

The Political Economy of Corporate Governance Reform: Institutional Pathways and Policy Trade-offs

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ABSTRACT

Corporate governance reform is rarely a purely technocratic exercise. It is shaped at every stage by political interests, institutional legacies, and the distributional consequences that any reform creates for shareholders, managers, workers, and the state. This paper examines the political economy of corporate governance reform through three interlocking questions: how institutional context shapes the pathways through which reform becomes possible, what policy trade-offs arise when reform is attempted, and how governance failures produce trust deficits in workplace settings. Drawing on comparative institutional analysis and documented corporate scandals, the paper maps the conditions under which reform stalls, advances, or produces unintended consequences. It concludes with practical advisories for workplace managers who must maintain organizational integrity within governance frameworks that are often contested, incomplete, and unevenly enforced.

Keywords: Corporate governance, institutional reform, political economy, varieties of capitalism, board accountability, workplace trust, regulatory compliance

INTRODUCTION

Corporate governance sits at the intersection of law, economics, and power. It determines who controls a corporation, to whom management is accountable, and how the gains and losses from corporate activity are distributed. These are not purely technical questions. They are political ones, and the reform of governance arrangements is correspondingly political, contested by the actors who stand to gain or lose from any change in the rules.

The two decades between the collapse of Enron in 2001 and the governance failures that attended the COVID-19 economic crisis produced a recurring pattern: scandal, legislative response, partial reform, regulatory fatigue, and then the conditions for the next scandal. This cycle is not an accident. It reflects the structural difficulty of reforming governance arrangements when the actors with the most to gain from maintaining them have the greatest capacity to resist change.

This paper takes the political economy of governance reform seriously as an analytical problem. The first section establishes what corporate governance is and why politics shapes it so decisively. The second examines the institutional pathways through which reform happens across different national contexts. The third maps the trade-offs that reform efforts routinely generate. The fourth presents documented cases in which governance failures produced measurable trust deficits within organizations. The paper closes with concrete advisories for managers who need to function within governance frameworks they cannot fully control.

CORPORATE GOVERNANCE AND ITS POLITICAL FOUNDATIONS

Corporate governance describes the rules, relationships, and practices that determine how a corporation is directed and controlled: how decisions are made, who makes them, and who bears the consequences when

they go wrong. The OECD (2015) defined it as involving a set of relationships between a company's management, its board, its shareholders, and other stakeholders, providing the structure through which company objectives are set and performance is monitored.

That definition sounds orderly. The reality is considerably messier. Governance arrangements reflect the prior distribution of power among the groups they govern. Shareholders, managers, workers, creditors, and the state all have interests in how corporations are run, and those interests regularly conflict. The governance framework that emerges in any given country is therefore not a neutral optimal solution but a settlement: provisional, historically contingent, and subject to renegotiation whenever the balance of political forces shifts.

Roe (2003) made this point with particular force. His analysis showed that differences in corporate governance across countries cannot be explained by efficiency alone. Political factors (the strength of social democratic parties, the power of organized labor, the state's relationship with finance) predict much of the cross-national variation in ownership structure and board composition. Countries with strong labor movements tend toward more concentrated ownership structures because concentrated owners have the power to counter labor at the bargaining table. Countries with weaker labor movements can sustain dispersed ownership because the coordination problems that dispersed ownership creates are less politically costly.

Fligstein (1990) traced the historical evolution of American corporate governance through the twentieth century, showing how successive conceptions of corporate control (manufacturing control, sales and marketing control, and eventually shareholder value) each reflected not just managerial ideology but the political environment in which corporations operated. The rise of shareholder value maximization as the dominant conception of corporate purpose in the 1980s and 1990s was not a discovery of an optimal governance principle; it was a political and cultural shift, enabled by regulatory changes and accelerated by institutional investors whose own interests aligned with the new doctrine.

INSTITUTIONAL PATHWAYS: HOW REFORM HAPPENS

Understanding why corporate governance reform takes the shape it does in any given country requires paying attention to institutional context. Hall and Soskice (2001) offered the most influential framework for this analysis in their account of varieties of capitalism. They distinguished broadly between liberal market economies (such as the United States and the United Kingdom), where coordination happens primarily through market mechanisms, and coordinated market economies (such as Germany and Japan), where coordination happens through networks, associations, and long-term relationships.

In liberal market economies, corporate governance reform tends to arrive through legislation following visible crises, because markets lack the coordinating mechanisms to produce reform through negotiated change. The Sarbanes-Oxley Act of 2002, passed in the aftermath of Enron and WorldCom, is the clearest American example. The Act imposed new requirements on corporate boards, executives, and auditors, including mandatory CEO and CFO certification of financial statements and criminal penalties for deliberate misrepresentation. It moved quickly because the political cost of inaction (after billions of dollars in losses and hundreds of thousands of jobs destroyed) was higher than the cost of acting.

In coordinated market economies, reform tends to be more incremental and negotiated, because the stakeholder networks through which governance functions have established channels for managing disagreement. Germany's system of codetermination, under which workers hold seats on supervisory boards, was not imposed by a single piece of legislation but built up over decades through negotiation between employers, unions, and the state. This makes it more stable and harder to dislodge than

governance arrangements that rest on legislation alone, but also slower to adapt when adaptation is needed.

Aguilera and Jackson (2003) pushed this analysis further by identifying the specific coalitions that form around governance reform in different institutional contexts. They showed that the same actor (organized labor, for instance) can support or oppose governance reform depending on how that reform interacts with the existing rules of the game. Labor that benefits from codetermination has an interest in protecting the governance arrangements that give it voice. Labor that is excluded from governance has an interest in changing them. The institutional environment determines which coalition is possible.

Bebchuk and Roe (1999) introduced the concept of path dependence to explain why governance arrangements persist even when they appear to be suboptimal. Once a set of governance rules is in place, the actors who benefit from those rules develop interests in maintaining them and the political capacity to resist change. Ownership structures, board compositions, and legal frameworks create complementary institutions that reinforce each other, making any single element difficult to change without destabilizing the broader arrangement. This insight explains why corporate governance reform is so often incremental even when the case for more substantial change seems compelling.

La Porta et al. (1998) identified legal origin as another major determinant of corporate governance structure. Countries with common-law traditions tend to offer stronger protections for minority shareholders than those with civil-law traditions, which in turn affects the viability of dispersed ownership structures and the kind of governance reforms that legislators will find practical. These legal legacies were not designed with corporate governance in mind; they reflect centuries of legal development for entirely different purposes. But they constrain the governance options available to reformers today in ways that pure efficiency arguments cannot easily override.

POLICY TRADE-OFFS IN CORPORATE GOVERNANCE REFORM

Governance reform always creates winners and losers. Recognizing that clearly is not cynical; it is necessary for understanding why reform proposals that seem obviously beneficial still face serious resistance and why that resistance often succeeds.

SHAREHOLDER RIGHTS VERSUS STAKEHOLDER INCLUSION

The most persistent policy trade-off in corporate governance is between shareholder primacy and broader stakeholder inclusion. Shareholder primacy holds that a corporation's primary obligation is to maximize returns for its owners. Stakeholder theories argue that corporations have obligations to workers, communities, customers, and others whose interests are affected by corporate decisions.

Coffee (2001) showed that dispersed ownership (the model in which thousands of small shareholders own a corporation rather than a handful of large block-holders) creates specific governance challenges. Dispersed shareholders have little individual incentive to monitor management closely, which can allow managers to pursue their own interests at shareholders' expense. The regulatory and legal framework that supports dispersed ownership is correspondingly complex and expensive to maintain, and it creates different governance problems than concentrated ownership does.

Stakeholder inclusion reforms (mandatory worker representation on boards, environmental and social reporting obligations, executive pay disclosure) consistently face opposition from managers and large shareholders who interpret them as constraints on the corporation's freedom of action. Proponents argue that stakeholder inclusion reduces the risk of the kind of governance failures that result when management answers only to the most short-term-oriented shareholders. Both sides have evidence, which is one reason this debate has continued for decades without resolution.

TRANSPARENCY VERSUS COMPETITIVENESS

Disclosure requirements are among the most commonly deployed governance reform tools. The logic is straightforward: if investors, workers, and the public can see what companies are doing, they can hold management accountable. But disclosure requirements carry costs, and those costs are not evenly distributed.

For large corporations with sophisticated legal and compliance functions, disclosure requirements are manageable, though not trivial. For smaller companies, the same requirements can be disproportionately burdensome. This asymmetry creates political constituencies for limiting or carving out exemptions from disclosure requirements, and those constituencies are often effective. The result is a governance landscape in which the largest and most systemically important corporations frequently face lighter proportional regulatory scrutiny than the reform's architects intended.

SHORT-TERM ACCOUNTABILITY VERSUS LONG-TERM INVESTMENT

Quarterly reporting obligations, mark-to-market accounting, and the pressure of activist shareholders who hold positions for months rather than years all push corporations toward prioritizing short-term results. This is a governance consequence of the shareholder primacy framework: when shareholders can exit a corporation instantly, corporate management has strong incentives to manage for those shareholders' time horizon, which may be very short.

The trade-off between short-term accountability and long-term investment is real and documented. Milhaupt and Pistor (2008) showed that different legal systems produce different time horizons for corporate investment. Legal systems that concentrate ownership (through family ownership, state ownership, or bank-centered finance) tend to produce longer investment horizons because the dominant shareholders are not trying to exit. Legal systems that support dispersed ownership face the opposite pressure. Reform proposals that try to lengthen time horizons within a dispersed-ownership system (differential voting rights, mandatory holding periods, long-term pay structures) face resistance from the short-term investors whose cooperation the system depends on.

GOVERNANCE FAILURES AND WORKPLACE TRUST DEFICITS: DOCUMENTED CASES

The connections between governance failure and workplace trust deficits are not theoretical. The cases below are documented and illustrate how structural governance weaknesses translate into damaged relationships between employees, management, and the organizations they work within.

Enron (2001)

The collapse of Enron in December 2001, at the time the largest corporate bankruptcy in American history, destroyed approximately \$74 billion in shareholder value and eliminated the retirement savings and jobs of thousands of employees. The governance failures at Enron were extensive and well documented in subsequent congressional investigations. The board of directors had approved transactions that company executives had constructed to hide debt off the balance sheet. The audit committee had approved accounting practices that allowed Enron to report revenues it had not actually received. Analysts at major investment banks continued to issue buy recommendations on Enron stock while privately expressing serious doubts in internal communications.

For Enron's employees, the trust deficit had multiple dimensions. Many had been encouraged, and in some cases effectively pressured, to hold their retirement savings in Enron stock through the company's 401(k) plan, while senior executives who knew the company's financial position was deteriorating were selling their own shares. The employment relationship was structured in such a way that workers bore the downside of governance failure (job loss, pension loss) while executives who engineered that failure had

already extracted their gains. The Sarbanes-Oxley Act (2002) followed directly from this episode and others like it, imposing new board accountability requirements and criminal penalties for financial misrepresentation. But no legislation could restore what the workers who lost their pensions at Enron had lost.

Volkswagen Emissions Scandal (2015)

In September 2015, the US Environmental Protection Agency revealed that Volkswagen had installed software in approximately 11 million diesel vehicles worldwide that detected when the vehicle was undergoing an emissions test and activated full emissions controls only during the test. Under real-world driving conditions, the same vehicles emitted nitrogen oxides at up to 40 times the permitted level. The software had been installed deliberately, by engineers who knew what they were building, over a period of several years.

The governance question the Volkswagen scandal raised was not primarily about the engineers who built the defeat device. It was about how a corporate culture and governance structure allowed that decision to be made and executed without anyone with the authority to stop it doing so. Volkswagen had a supervisory board structure that included worker representatives, one of the features of coordinated market economy governance that is often cited as a strength. But the governance structure did not prevent a culture of pressure to meet emissions targets at any cost from producing a systematic, deliberate fraud.

For Volkswagen's workforce, the aftermath was damaging in specific ways. The company faced fines exceeding \$30 billion globally. Thousands of jobs were at risk. And employees who had nothing to do with the defeat device found themselves working for an organization whose reputation for integrity had been comprehensively destroyed. The trust deficit was both internal (workers questioning what else they did not know about the decisions made above them) and external, as the public and regulators withdrew confidence in the company's assertions about its conduct.

Wells Fargo Fake Accounts Scandal (2016)

In September 2016, Wells Fargo entered a \$185 million settlement with US regulators over the creation of approximately 3.5 million unauthorized customer accounts (a number later revised upward) by bank employees who faced intense pressure to meet aggressive cross-selling targets. The accounts were created without customers' knowledge. Employees transferred customers' funds to the unauthorized accounts and in some cases applied for credit cards customers had not requested.

What made the Wells Fargo case particularly revealing as a governance failure was the evidence that senior management had known about the problem for years. The bank had fired approximately 5,300 employees for creating unauthorized accounts between 2011 and 2016. Each firing was treated as a problem of individual employee conduct rather than as evidence of a systemic governance failure driven by incentive structures that the board and senior management had approved and maintained.

For the employees involved, the governance structure had placed them in an impossible position. The pressure to meet cross-selling targets was real, the consequences of missing them were real, and the guidance they received about how targets were to be met was, at best, willfully vague. Workers who committed fraud to meet targets their employer set were fired for it. Workers who refused to commit fraud faced the same pressure without the same protective cover. The trust deficit this created was severe: employees could not trust that the organization they worked for would exercise its power in ways consistent with the standards it publicly claimed to uphold.

Carillion (2018)

Carillion was a British construction and outsourcing company that collapsed in January 2018 with approximately 1.5 billion pounds in debt and a pension deficit of around 2.6 billion pounds. The collapse was preceded by years of accounting practices that presented a misleading picture of the company's financial health. A parliamentary inquiry described the company's board as manifestly inadequate, its accounting as aggressive and misleading, and its auditors as failing to ask the questions their role required.

The human cost was immediate and concrete. Approximately 43,000 UK employees were directly affected. Thousands of workers in the company's supply chain (small subcontractors and suppliers) were left with unpaid invoices. Pension fund members faced reduced benefits. Many workers found out about the company's collapse not through any formal communication from management but from news reports.

Carillion illustrates how governance failure at the top of an organization produces a trust deficit that extends far beyond the organization's immediate employees. The subcontractors who had built relationships with Carillion, sometimes over decades, had no meaningful insight into the company's governance or its financial condition, and no practical way to protect themselves once the failure occurred. The governance arrangements that should have produced accountability produced instead a comfortable consensus between management, auditors, and institutional shareholders that the company's problems were temporary and manageable. They were not.

ADVISORIES FOR WORKPLACE MANAGERS

The failures documented above share a recognizable structure: governance arrangements that were formally adequate but functionally captured by the interests they were supposed to oversee; pressure systems that pushed employees toward conduct that served short-term performance metrics while undermining organizational integrity; and communication failures that left workers without the information or channels they needed to raise concerns before those concerns became crises.

Managers at all levels operate within governance frameworks they did not design and cannot unilaterally change. But within those frameworks, there is often more room to act than managers realize. The advisories below are aimed at that space. They are practical and proportionate, and most can be implemented without waiting for the board or the legislature to act first.

KNOW THE GOVERNANCE FRAMEWORK YOU ARE OPERATING IN

Managers who do not understand the governance structure they work within are poorly positioned to recognize when that structure is failing. Every manager who leads a team, a department, or a business unit should be able to answer these questions without hesitation: Who does this organization formally answer to? What are the board's stated responsibilities for risk oversight? What are my own obligations under the organization's code of conduct? What happens, formally and practically, when I raise a concern?

These sound like compliance questions, and in one sense they are. But understanding the governance framework you are operating in is also a self-protective act. Managers who misunderstand their own obligations under a governance framework, and who therefore inadvertently violate them, are not protected by their ignorance when things go wrong. The Wells Fargo supervisors who knew about unauthorized accounts and did not escalate them became part of the governance failure, not passive victims of it.

Implementation: Obtain and read the organization's current governance documents (code of conduct, ethics policy, whistleblowing policy, board charter if available). Note any gaps between what the documents say and what the organization actually does. Those gaps are where governance failure typically begins. Raise them through whatever formal channel is available, and document that you did.

TAKE INCENTIVE STRUCTURES SERIOUSLY AS GOVERNANCE TOOLS

The most damaging governance failures (Enron, Wells Fargo, Volkswagen) all involved incentive structures that rewarded the wrong things. In each case, the pressure to deliver specific measurable results overwhelmed the judgment of individuals who in other contexts would likely have acted very differently. Incentive design is governance, even when it is not treated as such.

Managers who set performance targets for their teams are making governance decisions. A target that is achievable through legitimate means is governance that works. A target that is achievable only through cutting corners, misrepresenting results, or putting pressure on others to do the same is governance that produces exactly the outcomes it is designed to prevent. The distinction matters, and it is one that managers can assess themselves without waiting for a board review.

Implementation: Review the performance targets currently in place for your team. For each, ask honestly: can this target be met through the means we say we expect people to use? If the answer is no, or if you are not certain, escalate. Document the review and its outcome. If you have direct authority over target-setting, build an explicit ethics check into the target-setting process, not as a bureaucratic formality, but as a genuine evaluation of whether the target creates pressure toward conduct the organization would not endorse.

BUILD REAL ESCALATION CHANNELS

Most organizations have formal mechanisms for raising governance concerns: ethics hotlines, ombudspersons, audit committees, whistleblower policies. Most organizations also have informal cultures that, to varying degrees, discourage using those mechanisms. The gap between formal policy and informal culture is where governance failures grow.

Workers who observed the conduct that ultimately destroyed Enron, Carillion, and Wells Fargo often knew something was wrong before it became public. In some documented cases they raised concerns. Those concerns were dismissed, managed, or responded to in ways that made clear that raising them further was not career-compatible. When the formal escalation channel exists only on paper, it provides no governance benefit. It simply gives the organization something to point to when asked why no one spoke up.

Implementation: Test your escalation channels annually and actually. A channel that no one uses is not evidence that there are no concerns; it is evidence that the channel is not trusted. Survey your team anonymously about whether they know how to raise a concern, whether they believe they could do so safely, and whether they have ever chosen not to because of concerns about the consequences. Use the results to identify where the channel is working and where it is not.

MAKE THE CONNECTION BETWEEN GOVERNANCE AND DAILY WORK VISIBLE

One of the most consistent features of major governance failures is that they are experienced by most employees as something that happened far above them, decided by people they never met, in a language they were not trained to speak. This is how governance becomes abstract, and abstraction is how the connection between individual conduct and organizational integrity gets lost.

Managers are in a better position than most to make that connection concrete. When the board updates the code of conduct, a manager can explain what it means in practice for this team, in these circumstances. When a regulatory change affects how the organization is required to report its activities, a manager can explain why that change matters and what behavior it expects. When someone on the team raises a concern about a decision or a practice, a manager who understands the governance framework can evaluate it with some rigor rather than dismissing it as outside the scope of normal work.

Implementation: In team meetings, when governance-relevant decisions are made at the organizational level, spend ten minutes explaining what they mean for how your team works. When new compliance requirements arrive, explain the reasoning behind them as well as the mechanics. Workers who understand why a governance requirement exists are more likely to apply its spirit as well as its letter. Workers who see it only as a bureaucratic imposition will comply minimally and selectively.

PREPARE ACTIVELY FOR REGULATORY CHANGE

The pattern documented by Hall and Soskice (2001) and Roe (2003) makes one prediction with high reliability: governance regulation follows crisis. After Enron came Sarbanes-Oxley. After the 2008 financial crisis came Dodd-Frank in the United States and a wave of regulatory reform across Europe. After Carillion came reform proposals around audit competition and director accountability in the United Kingdom. The timing of regulatory change is unpredictable; the direction of travel after a major failure is much less so.

Organizations that wait for regulatory change and then scramble to comply are in a worse position than those that have already built the substance of good governance into their operations. The difference is not just operational efficiency; it is the difference between governance as a commitment and governance as a compliance exercise.

Implementation: Assign someone in your area of responsibility to monitor regulatory developments in your sector. This does not require a legal expert; it requires someone who reads the relevant regulatory publications and summarizes what is coming. Build a quarterly review into your team's calendar in which you assess your current practices against likely future requirements, not just current ones. Organizations that do this will not be caught off guard by regulatory change. They will have addressed most of what regulators will eventually require before they are required to.

TREAT THE RELATIONSHIP WITH WORKERS AS A GOVERNANCE MATTER

The cases reviewed in this paper all involved organizations in which the relationship between leadership and workers was structured in ways that concentrated the risks of governance failure at the bottom of the organizational hierarchy while concentrating the gains at the top. This is not just an ethical problem; it is a governance problem. Organizations that absorb risk into their frontline workforce while insulating senior management from consequences are structurally incentivizing exactly the conditions that produce governance failures.

Managers who treat their relationships with workers as a governance matter (not as a morale issue or a human resources concern but as a fundamental question of organizational accountability) are building something that formal governance structures often fail to provide: a layer of honest feedback between the point where decisions are made and the point where their consequences are felt.

Implementation: In every significant decision that affects your team, ask who bears the risk if this goes wrong. If the answer is consistently the people with the least power in the organization, that is a governance warning sign. It does not necessarily mean the decision is wrong, but it means the risk distribution needs to be examined consciously. Make that examination a standard part of how decisions are evaluated, not an afterthought.

CONCLUSION

Corporate governance reform does not happen in a vacuum. It happens in political environments shaped by the interests of those with the most to gain from the status quo, in legal frameworks that reflect centuries of prior development, and through institutional pathways that vary dramatically across national contexts. Understanding this does not make the case for reform weaker; it makes it more realistic. Reform that

ignores the political economy of the institutions it is trying to change is reform that will be absorbed, captured, or outrun by the forces it was designed to constrain.

The cases examined in this paper (Enron, Volkswagen, Wells Fargo, and Carillion) demonstrate that governance failure is not a rare or exotic event. It follows a recognizable pattern: pressure systems that reward short-term results over long-term integrity, accountability structures that are formally present but practically captured, and communication channels that exist on paper but are understood by everyone to carry real personal risk when used. Each of those conditions is addressable at the level of the individual manager, without waiting for the legislature or the board to act.

The advisories offered here are not a substitute for better regulation, stronger board oversight, or reformed incentive structures at the executive level. Those things matter and their absence is consequential. But managers do not govern organizations from the outside in; they govern them from where they stand. Understanding the governance framework they work within, designing incentives that reward integrity alongside performance, building escalation channels that actually function, connecting governance requirements to daily work, preparing for regulatory change, and treating the employment relationship as a governance responsibility are within the reach of most managers in most organizations today. The main prerequisite is deciding that they matter.

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