

## Guest Editor's Introduction: A New Wave in the History of Corporate Governance

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This special issue showcases a new wave of historical research on corporate governance. The new wave is reacting to the exhaustion of the intellectual agenda of the initial scholarship devoted to the question of the emergence and variable development of corporate governance systems in different national economies. Indeed, in many ways the new wave represents a moment of genuine intellectual liberation. Much of the old literature focused nearly exclusively on questions regarding the concentration or dispersion of ownership, and attendant issues of the strength of minority protections, the role of banks, and the depth of the securities market in different countries. New wave scholars are asking historical questions about types of corporate governance and the evolution of national systems that literally could not be seen within the categories of the old debate—or if they could be seen, were thought to be so tangential to the dynamics of efficient governance that they were ignored. How is it possible, for example, for there to have been a deep securities market and strong universal banks in pre World War I Germany? Or, what role in national economic development did pyramid holding structures play in turn of the century Japan? Did the existence of a legal alternative to

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the joint stock company, such as the private limited liability company (PLLC) affect the manner in which different countries embraced the joint stock corporation?

New questions have also stimulated search for new kinds of data, and most of the new wave historians of corporate governance have been immersed in archival research that was simply not characteristic of the work that their predecessors undertook. This close archival work has in turn generated new observations and new questions. How did the various stock exchanges in the USA between 1880 and 1930 actually work? Who bought what, where, how, and to what effect? Or, how did the cosmopolitan character of London impact the relationship between finance and the large and numerous British global corporations? How was family ownership concretely related to the dispersal of stock?

All of the above questions are posed and, to a degree, answered by the essays in this issue. The purpose of this brief introduction will be to outline why those are interesting and quite new questions in the context of the historiography of corporate governance. The first section will outline how the first wave of research into the comparative history of corporate governance exhausted itself and, thereby, created the possibility for new wave scholars to pose alternative sorts of questions. The second section sets out the thematic and methodological distinctiveness of the new wave of research. The third section outlines the specific contributions to the special issue.

### First Wave History of Corporate Governance

The first wave of literature on the history of corporate governance was done primarily by lawyers and economists.<sup>1</sup> For them, the primary puzzle was: Why is corporate governance across the world divided into dispersed ownership systems and concentrated ownership systems? Why one system in one country and another in another? Simplifying greatly, there were four primary explanatory camps in the first wave: a Chandlerian–natural order view, a political view, a legal view, and a class view. All of these views have problems.

The Chandlerian–natural order view claimed that as firms grew in scale and scope their financing needs outstripped their internal

1. For a more thorough overview of this literature, see Gary Herrigel, "Corporate Governance," in *The Oxford Handbook of Business History*, eds. Geoffrey Jones and Jonathan Zeitlin (Oxford, U.K., 2007-forthcoming).

ability to finance growth. Owners hired professional managers to run their large operations and turned to securities markets for finance. Ultimately, this led to the dispersion of company ownership as managers turned to broad sources for finance and owners diversified their holdings across the securities market to increase their returns and minimize their risks. On this (very Smithian) view, dispersed ownership emerged where there are the least constraints on expansion and market development, while concentrated ownership persisted where market expansion was constrained by political, legal, and cultural obstacles.<sup>2</sup>

This is a very elegant evolutionary explanation for the emergence of the modern dispersed form of corporate ownership. It has become clear, however, that it really has no factual basis in the historical record. Most evidence on corporate expansion in the late nineteenth and early twentieth century, in the USA as well as in Europe, emphasize that growth generally was financed by retained earnings and not over the capital market—that is, neither through bank lending nor through the issuing of securities.<sup>3</sup> Moreover, Britain, Germany, and Japan—all countries with concentrated ownership structures at the beginning of the twentieth century—had much higher market capitalizations than the USA, even as late as 1913.<sup>4</sup> Owners, in other

2. Alfred D. Chandler, Jr., “Administrative Coordination, Allocation and Monitoring: Concepts and Comparisons,” in *The Essential Alfred Chandler: Essays Toward an Historical Theory of Big Business*, ed. Thomas K. McGraw (Cambridge Mass., 1988), 398–424; Chandler, “The Development of Modern Management Structure in the U.S. and U.K.,” in *ibid.*, 356–81; Chandler, *Scale and Scope: The Dynamics of Industrial Capitalism* (Cambridge, Mass., 1990) and *The Visible Hand: The Managerial Revolution in American Business* (Cambridge, Mass., 1977).

3. Mary A. O’Sullivan, *Contests for Corporate Control: Corporate Governance and Economic Performance in the United States and Germany* (New York, 2000); Caroline Fohlin, “The History of Corporate Ownership and Control in Germany,” in *A History of Corporate Governance around the World: Family Business Groups to Professional Managers*, ed. Randall Morck (Chicago, 2005), 223–77; Patrick Fridenson, “France: The Relatively Slow Development of Big Business in the Twentieth Century,” in *Big Business and the Wealth of Nations*, eds. Alfred Chandler, Franco Amatori, and Takashi Hikino (New York, 1997), 207–45; Claude Fohlen, “Entrepreneurship and Management in France in the Nineteenth Century,” in *The Cambridge Economic History of Europe. Volume VII: The Industrial Economies: Capital, Labour, and Enterprise. Part 1: Britain, France, Germany and Scandinavia*, eds. Peter Mathias and M. M. Postan (Cambridge, U.K., 1978), 347–81; Wilfried Feldenkirchen, “Banking and Economic Growth: Banks and Industry in the Nineteenth Century and their Changing Relationship During Industrialization,” in *German Industry and German Industrialization*, ed. W. R. Lee (London, 1991), 116–47.

4. Raghuram G. Rajan and Luigi Zingales, *Saving Capitalism from the Capitalists* (Princeton, N.J., 2003); Rajan and Zingales, “The Great Reversals: The Politics of Financial Development in the Twentieth Century,” *Journal of Financial Economics*

words, were not forced to dilute their interests in American firms *because* they could not otherwise expand their enterprises.

The political, law, and class explanations all acknowledge and seek to address the weakness in the natural evolution view. Mark Roe is most prominently associated with the political explanation for the existence of dispersion or concentration in holdings.<sup>5</sup> He argues that strong political forces favoring stakeholders over private property rights produced concentrated holdings systems, while weak political support for stakeholders allowed for dispersion. The problem with this view is that it cannot account for developments in crucial cases. It has been widely noted, for example, that the argument does not fit the British case very well at all. There, at the beginning of the twentieth century, liquid markets, strong protections for minority shareholders, and conservative governments coexisted with persistently concentrated ownership structures. In the 1950s, 1960s, and 1970s the dispersion of ownership occurred during periods when labor had significant political power, and there were widespread industry nationalizations, and the expansion of the welfare state.

Roe's view also has difficulty accounting for the German case between 1884 and 1914. At that time, the German economy had concentrated ownership and strong banks, but recent research has made clear that the banks were not significant holders of equity in corporations; nor were they important lenders. They engaged in a broadly diversified array of financial activities, including underwriting securities issues in, what were at the time, comparatively strong securities markets measured by relative capitalization as well as by number of listings.<sup>6</sup> Moreover, legal protections of owners of stock were also comparatively strong.<sup>7</sup> Thus,

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69 (July 2003): 5–50; Fohlin, “History of Corporate Ownership”; and O’Sullivan, this issue.

5. Mark J. Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (New York, 2003) and *Strong Managers, Weak Owners: The Political Roots of American Corporate Finance* (Princeton, N.J., 1994).

6. Rajan and Zingales, *Saving Capitalism*; Rajan and Zingales, “Great Reversals”; and Fohlin, “History of Corporate Ownership.”

7. Brian R. Cheffins, “History and the Global Corporate Governance Revolution: The UK Perspective,” *Business History* 43 (Oct. 2001): 87–118; “Mergers and Corporate Ownership Structure: The United States and Germany at the Turn of the 20<sup>th</sup> Century,” *American Journal of Comparative Law* 51 (Summer 2003): 473–504; “Mergers and the Evolution of Patterns of Corporate Ownership and Control: The British Experience,” *Business History* 46 (April 2004): 256–84; and “Putting Britain on the Roe Map: The Emergence of the Berle–Means Corporation in the United Kingdom,” in *Corporate Governance Regimes: Convergence and Diversity*, eds. Joseph A. McCahery, Piet Moerland, Theo Raaijmakers, and Luc Renneboog (New York, 2002), 147–74.

relations of concentrated ownership and strong banks existed far before there were significant labor stakeholder laws imposed on corporations. Indeed, during the first twenty years in the formation of the joint stock enterprise in Germany there was a state imposed ban on socialism in all areas, including trade unions. The lifting of the law seems to have neither encouraged nor discouraged owners to change the concentration of their earnings. The lack of stakeholder threat and the presence of functional securities markets did not significantly induce closely held German firms to expand by diluting ownership (or by increasing debt).

A prominent alternative to Roe's political explanation for the differences in the structure of holdings is the "Law Matters" school of Rafael La Porte, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny.<sup>8</sup> These economists suggest that dispersion versus concentration can be accounted for by whether the economy is governed by common or civil law. Common law, in their view, provides stronger protections for minority shareholders and subjects firms to less arbitrary interventions by the courts than do centralized civil law systems. Hence, economies governed by the former tend to have dispersed ownership structures and those with civil law concentrated on ownership structures. Their huge database across a large number of economies in the 1980s and 1990s showed very clearly that ownership structure was significantly correlated with the type of legal system in the country.

The problem with this view, however, is that it cannot account for the tremendous changes in the structure of corporate ownership that have occurred within national economies over time. The Japanese and British have had wide swings in the proportion of their corporations that have had dispersed ownership structures—dispersion being far more common prior to World War I, for example, than it was after World War II in Japan, and the reverse in Britain. We thus find much variation in the structure of ownership with no variation in the legal system.

A final set of arguments, offered perhaps most prominently by Raghuram Rajan and Luigi Zingales, attempts to account for the evolution of corporate governance structures across country cases,

8. Rafael La Porta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert W. Vishny, "Agency Problems and Dividend Policies around the World," *Journal of Finance* 55 (Feb. 2000): 1–33; "Corporate Ownership around the World," *Journal of Finance* 54 (April 1999): 471–517; "Law and Finance," *Journal of Political Economy* 106 (Dec. 1998): 1113–55; and "Legal Determinants of External Finance," *Journal of Finance* 52 (July 1997): 1131–50.

and in particular, for the causal role of interest groups or classes either driving or blocking the dispersal of holdings.<sup>9</sup> Rajan and Zingales argue that openness to trade and cross-border capital flows creates pressure within an economy for financial market development. Better law (e.g., minority protections, clear property rights, reliable enforcement), greater transparency, more active and deep securities markets result. Under such conditions, competition from new entrants in domestic markets is so great that it is difficult for large players to protect monopoly rents. Control by large banks over credit markets, by large firms over their product markets, by banks over firms, or even by owners over corporations is undermined, and competitive, dynamic, and arms-length market relations appear. On the other hand, when trade and capital flows are compromised or limited, then exposure to competition is lessened and “incumbent” players in the economy—large industrial firms and banks—can exploit their positions to constrict the possibilities for new entrants, limit competition, and keep their rents high. Concentrated holdings, relational banking, bank-driven financial systems, in the Rajan and Zingales argument, all result from structural conditions in which exposure to trade and mobile capital are limited and incumbent self dealing is successful.

Rajan and Zingales account for the dramatic contraction of capital markets and the growth of relational banking, and concentrated ownership in Japan, Germany, and France after the Second World War in precisely this way. They refer to these dramatic shifts as “Great Reversals.” In making their case for the significance of market collapse at mid century, however, Rajan and Zingales create a tremendous puzzle regarding the first part of the twentieth century. The authors’ data for 1913 show how surprisingly developed both the French and German financial systems were and how relatively open were their economies. Both Germany and France had higher ratios of bank deposits to GDP, higher stock market capitalization as a percentage of GDP, and higher equity financing to fixed investment ratios in 1913 than did the USA.<sup>10</sup> However, their development in the financial and legal realms did not translate to the broad diffusion of holdings and an outside, arms-length system of corporate governance and finance. Rather, both Germany and France were extremely heterogeneous on both scores. The persistence of concentrated holdings, despite

9. Rajan and Zingales, *Saving Capitalism*; Rajan and Zingales, “Great Reversals.”

10. Rajan and Zingales, *Saving Capitalism*, 191–96; Rajan and Zingales, “Great Reversals, 26–30.”

structural conditions favoring competition and the free flow of capital, apparently has to be explained by something else. Dispersion of ownership, active securities markets, and market based financial systems are the result of more than simply the existence of free movement in goods and money across borders.

As different as they all are, these classes of explanation have a similar problem. Their explanations for synchronic contrasts are contradicted by longer term diachronic evidence, or vice versa. Structural explanations, in particular, do very poorly: Actors in similar market conditions or with similar features in their institutional contexts repeatedly do very different things. A related problem in these first wave arguments is that they have overly stylized the empirical terrain. Seeking to fit all national corporate governance systems into either concentrated block-holding systems or dispersed ownership systems has not been a successful strategy. This is true for two reasons.

First, national systems simply do not neatly divide in that way—certainly not over time, but very often even at specific points in time. If one takes the five most developed economies—the USA, the UK, France, Germany, and Japan—all have examples of dispersion and concentration, arms-length and relational finance, and stockholder and stakeholder governance. The periods when the pure types of system resemble actual cases are extremely fleeting—the last fifteen years in the USA and the UK resemble the outsider/dispersed holding model, while France, Germany, and Japan (in different ways) resemble the concentrated holding/insider model for the period between (roughly) 1945 and 1990. Otherwise, the cases provide remarkable heterogeneity—stakeholderism and relationality in the USA, robust securities markets in pre 1913 Germany, Japan, and France. Moreover, improbable combinations abound—such as the particularly intimate role of German banks within corporations with dispersed ownership and more arms-length ties to closely held corporations in the pre-1913 period (Fohlin this issue), or in the strong stakeholder commitments of dispersely held American corporations in the post 1945 period.

Secondly, the arrangement of relations between ownership and management within joint stock, limited liability, publicly held, predominantly large scale, corporate enterprises represent only one (relatively narrow and very historically delimited) range of solutions to a broader problem of enterprise governance that has historically allowed for a very rich array of solutions. Privileging the particular problem of the ownership of corporate stock and managerial control of enterprise turns the eye away from a broad array of alternative ways in

which power can be allocated and value generation controlled within an enterprise (see Lamoreaux et al. this issue).

### The New Wave

The new wave of research on the history of corporate governance takes the empirical and conceptual limitations in the first wave debate as its point of departure. There are three ways in which the articles showcased here depart markedly from the kind of research heretofore dominating discussions of the history of corporate governance.

First, the new wave is much more archival and properly historical. Scholars are attuned to the ways in which the data, mechanisms, and institutions they are uncovering in the archives are embedded in a larger social, political, and economic context. First wave scholars tended to be interested in data from the past to bolster their arguments about differences they were observing in the present. As a result, they tended to instrumentalize their view of the past. New wave scholars are much more humble in the face of the complexity and openness of the present and as a result seem to be exploring and extending the range of governance experiments presented by the past in an effort to understand the range of contemporary possibility.

Second, the new wave is also much less enamored of path dependency than the first wave scholars were. All of the essays collected here, for example, emphasize the striking variety of governance forms and financial arrangements within the national cases they investigate, not only over time, but also at any one point in time. The old scholarship tended to reduce national cases to homogeneous types that emphasized historical continuity; however, the new wave emphasizes complexity, variety, process, and recombinatory change over time within cases. They are also acutely aware of the tendency of actors within one national case to observe and borrow the techniques, practices, and even legal forms developed in other national economies. The old scholarship tended to characterize national economies as isolated containers and as a result turned difference into mutual exclusion.

Finally, the new wave is more critical of both the American normative bias that underlay much of the first wave scholarship, as well as the (neo-liberal) tendency in that literature to value market arrangements as superior to coordinated arrangements. If in the first wave, the debate was about how (or if) the dispersed system of corporate holdings in the USA was the most efficient end point to the historical evolution of the corporation as an organizational form, in the

new wave, the USA becomes just another mixed case. Virtually, all of the cases outlined in the volume show how coordination and market processes, banks and securities markets, family firms and dispersed stock ownership, combined in interesting and often even improbable ways. Markets were not always the most productive alternative, nor did their existence impose particular governance structures on actors, or prevent more coordination based forms of governance practice from developing further in individual societies.

### The Essays in This Issue

Given the exhaustion in the old wave debate and the new empirical and conceptual departures that drive the current research, it should not be surprising to learn that the new wave essays in this volume relish paradox and hybridity. For example, Mary O’Sullivan, in her contribution, uses archival and newspaper listing data to reconstruct the history of the US securities markets in a way that both confirms and refutes old truths. She shows that there were many more securities being sold in the USA at the turn of the twentieth century than the empirical work of Rajan and Zingales suggests. However, the securities were not traded in any central place. Instead, there were a broad array of different exchanges, both within New York and regionally, that traded different securities in different ways and for different purposes. In the end, she emphasizes that knowing that there were exchanges is not enough to know how they worked. One needs to understand the sociology of both supply and demand in the markets to understand how they worked.

Randall Morck and Masao Nakamura, in their contribution on Japan, use the new found freedom that the exhaustion of the argument about bipolarity of concentration versus dispersal has created to ask interesting new questions about the consequences of particular corporate governance arrangements on economic development. They indicate that traditional understandings of “big pushes” in the development literature focus their attention on the role that states play in arranging complementary resources for the stimulation of industrialization. Their article shows that it is possible to view turn of the century Japanese industrialization as a good example of the logic of a “big push” at work. However, distinctively, in the Japanese case it was the privately held Zaibatsu pyramid holding structures, and not the Japanese state, that undertook the arrangement of resources in ways that accelerated industrialization. This story, intriguingly, suggests is that it was necessary to use coordination over market

mechanisms to achieve growth, but it was possible to achieve this publicly beneficial coordination through private means.

Caroline Fohlin's essay is a synthesis of several of her previous, very successful and highly econometric essays. The point she makes very forcefully here is that the binaries that have guided analysis of finance and corporate governance in the historical debate should not be viewed as mutually exclusive in practice. Thus, she shows how deep securities markets in Wilhelmine Germany were completely consistent with the existence of strong universal banks who participated quite intimately in the affairs of their client firms. Indeed, *pace* Rajan and Zingales, she shows that in legislation after legislation during the period, the universal banks paradoxically used their power in the market to back legislation to strengthen market exchanges.

Leslie Hannah's essay on the comparative significance of the British corporation in 1900 pushes a similarly paradoxical line. It shows that British corporations were far more global and much more widely held than any of their contemporary national competitors at the time—including firms in the USA. Moreover, Hannah suggests that learning about the distinctively global character of the *fin de siècle* British corporation—and also about cosmopolitan London at the time—is likely to provide fertile ground for contemporary analysts looking for precedents for the organization of global firms. This is to a much greater degree, he suggests, than the American corporation celebrated by Chandler.

Finally, Naomi Lamoreaux and her collaborators suggest that the centrality of the corporation in the narratives of American industrialization (and in contemporary debates about the role of corporate governance in economic development) may be an artifact of the absence of alternative limited liability forms in the USA. Looking at the development of the PLLC in Germany, France, the UK, and the USA, the authors show that when the entrepreneurs were confronted with the possibility to avoid the legally relatively restrictive joint stock corporate form, they did so quite eagerly. This was especially true of Germany after the passage of the law creating societies with limited liability (Gesellschaft mit beschränkter Haftung—(GmbH)). Once the law was passed, the growth in the number of GmbHs increased rapidly, while the formation of new Aktien Gesellschaften (AGs) trailed off. Similar results were found in the UK and France. The form also proliferated very rapidly in the USA—but its adoption occurred nearly a century after the other three countries. As a result, American entrepreneurs were confronted often with an unpalatable choice between partnerships on the one hand and

joint stock corporations on the other. When there is only one way to limit liability, the message is, it is not surprising that the incidence of those embracing the form is higher than in places where alternatives were available.

## Conclusion

None of the contributions in this volume closes off debate. All are more suggestive in their analysis and in the data they present than they are definitive. There is much more work to be done. It is the beginning of a new wave. The orientation of this new research, however, differs markedly in sensibility from that of the first wave conducted by economists and lawyers. New wave scholars are interested in openness and the exploration of organizational and governance variety across cases and heterogeneity within cases. In this, they resemble a much earlier generation of economic historians working on the subject. Indeed, it is tempting to suggest that if the new wave is going to develop its perspective further, study of the conceptual strategies of these older, long neglected historians could be surprisingly beneficial.

Gustav Schmoller provides an excellent example of the older historical concern to elaborate organizational and governance structure heterogeneity within the economy. In a fascinating series of articles on the historical emergence of the corporation, Schmoller surveyed a broad array of arrangements governing relations between owners, managers, and stakeholders ranging from manorial and household production systems (*oikos*) and producer cooperatives (*Genossenschaften, artels*), to the governance structures in early trading houses and shipping enterprises, guilds, and domestic putting-out systems.<sup>11</sup> Schmoller focused on the way power was allocated and value generation was controlled in these organizations. In the household economy, power was centralized and hierarchical. Efforts

11. Gustav Schmoller, "Die geschichtliche Entwicklung der Unternehmung. I und II. Die älteren Arbeitsgenossenschaften und die ältere agrarische Familienwirtschaft," *Jahrbuch für Gesetzgebung, Verwaltung und Volkswirtschaft im Deutschen Reich* 14, no. 3 (1890): 735–83; "Die geschichtliche Entwicklung der Unternehmung. III und IV. Handel, Handwerk und Hausindustrie," *Jahrbuch für Gesetzgebung, Verwaltung und Volkswirtschaft im Deutschen Reich* 14, no. 4 (1890): 1035–76; and "Über Wesen und Verfassung der grossen Unternehmungen," in *idem Zur Social- und Gewerbepolitik der Gegenwart. Reden und Aufsätze* (Leipzig, 1890), 372–440.

were made from the top of the hierarchy to direct and capture the value generated by the disparate production processes in the household. By contrast, cooperative arrangements avoided hierarchy, coordinated the flow of production collaboratively, and distributed rents across all participants (normally according to an agreed upon formula).

Schmoller explored a wide array of possible variations on each of these governance forms: partnerships, profit-sharing arrangements, collective ownership, etc. In his view, this historical variety served as resources for governance experiments in the industrial economy emerging around him. He did not frame his project in a way that sought to identify the best or most efficient governance form; rather he tried to show the capacity of multiple governance forms to reproduce themselves under new competitive circumstances. Indeed, much like the new wave today, Schmoller was fascinated by organizational plasticity and the range of possibilities for constituting relations among owners, workers, and managers in his own time. And he was acutely aware of the conceptual and practical interchange among organizational fields in the economy, society, and politics, as well as the constitution and continuous recomposition of organizational practices in economic life.

None of the current new wave historians are exploring the range of organizational possibilities quite as broadly as Schmoller or his contemporaries were, but perhaps they should. Like Schmoller in his own time, we are living in a time of profound transformation in the structures of governance in the political economy at all levels across the globe. The promise of the new wave is that the historically informed study of corporate governance will once again develop analytical frameworks that help to generate a sense of possibility. In any case, the great contribution of the current new wave is that they have begun to abandon the analytical tendency to seek out frameworks of path dependency and systemic homogeneity that foreclose it.

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