Brooklyn Journal of International Law

Volume 23 | Issue 3 Article 4

3-1-1998

Cultural Lag and the International Law of Remote Sensing

Susan M. Jackson

COMPATIBILITY AND COMPETITION BETWEEN EUROPEAN AND AMERICAN CORPORATE GOVERNANCE: WHICH MODEL OF CAPITALISM?

*Gustavo Visentini**

I. THE DEBATE ABOUT CORPORATE GOVERNANCE

In the last few years, corporate governance was the object of a wide debate among authors and commentators. The debate focused upon the relationships among the various corporate actors, especially with regard to publicly held corporations. In this context, it is the existence of public shareholders, passive and supposedly defenseless, and the rise of institutional investors that has stimulated most of the discussion.

Corporate governance has been described in a variety of ways. For example, Joel Seligman identifies corporate governance with the management of the corporation and the corporate devices associated with the control of management (*e.g.*, reporting, auditing, etc.)[1] Along the same track, the mission statement of the Viénot Committee in France on the *gouvernement des entreprises* was especially concerned with *la composition, les attributions et le mode de fonctionnement des conseils*.[2] An apparently more complex approach is followed by Colin Mayer who starts out his analysis associating corporate governance with the principal-agent (investors-managers) rela-

---

* Professor of Law at LUISS Guido Carli University, Rome, Italy; Director of CERADI-LUISS, Center of Research on Business Law; Chairman of the Association of Italian Mutual Funds. This Article was written with the collaboration of Dr. Eugenio Ruggiero. It reproduces, with additions and footnotes, the text of a speech given at the conference "Corporate Governance: Crossborder Perspectives" held in Paris, France, on March 17, 1997, and organized by the Association d'Economie Financière.

1. *See generally* JOEL SELIGMAN, CORPORATIONS: CASES AND MATERIALS 133-230 (1995).

2. ANDRÉ TUNC, *Le Rapport Viénot sur le Conseil d'Administration des Sociétés Cotées*, REVUE INTERNATIONALE DE DROIT COMPARÉ [R.I.D.C.], July-Sept. 1996, at 647, 648. A similar approach is in the Cadbury Report on the Financial Aspects of Corporate Governance, where it is said that "[c]orporate governance is the system by which companies are directed and controlled." COMMITTEE ON THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE, THE FINANCIAL ASPECTS OF CORPORATE GOVERNANCE 15 (1992).

tionship problem, concerned with ways of bringing the interests of the two parties into line and ensuring that firms are run for the benefit of investors.[3] More generally, corporate governance has been defined as the relationship among various participants (shareholders, directors, creditors, labor, etc.) in determining the direction and performance of corporations.[4]

Given the variety of definitions, it is important to try and agree on a common meaning of the issue at hand.

II. THE LEGAL RELEVANCE OF CORPORATE GOVERNANCE

The above attempts to define corporate governance are probably all equally correct, although possibly vague in their legal application. For legal purposes, the definition of a concept and the use of a new word to describe it is useful as long as the underlying idea is different from already familiar concepts, and as long as the definition carries a specific legal significance.

Hence, it is meaningful to talk about "corporate governance" when the term is used to deal with something other than the traditional corporate law issues concerning the management of the corporation, or the relationship between shareholders and directors/officers. Indeed, this is what corporate law has always been about. Therefore, since legal scholars have felt the need to employ a relatively new term, *i.e.* "corporate governance,"[5] it follows that they intended a different object for review.

The relationships among the participants in a corporation are, in general, a common element to all suggested definitions. Following this observation, it may then be more appropriate to view corporate governance as a peculiar profile of a whole set of legal tensions and relationships that find their focus point within the company. Corporate governance would then be

---

3. *See generally* COLIN MAYER, CORPORATE GOVERNANCE, COMPETITION AND PERFORMANCE 8-9 (OECD Econ. Dep't Working Paper No. 164, June 1996).

4. *See* ROBERT A.G. MONKS & NELL MINOW, WATCHING THE WATCHERS: CORPORATE GOVERNANCE FOR THE 21ST CENTURY xvii (1996). A similar approach appears to be followed in the American Law Institute's Principles of Corporate Governance. *See generally* AMERICAN LAW INSTITUTE, PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS (1994).

5. The term "corporate governance" is quite new in legal jargon. Traditional law dictionaries, such as BLACK'S LAW DICTIONARY (6th ed. 1990) and BALLENTINE'S LAW DICTIONARY (3d ed. 1969), do not even mention it.

concerned with the overall structure, not only of corporate regulation, but also of all those other areas of law affecting corporate action and the exercise of power within the corporation.

This approach allows a systematic review of the existing positions of power and the effective protection of the rights that accrue from corporate interactions and relationships. Eventually, corporate governance will constitute a method for approaching issues arising from the tensions within the corporation itself, as opposed to being a model for the management of the corporation.[6] As such, the issue of corporate governance becomes important in order to gain a systematic understanding of the corporate phenomenon.

It is therefore most useful to academics and to legislators in order to more correctly appraise the impact of new laws on the existing system. It may have less relevance for the practitioner or the judge in applying day-to-day law.

Summarizing all of the above concepts, corporate governance may be described as the process of bringing together the different forces which, based upon rules of law,[7] have a significant impact on those who participate in the corporation and, eventually, determine how power is exercised within the corporation.[8]

---

6. *See* GUSTAVO VISENTINI, ARGOMENTI DI DIRITTO COMMERCIALE 449-51 (1997).

7. These forces have their basis in rules of law that derive from varied sources: corporate law, banking law, securities law, bankruptcy law, labor law, etc. For example, it is usually in banking law that we find the rule allowing, or not allowing, banks to hold shares in industrial companies; a further example is American securities law, where we find a thorough regulation of the proxy system. From a historical perspective, one of the very first developments of corporate law affecting the corporate governance structure was the rule allowing corporations to participate and hold shares in other corporations.

8. Arthur R. Pinto & Gustavo Visentini, *Introduction* to THE LEGAL BASIS OF CORPORATE GOVERNANCE IN PUBLICLY-HELD CORPORATIONS (Arthur R. Pinto & Gustavo Visentini eds., forthcoming 1998) [hereinafter LEGAL BASIS OF CORPORATE GOVERNANCE]; *see also* Gustavo Visentini, *Corporate Governance: The Case of Banking*, BANCA NAZIONALE DEL LAVORO QUARTERLY REVIEW [BNL Q. REV.] 164-67 (Special Issue, Mar. 1997).

III. THE MARKET-ORIENTED MODEL AND THE BANK-ORIENTED MODEL

For purposes of this article we can adopt the common distinction of the major existing corporate systems, which is comprised of two main models: a market-oriented model, well represented by the United States; and a bank-oriented model, well represented by Germany and continental Europe (mainly France and Italy).[9]

The distinction between the two models relates to the different structure of the financial system, which is then reflected onto the corporate governance structure by envisaging the configuration of a different model of shareholder.

In the market-oriented model we find a situation where corporations collect capital directly from the public, and the public investors directly bear the business risk of their investment.[10] Securities are spread out among the public at large,[11] and the financial markets are very competitive.[12] In

---

9. *See* Curtis J. Milhaupt, *The Market For Innovation in the United States and Japan: Venture Capital and the Comparative Corporate Governance Debate*, 91 NW. U. L. REV. 865, 872 (1997); *see also* JORDI CANALS, UNIVERSAL BANKING 21, 44-45 (1997) (providing a recent illustration of the market and bank-oriented models).

It is clear that each country's system has its own peculiarities and differences. For example, it is unquestionable that not all U.S. listed companies are pure publicly-held companies: quite a few of them do in fact have a precise controlling shareholder. However, the model of the publicly-held corporation shapes the legislation. The utility of proceeding through model assumptions simplifies the logic of the relevant arguments and allows for a general overview which can then be easily adapted to specificities and contingencies.

10. *See* CANALS, *supra* note 9, at 42.

11. Over 48% of U.S. listed shares are held by households. *See* ORGANIZATION FOR ECONOMIC COOPERATION AND DEVELOPMENT, OECD ECONOMIC SURVEYS 1994-1995, ITALY 59 (1995) [hereinafter OECD ITALY]. In Germany and France, the concentration of listed shares owned by households is much lower, around 17-20%. *See id.* Arthur Pinto reports that in 1992, about 51 million Americans owned shares in publicly held corporations or in stock mutual funds. *See* Arthur R. Pinto, *United States*, *in* LEGAL BASIS OF CORPORATE GOVERNANCE, *supra* note 8. Moreover, in 1994 there were approximately 9,600 publicly held corporations traded in various markets. *See id.*

12. In 1996, over 2,900 companies were listed on the New York Stock Exchange (with a turnover value of more than $2,200 billion). *See* RAPPORTO IRS SUL MERCATO AZIONARIO 137 (1997) [hereinafter 1997 RAPPORTO]; RAINER MASERA, SAGGI DI FINANZA 298 (1997). Exchanges in Germany and Paris each totalled approximately 600 listed companies in 1996, with quite lower trading volumes. *See* 1997 RAPPORTO, *supra*, at 137; MASERA, *supra*, at 298. The figures are even lower for Italy (240 listed companies with a trading volume of about $70 billion). *See*

terms of ownership structure of the companies, the market-oriented model is characterized by high fragmentation of ownership, where the single shareholder can hardly ever autonomously affect the management of the corporation.[13]

The bank-oriented model, on the other hand, is characterized by a very high degree of intermediation in the channeling of savings from households to companies.[14] Corporations collect capital primarily through banks.[15] Banks serve as intermediaries with the public, providing credit, owning significant amounts of stock in the corporations, and offering a very wide range of services both to investors and to corporations.[16] The immediate consequence is a high quota of debt (and more specifically bank debt) in the company's financial resources,[17] and the typical presence of major shareholders in the ownership structure of bank-oriented model corporations.[18]

So far the two models have been assumed as mere evidence of a situation of fact. We now proceed to appreciate the distinction between the two models in its more precise legal significance.

IV. THE LEGAL FOUNDATION OF THE DISTINCTION BETWEEN THE BANK-ORIENTED AND THE MARKET-ORIENTED MODEL

From a legal point of view, the main difference between the two models does not lie in the existence of public share-

---

Lorenzo Stanghellini, *Corporate Governance in Italy: Strong Owners, Faithful Managers. An Assessment and Proposal for Reform*, 6 IND. INT'L & COMP. L. REV. 91, 135 (1995).

13. Statistics show that the average percentage of outstanding shares owned by the largest five shareholders in the United States is 25.4%. *See* OECD ITALY, *supra* note 11, at 61. In Germany it is 41.5% and in Italy it is 86.9%. *See id.*

14. *See* CANALS, *supra* note 9, at 51.

15. *See id.*

16. *See generally id.* at 54-55.

17. In 1992, the leverage ratio (gross debt to total assets) of non-financial firms was around 60% in Germany and France, and over 75% in Italy, compared to about 50% in the United States. *See* OECD ITALY, *supra* note 11, at 71. Furthermore, in 1992, confirming an equivalent trend for the previous ten years, bank financing over total debt amounted to about 30% for German and Italian companies, while it was only around 16% for American companies. *See* CANALS, *supra* note 9, at 24.

18. Single majority stakes account for about 60% of total stock market capitalization in Germany, France, and Italy. *See* OECD ITALY, *supra* note 11, at 59-60. The contrast with the United States, where the figure is about 5%, is quite evident. *See id.*

holders as opposed to major shareholders. Rather, it lies in the separation of the banking industry from the securities industry, and in the different range of activities that banks can engage in.[19]

In the United States, the separation of banks from the securities business, and hence the prohibition on commercial banks from holding shares in industrial companies and engaging in businesses outside of banking, is established by the well known Glass-Steagall Act of 1933.[20]

Traditionally, in continental Europe, this has not been the case, either because the separation did not occur or because it was much more relaxed.[21] Germany is the best example of a legal system that allows banks to hold ownership stakes in industrial companies and offer securities trading services to their customers.[22] As of the issuance of the European Community's Second Banking Directive[23] (Second EC Directive), the German model of universal banking has been accepted by the European Community as a whole.[24] Indeed, even in countries like Italy where, until the implementation of the Second EC Directive, commercial banking was formally separated from investment banking, such separation was not as strict as it was, and to a large extent still is, in the United States.[25] In fact, although Italian commercial banks could not directly hold shares in industrial companies, they could hold shares in investment banks that in turn held shares in industrial companies.[26]

---

19. *See* CANALS, *supra* note 9, at 133-35.

20. 12 U.S.C. §§ 24, 78, 377, 378 (1994); *see also* CANALS, *supra* note 9, at 75.

21. *See* CANALS, *supra* note 9, at 134.

22. *See* Gesetz über das Kreditwesen (KWG) § 1, v. 7.10.1961 (BGB1. I S.881), *amended in* v. 10.28.1994 (BGB1. I S.3210); *see also* Theodor Baums & Philipp v. Randow, *Shareholder Voting and Corporate Governance: The German Experience and a New Approach, in* CORPORATE GOVERNANCE IN TRANSITIONAL ECONOMIES: INSIDER CONTROL AND THE ROLE OF BANKS 435, 439-51 (Masahiko Aoki & Hyung-Ki Kim eds., 1995).

23. Second Council Directive 89/646/EEC, 1989 O.J. (L 386) 1.

24. *See* CANALS, *supra* note 9, at 134.

25. *See* JORDI CANALS, COMPETITIVE STRATEGIES IN EUROPEAN BANKING 171 (1994); *see also* CANALS, *supra* note 9, at 134 (discussing the strict separation between commercial and investment banking in the United States).

26. *See* Royal Decree-Law of Mar. 12, 1936, No. 375, arts. 33, 35 (converted into Law of Mar. 7, 1938, No. 141, Gazz. Uff. Supp. (Mar. 15, 1938)), and the corresponding regulations of the Bank of Italy, located in the Istruzioni di Vigilanza, para. 20, *reprinted in* ASSOCIAZIONE BANCARIA ITALIANA, RACCOLTA DI

The higher, or lower, degree of centralization of the system of financing for firms determines the greater, or lesser, concentration of their ownership structure.

In the market-oriented model, firms have a broader choice of financing alternatives and enjoy greater competition among suppliers of capital.[27] The banking industry is not the sole provider of credit: corporations can choose to sell debt to the public directly, or privately to banks or other financial institutions (*e.g.*, insurance companies, pension funds, etc.)[28] Also, when raising equity, corporations can choose to go public, through the market, or private, through institutions or large investors. Therefore, within the same financial system, one finds competition not only within the single segments of the financial system (banks vs. banks, securities vs. securities, insurance companies vs. insurance companies), but also between such segments as a whole (banks vs. securities, banks vs. insurance companies, etc.)

On the other hand, in the bank-oriented model, most often a single bank, or bank group, will dominate the financing of the firm, whether such financing takes place in the form of equity or debt, public or private.[29] Banks, either as a single company or as a group of companies, are "universal" in the services they offer.[30] Thus, banks dominate the financial system, either directly or through their affiliates.[31] They own brokerage firms, organize mutual funds, and take part in and lead underwriting agreements.[32] The role of the bank is then central to corporate finance.

The main area of competition in supplying financing to firms involves institutions, rather than forms of financing and

---

TESTI LEGISLATIVI E NORMATIVI IN MATERIA CREDITIZIA 376-77 (1978).

27. *See generally* CANALS, *supra* note 9, at 42.

28. *See generally id.* at 99 (discussing the diminishing role of traditional bank loans as a means of corporate financing).

29. *See* Milhaupt, *supra* note 9, at 872.

30. *See, e.g.*, Theodor Baums & Michael Gruson, *The German Banking System—System of the Future?*, 19 BROOK. J. INT'L L. 101, 105-06 (1993) (discussing the broad range of services offered by the "universal" banks of Germany).

31. *See generally* Milhaupt, *supra* note 9, at 872.

32. *See, e.g.*, MARK J. ROE, STRONG MANAGERS, WEAK OWNERS 188 (1994) ("[t]he largest German banks are also Germany's largest brokerage houses."); Baums & Gruson, *supra* note 30, at 106 (services offered by German banks include "underwriting and trading, mutual fund operations, and investment advising.").

financial products. This is not to say that stock ownership is not relevant; actually, in countries like France or Germany we find quite active stock exchanges.[33] However, their role is ancillary to the main banking circuits. Stock markets offer companies a possibility to diversify their sources of financing, and investors a speculative niche to invest their savings. Stock exchanges remain within the banking circuits and securities trading becomes one of the services offered by the banks. Most of the securities firms are bank affiliates. Although securities buy and sell orders are executed on the exchange, they are channeled through the banking network.[34] Thus, the organization of the stock exchange itself rests upon banks: in Italy, for example, the Stock Exchange was recently transformed into a private company (Borsa s.p.a.) and its shares were sold to intermediaries, 90% of which were banks or bank affiliates.[35] A good indicator of such an ancillary function of public markets in corporate finance is the fact that the development of the securities markets in those countries involves stock rather than debt instruments.[36] This is a reflection of the banking industry's predominance with respect to the provision of credit to firms.

The central position of the banks within the financial system is also relevant for the quality of trading on the stock exchange. The involvement of banks in industrial companies as stock owners provides an incentive for banks to act as *de facto* market makers for trading on those shares, thus increasing the liquidity of the market itself.

In summary, it may be said that in the bank-oriented

---

33. *See* Andrew Fisher & Andrew Jack, *German, French Bourses in Link-up Talks*, FIN. TIMES, June 21, 1997, *available in* 1997 WL 11036353. However, the phenomenon is quite recent in its developments. *See* Andrew Fisher, *DTB is Preparing to Spread its Wings*, FIN. TIMES, June 27, 1997, *available in* 1997 WL 11037887; Andrew Jack, *International Company News: Matif Celebrates 10 Speculative Years—The Paris Exchange Has Seen Rapid Growth Since its Inception*, FIN. TIMES, Feb. 22, 1996, *available in* 1996 WL 6145355.

34. In Italy, for example, about 70% of the securities trading was done directly by banks in 1996. *See* BANCA D'ITALIA, ASSEMBLEA GENERALE ORDINARIA DEI PARTECIPANTI, RELAZIONE DEL GOVERNATORE: SULL'ESERCIZIO 1996, at 319 (1997). Of the remaining 30%, about 60% was done by securities firms included in banking groups. *See id.*

35. *See* Antonio Quaglio, *Borsa Spa, l'Imi sigla il trionfo Sint*, IL SOLE-24 ORE, Sept. 13, 1997, at 27.

36. Debentures represent only about 3% of total liabilities of German companies, compared to 23% for the United States. *See* CANALS, *supra* note 9, at 170.

model, securities trading and direct collection of capital from the public become components of the banks' management policy, whereas, in the market-oriented model banks are direct competitors of the public markets in providing finance for industrial companies.

This situation does not necessarily lead to the conclusion that, because the banking system faces no competing forces from different forms of financing, it is less efficient. As long as there is competition within the banking system, finance will still be efficient, whether it is allocated through bank groups or through several and separate channels.[37]

V. THE LEGAL STRUCTURE OF THE FINANCIAL SYSTEM AND ITS EFFECTS ON CORPORATE GOVERNANCE RULES

In the market-oriented model, the variety of competing sources of funds for firms causes a more diffuse control of the corporation and creates a complex system of checks and balances among the various stakeholders.[38] This situation finds immediate evidence in the U.S. corporate governance rules, which have their major focus upon the protection of individual investors such as shareholders or creditors.[39] This protection takes place through stringent mechanisms of disclosure and effective enforcement of liability that resemble those afforded

37. In this respect, a critical look should be given to the Italian financial system, which falls within the bank-oriented model. Examining the ownership structure of the banking system, it may be noticed that most banks, and surely the largest ones, have a direct or indirect proprietary connection with one single shareholder (the State). *See* Giuseppe Bisconti & Luciano Monaco, *Italy*, *in* BANKS ABROAD 213, 214 (Friedrich Schwank & Frank R. Ryder eds., 1986). The impression is that such a situation creates the conditions for the operation of an oligopoly and, to a large extent, of an implicit cartel, which may bring the system far from efficiency. Ultimately, rather than talking about the Italian banking industry, one could actually end up talking about one large Italian banking group. For this aspect, the situation appears even more critical when considering the wide powers enjoyed by the Bank of Italy, *i.e.*, the banking supervisory body. *See* EUROPEAN BANKING LAW: A GUIDE TO COMMUNITY, MEMBER STATE AND EFTA NATIONAL LEGISLATION 62 (Coopers & Lybrand Europe ed., 1990).

38. *See* Milhaupt, *supra* note 9, at 872-73.

39. *See, e.g.*, Kamen v. Kemper Fin. Serv., 500 U.S. 90, 95 (1991) (discussing shareholder derivative actions, the purpose of which is "to place in the hands of the individual shareholder a means to protect the interests of the corporation from malfeasance."); Herman & MacLean v. Huddleston, 459 U.S. 375, 390 (1983) ("[d]efrauded investors are among the very individuals Congress sought to protect in the [U.S.] securities laws.").

by the law of consumer protection.[40] Indeed, in this system, the first and main mechanism for the protection of individual investors is the development of rules encouraging and ensuring the correct functioning of securities exchanges and the prompt liquidity of investments.

There is no doubt, however, that also in the United States system there are very large investors, such as pension funds, that may have the resources to acquire large stakes in companies and hence take an active role in their management.[41] This has hardly ever happened in the past, although today the situation is moving towards a change.[42] In any case, it should be stressed that, because of the features of the banking business and its wide range of contacts with the firms (deposits, loans, liquidity management, etc.), no institutional investor, other than banks, is able to acquire the same expertise and "know how" to be involved in active corporate participation. The development of the U.S. corporate governance structures reflected the need for specialization, which would then enhance efficiency: shareholders would specialize in risk-bearing but wanted diversification, and firms needed specialized, professional management. Furthermore, there are many legislative rules that contribute to the passive role of institutional inves-

40. An example of this can be found in the U.S. rules prohibiting insider trading. *See* 17 C.F.R. § 240.10b-5 (1997).

41. The United States is experiencing a very high degree of institutionalization of savings. In 1994, financial assets entrusted to institutional investors (mutual funds, pension funds and life insurance companies) were about 37% of total households' financial assets, compared to 29% in Germany and 27% in France. *See* RAPPORTO IRS SUL MERCATO AZIONARIO 78 (1996) (statistics described in Table 2.1).

42. In recent times, the situation has been changing. U.S. institutional investors, and more specifically pension funds, are starting to become more involved in the management issues of corporations. *See* William Dale Crist, The Domestic and International Corporate Governance Role of the California Public Employees' Retirement System (an Example for Study) 1-8 (Oct. 1994) (unpublished paper, presented at Universitá Cattolica Del Sacro Cuore, Milan, Italy, on file with *Brooklyn Journal of International Law*). Even the latest guidance given to pension funds by the Department of Labor under the Employee Retirement Income Security Act of 1974 reports that in certain situations it may be appropriate for a fiduciary to engage in "activities intended to monitor or influence the management of corporations . . . [if] the responsible fiduciary concludes that such monitoring . . . is likely to enhance the value of the plan's investment." Interpretative Bulletin Relating to Written Statements of Investment Policy, Including Proxy Voting Policy or Guidelines, 29 C.F.R. § 2509.94-2 (1996). However, this does not seem to be affecting the structure of the financial system and corporate governance, since, on the whole, institutional investors remain independent from the banking system.

tors in corporate governance.[43] The Glass-Steagall Act is an example, together with the original localization of banks at the state level;[44] so is the "prudent man" rule obliging fund managers to diversify their investments and to adopt the so-called "Wall Street rule" in their management strategies.[45]

In the bank-oriented model the situation is instead symmetrical. A greater concentration in the ownership structure of corporations, which is made possible by the existence of institutions, mainly banks, that can assume large stakes of stock in the companies, configures a system of corporations where the predominant shareholder pattern is the large and active shareholder. Control is tightly held through complex systems of close relationships, consisting of shareholders' agreements or of sophisticated cross and circular holdings of shares.[46] In the European model, the bank is universal. It has few barriers with respect to holding shares in industrial companies and, even where those barriers exist, their threshold is high enough to allow banks to have an important, and often determinant, voice in management.[47] The corporate governance rules that then follow are designed in view of such shareholder patterns. Therefore, a greater variety and amount of corporate power is

---

43. According to Mark Roe, such legislation is founded upon a precise political drive against high concentrations of private power. *See* ROE, *supra* note 32, at xiv.

44. *See generally* Edward L. Symons, Jr., *The United States Banking System*, 19 BROOK. J. INT'L L. 1, 4-5, 9-10 (1993).

45. The prudent man rule governs investment management by trustees and various other fiduciaries. *See* Jeffrey N. Gordon, *The Puzzling Persistence of the Constrained Prudent Man Rule*, 62 N.Y.U. L. REV. 52, 52 (1987). The typical formulation of the Wall Street rule is that institutional shareholders should "either vote with management or, if unhappy, sell." Mark J. Roe, *Political Theory of American Corporate Finance*, 91 COLUM. L. REV. 10, 28 (1991).

46. For an overview of the German system of circular shareholdings, see Ulrich Wastl & Franz Wagner, *Wechselseitige Beteiligungen im Aktienrecht*, DIE AKTIENGESELLSCHAFT, June 1997, at 241, 241-50. For the Italian case, see Giovanni Ferri & Sandro Trento, *La Dirigenza Delle Grandi Banche e Imprese: Ricambio e Legami*, *in* STORIA DEL CAPITALISMO ITALIANO (Fabrizio Barca ed., 1997), and the research led by CARLO DE GENNARO, MIRTA MUSOLINO, & LUCA TORCHIA, *Struttura Proprietaria e Modelli di Controllo con Riferimento alle Società Italiane Quotate: Alcune Consderazioni alla Luce di Una Verifica Empirica* (forthcoming 1997).

47. According to the European Community's Second Banking Directive, banks' ownership of shares in one non-financial company should be limited to 5% of such company's equity capital, and the bank may not concentrate holdings of a single company above 15% of its own capital. *See* Second Council Directive 89/646/EEC, *supra* note 23, art. 12(1); *see also* CANALS, *supra* note 9, at 134.

granted to the individual shareholder, with the assumption that the shareholder will have the capacity and the incentive to exercise such powers. For example, we find a wider competence in the general meeting of shareholders. In the United States the role of shareholders in the overall management of the corporation is generally relegated to the appointment and removal of directors and to the amendment of the articles of incorporation.[48] On the other hand, in Italy and in other European countries, the shareholders' meeting is generally competent for the approval of the balance sheet and the distribution of dividends, the appointment of auditors, the issuance of new shares, the issuance of company debentures, and the single shareholder may individually challenge the validity of any shareholders' decision in court.[49]

VI. THE COMPETITION BETWEEN THE DIFFERENT MODELS OF FINANCIAL SYSTEM

The efficiency of a financial system, be it bank-oriented or market-oriented, is to be measured against the performance of its users, *i.e.*, industry and commerce. Finance may be said to have no value in and of itself: it is functional to the real economy and its quality must be appreciated in terms of utility to firms.

Despite the heavy debate among economists,[50] the overall efficiency of each economic system may not be said to substantially differ as a consequence of the financial model adopted: comparable standards of living in the different countries are evidence that the competitive advantages and disadvantages of either system eventually even out. Either system is then competitive in itself. The U.S. system is generally said to be more flexible in adjusting to changes because of its greater reliance upon market mechanisms.[51] However, such greater flexibility

---

48. *See* JAMES D. COX ET AL., CORPORATIONS § 13.1, at 306 (1997); HARRY G. HENN & JOHN R. ALEXANDER, LAWS OF CORPORATIONS § 188, at 490-91 (3d ed. 1983).

49. *See* Stanghellini, *supra* note 12, at 112, 175-76. It is evident, however, that the European model of corporate regulation, based upon a system of checks and balances maintained by the existence of several large and active shareholders, may easily cause distortions if the assumption (*i.e.*, the plurality of large shareholders) falls.

50. For a general overview, see CANALS, *supra* note 9, at 69-72.

51. *See* Jonathan R. Macey & Geoffrey P. Miller, *Corporate Governance and*

has heavy costs in terms of crises its industries have to undergo when facing those adjustments. On the other hand, the European system compensates for its alleged lack of flexibility[52] with a more stable and fine-tuned process of adjustment and adaptability, perhaps with lower peaks in its business cycles, but also with higher troughs.[53]

The American and European financial systems, as such, compete with each other. Given the barriers to entry into one system for financial institutions based and operating in the other system, the competition is evidenced by the competitiveness of industrial and commercial companies in their products markets. In this respect there exists competition between the two models of finance, and such competition is further enhanced by the existing competition among industrial companies.

In the last decade, a very important event that is strongly affecting the behavior of firms is the globalization of the markets. However, the trend towards globalized and world markets is much more a reality, both in fact and in law, for the markets for goods than it is for the markets for finance. Whereas goods can substantially move and trade freely around the world, there is still quite a high resistance in allowing full freedom of movement of capital. Indeed, even the International Monetary Fund (IMF) charter allowed Member States to maintain a protective regime over capital movements,[54] since the general idea was that the exclusive function of finance was to serve the real economy.[55] As long as each financial system re-

---

Commercial Banking: A Comparative Examination of Germany, Japan, and the United States, 48 STAN. L. REV. 73, 96-99 (1995).

52. *E.g.*, its delayed response to changes and slower transition.

53. The alleged different response of the American and European systems to efficiency drives has historical, political, social, and cultural roots. We take it as a common sense conclusion, since this is not the appropriate place to analyze it in greater depth.

54. Article VI, § 3 of the Articles of Agreement of the International Monetary Fund (IMF Agreement) states that "Members may exercise such controls as are necessary to regulate international capital movements." Articles of Agreement of the International Monetary Fund, July 22, 1944, art. VI, § 3, 60 Stat. 1401, 1409, 2 U.N.T.S. 39, 62. In this respect, the main objective of the IMF Agreement was to liberalize the making of payments and transfers for current international transactions. *See id.* art. VIII, § 2; *see also generally* Ronald I. McKinnon, *The Rules of the Game: International Money in Historical Perspective*, 31 J. ECON. LITERATURE 1 (1993).

55. Such an attitude was also present in academic and scientific milieus at

mained within its own boundaries (the only connection being the competition on the products market between their respective customers, the industrial companies), no issue of competing corporate governance structures could arise. The isolation of each financial system caused industrial companies to remain closely tied to their original sources of finance, thus avoiding any possible effect or alteration of the current corporate ownership structures.

However, the rapid progress in technologies and, above all, the change of attitude towards finance, along with the political decision to open up financial markets to international competition, are all factors that urge the globalization of the financial systems as well. This event may indeed bring about serious effects and alterations in corporate governance.

VII. THE GLOBALIZATION OF FINANCE: THE DIRECT COMPETITION OF FINANCIAL INSTITUTIONS AND ITS POSSIBLE EFFECTS ON CORPORATE GOVERNANCE

As globalization progresses, the legal distinction between the market-oriented model and the bank-oriented model becomes less significant. Financial institutions originally based in one model system will start competing directly with financial institutions based in the other model system, whereas so far they have only engaged in competition indirectly through the industrial companies to which they offered their services.

The direct competition among financial institutions will most probably cause greater uniformity and harmonization of the regulatory framework. Ultimately, however, it will break down the barriers between the single systems, transforming the financial system into a global one ruled by growing competition and market mechanisms.

In this respect, it is worth noting that the globalization of finance is growing stronger and stronger with respect to investment services,[56] while there are still quite high barriers to

---

that time. For example, the famous Modigliani-Miller theory, holding that the composition of finance is irrelevant in determining the value of the firm, dates back to those years. *See generally* Franco Modigliani & Merton H. Miller, *The Cost of Capital Corporation Finance and the Theory of Investment*, 48 AM. ECON. REV. 261 (1958).

56. For example, more and more companies are starting to list their shares both on national and on foreign exchanges. *See* Daniel Kadlec, *Investing Abroad,*

the transnational offering of banking services. There are several reasons explaining the slower banking globalization process. At an economic level, the real competitive advantage of banks is their diffuse retail network, and the setting up *ex novo* of an effective network requires huge investments. At a political and legislative level, banks are deemed to be a strategic industry for the national economic system because of the public policy concerns connected with banks and their role in monetary policy. Such factors tend to keep the banking industry protected from outside competition.

However, even assuming a full legal aperture of the financial markets, competition is going to spur much faster in the investment services industry than in the banking industry, since investment services do not benefit (or suffer) from the same economies of scale and experience as banking. As it was explained before, the banking system, in its own essence, has a greater capacity to resist new competitive forces, especially due to its close connection with the local communities and its productive texture. In this framework, U.S. investment firms may have a competitive advantage against similar European firms, given their greater habit to adjust to market forces. Nevertheless, U.S. investment firms and banks lack the experience and the economies of scale of European universal banks, whose long tradition of engaging in a wide range of services and exploiting synergies among them, will contribute to their soundness and their capacity to enter new markets.

The globalization of finance, forcing financial institutions coming from different systems to compete directly with each other in providing resources to industrial companies, will bring about new developments. U.S. institutional investors, with their own "investment culture," are entering the European markets more and more, whereas the same will happen with European universal banks and the U.S. markets.[57] This will

---

TIME, Sept. 29, 1997 at B11, B12. More significantly, in some instances companies do not even consider listing on their national exchanges and directly list their shares on foreign exchanges. Moreover, as a consequence of the greater liberalization of capital movements, mutual funds and pension funds are also starting to diversify their investments at the international level.

57. *See* James A. Fanto, *The Transformation of French Corporate Governance and United States Institutional Investors*, 21 BROOK. J. INT'L L. 1, 10-11 (1995) (discussing the increasing trend of U.S. institutional investors entering the European Market).

surely cause serious changes in corporate governance structures. As new actors enter the stage of the financial market, the plurality of sources of finance for firms becomes more diversified, and the traditional power structure within firms tends to be upset. Since globalization is affecting the investment services industry more than the banking industry, the primary area of greater competition will be Europe, rather than the United States. In fact, the principal actors of the European financial market, the banks, will still find hindrances in entering the U.S. market with all of their universal capacity.

VIII. THE POLITICAL ISSUES ARISING FROM GLOBALIZATION

Globalization and the movement towards greater aperture of the internal markets may raise political problems.

The enhancement of market mechanisms and the removal of barriers go along with the growing dimension of the markets. However, when such larger markets are politically fragmented (as it is still the case for Europe at the present time), the State's political responsibility to its own community comes to struggle against greater economic freedom.[58] Many measures are being taken that appear as protectionist devices implementing some sort of autarchy. One example is the granting of the so called "golden share" to the State when selling large state-owned companies, operating in strategic industries, to the public.[59]

Such concerns may be misread as mere local particularism or as expressions of an out-of-date nationalism. It should be recalled, however, that the State has a political responsibility to its constituencies and territories. It cannot afford to lose sover-

---

58. Undoubtedly, in a relatively smaller national context, the presence of most types of industrial plants within national territories maintains quite a significant political meaning.

59. In Italy, the Law n. 474/1994, regulating the privatization process of State-owned companies, grants the Government the possibility to keep special voting rights in public utilities companies (*e.g.*, electricity, telecommunications), providing the Treasury with the power to veto acquisition of large shareholdings by any single investor, and to forbid the breaking-up, liquidation or transfer abroad of the company. *See* Law of July 30, 1994, No. 474, Gazz. Uff. (July 30, 1994, No. 177), 80 Lex Part I, at 2787; *see also* COMMISSIONE PER IL RIASSETTO DEL PATRIMONIO MOBILIARE PUBBLICO E PER LE PRIVATIZZAZIONI, RAPPORTO AL MINISTRO DEL TESORO 39-42 (Nov. 7, 1990). Also, similar provisions are still in place in many of the British public utilities companies privatized during the 1980s.

eignty over particular industrial or commercial sectors, although those sectors may be more efficient if allocated outside the country and more so in view of the fact that very often, given the size of the country, the single undertaking coincides with the whole sector.[60]

Moreover, there is indeed an issue of democracy that should be carefully reviewed. Democracy, and more specifically economic democracy, may in fact be implemented through participation of people in the governing of firms;[61] but above all, it may also be implemented by subjecting the firms to the rule of law established by national parliaments. Actually, the latter is the most correct and most common form of implementation of economic democracy for the business environment.

When the allocation of economic resources takes place only as a consequence of an efficiency drive, such market mechanisms will eventually overrule Parliaments and Governments that will be, *de facto*, expropriated of their legislative and executive powers with respect to the global economic actors. As it can easily be imagined, the host country will have no sovereignty over the foreign institution, whereas the home country of the institution will have no interest in regulating the operations of the institution in the foreign country. The paradoxical consequence may then be to have institutions operating internationally only subject to the rules of the market, with no precise rule of law limiting the exercise of their power. An interesting parallel may be drawn with the events surrounding the development of the eurocurrency market a few years ago. Huge amounts of money were able to flow from market to market with no authoritative control over their origin and destination and ultimately blamed for the European currency crisis in 1992.[62] It is difficult to imagine that Governments

---

60. A typical example of this attitude is the EU Common Agricultural Policy. *See generally* EUROPEAN COMMISSION, BULL. OF THE EUR. COMMUNITIES SUPP. NO. 5/91, THE DEVELOPMENT AND FUTURE OF THE COMMON AGRICULTURAL POLICY 9-12 (1991) (describing origin and effects of the EU's Common Agricultural Policy).

61. Such an idea of democracy is reflected in NORBERTO BOBBIO, WHICH SOCIALISM? 100-01 (Roger Griffon trans., Richard Bellamy ed., Univ. of Minn. Press 1987) (1976); *see also* GUSTAVO VISENTINI, LEZIONI DI TEORIA GENERALE DEL DIRITTO 81-95 (1997).

62. *See generally* Barry Riley, *Portfolio of Uncertainties*, FIN. TIMES (LONDON), Oct. 26, 1992 (discussing the European currency crisis of 1992), *available in* LEXIS, News Library, Fintme File; Walter Russel Mead, *Europe's Death Knell*, L.A. TIMES, Sept. 20, 1992 (same), *available in* LEXIS, News Library, LAT File.

will allow similar events to happen and develop in the industrial sector!

The reaction to such situations tends to bring these institutions, and the relative massive flows of financial funds, under the rule of law of supra-national organizations, either strengthening existing ones or creating new forms of international collaboration. Prominent examples in this respect have occurred quite recently. Right after the Mexican crisis of 1995, a heated debate developed concerning the extension of the role of the IMF.[63] Moreover, the Basle Agreements on banking supervision were aimed at setting a uniform standard of banking supervision across the world, enhancing all forms of collaboration among national supervisory agencies.[64]

IX. CONCLUSION

In conclusion, I would like to briefly try to give an answer to the question posed in the title: "Which model of capitalism?"

Certainly, as a consequence of the globalization of the markets, for both goods and finance, one can notice a new type of capitalism. However, the novelty does not seem to concern the operational mechanisms of capitalism: the market still operates, and will continue to operate, according to mechanisms founded upon the struggle and dialectics among private, public and administrative powers. One may talk about a rediscovery of Keynesian philosophy over the role of Public Authorities and of regulation in the global economy.[65] That role, as it

63. *See generally* David Hale, *Such a Deal, The Much-Maligned Mexican Bailout is Looking Smart*, WASH. POST, June 2, 1996 (discussing the role of the International Monetary Fund (IMF) in assisting Mexico through 1995 financial crisis), *available in* LEXIS, News Library, Wpost File; Clay Chandler, *IMF Director Suggests Broad Changes*, WASH. POST, Apr. 19, 1995 (discussing reactions to IMF response to 1995 Mexican financial crisis), *available in* LEXIS, News Library, Wpost File.

64. *See* Timothy Haosen Wan, *Comparative Approaches to Regulatory "Safety and Soundness"*, *in* 1 INTERNATIONAL BANKING REGULATION AND SUPERVISION: CHANGE AND TRANSFORMATION IN THE 1990S 261, 264-66 (J.J. Norton et al. eds., 1994). The necessity of furthering the enhancement of more stringent forms of international banking supervision became ever more pressing and urgent after the recent Barings crack. *See* Sara Webb et al., *A Royal Mess: Britain's Barings PLC Bets on Derivatives—and the Cost is Dear*, WALL ST. J., Feb. 27, 1995, at A1.

65. Under the Keynesian theory, which was set forth in a definitive treatise written by John Maynard Keynes during the 1930s, the government seeks to control the economy through its fiscal policies. *See generally* JOHN MAYNARD KEYNES, THE GENERAL THEORY OF EMPLOYMENT, INTEREST, AND MONEY (Harcourt Brace

was described, is becoming more pervasive, but under a different perspective. In fact, the objective of strengthening and favoring the functioning of market mechanisms is gaining prominence over the objective of keeping the economy under strict control. The experience is there to demonstrate that the operation of market mechanisms cannot mean pure *laissez faire*! The novelty lies in the dimension of the phenomenon: the scale firms must face is a world scale, and the urge towards a global operation, not limited by national boundaries, is incredibly powerful. In this context, the legal framework, while becoming globalized in its protection and enforcement of property rights, becomes the essential pillar upon which the market operates and, hence, market forces efficiently allocate wealth and resources.

Therefore, no new model of capitalism is probably arising but, as a consequence of new forces and impulses, societies as a whole will certainly undergo a drastic and revolutionary change, heading towards a new international economic order, much the same way as it is happening for the international political order.

Jovanovich 1964) (1936).