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Varieties of private self-regulation in European capitalism: corporate governance codes in the UK and Germany

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Voluntary codes of best practice have become increasingly prominent in corporate governance regulation. Given their similarity in focus and substance, the global spread of private self-regulation in corporate governance is often attributed to the rise of institutional investors and seen as signalling a global convergence of standards among the traditionally divergent national corporate governance systems. Drawing on institutionalist approaches of Comparative Political Economy, we argue that national code developments are strongly shaped by national state–economy relationships, in particular by domestic 'key coalitions'. Comparing the emergence of corporate governance codes in the UK and Germany, our study reveals marked differences with respect to the formulation, substance and function of codes in national corporate governance. In the UK, the code largely reflects the demands of institutional investors for stricter standards. In contrast, members of the traditional German 'stakeholder coalition' pushed for a code that was intended to be more of a marketing than a regulatory instrument.

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1. Introduction[1]

Voluntary accords or codes of best practice have become increasingly prominent in European capitalism. They are not, or only marginally, based on

[1] The paper builds on findings from a research project (2005–09) on the transformation of corporate governance regulation in the EU (Germany, UK) and the USA. In the course of this project, 82 confidential expert interviews were conducted; these are referred to in the paper.

legislation and rely on the non-hierarchical coordination between private and public actors, or among private actors only. The rise of soft law is particularly evident in the area of corporate governance regulation, where commentators have observed the 'triumph of the code' (Monks and Minow, 2004, p. 297). Within the corporation, corporate governance codes generally focus, in particular, on the role, structure and the responsibilities of boards (Becht *et al.*, 2002, p. 67). A corporate governance code is usually issued by a collective body and chiefly applicable to listed companies, while enforcement and monitoring of compliance with the code provisions is left to the capital markets (Weil, Gotshal & Manages LLP, 2002, pp. 9, 68). The code movement started in the early 1990s in the UK, and by the end of 2001, codes were in existence in almost all of the member states of the European Union. In addition, there are several international codes, most prominently the OECD 'Principles of Corporate Governance', and numerous corporate governance guidelines or statements issued by individual investment institutions (Weil, Gotshal & Manages LLP, 2002, pp. 8–21; Monks and Minow, 2004, pp. 297–299; Wymeersch, 2005, pp. 406–407).

An extensive body of academic research in the realm of the global governance or corporate social responsibility debate attributes the growth of 'civil regulation' to the globalization of investment and management decisions, the lack of adequate state mechanisms at both national and international levels to govern global firms and markets and the rise of transnational civil activism, influencing the policies of national governments and intergovernmental organizations (Cutler *et al.*, 1999; Vogel, 2005, 2008). Private self-regulation is seen as constituting a shift from state-centric forms of command and control to market-based regulatory mechanisms, namely producer certification, product labelling and information disclosure. Engaging the corporate sector in the rapidly expanding web of 'multilateral, non-territorial modes of regulation' (Scherer *et al.*, 2006, p. 506) is seen as providing opportunities for consumers and investors to engage in politics via markets and to 'temper the hazards of global market forces' (Cutler, 2006, p. 200).

Given the proliferation of corporate governance codes, their similarity in focus and in their substantive recommendations, the existing research on corporate governance codes does indeed consider their cross-national diffusion as a testimony to the growing importance of capital markets and the global strength of, in particular, institutional investors, who promote similar 'best practice' standards on a worldwide scale (Wymeersch, 2002; Aguilera and Cuervo-Cazurra, 2004, pp. 230–247). The spread of codes is interpreted as signalling a convergence of standards among the traditionally divergent corporate governance systems of European countries (Cadbury, 2000, pp. 9–11), thereby constituting a possible cornerstone of an emerging transnational regime of corporate governance regulation (Nölke *et al.*, 2007).

Against this backdrop, we argue that, despite reflecting an apparent cross-national spread of 'best practices' in light of globalization and the rise of institutional investors, national code developments are strongly shaped by distinct features of national state–economy relationships.

Drawing on institutionalist approaches from the field of comparative political economy (Hall and Soskice, 2001; Schmidt, 2002; Amable, 2003), we perceive corporate governance codes as an institutional element of national 'varieties of capitalism' and assume that conflicts over the design and function of corporate governance codes are shaped by domestic 'key coalitions'—'socio-political groups which have the power to shape the rules, institutions and governance mechanisms of a national political economy and to negotiate changes in them' (Amable, 2003, pp. 10–12). We compare code developments in the UK and in Germany because they have traditionally represented different models of capitalism and corporate governance (Franks and Mayer, 1995, pp. 171–195).

In the UK 'outsider' system, corporate governance developed essentially as a power game between managers and investors. The structure of business relationships was market-driven, as companies financed themselves largely through the capital markets. Market-based mechanisms of monitoring and disciplining management—notably the takeover market—served to direct corporate strategy towards maximizing shareholder value. Institutional investors generally stayed at arms' length from the companies in which they invested and intervened only in periods of crisis (Black and Coffee, 1994, p. 57; Schmidt, 2002, p. 158). Other stakeholders, in particular workers, did not enjoy a voice in corporate governance. As the company is regarded as a domain of private transaction, regulated by contract rather than statute, both statutory and case law take a hands-off approach to the regulation of the structure and functioning of the one-tier board and the company (Davies, 2000). This hands-off approach corresponds well with the traditional 'laissez-faire' attitude of the British state towards the market. The state's role is limited to making it easier for a company's owners (shareholders) to make informed decisions by setting high financial disclosure requirements and ensuring the protection of minority shareholders. The market-making approach to corporate governance also reflects the strong position of the capital market in Britain, as well as the strong constituency of financial institutions located in the City (Donnelly *et al.*, 2000, p. 24; Vitols, 2001, pp. 337–345).

In the German 'insider model', company finance relied much more on bank credit than on the capital market. Business, financial intermediaries and labour were the key players, with the state 'enabling' (Schmidt, 2002, p. 114) negotiations between private actors. Listed companies were traditionally embedded in a broader set of relationships through the presence of blockholders, multiple ties between companies and banks and the influence of stakeholders in corporate decision-making. The German state constitutionalized the interactions between shareholders and management in the late nineteenth century by densely regulating the internal procedures of corporate decision-making. While the day-to-day running of the company was assigned to the management board, the supervisory board was made responsible for the appointment and monitoring of the management board and for approving certain business decisions. Germany's highly mandatory company law not only reflects a legalistic tradition, but also the enabling role of the state, using law to structure and facilitate negotiations between economic actors. This approach was later extended to integrate labour interests, with up to half of the supervisory board seats in large companies now being allocated by law to employee representatives. In practice, the supervisory board proved to be an amenable instrument for the control over company policy by insider networks. Banks, large shareholders—which were often non-financial companies and financial institutions—and labour were the key members of the 'stakeholder coalition' typically found on German supervisory boards, playing an active role in firm governance in coordination with, and as a counterbalance to, the management. Retired top managers of the respective company, as well as prominent customers and suppliers were also often represented on the board. Outside shareholders with a purely financial interest in the company did not wield any significant influence in this system (Hopt, 1998; Schmidt, 2003, pp. 9–22; Vitols, 2004).

We find that the different national corporate governance models have left their imprint on the process of code formulation, on code substance and on the function of the code in the respective corporate governance system. In the UK, the formulation of the code was driven by demands of national institutional investors to enhance the oversight function and the accountability of the board. The prime function of the code was regulatory, as it was to complement the weak requirements of British company law. In contrast, members of the German 'stakeholder coalition', propped up by the state, played the most influential role, leading to a code which, intended to be more of a marketing than a regulatory instrument, does not fundamentally challenge the position of the traditional 'insiders', i.e. corporations and trade unions.

Our paper proceeds as follows. In the following two sections we discuss the process of code development in the UK (Section 2) and Germany (Section 3). Following a comparison of the two cases (Section 4), the paper concludes by briefly discussing the implications of our findings for the debate on private self-regulation of global business (Section 5).

2. The British Corporate Governance Code: a 'UK solution'

2.1. The beginning: the Cadbury Committee

In the 1980s, the UK saw a shift in economic policies as it moved from being a Keynesian welfare state to being a neo-liberal state. The Thatcher government's privatization programme of nationalized industries and the decision to remove barriers to the financial market changed the British corporate governance scene. Shareholder ownership became increasingly internationalized as well as institutionalized, while family and state control diminished. Both foreign and British investors hence established a powerful interest group in the market as well as in the political arena, making the regulatory environment more complex (Davies, 1997). As institutions, both foreign and British, preferred to use 'exit' (sell shares) rather than 'voice' (e.g. the use of voting rights in the general meeting), they had no incentive to intervene in the internal structure of companies, leaving professional managers a great deal of discretion (Black and Coffee, 1994).

Moreover, a series of corporate scandals involving financial manipulation and fraud by self-serving directors, illustrated that the 'exit option' for shareholders offered neither investors nor other stakeholders sufficient protection against managerial failure and fraud (Howard, 2006, p. 414). Thus, at the beginning of the 1990s, the British corporate governance system was hit by a 'credibility crisis' (Wymeersch, 1998, p. 1072). The City, in particular accountants, investor institutions and the stock exchange, demanded improvements in the regulatory framework and audit quality in order to re-establish market confidence and attract investment, both from within the UK as well as overseas.

As the financial manipulation had been left undetected by auditors, the Institute of Chartered Accountants of England and Wales (ICAEW) was eager to restore its reputation. To this end, it sponsored the Committee on the Financial Aspects of Corporate Governance under the aegis of the 'charismatic' Sir Adrian Cadbury (Cadbury Committee). In the tradition of the informal, non-legalistic, flexible and individualized regulatory style of the City (Lütz, 2002, p. 115), the Committee was dominated by the market players (among them the accounting profession, institutional investors, lawyers, corporations, the Bank of England and the London Stock Exchange), while wider public interests were not represented (Cheffins, 1997, p. 399; Interview GB 3).

The corporate bodies, most notable the Confederation of British Industry (CBI), remained rather passive with regard to the set up and the Cadbury Committee's initial debate and were not directly represented in the Committee (Interview GB 21). The CBI had agreed with the ICAEW that the Committee should concentrate on the external governance aspects (financial reporting and audit), leaving the internal governance issues (functioning of the board), which had been a traditional concern of the CBI, untouched. However, following the dramatic collapse of the Maxwell cooperation in 1990, as well as mounting public and political pressure, the CBI had to accept that the Committee also considers extensively the flaws of the internal corporate governance system. The government made clear to the Committee that, in the case of failure of the self-regulatory approach, it would legislate on the matter (Cadbury, 1992). In its efforts to strengthen the oversight of boards over management through a strong element of independence of board members and a system of checks and balances, the Committee was supported by investor associations. The discussion paper on 'The Role and Duties of Directors' by the Association of British Insurers (ABI, 1990) brought their view forward of what they considered to be best corporate governance practices. Therein, it demanded the separation of the roles of the chairman and CEO, a strong body of independent non-executive directors (NEDs) and the establishment of specialized committees with regard to audit and remuneration (ABI, 1990). Similar demands were formulated in the Institutional Shareholder Committee's (ISC) Statement on the Role and Duties of Directors (ISC, 1993).

Although the Committee recognized developments in the USA, especially the New York Stock Exchange (NYSE) rules on audit committees, the Cadbury Committee was, in the end, looking for a 'UK solution' (Interview GB 3) to address the lack of control of boards over management. The Committee drafted a Code of Best Practice that provided, for the first time, broad principles of corporate governance, enhancing the accountability of management and boards towards investors. It set forth that the board should maintain a sound system of internal control to safeguard shareholders' investment and the company's assets. This investor-orientation was also reflected by other provisions, which mostly took up investors' demands. These included *inter alia* the separation of the role of the managing director and the chairman, a sufficient number (at least three) NEDs on the board, of whom the majority should be independent from management, and the establishment of specialized committees on audit, remuneration and nomination, staffed with NEDs, of whom the majority should be independent. The Code was enforced through the Listing Rules of the London Stock Exchange. Companies were required to report in their annual accounts on their compliance with the Code, or give reasons for non-compliance (principle of 'comply or explain'). Thus, the Code tried to strike a balance between investor protection and managerial flexibility. The Committee's regulatory approach remained uniquely British, as the enforcement of the Code was based on 'accountability through disclosure' (Keasey *et al.*, 2005, p. 25).

2.2 *Executive pay and the combined code*

Following a series of scandals involving extreme pay increases at privatized utility industries, there was public and market pressure on business to address this issue. The Conservative government feared the discrediting of its privatization programme (Moran, 2003, p. 122) and thus made clear to business that it would be prepared to legislate on the issue if no suitable solution was found. There was also considerable pressure by investors who felt that directors was profiting even when companies were not performing very well, and that inappropriate reward schemes might have reputational effects on companies, and hence affect share prices. They therefore demanded a strengthening of the link between performance and remuneration and the limiting of service contracts to three years. In their concerns, the investors were supported by the Labour party, which mounted a campaign against the ever rising pay of managers and called for legislative reforms in its 1997 election manifesto (Interview GB 5).

At this point, the CBI took the lead in corporate governance and set up the government-backed Study Group on Directors' Remuneration, chaired by Sir Richard Greenbury, to address the highly politicized question of executive pay. The Committee's main recommendation was to enhance the link between performance and remuneration, and to improve shareholder oversight through better disclosure of remuneration policies in the annual report, together with information on the remuneration packages, including bonus, long-term incentive schemes (share options) of individual directors by name and via an 'advisory' resolution on the remuneration report stating the company's policy in the matter.

A committee under the leadership of Sir Ronnie Hampel (Hampel Committee) was established in 1996 to review the functioning of the Cadbury Code. In contrast to the Cadbury Committee, the Hampel Committee struck a more business-friendly note. It argued that the focus on accountability and disclosure had led to growing costs of compliance for companies and a 'box ticking' culture among investors. Hence, company boards were hindered in their first responsibility, to enhance prosperity (Corporate Governance Committee, 1998, p. 17). While business and accountants applauded this analysis (Trapp, 1996), investors and shareholder interest groups were concerned that the new code would weaken established standards and fail to provide an improved definition of independence.[2] In the end, the final report of the Hampel Committee did not propose any sweeping reforms, but consolidated the recommendations into a Combined Code, which was attached to the Listing Rules. The Hampel Committee can thus be regarded as a 'failed attempt by management to win back some of the ground which it had conceded to the Cadbury Committee' (Davies, 2000, p. 438). The

[2] *Global Proxy Watch*, September 5, 1997.

Hampel Committee also recommended embedding the largely piecemeal and *ad hoc* rule-making process in a more robust institutional framework. Thus, the Financial Reporting Council (FRC)—an independent private regulator whose chairman and deputy chairman are appointed by the Department of Trade and Industry (DTI) and the Bank of England, funded equally by the government and business—became responsible for the review and development of the Code. Despite this formalization, the review process has remained a form of partial self-regulation, including all relevant market players (GB 18).

2.3 Post-Enron reform: the Higgs Review

In the 1990s, New Labour picked up corporate governance regulation as an instrument to promote British competitiveness and economic success. In its pre-election guide, it announced that its priorities were to review the role of NEDs, the regulation of executive pay and the role of institutional investors as owners of the company, as well as that it intended to set up an expert panel to advise the government on corporate governance issues (Young, 1996). Many observers expected, therefore, that it would not 'take a back seat in the corporate governance debate' (Keasey *et al*., 2005, p. 40).

In 2002, the government set up a review of the Combined Code under the auspices of Sir Derek Higgs with a view to clarify the role of NEDs. Although the government's decision was not directly linked to the corporate scandals that hit the US market in 2001, the corporate collapse of US companies such as Enron and WorldCom triggered a renewed public as well as parliamentary debate on corporate governance in Britain (House of Commons, 2002). Moreover, the enactment of the Sarbanes Oxley Act (SOX) and new NYSE Listing Rules in the USA put regulatory pressure on the government to review the British corporate governance standards and to limit any potential consequences of US regulation for British companies. Consequently, the government redefined the Higgs Review as a post-Enron response (DTI (Department of Trade and Industry), 2002). By setting up another review of the Combined Code, the Labour government kept with the typical British manner of corporate governance reform based on non-statutory, principle-based regulation rather than legislation. This voluntary approach was considered an alternative to the 'costly and prescriptive' SOA (Hewitt, 2002). Investors, companies and auditors, as well as the public, widely agreed with the government's decision. The final recommendations of the Higgs Review aimed at strengthening the board's internal control and accountability mechanisms. The most innovative proposals were the tough and detailed definition of independence of NEDs, who were to constitute half of the board's members. Higgs's definition largely followed the classification used by investors (Higgs, 2003, pp. 81–82).

Another progressive aspect of the report concerned the relationship between shareholders and the board—in particular NEDs. The report suggested that a Senior Independent Director (SID) should be responsible for the direct communication between NEDs and shareholders. Corporate interests, such as the CBI and Institute of Directors (IoD), found the definition to be too restrictive, making it difficult for companies to find adequate candidates (Interview GB 13). Corporate bodies also expressed their objection to the designation of a SID, as they feared that his role would be muddled with that of the chairman, who normally was the link between the board and shareholders (Tassel *et al.*, 2003). Investors feared that the strong opposition of companies would weaken their support for the principle of 'comply or explain', so that they would 'comply or do nothing' (Tassel, 2003). Following the extensive criticism and the shareholder-companies tensions, the FRC—with the support of the government—decided to set up a working group including Higgs, members of the CBI, the ICAEW and the investment community, before publishing a new Combined Code (Howard, 2006, p. 424). Subsequently, Higgs's proposals were softened,[3] but the investor-friendly character, notably the strict definition of independence, was preserved.

2.4 The Company Law Act

Although New Labour adopted the neo-liberal ideas and the inherent belief in the market, it was eager to develop a 'third way' in which market efficiency would be combined with social equity and 'equal opportunity' (Pearce and Paxton, 2005). Similar to left-wing parties in other European countries and the USA, New Labour searched for a reform agenda that would still appeal to a left-wing and working-class electoral base, but would also take into account the shifting interest group preferences that allow for the alignment of the centre-left with major financial institutions and increasing securities market investment (Cioffi and Höpner, 2006). In this context of modernization and competition, the idea of a 'stakeholder society and economy' seemed to be an attractive concept. In 1998, New Labour initiated a review of British company law, thereby affirming that the government had a responsibility to set 'rules by which every company must operate' (Beckett, 1998). The structure and membership of the Company Law Review reflected the idea of a balance of interests within the company. While the Code Committees had been dominated by the market players (the City, business and accountants), a new Company Law Review Steering Group was installed, which

[3]The Chairman was now allowed to chair the nomination committee and his role was strengthened in meetings with NEDs and shareholders, while the SID's role was reduced. Moreover, the CEO was now allowed to become chairman of the same company after consultation with major shareholders.

was eager to ensure that the outcomes would enjoy broad support. Due to the participatory character of the review, trade unions and NGOs that remained outside the consultations on the Combined Code were able to participate more directly in the debate.

The proper formulation of the directors' duty of loyalty was a core matter of controversy, both during deliberations on the Company Law Review and during the passage of the 2006 Act through Parliament. Should the Act keep the rule of shareholder primacy or adopt a more pluralist approach? Trade unions and NGOs favouring a pluralist approach argued that a company owes responsibility to society and to stakeholders as a whole, while business, supported by the legal community, was eager to preserve the status quo and thus the property rights approach, by which companies are owned by their shareholders and relationships with other stakeholders are regulated through private contracting. The statutory definition of directors' duties enshrined in the Act embodies the compromise formula of 'enlightened shareholder value': the 'interests of the non-shareholder groups are to be given consideration by the directors only to the extent that it is desirable to do so in order to promote success of the company for the benefit of its members' (Davies and Rickford, 2008, pp. 65–66; Parkinson, 2002).

2.5 Crisis responses: UK Corporate Governance Code and the Stewardship Code

The current financial crisis has led to heightened scrutiny of the role of boards and of institutional investors in the British system of corporate governance. Although the FRC 'did not find evidence for serious failings in the governance of British business outside the banking sector' (Financial Reporting Council (FRC), 2009), the Council proposed Code changes to make 'those on boards . . . think deeply about their individual and collective roles and responsibilities—chairmen, executives and NEDs'. While the 'comply or explain' principle and the Combined Code, now renamed the 'UK Corporate Governance Code', shall remain cornerstones of the existing regulatory framework, new principles have been added to the Code to counter the perceived 'short-termism' of corporate behaviour. The chairman and the whole board shall be re-elected annually to enhance accountability to shareholders, the board shall be balanced and its performance evaluated, the board will have to ensure adequate risk management and performance related pay shall be aligned with the long-term interests of the company and its policy on risk (Financial Reporting Council (FRC), 2009).

Probably more significant than these code changes is the introduction of a new 'UK Stewardship Code' for institutional investors. The Code, the first of its kind in the world, mirrors the UK's governance code for companies and is overseen by the FRC. It is based on guidelines produced by the ISC, which had turned best practice guidance for the investment industry into a voluntary code. Institutional investors in UK companies are requested to engage with company management and boards and to disclose how they vote, monitor companies and undertake corporate governance. The code is voluntary under the 'comply or explain' principle, also allowing foreign fund managers and sovereign wealth funds to sign up to it (FRC, 2010, pp. 7–8). While industry was broadly supportive of the code, they were anxious that, if the code were too prescriptive, investors would opt out or do the bare minimum. Not surprisingly, in the end, the code was watered down, due in part to fierce protests from some parts of the asset management industry about the significant costs of the new requirements (Heinemann, 2010; Masters and Burgess, 2010). Given that the European Commission is exploring the possibility of a single stewardship code for its 27 member states, the UK code is seen as a model for further stewardship guidelines on the European level (Sullivan, 2010).

3. The German code: marketing the German corporate governance regime

3.1 The beginning: private code initiatives

In Germany, state and private actors began to reassess the usefulness of the traditional corporate governance regime in the late 1990s in light of general concerns about the insufficient dynamics of the German economy and the internationalization of financial markets (Cioffi, 2002). Given Germany's traditional reliance on largely mandatory company law, reform proceeded at first by way of statutory changes, namely the enactment of the so-called 'Control and Transparency Act' in 1998 (Ziegler, 2000).

The growing salience of corporate governance reflected a structural shift in the German system of corporate finance. In these years, the major private banks started to extract themselves from the dense network of interlocking directorates and ownership ties in the course of their reorientation towards investment banking. Large companies were also increasing their financial autonomy from banks and now turning to the international capital markets as a source of financing (Beyer and Höpner, 2003). Thus, institutional investors, who had not been part of the traditional German 'stakeholder coalition', gained a new relevance for companies. In light of Germany's underdeveloped capital market and its traditional, government-run, 'pay as you go' pension system, this applied in particular to foreign investors such as large American public pension funds which had been actively pushing for 'good corporate governance' in their domestic market for years. German institutional investors also started to grow, but from a small base (Jürgens and Rupp, 2002, pp. 31–36). By the late 1990s, only two of the domestic funds cautiously emulated American-style investor activism (Ferber, 2004).

In this context, the concept of a non-binding code of best practice chiefly took hold because it was seen as a valuable tool to attract and communicate with Anglo-Saxon investors who increasingly called for corporate governance principles for German listed companies (CalPERS, 1998). The first German code initiatives came from the private sector. Christian Strenger, the former head of the mutual fund company DWS, Germany's pioneer in terms of investor activism, assembled a group of company legal experts, representatives of companies and individual shareholders, which presented a code in early 2000. While being relatively moderate, the code was inspired by the international corporate governance debate, in particular the principles issued by the OECD and the International Corporate Governance Network (ICGN). Strenger saw corporate governance guidelines not only as necessary to improve the performance of companies. He also argued that the lack of a set of internationally acceptable principles allowing investors to systematically evaluate the practices of individual companies put German companies at a disadvantage in the international financial markets (Schneider and Strenger, 2000). Like Strenger, a number of global players in German finance and industry had become concerned that particularly coveted international investors perceived Germany as a 'developing country' in terms of corporate governance and were therefore suspicious of the German market (Interviews D 6, 30 and 31). While the code drafted by the Strenger group emphasized the oversight function of the supervisory board, a second code, that was put forward shortly thereafter by a group of company directors and consultants surrounding Axel von Werder, an economics professor, centered on the management board (Berliner Initiativkreis, 2000).

3.2 The formulation of an official code

Strenger's efforts to promote his group's code to German companies initially met with frequent reservation. Companies pointed to the already highly regulated German company law and found it problematic that two different codes existed (Strenger, 2001, p. 62). At this point, the incumbent SPD-Green government stepped in. Spurred into action by the near-collapse of Philipp Holzmann, a leading German building company, it appointed a government commission which was to review the German regulatory framework in terms of potential weaknesses and the expectations of the international capital markets (Interviews D 16, 21 and 26). This commission, called 'Baums Commission' after its chairman Theodor Baums, a law professor, included representatives of all stakeholders. In addition to proposing a host of statutory changes, the commission strongly recommended the introduction of an official German code.

Yet, the state and the major business associations, most notably the Federation of German Industries (BDI), but also the associations of insurers and banks, warmed to the idea of a code because it provided an opportunity to explain and market the German corporate governance system to foreign, especially Anglo-Saxon, investors. It was widely felt that the negative international reputation of the German corporate governance system stemmed, to a significant extent, from a lack of knowledge about Germany's unfamiliar and complex legal framework. Similar to the BDI, Ulrich Seibert, the responsible government official from the Federal Ministry of Justice, felt that German company law already provided for a comprehensive and detailed regulatory framework, which left relatively little leeway for companies. Thus, he argued that, contrary to the UK, there was no real need for a code to cure weaknesses in the law (Seibert, 2002). The fact that, by then, most major capital markets had codes also contributed to the acceptance of this instrument in Germany (Interviews D 6 and 21).

The other traditional key group, the trade unions, which, due to the co-determination regime, generally favoured measures to increase transparency and strengthen the supervisory board, would have preferred binding rules to a self-regulatory code, but they supported the project, provided that they would be represented in the code-drafting commission and that the issue of co-determination would be excluded from the commission's mandate (Interview D 22). Apart from Christian Strenger, domestic institutional investors and their association scarcely participated in the reform debate. Foreign institutional investors were also, in the main, not directly involved; in addition, until recently they generally refrained from directly engaging with German companies on corporate governance issues. They primarily used forums like the *ICGN*, conferences or similar contacts with national actors to convey their expectations. Generally, they also showed a certain degree of understanding for the different conditions in the European markets (Interviews D 37 and US 8).

In light of this actor constellation, the beneficiaries of the old 'insider' model were able to substantially shape the process of code formulation. Following the Baums Commission's advice, the government, in 2001, appointed a standing code commission to draw up and annually review the new code. While the British 'comply or explain' approach to code enforcement was adopted in Germany as well, this obligation was, in contrast to the UK, officially laid down in the 2002 'Transparency and Disclosure Act'. The composition of the 13-member code commission, which was solely composed of private actors, not only replicated the traditional 'stakeholder coalition', albeit in an augmented form, as investors were given two seats. It was also clearly biased towards companies, with two of the four industry representatives having been characterized as 'hardliners of Rhenish capitalism' (Jürgens and Rupp, 2002, p. 23). By striving for a ‘balance between progressivity and broad acceptance’ (Seibert, 2002, p. 582) by the business community, the government, whether deliberately or not, helped to constrain the commission’s reformatory zeal, in effect strengthening the code’s explanatory function vis-à-vis its regulatory function.

About half of the new code’s text presented in February 2002 elucidated the legal framework, which signifies that, due to Germany’s legalistic tradition, there was indeed considerably less scope for self-regulation than in countries like the UK. While the code’s recommendations were designed to address the main criticisms of the German corporate governance system voiced by Anglo-Saxon investors (Cromme, 2001), in important points the code contained compromise solutions which were apparently weaker than the already moderate Strenger group code and certainly less demanding than the Anglo-Saxon ‘best practice’. This is particularly evident with regard to the recommendations on takeovers, which were the most hotly contended issue within the commission at the drafting stage. Reformers like Strenger and the representatives of banks and insurance companies wanted to strengthen the position of investors of the target company, whereas the two hardliners from the industry side and the labour representative insisted on maintaining the latitude for defensive actions, which is given to companies in the 2002 German takeover law (Enzweiler, 2002; Ehren and Enzweiler, 2002).

Compared with Anglo-Saxon standards, the code applied a rather cautious and selective approach towards supervisory board independence. It specified substantive independence requirements for the board only with regard to the number of former members of the management board, which was to be limited to two, and the incompatibility of directorships at competing companies. Also, the audit committee was not to be chaired by a former executive. With regard to other conflicts of interest of supervisory board members, such as may result from business relationships, the code relied primarily on disclosure requirements.

While certainly increasing transparency and promoting sensibility for conflicts of interest, the code stopped short of fundamentally challenging the position of the traditional ‘insider’ networks in the German corporate governance system, which had been criticized especially by foreign investors.[4] This is mainly due to the dominant role of companies in the code commission, but also to the relatively moderate, incrementalist approach pursued by the investor representatives. Moreover, while siding with investors on some issues such as transparency, the labour unions helped prevent more far-reaching changes in important aspects (Interviews D 22 and 31).

[4]For example, CalPERS, ‘Germany Market Principles’.

3.3 Subsequent code amendments

Against this background, it is not surprising that subsequent initiatives to achieve tighter rules in sensitive areas proved to be contentious. In 2005, the issue of supervisory board independence was again put on the agenda of the code commission through a Recommendation of the EU Commission on this topic (European Commission, 2005). Opting for a minimalist interpretation, the code commission adopted the requirement for 'an adequate number' of independent board members, but did not take up a series of more far-reaching provisions of the EU Recommendation, notably its transparency requirements and the set of detailed independence criteria (Spindler, 2005). The company representatives in the commission pointed out that such a catalogue of criteria would impede the traditional utilization of the knowledge of clients and suppliers in the board and threaten the German practice of group management (*Konzernsteuerung*). More generally, they argued that the stringent and formalistic Anglo-Saxon independence standards were tailored to one-tier boards, whereas the two-tier board model already provided for certain checks and balances. The co-determination regime also constitutes an important impediment to far-reaching independent requirements. Perceiving the first draft of the EU Recommendation as a threat to this system, the labour unions had achieved an exemption clause for employee representatives in the final text of the recommendation (DGB (Deutscher Gewerkschaftsbund), 2004). Prompted by the EU Recommendation and growing investor criticism, the code commission also adopted a provision that it should not be the rule for former management board members to become the chair of the supervisory board.

Investor representatives pushed for further changes, such as a shorter length of contracts for members of the management board, so as to bring German standards more into line with international norms and to reduce severance payments in cases of premature contract termination (Büschemann, 2006). In light of rising criticism from the industry that shorter contract periods would not fit with the traditional long-term orientation of German companies and would also entail more frequent struggling with the employee representatives on the supervisory board, the code commission decided against any further changes in its 2006 meeting (Interview D 30). The problem of 'golden handshakes' without curtailing contract periods, however, was addressed in 2008, when the commission introduced a recommendation on severance payment caps (Government Commission, 2008).

3.4 Crisis responses: the Act on manager pay

The financial crisis shifted the ongoing discussion on management board salaries towards the long-term state of well-being of the company. In addition, scandals at blue-chip companies such as Siemens and Deutsche Telekom—over corruption, corporate spying on staff and excessive executive salaries—have triggered government action on the topic of manager pay. The extreme increase in variable remuneration components for top managers, linked to developments in the company's profit or share price, is viewed as having caused the temptation to take irresponsible risks, thereby promoting short-termism. The 'Act on Appropriateness of Management Board Remuneration' (*Gesetz zur Angemessenheit der Vorstandsvergütung*) (*VorstAG*), adopted by the German parliament in September 2009, contains rules for supervisory boards concerning the determination of management remuneration. The remuneration structure of listed companies is to be oriented towards sustainable corporate development; the supervisory board should provide the possibility of introducing caps in the event of unusual developments. Variable components of the remuneration package shall be based on assessment criteria covering a number of years, and longer periods will apply concerning the exercise of options under share option schemes. In order to prevent any conflicts of interest, a 'cooling off' period of two years is to apply for the appointment of management board members after the end of their appointment to become members of the supervisory board (Federal Ministry of Justice, 2009).

The new Chairman of the Government Code Commission, Klaus-Peter Müller, supervisory board chairman of the *Commerzbank*, in principal embraced the spirit of the new legislation and admitted that the business community has been 'silent for too long on excessive manager pay in the past' (Müller, 2009). The code was amended by adopting the main principles enshrined in the Act; in addition, the Government commission finalized recommendations to increase the proportion of women and international representatives on German supervisory boards (Government Commission, 2009).

4. Comparison

In both countries, the introduction of the codes can be attributed predominantly to the internationalization and institutionalization of share ownership, with spectacular scandals fuelling the pressure for reforms. Moreover, there has been a cross-national diffusion of Anglo-Saxon best practices regarding the adoption of 'comply or explain' as the principle of code enforcement in Germany; it is also likely that the UK will become the 'norm leader' for further stewardship guidelines within Europe. In response to the financial crisis, the traditional beneficiaries in the two systems of corporate governance have been challenged. In Germany, the debate has shifted towards the topic of manager remuneration, which is considered to promote short-termism in company behaviour. In the UK, institutional investors have become targets of self-regulation to the extent that they are requested to engage more actively with company management and boards. Also, both the UK and German government have fostered new regulation with the intention to counter short-termism and to shift companies' strategy more towards the long-term interests of the firm.

Yet, beyond recent evidence for converging institutional patterns, corporate governance codes are far from constituting a single 'non-territorial mode of private regulation', as the global governance debate would state. Our in-depth study has revealed significant differences with respect to the process of code development, the substance and the function of the codes. We argue that these disparities reflect the imprint of the different 'key coalitions' (Amable, 2003) and the respective pattern of state-economy relations in our two countries.

In the UK, the investor-oriented London City, traditionally a highly influential actor in the British liberal market economy, has been the dominant player in the process of code formulation. City-led committees, dominated by different types of market players, have incrementally developed corporate governance principles. The proposed reforms were intended to re-establish confidence in the British capital market after a series of corporate scandals which brought the regulatory deficit of British corporate governance to public attention, most notably the insufficient control of self-interested managers by corporate boards or the market of corporate control. The Cadbury Code was a 'UK solution' to the lack of statutory regulation or case law regarding rules concerning the board's structure and function; it therefore possesses a strong regulatory function. As regards the content, the code largely endorsed demands by a strong and vocal constituency of institutional investors to enhance the oversight of the board over management. The recent financial crisis has spurred the consolidation of the code system. The new 'UK Stewardship Code' is a notable innovation, targeting investors as the main key players, while at the same time allowing institutional shareholders to model the code on existing best practice guidelines.

In the UK, the state, in line with its habitual arm's length relations to business actors, left it mainly up to market participants to complement a weak legal framework. Both Conservative and Labour governments threatened legislative action in light of corporate scandals which spurred the process of private code development. A politicization of corporate governance occurred when the Labour government took up the stakeholding concept and initiated the Company Law Review. 'Path departure', however, related more to the form of consultation than to the substance of the final Act. Due to the broadly designed and inclusive character of the review stakeholders, trade unions and NGOs were able to participate in the discussion, but the content of the final law (e.g. the definition of director's duties) to a large extent reflects shareholder concerns.

In Germany, members of the old 'stakeholder coalition', in particular nonfinancial and financial corporations and also the trade unions, played the most influential role in the process of code formulation. Compared with the UK, the state's involvement was also much more pronounced. Given the existing comprehensive legal framework, both companies and state officials as key actors perceived the introduction of a code not as a primarily necessary to address regulatory problems, but to market the German corporate governance regime to foreign investors. While the first code initiatives came from the private sector, it was the state which, spurred into action by a major scandal, set up a corporatist commission to develop and annually review an official code, thus performing its traditional role as an 'enabler' of business interactions. Although the code sought to address the main concerns of international investors in its recommendations (e.g. especially concerning independence of the supervisory board), these are considerably less demanding than the British model and do not fundamentally undermine the positions of the traditional 'insiders' in the corporate governance regime. This reflects not only the strong position of companies in the code commission, but also the still comparatively weak articulation of investor interests in Germany in general. It is only in response to the crisis that the German government was willing to act on excessive executive salaries, thereby forcing the Code Commission to formulate amendments on this matter. The position of the trade unions, another traditional key player, was ambivalent. They acted as a veto player on certain important issues, while promoting shareholder-friendly rules on other aspects.

5. Conclusion

Our study on corporate governance codes seeks to enrich the academic debate on private self-regulation of global business with regard to several aspects.

Corporate governance codes share some similarities with other forms of voluntary regulatory standards such as labour or environmental codes, but probably bear greater differences. The codes studied here tackle problems of transparency, accountability and conflicts of interest between management, investors and wider groups of stakeholders. They are instruments to raise the attractiveness of listed companies for investors by means of certification that national patterns of corporate control correspond to standards of 'good corporate behaviour'. Yet, compared with other codes that regulate the social conduct of firms, corporate governance codes are not instruments of 'civil regulation' in a broader sense, given that code development is shaped by an 'inner circle' of law experts, corporate and financial leaders and investor representatives. It was only in the course of the UK Company Law Review that state intervention enabled the participation of NGOs and trade unions in the process of consultation.

Corporate governance codes are more 'market-making' than 'market-shaping' instruments. Monitoring and enforcement of compliance with code provisions is left to the capital market. Whether market pressures are an efficient compliance mechanism, however, depends on the domestic financial and corporate governance system. Where companies finance themselves largely through the capital market, as in the UK, and direct corporate strategy is to maximize shareholder value, then code enforcement is spurred through market pressures and listing rules of the stock exchange. When companies rely mostly on bank credit for financing, and a strong domestic investor base is absent, as in Germany, the code is, more significantly, of a symbolic purpose to marketize existing patterns of corporate control.

Despite obviously reflecting Anglo-Saxon best practices, there is no single code model, but rather nationally distinct varieties of corporate governance codes. Our findings highlight the staying power of national key coalitions. In conjunction with the state, those socio-political groups, which have been decisive in forming the rules and institutions of the national political economy during the post-war decades, are still dominant in shaping the contours of private self-regulation. The enduring power of the traditional key coalition is also apparent in other areas of corporate governance regulation, such as legal changes in internal corporate governance or accounting (Lütz and Eberle, 2008). Institutionalist approaches of comparative political economy, and notably Amable's power-based model of institutional evolution, provide a highly useful lens for identifying the domestic sources of private business regulation.

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