Book Review


The corporate governance debate, thrust centre stage in the wake of market and government reaction to the recent series of high-profile international governance failures, of which Enron is now the paradigm example, shows no sign of abating. The extent to which, and how, corporate governance should be reformed, and its role in corporate performance and economic growth more generally, continues to engage academic commentators, regulators, the media, and industry on a number of fronts. To take but three examples, the role of the non-executive director in governance remains under scrutiny, the institutional investor community appears to be engaging more aggressively in voice over exit, particularly on the core governance questions of executive pay and board composition,¹ while the debate on the role of the auditor in effective governance, already the subject of close EU attention following the publication of the Commission’s Statutory Audit Plan,² has been re-ignited in the wake of the Parmalat scandal. The much-disputed link between good corporate governance and enhanced corporate performance may shortly receive important new evidence as major index providers compete to produce corporate governance-based indices.³ Internationally, the move to adopt principles and codes of corporate governance continues with the OECD preparing to issue new principles on corporate governance later in 2004⁴ and with the EU Commission placing corporate governance reform at the heart of its May 2003 Company...
The trend towards adoption of corporate governance codes domestically across the EU is also deepening. December 2003, for example, saw the adoption of a new Dutch Corporate Governance Code, based on the recommendations of the Tabaksblat Committee. This swathe of international and domestic initiatives provokes a key question: what do they reveal as to the evolution of corporate governance systems? Corporate governance systems classically split into, very broadly, Anglo-American, dispersed ownership-based regimes, and controlling-shareholder-driven regimes. Are governance systems converging, and if so, towards what model and what are the economic implications, or are they, in the midst of the reform process, diverging and responding to links between governance systems and domestic cultural, political, and economic imperatives?

*Corporate Governance in a Globalising World* provides a very useful framework within which these developments can be assessed. This timely book considers the corporate governance debate, and specifically the convergence question and its implications for European governance, in the context of the extensive academic literature, the burgeoning empirical evidence, and, particularly interesting to this reader, industry questionnaires. It succeeds admirably in its stated objective of provoking debate by highlighting the different perspectives and evidence which undercut the convergence question.

After a short introductory chapter, chapter two usefully and concisely surveys the corporate governance convergence literature and provides readers, and particularly those new to this fast-developing field, with an admirably comprehensive and sure-footed guide through the thicket of theory and prediction. Corporate governance systems are broadly classified by the authors into the well-established division between outsider regimes (characterized by long-term financing through equity and bond markets and widely dispersed ownership) and insider regimes (characterized by concentrated ownership and greater reliance on bank finance). The particular challenges both regimes pose to effective governance are considered. The outsider discussion, for example, examines the classic governance difficulties posed by strong managers and weak owners and the difficulties of exit over voice. The convergence literature is divided into three categories: supporting convergence towards a market-oriented model based on Anglo-American governance; supporting convergence towards a hybrid governance model which, resting on the controversial assumption that discrete elements of governance systems can be exported.
without prejudicial effects, reflects cross-fertilization between different models; and divergence towards a range of different governance models. The driving forces for each model, raised in the literature, are considered in some detail and over a wide canvas. The hybrid convergence model, for example, is placed in the context of the knowledge society, which replaces the traditional labour versus capital conflict with a greater focus on co-operation and democracy and relies on networks and joint ventures as well as on traditional legal structures. The hybrid model is also considered in light of wider political movements towards a “middle way”, such as the “third way” (UK), the “active welfare state” (Belgium), and the “poldermodel” (the Netherlands). The barriers to convergence towards the outsider system (including path dependency and the reality of a multitude of different outsider systems) or a hybrid system (including the embedding of governance systems within national legal, cultural, and economic systems which militate against the export of isolated elements) are also considered. While the literature survey is useful in itself, it is also placed in the context of the EU position, which gives coherence to the chapter. The authors consider that the range of governance models, and their impact on an economy’s competitive position, demands that the EU consider which governance model(s) best supports its economic priorities and business policies. This observation has turned out to be prescient. The Company Law Action Plan has recently unveiled the Commission’s corporate governance reform agenda. While the Plan rejected adoption of a particular governance model, it has been criticized for relying too heavily on reforms which reflect the challenges of outsider, dispersed ownership governance and which sit uneasily in blockholding governance regimes. A first-principles debate on the role of corporate governance in the EU’s economic development is critical to an effective EU response and appears to be, as yet, missing at political levels.

The extent to which convergence in corporate governance is occurring in practice is extensively discussed in chapter 3, which draws on a wide range of reports and studies, making this chapter a particularly useful research tool. Convergence is tested against a range of governance indicators, four of which are further discussed below: the role of the capital markets; ownership and control; shareholders’ rights and protections; the market for corporate control and anti-takeover mechanisms; board systems; disclosure rules and accounting standards; and accountability and the role of the firm. With respect to the capital markets, for example, the studies reveal that market capitalization is growing across continental Europe and that the USA is “no longer the ultimate example of a market-oriented country”: prior to the recent market correction, in 1998 and 1999 IPO issuance was as high, or higher, in many continental European

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6 K. Lannoo and A. Khachatryan, Reform of Corporate Governance in the EU, CEPS Policy Brief No. 38, October 2003.
countries as in the UK or the UK. The authors conclude, however, that while there is a degree of convergence, in some continental European economies, towards outsider governance, others lag behind, leading to growing divergence within the EU.

Chapter three’s discussion of ownership structures is particularly noteworthy given its range. At the heart of the studies discussed is the finding that major shifts in ownership structure are occurring in continental European companies, although divergence is emerging as companies adjust to Anglo-American capitalism and its structures at different speeds. Among the many thought-provoking results discussed is that while European companies are becoming increasingly market-oriented, shareholder behaviour differs between Anglo-American and continental European markets. Continental markets tend to be considerably less liquid due to the smaller size of a company’s free float, and the longer time horizon of investors: for example, on average a Belgian share is traded every 36 months. As in chapter 2, the evidence is continually placed in context. The authors ask, for example, whether shareholder concentration can be beneficial and consider the evidence that large shareholders can act as positive active monitors. Even as dispersed ownership becomes more prevalent, many listed European companies operate under close monitoring by major shareholders. As the authors note, this trend is now appearing in Anglo-American governance as institutional investors increasingly challenge what is perceived as poor corporate governance practices, most controversially, certainly in the UK, in the field of executive pay. The growing importance of institutional investors emerges as somewhat of a theme of chapter 3. The shareholder rights discussion, for example, highlights the growing global importance of institutional investor activism. Of particular interest is the authors’ use of industry documents, such as press releases by Hermes, a leading institutional investor activist on good governance. The discussion identifies the impact of foreign institutional investors on continental companies: the condemnation in 1993 by CalPERS at the general meeting of German company RWE of its dual voting structures is identified as one of the first signs of foreign intervention. Activism remains generally less aggressive in approach, however, in continental Europe than elsewhere. The authors point to a preference for one-on-one meetings with management and a less direct involvement in the general meeting. The Commission’s Company Law Action Plan picks up this theme. While institutional investors will not be required to exercise votes with respect to governance issues, they will be required to disclose their investment policy and their policy concerning the exercise of voting rights in companies in which they invest.

Board composition and the avoidance of conflicts of interests are key concerns of the Commission’s Company Law Action Plan. The Commission takes, however, as its starting point that neither the unitary nor two-tier board structure should be imposed. The extent to which convergence in board
structures has occurred in practice is considered in great detail in chapter three and provides an essential backdrop to the Commission’s reforms. The non-executive director, for example, is central to the Commission’s reform agenda, particularly with respect to compensation, audit, and nomination committees, although the Commission acknowledges the difficulties in imposing independence requirements in a blockholding context. Chapter three reveals that independent directors are, however, on the rise across the continent. In France, the majority of CAC-40 companies have a majority of independent board directors, while the election of independent directors is occurring in smaller Member States, such as Belgium. The empirical evidence is also placed on the context of current research on the effectiveness of the independent director, which, particularly in the USA, remains equivocal.

Chapter three concludes with a consideration of the wider role of the firm, and, in particular, the relative balancing of shareholder and stakeholder interests, which is identified as critical to a correct interpretation of convergence/divergence trends. Classically, insider systems are more oriented to “long-term partnership with internal production factors”, while outsider regimes are primarily market-driven and place the shareholder in the “prominent place as the “principal” of the firm.” The authors place this discussion in the context of the anti-globalization movement, in particular, and the emergence of the corporate social responsibility movement with its emphasis on the triple bottom line of economics, ethics, and environment. They note a growing realization in market economies that sustainable shareholder value and respect for stakeholder interests go hand in hand. International initiatives such as the OECD’s Guidelines for Multinational Enterprises are identified as important influences which serve to narrow the gap between shareholder and stakeholder models. The chapter concludes, however, that notwithstanding some cross-fertilization between models, companies which follow Anglo-American governance still give top priority to the creation of shareholder value, while European, insider companies tend to take a more holistic approach to governance structures.

Chapter four is particularly interesting and novel and provides a revealing backdrop to the Action Plan. It considers the results of a survey of industry-based and academic governance specialists from across Europe and seeks to offer new insights into the convergence debate. The results are thought-provoking. Only 32% of respondents, for example, believe that European convergence (for listed companies) will be towards the Anglo-American outsider model: 40% support the emergence of a hybrid model while 29% expect diverging regimes to co-exist. A particularly welcome feature of chapter four is its consideration of the governance of non-listed companies. These are very largely outside the main focus of the Commission’s Action Plan, which is largely concerned, so far as corporate governance is concerned, with listed
companies. Nonetheless, such companies dominate in Europe. Recent trends also suggest a certain disenchantedment with listing. The authors suggest that non-listed, “more closed” companies face particular corporate governance challenges and problems, given the absence of market scrutiny, and call for a sharper focus on their governance structures. The special position of non-listed companies in the convergence discussion is reflected in the survey. A clear majority of two thirds of respondents considered that different governance structures would co-exist for non-listed companies, while only one third supported the use of recommendations for these companies, as compared to 70% in favour of recommendations for public companies. Respondents were similarly in agreement as to the link between governance structures and political and economic purpose. Almost 75% of respondents found a connection.

Given the recent adoption of the Commission’ Action Plan, and its reliance on harmonization of key principles via Directives and Recommendations, chapter four’s detailed consideration of the role of recommendations and harmonization in European corporate governance convergence is timely. The authors consider how a common European response to corporate governance might emerge (market forces producing an optimal set of standards, mutual recognition of standards, regulatory competition, or partial harmonization addressing aspects of governance but sensitive to the particular domestic features of governance). The Action Plan can be described, in some respects at least, in terms of partial harmonization. The executive pay reform agenda, for example, includes a Recommendation on the creation, form, and composition of remuneration committees, in response to the conflicts of interest generated by pay setting, which is designed to accommodate national governance regimes and operate on a “comply or explain” basis. The Commission may have grounds for being somewhat sanguine as to the market reaction to its Action Plan. While the Action Plan was produced after the publication of this book, almost two thirds of survey respondents believed that partial harmonization would occur, while more than 80% encouraged the Commission to take action in this area. Academic opinion is more divided on the merits of harmonization over competition, as is clear from chapter four’s survey of the literature on harmonization. In terms of the content of the Action Plan, more than 70% of respondents considered that any EU action should address basic principles of accountability and fiduciary duties of directors, minimal levels of disclosure

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7 Although the Commission notes that “some” of the reforms “are considered to be usefully applicable to non listed companies.” Note 5, para. 2.1.

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and transparency, and integrity and ethical behaviour, all of which are addressed in the Plan, albeit to different degrees. Readers seeking to examine the implications of the Commission’s first considered foray into corporate governance in the Action Plan will find this chapter particularly thought-provoking: not least among the surprises is the view of one third of respondents that a European Securities and Exchange Commission would enhance enforcement and address the perceived comparative advantage of the USA in enforcement.

Chapter five moves away from the predominantly empirical discussion to propose a thoughtful and engaging framework to deepen and widen the corporate governance debate. In particular, the authors call for the debate to move beyond traditional financial corporate governance, which typically focuses on risk management and shareholder value, to encompass socially responsible governance. They predict that, if the 1990s were the decade of the shareholder, the 21st century will, in its first decade, see stakeholders emerging as claimants on corporate governance, in a reflection of the position in many continental European countries. Socially responsible governance is defined in terms of the firm as a long-term partnership of shareholders and other stakeholders in which shareholders become shared value holders. Reflecting a theme which emerged in chapter four with respect to the role of corporate governance in non-listed companies, a range of potential models of analysis are also considered. At the core of the analysis is the principle that different firm characteristics (ownership structures and types of shareholder, for example) determine the particular conflicts of interests or agency problems for which governance recommendations are required. The nuanced analysis first considers the governance problems raised by three more traditional models: private family-owned businesses; concentrated ownership with controlling blockholders; and autonomous firms in which management enjoys a strong position, either as a result of dispersed ownership and one share one vote (as in the classic Berle-Means company) or, by contrast, as a result of non-voting share systems (as in the Netherlands). The authors expand the framework, however, to include more recent (albeit already under discussion) governance models. These include the Silicon Valley model which addresses network-based firms characterized by a lack of arms’ length financing and interlocking governance roles (as experienced by, for example, the venture capitalist). The Institutional Investor Capitalism model, by contrast, examines the particular agency problems raised within institutional investors with respect to conflicts of interest and the control bias. Taking a somewhat maximalist view of governance, the authors go on to suggest that the sphere of application of governance principles should not be limited to the corporate/business world but extend to appropriately tailored rules which address the management of the specific conflicts of interest and the control bias problems in, for example, governmental enterprises, supranational bodies, and non-governmental organizations. This argument, which is a natural
extension of their previously expressed view of governance as reflecting the particular problems raised by the specific characteristics of different types of firms, becomes particularly appealing in the light of the extent to which bodies such as the OECD, the Commission, the SEC and other public regulators are shaping the corporate governance reform process. Their conclusion that the governance debate should be repositioned, given that focusing on the financial corporate governance of the Berle-Means firms’ is not useful to the rich pallet of business and other organizations” and ultimately inefficient, is compelling. Finally, chapter 5 considers the enforcement and monitoring problem and specifically the merits of self regulation, which the authors support when buttressed with effective monitors, such as the securities markets and, less securely, institutional investor activism. They devote considerable space to the divided academic opinion and more positive industry experience (such as the “CalPERS effect”) of the institutional investor as monitor, but remain unconvinced as to the extent to which there is a link between shareholder activism and good corporate governance. They make the pragmatic assessment, however, that “as long as the business world in general and institutional investors more specifically believe in such a positive relationship, they will have the last word.” The final chapters 6 and 7 summarize and conclude the discussion. A number of appendices provide a mine of useful information, including an examination of shareholders rights and protections across the world (Appendix 3), a discussion of the Lamfalussy Report (Appendix 5), a table examining announced hostile corporate take-overs (Appendix 8), and the OECD Principles for Multinational Enterprises (Appendix 9).

Overall, allowing for some minor infelicities of language, this is a thought-provoking read which combines empirical analysis with comprehensive reviews of the relevant literature and considered analysis. It will be particularly useful for those seeking a primer to the problem of corporate governance convergence, given its consolidation of a wide range of materials and literature, but it also sets out an insightful agenda for future discussion. That the book is in some areas, notably with respect to the adoption of the Commission’s Company Law Action Plan, overtaken by events does not diminish its usefulness: rather it allows the reader to place recent developments more fully in context. It is recommended as a timely addition to the corporate governance literature.


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Book Review


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Open source and free software, like GNU/Linux, Apache and MySQL, is not only a challenge for the traditional software industry but also for economic and legal research. The questions raised by this phenomenon are complicated from a twofold point of view. Firstly, the characteristics of open source software development and distribution are different from those of the ordinary software business; they are not familiar to our eyes. Therefore, further research has to be done with regard to the facts. Secondly, the underlying economic and legal questions have to be answered. What is the motivation of free software developers and businesses to contribute source code to these programs? What are the ways of distribution? How are open source communities organised? What are the characteristics of the underlying software licenses? Are these licenses valid in the US and European legal systems and can they be enforced?

Van Wendel de Joode, De Bruijn and Van Eeten, researchers of the Faculty of Technology, Policy and Management of the University of Delft, tackle most of these questions. Their study is the economic part of the Dutch National Program for Information Technology and Law (ITeR). The Institute for Information Law (IViR) of the University of Amsterdam is conducting research on the legal status of the free software licenses that is also part of the ITeR program. It is therefore not surprising that the book reviewed here mainly gives an economist’s answers to the questions raised. It does not provide a detailed analysis of the legal problems of free software licenses.¹ Nevertheless, this book is to be recommended to jurists, because it contains a broad selection of first-hand information taken from interviews with some of the main players of the open source community.

The first chapter describes the basic characteristics of open source and free

software communities. Unfortunately, the study focuses only on free software that was *originally developed* by communities like GNU/Linux. However, the open source phenomenon is a broader one. Some of the best-known and most common open source programs, like the Mozilla web browser and the Open Office office package, were not developed by communities but by companies. They were first distributed like ordinary ‘proprietary’ software and were later given away ‘free’ under a free software license because the market for those programs broke down. The historical development and characteristics of these examples differ in a substantial way from the ‘pure’ community programs. The copyright of ‘pure’ community programs is owned by a widespread and sometimes not very well-organised community. Here, the development is done and paid for by independent programmers and interested professional contributors. Programs initially developed by companies are owned mainly by them, except for smaller portions of source code that are contributed by the community. In these cases, a single company initiates and often continues spending resources on the ongoing process of software engineering. These companies contribute to the open source communities by maintaining free projects. It would have been interesting to compare these two models.

Nevertheless, this chapter provides a valuable survey of the historical development, communities and characteristics of free software. The two main subsections on communities (1.4 and 1.5), on roles in open source and free software communities and on distributed ownership and control are of particular interest for the legal debate. The authors clearly show the extent and the limits of centralised control in open source communities. Although communities generally have ‘maintainers’ that control the database in which the ‘official’ release of a program is stored and sometimes control the trademark of the software, the power of these maintainers is limited. The maintainers might have the authority to make decisions concerning the official releases, but they cannot tell the developers what to do. The ordinary community member does not have any duties. Contribution to the project is voluntary. Legal scholars who aim to describe open source communities in terms of corporate law have to consider these internal structures of free software communities.

The second chapter gives an interpretation of open source communities with regard to the economic theory of public goods (sections 2.2 and 2.3). The user’s needs and the contributor’s benefits in relation to free software development can be perfectly interpreted by economic theory. The following sections (2.4 and 2.5) provide an economic analysis of the nature of innovation in general and the mechanism of innovation in open source communities in particular. These sections are of special interest in relation to the economic analysis of intellectual property rights. Intellectual property rights in the field of information technology are usually justified on the basis of their positive impact on innovation. It is obvious that the high innovative potential of open source communities raises a serious challenge to this classic justification. Van Wendel
de Joode et al. conclude that open source communities do not use a ‘rational approach’ in creating innovation; rather, they are based on a unique constellation of mechanisms that ensure an ongoing process of ‘variation and selection’.

Chapter 3 gives an introduction to US and European copyright and patent law and examines the underlying common principles and different approaches. Legal scholars with a specialisation in intellectual property rights will find little new in this chapter. The survey given is nevertheless useful as a largely reliable introduction. It is obvious that such a general introduction cannot explain all the details of the varying European and US copyright and patent systems. However, some of the authors’ statements need further clarification. To give an example, it is not true that all European copyright systems allow the contribution of copyrighted works to the public domain as long as the moral rights are excluded from this waiver. Most continental countries like Germany and France deny the validity of such extensive assignments. Besides the moral rights, there are other parts of the droit d’auteur that cannot be waived. This fact is not only interesting from a theoretical point of view, but also from a practical one. Under the US copyright system, the exploitation of intellectual property by assignments and licenses is founded on the principle of freedom of contract. In contrast, the (continental) European copyright systems are based on the idea of paternalism: their aim is to protect the author. This difference causes a number of serious legal problems for open source licenses in Europe.

Chapter 4 describes mechanisms to protect the commons. Section 4.2 examines the characteristics of the BSD license, which is used for Berkeley Software Distribution, and the GNU General Public License (GPL), which is used for the development and distribution of the GNU/Linux operating system. Here, once again, the authors’ selection provokes questions. It is true that these licenses are two of the most popular open source licenses. The BSD license does not restrict the user in case of modifications. In other words, the licensee may distribute modified versions of the software under a license of his own choosing. He is also free to transform the licensed product into proprietary software. The GPL is more restrictive. Under the terms of this license, the licensee must distribute the modified software under the same license terms as the software originally acquired. Section 2 (b) of the GPL states: ‘You must cause any work that you distribute or publish, that in whole or in part contains or is derived from the Program or any part thereof, to be licensed as a whole at no charge to all third parties under the terms of this License.’ Conditions like these are called ‘copyleft’ clauses. These clauses provoke a crucial question for businesses: when does the combination of a ‘copyleft’ program with the business’s own software create a single program falling within the scope of Section 2 (b) of the GPL, and when it is merely an aggregation of two given programs? The GPL is not very clear on this point. Other software licenses, like the Mozilla Public License, are more tolerant towards the combination of software under different licenses. In order to give a representative survey, the Mozilla Public
License should have at least been described as the third basic type of free software license.\(^2\)

The subsection on the future GPL version 3.0 is of particular interest. The authors took this opportunity to conduct an interview with Bradley Kuhn, an official from the Free Software Foundation. On the one hand, it is interesting to see that the free software community is trying to adopt its licenses to new technical possibilities, such as web applications. On the other hand, it is alarming that there seems to be no vision regarding the internationalisation of the license policy. Free software licenses like the GPL were written by US lawyers with a US legal background. When they were written, nobody could have expected the rise of world-wide communities. Today, the licenses pose a lot of legal problems in European and other legal systems, especially with regard to copyright and contract law. The open source communities should take this challenge more seriously.

The study continues with a survey of the organisations behind the free software communities (‘beachheads’), especially the Free Software Foundation (FSF) and the Open Source Initiative. It is to be regretted that the authors obviously did not talk to the FSF Europe, which was founded in 2001 as an official sister organisation of the North American FSF. That would have helped to provide a more ‘multilateral’ view of the issue. Nevertheless, the subsection contains a lot of interesting details about the work of these organisations.

It is obvious that open source software is today not only developed and distributed by altruists but also by businesses. Chapter 5 therefore examines a number of business models based on free software (‘hybrid business strategies’). The chapter focuses on software development for the specific needs of customers and the method of dual licensing. Unfortunately, the most common business model based on free software is missing from the survey. A lot of small and medium-sized enterprises are earning money from all kinds of services linked to GNU/Linux and other open source programs, such as migration to open source products, support services (e.g. hotlines) and consulting.

The last chapter gives a summary of the results and some concluding remarks on the role of governments. The authors plead for a balance of ‘proprietary’ and open source software strategies. Governments should ensure that software continues to be developed in both communities and companies. The authors deserve support for these results. It would have been interesting to read the authors’ opinion on the German situation. The new German Urhebervertragsrecht (copyright contract law) contains a special exception concerning the intellectual commons in Section 32(3)(2) of the German

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\(^2\) For a systematic list of open source licenses, see <http://www.ifross.de/ifross_html/lizenzcenter-en.html>.\footnote{For a systematic list of open source licenses, see <http://www.ifross.de/ifross_html/lizenzcenter-en.html>.}
Copyright Act. It thus appears that some governments are ready to assume the role that is required of them.

To sum up, it can be said that the authors give a very useful survey of the structures and characteristics of open source communities. Despite the critical remarks, this book is recommended to all economists and legal scholars who wish to deepen their knowledge in this field. It can also be recommended to government officials working on public policy in the field of information technology.

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