THE BROOKINGS INSTITUTION

1775 Massachusetts Avenue, NW Washington, DC 20036-2188
Tel: 202-797-6000 Fax: 202-797-6004
www.brookings.edu

U.S.-FRANCE ANALYSIS SERIES
January 2003

THE TRANSFORMATION OF CORPORATE GOVERNANCE IN FRANCE

Michel Goyer
Massachusetts Institute of Technology

Corporate governance first appeared as a topic of conversation in France in the mid-1990s in the wake of two quasi-simultaneous developments: the growing importance of foreign ownership (i.e. Anglo-Saxon institutional investors) and the succession of spectacular financial losses resulting from unmonitored managerial initiatives (e.g., Credit Lyonnais, Michelin, Paribas, Suez, Union des Assurances de Paris). As one might have expected, the reception was rather cold if not openly hostile to this new American export.[1] In France, the terms "corporate governance" and "shareholder value" have generally been associated with lay-offs and short-term thinking that privileges the next quarter's financial results over the long-term health and social responsibility of the corporation. The contempt shown by managers, state officials, trade unionists, and the general public toward foreign mutual and pension funds was not a surprise. After all, France has been on the forefront of the anti-globalization discourse despite fully embracing most of globalization's consequences.[2]

Behind the seemingly stable discourse on corporate governance, however, lies a changing assessment of its centrality for the French economic system. The impressive performance of the American economy in the 1990s meant that its model of corporate governance came to serve as a benchmark for other countries to emulate throughout the decade. Moreover, access to international equity capital was seen as contingent on the adoption of good governance practices and an emphasis on shareholder interests. By contrast, the current decade—which has seen the bursting of the Internet bubble and the proliferation of corporate scandals in the United States—has the French gloating with joy. The recent misfortunes of American firms—most notably Enron and Worldcom—have been seen as a vindication of the French model. Commentators point to the opposition of management at Suez (utilities group) to adopt Enron-style off balance sheet accounting in order to dress up its financial ratios despite the pressures of its auditors, as

[1] See John Tagliabue, "Resisting Those Ugly Americans", *New York Times*, January 9, 2000; Philippe Labarde and Bernard Maris, *La Bourse ou la Vie*, Paris: Albin Michel, 2000.

[2] See Suzanne Berger, "Trade and Identity: The Coming Protectionism?" in *Remaking The Hexagon*, Gregory Flynn, ed. Boulder: Westview Press, 1995; Philip Gordon and Sophie Meunier, *The French Challenge: Adapting to Globalization* Washington: Brookings Institution Press, 2001.

well as to the refusal of the *Commission des Operations de Bourse* (the French securities regulator) to give into Vivendi Universal's demands on the use of questionable methods for reporting financial results as examples of the success of the French system in curbing corporate greed.[3]

The French *schadenfreude* over problems in the American system of corporate governance should not mask substantial changes in the way French firms are doing business at home and abroad. The old model of corporate governance has changed beyond recognition. Its transformation is most prominent in three areas. First, the ownership structure of companies underwent a major transition in recent years from concentrated cross-shareholdings in the hands of friendly fellow domestic companies to high levels of foreign ownership.[4] Foreign investors – composed primarily of Anglo-American mutual and pension funds, now own a little over 40 percent of the equity capital of blue-chip CAC 40 firms.[5] This was a result, in large part, of the deliberate strategy of firms to sell their cross-shareholdings in an effort to convince foreign investors that they would be responsive to shareholder concerns.[6] Second, large French firms have reversed their strategy of corporate diversification in many business areas and have dismantled their conglomerate structure. Blue-chip companies, with the notable exception of some traditional family-owned firms, are currently focusing on a limited set of core competencies.[7] As a result, employees of French companies can no longer enjoy the employment protection offered by the internal labor market of conglomerates and the cross-subsidization from fast growing units to poorer performing counterparts. Their employment tenure is increasingly dependent on the financial performance of the firm. Third, French firms have adopted managerial performance incentives. A little over half of the total remuneration of French CEOs and top managers now comes in the form of variable pay based on some performance measure as opposed to a fixed salary.[8] As a result, large French firms now pay out the biggest stock options packages among continental European companies.[9]

---

3 Victor Mallet, "Exception is Not the Rule," *Financial Times*, July 29, 2002, p. 6.

4 See Francois Morin, "A Transformation in the French Model of Shareholding and Management," *Economy and Society,* no. 29, pp. 36-53.

5 Michel Goyer, "Anglo-American Institutional Investors and the Transformation of Corporate Governance in France and Germany", paper presented to the conference on Transforming the Democratic Balance in France, Harvard University, May 2002.

6 Francois Morin, *Le Modele Francais de Detention et Gestion du Capital* Paris: Les Editions de Bercy, 1998.

7 Michel Goyer, "Corporate Governance, Employees, and the Focus on Core Competencies in France and Germany," in *Global Markets, Domestic Institutions: Corporate Law and Governance in an Era of Cross-Border Deals*, Curtis Milhaupt, ed. New York: Columbia University Press, 2003.

8 Towers Perrin, *Worldwide Total Remuneration,* 2001 Annual Report, Philadelphia.

9 See *L' Expansion,* September 13, 2001, pp. 92-97.

The recent changes in French corporate governance have led to the adoption of various practices intended to promote shareholder value. Nonetheless, the governance of French enterprises continues to look distinct from the norms and practices that prevail in both the United Kingdom and the United States. There are two areas in which companies have resisted the demands of Anglo-Saxon institutional investors in a particularly fierce manner. First, the French system of corporate governance remains largely opaque. The number of companies using an international accounting standard among the country's largest 100 has barely risen, from thirty-five in 1997 to thirty-eight in 2000.[10] This evolution contrasts substantially with the German experience of greater financial transparency whereby the number of top 100 firms using an international accounting standard increased from nine in 1996 to a little over 70 in 2001. Second, French companies still maintain various practices that effectively disenfranchise minority shareholders, allowing them to raise capital without losing control of the firm. The use of unequal voting rights and of ownership ceilings stands apart from practices in the other economies (see Table 1).

Table 1

Firms with Unequal Voting Rights (2001) (in %)

Exception to one-share, one-vote	France Top 40	Germany Top 30	Japan Top 250	UK Top 250	US Top 1000
% of firms with ownership ceilings	30	6	0	0	0
% of firms with unequal voting rights	58	13*	0	10	10

*Figure is for top 250 German firms
Source: Goyer (2003)

The French experience in transforming corporate governance points to the importance of two issues: process and sustainability. Large firms have been the drivers of the process of change in French corporate governance, with little involvement by either employees or state officials. In this way, the process has mirrored that of the industrial restructuring of the past twenty years.[11] The decision to adopt shareholder value institutions and practices has been made on a company-by-company basis by the CEO and top managers without coordination with other firms. French companies dismantled their conglomerate structure without providing employment guarantees or other concessions to employees.[12] The use of stock options is limited to CEOs and to top

[10] See Goyer (2003), *op. cit.*

[11] See Bob Hancke, *Large Firms and Institutional Change: Industrial Renewal and Economic Restructuring in France* New York: Oxford University Press, 2002.

[12] Fabienne Dufour, " *Les clauses de garantie d' emploi dans les accords d' enterprise",* in Jean-Yves Kerbouch and Christophe Willmann, eds., *Le Salarie, l' Entreprise, le Juge et l'Emploi* Paris : La Documentation Française, 2001.

management—less than one percent of French employees are eligible for them.[13] The sale of cross share-holdings took place in an uncoordinated fashion as firms sold their participation in other companies without seeking the approval of the managers of the companies being sold.[14]

It remains to be seen however whether such an ad-hoc system of corporate governance will prove sustainable and conducive to economic growth. The relationship between corporate governance and economic performance is a complicated one as many factors impact on growth. However, it is safe to conclude that the transformation of corporate governance in France has not prevented firms from becoming nimble players on the international scene.[15] In fact, the stock market capitalization of French companies has skyrocketed in recent years, leaving the other continental European economies well behind in terms of capitalization as a percentage of GDP. (See Chart 1).

---

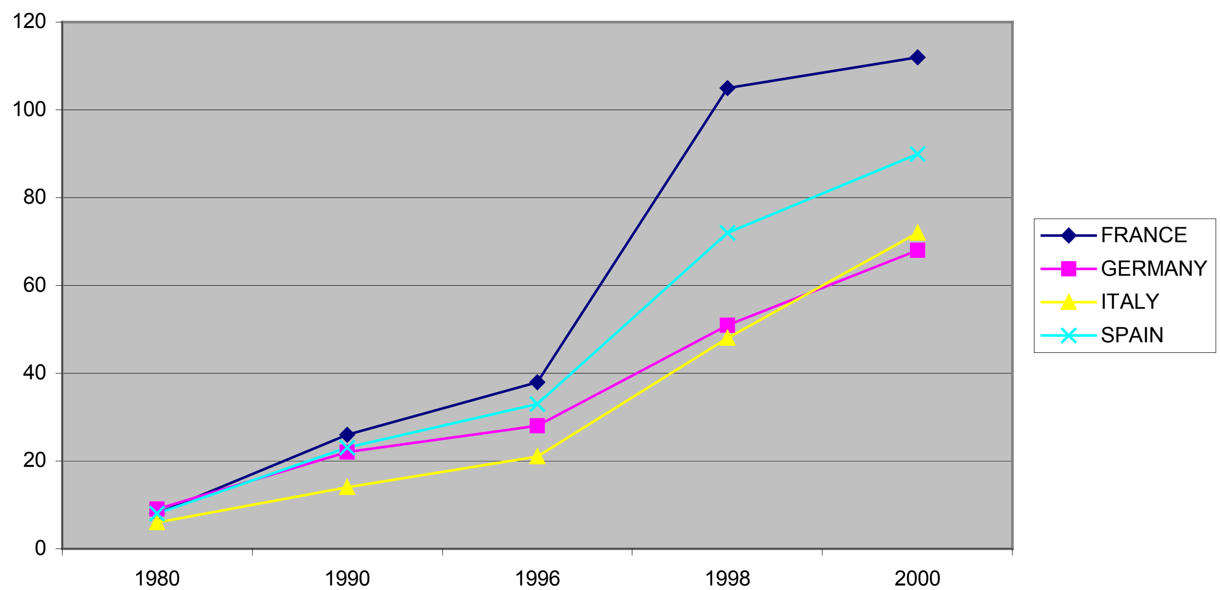
[13] See "*Enquete sur les stocks options et l' actionnariat salarie", Le Monde,* March 4/5, 2001.

[14] Francois Morin (2000), *op.cit.*

[15] See Gordon and Meunier (2001), *op. cit.*; and Peter Hall, "The Evolution of Economic Policy" in Alain Guyomarch, Howard Machin, Peter Hall, and Jack Hayward, eds., *Developments in French Politics 2* Basingstoke: Palgrave, 2001, pp. 172-190.

Chart 1[16]

Stock Market Capitalization as a Percentage of GDP, 1980-2000



Nonetheless, the success of the French stock market and of French domestic firms does not

---

[16] Note: Time scale is compressed and 1998 figures for France are from 1999.

guarantee the sustainability of the current French system of corporate governance. There are two basic reasons to be skeptical that the current hybrid system can survive. First, even productive economic arrangements might generate a political backlash if they are not seen as legitimate.[17] The management-led process of transformation of corporate governance in France has generated a profound degree of public dissatisfaction. This discontent toward shareholder value is part of a general dissatisfaction with the willingness of the government to allow globalization to take its course, as demonstrated by the French elections of May 2002. Despite the excellent macroeconomic performance of the French economy and an impressive record of job creation under the leadership of former Prime Minister Lionel Jospin, over 40 percent of the French electorate voted either for a candidate of the far right or the far left in the first round of the presidential elections, eliminating Jospin in the first round. Nearly 40 percent of the electorate did not even bother to vote in the first round.

Second, it is ironic to note that French firms have adopted a U.S.-style system of corporate governance practices at the same time as financial scandals are shaking the American system. In particular, large French firms have been eager to introduce managerial incentives (i.e. stock options) without the necessary counterparts of greater financial transparency and stringent criteria for awarding options. As in the American case, lack of financial transparency might enable French executives to undertake complex company restructurings, particularly acquisitions that are designed more to increase the short-term value of the company's stock, and therefore their options, than to establish a long-term, competitive firm strategy. Similarly, lenient criteria attached to stock options packages may mean that, during a bull market or even strong sectoral growth, managers will be enormously compensated even when the increase in stock price is demonstrably unrelated to the actions of CEOs or other top executives. Finally, the lack of monitoring with regard to executive compensation in France might be a source of instability in current institutional arrangements of corporate governance since it makes the system prone to financial scandals.

The principal challenge for the French system of corporate governance consists in resolving the tensions embedded in the process of change. On the one hand, individual companies introduced several shareholder value practices in the French system of corporate governance. The involvement of employees and state officials was rather marginal in this process of change. On the other hand, the French electorate is still attached to Republican ideals and looks to the State as the guardian of its values. French political discourse still assigns a critical role to the State in the economic sphere despite the structural transformation of the French economy and the associated dismantling of the *dirigiste* apparatus.[18] In general, the evolution of policy-making in France in the last two decades reveals a striking lack of communication between the political,

[17] Mark Roe, "Backlash", *Columbia Law Review,* 98, pp. 217-41.

[18] For an evaluation of the discrepancy between economic performance and political disaffection in France, see Peter Hall, "The Economic Challenges Facing President Jacques Chirac", Brookings Institution U.S.-France Analysis Series, June 2002 at http://www.brookings.edu/fp/cusf/analysis/hall.htm

economic, and social spheres.[19] Thus, the policymakers, who are necessary for the legitimation of the new system of corporate governance, have exerted little influence in recent years.

However, one should not look for a return of the State in economic affairs to resolve this tension. The institutional apparatus that supported the *dirigiste* system has crumbled under both the pressures of globalization and the inability of state officials to credibly discipline poor performers. The direct role of the State in corporate governance should instead consist in using the prestige of office as a bully pulpit to reconcile Republican values and market competition. In future, intervention by state officials is likely to be characterized by symbolic gestures and political discourse, rather than the direct interventions of the past.[20] Moreover, state officials should rely to a greater extent on the *Commission des Operations de Bourse* to monitor French executives in order to avoid the types of financial scandals that have recently plagued the U.S. In contrast, French businesses should learn to develop a capacity for strategic thinking—most likely via business associations. Concerns about the legitimacy of managerial actions in France often arise from the inability of firms to cooperate with one another to improve the skill of the workforce.[21] Moreover, French companies can no longer rely on the state to soften up the costs of adjustment for workers in the form of early retirement and other compensatory policies. Company executives and state officials do not need to coordinate their action, but they certainly have to start independently addressing the concerns of voters and workers.

---

[19] Suzanne Berger, "The Decay of the Parties of Government and the Shift in Themes that Animate the Electorate," paper presented to the conference on Transforming the Democratic Balance in France, Harvard University, May 2002.

[20] See Peter Hall (2002), *op.cit*.

[21] Pepper Culpepper, "Employers, Public Policy, and the Politics of Decentralized Cooperation in Germany and France," in Peter Hall and David Soskice, eds., *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* New York: Oxford University Press, 2001.