Continuity and Change in Corporate Governance: comparing Germany and Japan

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Germany and Japan are often seen deviating from an economic model of shareholder control and thereby as being similar by virtue of their mutual contrast with the US. Given the common challenges for bank-based and stakeholder-oriented models of corporate governance, Germany–Japan comparison seems particularly timely. This article provides an introductory overview and analysis for the Special Issue by comparing recent developments in corporate law reform, banking and finance, and employment in Germany and Japan. While rejecting arguments for international convergence, we discuss this evidence of simultaneous continuity and change in corporate governance as a potential form of hybridisation of national models or renegotiation of stakeholder coalitions in German and Japanese firms. One consequence is the growing diversity of firm-level corporate governance practices within national systems.

Keywords: Corporate governance, stakeholders, comparative management

Introduction

A growing body of literature on comparative corporate governance has begun to explore the similarities and differences in corporate governance structures and practices across countries. To a remarkable extent, the US and sometimes Britain remain an implicit baseline for international comparison. Likewise, corporate governance reform around the world is often informed by the principles underlying the US model of corporate governance – such as shareholder rights, transparency and disclosure, variable management compensation and external independent directors.

Meanwhile, the diversity of corporate governance in the non-English-speaking world is less well understood. Germany and Japan are often seen deviating from an economic model of shareholder control and thereby as being similar by virtue of their mutual contrast with the US. Various labels describe them, sometimes uncomfortably, as bank-based, insider, stakeholder, coordinated or non-liberal models of corporate governance. Only recently has a small but growing literature tried directly to compare the similarities and differences between "deviant" models such as Germany and Japan (Dore, 1996, 2000; Streeck and Yamamura, 2001; Yamamura and Streeck, 2003) or differentiate among East Asian, Latin and other European models (Whitley, 1999; Aguilera and Jackson, 2003; Nam and Nam, 2004). German publications on Japan (Hirata, 1996; Jackson, 2002; Waldenberger, 2002; Moerke, 2004) and comparative studies written in Japanese (Sakakibara, 1995; Fukao and Morita, 1997; Kikuchi and Hirata, 2000; Seki and Ueda, 2000; Kikuzawa, 2004) remain little known to English readers. Given the common challenges for bank-based and stakeholder-oriented models of corporate governance, Germany–Japan comparison seems particularly timely.

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Similarities

Germany and Japan have striking similarities. Corporate ownership is typically concentrated among a stable network of strategically oriented banks and other industrial firms, rather than fragmented among individuals and financially oriented institutional investors.[1] Consequently, the market for corporate control is largely non-existent. Banks play the central external governance role through relational financing, commingling debt and equity, providing financial services and monitoring in times of financial distress.[2] Employees exercise voice within corporate governance through legal rights to co-determination in Germany or extensive use of joint labour-management consultation in Japan.[3] This long-term role of employees is reflected in long employment tenures, infrequent use of lay-offs and high investment in firm-specific skills.

Meanwhile, top managers in both countries tend to be internally promoted. Managerial compensation is much closer to that of average employees' schemes and lack strong shareholder-oriented incentives such as stock options. Consequently, managers are often said to be less finance-oriented and focused on long-term product strategy. As a result, managers are able to build corporate governance "coalitions" among stable investors, banks, employees and inside management. This corporate governance model was widely considered to have been successful and contributed comparative institutional advantages of German and Japanese firms in markets characterised by incremental innovation and the manufacture of high-quality products (Aoki, 2001; Hall and Soskice, 2001).

Differences

Despite broad similarities, the role of law is nonetheless a key area of difference between Germany and Japan. Co-determination in Germany is a legal institution where employee voice is a matter of public interest and supported through politics. Likewise, the two-tier board system reflects strong legal intervention into the internal make-up of the enterprise in order to promote effective checks and balances between management and shareholders. These non-contractual rights and obligations based in law contrast sharply with the informal arrangements of employee participation in Japanese firms, as well as the lack of separation between monitoring and management functions within Japanese boards.[4] These differences are sometimes contrasted as a constitutional model in Germany versus a community model in Japan (Jackson, 2001).

Likewise, in Germany, business associations play a stronger governance role. For example, collective bargaining takes place at a sectoral level between industrial unions and employers associations. Likewise, worker training involves an extensive apprenticeship system that coordinates and gives public certification to training efforts by companies. Training is conducted "on the job", since universities and colleges concentrate more on the development of social skills than on the intermediation of specific, business-related knowledge.

Meanwhile, Japanese business associations tend not to take on similar governance functions. Unions are organised around enterprise, rather than industry or occupational lines. Figure 1 also shows that coordination across firms takes place on the basis of business groups (*keiretsu*), either vertically (Toyota and their supplier, for instance) or horizontally organised (like in the Mitsubishi group). Japanese horizontal *keiretsu* groups link corporations and banks within extensive patterns of horizontal cross-shareholding (Gerlach, 1992; Moerke, 1999), unlike the pyramidal conglomerate holding companies (*Konzern*) in Germany that concentrate ownership much more (Beyer, 1998). Thus, important differences are apparent in the relative importance of horizontal "class" identities of capital and labour versus vertically segmented "enterprise" identities as a basis of economic organisation (Dore, 1996).

Pressures for change

Despite past successes, Germany and Japan have faced strong pressures to change their corporate governance systems. Internationalisation has created pressures to move toward a more market-based and shareholder-oriented model of governance. In Japan, foreign investors owned 18.3 per cent of stocks listed on the Tokyo Stock exchange in 2002, compared to 4 per cent in 1990 (TSE, various years). Foreign direct investment has increased. Foreign companies made unprecedented acquisitions of large stakes in Japanese companies such as Nissan, Mitsubishi Motors or Chugai, as well as bankrupt institutions like the (then nationalised) Long-term Credit Bank of Japan (now the successful Shinsei bank).[5] International standards are also playing a growing role in corporate regulation, such as international accounting standards or the application of the US Sarbanes-Oxley Act. These trends apply to Germany as well. EU efforts to harmonise capital market regulation also have a pro-

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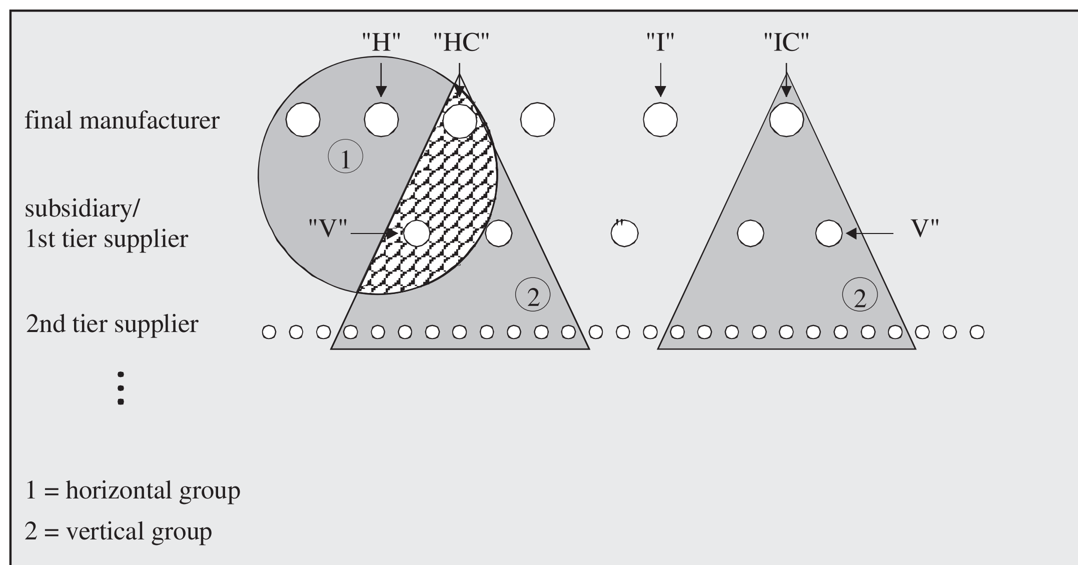

Source: Adapted from Gerlach (1992).

Figure 1: Inter-firm networks in Japan

found impact for German financial market liberalisation.

Deregulation and liberalisation have created new pressures. Financial deregulation in the 1980s allowed for a shift towards bond finance enabling the substitution of direct financing via banks.[6] This process, of course, had effects on the capital market as well as on the banking system, which underwent a stock and land price bubble at the end of the 1980s. The collapse of this bubble economy contributed to the huge problem of non-performing loans (NPL) held by Japanese banks. The NPL crisis greatly eroded the capacity of Japanese banks to play their former beneficial role in corporate governance. Meanwhile, also in Germany, the availability of internal and direct finance liberated large firms from their dependence on banks, and the banks themselves have undergone strategic reorientation toward new business models.

Finally, the advent of new information technology industries places changing demands on corporate governance. The US is perceived as having renewed competitive strength due to its liquid stock markets, venture capital and strong external labour markets with portable professional qualifications. Meanwhile, Germany and Japan have more integrated and network-based production models stressing incremental innovation and the strong development of shop floor skills. These models flourished under conditions of strong economic growth, but were argued to be less well suited to deal with slowed growth, restructuring, mergers and acquisitions, or decline of mature firms. Thus, the life-cycle demands upon corporate governance institutions have become more diverse (Filatotchev and Wright, 2005) and exposed gaps in the areas of new venture entrepreneurship and corporate restructuring.

To explore these issues, an international conference was organised in February 2004 on the topic of "Changing Corporate Governance Systems – Germany and Japan in Comparison" by the German Institute for Japanese Studies (DIJ, Deutsches Institut für Japanstudien) and Japan Investor Relations and Investor Support, Inc. (J-IRIS) in cooperation with the Research Institute of Economy, Trade and Industry (RIETI) in Tokyo. The conference aimed to together both leading practitioners and researchers deeply involved in the debates in each country.

This article will introduce the main research findings from this Special Issue and compare Germany and Japan across four broad areas: corporate law and regulation, the financial system and the role of banks, issues of employees and management pay, and finally how corporate governance relates to broader issues of accountability, distributional justice and corporate performance. The papers all share a simultaneous stress on change *and* continuity, suggesting some limits to convergence and the continued relevance of some "traditional" German and Japanese practices within a more liberalised international environment.

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Issues in legal reform

Since the mid-1990s, Germany and Japan each adopted a series of legal and regulatory reforms related to corporate governance. Although approached incrementally through numerous small legislative measures, the parallels between the countries are striking and the cumulative impact likewise substantial.

A first series of changes concerns the liberalisation of how corporate equity is used, such as share swaps, stock options and spin-offs. In Japan, the post-war ban on pure holding companies was removed. These changes are largely policy-push reforms lobbied for by corporations to facilitate corporate restructuring (Shishido, 2005), but also give managers greater scope to actively "manage" stock prices. A second set of changes concern international accounting standards. Both Germany and Japan had rather creditor-oriented accounting principles that stressed conservative valuation and allowed for substantial building of reserves. New market-oriented rules introduce much greater volatility into corporate balance sheets, since long-term stable shareholdings are now marked to the market price. A third set of changes concern efforts to promote greater transparency and disclosure, as well as strengthen shareholders' rights through derivative suits or removing voting rights restrictions.

Beyond these parallels, some differences emerge around the issue of the board itself. Here Germany and Japan have very different starting points. Japan has a unitary board of directors with only minimal legal distinctions between inside and outside members or between management and monitoring functions, such as the role of the statutory auditors. Meanwhile, Germany is a key example of a two-tier board system that developed strong legal distinctions between the roles of the management board and the supervisory board, as well as having a long tradition of outside members that represent various stakeholder groups including banks, large blockholders and employees. Germany has retained its two-tier system as being consistent with international trends. The focus has been on improving the monitoring functions during 1998 corporate law reform and the subsequent comply-or-explain approach introduced by the German Code of Corporate Governance.

Whereas the two-tiered structure in Germany has remained remarkably stable, Japanese boards have lacked a clear role for outsiders. As long as banks played a strong external governance role, there seemed little need to change the insider boards. But the weakened role of Japanese banks and international debates led policy makers to rethink this basic approach. Various measures were passed to strengthen the independence of so-called statutory auditors. Or perhaps more radically, Japanese law now permits the adoption of a US-style board based on committees for nominations, compensation and auditing that have a majority of outside directors on them.

In this volume, two contributions (Cromme and Nietsch) deal with changes in the legal environment in Germany, whereas the third (Seki) deals with Japan. From his perspective as Chairman of the German Corporate Governance Commission, Gerhard Cromme provides an insider's view of the development of the German Corporate Governance Code. He notes that while Germany remains distinctive in having a two-tier board structure and employee co-determination, the general principles underlying the actual roles and functions of the board are increasingly similar to best practices elsewhere in the world. Cromme also stresses the deep connection of the German debate to corporate governance debates in other countries. For instance, the principles of "comply or explain" in the German Code were inspired by the Combined Code in the UK. As important new approach to industry self-regulation, the German Code has been able to gain widespread acceptance. The Code reflects efforts to improving corporate governance standards in order to make them transparent to growing ranks of international investors.

Next, Michael Nietsch offers a detailed analysis of the legal changes shaping German corporate governance. After discussing the German Corporate Governance Code, Nietsch explores the various amendments to corporate law itself. Like Cromme, Nietsch argues that board structures and their diversity across countries may be less important than the underlying tasks that boards fulfil. Here the German two-tiered board structure has proven remarkably resilient. Yet voluntary reforms embedded within the German Code are still useful in promoting best practices in how the board operates, such as improving the flow of information and clarifying the responsibilities of various members. These current developments in law and self-regulation are inter-related and far from complete. The German Corporate Governance Code is checked and amended (if necessary) every year.

Turning to Japan, Takaya Seki's paper offers a practitioner's view on recent legal reforms and their significance for investors. Cross-shareholding in Japan developed historically as a protection against hostile takeovers and to underwrite long-term business relation-

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ships. But the proportion of cross-shareholding has recently declined, and ownership by foreign and domestic institutional investors is increasing. Corporate governance patterns are therefore under increasing pressure. Seki argues that foreign and institutional investors are less concerned about long-term business relationships and are focused more on stock market returns. Moreover, these new shareholders are playing a much more active role in corporate governance. While shareholder activism by foreign institutional investors is well known, Seki demonstrates that domestic pension funds in Japan have also become more interested in exercising voice in corporate governance, as reflected in the surprising increase of "no" votes cast at shareholders' meetings.

Japan has also seen a wave of legal reforms that aim to strengthen the external monitoring functions within the board and improve shareholder rights. The centrepiece was the introduction of the committee system that allows firms to adopt a "US-style" board system that uses committees with a majority of outside directors. Seki notes that in the first year of implementation, just 43 companies (around 3 per cent of First Section listed firms) have adopted this system. However, Seki argues that the impact of these reforms is greater and may have galvanised rethinking the traditional Japanese system of oversight by statutory auditors. Not only have these auditors been also made more independent, Seki argues that their future role may indeed be less passive.

Corporate governance, banks and finance

Germany and Japan are both prime cases of relational banking. Banks traditionally involved long-term and complex relations with industrial firms based on credit, large equity stakes, financial services and advice, representing shareholders as a delegated monitor or through proxy votes, holding seats on corporate boards, and being active in corporate rescues (Aoki and Patrick, 1994). Financial liberalisation has eroded at least some rents from relational contracting. Market-oriented reforms have reduced advantages of private information by increasing public disclosure and transparency. Liberalisation also eased corporations' access to external capital markets and increased competition among financial intermediaries.

Japanese main bank relationships were dramatically weakened as a consequence of the bubble. Financial liberalisation gave corporations greater access to bond markets and rising share prices led to cheap equity finance – consequently reducing the demand for bank credit by large corporations. Banks initially compensated by lending to smaller and riskier firms, which later resulted in a huge volume of bad loans and unrealised losses on stocks purchased at the height of the bubble. As this banking crisis unfolded, banks reduced outstanding loans to meet capital adequacy ratios and created a credit crunch for smaller firms despite the Bank of Japan's zero interest rate policy. Banks also divested from shares or sold and repurchased holdings in order to improve balance sheets by booking unrealised gains. The introduction of market-based accounting, discussed in the previous section, has further reinforced equity divestment.

An interesting question arises as to why Japan experienced as banking crisis, whereas Germany was able to avoid a similar lending bubble. This divergence may suggest how important differences are in the governance of the banking sector itself, both in terms of prudence regulations, risk management and relationships between banks and regulators. Although it was stressed quite often that banks play similar roles in Japan and Germany, differences in their behaviour need to be better researched. Today German banks seem more willing to let even major firms go bankrupt, such as Holzmann in 1999 and Walter Bau in 2005. Meanwhile, Japanese banks remain more cautious about foreclosing on their clients. The adaptation of German banks to market liberalisation appears to have been very difficult, but less crisis-driven.

German private banks have shifted away from industrial loans and deposits, and toward highly profitable investment banking services (Deeg, 1999). As large firms have become increasingly self-financing or look to international equity markets, banks have sought to diversify from lending activities that generate interest-based income to other types of fee-based income. Deutsche Bank and Dresdner Bank acquired British and US investment banks, shifted their equity holdings to subsidiary companies and divested from some large stakes (Boehm, 1992). Banks are also slowly reducing their supervisory board seats: private banks held 20 per cent of seats in the largest 100 companies during 1974, but only 6 per cent in 1993 (Sherman and Kaen, 1997, pp. 11–16). German banks also face growing dilemmas in maintaining traditional relational banking arrangements within a more market-oriented financial environment. For example, board representation may lead to conflicts of interest with banks' investment banking activities (Höpner and Jackson, 2001).

Three papers (Vitols; Hackethal, Schmidt and Tyrell; Arikawa and Miyajima) also point

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out interesting continuities in the relation of corporate governance and banks. Sigurt Vitols' paper examines to what extent Germany's bank-based financial system has actually changed. Vitols shows that despite the attempts to modernise the financial system and promote the "New Economy", Germany still remains a bank-centred financial system with an underdeveloped capital market based on indicators like stock market capitalisation and the number of IPOs. Despite the boom of stock market activity during the IT bubble in 1999 and 2000, levels of activity have rapidly declined. The company sector also continues to show a strong demand for bank finance, underpinning the continued importance of banks.

Vitols explains this continuity by focusing on several institutional factors often ignored in recent debates. German households still have only a very limited demand for purchasing equity. Given the comparatively low degree of income inequality in Germany, a large group of middle-income households exist that prefer less risky assets such as bank deposits, unlike high-income households. German public pensions remain important and private pension provision quite limited, despite recent reforms. On the company side, the large sector of SMEs in Germany often specialises in lower risk technologies supporting Germany's competitive industrial infrastructure, and thus sustains demand for more traditional forms of bank finance. Thus Vitols argues that the distinctive characteristics of Germany's financial system are not merely the product of financial regulation, but sustained by the complementary institutions that govern household income and investment, as well as industrial organisation.

Following from this, the paper by Andreas Hackethal, Reinhard Schmidt and Marcel Tyrell stresses that the main area of change in Germany is indeed restricted to the large private banks. These banks have reduced their long-term shareholding and seats in supervisory boards. However, given the broader continuities, this change in the role of key insiders in itself has not meant the convergence of Germany on a shareholder-oriented system. Rather, the authors provocatively suggest that one potential result of banks' retreat is not shareholder power, but the increased autonomy of management and separation of ownership and control.

Turning to Japan, Hideaki Miyajima and Yasuhiro Arikawa investigate the pattern of bank lending to firms during the 1990s and its implications for corporate governance. Larger and successful firms listed at the first section of the Tokyo Stock Exchange tend strongly towards capital market finance. Meanwhile, firms with low growth prospects or young firms still depend on the banks to finance their investments. A paradoxical situation emerged where potentially worthy firms faced a growing credit crunch, as bad loans and capital requirements made it hard for banks to offer new loans, but past loans to bankrupt clients were continuously rolled over.

Miyajima and Arikawa suggest that rolling over old loans to so-called "zombie" firms depends on whether the concentration of main bank loans is very high. Such high concentration of bank loans to poorly performing firms gives strong incentives for banks not to push the necessary restructuring onto the client, given the constraints placed on the struggling banks to avoid their own capital shortage. The main bank system thus lost its positive function as an effective in-corporate monitor (bright side) in the 1990s, and revealed a dark side. However, the authors do not predict the demise of the Japanese main bank system. The future role of the banks depends strongly on the restructuring of the banking sector itself – through new bank strategies, recent banking mergers,[7] policy measures to reduce bad loans and complementary roles in corporate restructuring played by new private equity investors and reformed bankruptcy procedures. All these factors may contribute to revitalising bank monitoring capabilities, which will make the threat of intervention credible for struggling client firms.

Taken together, bank–firm relationships thus display both continuity and change. Erosion has been substantial among the largest blue-chip firms in both Germany and Japan. At the same time, other segments of firms continue to have very strong relationships with banks. Thus relationship banking has not diminished completely, but has shifted towards different groups of firms. Banks are unlikely to regain their past monitoring capacity with regard to very large firms, but may continue to play a unique governance role among smaller credit-oriented firms.

Corporate governance, employees and managers

Complementarities have been posited between human-resource management and corporate governance. However, the pressure of foreign ownership and regulatory reform has increased the salience of shareholder interests among managers and has cast some doubt on the viability of long-term employment and the stakeholder-oriented nature of corporate governance. Two papers (Jackson and Kubo)

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examine these issues with regard to employment adjustment and managerial pay.

Gregory Jackson explores the linkages of corporate governance and employment by looking at cross-national data and recent theoretical models of these linkages. His paper then compares the impact of corporate governance on four sets of employment outcomes in Germany and Japan. While corporate governance does impact employment, the evidence does not suggest a convergence toward a US model based entirely on shareholder value. For example, firms facing capital market pressure are more likely to reduce employment, but employment adjustment remains much less rapid and more "benevolent" than in the US. Still, the core group of employees is obviously shrinking and suggests a more limited scope of the stakeholder model.

Importantly, the formal institutions supporting employee participation seem quite stable. In Germany, the first German Governmental Commission on Corporate Governance explicitly excluded co-determination from its target areas for reform of the legal framework of corporate governance (Baums, 2001). Moreover, employee representatives to the board are even recognised as independent outsiders under Sarbanes-Oxley in the US. Likewise, most Japanese managers express continued commitment to a modified notion of lifetime employment and stakeholder-oriented corporate governance.

Katsuyuki Kubo's paper deals with a very special group of employees – the directors, i.e. members of the top management of Japanese stock corporations. Insider-domination of Japanese boards is particularly strong in Japan due to the seniority orientation, in-house career system and small external labour market for managers. Meanwhile, German managers have been some quicker to adopt variable and performance-oriented pay packages, although to a lesser degree than in the US. And external labour markets are growing more rapidly. Building upon previous research on the link between director compensation and corporate performance (Jensen and Murphy, 1990; Kaplan, 1994), Kubo shows that no correlation exists between directors' compensation and shareholders' return in Japan. More specifically, the sensitivity of director pay to corporate governance is quite low in Japan, and increasing this sensitivity has no significant effect on performance.

This finding casts doubt on the usefulness of high-power incentives as a corporate governance mechanism. Kubo stresses that in Japan a positive correlation does exist between directors' compensation and employees' wages. He suggests that a post on the Board of Directors is indeed a part of the career path in Japan, and the task of a director is to motivate the employees rather than maximise shareholder value. Here Kubo ties in closely to Ronald Dore's contribution – Dore pays special attention to the fact that managers tend to see themselves as employees of the firm in Japan and that the pressures from lifetime peers within the firm may be an important internal factor assuring corporate accountability.

Rethinking good corporate governance?

The above discussion documents both significant changes and continuities. But it is a separate question as to whether Germany and Japan *should* move closer to the Anglo-Saxon model of corporate governance in order to assure the accountability of top managers and good company performance. The final two papers (Dore and Yoshimori) explore the issues involved in choosing between corporate governance systems.

Ronald Dore distinguishes between the shareholder versus stakeholder dimension of corporate governance, on one hand, and the issue of accountability as a common underlying issue in corporate governance, on the other. Dore argues that accountability can be achieved in both shareholder- and stakeholder-oriented systems, but in different ways. An overlooked issue in this regard concerns the socialisation and career paths of top managers. In Japan, managers enter the firm as ordinary employees, slowly work their way up through the ranks and rise into the highest ranks ahead of their cohort peers only very late in their careers. Dore argues that this long-term socialisation into a corporate culture during one's career path provides important motivational resources for Japanese managers that place many important checks on opportunistic behaviour.

Consequently, the institutions governing managerial careers underlie important different governance institutions across countries. For example, the importance of intrinsic motivations to establish a good reputation among company peers is greater in Japan relative to extrinsic motivations for monetary reward. These and other internal mechanisms of social control are often lost in US debates that appeal to high-powered incentive schemes and external control by outsiders. Dore's analysis raises serious questions as to whether adopting US-style corporate governance practices will improve corporate accountability in Germany and Japan. Alternatively, change may influ-

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ence distributional outcomes (the question of who gets what) and erode the more egalitarian institutions that reduce inequality between top managers and employees.

The paper by Masaru Yoshimori focuses on corporate performance through paired comparisons of Toyota and GM, as well as Canon and Xerox. His case studies suggest that the Japanese corporate governance system is not necessarily linked with bad performance. Nor does US-style corporate governance guarantee good performance. Rather, the role of values, corporate culture and strategy are central to the excellent performance of Toyota and Canon. Yoshimori thus argues that the huge emphasis placed in international debates on external corporate governance by outsiders may have relatively little impact on the bottom line. Parallel to Dore, the paper draws attention to many of the internal factors that shape organisational behaviour, including corporate culture and strategy.

And convergence?

Much attention has surrounded the question of international convergence of corporate governance systems. The papers in this Special Issue seem to suggest that strong convergence is not taking place. Continuities were pointed out, such as differences in the structures of corporate boards (Nietsch), the continued weakness of capital markets (Vitols, Miyajima and Arikawa), the importance of employees as stakeholders (Jackson), the career patterns of top managers (Kubo, Dore) and corporate strategies based on long-term relationships (Yoshimori). These features seem sufficient to argue that German and Japanese corporate governance still remain quite distinct from their US or British counterparts.

Yet equally importance must be placed on the significant changes underway in Germany and Japan. Changes in the financial liberalisation (Introduction), the growing role of outside directors (Cromme), the role of foreign investors (Seki) and bank–firm relationships (Haeckethal *et al.*, Miyajima and Arikawa) all suggest that popular understandings of the German and Japanese models must be revised. A challenging question remains for social scientists as to how to interpret the balance of continuity and change.

From a systems-based perspective, current developments are sometimes seen in terms of a "hybridisation" of national corporate governance systems (Jackson, 2003). Old structural elements from stakeholder-oriented models (e.g. employee co-determination) are being recombined with newer elements of shareholder-oriented models (e.g. transparency and disclosure) so as to arguably produce distinct "hybrid" practices based on these unique combinations of features. However, hybrids may be unstable if their component elements lack complementarities. Some authors are therefore sceptical about the long-term adaptation of stakeholder models to international pressure (Lane, 2003). However, hybrids may be stable if existing institutions can be reconfigured to "fit" within a firm-specific competitive environment, existing firm coalitions or a national institutional context (Streeck and Thelen, 2005). Conflicting logics, such as shareholder- and stakeholder-oriented control, may even help balance each other.

For now, a more clear consequence of hybridisation is the growing heterogeneity of corporate governance across firms within Germany and Japan (Aoki *et al.*, 2005). Corporations choose their corporate governance practices within the boundaries of prevailing institutional constraints and past organisational coalitions. While national models were never entirely homogeneous, the capacity to generate isomorphic practices across companies and sectors within a particular country is declining. Inherent institutional tensions, mentioned above, facilitate deviant patterns of behaviour (Whitley, 1992, p. 248) and greater firm-specific experimentation in combining elements of different models. Even though firms retain distinct "profiles" across countries, the range of internal variation is growing particularly between large internationalised corporations and smaller domestically oriented corporations.

At the firm level, changes in corporate governance can perhaps be described in terms of changing coalitions among key actors. Some authors describe the emergence of an augmented stakeholder coalition that now includes institutional investors, and the outcome of a kind of "negotiated shareholder value" in Germany (Vitols, 2004). Here performance incentives for employees remain less strong than in the US or UK, perhaps representing a more egalitarian version of Anglo-American practices.

Along similar lines, Jackson stressed that moving toward greater shareholder value has not led to the complete exclusion of other stakeholders from corporate governance. Not all changes lead to zero-sum shifts in power between owners and employees. Rather tensions are growing between corporate insiders and outsiders, such as between stable shareholders and institutional investors or between core and more peripheral groups of employees. Among investors the balance of power is shifting, albeit moderately, from insider to out-

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siders as institutional investors gain influence and banks play a weaker role. Meanwhile, power among employees is shifting from outsiders to insiders as firms restructure and divest from non-core activities.

In both Germany and Japan, reform is perhaps less about class conflict than about cross-class coalitions among insiders that bind together insider management, stable shareholders and core employees. Hackethal, Schmidt and Tyrell likewise stress the *continuity* in the basic insider coalition in Germany. The authors even speculate that moves to market-based forms of governance may have a potentially paradoxical result of *weakening* corporate accountability to the extent that banks play a weaker role as corporate insiders, but is not compensated for by more active role of outsiders. Still potential coalitions may arise among outsiders such as institutional investors and unions or union federations that each pressure for greater corporate accountability.

Despite many parallels between Germany and Japan, the future development of corporate governance will also be shaped by their differences. In some sense, the underlying sources of path dependence may be different. The continued importance of employees as stakeholders in Germany depends highly on the political and legal nature of co-determination. In Japan, stakeholder governance continues in part because the external labour market for top managers seems much further away. Other equally important differences relate to the role of the state. German developments will be bound ever more closely with policy in the European Union and integration of the European economy, whereas Japan remains a more "sovereign" nation-state driven by domestic policy concerns (Katzenstein, 2003). These regional differences will remain extremely important in mediating global pressures.

Notes

1. Thus, unlike Anglo-Saxon institutional investors oriented to financial gains from share-price appreciation and dividends, ownership is primarily held by investors with strategic organisational interests in promoting inter-firm cooperation, reducing risks and generating relationship-specific rents.
2. Japanese main banks act as delegated monitors through direct equity stakes, credit and dispatched directors (Sheard, 1994). German universal banks are linked to business through credit, equity stakes, the exercise of proxy votes and supervisory board representation (Edwards and Fischer, 1994).
3. Co-determination (Mitbestimmung) involves legal rights to information, consultation and co-determination for works councils representing employees at the plant and company levels. Employees are also allocated between one-third and one-half of the seats on the supervisory board, placing them alongside shareholders in appointing and monitoring management, giving business advice and ratifying important strategic decisions with the shareholder representatives. Japanese labour–management consultation is less formalised in law and more restricted to the core workforce among large corporations.
4. Consequently, Japanese boards are more hierarchically structured, with decision-making focused on a group of senior representative directors under the CEO. In Germany, the whole managing board has equal responsibilities, in principle, and more influence and more leeway to participate.
5. Overall inward FDI relative to GDP remains extremely low in Japan compared to other countries, but has increased concern about corporate reform to attract more international investment, such as reducing cross-shareholdings, facilitating M&A, privatising government business or liberalising the use of stock options that US and other foreign firms perceived as necessary to attract qualified staff.
6. The process that enterprises attempt to loosen their ties to the banks in Japan is called ginko banare – literally "increasing distance to the banks" or even "leaving the banks".
7. The major mergers follow: (1) Industrial Bank of Japan, Dai-ichi Kangyo Bank and Fuji Bank, forming Mizuho Holdings; (2) Sumitomo Bank and Sakura Bank, forming MitsuiSumitomo Financial Group; (3) Sanwa Bank, Tokai Bank and Toyo Trust Bank, creating UFJ, (4) Bank of Tokyo-Mitsubishi and Mitsubishi Trust and Banking forming Mitsubishi Tokyo Financial Group, as well as (5) Asahi and Daiwa Bank forming Resona Holdings.

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"The more financially numerate we are, the greater the temptation to forget the human factor, to dismiss it as 'fluffy stuff' or to place it outside the category of measurable and manageable business factors." *Lynn McGregor, Managing Director, Convivium, "The Human Side of Corporate Governance", International Corporate Governance 128, June 2004*

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