LUND UNIVERSITY

CORPORATE GOVERNANCE IN AN ENLARGED EUROPEAN UNION:

BUSINESS GROUPS CREATING INSTITUTIONAL CERTAINTY AND EFFICIENCY*

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Abstract

The textbook version and the western ideology of a corporation are an autonomous corporation surrounded by markets. This is truly an Anglo-American phenomenon. Continental and Northern Europe have a widespread use of constellations of dependent corporations, here termed business groups. When Eastern Europe turns 180 degrees, orienting themselves towards the European Union and towards capitalism, they have to construct their own institutions of capitalism through cruising between economic facts and economic ideology. This paper will: 1. Argue that institutions are created in a process of formal and informal institutionalisation, 2. Argue that there are two main institutional systems of corporate governance, the European-Asian Business Groups system and the Anglo-American Autonomous Corporation system, 3. Define the concept of Business Groups, 4. Show the presence of Business Groups in a selection of Western Europe countries, 5. Present four hypotheses explaining the existence of the Business Group, and finally, 6. Use the hypotheses to show that it is likely that business groups will appear, and that they will be efficient organisations in the Eastern European economies, with a special reference to Poland and the Check Republic. It is concluded that there are to be less condemnation of business groups, but more understanding where they are viable organisations, what the prerequisites for their utilisation is and what regulations, if any, that is needed.

- First draft (990406), be indulgent, but please let me know of your criticism -

* The work this paper represents was partially funded by The Swedish Council for Research in Humanities and Social Sciences, and The Bank of Sweden Tercentenary Foundation. Ivana Cesljas provided helpful comments.

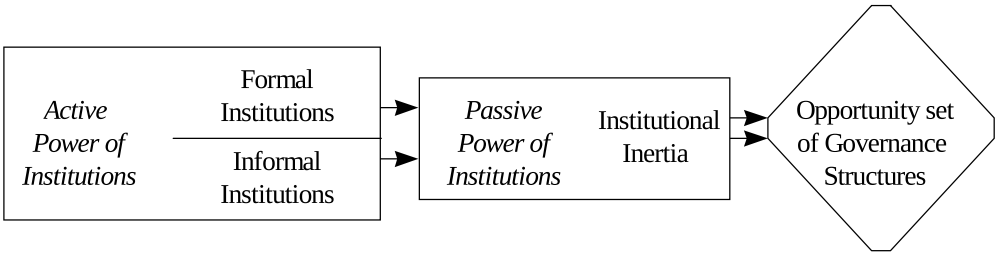
1. Resource Intermediation, Governance Diversity and Institutional Uncertainty

Resources have to be intermediated from their sources to their productive use. The economy is offering a diverse set of governance structures to accomplish this task. Researchers have systemised the diverse set in mainly two structures, the market and the hierarchy. The Market, mainly defined and researched in the field of economics, consists of autonomous parties, relating each other through bargaining and co-ordinating their actions through exhaustive contracts. The Hierarchy, mainly defined and investigated in the field of organisation theory, consists of non-autonomous parties, relating to each other through authority and co-ordinating their efforts through the command. These two forms have been noticed to not fully exhaust the diversity in the economy. On the contrary, even Williamson (1996), one of the main advocates for the polar distinction of market and hierarchies, have been arguing for a conceptual extension, entitled the swollen middle, or distinguished as a conceptual separate third form, entitled the hybrid. Many attempts have been made to conceptualise the third form, some reviewed in Collin (1993a). It is sufficient for the argument here to notice that the third form of intermediation of resources in the economy, termed the Brotherhood (Collin, 1993a) or the Clan (Ouchi, 1980) involves parties that are dealing with so complex resources that the autonomy of the parties have to be high, the relation between the parties therefor needs trust, and the co-ordination between them will be based on ideology, that is, a shared system of norms and values.

With the transition of the state governed economies in Eastern Europe, the main methods of privatisation appear to have been following the line of market or hierarchy. Czechoslovakia, and later the Czech Republic preferred a radical market orientation, and Poland were oriented towards hierarchy, with state involvement (Coffee, 1998). The possibilities of privatisation through organisations that are based on the nebulous principles of the brotherhood have not been considered. Yet, this is what appears to have emerged in the two transitional economies. In the Czech Republic the main banks of the Republic control the largest funds owing the majority of the privatised corporations. On top of this concentration, the banks themselves were privatised, with the result that the largest actors, the banks, entered as owners, i.e., a cross ownership structure emerged between the major banks (Coffee, 1998). Poland selected a more state governed road, creating 15 National Investment Funds, partly owned by the state and partly by private owners, which gained ownership of more than 500 medium-sized corporations. In both cases it appears that the results have been a financial system less dependent on market control, than on control through organisations and systems of organisations, be it conglomerates, holdings companies or large investment funds. Apparently, what emerge are constellations of ownership and resource exchanges that approach the conceptual content of brotherhood transactions and business groups organisations.

Facing institutional uncertainty, which is the very meaning of transitional economies where liberalisation, privatisation and political reorganisation occur, actors are engaged in institutionalisation. The state tries to impose restrictions, i.e., creating formal institutions, and the actors create organisational responses on the uncertainty and the formal institutions, with help of their innovativness and traditions, i.e., they utilise and shape informal institutions. This way of perceiving the economic system is inspired by Lubatkin, Lane, Collin & Very (1999). They argue that there is a case for governance diversity since every country and every cultural field has different sets of possible governance structures available to it. These opportunity sets (figure 1.) of governance structures are created by the influence of both formal and informal institutions and the supply of the sets is made stable through the character of institutions being inert.

FIGURE 1.
CORPORATE GOVERNANCE DIVERSITY



To state it differently, institutions influence human behaviour and, thus, structure the possibilities for human action through an active power that is based on formal institutions such as the law, and informal institutions, such as the culture. This influence is mediated through the passive power of institutions, termed institutional inertia, which is none other than the taken-for-granted nature of institutions and the investment character of institutions.

Institutions have the important function of creating predictability for human actions. Humans tend to assume that what exists today, will exist tomorrow. This is the taken-for-granted character of institutions. Many rules and norms obeyed by individuals are not reappraised each time they are followed. Indeed, it would be very unpractical and time-consuming if every individual action had to be performed according to the rationalistic model of decision making, i.e. its premises and consequences had to be thoroughly checked and compared to every possible alternative. Hence, most actions are performed by unconsciously applying rules, which makes it possible for us to devote our time and energy to matters in our surroundings that are more important.

Additionally, institutions have a long-term investment character, one of it being that they earn trustworthiness through time. Without this trustworthiness, institutions could not be relied on nor could they be expected to produce predictable behaviour. Trustworthiness of institutions together with their taken-for-granted character constitutes institutional inertia.

To summarise, institutions shape the behaviour of humans in order to make the world more predictable, to economise on energy and to safeguard investments. They represent investments in social predictability and tend therefor to change slowly. They have formal representations, such as the law, and informal representation, such as culture. Institutions shape the opportunity set of available governance structures.

It can thus be stated that the transitional economies face high levels of institutional uncertainty, that the state reshape the formal institutions and the actors in the economy acts upon informal institutions, but that the intended development is hampered by institutional inertia. One of the outcomes of this process is the emergence of organisations similar to the capitalistic business groups. In fact, as will be argued in the next section, this could not create a surprise, since this is the very dominating way of organising a capitalistic economy, at least, the sector of big business.

2. A Corporate Governance System of European-Asian Business Groups or of Anglo-American Autonomous Corporations

In studying corporate governance, it is useful to distinguish between an economic system consisting of autonomous corporations and a system consisting of business groups where many large corporations are joined together to form a constellation of corporations. This part of the paper is devoted to make the distinction between these two economic systems, the autonomous corporation system abbreviated as ACS, and the Business Group system abbreviated as BGS.

In a situation where the autonomous corporation is the basic unit of economic organisation, that is, in ACS, each corporation is an autonomous entity quite independent of its external stakeholders. Anonymous financiers in a volatile market for equity and debt, thus, confront it. The main arena of control for such a corporation is the stock market and it relies on strong external markets for managerial labour. The organisation of a large independent corporation is formed as multi-divisional, and it has boards that are quite independent of the shareholders and other major stakeholders, such as the suppliers and the employees. These corporations are situated in systems characterised by strong financial markets, small governmental direct intervention and a competitive culture.

In contrast, dependent corporations are prevalent in BGS, where the financial markets are weak, government direct intervention is strong, and there is a rather co-operative or authoritarian culture. Corporations tend to belong to a business group and depend on the group for the supply of its board directors. The arena for corporate control is a social arena where public, hostile take-overs are rare and negotiated bids dominate. Furthermore, such group corporations depend on internal markets for managerial labour, and their boards are representative of various stakeholders and not just the owners of the shares or the management.

The BGS consists of two distinct subsets, namely, the Germanic and Latin BGS (cf. de Jong, 1991). These two subsets differ mainly with respect to the degree of government intervention and board representation. In the Germanic subset the role of government is fairly passive whilst in the Latin subset the government exerts an active role through state ownership. As far as board representation is concerned corporations in the Germanic subset are especially open to the employees' participation whilst their counterparts in the Latin subsystem are mainly preoccupied with their major stake holders, namely the family.

The Autonomous Corporation System is mainly to be found in the US and the UK, whilst the Germanic BGS subset is dominant in Germany and Japan, and the Latin subset is prevalent in Italy, France, and South Korea. They have emerged as different systems influenced by many factors, among them the formal part is the legal system, and the informal part is the financial system and the culture of the country.

The mode of financing of each of these different systems of corporations is characteristic of the way they have been organised. The financing of the corporations, apart from retention’s, which is the dominating mode in every system, is performed through markets in the ACS. This contributes to the arm-length character of both the financial system and of its system for corporate governance. This arm-length character is enforced by the legal system. It promotes accounting rules governed by the principle of true and fair view, i.e., an emphasis on the information content of the accounting system, which is imperative to shareholders and other stakeholders who are positioned far from the corporation. In the ACS, the legal system discourages ownership concentration through legal restrictions on ownership by banks and other financial corporations. It, thus, contributes to the centrifugal force that puts the corporation at an arm-length distance from its shareholders.

The financing of corporations in BGS is an internal matter, in which the group in the Latin system and the banks in the Germanic system are the suppliers and allocaters of financial funds. In the Germanic system banks acts as intermediaries, functioning as the contributor or the organiser of the loans. Thus, when numbers show how little banks contribute to corporations, the whole story is not told. What is missing from these numbers is the amount of loans organised by banks and the value of financial services they provide. The central role the bank play in financing corporations is the reason why the business group system has sometimes been termed a bank system (Berglöv, 1990). But the flaw in this terminology is that it creates an image of the banks as being the major financiers of corporations. This is wrong. A more accurate description is that banks play a central role but only as intermediaries and as suppliers of services. But this is applicable to countries such as Germany and Japan where the Germanic system of corporate governance is in place. In the Latin system, notably found in Italy, financing of corporations tends to occur through the transfer of credits inside the business group. There are no banks playing an intermediate role, but the group functions as an organisation, by collecting and allocating capital to member corporations – which is a quite similar function as the internal capital market in the conglomerate of the ACS.

The close connection of corporations to a financial organisation in the Germanic BGS, and the pivotal role of the business group in transferring capital in the Latin BGS, creates ties of kindredness. This is not discouraged by the legal system that lacks statutory provisions proscribing the development of such close ties and their consequent concentration of ownership. On the contrary, government is active in promoting the development of business groups and fostering close ties between corporations. In Japan, the state has played an active role in certain sectors, for example, in organising technological development. Government intervention in financing Chaebols and in promoting their development through subsidised loans has recently been highlighted and offered as an explanation for the 1998 crisis in South Korea.

The field of culture which breeds three distinctive cultures, namely the competitive, co-operative and authoritarian, could also be considered to be one factor fostering different governance systems (Hofstede, 1980). The competitive feature of the Anglo-American cultural field fits well with the arm-length competitive governance system in the UK and the USA. The culture of co-operation in Germany and Japan is in tune with the Germanic type of governance. Lastly, the authoritative cultural feature of such countries as Italy and South Korea appears to go well with their Latin systems of governance. This is not to argue that culture is the cause for creating different systems of governance. Our model of institutional influence makes it clear that culture is only one of the several factors furnishing the grounds for the emergence of a set of possible governance structures.

Thus, we have indicated that there is a distinction, mainly between ACS and BGS. We now elaborate the definition of a business group since they are considered to be important in the BGS, and because we need a prior understanding of Business Groups before we enter more deeply in some European countries experience of business groups.

3. Business Groups defined

Business groups (BGs) can be defined as legally independent firms that are joined together by some mechanism, mainly equity ownership, and co-ordinate their use of one or several resources, such as financial resources and managerial labour (Collin, 1998). The firms involved are legally independent and have typically several shareholders. The communion of firms in BGs is created by the sharing of resources and by common ownership. The sharing and co-ordination of resources distinguish BGs from simple market and hierarchy transactions, thus representing a third ideal-typical governance structure. It is an interorganisational form, though quite different from such types of interorganisational co-operation as joint ventures where organisations involved share resources through an independent organisation.

Business groups exist in developed economies, such as Germany, and also in small developed economies such as The Netherlands. They exist in developing economies such as South Korea and in transitional economies such as Poland. They appear to be important organisations in the countries where they are found and they typically organise the sector of big business. They are informal organisations, and they are not legally recognised or regulated by state governments through legislation (Brioschi, Buzzacchi, & Colombo, 1989).

The business groups differ, however, when it concerns the form of ownership ties, the degree of diversification of operations and the organisation of their capital supply. The form of ownership ties between firms in a business group can be described as being either spherical or pyramidal. Spherical groups are characterised by cross-ownership where group firms have equity shares in the other firms, implying that a controlling position can only be achieved through the aggregation of all of the equity holdings of firms belonging to it. The horizontal Keiretsu in Japan is an example of spherical business groups. In pyramidal groups, in contrast, one or a few corporations have a controlling interest in several firms, which in turn have controlling interests in other firms of the group. This form of business groups can be observed in Chaebols in South Korea. The degree of diversification, i.e., the number of businesses in which the group is involved, can be very high as for most spherical groups. But there are cases in which diversification is low as it is for some of the pyramidal groups in Japan, South Korea and Taiwan. The organisation of capital supply, which constitute one of the main explanations for the existence of business groups in the first place, seems to be important for many business groups, and there are a variety of mechanism, the Haus-bank in Germany and internal transfers in Italy

To summarise, Business Groups are constellations of legally independent firms joined together by some mechanism, especially equity ownership, co-ordinating one or several resources. The groups can be either pyramidal or spherical. They differ in their degree of diversification and use either a main bank or an internal fund allocation mechanism for the supply of capital.

4. Business Groups in some Western European countries

We now turn to a selection of European countries and present the occurrence of business groups as found in the literature. The emphasis is on Europe since the transitional countries of eastern Europe share some history and some cultural features with the western Europeans, which the Asian countries does not. The different countries has been forced into the category of either Germanic or Latin BGS, which, as with all categorisations, is a simplification.

BUSINESS GROUPS IN THE GERMANIC BGS

Germany: Bank groups

Germany has been known to have a high level of co-operation between their corporations, sometimes termed as cartels, sometimes as bank groups. The state government added to the economic systems co-operative character through promoting cartels, offering protection for many of the national industries, and through promoting national industry through investments in infrastructure (Lash & Urry, 1987). Cartels between private corporations combined with a promotive and protectionist state have rendered the German system the characterisation of being a system of 'organised capitalism'.

One of the basic explanations to this co-operative system has been that strong banks infused co-operation between the industrial corporations as a way of avoiding profit-decreasing competition at the home market, and to increase the competitive capabilities of the corporations at the world market. Germany was late industrialised with a small home market, inducing the corporations to engage in world competition. Engaged in industries with enormous demand on capital made the corporations dependent on external capital sources. These sources were not found in capital markets, but in capital organisations, such as banks. A low level of integration between the different Länders promoted a financial system based on organisations instead of markets, making the financial system mainly bank-oriented. Thus, a strong but an asymmetric dependency relationship emerged between all-encompassing banks, i.e., universal banks, and corporations engaged in heavy industries. The banks, despite the fact that they were large in size, were significantly exposed to the large corporations risk since the banks loans and investments were so large. Opportunities to decrease the investment risk were therefor utilised, such as stimulating the corporations to engage in cartels.

Hilferding (1910) was one prominent writer that stated the hypothesis of the construction of bank groups due to the bank interest in stable monopoly profits. This financial state, where industrial and bank capital was merged in the interest of the banks, where termed the Financial Capital. Chandler (1990) echoed that hypothesis: "*Because the banks invested in a number of firms, they normally preferred cooperation to competition, particularly when competition abroad often promoted cooperation at home.* (Chandler, 1990:427). The hypothesis has been questioned to what extent the banks played a decisive role in the different industries and whether there were monopoly profit motives to the cartels (Lash & Urry, 1987). What is indisputable is, however, that banks have been central in the development of the large corporations in Germany.

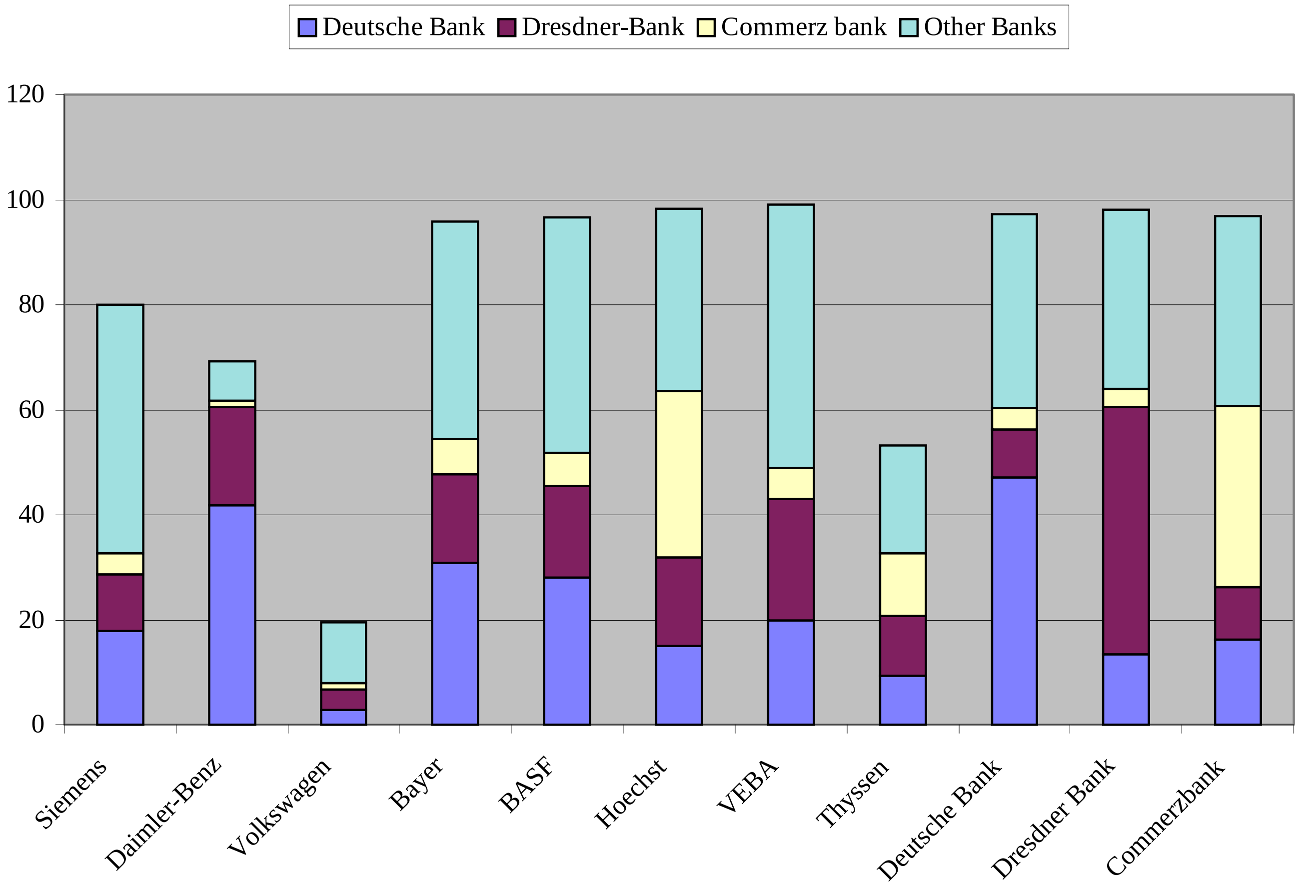
The system of organised capitalism being created in the beginning of the 20-century, it is surprising to find a very similar structure at the end of the century. The financial system in Germany is still bank-oriented with strong ties between the industrial corporations and the large banks. The share markets of Germany, although having a high turnover, represents a small part of the national capital. The pension funds, so important in Anglo-American countries, for example their assets representing 35% of GNP in USA, amounts to only 3% of the GNP in Germany (Thomas & Waring, 1995). The capital is instead locked into the corporations, making their solvency (equity/total capital) low. Charkham (1994) shows that the solvency 1988 for Japan firms was 19% (the debt-to-equity ratio= 4,19), for USA 49% (0,76), for UK 49% (1,03), and for German firms 19% (4,25) if provision is regarded as debt, and 40% (1,52) if it is regarded as equity.

The banks have retained their central position in the web of large corporations during the 80s. Figure 2. indicate that the three big banks at the middle of 1980 had the potential capacity to strongly influence the corporations through their control of voting right.

FIGURE 2.

THE DISTRIBUTION OF VOTING RIGHTS PRESENT AT SHARE HOLDER MEETING 1986

Data from Baums, 1993, which got it from Gottschalk, 1988. Per cent of shares (of those present at the shareholder meeting) voted by the three major banks and other banks of West Germany 1986.



The figure shows clearly that when voting rights are important, that is, at the shareholder meeting, they are represented by the banks. This does not imply that the banks are large shareholders. It only shows that banks, especially the large ones, collect voting rights through ownership or through proxy. It does not necessarily indicate autocratic power. Decisions at shareholder meetings, especially in co-operative systems, seems to be characterised by negotiations and decisions before the point in time when the decision has to be made, presenting the shareholder meeting decision as an act of ratification or a simple acknowledgement of previously made decisions. Thus, the data could be interpreted as representing a system in which banks are the leaders, the very central authority of decisions.

But it could also be interpreted as Cassis (1997) has expressed it, that the banks have created ‘communities of interests.’

It is commonly understood that the corporations, although having many links to many banks, one bank is the most important bank for the corporation. This bank tend to appear most frequently on contracts dealing with credit and service, but it has, by all means, no monopoly position. This is the system of Haus-bank, found in other countries where the credit markets are small. The Haus-bank system does not restrict corporations to a single bank, but as the diagram of voting shares indicate, several banks can be engaged in one corporation, but there is one bank that is the main bank, the Haus-bank. Thus, the web of relationships can be very complex, but there are condensations around banks, making it quite reasonably to term the German business groups for bank groups. One has, however, to very strongly remind users of the term that the term does not give any indication, what so ever, of power. It does not connote that banks are powerful, only that they are central in the German business group system.

One indication of the community of interest is the system of interlocking directorships. In Germany, large corporation have to have a two tier board structure, an Aufsichtsrat, with members appointed by the shareholders and the employees and their organisations, and the Vorstand, which is the management board mainly crewed by insiders, i.e., people employed by the corporation. An investigation from 1990 (Charkman, 1994) showed that the eight largest corporations in Germany (Daimler Benz, Siemens, Volkswagen, Hoechst, BASF, Bosch, Bayer and Thyssen) had rather intense board relationships with the hundred largest corporations, on average connected with at least 20 of 100 corporations through board memberships. Thus, the corporations are not exclusively connected to banks, but to other industrial corporations as well.

These communities of interest, here termed bank groups, imply that the German arena for corporate control contests is not a market, but a social arena. At this arena, there is no such thing as a hostile take-over, but hostile stake accumulation (Jenkinson & Ljungqvist, 1996) which ends in a negotiation of control transfer, presumably with banks engaged in the process. Thus, there can be many and large take-overs, but not with the drama as the market for corporate control can offer.

The data on the business groups of Germany is meagre. Those presented here indicate the presence of bank groups were banks are central parties, providing webs of communication, and credit and financial service facilities.

The Netherlands: Holding Companies

The Netherlands has been a truly internationally oriented country, with large colonial interest. The capital from these activities was transformed into industrial capital. Thus, contrary to the bank lead development in other Germanic countries such as Austria and Belgium, the industrial development in the Netherlands was financed by colonial capital (Stockman, Wasseur & Elsas, 1985). The international orientation is stressed by the fact that the Netherlands has large corporations with split ownership between owners situated in the Netherlands and in another countries, for example, Shell and Unilever with British capital and Estel with German capital.

In a network study, Stockman et al (1985) found that interlocks were formed between banks and insurance firms. No interlocks were found, however, between the banks or between the insurance firms. This indicates the existence of financial groups separated from each other.

Belgium: Holding Companies

The Belgian economy have been dominated in modern time by holding companies, and especially the corporation Société Générale de Belgique, which 1988 represented approximately 30% of the Belgium economy 1988 (Wymeersch, 1994). During the industrialisation in the 19th century two different kinds of groups emerged in Belgium (Kurgan-Van Hentenryk, 1997): Financial groups were created with banks in the centre; and Industrial groups emerged, based on family ownership. Ties between the financial groups and the industrial groups led to banks being engaged in long-term financing (Stockman, Wasseur & Elsas, 1985), with several banks facing severe financial difficulties as a consequence of the Big Crash at the end of 1920. This financial failure resulted in a law issued by the government in 1934 forbidding banks to own shares.

At present times, the holding company is very important as an organisational form. In 1992 there were 92 businesses registered as holding companies, representing a value amounting to 81 per cent of the total value of stocks traded on the Brussel stock exchange. (Wymeersch, 1994). The old legislation forbidding banks to engage in long-term financing of industry was abolished 1990, but it appears to not have changed any relationships between the banks, the financial groups, and the industrial groups. The groups are typically pyramidal in form, with transfers of personnel and capital, but lacking important intra-trade (Kurgan-Van Hentenryk, 1997). Many of the holding companies are highly diversified. For example, the enormous Société Générale de Belgique is engaged in eight business industries (Wymeersch, 1994). This structure is a result of a focusing strategy, where the new owner, Compagnie de Suez, has been engaged in sliming the corporation. Quite interesting to note is, contrary to many business groups, that the holding company of Société Générale de Belgique had no dominating owner. It made the company vulnerable to acquisitions and concentration of ownership power. Eventually, a French corporation appeared on the scene and got a major stake in the corporation. The connections to France is, however, not unimportant. Cobepa, for example, is a business group engaged in corporate development, but is a subsidiary to Paribas, one of the large France business groups.

The government was active during the end of the 1960s in engaging the private economy on the necessary restructuring of the economy during the recession. They especially issued regulations that were aimed at getting co-operative actions from the dominant holding companies. Today the regulations are abandoned. The governments action are today directed towards regulations fostering disclosure by the holding companies.

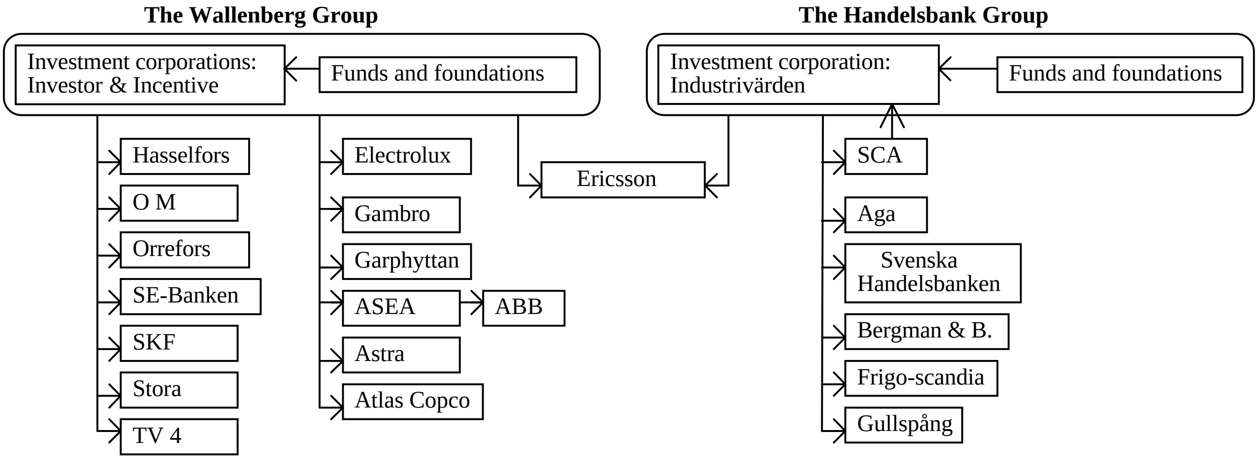
In sum, Belgium represents a small economy, with export oriented firms, having many pyramidal organised business groups which together dominates the economy, with an active government, recognising the companies, and during certain times, having ambitions to engage the groups in political affairs.

Sweden: From Bank Groups to Holding Companies

Two BGs dominate the Swedish industrial economy, each consisting of industrial and financial corporations connected through relations of ownership, interlocking directorates and financial service. The Wallenberg-group and the Handelsbank-group in some sense control corporations that in 1995 represented approximately 52 per cent of the stock value of all the corporations listed on the Stockholm stock exchange. The largest group is the Wallenberg group, controlling 39 per cent, while the Handelsbank group controls 13 per cent.

Both groups are very old, having come into existence during the depressed years in the 1920s and 1930s (Larsson, 1995; Sjögren, 1991), due partly to a number of dynamic financiers and to several financial failures that transferred large numbers of shares to the two major banks, and partly to the breakdown of confidence in the share markets that made it difficult for the banks to sell these shares. The groups have been centred around these two large banks, Stockholms Enskilda Bank in the case of the Wallenberg group and Svenska Handelsbanken in the case of the Handelsbank group, their main-bank or Haus-Bank (Berglöv & Sjögren, 1995) relations having been maintained.

FIGURE 3.
TWO SWEDISH BUSINESS GROUPS IN 1996*
(The arrows indicate share ownership. Only the major companies are included)



* Source: Sundqvist 1995

Most of the companies belonging to the one group or the other are large multinational corporations. Two of these, Stora (belonging to the Wallenberg group) and SCA (belonging to the Handelsbank group), utilise raw materials from the large forests in the northern and central parts of Sweden. Various others develop and utilise technical innovations, in particular Ericsson (telephones, a company split in its ownership between the two groups), Aga and Astra. For the year 1990, the non-domestic sales of the 20 largest corporations in the two groups were found to be 78 per cent (median: 82) and their non-domestic employees to represent 48 per cent (median: 57) of their working force.

The BGs have built up and organised corporations that are very large in size and very international in geographical scope. A comparison (available upon request) of corporations belonging to the two BGs with non-business-group corporations, which the present author carried out applying Anova and Scheffe tests to data from 70 corporations listed on the

Stockholm stock exchange in 1990, indicated corporations belonging to the two BGs to have significantly higher non-domestic sales and employment, and also to be larger in size, whether measured by sales, employment or share value, than the other corporations were. The BGs are thus highly diversified and international in their orientation.

The strong ties the member companies once had with the two banks have in part been replaced by strong ties with two investment corporations: Investor in the case of the Wallenberg group and Industrivärden in the case of the Handelsbank group. The Wallenberg group has been managed through control of several foundations and Investor until the 80s by the family heads of the Wallenberg clan, Jacob and Marcus Wallenberg, which since then have been superseded by the new family head, Peter Wallenberg, son of Marcus Wallenberg. These features make this group a pyramidal one. The Handelsbank group, in contrast, is a spherical group. It has no such ultimate capitalist as Mr. Wallenberg. Rather, it is much more nebulously based, cross ownership and historical relations playing a major role. In both groups, interlocking directorates form a closely-knit network, linking all the corporations involved. The members of the boards are generally not employed by the corporation in question.

These two BGs are distinct from one other. There is only one major corporation, namely Ericsson, that is shared by the two groups, each of which has an equal share of the votes and an equal number of directors on the company board. Each of the other major corporations in the two groups belongs to either the one group or the other but not to both. In a manner similar to the inclusion of the member corporations within a single group, those persons who link the corporations of the one business group through interlocking directorships do not have extensive relations with persons or corporations belonging to the other group. Thus, there are very few overlaps between the two BGs.

The persons at the board level in the groups have in most cases been in the respective group all their working life, although always in more than one corporation (Collin, 1993b). At the top management level, as well as further down the hierarchical ladder, the turnover is slightly higher, but even there it is quite common for persons to stick to the corporation or at least to the group (Collin, 1997). The BGs can thus be considered as forming an internal managerial labour market. In contrast to the vertical Keiretsus in Japan, the intercorporate trade seems to be very slight, probably due to the groups' diversified character.

In sum, the two BGs build strongly on ownership ties and interlocking directorates, the financial corporations serving as centres. There is an internal managerial labour market in each. The two groups organise the largest and most international corporations of Sweden and divide a considerable part of the Swedish industrial economy into two separate camps. One of the BGs is pyramidal and the other spherical. Both are highly diversified and have main-bank relationships.

BUSINESS GROUPS IN THE LATIN BGS

France

Industrial groups, defined as constellations of corporations where a parent corporation owns at least 50% of voting share capital, are numerous. Encaoua & Jacquemin (1982) found that of the 500 largest French companies, 319 companies (64%) were industrial groups. One should note, however, that financial groups are excluded from their sample, the reason being that they are not engaged in the operations of the companies. The 319 industrial groups accounted for 40% of industrial employment and 50% of value added. The size distribution of industrial groups is skewed since 55% of total group employment is contained within 28 of the groups. Using a data material from 1974, Encaoua & Jacquemin found that French industrial groups tend to dominate industries were there are economies of scale, intense R&D, high capital intensity and high export quota. The authors could not, however, find evidence of monopoly of collusion between groups.

Based on interlocking directorships, Swartz (1985) found that the most interlocked corporations were the two financial corporations, Suez and Paribas, based on the nationalisation of Suez respectively on an old bank. Thus, there appear to be two kinds of business groups in France, industry based and financially based groups.

Austria

Austrian listed corporations are not many, and the information of them are traditionally European, that is, limited. Jud (1994) have, however, found that many listed corporations were controlled by the state or by the two large banks. Creditanstalt-Bankverein (CA) has more than 50% of the share capital in 6 corporations and a strong minority interest (>10%) in 5 corporations. Z-Länderbank Bank Austria AG controls 2 corporations and has a minority stake in 7 corporations. The most important share holder is, however, the Republic of Austria, besides controlling interest in many listed corporations, owns 66% of CA and 25,9% of Bank Austria. To this share holding should be added the holding company containing nationalised corporations, named Holding Österreichische Industrieverwaltungs-AG (ÖIAG), with an share of employment in manufacturing industry amounting to 19% in the year 1981 (Ziegler, Reissner & Bender, 1985). The banks organising business groups of their own, but the state appears to organise, or at least, is capable of organising a national business group through its strong share holding positions.

The state has been influential in the private economy ever since the nationalisation of corporations and whole industries, such as banking, in the 30's and shortly after the Second world war.

The close links between Austria and Germany can be seen in the formal system of corporate governance, for example, they have the same co-determination system engaging the employees in the corporate control structure. Despite this influence, Austria has been mentioned here as belonging to the Latin system, due to the importance of the state.

Italy: Pyramidal Groups

Italy has pyramidal organised business groups, where only a few large groups are of vital importance. The groups have a function of financial intermediary, maybe being an effect of the arm-lengths relationship to the banks. The state is a very important shareholder in the Italian economy, with a business group of its own, a structure that was created after the Great Crash.

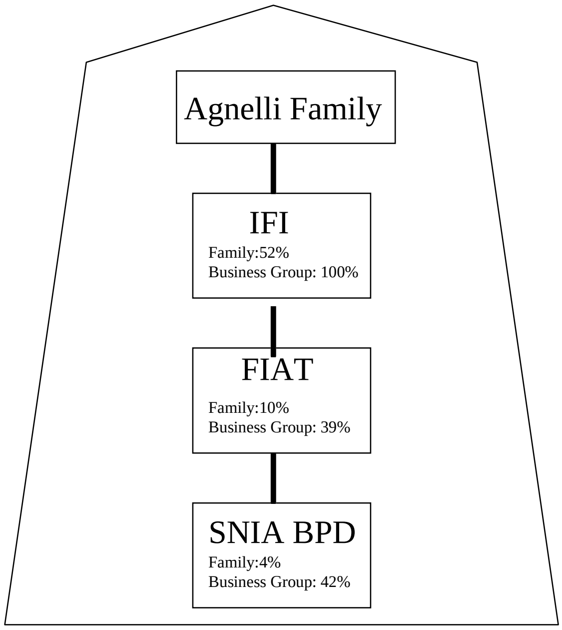
Italy has had strong business groups ever since the break down of the private economy during the time of the Great Crash. The banks and the industrial corporations were gathered into networks of corporate ownership before the Great Crash. In order to save the corporations after the Great Crash the state gained control of a majority of the large enterprises in Italy. Believing that the close relationship between the industrial corporations and the banks was not good for successful development, a law was issued 1936 forbidding ownership ties between the corporations and the banks.

The state became then heavily engaged in the industrial and financial corporations of Italy. According to Amatori (1997), on a list of state ownership of industrial property, Italy had the second position, after Soviet Union 1936. The state organised, for example, a holding company 1933, named IRI (Instituto di Ricostruzione Industriale, i.e., Institute for industrial reconstruction) with the aim of releasing the banks from their industrial share ownership. The had a specialised ‘Minister of State Shareholdings’, and the well known oil company, Agip, were owned by another state holding company, ENI, created in the 50s, which organised the state controlled energy sources. The engagement by the state in the manufacturing sector has not decreased during the years. On the contrary, according to Amatori (1997) IRI and ENI had respectively 6% and 2% of the manufacturing sales 1961, and had increased its share 1991 to 24% and to 15%, an impressive 40% share 1991 of all manufacture sales in Italy by state controlled corporations. While the classification of corporations always can be debated, whether they are state controlled or not, what is obvious, is that the state has important ownership interest in the economy.

Another aspect, more important here, is that the large corporations and many of the medium sized corporations belong to business groups. Brioschi, Buzzacchi & Colombo (1989) reports that of 202 quoted corporations at Italian stock exchanges, 76 corporations (38%) representing 74,3% of capitalisation, belonged to the five largest business groups. These are the Ifi-Fiat group, controlled by one of the last large capitalist families remaining in Europe, the Agnelli family, with its head Giovanni Agnelli; the IRI-group, which is the state controlled group; the Generali group, which is ….; the Montedison group, which is…; and the Cofide-Olivetti group, controlled by Carlo De Benedetti. Thus, the state and families are important owners in the Italian ownership structures.

The typical organisational form of the Italian business group is the pyramid. The controlling interest is focusing its share ownership at the top, in a few corporations. These corporations own shares in subordinated corporations, which, in their turn, have share ownership in subordinated corporations. Thus, a hierarchical ownership structure, involving minority owners at almost every level. The example of the Agnelli group (with data from Brioschi, Buzzacchi & Colombo (1989)) illustrate the pyramidal character of Italian business groups. In figure 4. three corporations on different levels in the Agnelli group are picked as representatives of the group. Family ownership and business group ownership shares are given for the three corporations. N the top, a hundred per cent controlling interest is present. It decreases down the hierarchy to around 40%, but the family ownership interest decreases sharply, to 10% respectively 4% ownership shares. As an expression of the diminishing share ownership by the controlling interest, one can calculate the share of family ownership of the total controlling ownership. For Ifi it is 52%, for Fiat it is 26% and for SNIA BPD it is 9%.

FIGURE 4.
THE PYRAMID CHARACTER OF THE AGNELLI GROUP BY THREE EXAMPLES



The different business groups are not separated, however, but linked together through small equity shares. For example (given by Brioschi, Buzzacchi & Colombo, 1989), Gemina, an Agneli group corporation, owns 5% of Pirelli & C, a corporation belonging to the Orlando group, which is a small group operating mainly in the copper industry, and Pirelli & C owns 2% of Gemina shares. The impression is that these ownership shares are not insignificant, especially not in smaller groups, and that they can be of some importance if control is contested.

Due to lack of empirical data, no certain statement can be made about the level of diversification. It appears, however, to be rather mix levels of diversification in the different business groups. Some, especially the large ones, appear to be rather highly diversified, and smaller ones appear to have less diversification level.

The business group can function as an internal capital market, as argued by Buzzacchi & Colombo (1996). They show indirectly that the ownership structure of corporations cannot solely be explained by factors such as industry, but needs the explanatory variable of business group. They found differences in ownership structures that could be explained by the fact that corporations were used as financial devices, drawing financial funds from the public and then redistribute it to corporations inside the group which demanded financial funds. Although lack of direct empirical proof, i.e., the very flow of financial resources between the business group corporations, it is feasible that in an economic system where banks are absent as dominating financiers, and now other important financial mediator is present, the business group becomes the financial intermediator.

5. Explaining Business Groups

In section 4 we found that business groups are quite frequent ways of organising the control and the supply of financial resources in European countries. This section is devoted to the task of formulating four hypothesis explaining the existence of BGs.

The existence of BG has almost exclusively been explained by their being a solution to problems associated with market inefficiency, such as capital shortage (Brioschi, Buzzacchi & Colombo, 1989; Buzzacchi & Colombo, 1996; Leff, 1978), absence of risk reduction possibilities (Brioschi, Buzzacchi & Colombo, 1989; Leff, 1978) and information asymmetry (Amsden & Hikino, 1991) all due to undeveloped capital markets. A more general explanation that has been offered focuses on the market's lack of reliability and the lack of trust in it, its being argued that BGs have the function of producing institutional stability and goodwill (Daems, 1978; Khanna & Palepu, 1996; Leff, 1978; Ponomarev, 1995). Less common are explanations to the effect that BGs are induced by state governments (Chang & Choi, 1988) or are based on privileged groups having access to state bureaucracy (Khanna & Palepu, 1996).

I have proposed a typology of hypotheses based on different organisational perspectives (Collin, 1998). The purpose has been to create a framework for hypotheses with the capacity to not only include the dominant view in the literature of BGs, i.e. the view which gives precedence to economic efficiency, but also to increase the explanatory breadth of this framework so that other types of efficiencies which also enhance the survival of organisations in general and BGs in particular could be studied too.

The typology (Table 1.) highlights how organisational theories, which explain the existence of organisations, can assume two important and different inclinations. The vertical dimension in the typology expresses different views on organisational efficiency, and the lateral dimension indicates different levels of analysis. The dimension of organisational efficiency is scaled to account for theories emphasising the importance of institutional efficiency for organisational survival, such as Neo-Weberian theories of organisations (Perrow, 1976), institutional theory (Pfeffer & Salancik, 1978), and the old institutional school (Veblen, 1923), and theories emphasising the importance of governance efficiency for organisational survival, such as transaction cost theory (Williamson, 1975; 1996). The level of analysis refers to whether the explanation focuses on the organisation and its discrete exchanges, or on the society at large in which the organisation is embedded (Granovetter, 1985).

TABLE 1.

FOUR HYPOTHESIS TO EXPLAIN THE EXISTENCE OF BUSINESS GROUPS

	Organisational level	**Societal level**
Institutional Efficiency	Power: *H1. Institutional inertia*	Isomorphism: *H2. Cultural fit*
Governance Efficiency	Corporate governance: *H3. Economic efficiency*	Governmental governance: *H4. Political efficiency*

Put together, these two dimensions create a framework where we can identify four different general hypotheses regarding the existence of organisations.

Institutional efficiency refers to the ability of an organisation to defend itself as an institution. It is accomplished at the organisational level through the capacity to be institutionally inert, and at the societal level by the propensity to be culturally fitted. The institutional inertia hypothesis (*H1.*) argues that organisations survive because they have the capacity to be institutionally inert through power, be it power applied through accumulated resources (Perrow, 1986), or power exerted due to the circumstance that many peoples wealth and habits depend on the organisations survival (cf. Veblen, 1923).

The cultural fit hypothesis (*H2.*) focuses on the norms and values at the societal level, and argues that organisations exist if they are regarded as being legitimate entities, which amounts to them being isomorphic with societal values (Pfeffer & Salancik, 1978). One can reason that BG is an organisational form that is largely a consequence of the culture in which it is embedded, making the national character of the country a variable explaining it. The cultural fit hypothesis, accordingly, states that business groups, assuming that they require a high level of co-operation and trust relationships for their efficient functioning, exist in countries where norms of co-operation, consensus and equality are prevalent.

Governance efficiency, as another type of organisational efficiency, refers to the capacity of an organisation to create value, and, thereby to survive at the organisational level by economic efficiency and at the societal level by political efficiency. The economic efficiency hypothesis (*H3.*) claims, in line with the premises of the transaction-cost economics (Williamson, 1975; 1996), that organisations survive if they are governed in accordance with the imperative of minimising transaction costs. This third hypothesis, in agreement with the bulk of the literature on BGs, concerns with the economic efficiency of corporate governance, and, the fact that corporations in a business group are economic organisations which are primarily involved in a variety of different markets, such as the product market, the labour market, the equity market, and the market for corporate control. The economic efficiency hypothesis, accordingly, considers the organisational form of a business group to be a consequence of the minimisation of transaction costs providing a solution to the corporate governance difficulties connected with measuring and monitoring the resources of credit capital and management labour. The political efficiency hypothesis (*H4.*) argues that an organisation could exist if it succeeds to create value either for the central government or a regional or a local authority. It assumes that national governments strive for manageability of the economy and this could be accomplished by establishing influence through maintaining contacts with a small number of highly influential actors. The political efficiency hypothesis is that business groups provide for the government manageability through a small number of core actors whose influence in business circles is very great.

Applied on the Swedish case, I evaluated the explanatory power of these four general hypotheses about the existence of organisations, all of which have been derived from the proposed typology whilst each retaining its distinct explanatory power based on different organisational theories (Collin, 1998). Using both qualitative and quantitative data and different analytical techniques, it could be showed that the Swedish BG could hardly be explained using the institutional inertia hypotheses, that the cultural fit hypotheses had a weak explanatory power, and that the economic and political efficiency hypothesis had a rather strong explanatory value. These results are mainly supporting the results from the literature indicating the importance of economic and political factors.

One has, however, to acknowledge that the cultural fit hypothesis is hard to evaluate using only one case. As indicated earlier, it is conceivable that culture has a bearing since it is a part of the informal institutional structure, and thereby influences the opportunity sets of governance structures.

6. Transitional Economies moving towards the European-Asian BG-system

This far we have showed that 1. The European-Asian corporations and corporate system differs from the Anglo-American system; 2. That one of these differences are the existence of Business Groups; 3. That there are at least two different kinds of BG systems in Europe, and finally 4. We have offered four hypotheses for the existence of business groups. In this section we will pay attention to the Czech Republic and Poland and explain their experience with the use of the papers arguments.

Reporters of the development in the Czech Republic and Poland have reported that the privatisation has led to large, more or less, bank controlled constellations of corporations (Campbell & Jerzemowska, 1998; Coffee, 1999). The growth of business groups in Poland has been acknowledged through a scientific conference, first in its kind, with a succeeding publication Romanowskiej, Trockiego & Wawrzyniaka, (1998). Indeed, there are signs that business groups will appear in these two countries, as there are signs of similar development in for example Russia (Freinkman, 1995; Petrenko, 1995; Ponomarev, 1995).

Some characteristics are more or less the same for these countries: Institutional transition through institutional dismantling and institutional creation, weak markets for capital and for managerial labour, weak governments, and severe resource scarcity. With reference to the hypothesis above, one can find some rational to the development of business groups.

- Institutional Inertia: The hypothesis express that an organisation that has experienced a period of success has built up resources making it possible for them to survive despite them being inefficient. In the case of Eastern Europe's corporations, this is hardly the case. On the contrary, many corporations appear to experience severe resource scarcity, in part due to the planning era where their production was guided by planners instructions and not market demands. They need to attract resources, such as risk capital and loan capital, and to attract professional managers capable of handling the new turbulent situation. Due to institutional uncertainty and due to low information capacity both on the corporate level with opaque accounting and on the stock market level with thin markets and a small business press, there are huge asymmetric information problems. The organisation, such as a business groups, can reduce the information problem slightly, but probably, more important, can offer a stronger incentive scheme aiming at co-operation. With these improvements better conditions for exchange of vulnerable resources, such as capital, has been established.

- Cultural fit: The hypothesis argues that the institutional form has to fit with the social surroundings, with the culture and the institutional environment at large. What happens in these countries is institutional transition, from the institutions of a planned economy, to a market oriented economy. The countries lack recent capitalistic traditions, perhaps with the Polish peasants as an exception. Thus, the informal institutions oriented towards capitalism are not well established. The legal protection, it has been argued, is less well developed, thus making the formal institutions weak. The image arrived at is a picture of an institutional vacuum. For the actors and the organisations an institutional transition imply that they have a hardship finding ‘taken for granted’-institutions to fit into. This situation would induce people to construct their own rules of the game. Mafia is an organisation creating institutional certainty outside the realm of legality, ultimately ensuring compliance through violence. Organisations such as business groups create pseudo-legal rules of the game, enforcing them through incentive systems and social control. Thus, one could assume that business groups offer institutional certainty in transitional economies.

- Economic efficiency. The hypothesis argues that business groups are efficient organisations for intermediating especially capital and managerial labour in situations of market failure. In the case of Poland and the Czech Republic, the stock markets are thin, the Warsaw stock market being the most developed in terms of liquidity and turnover. The banks appear to be the most powerful organisations left, and the only one capable of handling the liquidity in the financial system. The business press is presumably thin and the number of actors on the stock market and the number of analysts are presumably low, making the stock price of low informational value. Thus, the conditions for an efficient stock market, that of liquidity, numerous actors, a diverse set of information channels, a large business press, is not present. With a price that cannot be expected to be fair, the corporation cannot expect to get finance when in a need, and it can be vulnerable for take-overs, not due to bad performance, but due to bad pricing. Thus, the market can not be expected to solve the corporate needs of competent owners and financiers. As history has showed, business groups can protect the corporation and deliver capital. The other main resource is managerial labour. In economic transition, absent well-developed business schools, there is presumably a lack of a business educated and experienced managerial class. To develop this competence, the firms has to invest in development of their managers, but they have to enclose them, thus protecting their investment. Business groups, offering numerous positions, can attract managers and enclose them through creating an internal managerial labour market. Thus, business groups can presumably offer institutional efficiency in transitional economies.

- Political efficiency: The hypothesis argues that a weak state, for example weak through low capacity to enforce laws, or a state that chose to keep in the background, can use business groups in order to ensure capacity of governance. The state in Poland has retained their influence through state ownership, and in the Czech Republic through state ownership of the banks that controls the funds. Thus, the state has ensured themselves to have a capacity to govern, absent stronger government instruments.

Business groups are indeed viable organisations. The hypotheses constructed in order to explain the existence of Swedish business groups could be used to make predictions about the development in transitional economies, stressing conditions of institutional uncertainty, market inefficiency and weak states.

6. Conclusions: System compatibility

Summarising the paper, we have argued that business groups are viable organisations in a financial system characterised by dependent corporations. The theoretical basis is institutional economics, arguing that institutions produce predictability, it saves on energy and safeguard investments, and that the institutional opportunity set of governance structures is produced by an interplay of formal and informal institutions. The dominant institutional development in Europe has been that of strong organisations and weak markets, creating a kind of capitalism that differs from school book images, i.e., the Anglo-American system. One noticeable part of the European-Asian capitalistic system is that of business groups, i.e., constellations of legally independent firms that are joined together by some mechanism, mainly equity ownership, and co-ordinate their use of one or several resources, such as financial resources and managerial labour. We have showed their existence in some west European countries, divided into the two large subgroups of Germanic and Latin business groups systems. Four hypotheses were levered, and it was speculated that the cultural fit and institutional inertia hypotheses had rather weak explanatory power, but the economic and political efficiency hypotheses were assumed to have strong explanatory power. With reference to four important features of Eastern Europe especially Poland and the Czech Republic, it was argued that during times of institutional transition, with weak markets for capital and labour, weak governments and severe resource scarcity, business groups could be predicted to be one outcome, mainly due to their capacity of creating economic and political efficiency.

The present paper indicates that irrespective if the European Union may have problems of political identity, it has less problems of economic system identity. The dominating method of governing large, capital-intensive corporations is the business group, creating powerful owners and dependent corporations. Maybe less shaped by culture but more by economic reasons and state governability, the business groups of Europe emerged during the 20^{th} century and are performing fairly well today, although signs of restructuring can be noticed in many European countries. The direction is, however, hard to predict. And if history has learned us anything, it is that researchers should restrict their predictions about social development to their academic papers and statistical test, not to expand into politics.

The new applicants to the Union from the east has economies that hasn't developed according to the lines of the continental European capitalism, i.e., the dependent corporation system. When they today are levelling actions towards westernisation, it appears as some countries, for example, the Czech Republic, are aiming more at a system of independent corporations, but whatever political orientation, the countries appear to gain a system more similar to the European dependent corporation system. Thus it appear that harmonisation on an informal institutional level would in this area be less troublesome.

The business groups, although having characteristics of groups that could hint at old corrupt regimes, has been efficient organisations in Western Europe and can therefor be expected to create efficiency in the east too. One crucial prerequisite is, however, that the business groups of east have the same preconditions as the western groups had, that of at least experiencing international competition of their product markets. This is, however, a speculation made here. In fact, there are so little reasearch made on business groups that what we have are hypotheses on prerequsites of their existence, but not well developed hypotheses about their efficiency. Thus, there is a need to make research about the western business groups in order to create indications of the prerequsites for succesful use of business groups as organising proinciple for large firms. That is needed since it appears that business groups are mainly constructed out of informal institutional forces, and not restricted by formal institutionalisation. The issue of regulation is always brought up, as soon as economists gather. In most countries, business groups have not been directly regulated. That indicates that freedom of contract should be extended to freedom of organising. But, as earlier said, there are no advanced knowledge in this field, making it nearly impossible to put that as a conclusion, but only as a superstition.

The difficulty could, however, appear if the Union does not learn the lesson of the Marxists, to have policy attuned with the economic development. That would happen if the

Union does not acknowledge its own business system and demands politically formal institutions belonging to the independent corporation system. Ambitions towards restricting the freedom of contract through regulations such as ‘one share - one vote’ is inspired by the Anglo-American governance system, and therefor probably inconsistent with the present European-Asian system.

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