# Stacking the Friday Workshop: An Introduction

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Time was—and not that long ago it was—corporate law boasted as many active scholars as a legal theory workshop on a late Friday afternoon. A few men and women worked regularly in the field, but not many. Among those who did, the well-advised hedged their bets by cultivating a parallel reputation elsewhere.

No longer—and the time all this changed is easy to nail. Almost single-handedly (if a pair can wield a single hand) in the early 1980s Frank Easterbrook and Daniel Fischel drew to the field the corps of scholars who would dominate it for the next three decades. The debate over which they attracted the scholars involved takeovers. Borrowing Henry Manne's notion that a "market for corporate control" constrained executive behavior,[1] the two argued that the managers of a firm targeted by a takeover should never resist.[2] Takeovers generate large returns to target shareholders *ex post*, they explained, and the risk that a badly run firm will attract acquirers will keep all firms better managed *ex ante*. To facilitate this beneficent corporate control market, managers of firms faced with a hostile bid should roll over and play dead.

Easterbrook and Fischel used a logic that intrigued some but infuriated others, and the rest is—well, the rest is where we are. Almost single-handedly, they brought corporate law to life as though they were stacking a Friday workshop. Less politely put, they launched a venomous debate, and (scholars being what they are) that venom drew to the field the then-still-young scholars who would make it their own. Even if Easterbrook and Fischel would themselves stop writing in the field, over time the scholars they attracted to it would resuscitate a wide variety of corporate subfields: insider trading, inter-jurisdictional legal competition, executive compensation, the contrast between mandatory and enabling rules—and corporate governance.

Among these subfields, corporate governance has generated the most comparative work, and the essays in this symposium extend that

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[1] Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965).

[2] Frank H. Easterbrook & Daniel R. Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 HARV. L. REV. 1161, 1164 (1981).

work along a distinctly East Asian dimension (a dimension pioneered in the law by such scholars as Curtis Milhaupt and Mark West). It is not a dimension for the indolent. Because the essential research is neither exclusively legal nor exclusively behavioral and imposes stringent linguistic requirements, it makes grueling demands of those who would advance the field. Necessarily, the questions at the heart of comparative corporate governance research involve (1) the nature of the actual institutional constraints themselves, and (2) the ways real world executives, investors, and other market participants respond to those constraints.

Done properly, the investigation into these institutional constraints will generally start with the law. Obviously, participants to the corporate enterprise face institutional constraints not enforced by courts. Yet because the law in well-functioning legal systems (Jie Yuan reminds us that this excludes China)[3] lets these participants harness the coercive power of the state, the strongest constraints often do involve the law.

Now, a legal education may not be a prerequisite for studying the law, but it does help. And because so many of the strongest institutional constraints are legal, the right way to begin studying the institutional structure is simple enough to state: read the cases. Given the preeminent role courts in well-functioning democracies play in interpreting and enforcing the law, there is no substitute for analyzing cases. Given the haphazard quality of any work in English, there is no substitute for reading the cases in the original. And given the ubiquity of modern legal databases, there is no excuse for doing anything else. To take one example of an oft-made claim: did Japanese bureaucrats have the power to shape corporate governance by forcing firms to follow their informal advice? Skip the predictable twenty secondary sources, few of whose authors ever read a case anyway. Type the Japanese characters for administrative guidance into the Lexis or Hanrei Taikei database and read the cases the computer spits out.

By contrast, the way these institutional constraints shape human behavior requires a statistical inquiry seldom taught in laws. Because we want to know the systematic rather than the idiosyncratic or the peculiar, we will generally need to create large data sets. The process is tedious—but who ever said good scholarship was easy? And given that we do not advance the social scientific enterprise by citing and re-citing what others claim to have found, we will need to create the data sets

[3] Jie Yuan, *Formal Convergence, Substantial Divergence? Evidence from the Adoption of Independent Director System in China*, 9 ASIAN-PAC. L. & POL'Y J. 71 *passim* (2007).

ourselves. Only then can we even hope to test rigorously the systematic effect that institutional constraints have on human behavior.

To take another familiar example, do cross-shareholdings stymie the corporate control market in Japan? There is but one way to answer the question responsibly. It is not to scour the newspapers for accounts of cross-holdings. It is not to telephone executives and ask how much of their stock is cross-held. It is not to rely on research institutes that spout numbers of dubious pedigree. It is to collect the data oneself and count—to calculate how many shares of firm A's stock are held by firms in which A owns how many shares.

Less well appreciated, research on corporate governance also requires inter-disciplinary theory: a logically coherent set of predictions about how individual human beings will react to a given set of institutional constraints. Absent that logically coherent theory, any empirical investigation degenerates into so much data-mining. Crucially, legal education does not provide such a theory.

The impact of outside-director requirements illustrates the importance of logically coherent theory. Legally trained but a-theoretic reformers routinely urge governments to require that firms appoint more outside directors. As Peter Lawley and Yuan observe, outside directors (much turns on the definition, of course) present a trade-off: they may be independent, but they also may know little about the firm.[4] If firms face competitive product, labor, and capital markets (which they do in Japan and South Korea but not in China), those extant firms that could benefit from outside directors will tend already to have them. To the extent that the outside-inside distinction matters, any requirement that all firms appoint outsiders merely places those men and women in positions where they help the least. This retrospectively self-evident logic is a staple of economics—but given the fundamentally a-theoretic nature of legal education, it is a point legal scholars routinely miss.

Turn, then, to the formal focus of this symposium: whether corporate law and practice are converging across the globe. Prominent corporate law scholars have argued that they are. Most of the symposium participants claim not. Mostly, they give answers that range from "no" to "only sort of."

To begin to make sense of these responses, consider the logic behind the convergence claim in the first place. First, corporate law governs voluntary transactions among adults with financial resources. As such, a value-maximizing corporate law regime is one that enforces the

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[4] Peter Lawley, *Panacea or Placebo? An Empirical Analysis of the Effect of the Japanese Committee-System Corporate Governance Law Reform*, 9 ASIAN-PAC. L. & POL'Y J. 105, 114-17 (2007); Yuan, *supra* note 3, at 89-90.

terms those adults negotiate. It does not limit the choices available to them. In the language of the moment, it supplies enabling rules. It does not impose mandatory provisions. With exceptions to be sure, Delaware (the state that governs most big American firms) primarily offers just such enabling rules.

Second, over the second half of the 20th century, technological changes dramatically increased the potential scope of product and capital markets around the world. The heightened international product-market competition increased the pressure on firms to raise funds cost-effectively. The potentially cheaper access to funds elsewhere increased the attempts by firms to raise their money abroad.

The product-market competition pushed legislators across the globe to adopt enabling rather than mandatory corporate rules. It did not necessarily push them to mimic Delaware. After all, legislators face endless variations on more-or-less equally efficient enabling regimes. The Delaware corporate code is not the only decent regime available.

Yet capital-market competition did push legislators to choose Delaware variants. The U.S. capital market is easily the largest in the world. Firms from Country X will find it easier to tap that market if U.S. investors can readily gauge the legal rules in place in their home jurisdiction. So long as Country X legislators maximize votes by catering to domestic firms, they lose little and gain much by simply aping Delaware.

Third, because managers maximize profits subject to institutional constraints, any convergence in law will tend to drive convergence in behavior. Several symposium participants make much of the law-behavior dichotomy. Given that legal rules are not the *only* institutional constraints firms face, one would not expect changes in the law to generate exactly parallel changes in the firm behavior. Yet to the extent legal rules bind (and not all do), changes in legal rules *should* tend to generate predictable changes in firm behavior (albeit only tend).

This review of the dynamic behind legal convergence clarifies some of the otherwise cacophonous results that the participants here present. Yuan argues that American-style legal rules generate different responses in China than in the United States. True enough, but the Chinese government manipulates its product and capital markets with a heavy hand, and its legislators face no competitive elections. The economic and electoral market forces that otherwise drive legal convergence operate in China only haphazardly if at all.

Some commentators argue concerns other than efficiency surely drive many legislators. True enough again, but as Gary Becker showed two decades ago, the fact that legislators respond to voter preferences other than efficiency does not eliminate the pressure toward efficient

rules.[5] All else being equal, voters will still prefer politicians who enact efficient rules to politicians who enact inefficient rules.

Konsik Kim reports that audit committees function differently in South Korea than in the U.S.[6] Recall, however, that the mechanism that drives convergence involves value-maximizing enabling provisions. It does not involve badly inefficient mandatory rules like those in Sarbanes-Oxley.

Last, Puchniak and several others ask whether various country-specific models converge—models like the Japanese main bank system, the keiretsu corporate groups, or the stable shareholding patterns. Unfortunately, the question illustrates the need for careful empirical research. As Yoshiro Miwa and I show elsewhere, these alleged models are simply artifacts of bad scholarship. Creatures of the academic imagination, they do not now characterize the Japanese economy and never did. Nothing in the logic behind legal convergence suggests that professorial imaginations will converge.

In order to advance our knowledge of the field, we need solid studies of the way courts in different countries actually enforce legal constraints. We need logically coherent predictions about how people will respond to those constraints. We need original tests of whether and when these predictions hold true.

Several essays in this symposium nicely advance the first of these goals. Kenichi Osugi describes the legal changes governing takeovers in Japan.[7] Kim explains the new audit committee regime under South Korean law.[8] Yuan introduces us to the outside-director mandate in China.[9]

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[5] *See generally* Gary S. Becker, *A Theory of Competition Among Pressure Groups for Political Influence*, 98 Q.J. ECON. 377, 377 (1983).

[6] Kon Sik Kim, *Transplanting Audit Committees in Korean Soil: A Window into the Evolution of Korean Corporate Governance*, 9 ASIAN-PAC. L. & POL'Y J. 163 *passim* (2007).

[7] Kenichi Osugi, *Traditional Rules and Their Transformation: M&A Rules in Japan and the Corporate Governance Debate*, 9 ASIAN-PAC. L. & POL'Y J. 143 *passim* (2007).

[8] Kim, *supra* note 6, at 163 *passim*.

[9] Yuan, *supra* note 3, at 71 *passim*.

Other contributors provide additional insights. Lawley suggests ways that the Japanese reforms may shift behavior in unanticipated ways.[10] Puchniak discusses shifting patterns of corporate governance.[11] Together, the five essays collected here make a nice package. Together, they move the field solidly forward.

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[10] Lawley, *supra* note 4, at 105 *passim*.

[11] Dan W. Puchniak, *The Japanization of American Corporate Governance? Evidence of the Never-Ending History of Corporate Law,* 9 ASIAN-PAC. L. & POL'Y J. 7 *passim* (2007).