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Abstract

We reason that agency theory's behavioral assumptions may too closely reflect the US institutional context to explain the governance heritages that exist elsewhere. We propose that what constitutes opportunistic behavior and what can be done to limit it may vary due to differences in national background and formal institutions. We then test the validity of this nationally bounded model using historical sociology analysis of three nations whose corporate governance heritages are believed to differ (USA, Sweden, and France). Specifically, we review their political, cultural, and economic institutions to explore the different ways that their governance practices have evolved and infer causes for these historical variations.

Keywords: corporate governance, principal–agent relations, Sweden, France, USA

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The agency theory's principal–agent (P-A) corporate governance model introduced by Jensen and Meckling (1976) is the cornerstone of corporate governance research (Jensen 1998). The P-A model assumes that because the ownership structure at publicly traded corporations provides incentives for managers (agents) to act in a self-interested and opportunistic manner, owners (principals) have incentives to invest in formal governance mechanisms. A growing body of research, however, suggests that the P-A model does not adequately explain the key relationships within corporate governance in other nations (e.g. Charkham 1994; Pederson and Thomsen 1997). We believe that this may be because the P-A model suffers from a 'made-in-the-US' bias as it is too rooted in the US experience. The model was developed by, and has been largely tested by, US researchers examining US organizations and writing for US-based journals. As such, the P-A model ignores the fact that economic relationships like these are embedded within the context of informal and formal institutions that vary across nations (North 1990). The P-A model is not unique in this shortcoming. Williamson (2000: 610) observes that '[t]he institutions of embeddedness ... are an important but underdeveloped part of the [governance] story' and calls for more economic and sociological research along the lines of North (1990) and Greif (1998), research that examines how history shapes a nation's informal and formal institutions and thereby influences the governance of economics relationships.

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This paper takes up Williamson's call and uses Greif's concept of historical and comparative analysis (HCIA) to understand the processes by which a nation's historical institutional features interact in shaping the nature of its contemporary corporate governance norms. Our approach to HCIA differs from Greif's in how the key ideas are summarized and validated. Where Greif reduces historical process to fit game theoretic analyses, we preserve the contextual richness of those processes by using Skocpol's (1984) historical sociology methodology; that is, we first conceptualize a model and then use it as an exploratory lens to arrange a large amount of qualitative data into plausible explanation. As Kieser (1994) and Calori et al. (1997) note, historical sociology provides a rich and intuitive check of proposed concepts and theories rather than positivistic theory testing.

Building on the insights of both economists, we propose that, because each nation's historical and institutional context is unique, there will be more variance in corporate governance relationships between nations than within nations. The national context influences both how agents' opportunism manifests itself and how principals can seek to mitigate it. We then check the validity of this proposition by exploring the different ways that governance has evolved in the USA, Sweden, and France, and inferring causes for these historical variations. Following Morris et al. (1999), we include researchers from these three nations as authors to address the risk of subjectivity common to historical analysis and to provide complementary emic (inside) and etic (outside) perspectives on each nation's social context and its view of opportunism. Other nations might have been selected; as we will show, however, the nature of P-A relationships and opportunism found in these three nations notably contrast with each other. As such, these three nations represent a good starting point. We conclude by discussing how our insights can be extended to a broader array of nations.

A Brief Review of the Principal–Agent Model

At its most base level, agency theory is concerned with problems that can arise in any cooperative exchange when one party (the 'principals') contracts with another (the 'agents') to make decisions on behalf of the principals. However, contracts tend to be incomplete and subject to hazard because of the nature of people (e.g. self-interest, bounded rationality, risk aversion), organizations (goal conflict among members), and the fact that information in organizations is typically distributed asymmetrically, making it costly for principals to know what agents actually have accomplished. Agency problems develop because agents can hide information and/or take actions that favor their own interests. This gives principals motive for investing in monitoring and incentives.

Jensen and Meckling (1976) extended this base theory to problems rooted in separation of ownership from control. The central premise of their governance model is that shareholding causes a de facto delegation of managerial responsibility from a firm's principals (outside directors and other vigilant shareholders) to their upper echelon agents (executives). This delegation, in turn, causes a misalignment of incentives due to different preferences for risk. Principals should be indifferent to the specific (unsystematic) risk of any single firm, because they can diversify this source of earning variation away by holding a diversified portfolio of investments. In contrast, executives are very concerned about firm-specific risk, for it exposes their personal (human) investment in a firm to uncertainty about the firm's survival and performance. This uncertainty is neither covered by their employment contract, nor can it be diversified away by holding employment contracts in a diverse set of firms. In other words, delegation and the uncompensated risk caused by it pose a 'moral hazard' to executives (Alchian and Woodward 1988). This gives them incentive to seek additional compensation through opportunistic non-pecuniary means, such as free-riding, shirking and perquisites (Jensen 1998). Agency theory thus depicts the central role of corporate governance as restraining executives' self-serving inclinations (i.e. their attitude to behave in opportunistic ways) by engendering compliance through activities such as monitoring their conduct, providing incentives that encourage agents to act in the principal's best interests, and if necessary, threatening legal sanctions. These mechanisms, combined with agency theory's definitions of the firm and agency problems, constitute the specification of the base P-A model, which we summarize in Figure 1.

At the core of agency theory's governance model lie four assumptions:

1 Opportunism is an ever-present threat because executives (like all agents) are opportunistic by nature; they will act in their own self-interest in the absence of restraints, even if their actions diminish shareholders' wealth.
2 Executives' opportunistic tendencies are driven solely by their single-minded desire to maximize a single utility (generally a trade-off between money and leisure) because they are rationally economic (as opposed to also being social). As such, this model simplifies organized social life to being nothing more than a series of contracts between individuals.
3 Publicly traded corporations are characterized by information asymmetry that arises because principals are both separated from day-to-day control and are rationally bounded; that is, the firm's governing board has limited ability for distinguishing a priori between best behavior and self-serving behavior.

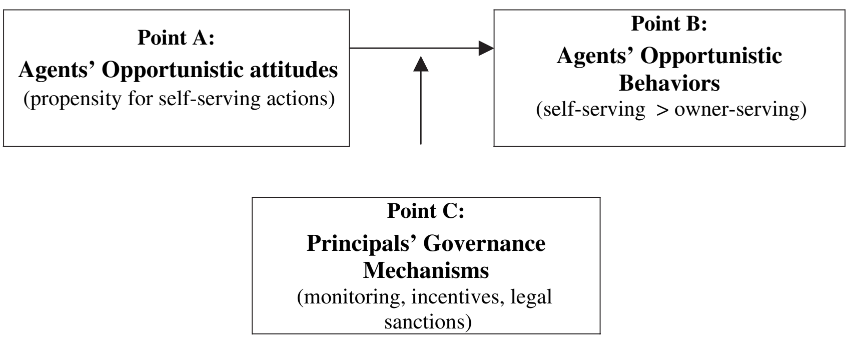

Figure 1. Agency Theory's View of Principal–Agent Relationships

4 Agency theory presumes, albeit implicitly, that its behavioral views about opportunism and enforced compliance are not nationally bounded, but instead represent a supranational lens for evaluating all corporate governance issues.

Placing the Base Model Under an Institutional Theoretic Lens

Recently several scholars have voiced explicit support for the fourth assumption (e.g. Buhner et al. 1997; Shleifer and Vishny 1997). However, this support is at clear odds with neo-institutional economists (e.g. Fligstein 1990; Greif 1998; North 1990; Williamson 2000) and sociologists (e.g. Berger and Luckmann 1967; DiMaggio and Powell 1983; Dobbin 1994; Giddens 1984; Granovetter 1992; Guillen 1994; Polanyi 1944; Whitley 1992). According to these two literature streams, a nation's institutions shape the 'rules of the game' by which individuals and organizations act and compete, and determine 'what organizations come into existence and how they evolve' (North 1990: 5). To Hofstede (1984), this 'collective mental programming' serves to legitimize certain ways of structuring economic exchange that set the governance practices in organizations from one nation apart from those of other nations. Williamson (2000) provides a model of institutional interactions and governance practices that is based on the level of social analysis. Level 1 focuses on social embeddedness, how norms, customs, and traditions shape the 'assumptions of the game.' These behavioral constraints arise from a nation's 'informal' or 'background' institutions such as family, religion, schools, sports, and the media (Whitley 1992). Williamson notes that because level 1 institutions evolve over hundreds or thousands of years, they are often taken as static by neo-institutional economics research. Citing North (1990), Williamson argues that the speed with which they evolve is less relevant to governance practices than their 'pervasive influence upon the long-run character of economies' (2000: 596). Within the context of level 1, the 'rules of the game' develop in part through the same slow evolutionary processes but also in part through key design choices (Greif 1998). These rules manifest themselves in the 'formal' or 'proximate' institutions that comprise level 2: a nation's political, legal, and financial systems (Whitley 1992). Nested within the contexts of levels 1 and 2 is level 3, the ways in which economic actors structure and manage exchanges. Williamson describes level 3's context-specific governance practices as the 'play of the game' (2000: 597).

Viewing the P-A model through the neo-institutional economic lens of Williamson's levels can provide insights into the origins of national differences in corporate governance. According to Whitley's (1992) sociological view, formal institutions of level 2 tend to have a coercive influence on human behavior (i.e. they establish a set of explicit legal rules that govern economic exchanges within a nation and a set of enforcement mechanisms to identify, prosecute, and punish individuals who act outside of the established bounds). As such, formal institutions sanction certain types of governance mechanisms, such as contracts, that parties to economic exchanges can use to safeguard their interests and/or protect themselves from opportunism. Formal institutions therefore directly determine the governance mechanisms that are sanctioned by the nation-state. To account for this and other institutional influences, we propose modifications to agency theory's P-A model and present this framework in Figure 2.

In practice formal institutions (point D in Figure 2) may themselves turn out to be costly (inefficient) and even self-defeating mechanisms for governing exchanges. First, most legal enforcement mechanisms are expensive and imperfect (Arrow 1974). Second, few rules and institutions are motivated purely for corporate efficiency gains; indeed, some government regulations may have the opposite effect (North 1990). Finally, a society may perceive a legitimate need for 'guarantees' against 'the intrusion of unscreened and unpenalized opportunism' (Williamson 1985: 65). Imposing these formal safeguards, however, may also serve to initiate a self-fulfilling prophecy by encouraging types of opportunistic behaviors that are more difficult to detect (Perrow 1986).

On the other hand, level 1 institutions are viewed as both effective and efficient mechanisms. A nation's background institutions (point E) have different effects on governance because their influence on human behavior is either mimetic (acquired, adopted, or consciously imitated as best practices)

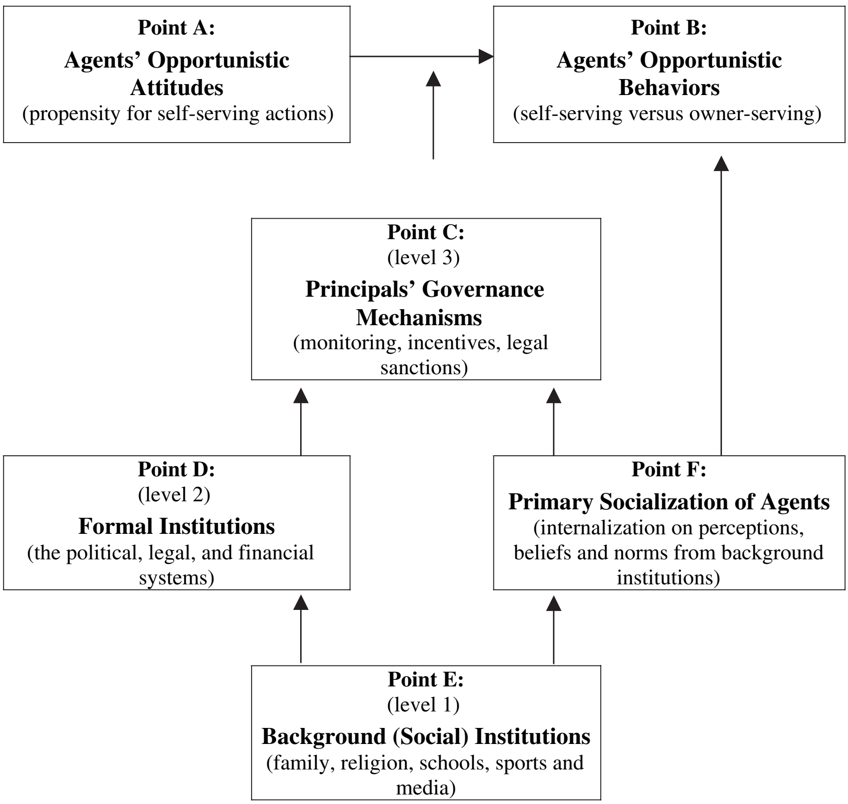

Figure 2.
A Nationally Bounded Model of Principal–Agent Relationships

or normative (imprinted or unconsciously incorporated through tacit beliefs) (DiMaggio and Powell 1983). They allow a society to disseminate explicit collective knowledge, or an internalized understanding of cause and effect relationships that allows a society to repeat those practices that previously led to favorable outcomes (Spender 1994). Background institutions also 'imprint' implicit collective knowledge, or 'culture': a set of social norms, values, and routines, tacit to a society.

Finally, a nation's background institutions play a major role in the socialization of a nation's citizens, thereby creating a framework of attitudes that shape behavior. According to Berger and Luckmann (1967), individuals develop a set of foundation cognitions (schema, belief structures, or mental templates) mostly through their primary socialization experiences with background institutions. Once this socially constructed view of reality is established, any new views that individuals are exposed to through secondary socialization experiences later in life are internalized only if they are consistent with their primary schemas. In other words, the influences on attitudes and behaviors that come from secondary socialization experiences are nested, or 'embedded,' within the context of their primary social experiences. Granovetter (1992), building on Polanyi's (1944) work on the relationship between economic and social transformation, conceptualized embeddedness as a mid-range influence mechanism, lying between 'oversocialization' (i.e. behaviors largely determined by relationships and social context) and 'undersocialization' (i.e. minimally influenced behaviors). It follows that national background institutions, particularly those that influence primary socialization experiences, embed their citizens with a set of foundation cognitions about opportunism — the propensity to self-serving actions (as opposed to owner-serving) and an understanding as to what entails opportunistic actions (point F). As such, these institutions directly affect the attitudes and behaviors that agents bring to their place of employment. Consistent with theories by Berger and Luckmann (1972) and Granovetter (1992), among others, these cognitions are likely to be modified by secondary socialization experiences that these agents encounter at their organization, but rarely will they be substantively changed.

DiMaggio and Powell (1983: 147) refer to the nation-state as a primary shaper of organizational forms, and Bartlett and Ghoshal (1999) and Calori et al. (1997) refer to it as a 'nationally-bounded administrative heritage'. We propose that a nation-state, and in particular its background institutions, also shapes a 'nationally-bounded governance heritage'. This heritage differentiates nations by their agents' opportunistic attitudes and behaviors (points A and B) and the variant of governance mechanisms that their principals select to resolve those problems (point C). Note that we are not suggesting that opportunism ('self-interest seeking with guile' in Williamson's terms) does not occur in some nations. Rather, we are suggesting that it will manifest itself in different ways in different nations. What principals in one country consider opportunistic behavior by an agent may be acceptable to principals in another country. Neither are we suggesting that there is a one-to-one correspondence between a certain type of institution and a certain type of, or degree of, opportunism. The essence of embeddedness is that it is the net, interactive effect of a nation's formal and background institutions that determines its unique approach to economic exchanges, not any single institution. Due to historical differences, some institutions will have more of an effect on P-A relationships in one nation than in another.

Summarizing this line of reasoning, we propose:

P1: Principal–agent relationships are bounded by the institutional context of a nation, such that there will be more variance in relationships between nations than within nations.

Exploring National Boundedness Using Historical Analysis

We began this paper by asserting that agency theory's P-A governance model might be too rooted in the US experience to explain the P-A relationships that emerge elsewhere due to differences in national institutions. While proposed theories of economic exchanges and governance practices do not have to be realistic in every detail, they do have to demonstrate some predictive ability to warrant further development and testing (Williamson 2000). Accordingly, we explore the face validity of this assertion and the first proposition by presenting brief historiographies of the USA, Sweden, and France. Consistent with this historical sociology methodology, we use the modified model from Figure 2 as an exploratory lens to arrange a large amount of qualitative data into plausible explanation (Skocpol 1984). We bear in mind that, while historical analysis has limitations (e.g. having knowledge about the model leads to preconceived notions about patterns in the data), it is not done in order to prove anything statistically; rather, historical analysis serves as an intuitive check of proposed concepts and theories (Calori et al. 1997; Kieser 1994). Further, we try to minimize problems of subjectivity by involving researchers from the three nations as authors.

We begin by exploring the ability of the model to explain P-A relations in the USA, for this should serve as an excellent baseline on which to judge the model's ability to make equally plausible explanations for the Swedes and the French. Since less has been written in management journals about the institutional and governance structures of Sweden and France, yet they notably contrast with each other and that of the more familiar USA, we give a more detailed historical description.

Principal–Agent Relations in the USA

Many US background institutions (Figure 2, point E), such as family and media, perpetuate positive attitudes about self-reliance, individual achievement, and the general belief that acting in one's self-interest is in many cases not only acceptable, but also necessary. Pedagogical methods at the nation's primary and secondary schools socialize and reinforce this national bias by emphasizing pragmatism, an action-oriented way of thinking about cause and effect that encourages children to search for solutions outside the dominant paradigm (Lessem and Neubauer 1994). This bias is further reinforced by school curricula and the media, which celebrate the nation's landmark events (e.g. Independence Day, the abolition of slavery) and legendary figures (Lincoln, King, the early pioneers, entrepreneurs such as Rockefeller, etc.). These celebrations both market specific historical data, and more importantly, ascribe meaning to them, which serve to shape the nation's social context by perpetuating key ethnocentric themes. It follows that the 'typical' US agents enter a US organization predisposed to act in their own best interests because they see themselves, and not their place of employment, as ultimately being responsible for their own security, advancement, and wealth. This predisposition is reinforced by the ownership structure of public US firms, which expose agents to risks for which they are not fully compensated, and therefore, organizations to the threat of moral hazard (point A). While aided by the formal institutions and their dense array of laws, regulations, and sanctions intended to protect the principals' property rights, information asymmetries remain. Principals therefore have the motive to invest in monitoring and incentive structures in the attempt to limit any residual non-shareholder maximizing behaviors (points C and B).

It, therefore, seems plausible from this brief analysis that agency theory's P-A model, which is largely a theory of self-interest and enforced compliance, is embedded in the US experience. That is, US executives, given their socialization experiences, and the organization, given its ownership structures, create a P-A context where opportunism is prone to being institutionalized, in the manner consistent with the first three assumptions previously listed which lie at the core of agency theory. We turn now to the face validity of our modified model in the Swedish and French experiences.

Principal–Agent Relations in Sweden

Nationally Bounded Influences

The values that have been suggested as shaping national institutions in Sweden (low power distance, egalitarianism, collective responsibility, and cooperation) are substantively different from those associated with the USA (Czarniawska-Joerges 1993). These values also highlight a stark contrast with agency theory's base model's assumptions that opportunism is an ever-present threat and that agents' opportunistic tendencies are driven by the single-minded desire to maximize a single utility.

As some historians note, the values dominant in Swedish culture arose from two historical trends, one long-term and emergent, the other a conscious decision by its leaders. Regarding the former, Sweden is a large country with an ethnically and culturally homogenous population of about 9 million. Unlike most European nations, Sweden never had a feudal society. Instead, by the 16th century, it already had a strong state and a strong class of peasants (most freeholders) (Anderson 1974), which fostered values of low power distance. The following story, related by Hofstede (1991), illustrates this ethnocentric theme.

'Shortly before Christmas one year, King Carl Gustav XVI was shopping at a Swedish store for presents for his children. Unfortunately for the King, he carried with him only his credit card. The store required that a proper form of identification, which the King could not present, accompany all credit card purchases. A standoff ensued until a man waiting in the queue intervened, removing a krona from his wallet that clearly displayed a portrait of the king. The salesperson relented, but only after the king wrote down his full name and address.'

Second, the Swedish societal norm of equality is reflected in their highly progressive tax structure, which gives it one of the tightest income distributions in the Western world. Their strong collectivist and cooperative traits are reflected by the tight linkages known as 'corporativism' that formed years ago between the state, capital, and labor and lasted until the mid-1980s (Marshall 1996). This powerful coalition began with the Saltsjobads agreement in 1938, when the parties agreed to peacefully negotiate all future disagreements through collective bargaining.

Not surprisingly, the Social Democratic Party, in control of government for almost 60 uninterrupted years, reflects Swedish values: this party was founded on the ideological platform of consensus decision-making. To symbolize their ideology, the party stated the slogan of 'the Peoples' home' to reflect a society based on solidarity, respect, and responsibility. Trusting even the capitalist class, the Social Democrats have never been keen to nationalize the productive assets of the nation. In fact, while about 50% of the GDP is distributed through the state and/or local municipalities, the government owns very little of the nation's productive assets, compared with other European nations. Since the 16th century, most of the nation's assets have remained in the hands of the private sector.

Given these social values and their impact on behavior, it may not be surprising that management scholars note that Swedish governance mechanisms do not fall neatly within, nor between, the classic agency theory dichotomies of markets and hierarchies, and principals and agents. That is, if markets represent those economic exchanges governed by the invisible hand of prices, and hierarchies those governed by the visible hand of imposed authority, then the dominant institutional form in Sweden fits neither definition. According to the Uppsala's School of Industrial Marketing, their economic exchanges are governed by cooperative networks, long-term considerations, and a large dose of trust (Johansson and Mattsson 1987; Larsson 1993; Collin 1993.) Indeed, the difference between the dominant values and norms underlying the US form of agency theory and the Swedish form is profound. Whereas the US form views each economic transaction dyad (e.g. buyer and seller) as the appropriate unit of analysis, and the joint profit optimization for each exchange as the key objective, the Swedish form seems to take a more open-systems, resource-dependent view, as expressed by network theory (Johansson 1989). Accordingly, the unit of analysis broadens to include the network of stakeholders who are linked by common dependence on the same scarce resource, and the objective of the exchange shifts from short-term efficiency to the long-term effective coordination of all exchange relations.

Put in terms of administrative theory, institutional context associated with Sweden is similar to what Barnard (1938: 261) described as 'the moral factor,' or the efficacy of cooperation, coordinated by shared purpose. This moral factor does not just happen; it requires a more cooperative and a priori trusting view of human behavior than what grounds agency theory. It also requires that specific inter-organizational coordination mechanisms be established, which, consistent with resource dependence theory, includes 'co-adaptation, trade associations, cartels, reciprocal trade agreements, coordinated councils, boards of directors, and social norms. Each represents a way of sharing power and a social agreement which stabilizes and coordinates mutual interdependencies' (Pfeffer and Salancik 1978: 144). As such, the amount of information asymmetry that arises in US public organizations, due to a separation of ownership and control, and which represents a core agency theory assumption, has less relevance in Swedish organizations.

Governance Implications

Together, these national governance differences suggest that whereas the US-focused agency theory is fundamentally about self-interest and enforced compliance, based on norms of individualistic opportunism, the dominant Swedish form is based on norms of collective responsibility and voluntary compliance. Stewardship theory (Davis et al. 1997), and its basic assumption of trust, seems more applicable here, particularly given Sweden's emphasis on social controls that build a tight coalition between all stakeholders, including shareholders and managers. Because it assumes that managers want to be good stewards of corporate assets (i.e. owner-serving more than self-serving), stewardship theory argues for governance structures that authorize managers to act on their own initiative. The board of directors is not first and foremost a device for monitoring managers, but an instrument for developing the corporation and its top management through the gathering of knowledgeable and competent board members as advisors.

Not surprisingly, Sweden's level of formal constraints on management and shareholders pales in comparison with US laws and regulations. Indeed, issues such as antitrust have attracted very little attention among Swedish lawmakers and politicians. This seemingly laissez faire behavior on the part of Swedish formal institutions may have precipitated higher levels of industry concentration than in most other advanced capitalist economies (Glete 1994: 20), and may have allowed two business groups to literally control, though technically not own, firms representing over 50% of the total value of all stocks listed on the Stockholm stock exchange. One is the Wallenberg group, one of the largest remaining family-run financial empires in Europe; in 1998 it controlled over 14 listed Swedish firms (including Ericsson, ABB, Electrolux, Investor, Saab-Scania, SAS, and Stora), representing close to 40% of the Stockholm stock exchange's value.

Rather than being a case of extreme capitalism in an institutional structure that otherwise promotes low power distance, egalitarianism, collective responsibility, and cooperation, these two groups represent one way in which Swedes deal with resource scarcity. For example, both were instrumental in revitalizing the country's industrial base following the recession and depression years of the 1920s and 1930s. For example, they organized internal capital markets through their own banking operations, organized internal labor markets for managers, and invested in technology and non-domestic sales. Thus, to many Swedes, they play a legitimate role in Swedish society, giving the government little provocation to restrain them.

Ownership concentration, however, suggests only part of the story of ownership empowerment in Sweden. Because there are few formal rules and regulations to constrain their behavior, Swedish owners have more freedom to act vigilantly than do their US counterparts. Their vigilance, however, is not motivated so much by a high threat of opportunism, as it is by their quest for a more productive use of its managers, given the limited size of Sweden's managerial labor market. By this definition, the Wallenberg group appear to act very vigilantly and in the process form their own tightly interconnected groups of companies similar to Japan's collaborative business networks or 'keiretsu'. However, where all the members of a keiretsu are interlinked by high levels of cross-ownership of equity, Swedish business groups typically have a central firm that controls the others, often without large holdings. That provides the group leader with a clear incentive to closely monitor the behavior of managers in their affiliated firms. Their ability to do so is facilitated by the fact that they have easy access to sensitive information, a privilege which comes not only because of their large equity holdings, but also because they serve as major credit advisors to the firms in their portfolio. With few formal rules to limit their behavior, the groups regularly exercise their power by placing a CEO from one of their holdings to serve as a director in several of their other holdings, thereby creating a dense interlocking network. For example, the Wallenbergs actively control career paths of the managers who work at each of their holdings and commonly transfer a manager from one firm to another, even though the two are technically independent entities.

While the Swedish institutional context differs from that of the USA, Swedish firms use some of the same corporate governance mechanisms advocated by US experts. For example, Swedish law recognizes the CEO and chairman as two distinct positions with separate functions. This split is considered to be in shareholders' best interests in the USA, but can also be seen as in keeping with Sweden's egalitarian nature: responsibility should be shared and dictators avoided. Swedish corporations also have begun to adopt US-style CEO incentive compensation (bonuses, stock options, etc.), although on a smaller scale. There is much more concern in Sweden with the relationship between the pay scales of top management and of other employees.

Opportunistic Tendencies

Agency theorists argue that managerial opportunism is motivated by three desires: job security, financial gain, and increased status (Salter and Weinhold 1988). The dominance of the major business groups in Swedish industry means that opportunistic behavior by managers is either not needed to achieve those desires or is likely to prove ineffective. Executives have a high level of job security. If their subsidiary is having financial difficulty, the rest of the business group helps support it. If they lose their job in one company, another group member typically hires them. Even fired CEOs move on to positions in affiliated business or trade organizations. This informal 'employment security network' reflects the small size of the Swedish managerial labor market and the belief that managers who fail in one position are valuable resources that can be used in other contexts. The relatively small size of managerial performance incentives, the high marginal rate of Swedish income taxes, and the dependence of a firm's financial performance on its relationship with members of its business group reduces the ability of managers to improve their personal finances through their own behavior. Finally, the primary source of managerial status in Sweden is derived from one's business group membership and from one's position within that group. Managers' individual interests are intertwined with those of their business group and the group's owners, resulting in little inherent separation of interests between managers and owners.

Moreover, Swedish managers are less likely to view self-serving individual opportunism as an acceptable option for advancing their personal interests. Instead, they are more likely to try to do so by working to advance the position of their firm and its business group, which leads to a more egalitarian management style and a willingness to support government initiatives. Swedish owners have been socialized to expect managers to put the interests of their business group ahead of their firm's short-term objectives. Where institutions in the USA encourage managers and owners to focus on competition between individuals, institutions in Sweden tend to focus on competition between groups, especially business groups.

This is not to say that managers in Sweden never act in their own interests. Rather, we suggest that on those occasions when they do, they will typically fail and pay a high price for violating their society's egalitarian and collectivist norms. For example, when Percy Barnevik, ABB's former CEO, received an extremely large bonus in the mid-1990s based on the incentives in his employment contract, he ran afoul of Sweden's egalitarian and collectivist norms. The Swedish public protested and he was forced to repay half of it to the corporation.

Summary Observations

Sweden represents an interesting example of a market economy whose formal institutions (Figure 2, point D) and governance mechanisms (point C) impose few behavioral constraints. In this institutional context, a few owners have attained highly empowered positions, unprecedented in the USA, both over the management of their firms and over many of the industries in which these firms compete. Using a base agency theoretic lens, one might predict that they might abuse their powerful positions by acting opportunistically in a self-serving manner. However, this prediction does not take into consideration Sweden's background social institutions (point E), the historical origins of those institutions, and the socialized constraints (point F) that come from them. In short, it seems plausible to conclude that Sweden has a governance heritage based on a different set of assumptions about the attitudes (point A) and behaviors (point B) of agents than that which lies at the core of agency theory's principal agent model. Consistent with proposition 1, we therefore conclude that P-A relationships in Sweden are nationally bounded.

Principal–Agent Relations in France

Nationally Bounded Influences

The values and norms underlying the background institutions of France largely fall between those of the USA and Sweden. While the institutions in the USA generally reflect a belief in the value of individualism and autonomy, and Sweden's emphasize egalitarianism and ideology, institutions in France typically combine Sweden's egalitarianism with a respect for authority and status growing out of France's unique historical context. As in Sweden, French institutions impart a different set of values than those assumed by the base agency theory model.

France's population has been historically more heterogeneous than Sweden's and less so than that of the USA. France sees itself not as a 'people' but as a nation defined by geographic borders and a political project (Smith and Blanc 1992). The idea of a French nation, which had emerged by the 12th century and developed further as monarchs struggled against feudalism, became a reality during the French Revolution of 1789, when the government acknowledged that anyone could become a French citizen provided they adhered to French values, particularly human rights, and supported the Republic (Schnapper 1991).

Similarly, where institutions in the USA and Sweden were strongly influenced by individualistic Protestant beliefs, those in France have been largely shaped by the Catholic ethos, which emphasizes a hierarchy of authority (including that of the Pope) and a dependence on priests as God's representatives (Mousnier 1979). These religious norms have contributed to a French preference for centralized administration based on personal relationships. For example, Louis XIV (1661–1715) appointed *intendents* to each province to ensure that his policies were carried out. Napoleon (1804–1815) sent powerful *prefets* to safeguard the interest of the national government in France's *departments* (analogous to states in the USA) (Duby 1973). In the post-World War II era (1945–1975), the French government practiced *pantouflage*, whereby civil servants were appointed to senior management positions in nationalized, state-run enterprises. These appointees, like *intendents* and *prefets*, provided a way for the French government both to transfer administrative expertise from the central government and to control key business decisions (Barsoux and Lawrence 1990).

The openness of French citizenship, respect for status and hierarchy, and centralization based on personal relationships have strongly influenced the evolution of the French education system. For example, France's Ministry of National Education attempts to assimilate different ethnic communities by ensuring that all children have access to the same educational opportunities (Noiriel 1990). At the same time, the French education system reinforces the importance of authority by teaching 'rationalism,' a structured way of thinking that builds on a hierarchy of knowledge (theory at the top, practice at the bottom) through a series of deductions. Using a Cartesian style of pedagogy, a typical French teacher begins by presenting a theoretical model whose practical usefulness is then debated, usually at considerable length (Weinshall 1971). Reliance on this teaching style implicitly communicates a high level of 'power distance' to students (Hofstede 1984). The egalitarian educational system that grew out of Napoleon's reforms has become very elitist at the post-secondary level (Dupaquier and Kessler 1992) and dominated by the *grandes écoles*, the premier national universities, whose mission is to identify and train France's best students (approximately the top 10%) to become future leaders in science, engineering, public administration, and business.

Admission to the *grandes écoles* is based totally on merit, in keeping with the egalitarianism of the Republic. *Grands corps* also represents elite castes in the French society. Each has its own identity and interpersonal networks (Crozier 1995) that grow out of the frequent breakfasts, lunches, and professional interactions that members have with each other. Each *corps* uses its network to place their supernumerary members in senior positions in other ministries or, more typically, in private or state-owned firms. When someone is ready to move to the private sector, his caste's network circulates information until a proper position is found and his nomination proposed. The effectiveness of this 'out placement' process has resulted in considerable influence. For example, in 1987, the chairmen of 14 out of France's largest 20 companies came from the *grands corps* (Bauer and Bertin-Mourot 1987); a decade later, according to *Les Echos* (a well-known economic journal) only 98 out of 218 Inspectors of Finance were working in their home ministry (30 October 1997: 4).

Governance Implications

As in Sweden, there are fewer formal institutional constraints on managers in France than in the USA, and those that exist are very liberally defined. Consequently, P-A relations in France are best understood by identifying dominant practices. For example, in most *sociétés anonymes* (the classical French corporate form), firms are managed by a *president-directeur général*, or PDG, who simultaneously assumes the roles of board chairperson and CEO (Salustro 1997). PDGs of the largest firms are usually employed by the state before assuming this top-level management position. Rarely having prior industry experience, their appointment is based more on the institution that they graduated from and their political affiliation.

A French board's legal authority to monitor PDGs is severely weakened by the manner in which boards are assembled. Most members of French boards of directors are directly appointed by the PDG, rather than elected by the shareholders (Bauer and Bertin-Mourot 1987), and are either representatives of large family holdings, scientific or technical experts, or themselves PDGs of another large firm. Indeed, it is expected that when a chairman is nominated to the board of another company he will reciprocate: yet another example of centralization through personal relationships. In 1995, 20 people occupied one-third of the board positions in the largest 75 public companies in France. Within this closed system, directors have little influence on key decisions that the firm makes. They are usually unfamiliar with the firm's industry and, because they are on several boards, have little time to devote to any one firm's situation. A survey of 341 top managers published found that directors gave advice on strategic orientation in less than 20% of the cases; few directors even discussed financial reports, budgeting, or internal controls (*Les Echos* 5 June 1995).

Moreover, French top managers from the elitist castes are rarely sanctioned or dismissed for reasons of poor performance. From interviews with 19 French top executives (CEOs and other top managers) who had been dismissed at least once, Bouchikhi and Kimberly (1996) found that unlike in the USA, where poor performance and takeovers were frequently the cause of dismissal, in France it is usually due to a change in government. A manager is most likely to be appointed to the PDG post when their political party is in power, and as long as the party remains in power, it is unlikely for the board to dismiss him or her. Once their party is out of power, however, the PDG may be more vulnerable.

French corporate governance differs from the US in two important ways. First, the costs of safeguarding against moral hazard are low due to the convergence of interests and linkages noted above, which is also demonstrated by the lack of formal sanctions that are used against top managers. Executives who act counter to their *corps*' interests face exclusion from vital networks of information and loss of status — an informal, but severe, penalty in this status-conscious society. Second, managers' decisions are closely monitored largely to evaluate employees' performance and demonstrate that the stratification of functions and responsibilities is being respected. Monitoring is also used to create barriers, or power distance, with the lower levels. Monitoring, however, is not done with the intent of minimizing acts of self-interest — the academic performance needed to qualify for a managerial position imbues them with a certain degree of trust, as does their position; it is assumed that managers will act as good civil servants and assist the state in implementing its plans by coordinating their firm's actions with state policies.

These differences have led to the development of a French theory of the firm that contrasts sharply with the contractual agency theory approach widely accepted by US scholars. Gomez (1996) depicts the firm as a convention that directs individuals' efforts and behaviors toward increasing efficiency, with the entrepreneur acting as the force that defines and shapes the convention to reinforce or modify these behaviors as needed. Governance of the firm is an additional information screen that clarifies acceptable behavioral norms and, through rewards and sanctions, encourages individuals to act in accordance with established rules. In short, Gomez sees the firm as a mechanism for achieving efficiency through socialization and the reinforcement of norms. Although this theory is in keeping with the values dominant in the French culture of collectivism, respect for authority, and hierarchical distinction, its view of the entrepreneur is antithetical to that found in more individualistic cultures such as the US. Gomez' entrepreneur is a source of stability and predictability, but not necessarily innovation.

Opportunistic Tendencies

The similarities in educational background and socialization, combined with a reliance on separate but functionally similar networks of reciprocal dependencies, give *grands corps* business leaders a common set of beliefs that differ considerably from their US and Swedish counterparts. Bauer and Bertin-Mourot (1987) found that the personal goals of chairmen were keeping and reinforcing their current positions or being nominated to run even bigger companies. Most believe that this is accomplished by preserving the social position of their *grand corps* by being good 'servants of the state' (the essence of their caste) and by preserving their personal power in their organization. Thus, while the chairmen are in many ways the descendents of the *intendents* and *prefets*, they represent the interests of their own *corps* first and the central government second.

When senior management acts on those beliefs and priorities, they reinforce the notion that an impenetrable barrier exists between them, the 'elite of the nation', and the managers below them; middle managers then create a similar barrier between themselves and lower management, and so forth. Career paths are limited to the range of positions allotted to the group to which one belongs. Each group considers its duties as being largely set by its profession (e.g. accountants, electricians, machinists) and bases its behavior on that profession's norms, implying that each has its own position within the hierarchy, and bridges between them do not exist. Indeed, in the rare cases in which someone is promoted to a higher level, they are considered a traitor by their original group and not accepted as a peer by their new group (D'Iribarne 1989), resulting in a self-reinforcing hierarchical structure that is almost impervious to change (Very and Riot 1999).

French shareholders also tend to differ fundamentally from US shareholders in their objectives and preferences. Very few of the 200 largest French firms have dispersed stock ownership. Of the 50 largest French firms in 1986, the French government was the majority shareholder in over half; the rest had a family or foreign entity as the dominant shareholder (Bauer and Bertin-Mourot 1987). Furthermore, the wave of privatization in the 1980s did less to diminish state influence on business than might at first appear. To prevent foreign competitors from gaining control of formerly state-owned enterprises, the government sold many of its stakes in companies to a tight-knit group of French firms already linked by shared investments and interlocking boards, boards dominated by members of the same *grand corps*. In short, senior management, directors, and shareholders of major French firms, as well as the government officials who regulate them, are members of the same small circle of societal elites who have similar interests and expectations regarding the firm's priorities and performance. As such, it is difficult to see where national policy ends and firm strategies begin.

Managerial opportunism in Sweden typically does not affect the status of individual managers, which is also true in France, where status is determined by the *école* that a manager attended. Unlike Sweden, however, opportunistic actions by French managers may affect their personal finances (e.g. the lack of board oversight makes it likely that PDGs would be disciplined for seeking unwarranted high levels of compensation). For example, French top managers may opportunistically improve their employment security by pursuing an 'entrenchment strategy' (Charreaux 1996). After creating a board of hand-chosen allies, PDGs acquire multiple 'mandates' to reinforce their power and position. Paquerot's (1996) study of 658 PDGs of companies listed on the Paris Stock Exchange found that most held multiple PDG positions (range: 1–19, mean 2.5), with most of the additional positions located in subsidiaries. Employment security is assured because someone dismissed as PDG of a parent firm (e.g. due to a change in government) would still retain positions with the subsidiaries.

While having one person serve as PDG of the parent and its subsidiaries may provide some advantages through unity of command, Paquerot (1996) found that the number of PDG positions was negatively associated with firm performance. This, however, is not a major concern in France. Couret (1996) notes that the principal reason French PDGs get labeled as ineffective or 'outlaws' is not because of poor firm performance, but because they have acted contrary to the 'social interest.'

Moreover, while the entrenchment strategy pursued by French PDGs is reminiscent of the kind of 'managerial hegemony' described by US corporate governance researchers (Kosnik 1987), it does not necessarily constitute agency problems in France. This is because the major shareholders are typically members of the PDG's own *grand corps* and are similarly socialized to coordinate corporate actions with governmental ('state') objectives and the 'social interests.' Though 'social interest' is not clearly defined (Couret 1996), traditionally it has focused on the needs of a broad definition of stakeholders, with the interests of shareholders receiving more attention lately. Whatever the definition, as long as top management and major shareholders belong to the same tightly knit caste, the kind of agency problems predicted by the base agency theory model are unlikely to arise.

Summary Observations

Whereas the dominant US model of corporate governance assumes norms of self-interest, opportunism, and enforced compliance, and Swedish governance is based on collective responsibility, reciprocity, and voluntary compliance, French corporate governance uniquely combines aspects of both to create a third type of P-A relationship. As in Sweden, the primary concern is with the collective good. However, the collective is not the business group, but the *grand corps* to which one belongs and, indirectly, the state itself. The collective self-interests of the three *grands corps* is to protect their historical prerogatives and establish new ones as opportunities arise; this leads to 'collective' opportunism as they jockey for position among themselves and strive to excel in serving the state through public administration and corporate management. Individual top managers are likely to voluntarily comply with shareholders' interests, as they are from the same social class of social elites or even the same *grand corps*. Thus, the most powerful actors in the French economy have personal and collective interests that are primarily non-economic in nature (Crozier 1995). Thus, like it was with Sweden, it again seems plausible to conclude that the French have a governance heritage based on a modified set of assumptions about the attitudes and behaviors of agents and principals that lies outside the assumptions of the base model, but are explained by the modified framework.

Conclusion

Our cross-national focus offers support for the speculation raised by others that the agency theory's governance model may be too rooted in the US institutional context. Drawing on theories from institutional economics and sociology, we proposed a framework for making the P-A model cross-nationally accommodating. Consistent with the methodology of historical analysis, we then used that framework as an exploratory lens to arrange a large amount of qualitative data into plausible explanations about the attributes of corporate governance in Sweden, which is based more on the norms of collective responsibility and voluntary compliance, and France, which is based more on collective self-interest.

We conclude that it is difficult for one nation to import or imitate the corporate governance practices of another nation. The assumptions, beliefs, and expectations that are ingrained in people through background socialization (schools, religion, family, play, etc.) not only shape their behavior, they also shape the nation's formal institutions (legal system, political system, financial system, etc.). Thus, the corporate governance practices of a nation are a solution to a set of problems designed to work in a specific context. Just as a software program will only work when used with the appropriate operating system, imported governance practices will only work when the adopting nation's institutions socialize managers and investors similar to those in the nation that developed the practices. This may explain why there has been a reasonable degree of success in sharing corporate governance practices between the USA, UK, and Canada, but far less success moving the best practices from those nations outside the Anglo-American world.

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