the decision, and supply information to employees about the realities of the business.\textsuperscript{249} In step three, announcing the decision, the company should explain the business rationale for the decision, have senior managers announce it, notify employees in advance of the effective date, beat the media to the announcement, and offer employees the day off.\textsuperscript{250} Finally, in implementing the decision, the company should tell the truth and “overcommunicate.”\textsuperscript{251} It should also involve employees in downsizing decisions, exercise fairness (in terms of some kind of objective criteria) as to separation, keep its promises in terms of its timetable, help department employees find other jobs, allow for voluntary separations, provide generous benefits and career counseling, and train survivors.\textsuperscript{252} Through this process, the corporation will maintain trust and minimize productivity losses.\textsuperscript{253}


\textsuperscript{247} \textit{Id.}

\textsuperscript{248} \textit{Id.} at 87.

\textsuperscript{249} \textit{Id.} at 87-88.

\textsuperscript{250} \textit{Id.} at 89-91.

\textsuperscript{251} \textit{Id.} at 92.

\textsuperscript{252} \textit{Id.} at 92-94.

\textsuperscript{253} For a more skeptical view of the importance of corporate culture, see Charles M. Yablon, \textit{Corporate Culture in Takeovers}, 19 \textit{CARDozo L. REV.} 553 (1997). Yablon compares corporate culture to arguments about God. \textit{Id.} at 553-56. To some, he suggests, God/culture is worthy of intense study. \textit{Id.} at 553. To “atheists” culture plays no role in takeovers. \textit{Id.} at 554-55. To “agnostics” culture might well exist. However, they believe that it is better to act under the
D. Impact on Comparative Criteria

The tri-partite model emphasizes the importance of property rights with citizenship participation. This is both a U.S. and a German strategy. It is American to the extent that it relies upon transparent disclosure of each subgroup and it is German to the extent that it features employee participation in the governance process.

The model also emphasizes the importance of mediating institutions, or subgroups, within the organization in order to balance power. This is both a U.S. and a Japanese strategy. It is American to the extent that mediating institutions have historically been an integral component of civil society and in its concern for creating checks to accumulation of power. It is Japanese in that it relies upon subgroups within the organization to be akin to families or, in even more Japanese terms, to be like Quality Circles. In such small groups, work is social as well as productive. In fact, the two often go together.

Finally, the model also emphasizes communication. This is an aspect of all three structures, although the members of the governance structure among whom communication takes place differs. In BMI, it takes place not simply among creditors, officers, or capital markets, but among those who finance and truly operate the business.

1. The Goals of the Corporation

The goals of U.S., German, and Japanese governance structures differ. Corporations must compete in global markets and doing so has advantages of efficiency as measured by profitability. Corporations, as collective entities, should operate according to contractarian models in this competitive environment. In BMI, these institutions do compete with each other, and their activities will be disciplined by external capital markets. Yet, in addition to the goal of shareholder protection, there is also a goal that those who work for the organization are allowed to be involved in work that enables them to flourish as human beings. BMI thus stands as a possible regime that allows

---

assumption that such a culture is not really there because of the difficulties associated with it. Id. at 555.


255. For a discussion of "Quality Circles," see Robert E. Cole, Quality Circles, in QUALITY MANAGEMENT HANDBOOK 85 (Loren Walsh et al. eds., 1986).

256. See supra Part II.A.1.
individuals to voice their concerns in a small, familial setting, while simultaneously being open to competitive market moves. The remaining comparative factors are ways that this balance is accomplished.

2. Ownership Structure and Composition of Board of Directors

Rather than an ownership structure focusing only on shareholders or on a small clique of creditors, BMI blends shareholder and employee ownership. The ownership structure has three components. One component is in ownership of shares of the company. As this Article argued, a transparent model, as followed by the United States, provides protection to shareholders by emphasizing full disclosure and liquid markets. These act as disciplinary mechanisms against managerial misfeasance and provide a model superior to the secretive workings of German and Japanese systems. ESOPs also enhance the ownership interests of employees.

The second component of ownership is that employees have a sense of ownership over their environment and the work they do. The ability to have control brings a communitarian dimension to work in a forum small enough to truly be a community. Recognizing this dimension of "ownership" is an important supplement to financial notions of ownership. By recognizing it, a communitarian sentiment of living in a workplace community can be combined with contractarian competitiveness in the marketplace through the collective action of the corporation as a whole.

Finally, there is ownership in a system of checks and balances that represents to the board the variety of values, both economic and non-economic, that members of the corporate community bring with them to work. As the research from Hampden-Turner on Anheuser-Busch suggests, the workplace may not be inimical to productivity, but a high-context environment may actually make the workplace more productive.257

Thus, "ownership" contains several nuances. Each of these nuances can be captured by BMI and in doing so, BMI can provide a blended model.

---

257. CHARLES HAMPDEN-TURNER, CREATING CORPORATE CULTURE: FROM DISCORD TO HARMONY 58-59 (1990).
3. Managerial Labor Markets and Executive Compensation

Finally, the U.S. model provides significant opportunities for managers to migrate to other firms and to do so with significant compensation. As a result, there is competition for talented managers and a system leading to a higher differential between highest and lowest paid workers in the corporation.\textsuperscript{258} Undoubtedly, complex business organizations need talented individuals and there may be a correlation between that talent and concrete returns on investment. Nevertheless, there is a danger in the differentiation between highest and lowest paid. Anthropologists advise that there "is every evidence . . . that humans' Pleistocene evolutionary experience did not prepare us to tolerate more than the most minimal command and control institutions. Nor were we prepared to tolerate much inequality."\textsuperscript{259} The German and Japanese models create less differentiation in compensation.

One way to mitigate the kind of resentment that could occur with high differentiation, assuming that such a differentiation is needed to be competitive and attract desired managers, is to have all of those in the organization have a voice in corporate decisions. This would occur in a republican, representative model rather than a democratic model of corporate governance. Nevertheless, it seems likely that significant differentiation would be more tolerable if it had wide-based support within the organization.

At the same time, of course, it is possible that such a scheme would prevent such differentiation. Although this could cause a competitive disadvantage, there may be countervailing factors to limit this danger. First, with information about competitive markets, employees may realize the necessity of paying top talent well. Second, if the more broad-based governance structure brought with it concerns and values to make the corporation a satisfying place to work, more than money may be available to attract top talent. In short, a broad-based model, such as the proposed BMI model, has the potential not so much to reduce competition for top talent, but to make the allocation of resources for such talent more acceptable and to create non-monetary benefits for talented executives.

\textsuperscript{258} See supra Part II.A.5.

\textsuperscript{259} Richerson & Boyd, supra note 200, at 269.
IV. Conclusion

Corporations are not communities without a human element. Corporations are institutions comprised of human beings, and the issues that arise with any kind of human community also arise in corporate life. The social existence of corporations, however, is dependent upon their successfully taking on the responsibility of being economically efficient producers of goods and services and organized practitioners of economizing values that battle entropic disintegration. Corporations are not only that. They remain human institutions, but one must take into account the special role that wealth production and property values have in corporate responsibility.

Those institutions should provide a system of checks and balances producing impartial treatment of (at least) internal constituents, a commitment to the common good, and adaptive openness to the outside community. Doing this requires a balancing of economizing, power-aggrandizing, and ecologizing values. These values can be manifested through increasing recognition of property rights, fostering the creation of mediating sub-units within the corporation, and by having those mediating institutions regularly identify and discuss the moral norms of its members. These steps would allow for the efficiency of markets to discipline corporations while preserving the moral goods of human lives in such corporations.

260. FREDERICK, supra note 213, at 30-43.
261. Id. at 144. Frederick refers to the goal of “homeostatic succession” and notes that radical shifts diminish the supportive system of life’s web. Id. at 142-45. Of course, this is not to say that all changes must be smooth. There may be some starts and stops in the evolutionary process. The point, however, remains that radical change involves significant risk to the beings living in the midst of such change and that the techno-symbolic ability of human beings can be used, particularly in corporate life, to make those changes less rather than more painful.