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**Organisational responses to institutional change- evidence
from the liberalised German airport industry**

Antje Fiedler

**A thesis submitted in partial fulfilment of the requirements for the degree of Doctor of
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Abstract

Since the 1970s, advanced capitalist economies increasingly adopted elements of neo-liberal policies, such as market deregulation and privatisation. For a long time, Germany was considered to be an outlier, resisting the pressure to converge towards the neo-liberal Anglo-Saxon model. Until the late 1980s, the German model was considered competitive due to high productivity, strong exports and R&D investments. However, in the 1990s, the German model came under pressure from rising international competition, high unemployment and a lack of innovation in high-tech industries. At the same time, pressure to converge towards a single model of corporate governance was exerted on member states of the EU by supranational policies. There is recent evidence that the traditional German model underwent significant changes towards a more liberal model.

The objective of this thesis is to investigate how two German airports responded to liberalisation and privatisation activities and, in particular, how organisational restructuring and competitive strategies were influenced by the national corporate governance system. The findings are based on qualitative empirical research conducted in 2008-2010, including thirty-two in-depth interviews with different stakeholders of the airports, such as managers, government and employee representatives and board members. Also, annual reports and publicly available documents including companies' websites and newspaper articles were studied.

The empirical results show that both airports adopted certain neo-liberal practices and norms. Corporate restructuring was driven mainly by the adoption of the IFRS accounting and a stronger shareholder value orientation at Airport 1, and by the adoption of New Public Management practices at Airport 2. Due to the restructuring, working conditions for the majority of workers deteriorated while interests of owners became the major priority. However, differences remain between the two airports in terms of worker participation. While Airport 1 still maintains classical features of the German model for some areas of the organisation, including worker participation and an emphasis on a highly skilled workforce, managers at Airport 2 departed from these features. Overall, the empirical results indicate that both airports undermined the classical German model by introducing managerial concepts from the Anglo-Saxon model.

This thesis is dedicated to the memory of my beloved grandmothers,

Oma Else Fiedler

and

Oma Minna Löber

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Table of Contents

| | |
|---|------|
| Abstract..... | I |
| Acknowledgements..... | III |
| Figures..... | VII |
| Tables..... | VIII |
| CHAPTER 1: INTRODUCTION..... | 1 |
| 1.1 Research Aim..... | 1 |
| 1.2 Background of the research..... | 2 |
| 1.3 Research design..... | 5 |
| 1.4 Thesis structure..... | 9 |
| CHAPTER 2: INSTITUTIONS, MARKET ENVIRONMENT AND INNOVATION OF FIRMS..... | 12 |
| 2.1 Introduction..... | 12 |
| 2.2 Theoretical Foundations of Institutions..... | 14 |
| 2.2.1 Definition and forms of institutionalism..... | 14 |
| 2.2.2 Institutional forces and organisational responses..... | 19 |
| 2.2.3 Establishment of institutions and institutional change..... | 24 |
| 2.3 Institutions on the level of society and innovation..... | 29 |
| 2.3.1 The Rise of Neo-liberalism and its core elements..... | 29 |
| 2.3.2 National corporate governance systems..... | 39 |
| 2.4 Market environment and innovation..... | 59 |
| 2.4.1 Market competition and innovation..... | 59 |
| 2.4.2 Firm's competitiveness and innovation..... | 63 |
| 2.5 Chapter summary and research question..... | 70 |
| CHAPTER 3: RESEARCH CONTEXT: THE GERMAN MODEL AND INNOVATION .. | 73 |
| 3.1 Introduction..... | 73 |
| 3.2 Dimensions of the German model and their impact on firm-level innovation..... | 73 |
| 3.2.1 Institutions of the labour market..... | 73 |
| 3.2.2 Institutions of the market for managers..... | 81 |
| 3.2.3 Institutions of the capital market..... | 87 |
| 3.3 Deregulation and liberalisation in the German airport industry..... | 100 |
| 3.4 Chapter summary and conclusion..... | 103 |

| | |
|---|-----|
| CHAPTER 4: METHODOLOGY AND RESEARCH DESIGN | 104 |
| 4.1 Introduction | 104 |
| 4.2 Philosophical stance | 104 |
| 4.3 Research strategy..... | 107 |
| 4.4 Research design and data collection..... | 110 |
| 4.4.1 Data sources..... | 110 |
| 4.4.2 The interview process | 114 |
| 4.5 Data analysis | 115 |
| 4.6 Quality of the research and limitations | 118 |
| 4.7 Chapter summary and conclusion | 120 |
| CHAPTER 5: EMPIRICAL FINDINGS | 121 |
| 5.1 Introduction | 121 |
| 5.2 Results for Airport 1..... | 121 |
| 5.2.1 Brief history of Airport..... | 121 |
| 5.2.2 Triggers of the restructuring | 122 |
| 5.2.3 Organisational objectives and culture before and after the restructuring..... | 126 |
| 5.2.4 Innovation at Airport 1 | 131 |
| 5.2.5 Differences in the working environment between the parent and subsidiaries | 134 |
| 5.2.6 The importance of training | 144 |
| 5.3 Results for Airport 2..... | 149 |
| 5.3.1 Brief history of Airport 2..... | 149 |
| 5.3.2 The trigger for restructuring | 150 |
| 5.3.3 Organisational objectives and culture before and after the restructuring..... | 154 |
| 5.3.4 Innovation at Airport 2 | 161 |
| 5.3.5 Differences in the working environment between operational and innovative activities..... | 167 |
| 5.3.6 The importance of training | 174 |
| 5.4 Chapter summary and comparison between Airports 1 and 2 | 178 |
| CHAPTER 6: INTERPRETIVE ANALYSIS | 190 |
| 6.1 Introduction | 190 |
| 6.2 New management practices and shareholder value strategy | 190 |
| 6.3 Organisational change and competitive advantages..... | 200 |
| 6.4 Institutional change, market competition and legitimacy | 206 |
| 6.5 The German model and employment practices..... | 211 |

| | |
|--|-----|
| 6.6 Concluding remarks | 218 |
| CHAPTER 7: CONCLUSION | 220 |
| 7.1 Introduction | 220 |
| 7.2 Summary of the research findings..... | 220 |
| 7.3 Theoretical contribution | 223 |
| 7.3.1 Making a case for discursive institutionalism | 223 |
| 7.3.2 Co-existence of divergence and convergence on the firm level | 225 |
| 7.4 Implications for policy makers and managers..... | 230 |
| 7.5 Future research | 232 |
| 7.6 Final thoughts..... | 233 |
| APPENDIX I – THE INTERVIEW GUIDE | 236 |
| APPENDIX II – PARTICIPANT INFORMATION SHEET (Organisation) | 238 |
| APPENDIX III – PARTICIPANT INFORMATION SHEET (Individual) | 240 |
| APPENDIX IV – CONSENT FORM (Participant)..... | 242 |
| REFERENCES | 243 |

Figures

| | |
|--|-----|
| Figure 1.1: Research context and the conceptual framework | 6 |
| Figure 2.1: Conceptual framework and core literature | 13 |
| Figure 4.1: Three domains of reality and the retroduction logic | 105 |
| Figure 5.1: Development of employment within the group..... | 155 |
| Figure 5.2: Holding structure in 1999 of Airport 2..... | 156 |
| Figure 6.1: Workers' AOM to innovate and the institutional environment..... | 217 |
| Figure 7.1: Processes of divergence and convergence triggered by institutional change..... | 228 |

Tables

| | |
|---|-----|
| Table 2.1: Main characteristics of the corporate governance system in LME and CME | 47 |
| Table 3.1: Differences between the IFRS and the German accounting regime..... | 94 |
| Table 4.1: Overview of conducted interviews | 113 |
| Table 4.2: Strategies to increase the validity of the research..... | 119 |
| Table 5.1: RoAirport, Airport 1 | 123 |
| Table 5.2: Restructuring at Airports 1 and 2..... | 185 |
| Table 5.3: Similarities between the restructuring of Airports 1 and 2..... | 186 |
| Table 6.1: Shareholder value principles and their implementation at Airport 1..... | 191 |
| Table 6.2: Core Elements of NPM and its implementation at Airport 2 | 195 |

CHAPTER 1: INTRODUCTION

1.1 Research Aim

Since the 1970s, many advanced economies have embraced elements of neo-liberal policies. Advocates of neo-liberal reform policies argue that free market competition encourages firms to carry out innovation, which in turn, will positively influence firms' competitiveness. Increased competitiveness of firms will then contribute to a country's socio-economic well-being through productivity and GDP increases, and the creation of attractive employment opportunities. However, Germany resisted for a long time the pressure to converge towards the neo-liberal model that favours liberal markets. In doing so it maintained an institutional environment characterised as a "coordinated market economy", favouring "relational contracting" through collaboration and networks, over free market competition (Hall & Soskice, 2001).

More recently, the EU started implementing neo-liberal policies including the deregulation of markets that affected its member states. As a result of the European integration, formal convergence of policies occurred in some areas amongst European member states, including Germany. However, it remains controversially discussed whether supranational policies of the EU will foster the development of a single model of corporate governance. Whether convergence to the neo-liberal model will occur on the firm level depends also on the behaviour of the institution takers, namely companies that create wealth for society through productive activities and innovation. Gilson (2001) argues that organisations will only follow a formal institutional framework if they believe that this improves their competitiveness on the market level. From this perspective, processes on the firm level may also be triggered by changes in informal institutions, such as cultural norms, or shared meanings and understandings (Gilson, 2001). The outcome of institutional change remains uncertain because firms may break free from existing institutional norms to remain competitive.

Despite the popularity of neo-liberal reform policies amongst policy makers, there is only little knowledge of how the adoption of neo-liberal reform policies influenced the actual behaviour of firms. Opponents question whether the implementation of such policies will increase economic prosperity and social well-being. Concerns have been raised that some members of society will be disadvantaged through neo-liberal reform policies because wealth

may be redistributed rather than created, implying that firm competitiveness has not been positively affected.

In order to gain insights into how reform policies such as liberalisation and privatisation affected the actual behaviour of firms, it becomes necessary to empirically investigate how these institutional changes influenced firm competitive strategies. The aim of this research is to gain a better understanding of how neo-liberal reform policies influenced firms' competitiveness by drawing on empirical firm-level evidence of the liberalised German airport industry. Consequences of the organisational restructuring during the institutional upheaval for the relationship between firms and their different groups of stakeholders will be investigated. The research was guided by the following research question:

“How have traditionally stakeholder-oriented German organisations sustained their competitiveness in changing institutional environments?”

1.2 Background of the research

The competitiveness of the German model remains controversial. The traditional German model of capitalism, aiming at balancing the interests of different stakeholders provided strong representation rights to employees (Börsch, 2007). The German social market economy (Soziale Marktwirtschaft) was associated with combining social welfare and economic growth to benefit embedded firms as well as society as a whole. Until the 1980s, the German model enjoyed worldwide a good reputation for being competitive, particularly in producing high-quality products (Streeck, 1988).

In the 1990s, after the reunification, unemployment in Germany began to rise. A group of prominent economists criticised the German model, arguing that fundamental market reforms, and particularly reforms of the labour market, were necessary to restore German competitiveness (Audretsch, 1995; Phelps, 2007a; Sinn, 2007). It was argued that Germany lacks investment and thus innovation in new industries with rapidly changing technologies (Phelps, 2007a), such as the biotechnology industry (Giesecke, 2000). Audretsch (1995) argued that high unemployment (11% in 1994) and deterioration of Germany's international competitiveness can be explained by a lack of innovative activities in new industries. The author made the case that traditional industries, in which German firms are still innovative, encounter a 'Standortkrise' (location crisis) characterised by high

production costs, particularly for local labour. German firms responded to this crisis by transferring their production to countries with lower labour costs, resulting in many redundancies. Moreover, workers who were made redundant were unlikely to be re-employed because of a lack of employment opportunities in the emerging industries (Audretsch, 1995).

The deteriorating performance of Germany in terms of employment and innovation has been explained by the institutional peculiarities of the German model of capitalism that is characterised by rigid labour markets and capital markets dominated by banks that provide loans rather than risk capital to firms (Casper, 1999). Hans-Werner Sinn (2007), President of the Ifo Institute for Economic Research, argued that German firms encounter difficulties in attracting workers for reasonable wages because of a welfare system that makes unemployment an attractive alternative. Advocates of neo-liberal policies suggested that Germany encounters problems to successfully compete in a global market economy because of over-regulation and state intervention in markets; the institutional structure of the German model came under increasing pressure to change (Audretsch, 1995).

On the other hand, other authors claimed that the German model remained strong (Hall & Soskice, 2001; Wever, 1995). For example, Hall and Soskice (2001) argued that Germany as a coordinated market economy has competitive advantages to carry out incremental innovation, compared to liberal market economies which have advantages for radical innovation. According to the authors, incremental innovations are required to remain competitive in the production of certain goods such as consumer durables or machine tools (Hall & Soskice, 2001). There is also empirical evidence indicating that Germany remained competitive in terms of exports and employment. Bell and Blanchflower (2009) showed that despite a drop in GDP of 5.9% between 2008 and 2009 (based on Quarter 2 of both years), unemployment remains low in Germany compared to other industrialised nations. Furthermore, Germany's export sector has regained market share since 2000 (Danninger & Joutz, 2008).

The increase in German firm's competitiveness is fuelled partly by institutional change occurring recently in Germany on both the national and supranational levels. A report by the UNO (2011) states that since labour market reforms, unemployment levels in Germany are the lowest in twenty years. There is evidence that the German model shifted towards a more neo-liberal model (Sanders & Tuschke, 2007; Streeck, 2009). Streeck (2009) argues that institutional change occurred in five sectors, namely the organisation of Germans capital

markets, collective bargaining, the relationship between intermediary organisations, social policy, and public finance. For example, the author provided evidence that collective bargaining and the relationship between intermediary organisations changed (Streeck, 2009). According to the author, this institutional change was driven by both exogenous and endogenous forces (Streeck, 2009). Siefert and Massa-Wirth (2005) argue that changing rules of collective agreements allowed more flexible agreements between workers and firms at the company level which, in turn, improved the competitiveness of firms. As a result of these changes managers had more room to negotiate firm-specific agreements regarding pay and working time, which in turn were helpful in restoring employment in Germany (Siefert & Massa-Wirth, 2005).

The relationship between German firms and capital stakeholders also experienced changes. Streeck (2009) provides evidence that the German capital markets traditionally characterised by the influence of large shareholders such as banks, changed recently. Banks are no longer willing to protect firms from hostile takeovers, nor to provide credit to them (Streeck, 2009). Moreover, the European Council (Commission of the European Communities, 2000) requested the adoption of International Accounting Standards (IAS) by all listed companies in the European Union to improve the comparability of financial statements by 2005. Sanders and Tuschke (2007) argued that German firms increasingly adopted shareholder value principles on the adoption of international accounting standards and the introduction of stock-option plans for executives.

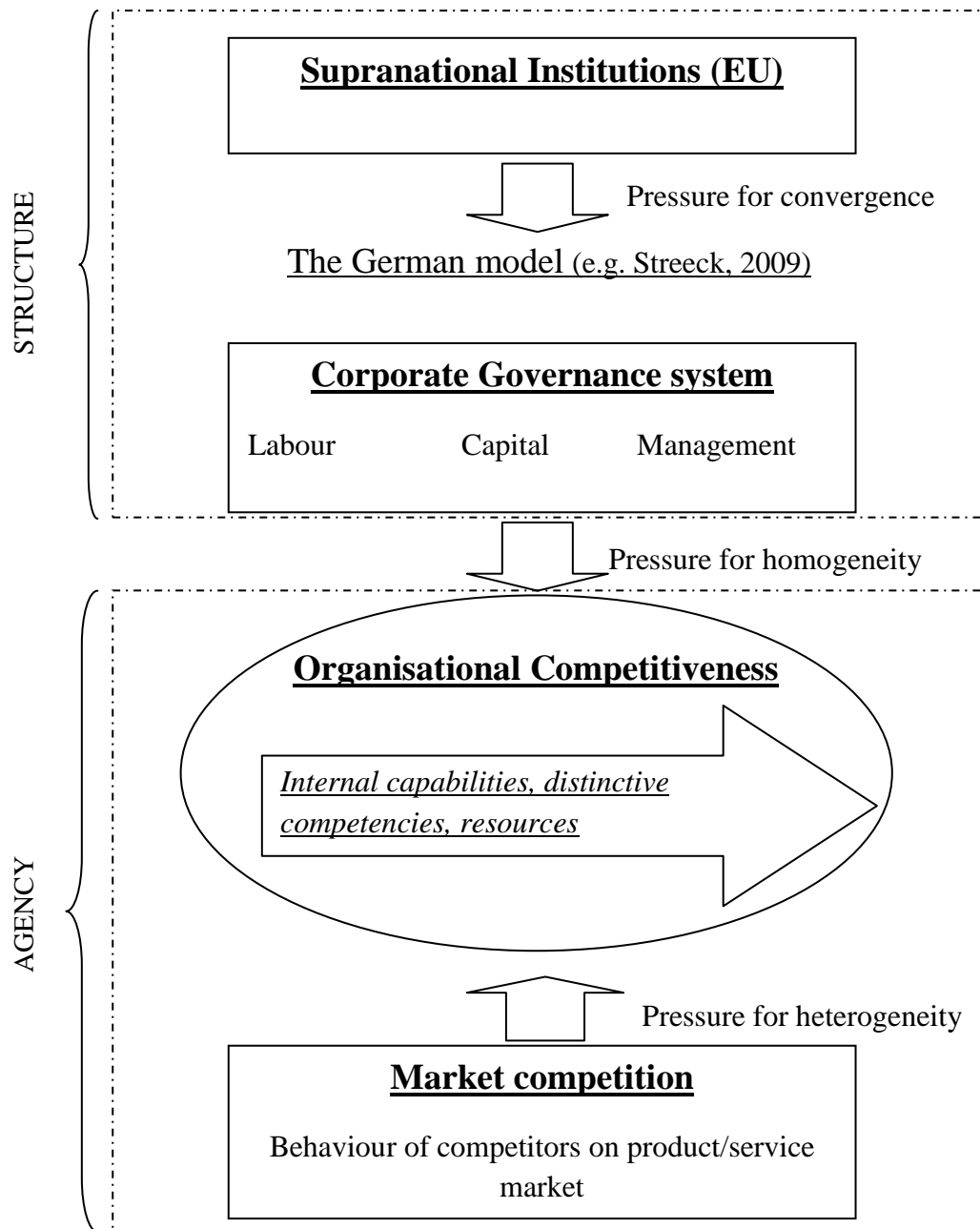
Given the evidence, it seems that German firms restored or even improved their competitiveness in terms of employment costs and productivity during the last decade, characterised by institutional change on both the national and supranational level. However, empirical evidence from the firm level, investigating how the changing institutional environment affected firm behaviour, is missing. It remains inconclusive whether institutional change triggered processes of convergence on the firm level towards the Anglo-Saxon model. A better understanding of consequences of institutional reforms for both firm competitiveness and society is particularly important for policy makers, but also of interest to different groups of stakeholders affected by the changes.

1.3 Research design

The underlying paradigm of this research is critical realism (Bhaskar, 1978; 1989). The ontological perspective of critical realism is based on the notion of dualism which means that structure and agency exist independently from each other, and both have causal powers to produce events (Fleetwood, 2004). From a critical realism perspective, structure is defined as a “set of internally related objects” (Danermark, Ekström, Jakobsen, & Karlsson, 2002, p. 206). Since social structure exists independently of agents, and influences and enables action (Danermark et al., 2002), agents, including organisations, have the ‘capacity for effective choice’ as to how to respond to the incentives of their social structure (Setterfield, 2003). To understand an event it becomes necessary to uncover the underlying process resulting from the interaction between structure and agents (Sayer, 1992). For researchers following the critical realism paradigm, the notion of dualism has specific implications for the research design. In order to understand an event, the research design must adopt a multi-level perspective to take into account that the event may be influenced by both structure and agency.

The critical realism perspective rests on specific assumptions about the importance of existing theory for the generation of knowledge. In accordance with the philosophical stance of critical realism, existing theory should be used by researchers to develop a conceptual framework to guide the research (Maxwell, 2005). To account for dualism, a multi-level approach has been adopted for this study. Both structure and agency have been theoretically identified to explain the phenomenon of firm competitiveness. Both the structure and agency are illustrated in Figure 1.1.

Figure 1.1: Research context and the conceptual framework



First, the corporate governance system on the national level, and institutions on the supranational level, have been identified as relevant structures. These formal and informal institutions on the societal level govern firms' behaviour with regard to firm competitiveness and innovative behaviour, which is the phenomenon of interest in this study, a nation's corporate governance system is of particular importance (Hall & Soskice, 2001). The corporate governance system comprises the institutional domains that govern the relationship between firms and the following three groups of stakeholders, 'shareholders', 'managers' and 'employees' (Aguilera & Jackson, 2003). The corporate governance system has been

established by actors to reduce uncertainty, and to help them to achieve their goals. It is believed that the system provides incentives for firms to behave in a certain way to increase their legitimacy, which in turn positively influences firm competitiveness. A degree of homogeneity among firms embedded within the same institutional environment is expected (Oliver, 1997).

Supranational institutions of the EU, on the other hand, influence the national corporate governance system of their member states. While the supranational forces provide incentives for the different national systems to converge in certain areas towards a single model, it is assumed that diversity between different national corporate governance systems will remain because of path dependency (Rhodes & van Apeldoorn, 1998).

Second, because of the notion of dualism, from the critical realism perspective it is assumed that the outcome of a phenomenon of interest (firm competitiveness), is also influenced by the behaviour of actors. From the critical realism perspective, both individual firms and the collective behaviour of market actors (competition) possess causal power to influence firm competitiveness, and a firm may carry out innovation “in the absence of institutional incentives” (North, 2005, p. 17). In order to understand organisational behaviour it thus becomes important to consider that firms will exercise strategic choice (Börsch, 2007; Child, 1997; Crouch, 2005a). The behaviour of firms is also influenced by other actors. It is often assumed that competitive forces provide incentives for firms to develop rare, unique and valuable resources that cannot easily be imitated in order to sustain competitive advantages (Barney, 1991; Porter, 1991). A degree of heterogeneity amongst firms is expected because of market forces (Oliver, 1997).

From the critical realism perspective, to understand firm competitiveness it becomes important to investigate the interplay between structure and agency. The underlying mechanisms that influence this process are not directly observable. However, the accounts of different stakeholders that observed an event serve to provide better understanding of the underlying mechanism that shaped the outcome of the phenomenon.

Considering that the German model shifted towards a more liberal model because of both exogenous and endogenous forces (Streeck, 2009), it can be expected that the causal power of structure, namely the corporate governance system, may trigger processes of convergence on the firm level towards a more liberal model. However, firms as institution

takers exercise strategic choice resulting in diversity on the firm level that lead to divergence. The objective of the research is to gain a better understanding of how institutional change influenced strategic renewal processes on the firm level.

In order to reconceptualise existing knowledge about how the German model influences firm competitiveness and strategies, an inductive approach has been chosen. This approach allows for the accounting of different triggers for organisational change on the firm level, including institutions on both the national and supranational level as well as the market environment. It can be expected not only that different institutional forces provide incentives that are conflicting, but also that actors as institutions takers may have different interpretations of the incentives of certain institutions. An inductive approach is also compatible with accounting for the different perceptions of firms concerning incentives from their environment.

The airport industry has been selected as an appropriate context for this study. As a result of the privatisation and liberalisation activities in the industry, airports transformed from publicly owned entities to commercially oriented enterprises (Graham, 2005). German airports suddenly encountered competition from other European companies for baggage handling services as a result of the liberalisation of the baggage handling market triggered by the Council Directive 96/67/EC (The Council of the European Union, 1996). German airports experienced significant changes in their market and institutional environment, providing an excellent research opportunity for the study of how organisations sustain their competitiveness during times of upheaval.

Two partially privatised German airports have been investigated. Their annual reports reveal EBIT-margin of 14.8% in 2009 (17.1% in 2008) for Airport 1, and 15.14% in 2009 (17.33% in 2008) for Airport 2, showing that both airports are highly competitive in terms of financial performance (Airport 1, 2008a; 2009, Airport 2, 2008; 2009). According to a recent BCG report (Verma, Sanghi, Michaelis, Dupoux, Khanna & Peters, 2011), the average EBIT margin of nonfinancial firms listed in Standard & Poor (S&P) 500 between 2000-2009 is 12%. Furthermore, both airports are among the five largest airports in Germany in terms of passenger numbers based on figures of the year 2006.

The data collection includes 32 in-depth interviews with different stakeholders, including employee representatives from both unions and works councils, managers, executives and members of the board. Additionally, publicly available documents including newspaper articles, annual reports and information publicised on the companies' websites were studied. Eisenhardt (1989a) argues that a case study research design is in general suitable for the building and extending of theory. Data has been analysed by adopting the process of building theory developed by Eisenhardt (1989a). A within-case analysis was first carried out to describe the unique pattern of organisational restructuring of each airport. The findings of both cases were then compared in order to uncover cross-case patterns between them. Both similarities and differences between the cases were described.

1.4 Thesis structure

The thesis is structured as follows. Chapter 2 develops the conceptual lens that guided both the data collection and interpretation of the results. To develop a conceptual framework, the chapter reviews different streams of literature. First, the principles of different schools of institutionalism are discussed to provide an overview as to how institutions influence the behaviour of institution takers, how institutions are established, and how they may change over time. Second, the core ideas of the neo-liberal paradigm and popular neo-liberal reform policies and management concepts are introduced. The main contribution of the 'diversity of capitalism' literature is then briefly summarised by providing an overview of characteristics of coordinated and liberal market economies, and how they influence firms' competitiveness. The differences between these different models of capitalism provide the basis for discussion about the convergence or divergence of different systems of corporate governance. The chapter concludes with a brief discussion on how competitive pressure from the market level influences firms' competitiveness.

Chapter 3 discusses the specific research context of this study, first introducing the most important institutional domains of the German model that govern the relationship between firms and their main stakeholders, namely employees, managers and capital stakeholders. Implications of these domains for firm competitiveness are investigated and detailed. The chapter then introduces the German airport industry as the industry context of

this study. This industry recently underwent institutional changes on both the national and supranational levels, those of privatisation and deregulation respectively.

Chapter 4 justifies and illustrates the methodology of this study, beginning with an outline of the epistemological and ontological assumptions of critical realism, after which the research strategy is introduced. A case study approach based on qualitative data has been adopted, this being the most appropriate to explain how patterns of change occurred. Also, introduced are the processes of data collection and analysis. The data analysis followed a retroduction logic aiming to uncover the causal mechanism that triggered organisational restructuring. Strategies adopted to increase the quality of the research are briefly discussed to conclude this chapter.

Chapter 5 presents the empirical findings of this study. First, the within-case results give details of the processes that triggered the organisational restructuring of each airport. The chapter also discusses strategies adopted by the airports to sustain their competitiveness during the institutional upheaval. It also discusses how changing strategies affected the relationship between airports and their different stakeholders. Second, both similarities and differences in the restructuring of the two airports are highlighted in the cross-case analysis.

Chapter 6 discusses the link between the empirical findings and existing theory. First, it investigates how both traditionally stakeholder-oriented airports embraced a shareholder value ideology through the implementation of neo-liberal management concepts. Second, it discusses how the understanding of firm competitiveness changed in the context of the liberalisation. After liberalisation, airports competed with other organisations in the value they create for shareholders; to increase competitiveness both airports significantly reduced labour costs for workers in some areas by disrupting established worker participation and collective bargaining through the creation of subsidiaries (subsidiarisation). Third, the chapter argues that although the restructuring was legitimised by the concept of competition, significant competition did not evolve, implying that the outcomes of competition are institutionalised. Fourth, airports have different perceptions of the benefits of the institutional domains regarding labour. While Airport 1 still maintains features of the classical German model on the level of the parent organisation to foster shop floor innovation, Airport 2 moved towards a neo-liberal model of governance, not expecting benefits of compliance to these norms.

Chapter 7 concludes this research project. The main theoretical contribution of this study is that on the firm level, both processes of convergence and divergence can co-exist. It is argued that whether convergence and divergence will occur is not necessarily determined by the incentives of the formal institutional framework, but largely depends on firms' perception as to what strategy is most likely to foster competitive advantages. Non-compliance with the prevailing institutional framework on the level of society can be perceived to be the dominant strategy, provided that non-compliance is supported by the incentives of the market environment.

CHAPTER 2: INSTITUTIONS, MARKET ENVIRONMENT AND INNOVATION OF FIRMS

2.1 Introduction

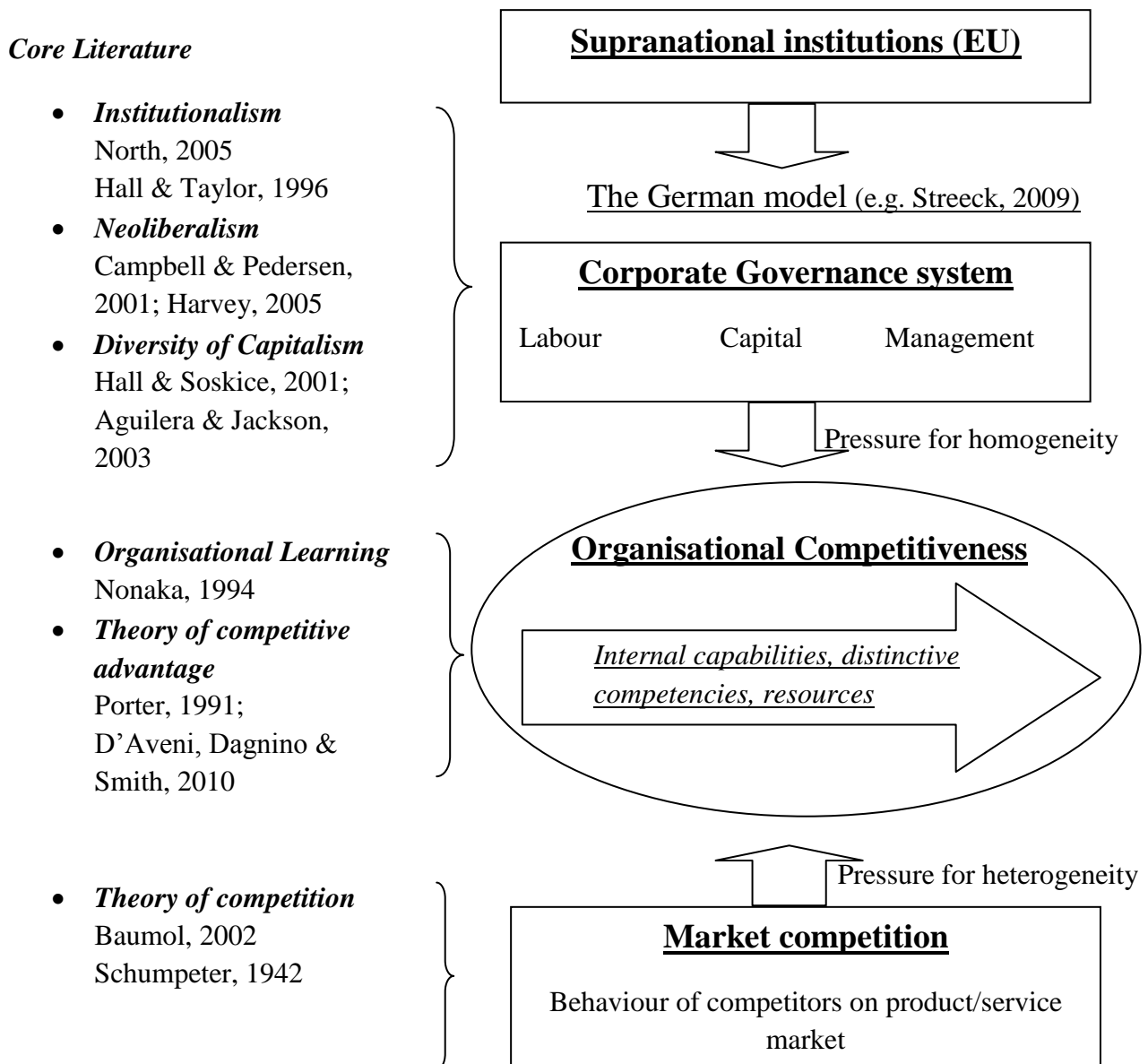
The aim of this chapter is to develop a conceptual framework from existing theory that guides the research. In the current literature, the majority of researchers draw on either empirical evidence of the corporate governance system on the level of society, or the dynamics of market competition, to explain competitive advantages of firms. Considering that both factors are believed to have an important impact on the firm competitive strategies, it is surprising that researchers have not considered the dynamics between these factors in their empirical research. While the institutional theory implies homogeneity between firms, the resource-based view (Barney, 1991) implies heterogeneity between firms that seek competitive advantage through scarce resources or capabilities (Oliver, 1997). Therefore, a contribution of this research is that it combines these two perspectives.

Literature on institutionalism is reviewed in this chapter. First, the general literature on institutions is considered. This stream of literature is concerned with how institutions evolve, how they change and how they influence the behaviour of firms. Assumptions of discursive institutionalism are examined in detail. More specific literature contributing to our understanding of the how political and economic institutions (corporate governance system) influence firms' competitiveness is then discussed. There is agreement amongst institutional theorists that institutions on the macro level, such as a formal corporate governance system, affect firms' competitiveness. Institutions are important in providing the enabling framework for innovation (Baumol, 1990; Tylecote, 2007), and here the basic assumptions of neo-liberalism will be discussed. The diversity of capitalism literature, which contrasts institutional arrangements of the corporate governance system of different countries, including the German and the neo-liberal Anglo-Saxon systems, will be discussed with regard to how the different systems influence the innovative activities of firms.

Briefly discussed is how competition on the market level influences firm's behaviour. It is assumed in the literature that market competition gives incentives for firms to carry out innovation (Baumol, 2002). Many prominent researchers investigate how market competition influences the innovative outcome of organisations (e.g. Armstrong & Sappington, 2006). Firms that are embedded in a dynamic market environment have incentives to carry out

innovation to sustain competitive advantages (de la Mothe & Foray, 2001; Lundvall & Vinding, 2004; Porter, 1998). Finally, theories on the firm level, such as the theory of organisational learning (Nonaka, 1994), are briefly introduced to explain how organisations can develop sustainable competitive advantages (Barney, 1991; Porter, 1991). Figure 2.1 illustrates the main streams of literature that have been reviewed for this thesis.

Figure 2.1: Conceptual framework and core literature



2.2 Theoretical Foundations of Institutions

2.2.1 Definition and forms of institutionalism

The role of institutions has been central to the study of sociologists (Barley & Tolbert, 1997), historians (Thelen, 1999) and economists (North, 2005) alike, and many prominent researchers are investigating how institutions are established (Thelen, 2004), and how they change (Campbell, 2004; Streeck & Thelen, 2005), or, more specifically, how they impact on the innovativeness of organisations embedded in a specific institutional context (Hall & Soskice, 2001). National institutions are arguably the incentive structure of society (Davis & North, 1971; North, 2005; North & Thomas, 1973), and are very important for the wealth and prosperity of nations (Campbell & Pederson 2001; Hall & Taylor, 1996; Hancké & Goyer, 2005).

Institutions can be defined as formal and informal rules that influence, enable or constrain human behaviour (Hodgson, 2003; Nooteboom, 2000a). Formal rules, such as property rights, are typically associated with some sort of legal rights and therefore provide leverage for enforcement (Knight, 1992). They are typically formulated and communicated in the form of rules and procedures by official channels of a society including state institutions, state-enforced laws, rules and regulations as well as organisational rules that govern the relationship between different interest groups (Helmke & Levitsky, 2004). In contrast, informal rules are, according to Helmke and Levitsky (2004), “socially shared rules, usually unwritten, that are created, communicated, and enforced outside of officially sanctioned channels” (p. 727). Just because formal institutions possess legal authority does not mean that they are necessarily more powerful than informal institutions. Helmke and Levitsky (2004) point out that in practice formal institutions may be ineffective and incomplete, and informal institutions can have greater credibility in governing the relationship between different actors.

Institutions govern the relationships between different groups of actors within a society and regulate the distribution of power between them (Campbell, 2004). North (2005) argues that institutions are established by actors in order to reduce the uncertainty of the external environment, and as a result, help to achieve a desired outcome more easily. While established institutions may have been created for a particular purpose, it remains inconclusive whether the institutions serve the initial aim, and there might be a gap between the intended and the realised outcome (Hayek, 1960; Thelen, 2004). According to Pierson (2000a; 2000b) reasons for a gap between the purpose and outcomes of institutions can result

from changes in both the social environment and the interests of actors. To understand performance it thus becomes necessary to understand how institutions work, looking at their incentives and unanticipated results (North, 2005), and also how interests of actors might change.

Because the concept of institutions is studied across disciplines there are various, and sometimes conflicting views about what constitutes an institution, and how they influence human behaviour. There is a lack of consensus about the appropriate content of institutional analysis (Schmidt V. A., 2006). As a result, different schools are occupied with the analysis of a heterogeneous set of institutions (Campbell & Pederson, 2001; DiMaggio & Powell, 1991; Hollingsworth, 2000). Mantzavinos (2001) argues that the different focus of these schools might be attributed to their different theoretical interests as well as different models of human agency. For instance, while economists assume that rational human agents try to maximise their utility by focussing on whether existing institutions produce efficient outcomes, sociologists are more concerned about whether outcomes are effective for society.

The most prominent forms of institutionalism include rational choice or economical institutionalism, historical institutionalism, and sociological institutionalism. In the literature, authors commonly refer to these three schools of thought as the 'new institutionalism' (Fligstein, 1997a; Schmidt V. A., 2010). First, rational choice institutionalists focus on formal institutions with legal authority, which define social roles and shape the power of different social actors (Dobbin, 2004). The underlying assumption is that actors have a fixed set of preferences and purposefully act to maximise their individual short-term interests (Hall & Taylor, 1996). Rational choice theorists believe that policy makers can - provided that they know the preference system of the actors - steer the behaviour of actors in a particular direction by setting the right institutional incentives (Hira & Hira, 2000). They believe that the objective of institutions is to shape the interaction of rational actors by monitoring, constraining and sanctioning their behaviour in order to achieve 'better' social and economic outcomes (Hall & Taylor, 1996; North, 1990).

Second, historical institutionalism refers to institutions as formal and informal rules and procedures that are embedded within organisational structures (Hall & Taylor, 1996). Attention is typically given to institutions that coordinate the relationship between organisations and their different stakeholders (Thelen, 1999). The main aim of institutions is to provide moral and cognitive templates for human actors, which shape both their

preferences and identities (Hall & Taylor, 1996). Campbell (2006) points out that historical institutionalists believe “actors are motivated by logics of both instrumentality and appropriateness in ways that are constrained by rules, procedures, cognitive paradigms, and principled beliefs” (p. 926). Thelen (1999) argues that existing institutions are the outcome of different, independent political processes and therefore one needs to accept that the “various ‘pieces’ do not necessarily fit together into a coherent, self-reinforcing, let alone functional, whole” (Thelen, 1999, p. 383). As a result, the institutional system is not necessarily harmonized, and because the various pieces interact, the actual outcome might differ from the intended. Overall, historical institutionalists aim to understand better how institutions are created over time by “concrete historical, processes”, and how different political processes interact (Thelen, 1999).

Third, the definition of sociological institutional theorists is expanded by a cultural dimension (Hall & Taylor, 1996). The definition of institutions in this stream includes not only formal and informal rules and procedures, but also cultural frameworks that guide human action (Campbell, 2004; 2006). Sociological institutionalists strongly believe that the assumption that actors are driven only by self-interests is oversimplified (Davis, Schoorman & Donaldson, 1997; Lubatkin, Lane, Collin & Very, 2007). Social actors are influenced not only by formal institutions, i.e. legal and political institutions, but also by their historical, cultural and social backgrounds (Barley & Tolbert, 1997). Campbell (2006) explains that from this perspective institutions motivate actors to behave in a certain way through the logic of appropriateness. Cultural frameworks and cognitive schemes, on the other hand, constrain and enable human behaviour (Campbell, 2006). Sociologists argue that as a result, the study of institutions needs to adopt a broader focus that includes the cultural environment, cognitive frames and the norm system in addition to the market environment (Campbell & Pederson, 2001).

Despite their different assumptions about both the nature of institutions and how they influence human behaviour, there is an agreement in the literature that the concerns of the different schools of thought are related to each other and that their findings should be integrated to obtain a better understanding as to how institutions work (Hall & Taylor, 1996). Prominent authors argue that the scholars of different paradigms are trying to solve similar problems, and researchers should therefore not draw a rigid line between these approaches (Fligstein, 1997a; Hall & Taylor, 1996; Thelen, 1999). A new form of institutionalism that

brings the different scholars closer together is the “constructivist” or “discursive institutionalism” (Schmidt V. A., 2008).

This research rests upon the framework of discursive institutionalism. Schmidt V. A. (2010) argues that discursive institutionalism represents a “fourth new institutionalism” which encourages researchers to draw on insights of all three paradigms of the new institutionalism to examine a particular question. Prominent authors make the point that combining the insights of different schools will enhance our understanding about how institutions work (Fligstein, 1997a; Schmidt V. A., 2010). For example, Crouch and Farrell (2004) argue that the combination of the rational choice and the sociological institutionalism is promising for enhancement of our understanding about institutions. The idea of combining insights from both economical and sociological perspectives is, according to Mantzavinos (2001), related to Granovetter’s (1992) argument claiming that the economical view on human agency is under-socialised (because it neglects social relationships between actors) while the sociological view is over-socialized (seeing actors as “blind followers” of social norms). The economic sociology tradition aims to “combine the analysis of economic interests with an analysis of social relations” (Swedberg, 2003, p. 1). Discursive institutionalism relates in many ways to the economic sociology tradition. Furthermore, discursive institutionalism encourages a more dynamic view on institutions by accepting institutional “disequilibria” (Hay, 2006) and emphasising the power of ideas and discourses to explain institutional change (Schmidt V. A., 2008; 2010).

Discursive institutionalism follows the economic sociology tradition by not privileging structure over agency. DiMaggio and Powell (1983) argue that the behaviour of organisations as actors is the outcome of structure. The authors argue that organisations within the same field, i.e. “a recognized area of institutional life: key suppliers, resource and product consumers, regulatory agencies, and other organizations that produce similar services or products” (p. 148) will evolve very similar due to institutional isomorphism: the results of rational decisions made by actors based on the constraints of their institutional environment (DiMaggio & Powell, 1983). Heugens and Lander (2009) point out that many researchers still advocate such a perspective that explains organisational behaviour with the structure of the institutional field. However, Heugens and Lander (2009) further argue that an increasing number of researchers believe that agency is an important source for change in its own right, and it can be expected that organisations embedded within the same institutional field may

act very differently. From this view, actors have a great degree of independence regarding the institutional framework (Granovetter, 1992). Institutions are seen as enabling organisational behaviour rather than constraining it (Heugens & Lander, 2009).

To illustrate the importance of actors over structure, Granovetter (1992) argues that individual actors have remarkably changed the institutional framework by using their personnel network. According to the author, it is possible that the behaviour of a particular organisation can define the structure and shape the rules of its entire industry (Granovetter, 1992).

Blyth, (2003) argues that institutions influence how actors see the world rather than constrain human action. Actors are embedded within their institutional framework, but not to a degree that prevents them from disagreeing with particular features of the institutional setting. Important in this setting is the assumption that actors are driven by interests and hence, exercise strategic choice (Beckert, 1999). In general, discursive institutionalism rests on the assumption that the preferences and interests of actors are not given. Interests of actors, including members of organisations as well as politicians, who have formal power to introduce institutional change, are unstable, and can be influenced and changed by ideas (Blyth, 2003). From the perspective of discursive institutionalism, ideas are thus a central mechanism to overcome rigid institutional rules and introduce change (Schmidt V. A., 2008). Under discursive institutionalism, actors may alter the institutional framework (Crouch & Farrell, 2004), create new institutions or even exploit existing institutions by using them in an unintended way (Fligstein, 1997a).

Finally, discursive institutionalism allows the incorporation of two well known market coordination mechanisms, namely competition and cooperation. While rational choice theorists advocate the power of free market, and thus favour institutions which promote competition, sociological theorists rather believe in cooperation, favouring institutions which foster commitment and trust. However, in reality, markets are governed by both competition and cooperation. This point was made clear by Teece (1992) who pointed out that “[c]ompetition is essential to the innovation process and to capitalist economic development more generally. But so is cooperation. The challenge to policy analysts and to managers is to find the right balance of competition and cooperation, and the appropriate institutional structures within which competition and cooperation ought to take place” (p. 1). In other words, innovation requires both, competition and cooperation. The key for economic success

is to find the right balance between those two components of growth. However, before discussing the influence of the institutional environment on the market, how institutions influence organisational behaviour will be explained; how they are created and changed.

2.2.2 Institutional forces and organisational responses

Institutions influence firm's behaviour. All schools of new institutionalism aim to gain a better understanding as to how institutions constrain or enable the perception and the behaviour of different actors. It is believed that action follows a certain logic guided by institutional incentives. In the rational choice model, behaviour follows incentives for fixed preferences (Blyth, 2003); in the sociological model it follows the appropriateness of the moral and cultural framework (Campbell, 2006); and in the historical model it follows "moral and cognitive templates" (Hall & Taylor, 1996). While the schools of new institutionalism rest on different assumptions about the incentives that govern behaviour, all expect that actors in the same institutional context will behave in a similar way, making human behaviour somewhat predictable (Gorges, 2001).

For the study of organisations, researchers have highlighted the relevance of informal institutions (Scott, 2008). A basic assumption is that such informal institutions influence the decision making of firms as well as their competitiveness (Barley & Tolbert, 1997). The argument goes as follows. Firms need to conform to incentives of their cultural and normative environment to gain legitimacy (DiMaggio & Powell, 1983; Scott, 2008). Organisational behaviour and actions that are in accordance with these institutional incentives will lead to a greater organisational legitimacy.

Organisational legitimacy is an important prerequisite for social exchange and relationships with other actors of society (Dacin, Oliver & Roy, 2007). Dacin et al. (2007) argue that organisations need to behave appropriately to gain the approval of different stakeholders upon which they dependent. From a strategic management perspective, a good reputation amongst suppliers and customers positively influences an organisation's competitiveness (Amit & Schoemaker, 1993; Barney, 1991; Hall, 1993), providing an incentive to embrace predominant legal and social norms and values that will foster intangible resources. Such intangibles can in turn constitute competitive advantages (Hall, 1993). On the other hand, noncompliance with the institutional setting comes with cost, such

as reduced “access to resources that accompany legitimacy” (Phillips, Lawrence & Hardy, 2000, p. 28).

A useful framework for explaining different sources of legitimacy was developed by Scott (2008), who argues that institutions can rely on three different mechanisms, namely regulatory legitimacy, normative legitimacy, or cultural-cognitive legitimacy, which gives firms incentives to behave in a certain way.

Regulatory legitimacy is the first pillar on which institutions can rest. In general, regulatory bodies can exist on different levels, including the national, supranational and global level, and regulation can thus be “polycentric” (Black, 2008). Organisations need to comply with these formal rules, laws and regulations, since noncompliance may lead to sanctions or punishment. While legal changes can empower social behaviour by providing more choice to organisations, these formal institutions often rely on a coercive mechanism to enforce behaviour. They are often formulated by powerful actors. Formal institutions are commonly studied by economist, or rational choice theorists because of their rational and objective nature. However, Scott (2008) also argues that formal institutions leave room for interpretation and may lead to an unintended outcome.

Normative legitimacy, based on normative approval, is built on social norms and values, such normative forces influencing behaviour by employing a moral governance mechanism (Scott, 2008; Suchman, 1995). Norms and values specify socially appropriate and desirable behaviour. Scott (2008) argues that the normative system defines “how things should be done” (pp. 54-55), and defines both appropriate goals for specific groups of actors and proper ways as to how these goals should be achieved. According to Scott (2008), actors follow normative institutions for two reasons. First, they strive to act in an appropriate way to fulfil the expectations of other actors. In this sense, actors have a social and moral obligation to behave appropriately. Failing to do so would risk their credibility and reputation. Second, actors may have internalised certain norms and values of their environment.

Suchman (1995) distinguishes between four different types of normative legitimacy, or what he calls “moral legitimacy”. First, organisations can achieve consequential legitimacy, which means that the output of an organisation is perceived to be morally legitimate, such as in quality and price. Examples include the achievement for certain emission standards for car manufacturers and mortality rates in hospitals (Scott & Meyer, 1991 as cited in Suchman,

1995). Second, an organisation can gain procedural legitimacy by applying organisational techniques and procedures that are perceived to be appropriate. An example where organisations may lose procedural legitimacy by violating normative expectations is the use of child labour in developing countries. Third, moral legitimacy can rest on the structural legitimacy of an organisation, based on its structural characteristics. Structural legitimacy signals its customers that it can indeed perform a certain type of work. Fourth, the moral legitimacy of an organisation can be accomplished by the appointment of charismatic individuals in top management (Suchman, 1995). Greenwood and Hinings (1996) argue that due to the normative embeddedness of a firm within its institutional environment, radical organisational change occurs very rarely, and convergent change is common.

Cultural-cognitive legitimacy rests on “shared meanings and understandings” (Berger & Luckmann, 1966) or taken for granted beliefs (Scott, 2008). These institutions refer to the “way how things are done”. These institutions represent cognitive maps that actors share, and through which the meaning of events, objects and activities is shaped. Shared cognitive maps are important for actors to make sense of their reality. Sharing similar belief systems or cultural-cognitive frameworks for making sense of their environment, in turn, results in mimetic behaviour of actors. Specifically, in regard to strategy, the reliance on similar cultural-cognitive frameworks may lead to the adoption of similar strategic responses across firms within the same industry. Within an organisation, shared cultural-cognitive maps foster similar patterns of behaviour and taken for granted routines (Scott, 2008).

From the traditional institutional perspective, the strategic choices and behaviour of organisations need to conform to the expectations and norms of their legal and social environment. Hence, the institutional perspective suggests to some degree homogeneity between firms as a result of conformative pressure (Oliver, 1997). The necessity for firms to achieve legitimacy implies constraints to human action (Meyer & Rowan, 1977; Scott, 2008), and to some extent, limits the options for actors to achieve their individual goals (Oliver, 1991).

In contrast, the discursive institutionalism anticipates that organisations interpret the incentives of their environment differently, and may pursue different interest, and therefore is suitable to solve the paradox between compliance and choice. An institution may not provide all three types of legitimacy at the same time; this would lead to an “overdetermined system” of institutions. Rather, it is possible that the different mechanisms are in conflict (Scott, 2008).

For discursive institutionalists, actions are influenced through dialog and interaction between different actors (Phillips et al., 2000), and actors may interpret the incentives of the institutions differently (Blyth, 2003). For example, Nelson (1991) argues that different strategies are the result of a complex reality. Due to this complexity it is not possible for a firm “to calculate an actual ‘best’ strategy” (Nelson, 1991, p. 67), and as a consequence, firms respond to their institutional environments with different strategies. Similarly, Blyth (2003) points out that since the imposed institutions “do not come with an instruction sheet” (p. 698), different actors may perceive the incentives of the institutional environment differently.

Furthermore, discursive institutionalism stresses that firms may also pursue different objectives. Discursive institutionalism not only emphasises that interests are socially constructed, but, differing from the perspective of rational choice institutionalism, believes that interests of actors cannot be objectively determined (Hay, 2006). It is argued that organisations aim to increase their organisational wealth to serve the common interests of their different stakeholders (Davis et al., 1997). However, the interests of different stakeholder groups may differ, and sometimes even conflict. Child (1972) argues that organisational decision making is exercised by “the dominant coalition” within the organisational context, namely by those stakeholders “who collectively happen to hold most power over a particular period of time” (p. 14). However, it is likely that in some situations, there exists no clear dominating stakeholder group but rather different groups holding power. In this situation, different groups hamper or challenge each other (Child, 1972).

The power of different stakeholder groups is generally influenced by the institutional environment. Even so, discursive institutionalism recognises that since the behaviour of actors is influenced by institutions on the level of society it is not expected that the behaviour of organisations embedded within the same context will be homogenous. The outcome of this bargaining process depends on many factors including informal institutions (Appel, 2000). The interests of the organisation are not easy to determine, and may change over time.

Furthermore, Nonaka and Toyama (2005) argue that firms may have different understandings about the reality that influences their strategy. While all car manufacturers may want to build “a good car”, their understanding about what constitutes a ‘good car’ may differ (p. 420). Firms may follow different strategies due to different objectives (Hay, 2006). In other words, within the constraints of their institutional framework firms are free to choose

strategies that they believe will best serve their goals and interests; they can exercise strategic choice (Child, 1997; Oliver, 1991), and differences between firms within the same context are highlighted (Nelson, 1991).

Discursive institutionalism allows a considerable degree of organisational freedom (Nelson, 1991). As a consequence, the behaviour of firms cannot entirely be explained by the analysis of institutions on the level of society but needs to be complemented by an analysis of actors and their (sometimes changing) interests (Hwang & Powell, 2005). Empirically, Hancké and Goyer (2005) have illustrated that organisations within the same institutional environment have adopted diverse strategies. According to Hancké and Goyer (2005), institutions are not simply constraints of human action; “actors can do unexpected things that do not necessarily follow directly from the institutional framework” (p. 59). From this perspective, it is important to consider that the degree of compliance to the institutional incentives may differ between firms, and that institutions leave room for differentiation.

It is seen that from an institutional perspective, firms have an incentive to behave within the norms and values of their environment. It can be expected that a relatively high degree of institutional compliance improves the legitimacy and acceptance of stakeholders of the organisation which, in turn, may influence a firm’s competitiveness. However, actors are not just ‘blind followers’ of institutional incentives. They may change the institutional framework (Crouch & Farrell, 2004) or even deliberately choose not to act according to the rules of the game (Beckert, 1999; Hancké & Goyer, 2005).

2.2.3 Establishment of institutions and institutional change

It is acknowledged that both the establishment of new institutions, as well as the change of existing institutions require agency (Battilana, 2006; Beckert, 1999). Therefore, to explain institutional change, it also becomes important to understand the role of agency in institutional change. There seems to be an agreement in the literature that the perception of actors is influenced by institutions that were established in the past. Also, actors that aim to introduce institutional change need to take into account existing institutions (Crouch & Farrell, 2004), which leads to the concept of ‘path-dependency’. This is a prominent concept that underlies the rational choice, historical and sociological institutionalism. Theorists argue that owing to path dependency, the direction of institutional change is often consistent with institutions that have evolved in the past and that institutional change often occurs incrementally (North, 2005).

Path dependency occurs for different reasons: First, early decisions about the institutional framework influence and limit the paths to be taken in the future because of “increasing returns” (Pierson, 2000b). Such a view is based on the assumption that a path develops as a “self-reinforcing sequence” (Mahoney, 2000). According to Pierson (2000b), it is costly to change the direction of a taken path because the relative “benefits of the current activity compared with other possible options increase over time” (p. 252). Exit cost will make it difficult to break free from the chosen path; some paths can no longer be taken if actors in hindsight realise that their initial choice about the institutional setting may not produce the desirable outcome (North, 2005). The concept of self-reinforcing patterns can be extended by including additional mechanisms that strengthen the reproduction of a certain pattern, including legitimacy and power (Mahoney, 2000). Second, path-dependency is seen to be the result of “reactive sequences”, implying an existence of a causal relationship between current and past events. However, according to Mahoney (2000), events that follow such an “inherent sequentiality” are rare.

Furthermore, the cognition of actors about existing institutions is built upon their past experiences as well as new knowledge. Actors have invested in the particular skills and knowledge that govern change. According to North (2005), learning is the key for institutional change. New knowledge may change the perception of the actors about how the existing institutional framework should be designed, and this may lead to a change of the framework. However, learning predominantly occurs incrementally meaning that the actors

typically alter their perceptions of institutions in little steps (North, 2005). The logical consequence of the concept of path dependency is the assumption that institutions are relatively static and provide stable conditions in the environment.

Important in this setting is understanding that the belief system and the institutional framework are related; they are “different sides of the same coin” (North, 2005). Because institutions are created through human agents, they inevitably reflect the culture and history of a society (North, 2005). While the former is the internal representation of a society, the latter is its external manifestation. This also implies that a radical change of the institutional framework requires a radical change of the belief system of a society. As a result of the concept of path-dependency, all of the three schools of institutionalism encountered difficulties in explaining radical institutional change (Crouch & Farrell, 2004; Schmidt V. A., 2008).

Thelen (2004) supports the assumption that radical institutional change is rare. The author illustrates, using the example of the German corporate governance system, that institutional arrangements are very resistant in “unsettled” times. However, Thelen (2004) argues that significant institutional change occurs in “settled” times through smaller changes that accumulate over time. In sum, a change in institutions could therefore be triggered by a change in the cognition of the human actors “who makes the rules of the game” (North, 2005).

A common explanation for institutional change, shared by all schools of institutionalism, is that institutions are designed and changed by powerful actors who pursue particular interests (Beckert, 1999; North, 2005; Thelen, 2004). Such a view implies that institutional change can be legitimised based on the “coercive pillar” (North, 1990), and that not all actors of a society are capable of establishing and changing institutions (Fligstein, 1997a; 1997b). Since institutions vary with the objectives of the powerful actors who have created them (North, 2005), a change in the institutional framework not only becomes inevitable when the interests of these actors change, but also when the power shifts between different groups of actors. Thelen (2004), for instance, emphasises that a shift in the political coalition is one of the main drivers for changes of the macro institutions. Beckert (1999) argues that a period characterised by relatively stable institutions may be attributed to relatively stable power relationships within this period.

According to DiMaggio (1988), actors in a society who have the power to create and alter institutions include large organisations, trade unions and governments. Generally, policy makers have legal power to enact rules and regulations that influence both the degree of competition and the corporate governance system. Firstly, policy makers can influence the level of competition on the industry level; for example, they may impose specific regulations for a particular industry. Further, it is often common that industries where competition is not feasible are subject to a specific regulation, one that aims to prevent the exploitation of market power by monopolistic companies. Secondly, policy makers can enact general laws for fair competition and corporate governance. These rules of the game will affect incentives for innovation and influence allocation of resources. However, in most cases different groups of actors, who may pursue different and sometimes even conflicting interests, possess a certain degree of power. As a consequence, the established institutions may be the result of a bargaining process between those actors (Campbell, 2004, North, 1990). From this perspective, it is commonly assumed that the institutional environment represents the ideologies and preferences of powerful societal actors, and institutional stability therefore reflects a lack of power or resources of the opposition (Beckert, 1999).

Blyth (2003) points out that interests are important to explain institutional change. According to Blyth (2003), one cannot assume that interests of agents are always given, and the interests of actors might indeed be the subject that needs explanation. Interests should not be “taken as granted” and one should consider that they might change. Taking this possibility into account, institutional change might in fact result from changes of interests. Human interests are influenced by cognition which is, in turn, guided by the belief system of the actor. Both cognition and the belief system are strongly influenced by the cultural and historical heritage of the actor (e.g. Maskell, 2004; North 2005), or in the words of Berger and Luckmann (1966) “reality is socially constructed” (p. 1). Therefore, a change of interests could be driven by changes of the belief system of actors or by changes of the cognition about the benefits of the existing institutions (North, 2005).

Discursive institutionalism highlights the potential of both interests and ideas to trigger institutional change (Blyth, 2003; van de Ven, 1986). While it acknowledges the importance of powerful actors for institutional change, it also accepts that actors who do not hold formal power but possess social and communication skills, may trigger institutional change through discourse. For example, Fligstein (1997b) argues that actors who possess

good social skills are capable of introducing institutional change. According to him, those actors can influence the interests of powerful actors, and convince them of the necessity of change by convincingly communicating the need for it (Fligstein, 1997b).

Ideas, which are discussed in the following, are central means for changing the cognition of actors, and play a very important role in institutional change (Campbell, 2004). According to Van de Ven (1986), building on the work of Donald Schön (1971), new ideas can be the cause of the creation of institutions as well as reasons for the alignment of existing institutions. The authors argue that actors create institutions because they believe and “become attached to ideas over time” (Schön, 1971). When an idea is recognised and becomes subject of a debate in groups or networks, those involved may also become drawn to the idea, and develop it further. Discussion about ideas therefore gives meaning to them (Van de Ven, 1986), and at the same time eventually challenges existing institutional settings. This is the case when actors become attached to the idea and believe that alteration of the existing institutional framework towards this idea may be more effective. In other words, ideas have the potential to change the cognition and the belief system of actors because ideas can give meaning to actors. As Campbell (2004) points out, ideas are important to legitimise institutional change.

However, while all institutional change starts with new ideas, not all ideas change institutions. Whether ideas will be turned into institutions depends not only on the commitment of actors to these new ideas but also on the resources of the actors who became attached to them (Van de Ven, 1986). In order to informally institutionalise an idea, it has to become accepted by several actors who adopted this idea in such a way that it guides their behaviour. For the formal institutionalising of an idea, it has also to be accepted by actors who have the power to introduce change in formal institutions. Empirically, Greenwood, Suddaby and Hinings (2002) demonstrate that theorising is a powerful device to legitimise institutional change. Using the example of professional accounting associations, the authors demonstrated that major changes of the accounting profession were triggered by discourse and theorising of accounting associations (Greenwood et al., 2002).

While ideas can explain incremental institutional change, Blyth (2003) argues that the concept of ideas is particularly strong in explaining institutional change in times of uncertainty and crisis. Blyth’s argument goes as follows: in times of a crisis, actors may question the function of the existing framework and are drawn to new ideas. Ideas, then, can

act as interpretive frameworks which provide agents with information as to how to assess the existing institutional framework regarding its “proper” and “improper” elements. The identification of weaknesses of the existing framework provides not only a starting point for institutional change but also the framework as to how these false elements “should be designed” (Blyth, 2003). Blyth (2003) challenges the assumption that institutional change always reduces uncertainty by arguing that in times of crisis, ideas - not institutions - are appropriate to reduce uncertainty because they can provide a “vision” for agents as to what direction should be taken over time.

Ideas have, unlike interests, the potential to change the understanding and the meaning of other actors in a discourse. Taking the assumption that ideas are one of the main sources for institutional change, it can be argued that institutional change can also be changed by new ideas of groups of actors who can mobilise supporters. Institutional change is linked to learning and innovation; the latter has been defined as the “development and implementation of new ideas by people who over time engage in transactions with others within an institutional context” (Van de Ven, 1986, p. 591). Institutional change as a result of ideas can therefore be interpreted as the result of learning and innovation through the interaction of actors.

For the study of innovation, it is further important to focus on the behaviour of actors that may not conform to existing norms and values. Schumpeter (1942) argues that radical innovation create “disruptive change”, whereas incremental innovation creates “continuous change”. Innovation does not occur isolated from its context (Edquist, 1996) and as a consequence innovation changes the context of its occurrence. Every innovation revolutionise the way how things are done, or introduces new activities and therefore inevitably challenges existing institutions. Van de Ven (1986), for example, argues that “[i]nnovations not only adapt to existing organizational and industrial arrangements but they also transform the structure and practices of these environments” (p. 591). Radical innovation changes the worldview (*Weltanschauung*) of how things are done. From an institutional perspective, innovation challenges the existing norms or cognitive frameworks of actors. If an actor introduces a new product or activity than they may face the challenge that the existing framework does not provide support as to how to perform this activity (DiMaggio, 1988). To gain legitimacy, actors may need to introduce institutional change (Barley & Tolbert, 1997).

Greenwood and Hinings (1996) argue that firms are more likely to carry out radical innovation in less-developed institutional fields. In mature industries, leading firms may set standards for other firms operating in that industry, and pressure to conform is relatively high. In contrast, in less-developed institutional fields, established networks are less pronounced and no templates exist as to how to behave. Therefore, it can be expected that organisations have more freedom for radical organisational change and innovation (Greenwood & Hinings, 1996).

2.3 Institutions on the level of society and innovation

2.3.1 The Rise of Neo-liberalism and its core elements

2.3.1.1 Neo-liberalism: ideology and reform policies

Since the 1970s, governments of advanced capitalist economies increasingly adopted elements of neo-liberal ideology and policies such as market deregulation, and the reduction of state intervention in market processes (Campbell & Pedersen, 2001; Harvey, 2005). Campbell and Peterson (2001) argue that the period of rising neo-liberalism has triggered significant institutional changes regarding social, political and economic policies across the globe. Knight (2001) points out that “[n]eoliberalism is a complex phenomenon” (p. 29), and, therefore, it is not surprising that the literature lacks a common definition of the term ‘neo-liberalism’ (Boas & Gans-Morse, 2009).

Generally, neo-liberalism is based on a set of ideas about how growth and prosperity can be achieved. A central assumption of the neo-liberal paradigm is that the dynamics of free markets will lead to the efficient allocation of resources, and hence foster economic growth (Harvey, 2005). State interventions, on the other hand, are undesirable because they disturb the market mechanism, and as a result lead to an ineffective and counterproductive market outcome (Sachs, Warner, Aslund & Fischer, 1995). From the perspective of neo-liberalists, economic prosperity, including employment and income growth, can be achieved by establishing conditions that foster entrepreneurial activities of individuals (Harvey, 2005). In order to facilitate such conditions, the main responsibility of the government is to establish an institutional environment that secures the freedom of its citizens, guarantees, and if necessary enforces private property rights and fosters free market competition and trade (Friedman, 1962; Harvey, 2005). Neo-liberals argue that the greatest institutional barrier to

economic development is the absence of property rights, and hence, diligently promote the privatisation of assets (Harvey, 2005).

Boas and Gans-Morse (2009) argue that the term neo-liberalism is commonly used with regard to a specific set of “economic reform policies”, including the liberalisation and deregulation of markets and the reduction of the involvement of the state including the privatisation of former state-owned assets. Privatisation is a key concept for implementing the ideology of neo-liberalism in reality. According to Savas (2000), “[p]rivatization is the act of reducing the role of government or increasing the role of the private institutions of society in satisfying people’s needs; it means relying more on the private sector and less on government” (p. 3). During the last two decades, the privatisation of public-sector enterprises has occurred in many countries. While the reasons governments give for privatisation are typically multiple (Megginson, 2005) and vary widely across countries (Vickers & Yarrow, 1988), two very common objectives for privatisation, namely economic and ideological reasons, are closely related to the ideas of neo-liberalism.

On the one hand, governments privatised companies for ideological reasons. Some see privatisation as a means of democratisation because government ownership is replaced by private ownership which reduces the power of the state (Bös, 1991). Public sector ownership restricts the economic freedom of individuals in two ways. First, it forces taxpayers to hold shares of the state-owned company (Vickers & Wright, 1989). Second, it reduces the option for consumer choice because regulation of industries artificially reduces the number of suppliers (Heald & Steel, 1986). On the other hand, governments privatise for economic reasons, which is based on neo-liberal beliefs. In the literature, the belief that privately-owned companies are more efficient than state-owned seems to be widely accepted. It is assumed that the change from public to private ownership would enhance both productive and allocative efficiency through both cost and quality innovation (Boardman & Vining, 1989; Cuervo & Villalonga, 2000; Hartley & Parker, 1991; Harvey, 2005; Kikeri, Nellis & Shirley, 1994; Martin & Parker, 1997; Megginson, Nash & Van Randenborgh, 1994; Sheshinski & Lopez-Calva, 2003; Zeckhauser & Horn, 1989).

Shleifer (1998) argues that with clearly defined property rights, private companies have incentives for both quality and cost innovation. Ownership of assets enables the owners to exercise control over their assets. Private owners have incentives to make investments in cost and quality innovation because they will receive the benefits of such investment. From

this perspective, private property rights are an important prerequisite for innovation, and set incentives to innovate (Hart, 1995; Hart & Moore, 1990).

Other reasons why private ownership is believed to enhance performance include the orientation towards commercial objectives by linking the incentive structure of managers to the profitability of the firm (Martin & Parker, 1997; Parker, 1993). Managers are motivated towards both profit making and innovating (Shleifer, 1998) which positively influence performance (Martin & Parker, 1997; Parker, 1993; Tyrrall & Parker, 2005). Due to a stronger profit orientation, inefficient production and services will be eliminated and the released resources can be used more productively (Beesley & Littlechild, 1986).

A third motive for privatisation is a financial rationale. Megginson and Boutchkova (2000) argue that privatisation enables governments to generate a large amount of revenue without having to increase taxes which should be avoided from the neo-liberal perspective, as high tax is believed to slow down economic growth. From a neo-liberal perspective, private ownership of property is the underlying, fundamental concept of all capitalist economies, providing incentives to innovate (Baumol, Litan & Schramm, 2007).

Privatisation can include both the transfer of state-owned assets to the private sector, called denationalisation, and the opening of former monopolistic markets to competition, called deregulation (Savas, 1989-90; Vickers & Yarrow, 1988; 1991). Hence, privatisation may change both the institutional environment of organisations (Johnson, Smith & Codling, 2000) and the internal governance structure. Denationalisation refers to the deliberate sale of state-owned enterprises or assets to the private sector (Megginson & Netter, 2001). Bös (1991) argues that denationalisation changes power relations within a society because “[d]ecisions on prices, investment, and technology are taken out of the domain of public bureaucrats and policy makers and shifted to people who are responsible to private shareholders” (p. 2). According to Vickers and Wright (1989) denationalisation includes four forms, namely the complete sale of public firms to private investors, the sale of subsidiaries of nationalised companies, the recapitalisation of public companies by private investors and the sale of government holdings. In addition, Savas (1989-90) identifies the liquidation of a poorly performing company as a form of denationalisation. It is important to note that governments may choose to carry out partial rather than full privatisation of an entity in order to maintain control (Kang & Sorensen, 1999; Martin & Parker, 1997). From the neo-liberal perspective, it

is assumed that the shift from public to private ownership will improve company performance through more clearly defined property rights.

Deregulation refers to the opening of former monopolistic markets to competition, thus enables private companies to tackle former government monopolies (Savas, 1989-90). The deregulation of markets represents a radical shift of the institutional environment for firms, and institutional theorists expect that such changes are accompanied by radical changes within the organisation (Greenwood & Hinings, 1988; 1993). Hence, from an institutional perspective, the main condition for companies restructuring in the context of privatisation may be the deregulation of markets rather than a change of the ownership structure (Eraković & Wilson, 2005; Ramamurti, 2000). Since free markets are considered to be the key to increasing economic efficiency under the neo-liberal paradigm (Friedman, 1962), it is not surprising that many authors advocate deregulation in the context of privatisation (Beesley & Littlechild, 1994; Vickers & Yarrow, 1988; Yarrow, 1989), and generally prefer free markets over regulated ones (Friedman, 1962).

Meyer, Brooks and Goes (1990) demonstrated empirically that the deregulation of an industry which redefines the competitive rules triggered radical changes within the embedded companies. Also, Eraković & Wilson (2005), using the example of New Zealand's public sector reform between 1985 and 1995, found evidence that not only privatised companies have experienced radical organisational transformations but also publicly-owned companies which were embedded in the changing institutional environment.

Boas and Gans-Morse (2009) point out that other groups of authors use the term neo-liberalism to refer to a development model based on a set of economic theories with policy implications that are believed to facilitate economic growth and democracy. The key implications of the neo-liberal development model for the role of different actors of society such as labour unions, governments and private enterprises differ significantly from the former "state-led development model", implying that a redefinition of the relationship between the state and other stakeholders becomes necessary (Boas & Gans-Morse, 2009, p. 144). From the neo-liberal perspective, individuals should be responsible for their personal welfare, which is rationalised by emphasising the freedom of individuals. Child and Rodrigues (2004) explain that under the neo-liberal ideology, the responsibility for provisions such as pensions and medical health care is shifted from employers to individuals.

From this perspective, deregulation or “liberalising” (Hall & Thelen, 2009) can be described as the withdrawal of government laws and regulations in favour of free markets. It includes removing barriers to market entry, and allows economic actors the freedom of price settings (Emmons, 2000). By using the idea that free markets will lead to the effective allocation of resources, politicians across the globe implemented significant changes of the legal institutions within their country, such as eliminating trade barriers, the deregulation of financial and labour markets and transferring public assets into the private domain (Klein, 2007). Initiatives that are linked to the liberalisation of labour markets include the disempowering of unions, decentralising collective bargaining, decreasing minimum wages and reducing employment protection (Hall & Thelen, 2009). For example, Child and Rodrigues (2004) point out that the neo-liberal logic of the free market coordination of resources requires “flexible” labour markets. Such markets, neo-liberalists argue, make it possible for people to be employed in those areas in which they add the most value. Therefore, according to Child and Rodrigues (2004), neo-liberalism “justifies measures, such as downsizing and outsourcing, that remove people from a firm’s establishment in the cause of improving corporate performance through greater labour productivity and increased strategic focus” (p. 146). While most of the initiatives weaken the protection of labour, they generally aim to better protect the interests of capital. For example, initiatives that are associated with liberalisation include the promotion of equity capital through the introduction of international accounting standards, and better protection for minority stakeholders (Hall & Thelen, 2009).

While there is a worldwide trend of governments to move towards free markets and hence to liberalise certain parts of their economic system, the degree of liberalisation varies between different countries (Hall & Thelen, 2009). Hall and Thelen (2009) argue that liberalisation cannot be defined as a single process including certain initiatives, but that neo-liberal initiatives need to be explored separately. They also insist that researchers investigating institutional reforms need to be aware that the outcomes of such institutional changes may vary in different settings because of the variety of responses of the actors in the economy as well as interaction with other institutional arrangements (Hall & Thelen, 2009).

2.3.1.2 Prominent neo-liberal management concepts

The ideologies of neo-liberalism are not only influencing policy-making across the globe, but also directly influencing the management of firms. In the literature two important managerial concepts have been identified that rest on neo-liberal logic, shareholder value management and the New Public Management (NPM).

Firstly, considering that neo-liberal ideology stresses the importance of private property rights for innovation and economic growth as well as the individual responsibility for social provision such as pensions, it is not surprising that key promoters of the neo-liberal ideology also favour shareholder value strategies over stakeholder value strategies. For example, Friedman (1970), made it very clear that the manager is the agent of the owners of the business, and is directly responsible for conducting the business in accordance with their preferences. Friedman also points out that the preference of shareholders is to maximise profit; according to Friedman (1970) “there is one and only one social responsibility of business - to use its resources and engage in activities designed to increase its profits so long as it stays within the rules of the game, which is to say, engages in open and free competition without deception or fraud” (p. 33). Regarding organisational goals, Friedman makes a strong case that the interest of the firm, and hence the goals of the managers ought to be to maximise the economic value for its shareholder.

Shareholder value management is based on the principle agent theory. This theory argues that the principal and the agent (a) pursue conflicting goals, (b) have different attitudes towards risk and (c) both aim to maximise their expected utility (Berle & Means, 1932; Eisenhardt, 1989b; Fama & Jensen, 1983; Hölmstrom, 1979). The main goal of corporate governance is to prevent the managers from pursuing their self-interests, and to ensure that they behave in the interest of the owner of a company (Farinha, 2003; Jensen & Meckling, 1976).

The principal agent theory suggests that managers will pursue the interest of the owners when their incentives are aligned with those of the owners. Therefore, Kerr and Bettis (1987) argue that “shareholders’ return should provide a logical basis for executive compensation” (p. 646). This can be achieved by introducing a variable salary component for managers based on shareholders’ return. There are many types of incentives for managers that are used in practice to align their interests with those of the shareholders of a firm, such as performance-based bonus, bonuses based on the achievements of predetermined goals,

stock options, salary revisions and performance-based dismissal decisions (Höpner, 2003; Jensen & Murphy, 1990). To ensure that managers act in the interests of the owners, concepts have been developed to operationalise shareholder value ideology into a shareholder value strategy. Management principles aiming to increase shareholder value can generally be summarised under value driven management (Ballwieser, 2009).

The foundation for shareholder value debate was laid with Rappaport's work *Creating Shareholder Value* published in 1986 (Ballwieser, 2009; Höpner, 2003). According to Rappaport (1986), the performance of managers should be judged solely by whether they create, and maximise, value for their shareholders. Rappaport criticises traditional profit-based accounting numbers such as earnings per share (EPS) and return on investments (ROI) because they ignore specific investment risk as well as the time value of money, and thus may indicate growth although they in fact generate negative returns for owners. Rappaport argues that managers need to adopt strategies that generate value for shareholders, and this is adhered to only if a company meets or exceeds shareholder expectations of return on equity. Therefore, the author suggests that managers should evaluate different investment alternatives with discounted cash flow techniques. Only projects with positive return on equity for shareholders should be realized. On the other hand, existing segments that are not earning the capital cost required by the owners should be outsourced (Rappaport, 1986).

Höpner (2003) points out that in the late 1980's different performance measures were developed concerning value driven management, including the Economic value added (EVATM), the CFRoI (Cash-flow return on investment), and the RoiC (Return on invested capital). Different concepts have in common that they all try to align performance indicators with the objectives of the external capital market, i.e., to improve the economic value for shareholders. However, Höpner (2003) believes that it is difficult to identify whether a company's adoption of a shareholder value strategy was indeed based on performance indicators, because perceptions about whether different performance indicators contribute towards shareholder value creation differ, and no standard has emerged. Nonetheless, Höpner (2003) argues that companies that adopt a shareholder value strategy have usually defined targets for the return on investment either for the segments or the organisation as a whole. A target for return on investment will increase the efficiency of the capital allocation. According to Höpner (2003) such a target will avoid cross-subsidisation in underperforming

segments, and those which are not achieving the return on investment target over time may be outsourced.

Secondly, a management concept based on the assumptions and beliefs of the neo-liberal ideology is that of New Public Management (NPM). According to Schubert (2009), NPM is built on similar assumptions of the principal agent theory and property right theory. Schubert (2009) points out that advocates of the NPM believe that the distribution of property rights, where the ownership and control of resources is separated, leads to an inefficient coordination of resources. The performance of public agents cannot be directly observed by the owners (who are in the case of a public company the society, i.e., taxpayers) resulting in a moral hazard problem (Schubert, 2009).

The main idea behind NPM is to transfer market principles and management practices from the private to the public sector (Drechsler, 2005) in order to increase the efficiency of the latter sector (Christensen & Lægreid, 2001; 2007). The term NPM had been first introduced by Hood (1991) who critically discussed the assumption that the concept of NPM is universally applicable in different spheres of public management (Hughes, 2008). Based on the neo-liberal ideology, NPM was first implemented in Anglo-Saxon countries, such as the UK and New Zealand. International institutions, including the World Bank and the OECD, advocated the NPM as being “international best practice”, its diffusion around the globe started soon after (Christensen & Lægreid, 2007; Hood, 1995).

Typical concepts to introduce competition into the public sector include: outsourcing and contracting out of services, (compulsory) competitive tendering (Wollmann, 2000); private-public partnerships, and what Sanderson (2001) described as ‘consumerism’ to provide consumers of public services with more choice and influence over the offered services in terms of quality and price. Furthermore, managerial concepts of NPM are categories by Sanderson in three key themes: (a) a greater cost awareness, including aims to increase both efficiency and productivity of public services; (b) decentralisation, including establishing managerial responsibility in relation to budgets and (c) ‘neo-Taylorian’ practices, including setting of performance targets and performance-related incentives to create motivation to achieve targets and improve performance (Sanderson, 2001). From the institutional perspective, ideological changes such as the shift towards neo-liberalism are driven by interest or ideas of powerful actors, who argue that free markets will create economic growth and prosperity.

2.3.1.3 Critics of the concepts of neo-liberalism

Institutional theory suggests that changes in the institutional framework will result in benefits for some and disadvantages for others. Changes driven by ideas, however, allow actors not to reveal the real motive for institutional changes. Ideas are a powerful tool for actors such as governments to justify institutional change and gain legitimacy by arguing that it brings benefits for society, even if they do not necessarily believe in the communicated outcome themselves (Stiglitz, 2008). There are some critical voices who argue that the neoliberal ideology was driven by powerful actors who did not disclose their true interests. For instance, Stiglitz (2008) speculates that governments have used the idea that flexible labour markets will lead to economic prosperity in order to justify the deregulation of labour markets, but the hidden agenda has been to strip away all protection for employees. Stiglitz (2000) argues that one cannot assume that powerful actors, who make decisions which impact on the whole of society, or even the world economy, consider the interests of all their members.

Clearly, from an institutional perspective it becomes necessary to empirically analyse whose interests are supported by changes in the institutional environments and whose are not. This point was made clear by North (2005) who argues that it is necessary to understand “who makes the rules and for whom and what are their objectives” (p. 15) as well as who might encounter disadvantages. According to North (2005) disadvantages for some actors arise from uncertainty due to institutional change. Therefore, changes in the institutional environment, such as the liberalisation of markets or the privatisation of former state-owned companies, need to be seen in the context of who changes the rules and for whom, as well as who is ultimately benefitting from the new set of rules.

There are some critical voices questioning whether the introduction of neo-liberal concepts, including the deregulation of markets and privatisation, has increased the wealth of the nations who embraced them. Some argue that the introduction of neo-liberal policies has redistributed wealth rather than created it (Harvey, 2005). Benefiters of the introduction of neo-liberal policies are believed to be the ruling class that holds finance (Duménil & Lévy, 2001; Harvey, 2005). Authors concerned with the negative implications of neo-liberal policies for both developing and developed countries believe that neoliberalism increases inequality and poverty within society (MacGregor, 1999). For example, Kenworthy, (1999) provides evidence that the retreat of governments from social welfare policies increases inequality and poverty. Similarly, Quiggin (1999) argues that neo-liberal policies have

increased inequality across a number of developed countries. Others go even further, arguing that neo-liberal policies have increased the international instability that has slowed down economic growth and sharpened the crisis of Third World countries in particular (Duménil & Lévy, 2001).

A recent report of the OECD (2011) reveals that income inequality is increasing in 17 out of 21 OECD countries. According to the report, inequality started to increase first in Anglo-Saxon countries, including the UK and the United States, from the late 1970s onwards. However, evidence of the report shows that inequality has recently increased in Western European countries, including Sweden, Germany and Denmark. According to the OECD (2011), the increase of income inequality can be explained by changes of wage and salary levels. In the majority of the OECD countries, the wages of the highest 10% of earners have increased rapidly, while wages of the 10% least-paid earners have declined. Part of the widening gap can be explained by an increase of part-time employment (OECD, 2011). The study explains that increases in capital income can explain only a relatively small degree of the rising income inequality because it only accounts for about 7% of household income on average. However, income inequality increased in most OECD “during periods of sustained economic growth” (OECD, 2011; p. 8). Three factors are identified by the OECD that contributed towards this growing inequality: (a) Globalisation, technological change and institutional reforms; (b) change in household structures; (c) changes in tax and social systems.

In developed countries, neo-liberalism is believed to be associated with disempowering labour resulting in greater inequality between the lower and higher income classes. Child and Rodrigues (2004) point out that the shift towards neo-liberalism has reduced the protection of the interests of employees in the UK and the USA. Evidence from these countries shows that changes in labour law affected the power of employees to take industrial action against their employers. Changes in legislation have reduced the possibilities for employees to protect their interests and as a result, trust in their companies is decreasing (Child & Rodrigues, 2004).

Overall, evidence as to whether neo-liberal policies will increase wealth and prosperity remains inconclusive. While many prominent academics and politicians advocate neo-liberal policies, critical voices doubt that the shift towards free markets will increase economic prosperity in the long term. The latter are concerned with negative implications,

specifically a greater inequality. However, Coburn (2000) makes a case that neo-liberalists do not perceive increasing inequality as a concern, but rather as a possible consequence of the free-market mechanism, and “opposes measures to redistribute income resources” (p. 140).

There are also critical voices regarding neo-liberal management concepts. For example, Young and O’Byrne (2000) point out that there is resentment in Europe regarding shareholder value strategy because it is believed that it neglects the interests of other stakeholders. Ballwieser (2009) argues that views about whether companies should follow a shareholder value view polarises academics in Germany, and empirically it remains inconclusive whether the adoption of shareholder value ideology will create additional value and employment in the long term or may do the opposite (Ballwieser, 2009). Others question the benefits of shareholder strategies for the long-term survival of companies. Implications of shareholder value strategy for innovativeness and competitiveness will be elaborated in more detail in the next chapter.

2.3.2 National corporate governance systems

2.3.2.1 Diversity of national corporate governance systems and the innovativeness of firms

Several prominent researchers investigate how economic institutions at the level of the nation-state, and in particular the corporate governance system, influence the strategic and innovative behaviour of companies and the innovativeness of industries (Aguilera & Cuervo-Cazurra, 2004; Aguilera & Jackson, 2003; Crouch & Streeck, 1997; Hall & Soskice, 2001; Phelps, 2007a; Tylecote, 2007; Tylecote & Conesa 1999). In the broadest sense, a national system of corporate governance includes all formal and informal rules that are introduced to govern the relationship and to resolve conflicts of interest amongst different stakeholder groups, companies and society. It determines to what extent a different stakeholder group can pursue their goals, or rather the power of different stakeholders (Börsch, 2004b; Cornelius & Kogut, 2003; Wieland, 2005).

Economic institutions that influence corporate governance include company law and corporate governance codex, the education and training system, the financial system, and the arrangements of unions/employment organisations (Hall & Soskice, 2001; Phelps, 2007a; Soskice, 1997). Aguilera and Jackson (2003) point out that since corporate governance is embedded in different national contexts, the relationship between different actors is

influenced not only by economic institutions but also by social and cultural expectations. Focussing exclusively on economic institutions to investigate differences between corporate governance practice between countries leads, according to the authors, to an “under-socialised view” on corporate governance (Aguilera & Jackson, 2003; Aguilera, Williams, Conley & Rupp, 2006). From this perspective, it becomes necessary to take into account different social expectations and norms of the contexts that also govern firm behaviour. For example, Aguilera et al. (2006) argue that different social and environmental concerns of stakeholders, which are in turn shaped by social institutions, govern the behaviour of firms in terms of corporate social responsibility.

Owing to different cultural, economical and historical backgrounds, corporate governance systems vary across countries. One of the central questions for policy makers is to decide how to govern markets within society in terms of government intervention and regulation (Lundvall & Johnson, 1994). It is expected that different corporate governance systems influence the innovative profile of embedded organisations, which in turn, influences economic growth and prosperity (Baumol et al., 2007; Crouch & Streeck, 1997; Hall & Soskice, 2001; Hollingsworth, 2000; Hollingsworth & Boyer, 1997).

It has become widespread in the literature to discuss the advantages and disadvantages of national corporate governance systems within different theoretical types of capitalism (Amable, 2003; Hall & Soskice, 2001; Whitley, 1999). Crouch (2005b) argues that most of the authors include a liberal market economy of capitalism in their study “and at least one other form to make a theory of diversity: hence dichotomy” (p. 440). On the one hand, liberal market economies (LMEs: i.e. shareholder-orientated corporate governance systems) are typically applied in Anglo-Saxon countries, such as the United States, the United Kingdom or New Zealand (for an overview see Hall & Soskice, 2001, p. 20). Governments of these countries have established institutions on the macro level that promote the coordination of markets, including labour markets, capital markets and markets for managers via free market competition and “exit” (Hall & Soskice, 2001). The coordination of markets via competition in LMEs follows the ideology of the neo-liberal paradigm (Crouch, 2005a). For example, labour markets are designed to be flexible so that companies may adjust the level of employment easily. Financial markets typically promote the availability of risk capital, which in combination with possibilities for hostile takeovers, forces companies to achieve a relatively high profitability each year (Hall & Soskice, 2001).

On the other hand, coordinated market economies (CMEs: i.e. stakeholder-oriented corporate governance system) rather endorse coordination of these markets via mechanisms such as commitment or trust (Hall & Soskice, 2001). CMEs are common in European countries, for example in Germany, Sweden and Norway. CMEs aim to balance the interests of several stakeholders, and thus, are typically associated with social democracy (Crouch, 2005b). Corporate governance in CMEs is based on commitment between different economic actors, and therefore contains an element of trust. Typically, coordination via markets is not as robust as in LMEs, the achievement of the equilibrium thus depending partially on the support of social and political institutions (Hall & Soskice, 2001).

The institutional domains shaping corporate governance in different countries can, according to Aguilera and Jackson (2003), be divided into those affecting labour, capital and management. These domains will be briefly discussed for both CMEs and LMEs. Firstly, institutional domains that describe the role of managers in a market system can be classified, according to Aguilera and Jackson (2003), into managerial ideology and career patterns. Managerial ideologies are influenced by the norms and values of the institutional environment that impose constraints as well as influence normative expectation about appropriate managerial decision making and actions (Aguilera & Jackson, 2003). The different ideologies of groups of managers in LMEs and CMEs are reflected in the differences between their managerial goals, namely whether managers should serve the interests of the shareholders (LMEs) or balance the interests of different stakeholders, including the shareholders (CMEs).

In LMEs, because managers are expected to prioritise the objectives of shareholders, the maximisation of shareholder value is of uppermost importance (Francis, 1997). As discussed earlier, shareholder value strategy is based on the principle agent theory, stemming from neo-liberal ideology. The interests of other stakeholders, including the managers' own interests, lie within those boundaries only as long as they do not compromise this responsibility (Friedman, 1970).

In contrast, in CMEs managers have a moral obligation to balance the interests of different stakeholders, such as employees, shareholders and customers (Berman, Wicks, Kotha, & Jones, 1999). This balance is believed to positively affect a firm's performance because both organisational survival and the increase in organisational wealth are in the common interests of all stakeholders. Thus, a pro-organisational manager who maximise

organisational performance, satisfies the competing interests of all stakeholders (Davis et al., 1997). CME managers are measured not only on performance related goals but also on whether they can secure employment and contribute towards the prosperity of the region.

According to Aguilera and Jackson (2003), different cognitive models of managers about appropriate goals result to some degree from different educational backgrounds, such as general management education and technical expertise. Keat (2008) argues that managers in LME tend to acquire more general skills through external training such as MBA degrees. In contrast, managers in Germany, for example, possess industry-specific technical knowledge. Kwee, Van Den Bosch and Volberda (2010) argue that different cognitive models result from different national backgrounds. The authors argue that managers from LMEs tend to have throughput-functional backgrounds, such as finance and accounting, that highlight the importance of short-term profitability and efficiency. On the other hand, managers from CMEs have output-functional backgrounds, such as marketing and product R&D, that stress the importance of corporate responsibility and the objectives of different stakeholders.

Aguilera and Jackson (2003) argue further that different career patterns influence the behaviour of managers. In some countries labour markets for managers are 'closed', which means that managers are promoted within the firm. Typically, managers have intensive firm-specific knowledge. In contrast, other countries have established open labour market for managers, strongly oriented towards their financial performance. In open labour markets for managers, quite a large component of the salary is usually based on variable pay, such as stock option. Höpner (2003) argues that managers in Germany and Japan are typically employed for longer periods within one company than their counterparts in America, which results in the acquisition of more firm-specific knowledge of the former group. Delmestri and Walgenbach (2005) find evidence that middle managers in Germany possess and use firm-specific technical knowledge and are directly involved in solving technical problems.

Secondly, the power and role of labour is formed by three institutional domains: the representation rights of workers within firms, union organisation and collective bargaining, and institutions for skill formation. These domains shape the two dimensions which are important to describe the role of employees in the economy, namely the degree of worker participation and the degree of skill transferability (Aguilera & Jackson, 2003). The degree of representation rights varies greatly across countries from "weak to strong forms of

intervention rights of information, consultation, codetermination, and unilateral worker control” (Aguilera & Jackson, 2003, pp. 455-456). Moreover, it depends on both non-statutory and statutory institutions. While some countries require worker representation by law, for example through formal worker representation on the company board, others do not provide internal channels for worker representation (Aguilera & Jackson, 2003). Typically, worker participation and consultation in most LMEs, like New Zealand, Australia, Canada and the United States, is on a voluntary basis (Haynes, Boxall & Macky, 2005). From the perspective of the ‘diversity of capitalism’ literature, worker participation in most CMEs seems to be effective, whereas it appears to be ineffective in most LMEs (Terry, 1999). Using the example of the UK and Germany, Vitols (2001) argues that strong representation rights of labour in Germany are the result of non-market institutions that promote consensus, while the coordination of labour via markets does not require a consensus and, workers’ representation is established on a voluntary basis. Effective employee representation may thus be established, but is not guaranteed (Terry, 1999).

Relevant non-statutory institutions for the ‘labour’ stakeholder group are unionism and collective bargaining (Aguilera & Jackson, 2003). According to Thelen (2001), in both LMEs and CMEs, changes occurred with regard to collective bargaining. With increasing competition, employers across the globe demanded a greater degree of flexibility regarding collective bargaining agreements. Thelen (2001) argues that despite very similar challenges faced by employees and politicians in CMEs and LMEs, differences between the coordination of the industrial relation system of LMEs and CMEs seem to grow. Employers in CMEs are achieving more flexibility with regard to collective bargaining agreements in terms of personnel policy and wage structures at the firm level by renegotiating aspects between centralised and firm-level bargaining. As a result, greater flexibility has been achieved for individual firms, while at the same time collaboration between managers and labour, as well as collective bargaining, has been maintained. In contrast, LMEs followed the neo-liberal ideology of unregulated markets by deregulation of collective representations rights; thus union influence weakens or diminishes (Thelen, 2001).

Finally, corporate governance is affected by the nature of the skills provided by national learning and training institutions (Aguilera & Jackson, 2003). Crouch, Finegold, & Sako (1999) have identified five major institutions involved in education and training of workers: government institutions, private educational institutions, free market institutions,

networks and corporate associations. These institutions are fulfilling the needs of various stakeholders in a market economy concerning the acquisition and use of skills (Casey, 2011; Crouch et al., 1999). Whereas skills acquired within a firm or a network are often specific to the particular firm or network, skills acquired within private educational institutions or government institutions, are transferable assets that are valuable for many companies. Depending on the skills employees possess, they may prefer to exercise control via either exit or voice. Control via exit is more likely, when the skills of workers are less firm-specific and therefore transferable across firms. In contrast, when the skills are firm specific, workers tend to prefer control via voice because they frequently have long-term interests in keeping their job (Aguilera & Jackson, 2003).

Employees in LMEs are encouraged to acquire portable instead of firm-specific skills. The capacity for long term planning is usually limited for companies operating in LMEs because their strategies are affected by the behaviour of the stock market. Thus, companies cannot enter into a long term commitment with their employees (Börsch, 2007), who in turn have no incentive to invest into firm-specific skills. Instead, they acquire portable skills which are relevant in different contexts that are attractive for other employers (Hall & Soskice, 2001). Overall, both employees and companies in LMEs are relatively independent from each other. In contrast, companies in CMEs, which are built upon commitment and trust between several stakeholders, give employees incentives to invest into firm-specific skills, both companies and employees committing to a long-term relationship including long-term employment contracts, internal promotion systems, and adequate wage levels for qualified employees (Börsch, 2007). Moreover, a greater degree of autonomy is given to highly skilled workers (Goyer, 2001), resulting in employees being willing to invest in skills that are more specific for a particular firm (Börsch, 2007).

Lastly, institutional domains that shape the relationship between firms and capital stakeholders in general include the following three domains: property rights, the financial system and inter-firm networks (Aguilera & Jackson, 2003). ‘Inter-firm networks’ refers to mutual shareholding between firms. ‘Cross-shareholding’ means that networks of companies hold mutual financial stakes in each other to show strategic interest and commitment owing to the high exit cost from the network (Aguilera & Jackson, 2003). Aguilera and Jackson (2003) refer to this phenomenon as “network multiplexity”. In countries where high degrees of multiplexity within interfirm networks exist, control is typically exercised via

commitment, whereas in countries with low degrees of multiplexity within interfirm networks, it is exercised predominantly via exit (Aguilera & Jackson, 2003). At the same time, cross-shareholding reduces the likelihood of hostile takeovers (Hall & Soskice, 2001). Hall and Soskice (2001) argue that cross-shareholdings, a typical characteristic of CMEs, are an important element in reducing uncertainty and establishing commitments between different firms.

The financial system describes the structure of the sources of finance available for firms within an economy, which in turn, affects corporate control (Aguilera & Jackson, 2003). Generally, two financial systems can be distinguished, the insider-dominated system, which is common in CMEs (or: bank-based system; 'relationship-based system; stakeholder system) and the market-based system, which is common in LMEs (or: outsider-dominated system; shareholder system) (Berglöf, 1997; Jenkinson & Mayer, 1992; Leuz & Wüstemann, 2004; Mayer, 1997; Vitols, 2004). In a market-based system, governments tend to promote the exercise of control via liquidity (exit) and equity (Aguilera & Jackson, 2003). The main source for capital is the capital market, and the decision to invest in a company depends on its current financial performance. Ownership is widely dispersed across a large number of shareholders and the relationship between investors and a company is distant (Edwards, 2004; Roe, 1993). Companies are monitored by the capital market instead of insiders and the functioning of capital markets is thus crucial for effectiveness of the markets for corporate control (Edwards, 2004; Hall & Soskice, 2001; Höpner & Jackson, 2001). Most investors have no private access to information about the financial situation of a company. As a consequence, there is a need for public disclosure and external audit (Jensen & Meckling, 1976; Nobes, 1998). Vitols (2004) points out that in an outsider system, the maximisation of current shareholder value plays the uppermost role in corporate governance.

Porter (1992) argues that the structure of the external capital markets shapes how firms allocate capital to investment projects within the boundaries of the firm. In market-based systems, the majority of capital is provided by institutional investors and individual shareholders aiming for the short-term profit maximisation of their investment (Aguilera & Jackson, 2003; Börsch, 2007); firms aim to maximise the return for shareholders in the short term, for example by focussing on financial returns and current stock prices. The success of managers is typically assessed by whether financial targets have been achieved. At the same time, the compensation of managers is linked to company performance in terms of the

interest of shareholders, such as stock options for managers. Furthermore, each unit is accountable for their financial results. The decision making of whether capital will be invested into a unit depends to a large degree on the financial criteria (Porter, 1992).

In contrast, an insider system-dominated system which is common in CMEs, suits capital shareholders who pursue strategic interests (Schmidt & Spindler, 2002; Vitols, 2001 2004) and thus, those who prefer voice over exit. Characteristically, ownership is concentrated, often held by banks, and financing via debt is common (Edwards, 2004; Roe, 1993). Typically, investors have a long-term interest and develop a stable relationship with the company based on trust (Aguilera & Jackson, 2003; Goyer, 2001; Short, Keasey, Hull & Wright, 1998). Larger investors are mainly informed through internal channels which provide information not available in an anonymous market (Schmidt & Spindler, 2002). According to Porter (1992), the insider system is characterised by investors, whose dominant goal is the continuity of the company so that for them the financial performance is of lesser priority. Investors who are committed towards the future development of the firm, rather than focussing on the short-term performance of a company, are classified as ‘strategic investors’ such as banks which typically strive for rights to control a company (Aguilera & Jackson, 2003). While managers operating within an insider system also exercise financial control, their main objectives are of a different nature, such as improving the company’s position in the industry in terms of technical leadership or developing product innovation (Porter, 1992).

Finally, the property rights of shareholders include formal laws and regulations that govern the rights of shareholders and investors within an economy such as voting and information rights (Aguilera & Jackson, 2003). Reasonably strong protection of minority shareholders can, according to Aguilera and Jackson (2003), be achieved by “high disclosure requirements and norms of one-share-one-vote” (p. 453), because such conditions create disincentives for block ownership. The property rights of a country determine the relative power of different types of capital shareholders. While CMEs tend to protect the interests of strategic investors to a greater degree, LMEs place a greater emphasis on protecting the interests of financial investors. A summary of the main differences between the corporate governance systems of LMEs and CMEs is provided by Vitols (2001). The differences are illustrated in Table 2.1.

Table 2.1: Main characteristics of the corporate governance system in LME and CME

| | LME (U.S., UK) | CME (Germany) |
|---|---|---|
| Employee representation institutions | Voluntary basis | Required by law (board-level co-determination) |
| Human capital formation | General human capital, short tenure (exit) | Firm-specific human capital, long tenure (voice) |
| Labour relations | Adversarial | Cooperative |
| Financial system | Market-based (exit) | Bank-based (voice) |
| Ownership concentration | Dispersed shareholdings by portfolio investors | Concentrated shareholdings by strategic investors |
| Monitoring | Market for corporate control (high disclosure) | Monitoring by banks/large shareholders (insider information) |
| Top management | Single board dominated by CEO | Dual board Multiple power centres |
| Primary corporate goal | Shareholder value (profit) | Multiple goals: profitability, market share, and employment security |
| Competitive strategy | Short term oriented: ‘big leaps’ Radical innovation in new sectors Price competition in established sectors | Long term oriented: ‘small steps’ Non-price competition through incremental innovation in established industries |

(adapted from Vitols, 2001, p. 339)

Researchers such as Hall and Soskice (2001) argue that coordination via markets as in LMEs is well suited to meet the requirements for radical innovations. Flexible labour markets allow firms that undergo radical changes to replace existing staff with new, allowing them to quickly obtain relevant skills and expertise for innovation (Börsch, 2007). Also, a company must justify a strategic shift only to capital stakeholders of the company, and redundancies are not negatively judged from a moral point of view. The presence of venture capital in LMEs, furthermore, is believed to be very important for radical innovation (Hall & Soskice, 2001). ‘Marketable assets’, such as general human capital and risk capital, which are more readily available in LMEs, are a key input factor for the development of radical innovation (Miozzo & Dewick, 2002), and radical shifts in strategy (Börsch, 2007).

Similarly, Phelps (2007a) believes that some key economic institutions on the macro level, such as financial institutions and corporate governance, determine the degree of ‘dynamism’ of the embedded companies. Economic institutions that foster a high degree of dynamism create great incentives for economic actors to strive for new abilities, and to

accomplish radical innovations, whereas economic institutions that create a low degree of dynamism hamper radical innovations and entrepreneurial activities (Phelps, 2007a). According to Phelps (2007a), a high degree of ‘dynamism’ is a key factor for an innovative economy. With such dynamism firms develop the capability to master new tasks and to adapt quickly to changing environmental conditions. In addition, a high degree of dynamism ensures the efficient allocation of capital to sectors with good prospects to enhance productivity. Phelps (2007b) suggests that “economic dynamism is best served by a system of institutions and mechanism like capitalism—regulated and deregulated as required in order to provide a high rate of commercially successful innovation of noncoordinated entrepreneurs, financiers, and consumers” (p. 557).

The emphasis on ‘non-coordinated’ implies that LMEs are superior in creating a high level of dynamism, and indeed Phelps (2007b) gives some empirical evidence that the economic institutions of the United States, Canada and the UK achieve better results than their European counterparts in worker satisfaction or “turnover of listed firms”, all signs of such dynamism. Radical innovations are mentioned in the same breath as rapidly changing technologies and markets, and thus require the rapid and dynamic responsiveness of organisations (Goyer, 2001; Phelps, 2007a; 2007b).

It is claimed that CMEs have a competitive advantage in fostering the development of incremental innovation characterised by continuous but minor improvements of products and processes (Goyer, 2001; Hall & Soskice, 2001). According to Hall and Soskice (2001), the particular advantages of carrying out incremental innovation result from the institutional domains affecting the relationship between firms and their workforce. Incremental innovation, the authors point out, usually requires specific knowledge from the shop floor that may lead to changes in the production process. Corporate governance mechanisms that foster secure, long-term employment and worker participation lay the foundation for such innovation because workers are only willing to share their knowledge if they do not have to fear negative consequences from such changes. Also, CME workers on the shop floor tend to possess the required skills and knowledge to contribute to innovation characterised by a mix of firm-specific and general skills of a high standard (Hall & Soskice, 2001). The intensive competition that fosters radical innovation is also reduced in CMEs from the inter-firm networks encouraging companies to compete on product differentiation rather than direct product competition. Finally, Hall & Soskice (2001) argue that radical innovations are less

likely because hostile takeovers sometimes required to gain access to new technologies are less common.

Radical innovation is unlikely in CMEs as it often requires a radical shift in strategy. Managers in CMEs need to find a consensus between the interests of different stakeholders in the event of radical strategy changes that inevitably result in a compromise over strategic decisions. From this view, Börsch (2007) concluded that radical changes of strategy in CMEs are less likely than in LMEs, and he suggested that “a strategy change of small steps seems likely to be taken by firms in stakeholder systems” (p. 18). However, Romanelli and Tushman (1994) found evidence that the accumulation of many incremental changes is not sufficient to accomplish a fundamental transformation.

The literature on the ‘diversity of capitalism’ implies that the corporate-governance setting of Anglo-Saxon countries sets the incentives to bring out radical innovations because of the highly competitive environment, whereas the institutional setting of most Northern European countries is believed to motivate companies to bring out incremental innovations (Hall & Soskice, 2001; Phelps, 2007a). It is suggested that most Northern European economies, and in particular Germany, patent frequently in well-established, traditional industries, such as in car manufacturing and engineering, whereas Anglo-Saxon countries will carry out innovations within new, radical, dynamic industries, such as biotechnology or information technology (Casper & van Waarden, 2005; Hall & Soskice, 2001).

2.3.2.2 Critics of the ‘diversity of capitalism’ literature and its implication for innovation

The recent literature of ‘diversity of capitalism’ has been critiqued by several authors. One major drawback is that most of the evidence is conducted on an aggregate level. Comparison of this statistical evidence is not without pitfalls. For example, Crouch (2005a) has argued that statistical data does not reveal the true picture of the economy, and makes the point that the conclusions made by Estevez-Abe, Iversen and Soskice (2001), who claim that Anglo-Saxon countries carry out more radical innovations because more academic patent citations are made by firms, is not persuasive.

Firstly, Crouch (2005a) argues that the findings that firms embedded in LMEs carry out more radical innovation than their counterparts in CMEs may be attributed to the extensive Anglo-Saxon literature in science. Secondly, the legal system of Anglo-Saxon countries differs significantly from the European traditions. Whilst European countries have applied a legal system determined by civil law traditions, that applied in Anglo-Saxon countries is based on a common law tradition. The patenting of innovations is encouraged to a greater extent by a common law system (Crouch, 2005a).

In the information technology sector in particular, often used as a classic example to demonstrate the radical innovation capacity of Anglo-Saxon countries (for e.g. Phelps, 2007a), patents for programs for computers are excluded from patentability in European countries (The European Patent Convention [EPC], Article 52, Paragraph 2), which makes the comparison problematic. The European Patent Convention takes the view that certain things like scientific theories and mathematical methods should not be regarded as innovation that is patentable because they believe that it would hamper free knowledge exchange and hence stifle the development of science (European Patent Office, 2006). Hence, innovations of European countries may occur but are not captured the statistics because of their public good character.

The focus on patents and formal R&D entails further drawbacks. Nowadays, many researchers consider the knowledge base central for innovation (Arrow, 2007; de la Mothe & Foray, 2001; Lam, 2004; Pfeffer, 2002) because innovation is facilitated by organisational learning (Lazonick, 2001; Lundvall & Vinding, 2004). The configuration of knowledge is also shaped by the institutional environment (de la Mothe & Foray, 2001). For example, Lam (2000; 2004) argues that different institutional settings give incentives to acquiring particular types of knowledge, such as tacit and explicit knowledge. Therefore, she suggests that researchers should focus more on how the institutional environment influences the accumulation of knowledge and organisational learning at the firm level.

Such a view implies that researchers should investigate how corporate governance systems influence the process of knowledge creation that leads to innovation, namely organisational learning. However, by focussing exclusively on formal R&D to explain differences in countries' innovation profiles, researchers account only for the outcome of such learning. Such view is problematic as past abilities to carry out innovations may differ from current and future abilities. However, problems of focussing on patents and R&D not

only arise from a static perspective on innovation, but also create a bias towards a specific type of knowledge, i.e. formal knowledge. In the innovation literature, it is widely accepted that the development of new knowledge and innovation requires tacit knowledge that cannot easily be codified or formalised (Inkpen, 1998; Nonaka, 1994). Furthermore, tacit knowledge is important for firms in the sustaining of competitive advantages (Reed & DeFillippi, 1990). By neglecting tacit knowledge, existing research may draw wrong conclusions about the long-term competitiveness and innovativeness of different systems of corporate governance. For the study of comparative advantages of corporate governance models on innovation, one needs to account for both tacit and formalised knowledge. To better account for how institutions influence tacit knowledge that is important for organisational learning, Lam (2004) suggested to study differences between key societal institutions such as the education and training system.

Another pitfall of statistical classification is the assumption that innovation within new industries automatically represents radical innovation, whereas innovation in old industries is only of an incremental character. The invention of the hydrogen-fuelled motor engine would thus count as an incremental innovation, whereas the launch of another Windows Version from Microsoft represents a radical innovation (Crouch, 2005a). The argument made by the author is also linked to the problem that arises in defining a new industry (Crouch, 2005a). According to Baumol et al. (2007) radical innovation has been noticeably absent in continental Europe. Others, however, argue that Germany is a pioneer in many environmental technologies, such as in climate protection (Jänicke, 2005). The existing theory on capitalism cannot explain why the German economy has an innovative capacity in new industries. The question is which economies will carry out radical innovation in future key industries.

There is also evidence that the widely held belief that innovative activities of U.S. firms evolved without government intervention are misleading. Fligstein (2008) provides evidence that Silicon Valley in the U.S. did not result solely from the entrepreneurial activities of a network of small firms, as many believe. Rather, Fligstein (2008) argues that the U.S. government played a crucial role in facilitating its emergence. According to the author, the U.S. government laid the foundation for innovation and entrepreneurial activities in Silicon Valley by providing government funding for research and development for technologies to both firms and universities. Initial and ongoing government funding was

important to enable the growth of the computer industry in Silicon Valley (Fligstein, 2008). Overall, Fligstein (2008) provides evidence that the emergence of the computer industry has not been facilitated by institutions of the free-market economy but from past institutions.

While many researchers have drawn their attention towards whether institutions promote radical or incremental change, little attention has been paid to the social outcome of innovation. The question remains which institutional settings promote innovation that is beneficial for society. Innovation is clearly a necessary precondition for economic growth (e.g. Solow, 1996), and also potentially increases the welfare of some actors in a society without decreasing the welfare of others. This point was made by O'Sullivan (2000) who states "innovation can mitigate conflicts among different interest groups over the allocation of resources and returns: an increase in the living standards of one interest group does not have to come at the expense of another" (p. 393). However, not all innovations fit this category (O'Sullivan, 2000).

Baumol (1990) agreed that different types of innovation exist. According to him, some innovation benefits society and hence prosperity and growth, whereas other innovation damages society. Instead of fostering growth innovation may redistribute resources in society. Hence, the allocation of the benefits of innovation will not necessarily be in favour of all actors; one cannot automatically assume that the all interests groups of a corporation will benefit from an innovation; or that innovation is necessarily associated with growth of the economic welfare of society from an allocative perspective. It remains inconclusive what kinds of institution foster innovation that also promotes sustainable economic growth.

Therefore, instead of focussing on whether innovation is radical or incremental, the more important question should be whether institutions promote innovation that is beneficial for both the economy and society. The aspect of whether those carried out in different economies are beneficial for society has been neglected in the recent literature on the diversity of capitalism. The identification and categorising, however, of a 'good' or 'bad' innovation depends often on the value system of the society, and it may bring only clear benefits to some actors while the benefits for others are questionable. A study focussing on the social outcome of the corporate governance system has been conducted by Lazonick & O'Sullivan (2001). The authors argue that during the 1990s the United States significantly improved their overall economic performance compared to other nations. However, they question whether the prosperity of its society will be sustainable; according to the authors,

richer households benefited from the growth, whereas those with lower income received less from the aggregate income. Further, they demonstrate that U.S. households had to work more hours in order to maintain their income. Lazonick and O'Sullivan (2001) question that free labour and capital markets of LME's are able to provide sustainable prosperity. From this perspective, the question as to whether an innovation is good or bad for society should also involve the dimension who is benefiting from an innovation and who is not. It seems to be important to also include the social impact of innovation.

To summarise, the main critique of researchers of the diversity of capitalism literature has been that the evidence given to illustrate the patterns of innovation in the two systems of corporate governance is conducted mostly on an aggregate level (Börsch, 2004b), and empirical evidence on the firm level is still rare. For example, Miozzo and Dewick (2002) have stressed that the mechanism of innovation must be analysed on the firm level. Börsch (2004a; 2004b) argues that most research on varieties of capitalism pays little attention to the investigation at the individual company level and instead, focusses on aggregates of companies, suggesting that investigation on the firm level can help to gain better insights on how different types of capitalism influence the innovativeness of companies (see also Hollingsworth, 2000).

Despite the concerns raised by some researchers that the existing evidence is not sufficient to prove that the LME system of corporate governance outperforms that of CME's, politicians and investors argue that the LME system of corporate governance is superior to the CME system (Jensen, 1993). Policy makers and academics alike are concerned with the lack of success in the high-technology industries, such as biotechnology and software in CMEs (Casper, Lehrer & Soskice, 1999). As a consequence, the German model of corporate governance in particular, often considered to be a prototype of the CME system, is presently under pressure to change (Dore, 2000).

A recent study by Kwee et al. (2010) questions the assumptions of diversity of capitalism literature from an empirical point of view. Kwee et al. (2010) conducted a longitudinal analysis of Royal Dutch Shell plc, 1907-2004 investigating how the different national backgrounds of top managers influence patterns of strategic renewal. The study shows that the background of managers influences both their innovative and growth strategy. The evidence suggests that managers with an LME corporate governance background tend to follow exploitative strategic renewal patterns and adopt external growth strategies, including

mergers and acquisitions. Exploitative strategic renewal is based on path dependency, incremental change, and a shorter-term orientation. It is concerned with optimising and improving activities of a firm based on existing knowledge. In contrast, the study suggests that managers with a CME corporate governance background are more likely to adopt explorative strategic renewal patterns, and prefer internal growth. Explorative activities are associated with new product and service offerings, new activities and technologies which are path breaking and therefore associated with radical change (Kwee et al., 2010). Specifically, the findings of this study, that managers in CMEs are more likely to carry out explorative activities associated with radical innovation (see for more details Section 2.4.2), whereas their counterparts in LMEs are prone to carry out exploitative activities associated with incremental innovation, is in stark contrast with the argument of the diversity of capitalism literature.

2.3.2.3 Convergence vs. Divergence of national systems of corporate governance

Increasing global competition leads to a debate on whether different models of corporate governance will converge or whether the divergence will endure. On the one hand, the diversity of capitalism approach (Hall & Soskice, 2001) highlights differences between LMEs and CMEs implying that diversity of different national systems of corporate governance system will remain. On the other hand, Guillen (2000) points out that proponents of the convergence believe that countries and firms are encouraged to adopt corporate governance standards that are suitable to sustain their competitiveness, which implies that a superior model of corporate governance exists.

In this vein, Guillen (2000) argues that academics can be generally divided into two groups: those who believe that different national systems of corporate governance will converge towards a single model, and those who believe divergence between different models will remain. Guillen (2000) then classifies the advocates of the convergence argument into three sub-groups. First, a group of academics believes that national systems will converge towards the Anglo-Saxon model that is considered to be ‘best practice’ because of its greater efficiency regarding capital markets, which are becoming increasingly competitive due to their internationalisation (Berle & Means, 1932; Rubach & Sebor, 1998). The view that the Anglo-Saxon model of corporate governance system is superior to the non-liberal models is aligned with the neo-liberal paradigm.

Second, Guillen (2000) argues that some authors believe that convergence will occur, but it is impossible to predict whether it will converge towards an existing national model, or towards a hybrid. Finally, there are others who believe that convergence towards a hybrid model will occur, combining the strength of different national models of corporate governance (Fleming, 1998, OECD, 1998b as cited in Guillen, 2000). Such a view is, for example, adopted by Rhodes and van Apeldoorn (1998) who state that since the early 1990s powerful businesses and politicians in Europe argue for an “embedded neo-liberalism” that contains neo-liberal and social elements. According to Rhodes and van Apeldoorn (1998), “Embedded neo-liberalism ... is premised on a strong belief in the free market and supports neoliberal policies of deregulation and flexibilization, but recognizes that the market must be embedded in a regulatory framework fostering both competitive business and social consensus” (p. 422).

Rhodes and van Apeldoorn (1998) make a case that European policies, including the Maastricht Treaty contains elements of both the LME and CME models of governance. At the same time, however, the authors believe that diversity of capitalism will remain on the level of the nation state due to path dependency, the dependency of firms of existing institutions as well as opposition of elites towards institutional change. However, some believe that convergence of different corporate governance systems amongst European countries is driven by European integration (Wessels, 1996). One of the major objectives of the EU is to achieve economic growth and prosperity amongst its member states by the establishment of free trade and market competition between its members resulting in greater market efficiency. In 1992, a common market was established amongst member nations, goods, capital, services and people moving freely within the EU (European Union, 2011).

To ensure that a single market could be effectively established, members agreed to give up national sovereignty in certain areas to the supranational European Commission (European Union, 2011; Dinan, 2005). The aim of supranational institutions on the European level is to unify the law amongst different members of the European nations in order to establish a “ ‘level playing field’ in the area of a single market” (Dimitrova & Steunenberg, 2000, p. 202). A prominent example, where the European policies overruled national institutions is, according to Dimitrova and Steunenberg (2000), the Economic Monetary Union (EMU) which resulted in similar monetary policies across members of the EU. From

this perspective, a convergent process between European nations may be driven by sub-national policies that change national policies.

In their edited book, Wessels and Rometsch (1996) compared the institutional development of 11 EU member states, which were investigated by different authors. They argue that the different national studies suggest that since the national institutions and supranational institutions act independently from each other, European policies clearly impact on national decision making. However, the authors conclude that there are “quite divergent patterns of action and behaviour of national institutions ... which do not seem to converge into one common (state) model” (Wessels & Rometsch, 1996; p. 329).

Dimitrova and Steunenberg (2000) discuss several studies that investigate whether European integration has led to uniform policy making amongst its members. The authors claim that the evidence remains ambiguous because most authors tend to find patterns of both divergence and convergence of national policies. Based on their analysis, they argue that European policy can result in four different outcomes, depending on the legislative processes and the implementation process. Convergence, the authors claim will only occur when two conditions are satisfied, namely that all national governments fully agree upon a uniform policy, and have no incentive to diverge from it. In cases where the Council grants exemptions for certain member states, these states have flexibility regarding the implementation of regulation in national policy, and convergence will not or only partially occur. The authors argue that in cases where a uniform implementation is required, but certain members do not agree with the policy, only partial convergence will occur. Falkner, Hartlapp, Leiber and Treib (2004) refer to cases where national governments do not comply with European policies as “opposition through the back door”. However, empirical evidence provided by Thomson (2010) shows that protracted noncompliance is in practice very rare.

Due to European integration, formal convergence has occurred with regard to some policies, but evidence suggests that diversity between different EU members will remain in most parts of the institutional systems. However, there is also an argument that with global competition, corporate governance systems across the global may functionally converge. According to Gilson (2001), functional convergence occurs when the institution takers believe that following existing formal institutions hampers their competitiveness. However, actors may not aim to formally change the formal institutions because of the associated cost, and instead undermine the formal institutions to achieve a desired outcome. Such behaviour

can result in a functional convergence meaning that actors embedded within different corporate governance systems behave in similar ways to remain competitive (Gilson, 2001). From this perspective, international competition is the main driver for convergence. If existing institutions negatively influence the competitiveness of their embedded firms, functional convergence will occur (Goyer, 2003).

Gilson (2001) provides an example of functional convergence. The U.S., Germany and Japan have all established different institutional characteristics by which to monitor the performance of managers: by strategic investors in Germany and Japan, and by markets of corporate control in the U.S. Managers who perform poorly, however, are replaced in all three countries. According to Gilson (2001) functional convergence therefore may occur, despite different formal institutions.

Functional convergence does not change legal institutions, but changes normative and/or cultural cognitive institutions in its context because it challenges the way things have been done in the past by adopting institutional practices from different contexts. Functional convergence may later result in formal changes of the institutional environment but this is not always the case (Gilson, 2001). To account for the possibility of functional convergence, it becomes necessary to take into account that institutional change may occur from the bottom, on the level of the firm.

The importance of firms' choice for processes of convergence has recently been stressed by researchers investigating comparative employment relations (e.g. Bamber & Lansbury, 1998; Kochan, Lansbury & MacDuffie, 1997). These studies underpin the importance of firm-level evidence to understand processes of convergence. For example, a study by Katz and Darbishire (2000) shows the importance of firms' choice for divergence or convergence. The authors investigated patterns of workplace practices in the telecommunication and automobile industries of seven countries. They identify four types of workplace patterns as variations of different successful 'national practices', such as Japanese practices, that are adopted across different countries. Hence, the authors argue that while national institutions still influence patterns of workplace practices and certain national differences remain, 'traditional national patterns' decline.

Despite studies in the field of employment relations highlighting the importance of firm-level data to understand institutional forces (Bamber & Lansbury, 1998), such approach

has been largely ignored by researchers studying international corporate governance systems. An early study which analysed the strategic behaviour adopted by privatised companies in different institutional corporate governance systems from a firm perspective was carried out by Börsch (2004b). The author investigated the adjustments by British Telecom and German Telecom (i.e. Deutsche Telekom) during privatisation, and found evidence that the strategic behaviour of the investigated telecommunication companies in their different corporate governance settings differed significantly. According to Börsch (2004b), both organisations “distinctive and closely follow the patterns of the corporate governance systems in which they are located” (p. 608). German Telecom introduced only incremental strategic changes, aiming to maintain a balance between the interests of employee representatives and managers. In contrast, British Telecom introduced more radical changes aiming to achieve high profitability to satisfy capital shareholders. The author concludes that the evidence of his study shows that divergence will remain.

The concept of functional convergence further implies that competitive pressure on the level of the market is the driving force of institutional change. Because of competition on the market level, organisations may need to break with existing institutional norms in order to survive. In view of this, it becomes necessary to discuss the implication of market competition for innovation.

The importance of market competition to understand processes of convergence of employment practices has been highlighted by Regini (1999). Based on empirical evidence in the deregulated banking industry in nine different countries (Regini, Kitay & Baethge, 1999), Regini (1999) argues that the interaction between market competition, technology and institutions shape employment relations on the firm level. On the one hand, increasing market competition and technological innovation triggered similar processes towards decentralisation and greater labour flexibility across banks in all investigated economies. On the other hand, national variations of Human Resource practices still remain due to institutional forces, including labour market legislation and industrial relations institutions (Regini, 1999).

2.4 Market environment and innovation

2.4.1 Market competition and innovation

The role of market competition for innovation has been highlighted by many prominent authors (Baumol, 2002; Schumpeter, 1942). Competition is one of the driving forces for firms to carry out innovation. For example, Fligstein (2008) points out that “[t]wo primary forces shape firms' strategic actions: the behaviour of their competitors and the actions of the government to define what is competitive and anti-competitive behaviour between firms” (p. 131); it can be argued that institutions on the macro-level influence the nature and pressure of market competition. However, institutions do not directly motivate human actors to carry out innovation. Incentives to carry out organisational innovation are created through market competition, which directly fosters innovation. Market competition requires firms to carry out innovation in order to survive (Baumol, 2002). Hence, the degree of market competition on the product and service level is influenced not only by the corporate governance system (Mayer, 1997) but also by the behaviour of the actors on the market, such as competitors and customers.

The behaviour of other actors also shapes the innovativeness of firms: innovation is the response of human actors to competition. Competition in the market puts pressure on organisations to outperform their competitors. Furthermore, on the level of the market, actors do not necessarily follow the coordination mechanism promoted by the institutional setting. For example, Hancké and Goyer (2005) write that some firms embedded in LME's coordinate their employment relations via coordination. In order to understand innovation, one also needs to consider the dynamics of the market environment.

Prominent researchers investigate how competition on product and service markets influences the innovative outcome of companies (e.g. Armstrong & Sappington, 2006). In general, the interaction between different actors on the market, that is to say competition, is assumed to provide incentives to carry out innovation. Innovation may be created internally, but its outcome will be judged by other actors in the markets. According to evolutionary theorists (Nelson & Winter, 1982), a successful innovation will be adopted over time. The adaptation of firms to a market environment can be illustrated by the dynamic interaction of variation, selection, retention and struggle (Aldrich & Ruef, 2006). The starting point is (often blind) variation which means that an organisation introduces an innovation in the market (Nelson, 1995). The organisation will either receive positive feedback for its action,

such as receiving profits, or negative ones, such as losing market share. Consequently, firms learn over time which actions and innovations are beneficial for them (Nelson, 1991).

The introduction of a successful innovation forces other actors in the market to respond to this innovation. They can either adopt it (DiMaggio & Powell; 1983) in which cases the innovation will become 'accepted practice' over time as more and more organisations adopt it (March, 2006; O'Neill, Poudier & Buchholtz, 1998), or they can refuse to imitate the innovation (Oliver, 1991), and choose another strategy. In this case, the initial innovation is challenged by other organisations by doing something differently which could result in a new innovation. Thus, an innovation has the potential to change the existing rules of the market environment. Nelson (1991) argues that the crucial function for competition is not to set incentives for companies to be cost efficient, but more importantly, to encourage organisations to try new variations of resource allocation. Thus, according to Nelson (1991), competition is the main driver for economic growth.

There is an argument in the literature that the incentives to carry out innovation are related to the degree of industry competition and uncertainties in the markets. Generally, market structures can be relatively stable or dynamic, and giving different incentives for firms to carry out different types of innovation. First, companies embedded within a relatively stable market environment are not under pressure to carry out radical innovation. These companies have incentives to focus on incremental innovation, which constantly improve existing products and processes (Dierkes 2001). According to Lundvall and Vinding (2004), for firms embedded in a stable environment with little change, the efficient allocation of resources is most important and they typically engage in cost saving activities.

By contrast, in cases where the environment is in upheaval- due to changing customer needs' for example- innovation is becoming most important for firms. Firms innovate to obtain competitive advantages that will help them establish a sustainable position in the market (Lundvall & Vining, 2004; Porter, 1998). As a consequence, firms operating in dynamic markets have more incentives to introduce products and processes that are radically new (de la Mothe & Foray, 2001; Dierkes, 2001). According to Lundvall and Vinding (2004), particular product innovation is important to achieve competitive advantage. For firms operating within competitive market environments, organisational learning is becoming more important as it is a pre-condition for innovation (Dierkes, 2001; Dosi, Marengo, & Pasquali, 2006). Dodgson (1993a) argues that organisational learning is the response to uncertainty and

competition; for him, it “is seen as a purposive quest to retain and improve competitiveness, productivity, and innovativeness in uncertain technological and market circumstances” (p. 378).

A characteristic of innovation is its implication that the conditions of markets are not stable but change over time. The actual condition of a market depends to a great extent on the innovativeness of the players. A market that is stable today might be in tumult tomorrow as a result of new innovation carried out by an actor who challenges the existing rules of the game. In order to compete, other players have to react to this innovation. Consequently, markets must be investigated from a dynamic perspective.

In some cases, however, competition may be impractical and firms have monopolistic power. In general, neither pure competitive markets nor monopolistic markets are suitable to facilitate innovation (Lundvall & Vinding, 2004). In purely competitive markets, companies have no incentives to invest in innovation because they cannot exploit quasi-rents, and consequently they are unable to recover their investments (Arrow, 1962; Dosi et al., 2006). A certain degree of patent and copyright protection ensuring that firms benefit from innovation is thus necessary to give incentives for firms to innovate without the threat of being copied immediately by competitors. The protection of R&D enables them to sustain a temporary monopoly position in relation to their competitors for a set period. However, since competition gives incentives to innovate in the first place, it is necessary for future innovation (Schumpeter, 1942).

Dosi et al. (2006) find empirically evidence that innovations were developed in markets with weak IP protection, such as the telecommunication sector, and they argue that strong patent protection may indeed result in fewer incentives to invest in knowledge, and may produce less economic growth over time. Drawing on the work of Teece (1986) they further make the point that the incentives for innovation which firms encounter depend to a great extent on opportunities given within the industry. The findings that the industry structure impacts on firms’ performance are consistent with Porter’s (1991) argument that the attractiveness of the industry is an important determinant for firm’s performance, and in some cases even more important their strategy and behaviour.

The literature implies that firms operating in turbulent environments are increasingly encouraged to collaborate. Collaboration between organisations typically requires commitment and trust; competition might in fact strengthen at the same time cooperation and trust, often believed to be in juxtaposition (Dodgson, 1993b).

To conclude, the level of market competition influences firm behaviour towards innovation. Firms embedded within dynamic market environments seem to have greater incentives to carry out innovation in general, and radical innovation in particular, compared to their counterparts operating in relatively stable markets. Furthermore, market environments with a high degree of uncertainty seem to foster collaboration between firms. However, from a dynamic perspective, it cannot be established whether the dynamics of the market environment are remaining the same over time. It can also be expected that firms will adopt different strategies to respond to changes in their market environment. In order to remain competitive: “firms compete not by striving to do the same thing most efficiently, but by trying to be different; to offer differentiated products on the basis of firm-specific competencies” (Nooteboom, 1999, p. 795; Nooteboom, 2000b, p. 67). With this in mind, it becomes necessary to highlight that organisational responses to the competitive environment are different and it becomes therefore necessary to understand how firms can develop competitive advantages.

2.4.2 Firm's competitiveness and innovation

In the previous section, the importance of the market environment for innovation has been highlighted. Oliver (1997) argued that integrating the theory of competitive advantages and institutional theory contributes to a better understanding of firm's heterogeneity. The aim of this section is to introduce some prominent theoretical perspectives that contribute to our understanding on how firms sustain competitiveness in changing market environments.

Burke and Lodgson (1996) argue that one of the biggest challenges for firms is to constantly create value for stakeholders. To overtake their rivals in terms of financial performance, firms can adopt different strategies which they believe will give them a competitive advantage (Porter, 1991). From a resource based view, superior firm performance results from the deployment of rare, unique and valuable resources (Barney, 1991). Managers aim to make choices that result in the creation of such "valuable resources" or of "distinctive competences" (Porter, 1991) that cannot be, or only partially be imitated by rivals (Barney, 1991; Porter, 1991).

Specific competencies and resources that may constitute a sustainable competitive advantage include both tangible assets, such as patents and valuable assets (Oliver, 1997) and intangible assets, such as interfirm relationships (Dyer & Singh, 1998) organisational culture (Barney, 1986), HR strategies (Becker & Gerhart, 1996; Pfeffer, 1994) and reputation (Amit & Schoemaker, 1993). According to Porter (1991), competitive advantages, in turn, can be categorised into two basic types of advantages, namely those of cost or differentiation advantages. Further, firms need to decide whether they apply a broad or narrow scope of their activities (mass market vs. niche market) (Porter, 1985; 1991). Depending on which of these generic strategies a firm follows it needs to develop specific competencies, which result in lower cost or a better quality performance respectively. Porter (1985) believes that firms that fail to adopt one of these generic strategies will be "stuck in the middle" and experience an inferior performance compared to firms that follow them.

Recently, the traditional theories of competitive advantages have been critiqued because of their static perspective on markets. Increasing competition means that firms are constantly seeking to "actively destroy their own and the advantages of their rivals" (D'Aveni, Dagnino, Smith, 2010, p. 1372). Resources that constitute competitive advantages may be copied or substituted by rivals, or they may become obsolete due to innovation (MacMillan, IC 1989 as cited in D'Aveni et al., 2010). To stay competitive while facing constantly

changing market environments, the capabilities of organisations to adapt to changing market conditions through innovation become crucial for the survival of the firm. At the same time, sustainable competitive advantages are becoming rare, and firms need to produce new competitive advantages over time (D'Aveni et al., 2010). From such a dynamic perspective, firms must increasingly rely on “temporary competitive advantages” (Thomas & D'Aveni, 2009) making indispensable the ability of a firm to adjust to the conditions of a dynamic market environment and to carry out innovation (D'Aveni et al., 2010).

The concept of temporary competitive advantages highlights not only the importance of a firm's ability to constantly adapt to changes of the environment, but also the importance of developing new competencies. Central to the understanding of how some organisations remain adaptable and flexible is the concept of organisational learning, that has been discussed by many prominent authors (e.g. Argyris & Schön, 1978; Cohen & Sproull, 1996; Lam, 2010; Nonaka, 1994). For example, Nonaka (1994) makes the case that in order to understand how organisations develop new knowledge it becomes necessary to adopt a dynamic view on the process of the development of innovation, which is compatible with the assumptions of advocates of temporary competitive advantages.

In general, knowledge is categorised into two different types of knowledge: explicit knowledge (i.e. formal/codified knowledge) and tacit knowledge (i.e. informal knowledge) (de la Mothe & Foray, 2001; Dosi, 1988; Lam, 2000; Polanyi, 1967). Explicit knowledge can be transferred and shared through systematic channels such as formal training and books that do not necessarily require a personal interaction between the subject of knowledge and its recipient. On the other hand, tacit knowledge, which contains subjective elements that cannot be understood independent of its context, is usually transferred by personal interactions, such as training on the job and that are difficult to communicate in words. Nonaka (1994) uses the example of apprentice work to explain tacit knowledge; “Apprentices ... learn craftsmanship not through language but by observation, imitation, and practice” (p. 19). While explicit knowledge may result into formalised R&D such as patents (Dosi, 1988), a firm also requires informal knowledge to create a competitive advantage. According to Dosi (1988), informal knowledge is complementary to explicit knowledge. Nonaka (1994) developed a model of organisational knowledge creation that highlights the importance of the interaction between knowledgeable individuals for the creation of new knowledge. New knowledge is created by combining different types of knowledge, those of informal and explicit knowledge. The

combination of different bodies of knowledge can, according to Nonaka (1994) result in four different modes of knowledge creation. Organisational knowledge can be created by systematically managing all four modes of knowledge creation between different members of the organisation (Nonaka, 1994).

From this perspective, the organisation is the platform on which different individual actors can share knowledge (Lawson & Lorenz, 1999). Hodgson (1998) argues that “the firm has a capacity to mould and integrate the individual perceptions, preferences, abilities and actions of its personnel” (p. 189). Individual actors commit to an organisation because they believe that this benefits them in some way. It can be established that organisational learning is facilitated by individual learning of members of the organisation (Kim, 1993) and may also involve external participants (Nonaka, 1994), such as customers (Lundvall, 2006).

While Nonaka’s model well describes how the combination of explicit and informal knowledge facilitates organisational learning, other authors are occupied in explaining the link between organisational learning and competitive advantage. One of the early models that adopted a dynamic view on competitive advantages, incorporating the development of organisational knowledge, was proposed by Reed and DeFillippi (1990). The authors state that competitive advantages can be a result of causal ambiguity. Three sources of causal ambiguity are identified by the authors, namely ‘complexity’, ‘specificity’ and ‘tacitness’. First, complexity arises from the combination of different and interdependent routines, technologies and individual knowledge that is difficult to imitate. Second, asset specificity, a concept based on Williamson’s transaction cost theory (Williamson, 1983; 1985), refers to transaction-specific investments into skills and assets between different parties. Third, tacitness, represented by investment in subjective and tacit knowledge that is transferrable only through personal learning, can hardly be imitated from a distance (Polanyi, 1967). In order to create sustainable competitive advantages, Reed and DeFillippi (1990) argue, firms need to invest and, if necessary re-invest, in assets and knowledge that are sources of causal ambiguity. Their model is based on the assumption of disequilibria, implying that competitive advantages may be only of a temporary nature, which is consistent with the theory of temporary competitive advantages developed by D’Aveni et al. (2010). Because competitive advantages are constantly challenged by competitors, firms cannot rely on “a fixed stock of competencies”. They need to engage in organisational learning to maintain the sources of ambiguity.

Arguably, one of the most prominent concepts addressing the need to analyse competitive advantage from a dynamic perspective has been developed by Teece, Pisano and Shuen (1997). The authors argue that competitive advantages result from “dynamic capabilities” of firms. These capabilities are defined as “the firm’s ability to integrate, build, and reconfigure internal and external competences to address rapidly changing environments” (p. 516). Like the model of Reed and DeFillippi (1990), the dynamic capability framework is built on the belief that markets are in disequilibrium as a result of innovation. Managers can exploit opportunities in a dynamic market by combining competencies and resources to build firm-specific capabilities that, in turn, translate into competitive advantages. The main task of managers is to sustain competitive advantages by managing and combining firm-specific processes, such as R&D. Managerial processes that lead to dynamic capabilities are path dependent, complex, and embody tacit knowledge. Due to complexity and tacitness, dynamic capabilities are difficult to understand by competitors and hence, difficult to imitate (Teece et al., 1997). The framework stresses that managers are the central agents for sustaining competitive advantage.

Competitive advantages from a dynamic point of view can also result from the capability of a firm to exploit external knowledge. This ability is represented by the absorptive capacity of a firm (Lichtenthaler, 2009). The concept of absorptive capacity goes back to Cohen and Levinthal (1989; 1990) who argue that the creation and adoption of innovation depends on the absorptive capacity of a firm (Dierkes, 2001). Cohen and Levinthal (1990) make the argument that the existing knowledge base of a firm, as a result of past and current learning, influences a firm’s ability to exploit knowledge available outside its boundaries, such as industry knowledge. Because investment into organisational learning comes at considerable cost, the amount of resources a firm is willing to dedicate to learning activities will inevitably depend on the perceived benefits of such an investment. A broader external knowledge base will give incentives for firms to invest into internal knowledge as it increases the likelihood for firms to exploit external opportunities (Cohen & Levinthal, 1990).

Zahra and George (2002) claim that the concept of absorptive capacity is a specific dynamic capability. Furthermore, the authors distinguish between the potential and realised absorptive capacity of a firm. The innovative output and current competitive advantages of a firm reflect its realised capacity, whereas the potential capacity reflects the capability of a

firm to successfully adapt to dynamic markets in the future, and therefore allows firms to sustain competitive advantages over time (Zahra & George, 2002).

The concepts of ‘causal ambiguity’, ‘absorptive capacity’ and ‘dynamic capabilities’ share not only the assumption that markets are in disequilibrium implying that competitive advantages need to be investigated from a dynamic view, but also their assumption about the nature of firm’s competitiveness. All approaches rest on the argument that the knowledge base of a firm is central for firm competitiveness. To stay competitive, firms are required to constantly engage in organisational learning. More specifically, all concepts implicitly or explicitly stress the importance of tacit knowledge for innovation. Very difficult to understand from the outset, tacit knowledge is difficult to imitate by competitors. Finally, all concepts stress the importance of existing knowledge for the exploitation of new knowledge, and therefore adopt that view that the development of knowledge is a process characterised by path dependency.

March (1991) argues that there are generally two types of innovation activities of firms, namely exploitative and explorative innovation. According to March (1991), firms need to balance between exploitative and explorative activities in order to adapt to changing conditions of their environment (March, 1991). Exploitation of existing opportunities is concerned with “such things as refinement, choice, production, efficiency, selection, implementation, execution”, whereas “[e]xploration includes things captured by terms such as search, variation, risk taking, experimentation, play, flexibility, discovery, innovation” (p. 71). Important for exploitative activities are existing competencies and market knowledge whereas explorative activities require the use of new technologies or knowledge to either enter new market and/or offer new products and services, or both (Cao, Simsek & Hongping, 2010; Kwee et al., 2010). Both activities are important for firm survival: exploitation to increase the operational effectiveness important for today’s success, and exploration to obtain strategic flexibility important for future’s success. However, the resources a firm can dedicate towards the development of these competences are limited, and thus competing, and managers need to make choices between the two (March, 1991). Kwee et al. (2010) argue that exploitative activities are related to strategic renewal that is path breaking, and represents radical strategic renewal, whereas explorative activities are related to strategic renewal that is consistent with the current path, and hence implies incremental strategic change.

Solving the paradox between exploitation and exploration is one of the central challenges of organisations, as pointed out by Levinthal & March (1993), who argue “[t]he basic problem confronting an organization is to engage in sufficient exploitation to ensure its current viability and, at the same time, to devote enough energy to exploration to ensure its future viability. Survival requires a balance, and the precise mix of exploitation that is optimal is hard to specify” (p. 105). According to the authors, difficulties in balance between these two activities arise not only from difficulties to determine the appropriate level of both activities, but also from the dynamics of learning that can result in both success or failure traps. On the one hand, organisational innovation may lead to a failure trap if innovations turn out to be unsuccessful. Organisations which introduce unsuccessful innovations will, according to the authors, intensify their engagement in explorative activities to introduce change. However, new innovations may also fail, trapping the organisation trapped into a cycle of failure. Efforts to carry out explorative activities lead to the neglect of exploitative activities (Levinthal & March, 1993).

On the other hand, organisations may excessively focus on exploitative activities, and encounter a ‘success trap’. Organisational learning in terms of exploitative competencies enhances efficiency and short-term performance. At the same time, the opportunity cost for explorative learning increases that are important for future success. Hence, successful exploitation may result in a ‘success trap’ as it drives out exploration (Levinthal & March, 1993). The focus on exploitation and efficiency has also negative implications for economic growth in general since innovation and learning are the main source for sustainable growth (Lazonick, 2001).

Zahra and George (2002) link the concept of exploitation and exploration to absorptive capacity and state that the realised absorptive capacity of a firm reflects exploitative capabilities based on acquired knowledge of the past, while the potential capacity reflects explorative capabilities utilising and acquiring external knowledge. O’Reilly and Tushman (2007) argue that exploitation and exploration require very different managerial processes, making it difficult for managers to successfully juggle these processes within the same organisation. It has been argued that organisations operating in dynamic environments need to become “ambidextrous” to resolve this paradox. The concept of ‘organisational ambidexterity’ goes back to O’Reilly and Tushman (2004; 2007) who argue that to sustain their long-term competitiveness, firms need to be simultaneously capable of introducing both

exploitative and explorative innovation. Through dynamic capabilities, the authors argue, organisations solve the paradox between successfully exploiting mature markets and carrying out explorative innovation for emerging markets (O'Reilly & Tushman (2007). The discussion implies that firms can create value through both explorative and exploitative innovation. Exploitative innovation is incremental and concerned with efficiency improvements, while explorative innovation is radical, and of disruptive nature.

Due to path dependency of the knowledge base and different strategic choices (Child, 1997) firms will develop distinct capabilities resulting in product and service offerings that are more or less valued by their customers. Dougherty (1992) points out that the value of innovation, and particular of radical innovation, may not be easily assessable for customers compared to existing products because the existing institutional framework does not provide relevant assessment criteria for innovation. From this view, it can be argued that innovation entails a degree of uncertainty about its value creation for customers.

Beckert (2007) argues that it is difficult for firms to calculate how customers will evaluate their product and service offering in the future because of uncertainty. According to him, the assessment of the value of goods and services is influenced by both objective and subjective judgement criteria. On the one hand, actors may define certain quality standards for products and services in order to classify them. Such classifications allow actors to base decisions on objective criteria such as price or quality. However, for more complex and/or heterogeneous products and services, objective assessments are becoming more difficult. As a result, subjective criteria increasingly gain importance (Beckert, 2009). Using the examples of markets for modern art and wine, the author demonstrates that in some cases, objective assessment criteria of a product may not be relevant at all. In those cases, the value is influenced by personal preferences as well as by “socially constructed judgements that reduce uncertainty and thereby stabilise the expectations in a market field” (Beckert, 2009, pp. 254-255). For instance, in order to create value for customers, the status of the owner of a certain product may be recognised. From this perspective, the value of products and services is determined not only by functional, but also by normative, social and cognitive assessments. The latter assessments refer to “symbolic” value that is socially constructed by market actors (Beckert, 2009). Such a view combines the theory of competitive advantages with institutional theory.

Since markets are embedded in society (Beckert, 2009) firms can sustain a competitive advantage by maintaining a product and service offering that is created and aligned with respect to societal norms and values. In this vein, stakeholders of companies are becoming increasingly aware of how products are produced and how they affect its wider community (Maignan & Ferrell, 2004). Therefore, when customers value more those products that meet their normative and ethical standards, a company can create value to its products and services by being socially responsible. In a similar vein, Hillman and Keim (2001) argue that relational value is created through the interactions between firms and their primary stakeholders. Relational value develops according to the authors over time and produces intangible assets such as reputation. It is argued that relational value has the strong potential to create competitive advantages because it cannot easily be duplicated by competitors. From this perspective, value is also created by social interaction and collaboration.

The discussion above highlights different perspectives on organisational competitiveness. Many authors emphasise the importance of firms' ability to develop and integrate knowledge to remain competitive. It is further argued that changing market environments create uncertainty that puts pressure on firms to develop new knowledge and competencies. Knowledge sharing and organisational learning that contribute to innovation are seen as key ingredients for firm competitiveness. It is also argued that it becomes necessary for firms to maintain good relationships with different stakeholders involved in the value creation process. The need for firms to find a balance between explorative and exploitative innovation is also discussed; firm competitiveness results from a balance between the efficiency of its current activities and the pursuit of future opportunities.

2.5 Chapter summary and research question

Institutions influence the behaviour and the competitiveness of firms. Different schools of thought are occupied in better understanding the interplay between institutions and actors. The literature review has revealed that the national corporate governance system is crucial for the economic growth and prosperity of a nation because it influences the innovative activities of firms. From the diversity of capitalism perspective, it has been argued that different corporate governance systems provide firms with specific competitive advantages. On the

one hand, CMEs provide incentives to carry out radical innovation, whereas LMEs provide incentives to carry out incremental innovation. However, critical voices have questioned the provided evidence by the diversity of capitalism for several reasons. It has been suggested that a more dynamic, process-oriented perspective on innovation that explicitly takes into account how organisations learn and create new knowledge necessary for innovation would enhance our understanding of corporate governance.

The aim of this study is to gain insights as to how firms embedded within the German corporate governance system responded to changes in their institutional environment. In particular, the consequences of institutional change based on neo-liberal reform ideas, specifically market liberalisation, on the competitiveness and innovativeness of firms will be highlighted. Since the 1990s, the German corporate governance system has increasingly come under pressure to change because of rising unemployment and a lack of innovation in high-tech industries. Recent evidence has been provided that the German model of corporate governance underwent significant changes towards a more liberal model (Streeck, 2009). Empirical evidence on the firm level as to how these changes affected the competitiveness of the embedded organisations is missing.

The literature review shows that the perspective of discursive institutionalism is suitable to explain path breaking changes in the institutional environment as well as heterogeneity between firms embedded within the same environment. Such a perspective seems to be most appropriate for the purpose of this study because it can account for a possible convergence of a corporate governance system.

For the study of corporate governance on the firm level it becomes important to take into account possibilities of both functional convergence and firm heterogeneity. The theoretical argument of functional convergence suggests that actors will break free from institutional constraints in cases where they believe their competitiveness is negatively influenced by their institutional environment. This view highlights that the innovativeness of firms is shaped not only by the corporate governance system but also by the market environment. The product and services offering of a firm is evaluated by customers in the market, and whether it meets the preferences of the customers also depends on the product and service offering of its competitors. In these cases, functional convergence may result out of the objective of firms to compete successfully on the market. With regard to sustaining a competitive advantage within a global market environment, constraints of their national

institutional environment may be disadvantageous for the competitiveness of embedded firms, and hence functional convergence occurs. From this view, competitive pressure from the market environment could be stronger than pressure from the institutional environment.

The effect of simultaneous pressure from the corporate governance system and from the market environment on the innovativeness of firms has largely been ignored empirically. Rather, authors tend to investigate the two levels individually. There seems to be a danger to focus on only one of these levels at a time, not only because they are related, but also because both of them seem to be very important for the innovativeness of firms. In order to account for both streams of literature, the research question of this study will include, in the study of firm competitiveness, incentives of the market environment as well as of the corporate governance systems.

Furthermore, from the resource based view, firms embedded within the same environment are incentivised to carry out innovations in order to gain a competitive advantage. Such a view suggests that firms within the same environment strive for heterogeneity in order to remain competitive, and it becomes important to take into account different responses of firms towards institutional incentives. In order to account for diversity, and explore how firms responded to changes of their market and institutional environment, a ‘how’ question seems to be most suitable. This research is therefore guided by the following research question:

“How have traditionally stakeholder-oriented German organisations sustained their competitiveness in changing institutional environments?”

In the following chapter, the context of this research will be discussed. Firstly, the institutional domains that govern the relationship between firms and their stakeholders will be investigated. The discussion follows the framework developed by Aguilera and Jackson (2003), which defines the most important institutional domains regarding the stakeholder group labour, capital and management. Second, the peculiarities of the market environment of the investigated firms need to be accounted for.

CHAPTER 3: RESEARCH CONTEXT: THE GERMAN MODEL AND INNOVATION

3.1 Introduction

This chapter discusses the most important institutional domains of the German governance system that affect firms' competitiveness. The discussion follows the theoretical model developed by Aguilera and Jackson (2003), who argue that corporate governance can be classified by its key stakeholders. According to the authors the three most important dimensions of corporate governance are institutional domains that govern the relationship between firms, and the following three stakeholders: employees, capital stakeholders, and managers. The model of Aguilera and Jackson (2003) implies that institutions on the level of society matter for the choice of actors while at the same time allowing room for different choices of actors. The institutional domains are discussed for the German context. Importantly, the implications of different institutions for firm's innovativeness and competitiveness are elaborated for each stakeholder dimension. The review of the literature has revealed that contextual factors influence organisational innovation efforts, special attention to innovation is therefore given. This chapter will briefly introduce the context of the German airport industry which recently underwent significant changes, including the privatisation of former publicly owned entities, and deregulation of the baggage handling market. Both privatisation and changes of the market environment will be briefly introduced.

3.2 Dimensions of the German model and their impact on firm-level innovation

3.2.1 Institutions of the labour market

According to Tylecote (2007), employees "are, or should be, key actors in innovation" (p. 1462). In Germany, the knowledge and skills of employees are considered to be significant for both inventions (patentable innovation) and innovation in general. For example, a draft revision of the Employees' Inventions Law released by the Federal Ministry of Justice [BMJ] reveals that over 80% of all patents in Germany filed are employees' inventions (BMJ, 2001).

From this perspective, it becomes important for the study of innovation and competitiveness of companies, to investigate the institutional settings that shape the personnel management of firms in Germany. Aguilera and Jackson (2003) identified three institutional domains, those of representation rights of employees, union organisation, and institutions for training and skill formation.

Representation rights for workers are statutory in Germany, and hence, influence of employees on key strategic decisions is ensured through formal institutions (Aguilera & Jackson, 2003). Participation of employees is governed by two laws, namely The Works Constitution Act (Betriebsverfassungsgesetz), which defines the role of the works councils; and the Co-determination Act (Mitbestimmungsgesetz), which governs the rules about employee board membership for listed firms. Wächter and Stengelhofen (1992) point out that co-determination reflects the social dimension of capitalism in Germany. In Germany, major political decisions with regard to institutional change are typically achieved by a consensus between different interest groups. Due to this social dimension, including co-determination, the German market economy is also called ‘Soziale Marktwirtschaft’ (social market economy) (Wächter & Stengelhofen, 1992).

Co-determination in the form of employee board membership was first introduced in Germany by law in 1951 in the coal, iron and steel industries (Montan-Mitbestimmungsgesetz, 21.05.1951) requiring equal representation rights of capital and labour in these industries. In 1952, statutory board membership was introduced in other sectors, granting one-third of representation rights to labour representatives (Betriebsverfassungsgesetz, 11.10.1952) (Meijer, 1996). Later, in 1976, the Co-determination Act was introduced. This Act requires listed companies and those with over 500 employees to grant one third of the representation rights at the supervisory board to labour representatives. Furthermore, in companies with more than 2000 employees, parity in representation between labour and capital is necessary (Mitbestimmungsgesetz, 04.05.1976).

The Works Constitutes Act (Betriebsverfassungsgesetz – BetrVG), which defines the role of the works councils in Germany, further facilitates employee representation at the level of the firm. The aim of the Works Constitution Act is to ensure a constructive cooperation between employer and works council for the good of employees and the organisation (BetrVG § 2). While there is generally no legal obligation to establish a works council, all German businesses employing five or more full-time employees must do so if their

employees require it. Once a works council has been established, the employee representatives have certain rights and duties in accordance to the regulation of the Works Constitution Act. These rights can be classified into right of information, right of consultation and right of co-determination (Sadowski, Backes-Gellner & Frick, 1995).

Important rights of employees include for example advisory rights in many work related issues, such as measures to secure employment, for example through the introduction of part-time work (BetrVG § 92a), and co-determination rights in other work related issues, such as rules of operation within the firm, holiday entitlements, form and principles of remuneration, and the design of employee suggestion schemes (BetrVG § 87). Co-determination rights also include matters of training, and further development of the workforce (BetrVG § 96). In consideration of the interest of the firms, employees and works councils need to give employees the opportunity to undergo internal and external vocational training. Consideration should be given to the particular needs of older employees, part-time employees, and those with families. Furthermore, the works council has a right to consult the employer on matters regarding the implementation and design of vocational training programmes (BetrVG § 97 § 98).

The works council also has information, consultation and co-determination rights regarding the design of jobs and processes and the working environment (BetrVG § 90). The employee needs to inform the works council about restructuring, the extension or establishment of new facilities, technical plants, operational processes and jobs. The employer needs to consult with the works council about consequences of such changes for employees, and take their suggestions and concerns into account (BetrVG § 90). In organisations with more than 20 full-time employees, the council needs to be informed regarding possible changes of the operations of the business that may negatively affect employment. The works council has the right to consult the employer regarding proposed changes (BetrVG § 111), and negotiate a reconciliation of interests and a social plan (BetrVG § 112). In cases where the restructuring results in considerable redundancies a social plan may be enforceable, depending on the scope of the planned redundancies and the age of the firm (BetrVG § 112a).

In addition to rights of co-determination, employees have certain information and participation rights. Not only does the employer need to inform the employees about safety and health hazards at the workplace, but also about changes in the activities of employees. In

cases where such changes reveal that the knowledge and/or abilities of the employees are insufficient, the employee needs to consult with the affected employees, and how these abilities can be developed in the future (BetrVG § 81). Finally, the works council has co-determination rights regarding employment decisions affecting individual staff members, such as recruitment, re-grading and transfer (BetrVG § 99), and dismissal (BetrVG § 102). As a result of co-determination, managerial decisions are influenced by their impact on employment and consequences for working conditions which often mitigates negative consequences (Wächter & Stengelhofen, 1992).

In the literature, it remains controversially discussed whether worker participation positively influences innovative activities of firms. On the one hand, it can be argued that co-determination has a negative impact on innovation. Not only may it lengthen the decision-making process about whether an innovation should be introduced, but the works council may oppose its introduction fearing that it could negatively affect employment (Kraft, Stank & Dewenter, 2009; Stracke & Nerdinger, 2010).

On the other hand, there is also an argument that co-determination can allow the diffusion of information better within the organisation, thus enabling innovation (Stracke & Nerdinger, 2010). Dilger (2002; as quoted in Stracke and Nerdinger, 2010) further argues that the works council will actively promote innovation and ideas in order to sustain the competitiveness of the organisation. Firms' competitiveness, in turn, is crucial to secure employment. The works council may pressure managers to invest in innovation (Dilger 2002, as quoted in Stracke and Nerdinger, 2010). Stracke and Nerdinger (2010) believe that the works council will be more supportive of innovation when the interests of the workforce are protected. Recently, there is some empirical evidence supporting the argument that worker participation positively impacts on firm's innovativeness. Stracke and Nerdinger (2010) empirically found that worker participation supported the innovative activities of German firms. Kraft et al. (2009) investigated whether the German co-determination law slowed down technical process, and found no support for this thesis.

Unionism and collective bargaining is the next institutional domain that is discussed in the German context. Representation rights in Germany are separated from the external collective bargaining between union organisations and employers' associations. Membership for employers and employees in the respective associations is voluntary (Hassel, 1999; Sadowski et al., 1995). The rules of collective bargaining are governed by the Collective

Agreements Act (Tarifvertragsgesetz). Collective bargaining happens outside the boundaries of the firm to avoid conflict, and works councils are generally not allowed to interfere with issues covered by collective bargaining agreements (Hassel, 1999). According to Streeck (2009) wages are typically negotiated by unions by industry, and also differ regionally.

Union organisations and employers' associations can negotiate a collective agreement, i.e. Tarif agreements, for their members. In this case, the members of these associations fall under the rules, including the tarif or wage rate, of the central collective agreement. Legally, an employer is only obliged to respect the collective wage agreement for members of the respective union organisation that negotiated the contract with the employers' association. However, Schnabel (2005) points out that in practice most of the employees also guarantee the benefits of the collective agreement to employees who are not members of the union. Such practice, the author argues, reduces the incentives of employees to become union members. The author further points out that recently some firms became members of the employer association, but requested a special form of membership, namely a so-called 'without-tarif-membership'. Such a membership excludes a firm from the central collective agreement negotiated by the employer association (Schnabel, 2005).

Traditionally, the majority of employees in Germany were covered by industry-wide collective bargaining agreements, over 70% in 1995, leading to relatively comparable labour costs for companies operating within the same industry (Streeck, 2009) and a high degree of consensus between employees and firms (Hassel, 1999). However, the strength of collective bargaining has been deteriorating since the end of the 1990s, and the number of workplaces and employees covered by a collective bargaining agreement is continuously decreasing (Hassel, 1999, Streeck, 2009). For example, according to Hassel (2007), between 1993 and 2003, German trade unions lost 24% of their members. Reasons for the decline of union membership include, for example, a retreat of firms as members in employer associations that are covered by collective agreements (Hassel, 1999; Streeck, 2009); a failure of trade unions to respond to the demands of changing labour markets towards a service economy (Hassel, 2007); as well as organisations undercutting, legally or illegally, the agreements made in collective agreements (Hassel, 1999). However, according to Streeck and Rehder (2003) the majority of organisations retreating from collective bargaining are small and medium-sized firms, while the membership of larger corporations remains remarkably stable.

There is an argument in the literature that collective bargaining outside firm boundaries has a positive impact on the relationship between managers and works councils (Hübler & Jirjahn, 2003). Streeck (1984b as cited in Hassel, 1999) for example, points out that conflicts between capital and labour do not directly affect the relationship between works council and management since collective bargaining takes place on a different level. Bargaining outside firm boundaries is particularly attractive for large firms as they are more prone to labour disputes. Furthermore, many larger firms would have to grant higher wage increases if agreements were made exclusively on an individual basis on the level of the company (Streeck & Rehder, 2003). With a better relationship, works councils in Germany may be more willing to negotiate productivity-enhancing work practices than their international counterparts, who are mainly concerned with increasing the financial situation of employees (Hübler & Jirjahn, 2003). From this view, it can be assumed that industry-wide collective bargaining facilitates the implementation of process innovation.

There is also an argument that industry-wide collective bargaining incentivises firms to invest in innovation. Haucap and Wey (2004) theoretically analyse incentives of different unionisation structures for firms to invest in innovation activities. They argue that firms that are embedded within a centralised collective bargaining system that sets industry wide wage rates (centralised bargaining) have greater incentives to invest in innovation than those in which bargaining is decentralised on the firm level (decentralised bargaining), or in which individual wages are set by one industry union (coordinated bargaining). More incentives for innovation are provided, the authors argue, because the 'equal pay for equal work' rule under centralised bargaining restricts the hold-up potential for unions. A firm that carries out innovation is less likely to increase wages on the firm level, and hence will gain a greater return on that innovation (Haucap & Wey, 2004).

Finally, Hassel and Schulten (1998) point out that industry-wide collective bargaining incentivises firms to compete on quality rather than price. With collective bargaining, firms are bound to certain wages, limiting competition on price. Firms under centralised collective bargaining are thus more likely to seek competitive advantages based on innovation.

Training and skill formation is affected by national learning and training institutions (Aguilera & Jackson, 2003). In Germany, employers' associations, the government, and trade unions jointly determine the process and content of vocational training (Streeck, 1988). People initially undergo an apprenticeship training based on a dual training system comprised

of training on the job within the firm, and attendance at a college. Further training of technicians and foremen (Meister) involves regular attendance at more advanced colleges on a part-time basis (Fachschule or Berufsfachschule). Completion of advanced training as foremen is a pre-requisite to becoming a trainer for those who undergo the apprenticeship training (Lane, 1990).

The comprehensive German vocational training system provides workers with both firm-specific and industry-specific skills (Estevez-Abe, Iversen & Soskice, 2001). Aguilera and Jackson (2003) argue that the combination of training inside the firm and at colleges ensure not only a high standard of training programmes, but also provides employees with transferable skills which reduce the dependency for both organisations and its workers. A high standard of training is greatly valued in German society. A report by the National Economic Development Office (1987) observes that Germany is “a society with a great respect for education and for relevant study with a widely-accepted tradition of apprenticeship as the basis for many careers. A large part of West Germany’s economic success is credited to its well-trained and disciplined workforce” (p. 44).

It has been argued that the highly skilled workforce provides German firms with an advantage to compete globally on quality (Streeck, 1988). It is widely accepted that a skillful workforce is very important for innovative activities, and therefore that education systems of a high quality standard will increase the innovativeness of an economy (for e.g. Foray, 2006; Lundvall, 2007; Lundvall & Borras 2006). Antonioli, Manzalini and Pini (2011) empirically found evidence that German firms perceive the combination of internal and external training channels as being suitable to fostering innovation on the firm level.

To provide incentives to workers to invest in firm specific skills, firms are traditionally committed to providing long-term employment opportunities. Such firms rely on internal promotion systems, and pay adequate salaries to qualified employees; the relationship between firms and their workforce is characterised by mutual commitment and trust (Börsch, 2007). There is an argument in the literature that job security is useful to enhance the innovative activities of firms and also contributes towards organisational change. For instance, Hübler and Jirjahn (2003) make the point that employees who fear unemployment tend to withhold ideas and information that could increase productivity. In contrast, employment security and commitment, as in the German model, encourages employees to share their ideas and knowledge about possible process and product innovation.

To study how the German model influences firm's innovativeness, it becomes further necessary to take into account the German Employees' Invention Act [Gesetz über Arbeitnehmererfindungen, 1957], a unique German legislation (Leptien, 1996) setting out a specific procedure to be followed by both employee and employer for worker inventions (Deck & Matthes, 2005; Goddar, 1999).

The German Employees' Invention Act (EIA) legally bonds employers to financially reward employees for inventions that are valuable to the organisation. The EIA is generally restricted to technical inventions that are patentable or protectable by a utility model (§1). Differing from other countries, the property rights of an invention in Germany do not automatically belong to the employer but reside with the employee who originated it. The employer, however, can acquire the property rights of the invention against monetary compensation. Leptien (1996) explains that the EIA is a compromise between two conflicting implications of the law as to whom the invention should belong. While the labour law implies that the outcome of labour belongs to the employer, the patent law implies that the invention belongs to the inventor. The EIA balances the interests of both parties: the employee is financially rewarded for their invention and the employee can obtain the exclusive right to exploit the invention (Leptien, 1996). According to Klotz (1988), there is an upper award limit imposed for an employee suggestion, namely 127.822,97 Euro [250.000 DM].

The human resource management literature argues that employee suggestion schemes in general provide opportunities for workers to contribute (Gerhart, 2005), and, if properly implemented, foster innovation and increase productivity. At the same time, an employee suggestion scheme is a means for employees 'to improve their working' conditions', and their income (Klotz, 1988). Rogers (1999) empirically provides evidence that an employee suggestion scheme can facilitate organisational change.

Many researchers, particularly from a principal-agent perspective, have argued that financial rewards are the main mechanism for motivating employees to perform (e.g. Opsahl & Dunnette, 1966). Lazear (2000) found empirical evidence that the change from hourly wages to piece-rate pay had increased the productivity of a large auto glass company by 44%. Shearer (2004) argues, based on a field experiment, that the change from fixed wages to piece rates significantly increased productivity. Despite this evidence, research investigating the relationship between innovation and financial incentives remains inconclusive. Leptien (1996) summarises different empirical studies from Germany regarding the impact on

performance-based incentives on employee motivation to engage in innovation and found that financial rewards were mostly of secondary importance.

It has been argued that financial compensation is not effective in increasing the motivation of individuals in the long term. For example, Kohn (1993) argues that financial rewards serve only to achieve “temporary compliance”. In the long term, the author believes, financial incentives may harm performance for several reasons; for example, through creating internal competition among colleagues, detrimental for team work. Similar, Herzberg, Mausner and Snyderman (1959) see financial rewards as “hygiene factor” not suitable for motivating individuals. According to Herzberg and his colleagues, employees can be motivated only by intrinsic motivators which lead to job satisfaction through a sense of achievement and psychological growth (Herzberg, 1987; Herzberg et al., 1959). Intrinsic motivators include “achievement, recognition for achievement, the work itself, responsibility and growth or advancement” (Herzberg, 1987, p. 92). Bassett-Jones and Lloyd (2005) found that financial rewards are not the main source of motivation for employees to engage in innovative activities. Their study, based on over 3200 survey responses from 32 large firms based in the UK, also confirms Herzberg’s theory that intrinsic motivators are more crucial.

3.2.2 Institutions of the market for managers

From a strategic management perspective, since managers are the key agents of innovation (Teece, 2010) it becomes important to discuss the institutional domains that govern the relationship between firms and managers. Aguilera and Jackson (2003) identify managerial ideology and career patterns as most important in understanding the implication of corporate governance for managers.

Managerial ideology is a specific ideology shared by a group of managers. Heilbroner (1985, as cited in Witt and Redding, 2009) refers to ideology as “a system of thought and belief by which dominant classes explain to themselves how their social system operates and what principles it exemplifies” (p. 107). Building on this definition, Witt and Redding (2009) argue that the world view is shaped by three types of beliefs. The following are distinguished: existential or descriptive beliefs (what is ‘true or false?’), evaluating beliefs (what is ‘good or bad?’) and prescriptive or proscriptive beliefs (what are ‘desirable/undesirable means or ends’ of action?) (Koltko-Rivera, 2004; Rokeach, 1973; Witt

& Redding, 2009). The rationale for managers to behave in certain ways is shaped by the underlying belief system that defines shared understandings about the purpose of the firm (Witt & Redding, 2009).

In Germany, managers are traditionally expected to mediate between the interest of different stakeholders (Jackson, 2001), and adopt a stakeholder strategy. Yoshimori (1995) argues that in Germany managerial ideology was highly influenced by Walter Rathenau, who was CEO of EIA and later became Foreign Minister. Rathenau (as cited in Yoshimori, 1995) made the case that a large firm is more than “a product of private interests’ but it is, individually and collectively, a part of the national economy and of the whole community” (p. 41). Yoshimori (1995) conducted mail surveys in different countries, including one in Germany in 1992, with 113 responses from middle managers. The survey revealed that 59.1% of the surveyed managers, who had to choose between either making some employees redundant or maintaining dividends, chose in favour of the interests of the employees. Furthermore, the survey found that 82% of the managers believed that the firm should serve the interests of all stakeholders. Yoshimori (1995) argues that German managers follow a dualistic managerial ideology, implying that firms should serve both shareholder and employee’s interests.

It has been suggested that German managers increasingly embraced elements of the shareholder value strategy in their ideology during the 1990s. Based on secondary data conducted at the end of that decade, Höpner (2003) argues that they highly value the shareholder value concept. The author states that increasing shareholder orientation is not a result of a lack of capital available for German companies, but driven by the managers themselves. According to Höpner (2003), a stronger shareholder orientation is facilitated by a changing career pattern of managers towards that of the U.S.. Second, managers may have more leeway regarding their decision making because of a reduction of insider monitoring in favour of monitoring via outsiders. Finally, Höpner (2003) argues that managers have an interest in adopting a shareholder value strategy that is monitored by outsiders because such a strategy significantly increases managerial income.

A more recent study conducted by Witt and Redding (2009), however, provides evidence that German managers still follow a stakeholder rather than a shareholder ideology. The authors investigated differences between German and Japanese managers’ perception about the purpose of the firm. In Germany, the authors interviewed 17 senior executives of

‘major firms’, namely firms that would qualify to be listed on the German stock exchange. Interviews were conducted between June 2002 and April 2003. According to the authors, German managers clearly prioritise the interests of employees over those of shareholders. The majority of managers believe that the creating and sustaining of employment are central roles of the firm. Employment not only needs to provide a living for employees, but should also allow the finding of ‘personal fulfilment’ and to provide opportunities for personal development. In contrast, the interests of shareholder value were less important for the managers. While managers acknowledged that shareholders should earn adequate returns, the shareholder value ideology was largely neglected by the German managers since “virtually no executive argued in favour of pursuing shareholder value” (Witt & Redding, 2009, p. 4).

However, the most important rationale of the existence of the firm from the perspective of German managers, found by Witt and Redding (2009), was the provision of goods and services. This was considered to be essential for several reasons, including providing for society and customers’ needs, economic growth, and social progress through innovation. Managers also commonly argued that they have an obligation to society to ensure the survival of the firm because it contributes to employment. Overall, all three studies suggest that German managers have adopted elements of the shareholder value strategy as part of their ideology about the purpose of the firm. While Höpner’s (2003) study does not investigate other elements of the managerial ideology, the studies conducted by Witt and Redding (2009) and Yoshimori (1995) suggest that the interests of employees are at least equally important to shareholder orientation. The empirical evidence suggests that manager in Germany followed a stakeholder ideology, and continue to do so.

There are some views in the literature that firms that adopt a shareholder-oriented strategy may enjoy specific competitive advantages. Hansmann and Kraakman (2000) argue that firms that have adopted a shareholder value strategy have a competitive advantage in rapidly changing market environments. Not only do they have better access to equity capital, but they can also more radically adapt to changing conditions of their environment because radical restructuring is more justifiable when a shareholder orientation is implemented (Hansmann & Kraakman, 2000).

In contrast, there are also views that a stakeholder orientation in general may be superior for the competitiveness of the company, and a firm’s success will more and more depend on its ability to balance and integrate the interests of different stakeholders into its

strategy (Freeman & McVea, 2001; Kaplan & Norton, 2000). Regarding innovation, researchers argue that relevant knowledge may exist outside the boundaries of firms, and therefore it becomes necessary to establish networks with different stakeholders (Hart & Sharma, 1993). Others argue that a stakeholder strategy helps to establish trust which can be a source of competitive advantage. Firms adopting a stakeholder strategy are not only taking care of employees needs but have advantages to carry out product and service innovation that uses the knowledge of shop-floor employees, or of other industry or community partners (Svendsen, 1998). Ayuso, Rodriguez and Ricart (2006) found evidence based on case study research of two Spanish firms that the dialog with employees and customers and the integration of their knowledge facilitated sustainable innovation.

The managerial ideology furthermore determines what actions are appropriate. Stewart, Barsoux, Kieser, Ganter and Walgenbach (1994) studied differences between middle managers in Britain and Germany as to how they do their job. Middle managers are generally considered to be “dealers of information”; a large part of their job is to gather information relevant for the activities for which they are responsible. Their responsibility is to transform strategies made by their superiors into reality. It is important that middle managers develop their staff according to organisational routines necessary to create value for the company. In achieving this, the authors argue, middle managers were listening to their staff (Stewart et al. 1994).

Regarding how German middle managers work, Stewart et al. (1994) gained the following insights. Most of the middle managers are technically oriented, and possess a deep understanding about the technical procedures and processes they supervise. Their main responsibility is the smooth and efficient operation of technical tasks around the production process and routines. Stewart et al. (1994) refer to German management style as “management through ‘expert knowledge’” (p. 123), and argue that technical knowledge is the source of authority for most middle managers rather than their formal position. People management was also perceived by managers as part of the responsibility, although it was of lower importance. German managers typically do not want to be perceived as “superiors”, but prefer to be seen as colleagues. Also, middle managers tend to communicate with their staff about technical oriented issues rather than motivation. In general, German managers tend to not make use of their managerial privileges, believing that part of their responsibility is to be a “role model” (Stewart et al., 1994).

Career patterns of German managers are traditionally very different from those of their international counterparts (Höpner, 2003; Schneider & Littrell, 2003). Fiss and Zajac (2004) argue that managers' educational background, will influence their underlying normative belief system and values, and different educational backgrounds will result in different cognitive models. The authors provide empirical evidence that CEO's with a background in economics or law are more likely to embrace the shareholder value orientation than those with a technical background. They authors believe that the stronger shareholder orientation results from the specific beliefs of the disciplines of law and economics that build upon agency theory and value driven management.

According to a report by the National Economic Development Office (1987), the traditional education of managers in Germany requires an intensive, long-term formal training that is often very closely related to the actual work of the company. At the same time, the report points out that the West Germans value 'Technik' (National Economic Development Office, 1987), and a sound knowledge of the production process has been considered to be important knowledge for manager (Höpner, 2003). Consequently, managers are often required to obtain a degree with a technical background either through vocational or academic training (Schneider & Littrell, 2003).

The majority of managers with a university degree traditionally held this in engineering, law or in natural science rather than in finance or economics (Höpner, 2003). While a university degree is in general highly valued, it is irrelevant which particular university one has attended, since elite universities do not exist (Höpner, 2003; National Economic Development Office, 1987). Managers are also expected to "do a period of apprenticeship" relevant to the actual function they aim to work in to demonstrate that they can perform well within this area (National Economic Development Office, 1987). Eberwein and Tholen (1993) argue, based on a sample of 111 managers, that the majority of Germany's managers are 'trained managers': 99 managers (89%) based on their sample. These are managers who received relevant systematic training around and were exposed to relevant practical experience. There is a belief that general management training, namely MBA degrees, which are common in the Anglo-Saxon context, is undesirable (Glunk, Wilderom & Ogilvie, 1997; Schneider & Littrell, 2003).¹

¹ For reasons why the MBA failed to establish in Germany see National Economic Development Office (1987, pp. 46-47).

Management development is often conducted internally in the large companies. Here, training is offered mostly to lower and middle levels, who receive training that is either job- or company-specific (National Economic Development Office, 1987, Stewart et al., 1994).

While German management training and education was perceived as being of a high standard in the past (National Economic Development Office, 1987), it recently came under criticism. Bloch and Groth (1998) point out that German managers failed to adapt to a changing, globalised market environment, despite their high education. The authors highlight weaknesses of German managers that were discussed by various German authors, including a lack of good leadership, an obsession about cutting costs leading to downsizing of personnel, a lack of pro-activity in times of crisis, a lack of taking on responsibility for mistakes, no willingness of risk taking and a lack of entrepreneurial spirit. The overall complacency of German managers and the focus on downsizing has, according to Bloch and Groth (1998), resulted in a lack of firm innovativeness.

Höpner (2003) provides evidence that the educational background of top managers changed in the 1990s. Based on the biographies of German top managers, he shows that the percentage of top managers who underwent a traditional vocational education has significantly decreased. Furthermore, the author argues that the majority of the CEO's in Germany completed a university degree and 59% also a Ph.D. The author claims that there is a clear trend that an academic education has become more important in Germany. While at the beginning of the 1990s around 14% of the CEO's had not completed a university degree, in the year 1998 and 1999, all observed CEOs had obtained a university degree. Furthermore, the author argues also that the number of top managers with a technical background is decreasing in German firms. The evidence he analysed revealed that the largest group of top managers had a degree in economics or business administration (about 39%, whereas only 32% had a technically oriented degree, such as engineering or natural science (Höpner, 2003).

Career patterns of German managers have also been discussed (Glover, 1978). Managers typically stay in a particular position long enough to acquire practical skills. Only after they have accumulated practical knowledge related to the production process, may promotion take place (Child, Fores, Glover & Lawrence, 1983; Lawrence, 1980). Eberwein and Tholen (1993) argue that the German career path is characterised by a relatively high vertical mobility regarding managerial positions due to three reasons. First is that traditional

structures were destroyed after the war. Second, the authors claim that children from lower social levels are more likely to acquire the formal, often technical or scientific, education required for top management positions. Third, they argue that promotion to top management depends on the 'Leistung' (performance) of a candidate that is independent of one's social origin (Eberwein & Tholen, 1993).

Closed labour markets, in which managers are mainly promoted internally (Aguilera & Jackson, 2003) are common in Germany. Managers tend to remain within the same firm, rather than change firms (Höpner, 2003). Recent evidence that confirms the closed structure of the labour market for managers has been provided by Höpner (2003), who investigated the activities of CEOs before they became CEO, and classifies them either as 'internal carrier' or 'external carrier'. The majority of CEOs (71%) had an internal career. However, between 1990 and 1997, the share of external hired CEOs has increased from 17% to 34%, which indicates that the external markets for managers are becoming increasingly important.

3.2.3 Institutions of the capital market

The financial system of an economy plays an important part for firm competitiveness. Porter (1992) argues "the changing nature of competition and the increasing pressure of globalisation make investment the most critical determinant of competitive advantage" (p. 65). More specifically, it has been claimed that the availability of different types of capital also influence the innovativeness of firms (Tylecote, 2007). For example, Lazonick (2004) argues that venture capitalists were important agents for the development of innovation in the semiconductor industry because they supported many start-ups. However, in order to obtain and maintain capital, companies need to fulfil the demands of different groups of investors.

The behaviour of investors is influenced by their individual choice and preferences. Porter (1992) suggests that investors behaviour will differ depending on their individual objectives; the ways they choose to monitor the management of a firm; whether they take an active role to influence management decisions or not; and "pattern of share ownership and agency relationship" (p. 69). Similarly, Aguilera and Jackson (2003) argue that the relationship between capital stakeholders and firms can generally be characterised by three dimensions: different interests of capital stakeholders, different time horizons and degrees of commitment as well as types of investments leading to different means of control. According to Aguilera and Jackson (2003), the interests, or objectives of capital stakeholders can be

characterised as strategic investors, who typically have a long term interest in the prosperity of a company, and financial investors, who pursue financial interest, often with a short-term focus. Second, the degree of commitment varies. Investors with a relatively low degree of commitment (or a high degree of liquidity) value the option to de-invest without loss. In contrast, investors with a relatively high degree of commitment value the possibility to influence companies' decision via 'voice'. Hirschman (1970) argues that by exercising voice, one can make another more responsive to one's particular needs. Finally, there are two types of investments: equity and debt (Aguilera & Jackson, 2003).

The relationship between capital stakeholders and firms is, however, influenced by the institutional environment (Porter, 1992). Financial institutions on the level of society shape the rights of different groups of investors, and thus favour certain kinds of capital (Aguilera & Jackson, 2003). In turn, the financial system of a country is influenced by different cultural factors. For example, Gray (1988) argues that a country's accounting system as an important part of its financial system (Leuz & Wüstemann, 2004), is influenced by societal norms and values. Aguilera and Jackson (2003) identify three institutional domains that influence and shape the different relational dimensions between capital stakeholders and firms across countries, namely: property rights, the financial system and inter-firm networks (Aguilera & Jackson, 2003). For discussion of the German context, two of these dimensions, namely the financial system and inter-firm networks, are traditionally closely related, and their consequences for the innovativeness of firms will therefore be investigated together.

Observing how this institutional domain is shaped in Germany, it becomes obvious that long-term relationships between companies and capital shareholders are very common. Cross-shareholding is common and as a result, the ownership of private corporations is highly concentrated (Short et al., 1998). Large portions of the shares are commonly held by banks and non-financial firms, including insurance companies, who often have no short-term liquidity option (Casper & Mataves, 2003; Glaum, 2000). On the other hand, stock markets are comparatively small (Leuz & Wüstemann, 2004). Due to the importance of banks for the financing of German firms, the financial system is often described as being "bank-dominated" (Glaum, 2000). The consequences of larger investors, such as banks, for the innovativeness of firms are arguably part of the second institutional domain discussed by Aguilera and Jackson (2003): the financial system.

In Germany, large shareholders such as banks typically exercise corporate control through voice on the supervisory board (Aguilera & Jackson, 2003; Casper & Matraves, 2003). Firms embedded within the German corporate governance system are legally required to adopt a two-tier board structure, the power in the supervisory board being dispersed between employees and owners (Casper & Matraves, 2003). Aguilera and Jackson (2003) argue that separating the control function exercised by the supervisory board from the management function generally strengthen external monitoring of firms. However, Streeck (2009) provides evidence that the influence of large shareholders such as banks, has recently declined in Germany because these shareholders are less prepared to provide credit to German firms (Streeck, 2009).

Regarding innovation, long-term relationships with large investors are by some considered to be important to realise long-term investment projects (Mayer, 1997). For example, Kaplan and Norton (1992) argue that the short term perspective of financial goals such as earnings-per-share, is not appropriate to ensure the continuous improvements and innovation needed for a company's competitiveness in the future. The authors argue that a "balanced scorecard" including both financial and operational measures, such as the organisation's innovation and learning activities, should be implemented to achieve both present and future performance (Kaplan & Norton, 1992). Also, there is a belief that there are some R&D advantages for a firm by having a relationship with a bank that is both equity holder and lender. For example, Hundley, Jacobson and Park (1996) point out that a bank can not only provide advice to the managers because of their knowledge about the firm, but is also a source of external finance for R&D.

Furthermore, Casper and Matraves (2003) argue that due to the concentrated ownership, German firms have access to 'patient' capital necessary for long term investments. A study by the U.S. National Academy of Engineering (1992) makes a case that patient capital is important for certain types of investments such as long-lived assets and in R&D. The authors make a case based on the technology sector that some projects require investors which are 'patient' because they need a long period to show their full potential.

"The point is clearly illustrated by an example of a new company developing and marketing a single product. It is not unusual for product development to take three years, production design two years, and initial market development, concurrent with production tooling and build up, another two years. It may take an additional five years for the company to show its full potential" (National Academy of Engineering, 1992, p. 20).

Overall, there is an argument that the availability of “patient capital” positively affects R&D, and hence the competitiveness of firms (National Academy of Engineering, 1992). Those that rely to a great extent on stock-market capital may encounter a competitive disadvantage as a result of the short-term focus of the investors.

On the other hand, others argue that due to cross-shareholding, hostile take-overs are not feasible, reducing market control of the firm (McCann, 2000). Some believe that financing models dominated by short-term oriented investors and an open market for corporate control - which is, according to Casper and Matraves (2003), absent in Germany because of the concentrated ownership - are superior to foster the innovativeness of firms. For example, Phelps (2007a) believes that exposure to a broad stock market encourages firms to carry out innovation. Goyer (2001) points out that both the ownership dispersion and the availability of high-risk venture capital support the ability to develop new products in rapidly changing markets. More specifically, Estrin and Perotin (1991) argue that the poor performance of state-owned companies is attributed to the absence of pressure from the capital market. Based on this argument the authors make the point that exposure to the capital market motivates companies towards efficiency improvements making it a crucial component for a successful privatisation strategy (Estrin & Perotin, 1991).

It could also be argued that the representation of employees on the supervisory board may conflict with financial performance goals, negatively impacting on competitiveness. Kaplan and Norton (1992) make a strong case that financial measures such as earnings-per-share, should be an explicit part of a firm’s strategy. Disappointing financial measures, the authors argue, can be the result of excess capacity that may directly result from quality and cycle-time improvements. Managers should be prepared to eliminate parts of the business that are no longer needed in order to achieve higher financial performance and greater competitiveness and should be prepared to lay off workers when necessary (Kaplan & Norton, 1992). However, like investors, employees are a key stakeholder group in insider-systems such as those of Germany (Vitols, 2004), redundancies are not easily justifiable, and one can expect resistance of works councils. (The implications of workers’ representation for the competitiveness on firms have been discussed in the previous section of this chapter: 3.2.1).

Overall, it cannot be established which system is superior for innovation and firm competitiveness. There are clearly advantages and disadvantages of both systems for different industries and time horizons. There is some evidence that the German government aims to promote an 'equity culture' amongst its population by providing opportunities for small shareholders to acquire equity. Ziegler (2000) argues that the main purpose of the privatisation of German Telecom in 1996 was to strengthen the German equity market, which is, compared to the U.S. and U.K. stock markets, relatively limited. The government started a massive marketing campaign to motivate individual investors to buy companies' shares. As a result, the ownership of Deutsche Telekom after privatisation was the most widely dispersed of all German companies, with 2 million shareholders (Ziegler, 2000). The financial system also influences the third institutional domain identified by Aguilera and Jackson (2003): the property rights.

It is of interest to note that the disclosure requirement in Germany for smaller investors and the protection of the interests of creditors changed rapidly during the last decade; elaboration of the major changes will follow. Discussion of changes in this institutional domain of the German corporate governance system will be more detailed than the other dimensions discussed in the previous section because they are changing fast. However, the disclosure requirements of capital stakeholders are also governed by the financial accounting system of a country (Leuz & Wüstemann, 2004), and consequently, Leuz and Wüstemann (2004) argue the accounting system can only be fully understood when one also considers the structure of financial markets in general. Hence, the discussion is not restricted to the domain of property rights, but one can expect that the financial markets will also be affected by these changes.

The information disclosure for capital stakeholders is largely determined by the accounting system of an economy. Gray (1988) argues that the accounting system is linked to societal values of a society. Based on social values defined by Hofstede (1980), Gray (1988) identifies four accounting values shaping the accounting systems of countries. First, the authors argue that there are countries that prefer an assessment of accounting principles based on a professional self-regulation, while others prefer accounting principles based on legal requirements and control. Second, accounting principles can be classified as to whether they strive for uniformity or flexibility. According to Gray (1988) uniform practices lead to consistency of accounting between firms, while flexible practices cater better for the

individual situation a company is facing. Third, the reporting of financial accounting can follow a conservative approach, for example by only allowing firms to report profits that are realised; or it can follow an optimistic approach, for example by allowing firms to report future profits. Finally, while some countries may favour a transparent accounting approach where information is publicly available, other may prefer accounting practices that make certain information accessible only to certain stakeholders, and withholding it to the wider public. Gray (1988) refers to the last dimensions of accounting values as ‘secrecy’ and ‘transparency’ respectively.

Heidhues and Patel (2007) apply Gray’s (1988) accounting dimensions and compare those with the international financial accounting standards (IFRS), which are “fairly closely modelled on ‘Anglo-American’ financial accounting” (Jones & Luther, 2005, p. 167). First, Heidhues and Patel point out that in Germany, accounting principles are enshrined in the HGB (German Commercial Code) and hence, based on legal control (Gray, 1988; Heidhues & Patel, 2007). According to Heidhues and Patel (2007), an important feature of the HGB was to balance the interests of creditors, the public and merchants. While accounting needs to protect creditors and the public by securing both the investment and taxation respectively, merchants have a right to privacy. In contrast, international accounting standards such as the IFRS are based on professionalism, and hence rely to a greater degree on the professional judgement on “providing shareholder information with the ‘substance over form’ approach” aiming to provide an accurate picture of the financial situation of the company” (Heidhues & Patel, 2007, p. 21).

The legal embeddedness of the accounting principles in Germany is also linked to the objective of achieving ‘uniformity’. A high degree of standardisation between different financial statements was desired due to taxation law, which was in turn, achieved through principles defined in the “*Grundsätze ordnungsgemäßer Buchführung*” (*Principles of Orderly Accounting*) (HGB, §38). For example, to achieve uniformity the HGB established a principle ‘*Maßgeblichkeitsprinzip*’ (*authoritative principle*) (§252[1]) that requires that the same accounting and valuation principles are applied in consecutive financial statements (Rahlf, 1999). On the other hand, IFRS accounting allows a greater degree of flexibility to accommodate for specific circumstances of an individual company (Heidhues & Patel, 2007).

Generally, the German accounting system is described as being ‘conservative’ or ‘prudent’ due to its propensity to report profits conservatively (Gray, 1988). This conservative approach can be explained by the dominance of debt financing, resulting in a strong protection of creditors (Leuz & Wüstemann, 2004). Protection of creditors’ interest is one of the core objectives of the traditional German accounting regime (Glaum, 2000; Haller & Eierle, 2004). To secure investor protection, German accounting is dominated by the prudence principle (Glaum, 2000), which limits payouts to shareholders to protect debt (Leuz & Wüstemann, 2004). Specifically, under the prudence principle losses need to be realised immediately while revenues can only be realised “if it is as sure as possible that there is no significant remaining risk to the transaction” (Leuz & Wüstemann, 2004, p. 459). The ‘pessimistic’ or ‘conservative’ approach has been criticised because of its tendency to produce hidden reserves. These not only distort the information function of accounting (Kuebler, 1995 as cited in Schön, 2006), but also negatively impact on the reported profitability of German firms compared to those that adopted international accounting standards such as the IFRS (Glaum, 2000), that are more ‘optimistic’.

Finally, the German model is characterised by allowing a high degree of secrecy to protect the privacy of the merchants (Heidhues & Patel, 2007). Gray (1988) argues that such an approach that favours secrecy, or ‘confidentiality’, is linked to a preference for uncertainty avoidance. The secrecy within the German accounting system further promotes a tendency to build up secret reserves (*stille Reserven*) by understating profits in order to reduce tax liabilities and reduce dividend payments to shareholders (Heidhues & Patel, 2007). However, secret reserves are an integral part of the conservative approach of the German accounting system in accordance to the HGB. For example, one of the principles, the ‘*Niederstwertprinzip*’ (*historic cost principle*), restricts the valuation of assets to their historical cost, namely their production cost or cost of acquisition (§253(1)). In contrast, under IFRS accounting, assets are valued based on the fair cost, based in turn on market valuation.

While the interests of creditors are reasonably well protected in the German model, minority shareholders are poorly protected compared to other countries as a result of weak information disclosure requirements (Aguilera & Jackson, 2003). However, after the privatisation of German Telekom the German Government started to establish better accounting standards for smaller investors (Ziegler, 2000). Nowadays, all listed companies

with the exception of Volkswagen have adopted the ‘one share one vote’ system (Heinze, 2001). Comparing the values of the traditional German accounting system with the IFRS accounting system it becomes apparent that these accounting regimes follow different accounting values (Heidhues & Patel, 2007). According to Gray (1988) these differences indicate very different social values of the economies. The main differences between the two accounting regimes are illustrated in Table 3.1.

Table 3.1: Differences between the IFRS and the German accounting regime

| HGB accounting value | Aim | IFRS accounting value | Aim |
|-----------------------------|---|------------------------------|---|
| Statutory Control | Protect interest of creditors, public and merchants (legal compliance required) | Professionalism | Provide true and fair information for shareholder (substance over form) |
| Uniformity | Standardization of accounting reports | Flexibility | Allow flexibility to accommodate for specific circumstances |
| Conservatism | Protection of creditors | Optimism | Higher profits and/or dividends for shareholder |
| Secrecy | Confidentiality of information | Transparency | True and fair information for shareholder over privacy |

However, the traditional German accounting system came under criticism after the application of Daimler Benz to the New York Stock Exchange in 1993 (Glaum, 2000; Haller & Eierle, 2004). Glaum (2000) argues that since this event, the German model is “changing fast”. Before 1993, there was a strong resistance of managers to publish their financial statement in accordance to the US-GAAP or IAS (Glaum, 2000). In 1993, Daimler-Benz listed on the New York Stock Exchange, and, as a consequence, published their financial statements as the first German firm under the US-GAAP. Significant differences between the reported net income of Daimler-Benz under the US-GAAP and the German Commercial Code (HGB) respectively, triggered a huge debate about the comparability and reliability of different accounting regimes (Haller & Eierle, 2004). At the same time, German companies were increasingly seeking international capital (Glaum, 2000; Haller & Eierle, 2004) because of shortages of investment funds in Germany due to the cost of re-unification (Nobes, 2006).

These events triggered a debate as to whether the German accounting system should be oriented more towards the needs of investors to be more attractive for international investors (Glaum, 2000; Haller & Eierle, 2004).

In this debate, many practitioners and academics argued that the German accounting system is obsolete. They advocate the adoption of internationally accepted accounting standards, which would significantly improve the comparability between different companies, and therefore enhance the usefulness of the financial statements for investors (Ballwieser, 1999 as cited in Haller and Eierle, 2004). The majority of academics and practitioners believe that financial statements prepared in accordance with the IFRS provide a better quality of decision-relevant information compared to the HGB (Trapp, 2010). Information reported under the IFRS are believed to better represent the economic reality of firms. Haller and Eierle (2004) point out that the change towards IFRS accounting was seen by its advocates as an opportunity to discard the prudent principle that has, despite its popularity in the past, recently been questioned to be an effective tool for the protection of the interests of creditors and investors. Because the data derived from the IFRS accounting “provides a comparable ‘true and fair view’” (Busse & Colbe, 2002, p. 168 as cited in Trapp, 2010) another advantage is that it can also be used to coordinate firms’ activities towards the creation of shareholder value (Trapp, 2010).

Glaum (2000) found empirical evidence that the attitude of German managers towards internationally accepted accounting practices, namely the US-GAAP and IAS, changed profoundly after 1993. Based on the evidence of two consecutive surveys of 1994 and 1997/98, the author found that German managers became increasingly critical regarding the German accounting rules. In 1994, 63% of them believed that the HGB provided the same or a higher information value to investors as the US-GAAP. In 1997, 70% of them believed that the US-GAAP provided investors with higher information value than the HGB. The study also showed that German firms are increasingly preparing their financial statements in accordance with the IFRS/IAS and, to a lower extent, in accordance with the US-GAAP (Glaum, 2000).

Until 1998, all firms located in Germany were required to prepare their financial statements in accordance with the HGB, or the ‘German-GAAP. However, under pressure from the professional and academic community, the German Government changed the German accounting law (Haller & Eierle, 2004). Haller and Eierle (2004) provide a summary

of the major legal changes of the financial reporting acts in Germany until 2004. After the Capital Raising Act, 1998 [Kapitalaufnahmeerleichterungsgesetz, KapEIA, 13.02.1998], listed stock corporations could choose whether they would prepare their financial statements in accordance with the HGB (until 2004) or internationally accepted principles, namely the IAS or the US-GAAP. Furthermore, the Governance Act, 1998 [Gesetz zur Kontrolle und Transparenz im Unternehmensbereich, KonTraG, 05.03.1998], requires that listed stock corporations prepare a cash flow statement and a segment report (§297). According to Haller and Eierle (2004), the debate about German accounting law was further fuelled by the strategy of the European Commission to require all listed EU companies to prepare in the future their consolidated accounts in accordance with the International Accounting Standards (IAS) to enhance the comparability of financial statements; as requested by the Council (Commission of the European Communities, 2000).

However, concerns were also raised against the adoption of IFRS accounting (Haller & Eierle, 2004). The IFRS may not sufficiently protect the interests of creditors because of the possibility of considering intangible assets (including R&D expenses) and expected profits (Arbeitskreis Bilanzrecht der Hochschullehrer Rechtswissenschaft, 2002). For example, Schön (2006), makes a case that although the prudence principle “leads to an asymmetric view of risks and opportunities” (p. 186) by realising losses immediately while reporting profits only when they are effectively realised, one should be careful to dismiss this principle completely. According to Schön (2006), one should keep in mind that dividends cannot be recaptured by a company in cases where expected profits fail to eventuate. Therefore, changes of the accounting principle that allow the distribution of expected profits to shareholders will inevitably increase the risk of creditors (Schön, 2006). Furthermore, Haake (2005b) argue, using the example of the goodwill impairment in accordance with the IFRS, synergies may not be allocated fairly between different business units for acquisitions.

Despite arguments against the introduction of IFRS accounting in Germany, the European Parliament and the Council implemented the Regulation No 1606/2002 of 19 July 2002 (European Parliament and Council, 2002) on the application of International Accounting Standards in 2002. The regulation requires all publicly traded firms in the EU to provide their consolidated financial statements in strict accordance to the IFRS Accounting principles from 2005 onwards. Through the introduction of IFRS accounting, and specifically IAS 14, the organisation needs to cluster activities into segments and to individually report

the profitability of each of them. The aim of this Directive is to harmonise the accounting principle between EU countries for certain firms (Sellhorn & Gornik-Tomaszewski, 2006). Through the implementation of the Council Directive, German companies will follow different accounting rules, including both the HGB and the IFRS (Haller & Eierle, 2004).

With the compulsory introduction of IFRS accounting, another change can be expected, namely the harmonisation of internal (or management accounting) and external reporting systems (or financial accounting) of German companies. Trapp (2010) argues that advocates of IFRS accounting often recommend the harmonisation of internal and external accounting standards, as is common in the Anglo-Saxon context. Trapp (2010) pointed out that orientation on external reporting system would reflect better the increasing importance of the shareholder value orientation of German firms.

According to Trapp (2010), advocates of the harmonisation of the reporting systems argue that the implementation of value driven management is necessary to focus on the shareholder' interests, namely to increase the value of the company. The goal of the value driven management approach is, according to Ittner and Larcker (2001), to provide "an integrated framework for measuring and managing businesses, with the explicit objective of creating superior long-term value for shareholders" (p. 350). In general, the principles of the IFRS are compatible with the concept of value driven management in terms of reporting and evaluating the annual financial performance of different business units (Haaker, 2005a). Value driven management aims to monitor which segments are economically viable, and to make managers accountable for creating value for shareholders (Haaker, 2005b). It aims to align firms' activities and strategies with shareholder objectives, and therefore requires information on the external reporting. An integrated reporting system based on external measures ensures that the objectives of the external shareholders are internalised, making them part of the internal decision making. Finally, advocates argue that the harmonisation of accounting standards reduces the complexity of the accounting and thus reduces inefficiencies (Trapp, 2010).

While there seems to be an agreement in the literature that the integration of the internal and external accounting systems would change the internal accounting of German firms (Jones & Luther, 2005), it remains controversial whether the distinctive German accounting system will be sustained. Traditionally, the internal management accounting is strictly separated from external financial accounting. The closest equivalent of management

accounting is, according to Ahrens (1999), “controlling”, which follows the principle of a circle of cybernetic control. The main objective of accountants (or controllers) is to provide quantitative and financial information about firm resources to managers that can support their decision making and provide feedback on whether their plans need to be revised (Ahrens, 1999).

Jones and Luther (2005) characterise the German accounting system as being “technically oriented”. It emphasises functional differentiation, which is based on the assumption that understanding the production function requires special expertise that “is not amenable to close interrogation by management accountants” (Jones & Luther, 2005, p. 169). Ahrens (1999) provides empirical evidence demonstrating that German accountants believe that quantitative accounting information is of only limited use for strategic decision making including investments in innovation. He found that German accountant practitioners “appeared to act on the basic premise that organisational action is very complex indeed and depends on functional expertise” (Ahrens, 1999, p. 71). Some accountants even believe that the accounting system encounters limits in conveying entrepreneurial insights, and cannot provide a comprehensive picture for the strategic decision making of managers. Consequently, the opinion of technical specialists for operational matters is of greater importance than those of controllers (Ahrens, 1999; Jones & Luther 2005); decision making is influenced mainly by the opinion of technical specialists.

In contrast, in the Anglo-Saxon context, decision making within firms is dominated by the financial accounting system. Financial numbers provided by accountants play a very important role in manager decision making (Jones & Luther, 2005). At the same time, Jones and Luther (2005) point out that accountants often have key positions within organisations, the authors characterising the management accounting of the U.S. and UK as “financially-oriented” (Jones & Luther, 2005). The traditional management accounting practices in Germany differ significantly from those in the Anglo-Saxon context.

An increasing number of German companies harmonise their internal and external accounting principles in the context of IFRS accounting, and implement an integrated accounting system (Trapp, 2010). There is still very little knowledge about how these changes will affect German accounting in the future (Jones & Luther, 2006). Some authors believe that the importance of management accounting in Germany will remain the same. Within this group, there are arguments that the harmonisation will improve certain elements

of internal reporting (Küting & Lorson 1999 as quoted in Trapp, 2010) because of the stronger orientation on the accounting standards of the IFRS (Trapp, 2010).

An early empirical study conducted by Jones and Luther (2006) investigated changes in accounting practices in German manufacturing in the context of IFRS accounting. The study provides evidence that the managers departed from a functional organisation, in which technical expertise dominated decision making, towards a more “entrepreneurial” culture. Managers are now “seen less as ‘technical specialists’ and more as ‘entrepreneurs’ who are customer-focused and responsible for the profitability of their unit” (Jones & Luther, 2006, p. 30). Under the new culture, financial performance indicators are now the most important performance indicators for managers. The authors found evidence that firms are increasingly implementing profit-based bonuses for their managers, including the accountants, who are now at the same time producers of profit information that determines their bonus. Evidence collected by Jones and Luther (2006) suggests that the German management focus shifted towards an “international management style” oriented towards the demands of the external capital markets.

From a theoretical perspective it can be expected that a change in both external and internal accounting objectives not only affects the decision making within the firm but also its innovativeness. Based on evidence from U.S. firms, Johnson and Kaplan (1987) make a strong case that management accounting based solely on financial information is not suitable for a firm’s sustainable development. The authors provide evidence that by shifting from traditional management accounting practices that focus on process information towards financial accounting, innovativeness and competitiveness of U.S. manufacturing firms has declined over time. According to Johnson and Kaplan (1987), information based on external accounting has provided misleading information to managers that do not reflect the reality of the firm. Based on their empirical evidence, Jones and Luther (2005) raise some concern that German manufacturing companies may pay too much attention to financial information for their future decision making, rather than on internal information.

3.3 Deregulation and liberalisation in the German airport industry

To understand the nature of the market competition of an industry, it becomes important to consider industry specific peculiarities and regulation. Therefore, in the following chapter, recent changes within the German airport industry that provides the context for this research are briefly discussed.

The German airport industry was liberalised because of supranational activities on the level of the EU. The deregulation and liberalisation of the aviation industry in Europe has been carried out in two phases. First, in the 1980s, some airline companies were privatised and the airline sector was deregulated. Second, following the example of the privatisation of the British Airport Authority in the UK, airports in many European countries were partially or completely privatised (Gerber, 2002).

Firstly, in Germany, four airports have been partially privatised since the mid-1990s. In general, it is common to sell airports fully or partially to strategic partners. In many of these cases, established airport operators are involved in the privatisation of airports to obtain not only financial resources but also management and technological expertise (Graham, 2003).

The first German airport to be partially privatised was the one in Düsseldorf in 1997. After a fire at the airport in 1996, a considerable amount of capital was needed to rebuild it, and the Government decided to sell 50% of its shares to a private consortium. In 2000, the airport in Hamburg was partially privatised. Today, 49% of the shares belong to a private consortium, and 51% to the city of Hamburg. In 2001, the airport in Frankfurt was partially privatised through a flotation of 29% of the shares on the stock market (Dummann, 2005). According to Graham (2003), the aim of share flotation within the airport industry has been first and foremost to transfer the control and the economic risks to the private sector, and thus provide funding opportunities for future investments. Graham (2003) argued that two prerequisites are necessary for a successful stock flotation. On the one hand, airports must meet minimum profitability requirements in order to attract private investors. On the other hand, the existence of fully developed capital markets is required (Graham, 2003). Finally, in 2005, 90% of the shares of Lübeck airport were sold to the New Zealand infrastructure investor Infratil (Lübeck Flughafen GmbH, 2008).

Secondly, the market for baggage handling was liberalised in Germany, effective in 2001. In 1996, the opening of the ground-handling market to competition was triggered by the Council Directive 96/67/EC “on access to the ground-handling market at community airports”. The Directive requires all commercial airports with more than 2 million passengers or 50.000 tonnes of freight to open the market for baggage handling to outside suppliers by January 1st, 2001. The access of outside suppliers can be limited for certain reasons such as safety or capacity and space constraints, but all airports have to grant access to at least one independent supplier of ground handling services. The objective of the directive is to reduce the cost of baggage-handling services and to improve their quality. Furthermore, in order to maintain fair competition, airports are not allowed to cross-subsidise their ground-handling services with profits from other activities. Baggage-handling service accounting must be kept separate from that of other activities of the airport (The Council of the European Union, 1996).

In Germany, the directive was transformed into national legislation on 10.12.1997 with the BADV [Verordnung über Bodenabfertigungsdienste auf Flugplätzen-(Bodenabfertigungsdienst-Verordnung)]. Before the legislation, airports in Germany had a monopolistic position for the ground-handling market (Templin, 2007). As a result of this directive, the German airports encountered for the first time direct competition from a third party handler within this area.

Access needs to be granted to at least one independent supplier who is neither controlled by Airport 1 nor is a user of the airport who carries out more than 25% of the passenger or freight. The number of service providers granted access varies slightly between airports for different types of services depending on capacity or space constraints (§3 BADV). The access for services at the airport of the parent company is restricted to two self handlers and two third-party suppliers (including the airport) for the following main categories: baggage handling, freight and mail handling and ramp handling services such as guiding the aircraft into the parking bay (Appendix 5 BADV).

For selection of the independent supplier, the airport is requested to ensure that a tender for the service is published in the *Official Journal of the European Communities*. Service providers must meet certain requirements such as a sound financial situation, which are laid down in Appendix 3, BADV. The selection of the independent service provider is made by the aviation authority of the state (Luftfahrtbehörde) after consultation with the

Airport Users' Committee, the airport provider and the work council of the airport. The airport provider is eligible to provide ground-handling services without being subject to the selection process (§7, §8 BADV).²

Furthermore, the BADV requires in Appendix 3 to § 8 (requirements for the performing of baggage-handling services), that the managers of the baggage-handling services are certified handlers (geprüfter Flugzeugabfertiger or similar qualification) and have at least two years' working experience in a managerial role in a baggage-handling company. Alternatively, managers who have five or more years of work experiences in a managerial role in a baggage handling company are suitable to work as managers (appendix 3, 2A;3).

The required training for the certified baggage handler has been well defined by German law since 1977. To acquire the qualification 'geprüfter Flugzeugabfertiger' (certified baggage handler), in accordance with the examination regulations [Verordnung über die Prüfung zum anerkannten Abschluß Geprüfter Flugzeugabfertiger] one needs to fulfil the following requirements: the person needs to complete training in a recognised trade including successfully passing a final exam as well as three years of relevant work experience at an airport (§ 2, 1.1). Alternatively, a person can take the examination when they have four years of relevant work experience at an airport (§ 2, 1.2). Finally, soldiers or former soldiers as well anyone who can prove that they have the necessary experience, knowledge and expertise through documents from the Ministry of Defence, or other testimonials, can take the examination (§ 2 Zulassungsvoraussetzungen).

In accordance with the BADV, workers performing operating activities are not required to have a formal qualification in the area of baggage handling. Here, the law requires only that they are aware of the security regulations and act in accordance to them. Furthermore, workers need to meet certain German language requirements. The training requirements are only loosely specified; employees should be trained in the same manner as others employed within the airport organisation. Only those who are operating service machinery are required to have a qualification as certified baggage handler or a similar qualification (Appendix 3, 2B).

² If Airport 1 is not providing ground-handling services and has no control over any undertaking which provides baggage-handling services, Airport 1 can select the suppliers after consultation with the Airport Users' Committee (§7).

3.4 Chapter summary and conclusion

The chapter discussed important institutions, and their recent changes, of the German model for three groups of stakeholders: employees, managers, and capital stakeholders. First, with respect to the relationship between firms and employees, it can be established that the influence of unions decreased, and an increasing number of firms withdrew from collective bargaining agreements. Despite these changes representation rights for workers remain intact. Second, it is debateable whether German managers have maintained a stakeholder orientation, or have shifted towards a shareholder orientation. There is some evidence showing that educational backgrounds of Germany top managers changed from vocational training and technically-oriented qualification towards academic degrees, which reflects a shift towards Anglo-Saxon practice. Third, firms listed on the German stock exchange have been required to adopt international accounting standards (IFRS) since 2005. It is unclear however whether the change in accounting regime from German Gap to IFRS is better suited to fostering firm competitiveness. Contemporaneously, the importance of large shareholders as sources of credit to German firms has decreased.

Evidence whether the German model changed towards a more liberal model remains inconclusive. It is further unclear from the literature whether a shareholder or a stakeholder ideology is more suitable in fostering innovation. The majority of the literature suggests that the institutional characteristics of the traditional German model tend to foster shop-floor innovation and assist firms to develop competitive advantage based on quality. Finally, the chapter provided an overview of the most important institutional changes of the German airport industry. It became obvious that German airports experienced radical changes of both their institutional and market environment.

CHAPTER 4: METHODOLOGY AND RESEARCH DESIGN

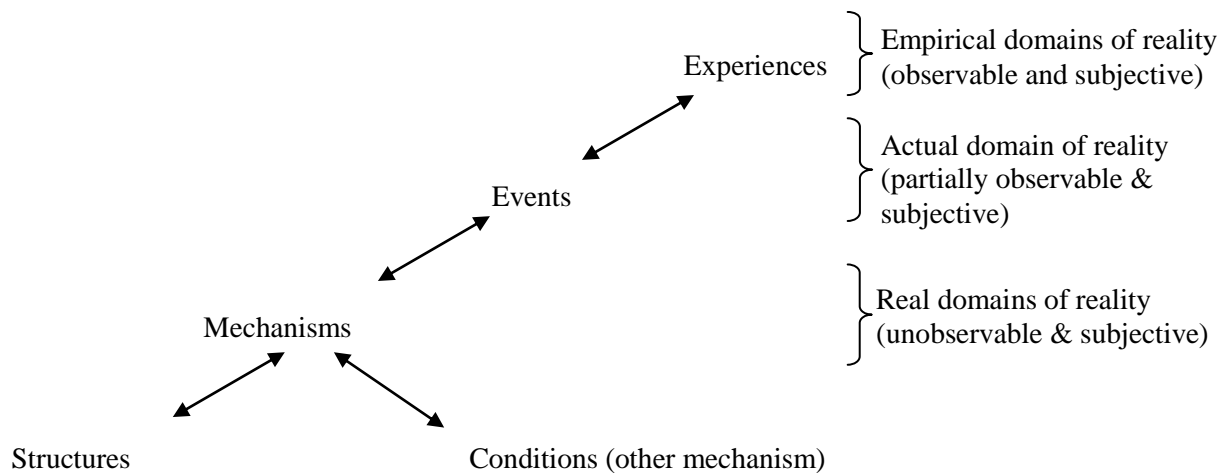
4.1 Introduction

In the previous chapter, an empirical research gap in how traditionally stakeholder-oriented German firms responded to the implementation of neo-liberal policy reforms, including deregulation and privatisation, has been identified. The objective of this study is to close this gap by gaining empirical insights into how German firms sustained their competitiveness during environmental upheaval. The nature of the research objective has implications for the appropriate research methodology and strategy. The objective of this chapter is to outline both the adopted research methodology and strategy used to close the identified empirical research gap. The chapter starts by clarifying the philosophical stance of the study, and then outlining the research strategy, including the adopted research methods. Next, the strategy used for data collection and data analysis is elaborated. The chapter concludes with a discussion of the techniques and tools used for the data analysis.

4.2 Philosophical stance

This study adopted the research paradigm of critical realism, which rests on the ontological assumption that reality exists independently of the researchers' knowledge (Danermark et al., 2002; Sayer, 2004) or identification of it (Fleetwood, 2004), and that not all parts of the reality are directly observable. The purpose of research is to obtain knowledge of the reality by conceptualising and explaining it (Danermark et al., 2002). This argument goes back to the work of Bhaskar (1978) who developed an ontological framework for critical realism. According to Bhaskar, reality can be divided into three domains, namely the empirical, the theoretical and the actual domain. Figure 4.1 illustrates the three domains of reality based on Bhaskar's (1978; 1989) theoretical framework (adapted from Morais, 2011).

Figure 4.1: Three domains of reality and the retroduction logic



(adapted from Morais, 2011, p. 68)

First, the empirical domain of reality consists of all directly observed events (first domain). However, events also occur independently of their observation by social actors, and therefore they exist without knowledge of them (Bhaskar, 1978). In other words, reality is not completely observed (Danermark et al., 2002). The actual domain of reality contains both experienced and unobserved events (second domain) (Bhaskar, 1978). Finally, the real domain of reality consists of objects, actors, and structure, which all exist independent of each other (third domain) (Bhaskar, 1978).

In order to understand the emergence of an event, it becomes necessary to investigate the underlying causal mechanisms between different actors, objects and structures which have the power of producing it. However, the causal mechanisms and structures are “hidden” (Bhaskar, 1978), and therefore cannot be directly observed (Sayer, 2000). Researchers can, however, learn about the hidden structures by observing events that are capable of producing them. The challenge for scientists is to explain the not readily observable structures and mechanisms which are part of the empirical domain of reality (Bhaskar, 1978; 1989).

Given this ontological position, it can be established that even though the actual domain of reality cannot be fully observed by humans, better knowledge of reality can be obtained by combining and analysing the insights of different people who experienced the same event in the actual domain of reality. Healy and Perry (2000) argue that from a realism perspective, the individual perception of a participant is not reality but “a window to reality through which a picture of reality can be triangulated with other perceptions ...” (p. 123). The

different subjective realities of people are thus all part of the objective reality, and a better understanding of the individual, subjective, realities helps us to understand the phenomenon better. For this, it becomes necessary to analyse both facts and meanings about the phenomenon to identify underlying mechanisms that gave rise to it.

The epistemological position of critical realism is that reality cannot fully be captured because of its complexity (Healy & Perry, 2000). Critical realists believe that all knowledge is “fallible” (Danermark et al., 2002) and that research findings are only “probably true” (Healy & Perry, 2000). Danermark et al. (2002) argue that “science offers an opportunity to obtain more or less truthful knowledge of [the] reality” (p. 39). The epistemological perspective of critical realism has important implications for the use of existing theory in research. This point was highlighted by Fleetwood (2004) who states:

“[T]here is no theory-neutral observation, description, interpretation, theorisation, explanation, or whatever. There is in other words, no unmediated access to the world: access is always mediated. [...] and if, entities do become the focus of human being’s reflection, then we may say they are conceptually mediated” (p. 30).

From a critical realism perspective, because observations of the reality are mediated by our pre-existing knowledge, researchers need to mediate their observations through theories and concepts to understand reality. This implies that theory and concepts should be used in all stages of the research, including early stages such as that of observation (Fleetwood, 2004).

Moreover, researchers must be value aware. Value awareness is bound by limitations of the researcher (to be discussed in section 4.6 of this chapter), but also explicitly considers limitations of existing theory and concepts because they might be incomplete or false (Healy & Perry, 2000). Thus, while existing theory has been used to develop a framework for the research, neither propositions nor hypotheses have been formulated. This way of proceeding has been advocated by Eisenhardt (1989a) who argues that there is a great danger that the existing theoretical concepts might bias or limit the research outcome. According to Eisenhardt (1989a):

“Investigators should formulate a research problem and possibly specify some potentially important variables, with some reference to extant literature. However, they should avoid thinking about specific relationships between variables and theories as much as possible, especially at the outset of the process” (p. 536).

The importance of using existing theory for qualitative researchers has also been highlighted by Maxwell (2005) who points out that researchers who are not using enough theory miss an opportunity to exploit the full potential of their research. According to him, there is not only the danger of missing important insights by neglecting existing theory, but it may also be helpful for identifying interesting gaps in the literature and for developing conceptual frameworks. On the other hand, the author argues, researchers should be critical of existing theory when it comes to develop theory as existing theoretical concepts may limit or mislead the researcher. Overall, Maxwell (2005) advocates a critical use of theory. The suggestions of both Eisenhardt (1989a) and Maxwell (2005) fit the epistemological assumption of critical realism. While both authors see the need for using existing theory, they also warn researchers that existing theory might bias the research outcome.

4.3 Research strategy

The purpose of this study is to investigate how changing institutional forces influenced the strategic choice of German firms in terms of their competitiveness and relationship between different stakeholders.

In the literature review it has been identified that existing research on how institutions influence firms' competitiveness draws mainly on statistical evidence. Some authors raised concerns about the dominant use of statistical methods, warning that this may entail crucial drawbacks (Börsch, 2004b; Crouch, 2005a). A significant drawback was highlighted by Börsch (2004b), who argues that statistical evidence ignores that organisations have the freedom of exercising strategic choice. Börsch's argument goes as follows: While institutions give incentives for organisations to behave in a certain way, there is no guarantee that organisations will adhere to these incentives. In other words, the actual behaviour of organisations may differ from the expectations of institution makers. Therefore, Börsch (2004b) suggests:

“[I]nstitutional analysis should be complemented by systematic firm-level analysis in order to model the interaction between institutional and enterprise change. A stronger actor-centred approach focusing on firms as actors in their own right may be able to capture better the dynamics of corporate governance, and analyse how institutions and firm strategies interact and how firm strategies might change institutional settings” (p. 609).

This research strategy addresses this concern, and uses a qualitative research method. Qualitative, empirical, firm-level data has been collected, suitable to enhancing our understanding of how institutions influenced firms' strategies and competitiveness. A case study approach has been chosen to extend existing theory.

Case studies can be used for both generating, developing and testing theory (Gibbert, Ruigrok & Wicki, 2008; Stake, 1998). Case studies enable the researcher to investigate contemporary events with an explicit consideration of their contextual conditions. A case study is particular suitable when researchers believe that contextual conditions significantly influence the phenomena (Yin, 2003). Because case study research allows the researcher to use multiple sources of evidence, it is often based on a range of methods including interviews, surveys and documentary analysis (Yin, 1993). Evidence can be brought in from either qualitative or quantitative methods, or even include a mix of both (Yin, 2003). Finally, the case study approach also fits well with the critical realism perspective (Healy & Perry, 2000), and is particular appropriate when one believes that existing theory may be false (Eisenhardt & Graebner, 2007).

More specifically, a case study enables researchers to use cases in an instrumental way (Stake, 1995, 1998). Researchers can deliberately choose cases with certain characteristics that are appropriate to provide insight into a specific phenomenon (Stake, 2000). Using case studies instrumentally means that for researchers the case is not of primary interest, but a means to learn more about a particular phenomenon (Stake, 1995, 1998).

In order to make a theoretical contribution to the literature on diversity of capitalism a case study of the airport industry has been conducted. The airport industry has been selected to gain insights as to how changes of the market and institutional environment influence the competitiveness of firms. As discussed in section 3.3, the German airport industry experienced radical changes of both their competitive and institutional environment due to privatisation and deregulation activities within the industry during the last decade. Also, airports increasingly encounter a more competitive environment as a result of increasing competition with other modes of transports that can act as substitutes, such as high-speed trains for medium distance trips (Roman, Espino & Martin, 2007). Due to these changes, airports have transformed from publicly-owned entities to commercially oriented firms (Graham, 2005). For example, Jarach (2001) points out that airports have evolved from conservative 'air-side business' to sophisticated companies that engage in various new

commercial activities such as commercial and tourist services. Organisational change does not occur independently from its context and therefore the airport industry provides a very good research opportunity for this study on corporate governance.

Two privatised German airports were investigated and compared. A case study of privatised airports provides a suitable context in which to learn how neo-liberal reform policies influenced the behaviour of firms. It experienced both privatisation and deregulation, which triggered organisational restructuring. Organisational change processes of privatised firms do not happen in a vacuum, but are influenced by contextual conditions.

The design of the research has been influenced not only by theoretical, but also by methodological considerations. Existing theory shows that the German institutional environment recently changed towards a more liberal model (Streeck, 2009). It can be expected that radical change of the institutional environment triggers processes of change at the firm level (Greenwood & Hinings, 1988; 1993). To understand such phenomena, a process model is required that can explain how patterns of change occurred. To develop a process model it usually becomes necessary to utilize qualitative data (Chiles, 2003).

Another frequent methodological concern is the researchers' understanding of the research context. Many prominent researchers have stressed that a deep understanding of the countries being studied is necessary to achieve high quality research. Only researchers who have a sound knowledge of the cultural background are able to understand the underlying meaning about what is being observed. This point was made clear by Tsui, Nifadkar and Ou (2007) who encourage scholars to spend a considerable amount of time within the country that they wish to study. According to the authors:

“High-quality, high-impact research is the result of the scholar's deep knowledge about the phenomena they study. This is true for cross-national research as well. International studies are not for those who cannot depart from the comfort of their homes or who dislike flying for more than a few hours. Good local knowledge cannot be attained in a matter of days, weeks, or even month. We encourage scholars of any nation to spend their sabbatical year (not months) in the country that they would most like to study” (p. 469).

The need for a good understanding of the context has been considered for the research design. I am very familiar with peculiarities of the German airport industry because I completed a master's degree in Germany, and one of my majors was 'transportation studies'. My master's

thesis investigated how capacity constraints impact on competition between airlines. Given my educational background and my general interest in both management issues and the transportation sector, the study of the privatisation of German airports provide me an opportunity to use and extend my existing knowledge.

4.4 Research design and data collection

4.4.1 Data sources

Different sources of data were used for this study, namely semi-structured interviews, on-site observation and documents. The use of multiple sources allows triangulating data, and therefore helps to enhance and deepen the researcher's understanding of the investigated phenomenon (Denzin & Lincoln, 1998). As a result, the use of different methods provides stronger and more robust conclusions (Eisenhardt, 1989a; Yin, 1993).

In this study, I used interview transcripts as the main source of data. I developed an interview guideline based on key theoretical concepts to guide the semi-structured interviews. The objective of the interviews was to draw key stakeholders, who had experienced the liberalisation of the German airport industry, into a discussion concerning their perception about the organisational change of airport privatisation. The aim of semi-structured interviews was to provide a standardised questionnaire for each interview to ensure that all areas were covered during each interview, while at the same time allowing a certain degree of flexibility in participant response. Bryman (1989) argued that semi-structured interviews are particularly suitable to gain insights about the participant's experiences involved in organisational change.

Initially, I asked three senior researchers to provide some feedback on the selected concepts covered in the interview guideline. Their comments and suggestions proved to be very beneficial for the final version of my interview guideline. The final interview schedule contained questions regarding the following areas: the company's strategic reorientation, organisational change and innovation, the company's learning experience, changes in the relationship between the organisation and key stakeholders, and the impact on regulation and government policies on organisational competitiveness.

In order to conduct semi-structured interviews with stakeholders of the partially privatised airports, I obtained ethics approval from The University of Auckland Human Participants Ethics Committee (Ref. 2007/256). In 2008, there were four partially privatised airports in the German airport industry. Due to the limited number of available cases, I decided to invite the CEOs of all four airports to participate in this study. Invitations were send out in March, 2008.

A decision of the CEOs about their participation in the research was made after a few days. Two CEOs declined to give their permission for the conducting of interviews with airport managers as key informants. However, both CEOs were available for an interview. Since contextual knowledge of the industry is important to understand the phenomenon, I interviewed them both even though a case study of these airports could not be prepared because the available data was insufficient. My knowledge about the German airport privatisation was, however, further extended by an interview with a union member who represented employees' interest at one of the airports that was not used as cases for this study.

Second, CEOs of two airports gave their permission that managers of their airports could be contacted for this research. Both airports provided contact details of key informants. The two participating airports belong to the five largest airports in Germany in terms of passenger numbers. In terms of EBIT margins, both airports are highly competitive, in 2009 achieving EBIT-margins of 14.8% (Airport 1) and 15.14% (Airport 2) respectively. This is considerably higher than the average EBIT margin of nonfinancial firms listed in the Standard & Poor rating (S&P) 500, which has was about 12% between 2000-2009 (Verma et al., 2011).

I contacted all managers of whom I had obtained contact details via mail or email to arrange an interview, which proved to be very effective. In general, I received a positive reply within a few days (over 75% of the contacted informants were willing to participate in the study). Appointments for the interview were made with those who agreed to participate in the study at their convenience at the airport premises.

After each interview, the informants were asked to suggest further potential informants. This technique to select potential informants by participant recommendations is known as 'snowball sampling'. As a result of this sampling technique, I conducted interviews with people from different managerial levels, some of whom were already retired. Other

groups of stakeholders who had experienced organisational restructuring were invited to participate, including employee representatives, members of the supervisory board, industry experts and government representatives. Care was taken to obtain a sample of people with similar functional backgrounds for each case.

In total, 35 in-depth interviews were conducted between May and July 2008 and informed this research study. The majority were face-to-face interviews, only two being conducted via Skype. For the case analysis of the two airports, 32 in-depth interviews were used, producing slightly over 37 hours of recording time. The average interview time was 1 hour 15 minutes.

For Airport 1, eighteen interviews were conducted including managers, a government representative, former and current board members, and employee representatives. Seventeen of the interviews were face-to-face, and one was conducted via Skype. The interviews with the government representative provided very useful information about the context of the airport liberalisation, but no quotes were used from these participants. Participants of whom quotes have been used included a wide range of people, including three females and fifteen males. Two of these sixteen participants had already retired. About half had been employed at the airport for at least 10 years, and two had worked for the airport for over 30 years.

For Airport 2, thirteen people were interviewed, including managers of the airport group, the former and current CEO, government representatives, the CEO of the strategic investor, and trade union representatives. Eight of the interviews were conducted face to face at the airport premises, and one was conducted via Skype. The interviews with the government representatives and the strategic investor provided very useful background information for Airport 2 and contributed towards a better understanding of the context, but no quotes have been used. For the case discussion, quotes from nine participants have been used; five of them had worked at the airport for more than 20 years, and two were already retired. Only one female participant was interviewed. Table 4.1 contains an overview of the 32 interviews used in this study, including one with an industry expert, relevant for both airports.

Table 4.1: Overview of conducted interviews

| Position | Airport |
|--|----------------|
| Trade union secretary, Werner | Airport 1 |
| Trade union secretary and member of supervisory board, Dennis | Airport 1 |
| Senior manager, Hans, Head of support unit 'revision, 'Prokurist' (authorised signatory) | Airport 1 |
| Former CFO and board member – Gerd | Airport 1 |
| Senior manager, Maja, Senior Vice President: segment 'Global Investments & Management | Airport 1 |
| Vice CEO - Dirk, the former Vice-CEO | Airport 1 |
| Senior manager, Stefan, Head of Training and Development | Airport 1 |
| Senior manager, Dominik, Head the unit 'Management Systems' | Airport 1 |
| Senior manager, Marc, Head of Finance & Investor Relations. | Airport 1 |
| Senior manager- Sonja, Head of the sub-unit 'R&D and Innovation-management | Airport 1 |
| Senior manager- Wiebke, Division baggage handling | Airport 1 |
| Senior manager, Markus, both Head of Management Development and the Head of Organisational Development | Airport 1 |
| Board member, representative of private capital stakeholders | Airport 1 |
| Member of the works council, Karl-Heinz | Airport 1 |
| Group of managers, including Heiko - Senior Executive Manager for Accounting Systems and Services | Airport 1 |
| Manager, Hugo, manager, sustainable management | Airport 1 |
| Government rep., involved in airport regulation | Airport 1 |
| Manager and trade union member, Christian | Airport 1 |
| Industry expert | Airports 1&2 |
| CEO (investor) | Airport 2 |
| Former government rep., involved in airport regulation | Airport 2 |
| Former senior managers, Head of airport controlling, Prokurist' (authorized signatory) and managing director for 2 subsidiaries, Dietmar | Airport 2 |
| Senior manager, Director of the division Centre Management, Michael | Airport 2 |
| Senior manager, legal department, Christine | Airport 2 |
| Current CEO, Ansgar | Airport 2 |
| Government rep., representing the government as investor | Airport 2 |
| Government rep., involved in airport regulation | Airport 2 |
| Former CEO (1994-2005), Rüdiger | Airport 2 |
| Senior manager, Head of the airport controlling and 'Prokurist' (authorised signatory), Roland | Airport 2 |
| Trade union representative, Peter | Airport 2 |
| Trade union representative, Simon | Airport 2 |
| Chief of traffic and Head of both air traffic and safety management, Klaus | Airport 2 |

4.4.2 The interview process

The interviews generally consisted of three parts. The intention of the first part was to establish some trust between me and the participant. I spoke a little about my educational background and interest in the airport industry. I usually explained that a major of my postgraduate degree, Dipl.-Kauffrau, was in transportation, and that also my master's thesis was related to the airport industry. I then gave a short explanation of my research topic. Participants had the opportunity to clarify questions regarding the study before signing off the Participant Information Sheet, and starting with the second part of the interview, which was recorded.

In the second part of the interview, questions were asked regarding the key concepts of interview guideline regarding the organisational restructuring after privatisation. Each interview usually started with a general question about the role of the interviewee at the airport. However, the following questions did not follow a rigid order. Most informants jumped between different areas from the interview schedule in their explanation of events. In these cases, the informants were not interrupted to maintain the flow of the interview. The interview style has been described by Silverman (2006) as "active listening". According to Silverman this ensures some flexibility for the interview because it allows the interviewee to freely talk about their experience. Nonetheless, it still gives the interviewer the control to keep the broader goal of the project in mind by guiding the interview as to which topics are discussed and which areas of the talk are discussed more in depth.

For comparability between cases, it was important that the same areas were covered in all interviews. To achieve this, I used a two-page interview map consisting of a list of the main areas that had been identified during the literature review. Areas that were covered during the interview were ticked off. This proved to be very useful, because it gave me the opportunity to concentrate on the interview, while at the same time not losing an overview of areas already covered. However, due to the broad range of the questions, some participants were unable to provide complete information, in which case, we moved to a different area of the interview schedule. Part 2 usually ended by asking if the participant would like to add further insights. The third part of the interview started when the tape was turned off and the official part of the interview had finished. Some of the participants then provided interesting thoughts and additional information which I noted down.

The interview part that was recorded with the participants' permission was transcribed into text. These transcripts were the most important source for this study, and provided valuable insights into mechanism that triggered and influenced organisational change. However, to further contextualise the research, the data was complemented by on-site observation. The majority of the interviews took place on the airports premise providing an opportunity to have informal chats with staff at the airport. I often spent a few hours at the airport between interviews, and I used this time to experience it from different perspectives. First, I used different modes of transport to come to the interview site, including airplanes, trains, taxi and shuttles bus and car. Because the connectivity options are an important factor for the competitiveness of an airport, I considered it important to experience these different options myself. I also visited different airport facilities such as food courts and shops. These are considered to be an important factor in the travel decisions of customers, and therefore influence its competitiveness.

Finally, secondary material, including organisational documents and newspaper articles proved to be very useful to verify insights from the interviews. In particular, annual reports provided by the airports were used during the data analysis to compare and contrast the insights from the interviews. Newspaper articles and press releases from both airports were also studied, and were important sources for following the development of both airports to the end of 2010.

4.5 Data analysis

Coding of interview transcripts and secondary data was done manually. The aim of the coding was to systematically sort the data according to key concepts. Many of the codes resulted from the pre-defined areas covered in the interview guideline, and therefore focussed on somewhat pre-determined concepts from the literature. However, the coding also allowed the emergence of new concepts requiring the creation of additional nodes. In order to develop theory, codes were both theoretically and empirically derived (Maxwell, 2005).

Patterns that emerged around concepts were useful in understanding how these concepts have influenced competitiveness at each airport. An important technique to discover relationships between these different concepts was to prepare memos and mind maps to create visual maps of the processes of organisational change.

The transcripts of the interviews were not translated in to English; I felt more comfortable coding them in German, and I also occasionally needed to listen to the actual recordings during the coding. Listening to the voice of participants allowed me to refresh my memory about the actual interviewee and the context in which the interview was conducted. It also ensured that subtle remarks and comments were not lost. Moreover, coding the interviews in German facilitated the integration of secondary data that has been used for triangulation. Secondary data including annual reports and newspaper articles were coded, not available in English.

Patterns that evolved during the coding also summarised the data, which were thus reduced through coding. Miles and Huberman (1994) refer to a coding process that contains researchers choices about which parts of the data are coded as ‘data reduction’, which is an important part of data analysis. Langley (1999) pointed out that a major challenge for theorising data describing processes is to understand patterns or sequences in events, for example, “do A and then B to get C” (Langely, 1999, p. 692). A reduction approach to analyse data as suggested by Miles & Huberman (1994) can be helpful to discover patterns of events that may explain the phenomena.

From the critical realist’s perspective, however, events may not necessarily be created by regular patterns, and patterns are not necessarily related to causality (Sayer, 2004). While data reduction is helpful in understanding data, it cannot be analysed through it. Similarly, while the search for pattern can be useful to identify events, it is “neither a necessary nor a sufficient condition for a causal law” (Morais, 2011, p. 70). Sayer (2004) argues that critical realist researchers need to perform a causal analysis to explain change. A suitable approach to perform a causal analysis is the retroduction approach.

Retroduction is a “... mode of interference in which events are explained by postulating (and identifying) mechanism which are capable of producing them ...” (Sayer, 1992, p. 107). In other words, “Retroduction means ‘moving backwards’ and that is what the process involves. It asks “What must be true in order to make this event possible?” (Easton, 2010, p. 123). The task of the researchers is to uncover the causal mechanism through observable experiences (Morais, 2011). Morais (2011) argues that researchers can achieve reduction by using subjective accounts of actors that experienced an event (empirical domain of reality), and re-describing them by comparing them to existing theory. The aim is to identify the mechanisms that have produced the events (Morais, 2011).

The retroduction logic combines a deductive sampling logic with an inductive replication logic (Morais, 2011). First, deductive logic is used to identify concepts of interests, and suggest what mechanism could have caused an event. Here existing theory is used to develop pre-concepts. The inductive logic is then used to explain and test what mechanism could have caused the events (Easton, 2010). Induction and deduction are systematically combined, meaning that the researcher goes constantly “back and forth” between theory and empirical data (Dubois & Gadde, 2002). Through the combination of deduction and induction, theory may be developed, extended or falsified (Morais, 2011). The data analysis was guided by existing theory that provided the concepts of interests. The interview data were then used to test existing theory and to discover new theoretical perspectives.

The data from each case was analysed from a retroductional approach. As Easton (2010) pointed out, from the retroduction perspective, researchers continuously ask the question “why” in order to identify the underlying mechanism that led to the events. During the analysis several mechanisms were discovered that could have explained the events. These were evaluated against new empirical data to eliminate rival explanations to identify a ‘falsifiable’ truth. For each case, a narrative, namely “a detailed story from the raw data” (Langley, p. 695) was constructed.

In accordance with Miles and Huberman (1994) differences and similarities between the two cases have been identified by conduction of both “within-case” and “cross-case” analysis. The main objective of the within-case analysis was to understand the processes triggered by liberalisation and privatisation of each airport. Miles and Huberman (1994) argue that a good understanding of each case is an important prerequisite for the cross-case analysis. Within-case analysis reduces the volume of the data, and provides an opportunity for the researcher to familiarise themselves with each case (Eisenhardt, 1989a). The results of the within-case analyses illustrated in Chapter 5 describe the unique process of organisational change of each airport. Following Pettigrew’s (1990) advice, throughout the within-case description, an attempt is made to “tell the story across levels of analysis” (p. 280). In particular, in the within-case analysis it was important to understand how the interests of different stakeholder groups have been affected by changes in the institutional environment at each airport.

After a within-case analysis for each case had been carried out, a cross-case analysis was performed. As suggested by Eisenhardt (1989a), similarities and differences between the two cases were identified. Particular attention was given not to overlook subtle differences between different concepts and patterns between the cases (Eisenhardt, 1989a). The results of the within-case analyses are also illustrated in Chapter 5.

4.6 Quality of the research and limitations

In general, qualitative researchers argue that reality is socially constructed, and thus contains subjective elements (ontological standpoint) (Denzin & Lincoln, 1998). There are several strategies qualitative researchers can use to enhance the objectivity of their findings. Objectivity can be enhanced by ensuring greater reliability and validity (Kirk & Miller, 1986). According to Hammersley (1992) “reliability refers to the degree of consistency with which instances are assigned to the same category by different observers or by the same observers on different occasions” (p. 67). In other words, it refers to the question of whether the results are replicable. On the other hand, validity relates to the question whether a measuring instrument is capable of measuring what it intends to measure (Polit & Hungler, 1995).

Several researchers have discussed criteria of judging the reliability and validity of qualitative research (Healy & Perry, 2000; Kirk & Miller, 1986; Long & Johnson, 2000; Silverman, 2006) and case study research (Gibbert et al., 2008; Riege, 2003). To increase the reliability of this study, the following suggestions made by Healy and Perry (2000) have been followed. First, the field and interview procedures have been described in section 4.4. Second, a case study database has been established. Both a case study database and case study protocols increase the reliability of a study because they provide an opportunity for other researchers to repeat a case study (Yin, 2009).

Johnson (1997) suggests several strategies to enhance the validity of qualitative research. Appropriate recommendations have been adopted in this study to enhance the research quality and to address potential limitations of researcher subjectivity. Table 4.2 summarises strategies suggested by Johnson (1997) that have been adopted to increase the quality of the research, and describes how these strategies have been implemented in this study.

Table 4.2: Strategies to increase the validity of the research

| Strategy | Descriptions | Application in this study |
|----------------------------------|--|---|
| Researcher as ‘Detective’ | Researchers task is to analyse evidence about cases and effects; ‘rival’ explanation should be systematically eliminated | During the data analysis different explanations were evaluated; the final case was made based on the available evidence |
| Low inference descriptors | Use of participants’ accounts, namely direct quotations | Direct quotes of participant are used in the case discussions to allow readers to directly experience the participants’ perspective |
| Triangulation | Using multiple sources to see whether the evidence points in the same direction, ‘cross-checking’ information from different sources | Use of interview transcripts, and secondary data such as annual reports and newspaper articles to triangulate the data |
| Theory triangulations | Using different theories to explain the data | Research aims to integrate different theoretical perspectives (e.g. discursive institutionalism) |
| Reflexivity | Self-awareness and ‘critical self-reflection’ by the investigator | Care was taken to consider examples that disconfirmed expectations resulting in unexpected findings |

(adapted from Johnson, 1997, p. 93)

From the perspective of critical realism, researchers have to be value aware. All knowledge is influenced by its social context, and therefore not value free. Hence, knowledge is subjective (Healy & Perry, 2000). It is important for researchers to be aware of their own limitations in interpreting the findings. Understanding my own researcher bias, resulting from my personal background, proved helpful in to challenging interpretations of the data. During my data analysis, I have constantly challenged my interpretations of data based on theoretical knowledge that I obtained or took for granted before I embarked on this research project, by trying to find counter arguments.

A specific issue of this research was that the data analysis was conducted in German and the findings were reported in English. Green and White (1976) have suggested that cross-national researchers must ensure an accurate translation of the instrument. Rather than directly translating the terms from one language to another, the authors suggest that researchers should use the process of back translation. After having the instrument translated by a bilingual researcher, a second translator should translate the instrument back to the original language. Differences between the original document and the back translation may indicate that instruments are not equivalent in both versions, and correction can be made

(Green & White, 1976). For this research, the challenge was not to translate theoretical concepts for the interview guidelines into English, since the research was carried out in German. Care was taken that the quotes used in the empirical findings were translated accurately. To ensure a greater accuracy, the quotes that were used in the empirical analysis were translated by a second researcher with fluent English and German language skill. In rare cases, some ambiguous words were replaced to avoid misunderstandings.

One limitation of this study is the limited number of cases, namely two. However, given that the number of potential cases was limited to four, the study covers 50% of the total population of the privatised German airport industry. Since two cases compare well with the five largest German airports in terms of passenger numbers, it can be expected that organisational restructuring has occurred throughout the German industry. Evidence from the interview conducted with the trade union secretary representing the interests of employees of a third partially privatised airport also confirm the findings of the other two cases.

A pitfall in using interview data is that this data may be biased because interviewees engage in retrospective sense-making. Eisenhardt and Graebner (2007) suggested interviewing participants from “diverse perspectives” because it is unlikely that all participants engage in similar retrospective sense-making. Therefore, different stakeholders have been interviewed to limit the danger, and organisational documents have been studied to triangulate the findings.

4.7 Chapter summary and conclusion

The chapter discussed the methodological consideration of this study, the adopted research and the data analysis procedures. The philosophical perspective of this study is critical realism, which requires specific consideration for the data collection and analysis; this has been elaborated. Existing theory was important to develop an interview guideline that guided the semi-structured interviews during the data collection. For the data analysis, a retroduction logic was applied. Finally, the chapter describes strategies that were adopted to ensure the best possible quality of the research. The aim of the next chapter is to present the empirical findings.

CHAPTER 5: EMPIRICAL FINDINGS

5.1 Introduction

The empirical findings of the two German airport organisations are investigated in this chapter. The organisational restructuring in the context of the liberalisation of the German airport industry will be investigated and discussed for both airports. After a brief outline of the history, the ‘triggers’ for the restructuring of the airport will be discussed. Second, changes in the organisational structure, and organisational objectives will be outlined. The importance of innovation for the competitiveness of the airports will be discussed and it will be highlighted how the liberalisation of the market affected the importance of innovation. The consequence of liberalisation for the working environment and the organisational culture will be detailed. Finally, changes in training and development for both managers and employees on the shop floor will be discussed in more detail since training directly influences a person’s ability to carry out innovation. After the organisational restructuring has been discussed for each airport, a brief overview is given of similarities and differences between these concepts for each airport.

5.2 Results for Airport 1

5.2.1 Brief history of Airport

Founded in 1924 as a public limited company, the organisation has operated at its current location since 1936 (Airport 1, 2010³), and since 1949, as a commercially operation. In 1955, Germany regained its air sovereignty (after WWII), and in the same year, the ownership structure of the organisation was rearranged at the first board meeting. Ownership was divided between a federated state (45,242%), a city (28.891%), and the Federal Republic of Germany (25,867%) (City-Dokumentation zur Nachkriegszeit, 2009).

Since 1960, the airport has been the biggest in Germany, with 2.2 million passengers (City-Dokumentation zur Nachkriegszeit, 2009). Growing passenger numbers and new types of airplanes made structural changes necessary, including the start of the building of a new terminal, which was inaugurated in 1972. The airport provided several facilities for its visitors, including a wide range of shops, a modern hospital, prayer rooms, restaurants and

³ The name of the airport as well as the location is withheld in the following discussion to ensure confidentiality.

conference rooms. In 1968, the public works planning procedure for a third runway started. However, complaints from residents within the region about the increasing noise level at the airport led to a massive dispute over the new runway. After a long process of mediation, the new runway finally opened in 1984 (City-Dokumentation zur Nachkriegszeit, 2009).

Following its initial public offering (IPO) in 2001, the airport changed its name (Airport 1; 2009). Today, the share capital is divided between a German Federal State (32.62%), the city in which the airport is located (20.19%), institutional investors (including the airline, which has established its home base at Airport 1 (9.96%), and the remaining shares (18.66%) as free float (including approx. 1% employee-owned shares) (Airport, 2008).

5.2.2 Triggers of the restructuring

In 2000, the organisation undertook changes in order to prepare for the imminent IPO to meet future legal requirements for listed companies in Germany. Of particular importance is that the organisation prepared its financial statements in accordance with International Accounting Standards (IAS) instead of the German Gap (Airport 1, 2000a).

The change of accounting principles to IFRS was one of the key reasons for organisational restructuring. IAS 8 made it necessary to classify the business areas of the organisation and the investments allocated to segments. Business areas were classified into the following four segments: ‘Aviation’, ‘Non-aviation’, ‘Ground handling’, and ‘Other business segments’. During the implementation of IFRS accounting principle, managers also decided to harmonise internal and external accounting in 2004. The aim was to increase the transparency of external reporting, and to enable a ‘hard close’ or ‘fast close’ to shorten reporting times of financial figures. To achieve harmonisation, managers aligned the organisational structure:

“We substantially restructured in 2003/04 to achieve congruence between the internal organisational structure and the external reporting of the results- since then, the structure is like a pyramid down to the smallest unit, for every cost centre, for every order, for every facility, everything is now assigned to segments on the highest aggregation level” (Heiko, Senior Manager, Accounting Systems and Services).

A value-oriented management tool was introduced aligning the requirements of the capital market with the goals of managers (Airport 1, 2001). For each of the four strategic business units, i.e. business segment, a key goal is now to create value for the group, measured by whether the strategic business units achieve return on the capital employed higher than the weighted average cost of capital (WACC) (Airport 1, 2004). The value measurement was first introduced in 2004 (Airport 1, 2004). Value contribution is measured by a specific performance indicator, ‘RoAirport’, which is calculated by the following formula: Earnings before interest and tax – WACC (before tax) x [average capital employed] of each segment. The WACC is based on the minimum cost for equity and debt. A manager pointed out that each segment is expected to achieve at least 10% RoAirport. The performance indicator is similar to the economic value added (EVA) concept. The difference is that EVA concept is based on NOPAT (net operating profits after taxes), and not on EBIT (earnings before interest and tax). Table 5.1 contains the development of RoAirport of each segment from 2003-2009 as well as that of the Group from 2001 onwards (Airport 1, 2002-2009):

Table 5.1: RoAirport, Airport 1

| Year | Ext. Activities | Ground Handling | Retail & Properties | Aviation | Group |
|-------------|------------------------|------------------------|--------------------------------|-----------------|--------------|
| 2001 | - | - | - | - | 12.4% |
| 2002 | - | - | - | - | 1.6% |
| 2003 | -3.2% | -0.15 | 14.8% | 6.5% | 7.2% |
| 2004 | -0.4% | 8.3% | 13.8% | 10% | 9.9% |
| 2005 | -1% | 14.2% | 14.7% | 10% | 10.9% |
| 2006 | 3.8% | 9.6% | 18% | 7.8% | 11.8% |
| 2007 | 8.7% | 3.2% | 19.6% | 4.5% | 10.9% |
| 2008 | 0.6% | 4.2% | 19.8% | 8% | 10.5% |
| 2009 | 8% | -8.4% | 17.6% | 3.3% | 7.8% |

Most profitable is the segment ‘Retail & Properties’. All other segments struggle to achieve the goal of earning 10% ‘RoAirport’. The value contribution of the segment ‘Ground Handling’ has decreased since 2005, and destroyed value in 2009 based on RoAirport. The introduction of competition puts pressure on the profitability of the segment ‘Ground Handling’. After the deregulation of the Ground Handling, a third party handler entered the market, and now competes with the services of the airport (Templin, 2007). However, as a trade union representative explains, the service offering of the competitor is limited because of a relatively unskilled workforce.

“For a large aircraft with 500 people and baggage and freight, I need skilled workers who have obtained a special training. ... but this is not necessary for competitors because they serve only passenger aircrafts... they focus on low cost airlines with tourists” (Dennis, trade union secretary).

The competitor offers services for lower prices by using a less-trained and consequently less-skilled workforce. It has been reported that the reliance on a less-skilled workforce has resulted in an increase of minor accidents and delays in processing during peak hours. The cost of services is further reduced at the expense of passenger comfort. For example, the new entrance uses mobile staircases almost exclusively for passengers to disembark. For the operation of those staircases, lower qualified personnel are required than for jet bridges, which in turn significantly reduces personnel costs.

In the first year of direct competition, Ground Handling maintained its customer bases, and even won new customers with its high service quality. In 2004, the market share of the competitor increased to 20% (Templin, 2007). However, according to Airport 1 (2008), the market share of the third-party handler significantly decreased in 2007 to 11.9%. Increased competition has led to downward pressure on charges for baggage handling services.

The alignment of the organisational structure and external reporting was helpful in strengthening the responsibility among managers for shareholder value. Creating value for shareholders is now a central goal for all parts of the organisation, and only segments and subsidiaries that achieve this goal can be sustained within the group. For wide acceptance of the profitability measures of the capital market, it was important to address the theme ‘value management’ in internal information and training sessions. Managers needed to understand how capital structure and different strategic decisions may influence the value creation of a segment.

In the past, managers of operating areas were concerned mostly with internal performance indicators, and it was at first difficult to change their mind-set towards external measures of the capital market. To align goals of managers with those of shareholders, a variable wage component coupled with external measures was introduced. Financial incentives were particularly important to implement a greater shareholder perspective:

“What was very, very positive and advantageous for the adoption [of external reporting] was that we changed variable compensation. The success of the people in operating areas was mainly measured by internal figures in the past,

nowadays it is measured by external figures, which are accepted at the stock market- and of course they have now an incentive to influence those. And this is helpful for the... change process” (Heiko, Senior Manager, Accounting Systems and Services).

By introducing a variable performance based on shareholder value creation, managerial goals are now aligned with those of the shareholders. This shareholder orientation is further stressed by the introduction of both a management stock option plan (MSOP), and a yearly share offering to employees since 2001. The MSOP was adjusted in 2005 to better align shareholder goals and managerial goals. Managers are eligible for stock option if the share price increased at least 20% over the initial issue price; they can exercise this for a period of two years, after a three-year lock down period. The minimum goal may be adjusted depending on the overall trend of the stock market, and/or the performance of selected shares of the aviation industry (webpage organisation, 2010). External measures became increasingly important during the IPO:

“The theme external measures to create shareholder value... for example the WACC... became the new magic word... How to calculate it? Everybody needed to know... and at the time we thought, who does not know it, must be very stupid!” (Markus, Head of Management Development).

The organisational structure in accordance to business segments is nowadays well accepted amongst managers. The majority of managers consider the performance-based incentive system in their decision-making, and aim to maximise their individual reimbursement. However, there are also critical views as to whether the new incentive structure will create value for the organisation in the long term. For example, some managers expressed concerns:

“The bonus of the executive team depends on the EBITA, which is a doubtful instrument to guarantee sustainable success” (Stefan, Head of Training and Development).

“I don’t really feel that the performance-bonus at the end of the year influences me- because I believe this organisation pays me to do something beneficial, in a sense that is sustainable, maybe for the next 30 years. And because of that, I sometimes suggest something what does not serve my own benefits” (Maja, Senior Manager, Global Investments and Management).

There is no current direct link between the performance-based bonus system, and future investment decisions. However, there are ‘strategic committees’ that are debating such investment projects. A manager highlights the synergies between different areas:

“Airports have extreme cross-functions across sections and investments are benefiting all segments to various degrees, and the art of the strategy is to make investment decisions which are economically viable for all areas” (Heiko, senior manager, Accounting Systems and Services).

The introduction of IFRS accounting changes not only the structure of the organisation but also the underlying belief system of the managers. The uppermost goal of managers is to generate value for shareholders. Investments in innovation very much depend on the perception of whether they directly contribute to shareholder value which can be generated by growth through innovation, such as the development of new products or services. If growth is not possible or desired, value can also be created through innovation which reduces cost, such as process improvement and the use of cheaper labour. In order to justify the latter, it will be shown that the concept of competition was necessary to justify organisational changes to employees and to pressure them to accept. The changing working conditions for people performing operating activities was perceived as fair and necessary by managers because of the competition. Changes in organisational purpose and culture will be discussed in the following.

In this discussion, the term ‘parent organisation’ refers to the parent company of the group, which also represents the organisation before privatisation. The term ‘subsidiaries’ is used for subsidiaries of the parent company which are directly or indirectly controlled by the parent company, and are providing services at the airport at the main location of the parent company for operating areas such as baggage handling or security.

5.2.3 Organisational objectives and culture before and after the restructuring

Airport 1 had always been a public limited company, focussing on profitability. Before 2000, the business activities of the organisation had been divided into six business divisions, and four service units. After the IPO, these business divisions did not change markedly. The four divisions ‘Traffic and Terminal Management’, ‘Information Technology and Telecommunications’, ‘Aviation Ground Services’ and ‘Airport Investments and Mergers’ were maintained, and the two divisions ‘Property and Cargo Development and Construction’ and ‘Facilities Management’ were merged into the division ‘Real Estate and Facility Management’. The five strategic business divisions were assigned to the for strategic business units.

Before the IPO, the culture of the organisation can be described as being people-oriented and strongly influenced by co-determination. The organisational culture was strongly oriented towards the well-being of employees, partly as a result of the influence of the work council. The concept of co-determination had an important role for the strategy of the company. Managers valued this concept and believed that it contributed significantly to the long-term success of the organisation. The executive team considered the practising of co-determination helpful for promoting entrepreneurial thinking amongst employees as well as to go through (sometimes difficult) periods of change. The opinions of managers and employees as to what direction the company should take were thus by and large aligned, and therefore managers could count on the support of the employee representative in the supervisory board. As a result, managers worked closely with the works council and trade unions on issues regarding daily business as well as the strategic direction of the organisation. The dominant belief amongst all parties was that more can be achieved by collaborating with each other. The former Vice-CEO argues that such a relationship cannot be taken for granted because:

“There are countries where trade unions and the employers see each other almost as enemies, so there is a clash between ideologies, but here, we had never such a constellation, never, never ever” (Dirk, former Vice-CEO).

The relationship between the managers and trade unions at the organisation was generally very constructive, both sharing similar values and ideologies about the purpose and direction of the organisation. The perception of managers of the airport about the concept of co-determination and the role of the trade unions is illustrated in the following statements:

“It [co-determination] is positive for everything! From everyday cooperation to long-term development, co-determination... is a key value in itself- it allows employees to explore entrepreneurial action, makes it more transparent, and in this respect makes change more bearable for employees” (Dirk, former Vice-CEO).

“The influence of trade unions... was traditionally strong. From my experience, however, this was advantageous for both the daily business and for the long-term strategy; because employees, even in the supervisory board, always worked hard to positively influences the development of the airport... there was a very intensive collaboration” (Detlef, former CFO).

While co-determination made organisational changes for workers more acceptable, it did not prevent many changes or important decisions. Rather, the critical dialog with the employee representatives helped to improve plans of the management teams. This becomes clear in the statement of one of the executive managers.

“It is not that we cannot do certain things because we have co-determination, I cannot think of one single case where a decision failed to happened because of the employee representatives – but I can think of many cases where we had to some extent difficult and lengthy discussions with employee representatives which have resulted in alterations... but this was not a disadvantage” (Dirk, former Vice-CEO).

The liberalisation of the baggage handling market, the IPO of the airport and the required adoption of new accounting standards triggered radical organisational changes. First, since the IPO of the organisation, the perception of managers about the purpose of the organisation has changed. The re-orientation towards a shareholder value ideology was a prerequisite to legitimising changes in the working environment for the majority of employees. While in the past, the purpose of the company has been to provide infrastructure for society, the main goal now is to generate shareholder value. This was described by the former deputy CEO, Dirk who states:

“After privatisation, we have to see ourselves as an organisation, which has to make profit, and that we are in business to generate shareholder value” (Dirk, former Vice-CEO).

Managers explained that the partial privatisation put pressure on the organisation to increase their profits. For each division, profit goals are now formulated. According to the managers, a new understanding was created that each business unit must earn its cost, and that business units not creating value have no right to exist anymore. With the IPO, the interests of the investors became imperative for most managers, and international activities such as mergers and acquisition to achieve growth became of greater interest. The focus on profits has also lead to a new form of competition. The airport management now compares performance of the airport not only to international airports but to other listed companies. The goal is to create more value for shareholders than other listed organisations. This benchmarking is conducted globally within the industry as well as with listed companies in Germany.

“Benchmarking... was not too important, the airport did not produce a loss, we have always earned our money, and we never obtained subsidies, but the perception has now changed, and this is a cultural differences- to say, we are in

competition with the goal to generate shareholder value” (Dirk, former Vice-CEO).

While the IPO clearly puts shareholders’ interests at the centre of attention, there has also been a change in perception of the importance of the interest of other stakeholders. A manager reported:

“Well, the old organisational culture was that the airport had an element of public service, and the new culture is that the airport is a profitable object” (Stefan, Head of Training and Development).

While some managers still feel responsible for the region and employees, an increasing number focus solely on shareholder value. The former Vice-CEO argues that this is a general trend of society, influencing the perception of many young managers at the airport. Managers like him, who believe that interests of different stakeholders need to be balanced, are nowadays considered to be old-fashioned.

The two viewpoints about the purpose of the organisation are demonstrated by the following quotes: First, a manager argues that the purpose of the organisation is to serve shareholder interests:

“Strategy must... increase turnover, increase profits, and therefore create value. If not you should not be listed on the stock market. Of course a strategy of an organisation could be that you are socially responsible, that you care about the environment, and all such things. But in the end, this is all blowing air. Because, if you are oriented to 100% towards the stock market, like we are, than you have two contact partners, customers and investors. For them, you do everything. All the others, are hot air!” (Marc, Senior Manager, Finance & Investor Relations).

On the other hand, the old management team still follows a different ideology, which is well represented by the statement of the former deputy CEO, Dirk:

“The fundamental issue – is the shareholder value everything, or is there beside the shareholder value also an own interest for the organisation- it is the question whether the firm is more than the sum of its investors... anonymous investors at share market have only one interest, the increase of the value of shares and dividends ... but the organisation as such is an asset for the workforce, it is the basis for their living, job for dad and mum, and hope for a job for their children, ... the airport has a value beyond its market value” (Dirk, former Vice-CEO).

The change of the purpose of the organisation towards the shareholder value ideology has also increased managerial wages as the former Vice-CEO reports:

„Who really benefitted, is the Top management;, here the salary markedly increased- the ‘true winners’... are the executive managers and amongst them the second and third management level, because the new benchmark for wages and salaries was totally different for a public company... it became necessary to pay the management adequately” (Dirk, former Vice-CEO).

The work of managers is perceived to have a greater impact on the value of the organisation than previously as a result of their contribution to growth. Because good managers are perceived to be more valuable, they receive better wages under the new paradigm; this became evident in the quote of a member of the work council:

“They [managers] are in the focus of analysts and the public and this has to be honoured, when we hired a new CFO he immediately earned 125.000 more, ... the same as the CEO, who said, ‘I also would like to climb the stepladder’- but this guy was good... what would it bring us to pay 100.000 less, and then we have someone who brings us millions of loss” (Werner, trade union secretary, member of the supervisory board).

Employees, on the other hand, who are working in a business division where continuous growth cannot be achieved, for example because of the saturation of a market, are not considered to contribute enough to the value. A low value contribution of a business unit can result in a loss of its justifiability for existence. In the case of Airport 1, operating activities such as baggage handling did not lose their justification for existing in the group, because they are an integrated part of value creation. Some managers confirmed that they believe that it is important to keep control over these activities because of their importance for the success of the group. However, they also argued that they do not consider operating activities such as baggage handling or cargo handling economically viable within the listed parent company due to their high personnel cost and few opportunities for growth and innovation as a result of regulation. To solve the dilemma between low profits and maintaining control, the executive team decided after the IPO that employment for those activities should be shifted into subsidiaries.

5.2.4 Innovation at Airport 1

5.2.4.1 Shop floor innovation within the parent

Within the parent organisation, a goal is to facilitate shop floor innovation to maintain a high quality of organisational processes. The airport argues that quality is important to sustain a competitive advantage, and aim to achieve excellence in this area through innovation. For example, managers have pointed out that with constant innovation a highly efficient baggage handling system was developed that allows them to guarantee a minimum connecting time of 45 minutes to their customers; this is vital to their competitiveness. Their fast and efficient baggage handling is considered to be a trademark of the airport. A manager reports that within the area of baggage handling, a great potential for innovation exists.

“[The baggage handling area] is very innovative... the work is technical and process-oriented ... it is important that each task is performed timely, in the right order, and right quality... to deliver to our customer... that the aircraft is ready on time, and safe. ... And because of this process, many innovations are possible” (Sonja, Senior Manager, Ideas-management).

The importance of ideas from different hierarchical levels for organisational success was highlighted in the Annual Report 2007 (Airport 1, 2007).

“The input of our employees is also given top priority in the innovation process. This is an essential prerequisite for maintaining and increasing our competitiveness in a constantly changing environment. By encouraging a continuous improvement process, the Company can be steered on a strategic growth course through ideas and innovations”

Managers and union members alike report that successful worker innovations have been carried out during the last years.

“Recently, we had a good example in regards to stairs used for aircrafts suggested to us by employees... Often the battery providing lighting to the stairs goes flat at night. Workers came up with the idea to build in solar cells into these stairs which can charge themselves during daylight. This is cost-effective; it is environmentally friendly” (Sonja, Senior Manager, Ideas-management).

A senior manager emphasises that all employees, irrespective of their position are encouraged to think about how to improve existing processes:

“We would like to see that our people worry about the daily processes they are involved in... they should not be restricted in their thinking” (Dominik, Senior Manager, Management Systems).

Different motives that foster innovation and ideas from employees have been identified. First, financial incentives may facilitate shop floor innovation. Managers give due care that the legal process is followed for all inventions which are subject to the German Employees' Invention Act [EIA]. However, managers believe that the EIA does not go far enough, and financial incentives are also offered for ideas beyond the legal requirements.

In order to exploit the full potential of shop floor innovation, managers argue that financial incentives alone do not suffice. A genuine appreciation of innovative efforts is important to motivate employees to share their ideas. Managers publicly celebrate successful shop floor innovation within the organisation, for example by symbolic rewards such as a presentation with a 'big cheques sign', trophies and dedicated articles in the internal newspaper. Such rewards encourage not only others employees of the airport to communicate their ideas, but also raise awareness in both managers and colleagues that shop floor innovation is both feasible and valuable. Senior managers report that innovations are prone to be suffocated by the direct supervisor of an employee, and it is important to establish a culture in which supervisors have trust in the potential and capabilities of their inferiors to innovate:

"Part of the culture is to acknowledge innovation... the management must realize 'hey, we have potentials in our workforce'. ... So, we never should say, 'hey, you are just a baggage handler, you don't have to think about fuel cells'; this should never be our culture!" (Sonja, Senior Manager, Ideas-management).

Another manager reports that it is often a challenge to find a balance between the daily business that influences present performance, and the development of new ideas that influence future performance:

"It is important to stay competitive in the future, and we aim to be a step ahead of competition, and facilitating new ideas is an important cultural feature, and we believe in it... it is our task to constantly promote it" (Dominik, Senior Manager, Management Systems).

The value contribution of shop floor innovation for the organisation is also highlighted by employee representatives:

"In the year 1993 ... 'they called everybody together, the little baggage handler, the secretary or craftsmen, ... over 3000 suggestions were submitted... 1500 of the suggestion of 3000 were considered to be good... and this has resulted in around 88 Mio" (Dennis, Secretary, trade union).

“There have always been programmes within the organisation to include all employees in the process. ... The intention has always been to make use of the know-how of the employees, to optimise processes” (Werner, trade union secretary, member of the supervisory board).

Shop floor innovation significantly contributed to the success of the parent organisation in the past. However, one of the trade union representatives observed that employees performing operating activities are not encouraged to engage in innovation as much as in the past. He argues that initiatives for new ideas and innovation nowadays often focus on a selective group of employees, and particular employees from lower hierarchical levels are frequently excluded. He believes that innovation is now increasingly encouraged from people who are concerned with “thinking” and not “doing”. One manager supports this observation by pointing out that value creation for customers through innovation in ground handling is limited:

“Because basically, ground handling is not rocket science. There is nothing where we could change much... There is a lot of manpower. There is some innovation to make the work easier, like the device to lift luggage, there is room for improvement, but basically, there’s not much” (Wiebke, Senior Manager, Aviation Ground Services).

Whereas in the past innovation was fostered throughout all hierarchical levels, the importance of shop floor innovation has decreased since the IPO. Most employment has been shifted into subsidiaries, where people are not actively encouraged to think about better ways of doing things.

5.2.4.2 Shop floor innovation and the role trust

Managers of Airport 1 argued that in order to foster shop floor innovation, it is important to establish trust and commitment of employees. Trust is a particularly important prerequisite for employees to share their ideas. There is no direct link between trust and the capability of workers to carry out shop floor innovation, but a lack of trust can become a barrier for employees to communicate their ideas:

“It is important to motivate through appeals, or team discussions... To promote an open culture, open discussions, to debate for a better solution... but it always comes down to the basic element of trust- trust in the organisation, trust in the superior” (Christian, Manager, trade union member).

One of the greatest barriers for employees in communicating their ideas to their superior is a lack of trust. One of the responsibilities of managers is to establish a positive, trusting, relationship with their workers:

“The operating areas are very heterogeneous... Not everybody has the courage to come up with an idea, and sometimes a very good one, this is a barrier we cannot completely mitigate. But we motivate, inform and communicate, and managers must know by now, when an employee does not trust... the idea stays in his mind” (Wiebke, Senior Manager, Aviation Ground Services).

However, with the IPO, the majority of employees did lose trust in their employer. Organisational change and restructuring have led to uncertainty amongst the majority of employees, and as a result ideas and initiative are held back; innovativeness from the lower hierarchical levels has suffered.

„The culture changed. Some trust is lost... if employees realise that the company [the subsidiary firm] reduces certain social benefits that also influences the organisational culture [of the parent]. Open discussion is reduced. ... Employees hold back ideas, enthusiasm and innovation... Know-how is lost and motivation has suffered” (Christian, Manager, trade union member).

Three themes have been identified which are used by the management team of the parent company to establish trust, namely an employee-oriented organisational culture including the well-being of employees, opportunities for training and development, and commitment. In the following discussion, differences between these factors will be discussed for the parent organisation and its subsidiaries. It will become evident that these themes are less important within the subsidiaries because of their focus on efficiency. Managers believe that at the level of subsidiaries, limits exist to the carrying out of shop-floor innovation. Therefore, a strategy focussing on efficiency and lowering cost is pursued. In contrast, within the parent organisation, innovation throughout all hierarchical levels is encouraged to improve quality.

5.2.5 Differences in the working environment between the parent and subsidiaries

In the context of the IPO and liberalisation, the parent company has shifted operating activities with a low potential for growth and innovation into subsidiaries. Processes which are believed to have a high potential for innovation, growth and profits on the other hand, remain the responsibility of the parent company. Shifting jobs into subsidiaries resulted in a separation of the daily business from the development of innovation. This separation has

triggered a division of the cultural and working environment for those performing operating activities within the subsidiaries and those employed at the parent organisation, which will be discussed in the following.

The founding of 100% owned subsidiaries made it possible to diminish cultural changes within the parent organisation. The restructuring did not so much happen within the strategic division of Aviation Ground Services of the parent company, but within the newly founded subsidiary. The majority of new staff performing baggage handling services are employed in this subsidiary.

The concept of employing staff performing operating activities in subsidiaries instead of the parent company, however, is not restricted to the baggage handling area; another prominent example includes aviation security services. To illustrate this, a contract to perform these services was recently given to the parent company by the German Government. The parent company subcontracted some of the services to a subsidiary (subsidiary c), which is the subsidiary of a subsidiary (subsidiary b) which is 100% controlled by the parent company (Airport 1, 2006). This practice allows the parent organisation to reduce personnel cost for these services while at the same time keeping full control over them. Control over the quality of these services is important because their quality is considered to have strategic importance for the success of the airport, outsourcing was not considered as an alternative. To solve the dilemma between low profits and control, the employment of workers performing operating activities such as baggage handling has been shifted into subsidiaries.

It is interesting to note that on the 1st January, 2007, the executive team of Airport 1 further restructured its security business. After the restructuring in the context of the IPO, all security services, including those at Airport 1, were performed by the German branch of an international subsidiary that was wholly owned by Airport 1. The employment of the security services at Airport 1 was transferred into its own, newly established subsidiary, which is again 100% owned by Airport 1. Three thousand employees were transferred from the international subsidiary to the new, which is directly under the control of the parent organisation (FAZ, 2007). Soon after the restructuring of the security business, the managers of Airport 1 announced that the international subsidiary, including its German branch, to be sold in 2008 (Analyst presentation, Airport 1, 2007). The managers argued that while the area is profitable, the area 'security' does not belong to the core business of the holding

(rheinmain.net, 2008). However, maintaining the employment of security workers at its home base seemed to be of strategic importance.

Cultural differences exist between the parent company and its subsidiaries. The culture of the parent company has been, and still is, heavily oriented towards the needs of its employees. An employee representative describes the organisation as “an organisation with worker participation, but also of social conditions”. Worker participation and co-determination are integral parts of the organisational culture. It is still important that the employees are satisfied with their working environment, and concerns about the well-being of the employees are embedded in the culture:

“We are a service company, and very concerned with our employees. A big percentage of our added value is carried out by our employees and as a consequence we strongly focus on the education of our employees. This is very strong here” (Dominik, Senior Manager, Management Systems).

Wage levels are an important element of employee oriented culture. Historically, the employment contracts for the parent company are subject to the pay scale of the civil service, which is quite attractive compared to agreements in other industries. A trade union representative reports:

“The money one can earn here is very good, plus we have a pension fund which is fabulous... This is quite considerable!” (Dennis, Secretary, trade union).

Furthermore, employees of the parent organisation receive additional financial benefits as managers and employment representatives report:

“Employees have a direct stake in the profit; in the form of a performance based bonus... I think we have a quote of 98% of the employees who directly participate from their performance financially” (Dominik, Senior Manager, Management Systems).

“We are benefitting from a good profit. This year we received vouchers valued 500€ for shopping, for travelling... this is an additional benefit on top of the salary” (Karl-Heinz, member of the works council).

While employees of the parent organisation enjoy attractive wages, the situation differs for employees of subsidiaries. The organisation aims to uphold the image of providing social benefits to all employees of the group in order to maintain a positive image of itself within the region. This goodwill of the people of the region is important for the airport, some managers pointed out. Due to negative externalities including noise the organisation

negatively impacts on the living conditions of people in the area. To balance this, managers aim at establishing the image of a socially responsible organisation. For example, managers highlighted in a press release that one of its subsidiaries offers many social benefits to employees, including competitive hourly rates, free parking and reduced rates for the food court. Highlighted are the collective agreements that have been established for all subsidiaries demonstrating the organisation's "social responsibility for its employees" (Airport 1, 2005). However, the wage levels of these agreements are very low, and additional benefits are not available for all employees of the group. The main motive for establishing subsidiaries was to shift future employment into subsidiaries paying lower wages:

"We did not transfer employees to the (subsidiary), but we do not take on new employees. And if we now need additional employees, we take them on in the (subsidiary). So, it was not an outsourcing, it was a newly established business to employ people..." (Wiebke, Senior Manager, Aviation Ground Services).

The subsidiaries then lend employees to the parent company, employees of the parent company, and the subsidiary:

"Our own 'subsidiary organisation' makes around 1000 employees available to us, which are working together with our employees in the parent company on the apron area... a vehicle to reduce the personnel cost in the long term" (Wiebke, Senior Manager, Aviation Ground Services).

Lower wages at the subsidiary level are justified by their perceived lower value contribution, their lack of potential for innovation, and by benchmarking of wages against competitors. The wages of the parent organisation are no longer justifiable for operating activities due to their relatively low value contribution. For example, the largest customer pressurised the airport to reduce prices by 20% for baggage handling services (FAZ, 2007). Second, managers argued that wages are benchmarked against those paid by competitors. The third-party handler who entered the market competes on the basis of lower cost, and paid considerably lower wages. In a newspaper article, the former CFO reported that personnel costs at the parent organisation in this area are between 25-30% higher than those of the competitor (FAZ, 2009). In 2004, after the third-party handler entered the market, the parent company lost about 20% of its market share (Templin, 2007). Consequently, as a result of decreasing value contribution and competitive pressure, the management team argued that it became necessary to reduce personnel costs.

Personnel costs cannot be reduced within the parent company because its employees enjoy ‘Besitzstandswahrung’. This means that it would be discriminating to employ existing employees under a poorer salary than previously. Also, the wage agreements for employees of the parent company are subject to the civil service. By shifting employment into subsidiaries the group circumvents contractual wage agreements of the parent company by negotiating different collective agreements, as an employee representative explains:

“Within the subsidiary, different wage agreements are negotiated. This means that the relatively good tarif agreement for the parent company is not valid in the subsidiary. ... The differences between tarif agreements are enormous, sometimes 15-20%” (Werner, trade union secretary, member of the supervisory board).

“We have employees employed at the level of the parent and we have employees at the level of the subsidiary doing the same jobs. But the wage structure is different” (Karl-Heinz, member of the works council).

Union members point out that collective wage agreement on the subsidiary level is very low considering the high living cost of the region, and that there is an urgent need to bargain for better wages. For example, a union representative points out that the wage level of the collective agreement for the subsidiary performing security services is aligned with the collective agreement of the security services industry, which is the “lowest level”. The minimum wages for the services industry was in 2011 increased to 7.50€ hourly from the 01.06.2011 (Tarifvertrag zur Regelung der Mindestlöhne fuer Sicherheitsdienstleistungen, 2011).⁴

Because of the low wage, employee representatives criticise the management. One member of the works council point out that the wages paid in subsidiaries are not significantly higher than the social benefit one who is unemployed would receive:

“Families are suffering due to the financial situation of subsidiaries... I believe the airport as an employer has a social and general responsibility, to not allow that employees here are suffering. And it is bad that if someone who works here just earns like Harz 4 [social benefit], and even needs to receive a subsidy because he or she is not earning enough, this should not be” (Karl-Heinz, member of the works council).

⁴ To compare, Jansen (2005) argues that based on the law on posting of workers for the building industry, that the actual minimum wage in West Germany for unskilled workers was 10,36 € in 2005. In 2007, it was controversially discussed in Germany whether a minimum wage of 7.50€ should be introduced (Bispinck & Schulten, 2008), while minimum wages in other European countries were for example 9.08€ in Luxemburg, 8.27€ in France and 7.96€ in the UK (Bispinck, 2007).

Some of the managers at the airport recognise that the wages for those activities are low.

“These might be simple activities, but a remarkable amount of competence is needed- even so it is badly paid. And there is a yawning gap of course regarding the payment structures, this has changed” (Stefan, Senior Manager, Human Resource).

The division between the financial rewards of the parent organisation and its subsidiaries clearly show that perception of the value contribution of operating activities such as security and baggage handling has changed since the IPO and the liberalisation of the market. Managers and employees working on the level of the parent organisation in areas that contribute towards shareholder value typically benefitted financially from the IPO. However, the perception of the value contribution of employees performing operating activities has decreased, which is reflected in the financial rewards.

Social benefits and the relationship between managers and employees differ between the parent company and its subsidiaries. In order to be attractive and gain the wide acceptance of employees, the management team of the parent company provides different benefits to its workforce. Trust and commitment are integral parts of the organisational culture of the parent organisation. Commitment and trust are mutually dependent, and also influence the innovativeness of employees. Only employees who believe that they have opportunities in the organisation in the future, and are satisfied with their working environment, will share their ideas:

“Innovation always requires that the existing employees are satisfied... It does not just happen for honour, it happens because one wants to, and has to, earn money. But it is always also based on this basic principle. ‘I am happy here, and I contribute to this organisation because I see a future for myself here’ (Christian, trade union member, Manager).

Thus, managers communicate to their employees that they value their ideas.

“This also means to take people seriously. To give them the opportunity to contribute” (Werner, trade union secretary, member of the supervisory board).

In the parent company, commitment towards employees has been and still is very high. In 2000, the annual report of the organisation states “[a]t (the parent company), there is a longstanding tradition of cooperation based on trust among employees, staff representatives, and corporate management” (Airport 1, p. 14). Part of this tradition is also the promise of the executive team to avoid employment termination if possible. The long term commitment of

the organisation to all staff was stressed by a manager in the area innovation management who stated:

“We aim to commit our employees to our organisation for as long as possible. And we have very long periods of employment here at the organisation. Many employees are here for their whole life... we have a very low fluctuation in most of the areas” (Sonja, Senior Manager, Ideas-management).

In order to enable workers to remain longer in operating activities and to improve their health and well-being, the parent organisation provides physiotherapy and a gym. Furthermore, employees of the parent organisation who are not capable of performing physically demanding jobs anymore, have the opportunity to stay employed within the company. This practice was, according to a union representative, very common in the past for employees of the baggage handling division. After years of physically demanding work in the area, exhausted employees were transferred to the security area to perform lighter work. While these employees often earned less money after their transfer, they still had a ‘home’ within the organisation. The opportunity for on-going employment shows a high commitment and responsibility of the parent organisation for its workers.

This kind of commitment is absent within the subsidiaries. The working environment is described by an employee representative: “We have high fluctuation, high sickness and temporary employment contracts of only two years.” First, the organisational structure of the group makes a commitment for long-term employment impractical. One employee representative explained that it is not possible to transfer less physically able employees from one subsidiary to another. Each organisation is responsible for its results, and has no incentive to take on less physically able employees from the group. Furthermore, there is no responsibility for the long-term well-being of all employees because of the focus on efficiency. Employees who cannot perform a certain activity anymore due to physical problems simply have to leave the company. The focus on economising on cost is not compatible with taking responsibility for the long-term employment of people. A manager explains the implication for the long-term perspective of employees, while an employee highlights societal consequences of temporary employment:

“But what does not work is a person staying in the same activity involving heavy physical work, because they cannot bear this for a whole working life. In the past, it was assumed that jobs should be mixed regarding their demands, but today it is understood that for the low-skilled hierarchical levels temporary

contracts are made, and then the whole team is replaced” (Senior Manager, Human Resources, Stefan).

“The employment was initially temporary for two years... and the employment agency complained that almost nobody was taken on... They [subsidiary] abused the system because they benefitted from government subsidies... Employees were typically provided by employment agencies and received wage subsidies. Within the subsidiary... for some workers the firm has to pay almost no wages” (Karl-Heinz, member of the works council).

Employee representatives are concerned about the health and safety of workers within subsidiaries. Employees within the subsidiary often report long hours without breaks and little care about their well-being. For example, employees who worked at a check-in counter were then required to immediately perform activities outside the building. Some of the workers reported that they were wearing only thin blouses. Others had to work long hours without breaks:

“And the people had to stand there (on the control check) over 6 hours without a break when I said, ‘now I will involve the authority for health and safety protection at the workplace because some people fainted’; they could not stand the pressure anymore... this was terrible” (Karl-Heinz, member of the works council).

Other differences in the working conditions involve work-life balance. The parent company is very concerned to create a workplace for their staff which allows a good balance between working life and family life. Employees within the parent company typically enjoy a relatively long holiday entitlement. The parent company recently won an award for being a family friendly organisation from the Ministry of Family Affairs. Criteria for this reward included factors such as family-friendly working hours. Employees are generally very satisfied with the working environment within the parent company, and the organisation is highly regarded as employer, something highlighted by both employee representative and managers:

“There was always a responsibility for employees ... in the area of training and education. ... To achieve family-friendly working hours. ... We have a kindergarten... This does not always work out from an economic perspective, but it pays off regarding the working atmosphere” (Werner, trade union secretary, member of the supervisory board).

“Employee satisfaction is very strong here, and we are proud of this culture. We have a kindergarten... employment security... work and safety is important, the identification with the organisation... we value our employees highly” (Dominik, Senior Manager, Management Systems).

“The whole workforce had a lot of privileges... holiday entitlement, ... we built a gymnasium, recreation facilities... a job ticket... The working hours were relatively human...” (Detlef, former CFO).

On the other hand, interviewees reported that conditions for employees in the subsidiaries differ significantly. Here, employees encounter difficulties in coordinating their working life with their family commitments because rosters are handed out at short notice, and have very little influence on whether they have to work morning or night shift. Others criticise that it is difficult to get time off for family celebrations, such as weddings. Union representatives stress also that social benefits within some subsidiaries are very low, and that employees would appreciate the opportunity of reduced parking or food court rates. An employee representative believes that the management lacks social skills:

“There are differences, for example the duty rosters are handed out on short notice, establishing of subsidiaries happened very fast, and we don’t have the same social competence within the management team...” (Karl-Heinz, member of the works council).

He further points out that workers are treated poorly within subsidiaries:

“I am here now for 23 years; I have always received my salary on time, and I have always been treated fairly; I always enjoyed my work here, but at the moment the pressure to perform is getting very strong because as a member of the works council I see many employees suffering” (Karl-Heinz, member of the works council).

Because of the low wages and poor working conditions, subsidiaries are increasingly facing problems in attracting workers. Many of the workers need to take on additional jobs to support their families due to high living costs in the region. As a result, people performing these activities are often overworked, and the quality of the services suffers. Not only do union representatives argue that subsidiaries are recently encountering problems in acquiring good potentials, but also the Head of the Human Resources. He explains that staff employed in security need to pass a test to be eligible to perform control activities.

“Just within this year, the number who failed the test increased from 10% to nearly 17%, just from January to May, and this trend continues... we are getting different potentials from the labour market- weaker potentials” (Stefan, Senior Manager, Human Resources).

The IPO has led to a change of the cultural environment for those who are performing operating activities in subsidiaries. On the one hand, the people oriented culture of the parent organisation is maintained for those employed in the parent as well as for its new staff. New

staff employed at the parent typically includes managers and highly skilled workers. But such positions are growing scarce for workers performing operating activities, who are now employed in subsidiaries. The change in the working environment was summarised by a member of the executive team in the following statement:

“For the majority of the employees, to express it with a communist expression: for the working class, life has definitely become harder, more pressure to perform, more pressure towards wages and salaries, outsourcing of parts of the business to gain acceptance for different wage agreements” (Dirk, former Vice-CEO).

Almost all managers and employment representatives believe that the increasing pressure for lower hierarchical levels is a necessary consequence of the liberalisation of the market. For example, for the baggage handling area, the separation of the activities led to the perception that this area is not profitable. One representative of the shareholders explains:

“Within subsidiaries working conditions are different compared to the parent organisation because some activities now encounter competition due to the European legislation, the competitor is working with cheaper labour, and then you can only keep up if you shift those activities... each segment must be profitable in the long term” (Werner Member of the Supervisory board, Shareholder representative).

However, one member of the executive team responded to the question of how the increase of competition has influenced the strategy of the airport, with the following quote:

“It (the competition) did not affect our strategy regarding the airport in any way but we could perfectly use the change of competition to put pressure on our employee they did more, they did better you have to or else we will fall down - so one can use such situation of competition to force motivation of employees” (Dirk, former Vice-CEO)

The practice of shifting activities into subsidiaries to rationalise on cost is not restricted to areas which encounter competition but also to other areas such as security. This shows that competition by itself is not necessarily the driving force behind such strategy. A people oriented culture still maintained at the parent organisation is not considered to be economically viable for people employed in the subsidiaries who create little value and have limitations in carrying out innovation.

The strategy within the subsidiaries has changed from striving for quality innovation, to economising on cost, while maintaining an acceptable level of quality. The aim to rationalise cost has significantly changed the working conditions for people performing

operating activities. Changes in working conditions for these activities have been legitimised by the shareholder value ideology. The old understanding of the purpose of the organisation prioritised the well-being of employees. Furthermore, managers believed that value is created collectively. The reimbursement of employees depended on their qualifications and length of employment, irrespective of their actual value contribution. The change towards the shareholder value maxim and IFRS accounting changed the way in which managers and employees are reimbursed. There is now the perception that value is created by individuals, and that there should be a link between a person's reimbursements and their value contribution for the organisation. Managers are considered to have a central role towards the value creation of the airport.

5.2.6 The importance of training

The change of goals has important implications for the use of high-skilled people and training, which will be discussed in this section. Training is a central concept for innovation. It plays a direct role in the capabilities of employees and managers to carry out innovation, as well as an indirect role because it is important to establish commitment and trust.

Firstly, training and continuing education are of strategic importance for the parent company (Airport 1, 2001), two separate units providing training opportunities for employees and managers, namely the Airport Academy and the Airport College. While the Airport College exclusively offers training to employees of the parent company, the services of the Airport Academy are offered to all managers of the group (Airport 1, 2004). The Airport College is mainly concerned with the initial training of employees, including occupational training in accordance with the education law and dual courses of study. The organisation provides 110 training places for 22 different occupations annually.

Basic training is an important foundation for the ability of tradesmen to innovate. A manager who underwent vocational training himself explains:

“My background is a technician tradesman. You learn early in your apprenticeship training that innovation, development and looking for improvements are part of the training. ... It belongs to the philosophy of a tradesmen and technician” (Christian, Manager, trade union member).

Also continuous training fosters new ideas. A manager argues that its provision helps to create a culture which fosters new ideas and enables innovation:

“This (training) plays a very important role, this begins with the willingness and capability to contribute... to realise, everybody can, is allowed to and should ... think beyond his or her direct area of responsibility... and we invest a lot in the qualification of employees in all hierarchical levels” (Sonja, Senior Manager, Ideas Management).

Within the parent company, further education is offered to employees throughout all hierarchical levels:

“Further education happens in all areas... we have a polished programme for business management training, certified training in areas of human resources, traffic... for special airport related areas, including baggage handling areas” (Stefan, Senior Manager, Human Resources).

“We offer ... qualifications for all levels... everybody here has the opportunity to go one step further, ... and sometimes one may be surprised to meet an employee, who did 5 years ago a very simple physical activity, and... who developed the potential to be innovative” (Sonja, Senior Manager, Ideas Management).

Within the parent organisation is a belief that innovation can come from all hierarchical levels. However, for the subsidiaries, the goal to carry out shop floor innovation is no longer relevant. The main objective is to economise on cost, and training is offered only to managers. The reduction of training is to a large extent the consequence of competition. The introduction of competition has changed perceptions about the standard of training necessary to perform the job. In the past, employees working in baggage handling, for example, were well respected as skilled tradesmen, and also paid adequately. For them, a very high standard of training was desired because the goal was to further develop capabilities.

With competition, the perception of the required training changed. Nowadays the focus is to provide sufficient training to perform daily business, and reduce training to a minimum to save cost. The objective is to maintain a certain level of quality with the lowest skilled workforce possible. In other words, the changing paradigm from developing new capabilities to efficiently performing the daily business changed the purpose of training:

“Training and education have become tighter, definitely shorter... the baggage handling area is using employees from the subsidiary to reduce cost where programmes are even denser. The focus is on what an employee needs for the direct action, and not what one needs for his or her development – it is based on

the concept that these people are leaving the organisation; there is fluctuation” (Stefan, Senior Manager, Human Resources).

“There is the attempt to reduce personnel cost, and therefore the effort to shift activities to employees, who have not received the full training” (Dirk, former Vice-CEO).

“Know-how is lost, and to some part efficiency, because employees hold back, the motivation has suffered, and I don’t believe that this will serve the process in the long term. Something is lost in the first years after the founding of a subsidiary” (Christian, trade union member, Manager).

Investments in training and know-how negatively affect the short-term profit goals. One of the union representatives feels that managers are putting greater emphasis on producing shareholder value than to sustaining capabilities. Others, including some managers, believe that the training necessary to secure existing capabilities is to some extent reduced to enhance short term profits.

Until now, negative consequences for the deskilling of the workforce can be mitigated by highly skilled people employed in the parent company. Employees of the parent organisation and subsidiary are working together in teams and quality can be maintained by a mix of people. While workers of the subsidiaries are performing relatively simple tasks, workers of the parent organisation bear the responsibility of the process and perform more difficult tasks. There is empirical evidence that a high quality of services is still maintained at the airport (Templin, 2007).

However, some have raised concerns about the long-term consequences of the deskilling and believe that over time, knowledge and capabilities will gradually be lost and negatively affect quality of the services. For example, a union representative reported that the management team failed for two years to take the planning for personnel in the security area seriously. Warnings from an employee representative that qualified personnel are becoming scarce have been ignored, and only after actual problems occurred, in delays of connection flights, did managers become aware of the decrease in qualified personnel.

There is a different perception among managers about how the reduced investment in training will affect the airport. The newer generation of managers, who were trained externally and lack a deep understanding of the processes of the airport, tend to advocate the deskilling to realise cost saving. An employee representative explains:

“And it always comes back to the point- I say it in my words, this person does the job — for 2.50€ and not for 10.50€ or 17€, or so. The non-expert, the one who was hired... on the external market for managers, who has not been educated here from the scratch... simply says... why do we need those? There are others which are much cheaper... why do we need to these expensive people?” (Dennis, Secretary, trade union).

At the same time, this group is increasing:

“In the past, we said ‘you need to understand how the airport operates‘ but this is not relevant anymore, for those who are working to buy or sell airports, it is firstly important to understand how to evaluate the target, how to negotiate. And you need completely different qualification then to understand airport operation... and for that reason, during the last seven years we really replaced the whole team” (Maja, Senior Manager, Global Investments & Management).

In contrast, the older generation of managers, who worked their way up through the ranks, tend to have a good understanding about the processes. These managers usually consider tacit knowledge that has been developed through training as being valuable for quality, and to have a higher appreciation of the work. For example, the former deputy CEO started working at the airport throughout his university studies in baggage handling. He is personally attached to the airport because of his long-term engagement and commitment to the airport organisation:

“I have always been ‘airport’, and in this respect, the organisation has a different value for me, it is not just an employer, where I did just a job, and earned really well in the end - for me, it is a part of my life” (Dirk, former Vice-CEO).

Within the parent, training and education is also a means of gaining the trust and commitment of employees, which in turn influences their motivation to engage in innovative activities.

The link between training and commitment has been explained by a manager:

“Of the 67 who finished (the dual study course) ... 60 are still employed in the organisation, and this demonstrates the commitment of these self-produced potentials - it is considerable higher... And the Head of the commercial training department, he has his 25 year- firm anniversary and basically he had 850 young trainees, and of those around 70% are still employed within the organisation” (Senior Manager, Human Resources, Stefan).

Training is important to motivate employees within the parent organisation, and for their well-being. Employee representatives and managers alike pointed this out:

“If I... participate in training, than I have perspectives here, and a chance of promotion, there is a closeness with the organisation... many people are here for 30, 35 years, und recently we had one, I think he was employed for 37 years in the organisation, and had not been sick for a single day” (Karl-Heinz, member of the works council).

“There is quite a bit (offer for training and development) that the organisation is doing to be attractive for employees” (Dominik, Senior Manager, Management Systems).

Finally, the provision of training, and in particular for young people, is considered to have huge social impact for the region, and is an element of a socially responsible organisation. The parent organisation provides a surplus of training to young people, and specifically for disadvantaged young people, to enhance its reputation within the region:

“Since privatisation there is a greater need to economise on cost, and the training programmes are also affected by the general need to save cost, But... we have continuously built up our capacity to provide training and education... it does not suit a privatised listed company to provide more training places then required - but we provide this” (Stefan, Senior Manager, Human Resources).

“[Training] This is done to maintain a good image within the region. It may sound a little bit corny, but there is a need to maintain a good relationship with the local politics, with the population.” (Werner, Member of the supervisory board, employee representative).

It is of interest to note that while the parent organisation is providing training and learning opportunities in order to gain acceptance within their region, and improve their image within their region, it does not feel obliged to promote training and education within their 100%-owned-subidiaries. These are not in the focus of the region, and the argument of cost is here stronger than that of responsibility for the region or the need of training to foster innovation. Managers within the subsidiary neither aim to commit employees to its organisation nor feel responsible for the well-being of employees. One manager and union member states:

“This is a problem within the subsidiaries. Education and training is markedly reduced compared to the parent company. We as work councils are permanently confronted with the argument of being economical, the resources are not available, and also people could not be employed permanently, even if they would be trained, and so on, This is for us very unsatisfactory..., the training culture is very poor” (Christian, Manager, trade union member).

Finally, within the parent organisation, the provision of training and education is perceived to be the responsibility of the employer, who also bears the costs of training. Employees of subsidiaries, however, are required to obtain basic qualifications externally. To be eligible to perform security checks at the airport, the Aviation Security Act requires a person to attend 160 hours of basic training followed by a rather difficult test with high failure rates (Berliner Zeitung, 2006). Previously, training was provided to existing employees during employment. Under the new model, the subsidiary pays for the training itself, but does not guarantee employment until the training has been successfully completed. Because the employees do not receive a wage, the costs for training are further reduced for the organisation. These costs are instead shifted to society because the social welfare department or the job centre bears the living costs for these workers.

“They have cunning way of doing this, this has changed, too. Before they get hired, they need to acquire the qualification, the subsidiary pays for the training, but they don’t receive (a salary), they are not yet employed; the passing of the training course is a condition for employment” (Stefan, Senior Manager, Human Resources).

Subsidiaries partially transfer training cost to the government or to potential employees by requiring that potential employees acquire highly firm-specific skills in their own time. The airport does not bear the full cost of training anymore.

5.3 Results for Airport 2

5.3.1 Brief history of Airport 2

The airport was founded in 1911 as a limited company (GmbH) and the operation of the airship hangar began in 1912. In 1953, the city decided to improve the facilities in accordance with the needs of the airlines, and invested about 12 million DM (German marks) in a new aircraft hangar. In 1959, a second runway was extended to enable a fully laden jet to take off. Increasing passenger numbers made further extension of the airport necessary, and by 1969, the facilities were adequate to handle up to 4 million passengers annually. During the 1980s facilities were improved continuously, including investments in two new terminals. During the last decade, passenger numbers have increased markedly and in 1987, the airport handled over 5.4 million passengers (company webpage, 2010).

Until 2000, the airport was 100% publicly owned. The majority of the shares belonged to the city-state in which the airport is located and the remaining shares to the Federal Republic of Germany and the Federal State. Since 1982, the partial privatisation of the airport was discussed, but the final decision was made only when the financial situation of both the Federal Republic of Germany and the Federal State deteriorated. In 2000, both the Federal Republic of Germany and the Federal State sold their 36% shares to a private consortium (Dummann, 2005; Wolf, 2003) for 540 million DM (approx. 270 Mio. €) (Dummann, 2005). Today, 51% of the airport is owned by the airport's city state and 49% by a private investor (IHK, 2010).

5.3.2 The trigger for restructuring

Major restructuring of the airport began with the outsourcing of freight services in March 1993. The managerial directors wanted to increase the efficiency of freight, and hired an external consultant for advice. To the surprise of the managers, the external consultant suggested completely outsourcing the freight area because of its incompetence. This was further advocated by customers and interest groups because of its poor quality. In contrast, employees' representatives strongly opposed the outsourcing plans, as a manager reported.

“This was very tough. It was, with respect to the trade union and the work council, literally a hateful thing. There have even been threats” (Dietmar, former Head of Controlling).

Despite strong opposition from employee representatives, managers did outsource freight services in 1993. In March 1993, one month after the outsourcing of the freight services was completed, the CEO's received the preliminary draft of the Council Directive (which later became the Directive 96/97) about the liberalisation of the baggage handling services. A manager remembers being approached by the managing director.

“EU officials proposed a preliminary draft for a Council Directive, which was sent to CEOs of various airports... And our managing director... said “Folks, now, it is getting serious. Competition is coming!” (Dietmar, former Head of Controlling).

The preliminary draft on the potential liberalisation of the baggage handling market fundamentally changed the assumptions of the airport managers about the future structure of the industry. With this document they believed that competition in the airport industry was

feasible. The managers perceived two strategies as to how to respond to the preliminary proposal. First, they could try to prevent the liberalisation by lobbying against the Council Directive. Second, the airport could anticipate that competition would develop and prepare itself for it. After internal consulting, managers at the airport were convinced that liberalisation could not be prevented, and decided to prepare the organisation for upcoming competition. They developed a concept to further outsource a range of activities including baggage handling. This time, the management team decided to keep control over the outsourced activities, and established fully controlled subsidiaries.

Outsourcing of different activities was an opportunity for managers to prove their ability to successfully manage organisational change. The failure of the freight area came as a shock to them. They were not only surprised how much the quality of the freight area lagged behind the industry standard, but also felt responsible for its failure. Therefore, the plan to undergo further restructuring provided an opportunity for them to prove their managerial capabilities, and to redeem themselves as successful managers. According to one, they “instrumentalised” the Directive to legitimate changes:

“When Brussels decided to liberalise, it only affected us here because we instrumentalised it, to make changes happen” (Dietmar, former Head of Controlling).

However, the view that the liberalisation was not preventable was not shared by others. Both the works council of the airport and managers of other German airports decided to lobby against the liberalisation of baggage handling services, and other airports funded expert reports which also opposed it. Their main argument was that the opening of market liberalisation was not feasible due to security issues and capacity constraints. Schmidt S. K. (1998) pointed out that even the German Government supported the position of the airports and offered strong resistance to the Council Directive. A manager summarises the different positions of the managers and trade unions:

“The work council took the side of the opponents of the outsourcing and did not want to give in to the Directive... Other airports collaborated with trade unions. But while they fought against the Directive, we prepared for it” (Dietmar, former Head of Controlling).

The restructuring at the airport was enforced upon employees and, the relationship between managers and employees became very difficult. The former CEO remembers that one of the employees told him a few years later, that he was the most hated person at the organisation

during this time. Changing the culture of the employees to be more market oriented was difficult:

“This was the most difficult part. To convince the people, who make this organisation what it is. It was the most difficult part, but also the part which I enjoyed the most” (Rüdiger, former CEO).

Further resistance towards the changes came from other German airports. Because of their positive attitude towards the Council Directive, the managers were bullied by other members of the industry. For example, a manager who represented the executive managers at a hearing about the liberalisation remembered the meeting:

“The president of the German Airport Association sat next to me when I put my hands up to share my view he [said]: “I forbid you to speak here. You are here at a meeting from the German Airport Association” (Dietmar, former Head of Controlling).

A manager explains why the former managing director of the airport received much critique from other managers:

“He [managing director] was reprimanded by many, because he behaved in this way... and simply did not participate in this policy prevention. ... Other airports had the view that our behaviour damages their position. ... One breaks out of the collective defence lines and also demonstrates: it is feasible. And still to claim... this cannot be done, of course, became absurd” (Christine, Manager, legal department).

Because of their divergent view about how to respond to the upcoming Directive, the airport took the role of an outsider in the industry. This role even motivated the embracing of change and the overcoming of the commonly held belief that public servant managers are conventional and sluggish. The resistance of the other airports thus helped to develop a culture for change:

“This... isolated us. But it also made us strong. We felt we were special. ... And this fostered a spirit amongst us... it was fun. It was very hard, but it was fun, something new” (Dietmar, former Head of Controlling).

The managers successfully restructured the airport despite resistance from both the industry and their employees. Managers actually enabled the liberalisation because they undermined attempts of other airports to lobby against it by demonstrating that the introduction of competition was feasible; they regained their identity as successful managers. They stood out from other managers of the industry, and enjoyed this position. They considered their action

as entrepreneurial and capable of adopting changes. On their way to success, managers tried hard to demonstrate to their external customers that they did not need to abuse their monopoly power in order to survive. For example, a manager remembered that even destructive decisions were made in the past to demonstrate that they are capable of achieving cost reduction without acting monopolistically:

“We have not raised prices, because this would be what a typical monopolist would do. This was very important, because we could not sell this to our customers. We were in a tragic situation. And to be honest, we just stopped to repair and maintain our facilities” (Roland, Senior Manager, Head of Controlling).

About five years after the restructuring, the approach of the airport to establishing independent subsidiaries was an accepted role model for the German industry. The model is now even called the “CityX- model” within the German airport industry⁵. Also, the airport was the first German airport to voluntarily implement price-cap regulation, putting pressure on them to lower starting and landing fees.

Managers unanimously agree that major restructuring was completely unrelated to the partial privatisation of the airport. Decisions for major restructurings were made, and for the most part also completed, before the change of ownership as the former CEO explains:

“Some parts of the restructuring have been made after the privatisation. However, there was in fact no causal relationship. One can also design an organisation entrepreneurially when it is publicly owned” (Rüdiger, former CEO).

However, it has been argued that the partial privatisation was very helpful in carrying out the organisational restructuring. With the involvement of the private investor the need for change could be communicated more convincingly:

“The role of the owner is more clearly defined making it easier to get through with certain... concepts because we can refer to the private investor – having a public owner, we cannot say to employees... “Look, the owner would like to have the following profits next year”- nobody would accept this... But if a private investor puts a few millions on the table it is becoming more plausible. And this helped us, to push through our business concept” (Roland, Senior Manager, Head of Controlling).

⁵ The name of the city cannot be disclosed. It is the city in which the Airport 2 is located.

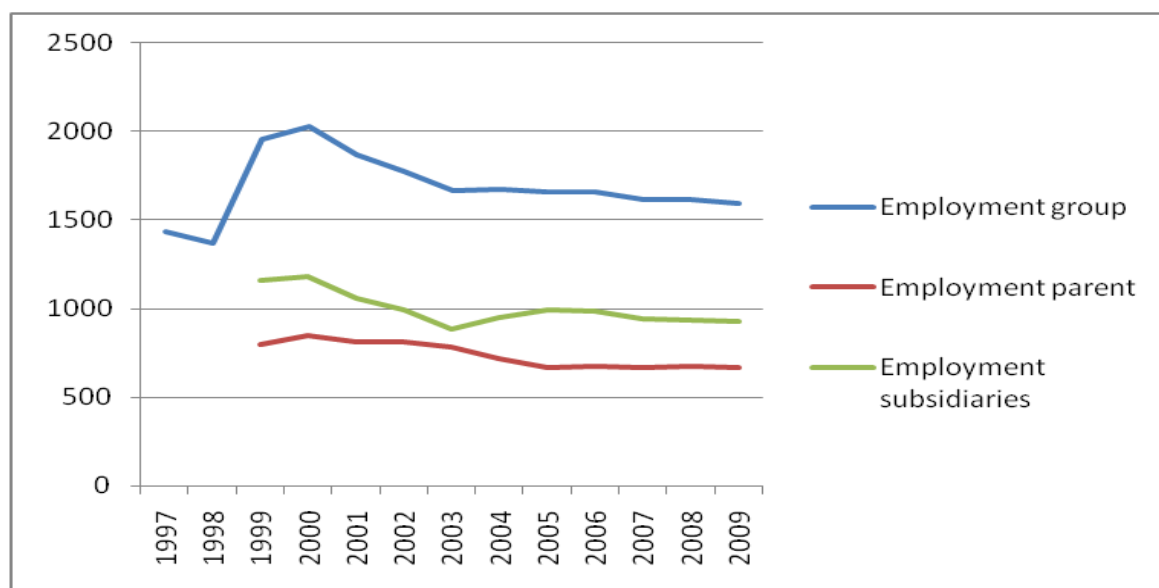
Looking at the story of the organisational restructuring, it becomes obvious that managers developed the skill to turn changes in the institutional environment to their advantage. Specifically, managers of the airport used the environmental upheaval in an instrumental way to legitimise internal restructuring. The concept of competition was used to justify changes in the working conditions of employees, which will be discussed in detail in the following, and differences between the culture of the parent organisation and its subsidiaries will be elaborated.

5.3.3 Organisational objectives and culture before and after the restructuring

Before 1993, all business activities of the organisation were embedded within one entity, within which about 1700 people were employed. After the restructuring, the majority of operating activities were shifted into independent companies. For example, between the year 1998 and 1999, employment within the parent organisation decreased from 1366 to 796 (-41.7%) employees, while that within the subsidiaries increased from 551 to 1157 (+11%) (Airport 2, 1999). As a result, since the end of 1999 the majority of the people working for the group are employed at subsidiaries.

Since 2000, the numbers of employees have declined constantly within the subsidiaries- with the exception of an increase in 2004. However, in the following year, numbers started to decline again. Similarly, the numbers of jobs have declined in the parent organisation until 2005 when 666 people were employed at the parent organisation. Since then, the number of people employed there fluctuates at around 670 employees. Figure 5.1 illustrates the development of employment within the airport in the parent and the subsidiaries.

Figure 5.1: Development of employment within the group

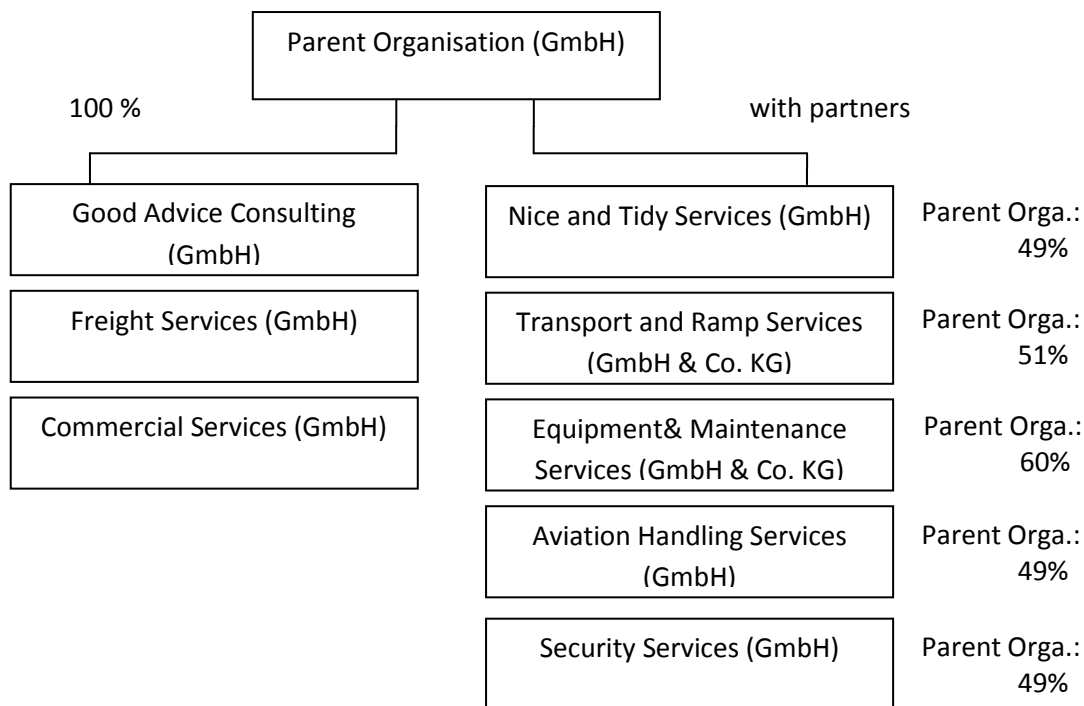


| Year | 1998 | 1999 | 2000 | 2001 | 2002 | 2003 | 2004 | 2005 | 2006 | 2007 | 2008 | 2009 |
|----------------|------|------|------|------|------|------|------|------|------|------|------|------|
| Total | 1366 | 1953 | 2027 | 1867 | 1774 | 1661 | 1669 | 1660 | 1656 | 1612 | 1612 | 1589 |
| Parent | | 796 | 845 | 809 | 808 | 777 | 716 | 666 | 673 | 667 | 674 | 665 |
| Subsid. | | 1157 | 1182 | 1058 | 996 | 884 | 953 | 994 | 983 | 945 | 938 | 924 |

Sources: Annual reports of the organisation Airport 2 (2001); (2005); (2009)

Between 1997 and 1999, eight subsidiaries were established, conducting business activities that were previously carried out by the parent organisation. The first privately owned subsidiary was founded in 1997 for conducting technical and cleaning services for aircrafts (Airport 2, 1999). Other activities shifted into subsidiaries include, for example, ramp services, and security services. The airport rationalised the establishment of subsidiaries by arguing that it would allow cooperating with affiliated companies through joint ventures, which in turn would facilitate the development of new capabilities and know-how to successfully compete in the market (Airport 2, 1998). In June 1999, the holding consisted of the parent organisation and eight subsidiaries, as illustrated in Figure 5.2

Figure 5.2: Holding structure in 1999 of Airport 2



Despite the goal to develop capabilities in cooperation with partners, the majority of the established subsidiaries were already 100% owned and controlled by the parent organisation by the end of 1999, namely seven out of thirteen. For the remaining subsidiaries, the parent organisation held a controlling stake for each, with an ownership share between 49%-60% (Airport 2, 2000).

The parent organisation followed the trend of establishing subsidiaries controlled by the parent organisation in the following years, and the number of subsidiaries increased. In 2009, the parent organisation had an interest in 15 organisations. For the majority of the subsidiaries (nine) the parent organisation retains an ownership stake of 100. For four subsidiaries the parent organisation retains ownership stakes of between 32.25% and 60% respectively. In addition, subsidiaries of the parent organisation held controlling stakes in other companies. The activities of the airport, are organised into four divisions: ‘Aviation’, ‘Ground Handling’, ‘Centre Management’ and ‘Real Estate Management’.

The restructuring of the organisation represents a shift towards a ‘landlord model’. The majority of employment of operational activities is shifted into legally independent organisations. The main motive behind this restructuring was that of becoming more market

oriented. Subsidiaries are required to successfully compete on the market, and to contribute towards the success of the group.

“We oriented our structure more towards the market. We have established an organisational structure... which is purely oriented towards profit and cost-centres” (Michael, Senior Manager, Director of the Division Centre Management).

Subsidiaries need to become economically independent from the parent organisation. The CEO explains that tendering is used to create competitive pressure for subsidiaries:

“Subsidiaries need to work under market conditions. We were always willing to offer some protection for some time... but we expect from subsidiaries competitive services... If a subsidiary is not doing a good job then it will be sold quickly and we are not burdened with it anymore... 2 years ago, we invited tenders for the services and operation of the car park, and the internal customer won” (Ansgar, CEO).

Both the former and the current CEO argued that clear responsibility for results for each area significantly improved accountability. The structural separation of responsibilities enhanced the economical accountability from a legal point of view:

“Clear responsibility (is important). ... I tried to transfer as many parts of the organisation as possible into economically independent private organisations (GmbH). In these parts, responsibility was clear from a legal point of view. And the people in charge had a concrete responsibility and were accountable... for their result” (Rüdiger, former CEO).

According to the former CEO savings of about 20% were achieved in these sectors through a greater economical awareness. The present CEO argues that responsibility of the subsidiary for costs leads to a greater efficiency:

“With outsourcing, we achieved enormous efficiency gains, because suddenly you have a transparency... asking suddenly: “Is this worth the money or not? Do I really need this... through this, the efficiency of the whole organisation is increasing” (Ansgar, CEO).

However, while the subsidiaries are now legally independent, and responsible for their results, it remains questionable whether they are truly economically independent as stated by managers of the airport. As discussed earlier, the vast majority of the subsidiaries are 100% owned and controlled by the parent organisation. Hence, they lack strategic autonomy. Subsidiaries and divisions may be accountable for the results but their scope to act as independent organisations in the market is limited because managers of the parent

organisation tightly control the decisions of the subsidiaries. Some areas lack operational decision-making autonomy:

“This structure – has quite a few so-called support departments... And all of these watch extremely carefully every step we do and this is my problem, every one of those wants to have the same justification from me. And the killer-questions is always “How often does this happen, Can’t we manage this differently?” (Klaus, Head of air traffic and safety management).

Important decisions are made by the parent organisation for the subsidiaries. Firstly, the freedom to make independent investment and hiring decisions is absent. For example, the managers of the parent organisation established a committee for hiring decisions. Establishing this committee was a consequence of hiring decisions carried out by a subsidiary in the past, as a manager remembers:

“Baggage handling hired independently, I think they employed around 80 new people on a permanent basis... And in Germany it is difficult to make employees redundant in times of fluctuation of workloads. ... And we realised this later during a meeting with the supervisory board” (Roland, Senior Manager, Head of Controlling).

The managers of the parent organisation were not very happy about this incident. To prevent similar incidences in the future, a committee was established:

„Every investment decision must go through a committee, which decides it... Like a tribunal... everybody here who needs additional personnel, needs to make his points to the committee and explain why” (Roland, senior manager, Head of Controlling).

The parent organisation also made the investment decisions for subsidiaries. Subsidiaries need to convince the managers of the parent organisation of the benefits of proposed investments. A strong justification is often needed to get it approved, and the process can be very time consuming.

“I am the tenant, and my responsibility is to make sure that the landlord provides everything I need. Of course, I have to pay. ... He [landlord] gets a specification book from me, but this does not say that I get what I want, because first he talks to me about it, and he says, “I don’t know if I can do it... and secondly, it cannot be very urgent. Maybe we can do just some more maintenance” (Klaus, Head of air traffic and safety management).

Also, the manager argues that even the approval for standard maintenance or the small investments necessary for the daily operation can be difficult and prolonged.

Secondly, the subsidiaries cannot act as independent companies and source input factors and services on the market. With the landlord model, subsidiaries are required to exclusively source certain factors from the parent organisation; for example, they need to rent facilities and office space for a priori set prices. They need to perform certain services demanded by the parent organisation for a priori set prices; they do not have the freedom to discontinue services offerings that are not economically viable. One of the trade union representatives argues that subsidiaries are not competitive:

“We have a small subsidiary responsible for the fleet, stairs, cars. They opened themselves to the market... people who brought their cars for inspection to them paid twice as much as in a garage. Because the residual costs in these subsidiaries are gigantic – They have huge spaces, for monstrous devices. And this all needs to be paid for. The parent organisation loads these costs onto their subsidiary, and they are reflected in the hourly rate” (Peter, trade union representative).

In short, high cost structure imposed by the parent organisation makes the subsidiaries uncompetitive as a result of their artificial cost structure, and they fail to establish relationships with new customers because of high prices. As a result, “Most of the subsidiaries [...] have only one customer: the airport” (Peter, trade union representative).

Such practice does reflect neither the nature of an economically independent company nor the characteristic of a profit centre. Rather, the new structure has changed the relationship between the parent organisation and its former employees working within the subsidiaries, who are now customers of the parent organisation.

Moreover, in some subsidiaries, even the marketing and negotiating over prices for their services are performed by the managers of the parent organisation:

“For subsidiaries, profits depend on the parent organisation which negotiates with customer. It really depends on what the parent organisation is prepared to give subsidiaries out of these contracts. It is quite a complicated story, how to calculate the result for the subsidiaries... much of it remains with the parent organisation, what one could have added to the subsidiaries” (Simon, trade union representative).

Airlines usually put pressure on the managers of the parent organisation to reduce prices. The CEO argues that the debating with airlines over prices was very unpleasant in the past:

“These were political quarrels; they wanted to reduce the price and used many arguments which were not very objective. And they discussed it publicly. It is a very unpleasant issue” (Ansgar, CEO).

To satisfy their external customers, managers were prepared to give considerable price reductions. These indirectly affected the parent organisation indirectly, but were made possible by considerably cutting down the profits of their internal customers, namely of subsidiaries. Managers of the parent organisation thus pass competitive pressure on to their subsidiaries. Cost savings are often achieved by a reduction of wages within the subsidiaries:

“The customer pressurised; he wanted lower prices. If I offer it for lower prices, and still want to cover my costs, I need to see how I can reduce it” (Christine, Manager, legal department).

“Our biggest customer... says: If you want to do business with us in the next three years, you must give us a better discount than last year. Three years ago, they wanted to have 30% off services. In the end, it was between 22%-23% cheaper. This year they came again... this is a home-made problem. The Airport gives discounts and the employees have to make up for it” (Peter, trade union representative).

The theme quality has recently become important with regard to sustaining the airport's competitive position. The current CEO explains that a goal is to improve the quality of the services.

“This year, we would like to be somewhere amongst the Top 20 (in terms of quality) - but the long-term goal is to be in the Top 10” (Ansgar, CEO).

Bearing the economic risk of their activities, the subsidiaries are clearly responsible for their outcome. However, they have very limited decision-making power. The parent organisation behaves in fact like a monopoly regarding their subsidiaries. On the one hand, the airport acts as a supply-side monopoly because it is the exclusive provider of certain input factors for the subsidiaries. Regarding input factors, the parent organisation can dictate both price and quality. On the other hand, the parent organisation established a demand-side monopoly because it remains the exclusive customer for certain services. The separation of the operating activities consequently allows the parent organisation to preserve the monopoly rents. This also increases the pressure of subsidiaries to lower the cost for their services.

“Today I had a meeting... about collective wage agreement at the employers’ association. I described my frustration that the parent organisation is a millionaire, and its subsidiaries are all Harz 4 beneficiaries [living on supplementary benefits]. The parent organisation makes enormous profits and subsidiaries are used... for tenders. How can it be that the airport... makes a profit of 48 million and its subsidiaries make no profit?” (Peter, trade union representative).

“We are now the most profitable airport in Germany, last year we made almost 50 Mio.€ profit... and the customers want our crown jewels but... they are kicking the wrong dog, because of the baggage handling area they won’t get any more out. Here, we are already at the bottom. And it starts to show consequences. Quality-wise and safety-wise!” (Klaus, Head of air traffic and safety management).

Looking at the attractiveness of the market, it remains questionable whether the objectives of the liberalisation have been reached. For example, regarding the baggage handling, none of the airlines at the airport utilise their right to perform these services for their own aircrafts, and the competitor only reached a market share of about 20 %, before he announced, in 2009, his retreat from the airport; nor did he even offer the full service spectrum at the airport because of a lack of know-how and airport devices. For example, a union representative explains:

“There is some difference in the know-how. The subsidiary of the airport uses bridges which connect the aircraft with the airport building. ... The competitor is working with stairs” (Peter, trade union representative).

A manager argues that the subsidiary of the airport needs to help out the competitor to complete certain services, for example to move aircraft from one position to another. The former CEO made the following comment as to whether competition has evolved over the years.

“Overall, I have to say, I am astonished how few competitors until today managed to business at different airports” (Rüdiger, former CEO).

5.3.4 Innovation at Airport 2

5.3.4.1 Types of innovation at Airport 2

Both managers and employment representatives believe that the potential for innovation at the airport is very limited, particular within operating activities such as baggage handling. Managers explain that there are areas with almost no room for innovation:

“Aviation, the runway system, terminals... You cannot expect huge innovation. ...The baggage handling system; they make a big fuss about it. But there is not much innovation. I would say the laundry transportation system of an average sized hospital is probably more complex. ... Centre management; ... there is no real innovation taking place. Ground Handling has not much potential for being innovative. ... And real estate management, to talk about innovation here is very difficult for me” (Dietmar, former Head of Controlling).

“Innovation...is not possible in all areas, because if an organisation only consists of creative and innovative people, it would be better as an advertising agency, not an airport” (Roland, Senior Manager, Head of Controlling).

Two types of innovation occurring have been identified. Firstly, innovation at the airport is driven by external consultants and firms. A manager explained that larger firms have more potential and necessary resources to develop innovation, such as new technologies. In contrast, the airport as a medium-sized company has limited resources to internally develop new knowledge or competencies. Secondly, innovation may be carried out by managers of the airport. Here, the focus is clearly on managerial innovation rather than technical innovation:

“I think it [innovating] is part of the managerial responsibilities. ... Innovation can be defined very broadly, they do not need to carry out technological innovation; they could be product or management innovation” (Ansgar, CEO).

Organisational innovation at the airport typically aims to achieve cost savings, and particularly labour costs.

“When I can only offer baggage handling services for certain prices... then I have to structure, and organise it in a way that I realise them. If not, I go bankrupt” (Christine, Manager, legal department).

Innovation clearly does not aim to build up new know-how; rather, it can be seen that it reduces the quality of services and destroys existing know-how. The aim of the managers is to meet a defined quality standard with minimal costs. However, concerns have been raised that this kind of innovation may risk the effectiveness of the airport in the long term:

“Efficiency improvements are happening, but they are a burden, for the quality, and safety and in the end put more weight on employees... if you reduce personnel and... to save money; this certainly could be described as being innovative, but if you want to maintain orderly and qualitative operational procedures, this should not happen” (Klaus, Head of air traffic and safety management).

At the same time, managers at the airport are very proud that they achieved significant efficiency improvements. For example, a manager reports that a benchmarking of take-off and landing fees with other German airports revealed the following:

“Today, we are the cheapest airport in Germany, and everybody acknowledges this. ... We are a role model” (Roland, Senior Manager, Head of Controlling).

The aim of the organisational restructuring is clearly to separate operational activities from the responsibility of the parent organisation. Operating activities with little room for innovation are increasingly encountering price competition, and consequently shrinking profit opportunities. The CEO explains that margins are shrinking without innovation:

“If you do not take on the challenge to innovate, the margins will over time reach zero or become negative” (Ansgar, CEO).

From this view, the restructuring of the parent organisation was pursued for a different reason. The managers of the parent organisation do not believe that innovation can be achieved within the operating areas. With a lack of innovativeness, margins of the operating areas, and hence its profits, must shrink significantly during the next years. Managers associated with these kinds of activities, however, would be considered poor performers under the organisational culture that demands that successful managers contribute significantly towards profits. Thus shifting operating activities from the parent organisation into subsidiaries shifted the responsibility over the profits away from the managers of the parent organisation to their counterparts of the subsidiaries. Clearly, the long-term vision of the managers is that of shifting most of the operating activities into subsidiaries:

“In ten to fourteen years the airport will become more like... a management holding. ... This has already happened in other countries” (Roland, Senior Manager, Head of Controlling).

“The organisational structure of the airport in the future will have very few operative activities” (Ansgar, CEO).

It is interesting to note that managers of the parent organisation are not prepared to approve investments, which would be required for change and innovation for these areas. The lack of resources and investments, however, will eventually result in low margins. Over time, the loss of profitability of the subsidiaries is likely to become a self-fulfilling prophecy.

5.3.4.2 The role of shop floor innovation

As a result of successful restructuring of the airport in the past, the managers firmly believe that change can best be introduced and driven by a small, but powerful group of managers. It is neither necessary nor even possible to obtain the broad support of the people within the organisation for organisational change:

“I would say we could not convince... 99% of the people to adopt a mindset towards change, and we still can't” (Dietmar, former Head of Controlling).

The managers also believe that organisational change needs to be enforced through pressure if necessary:

“Pressure and leadership is most important for organisational restructuring. Most employees are not looking for a change” (Ansgar, CEO).

From this perception, as well as the belief that the potential for innovation from the operating activities is very limited, it seems logical that most of the employees are only indirectly involved in organisational change processes and innovation.

The airport has built up a communication structure spanning different levels of the management team. Some meetings include only the managing board, while others are addressed to the extended circle, namely the full management team of the first reporting level. In addition, a manager conference is held quarterly for all managers of the group, including those of both the first reporting level and its subsidiaries. The CEO also invites managers of the first reporting level to face-to face meetings if needed. Employees can suggest ideas to their direct superior, who is ‘supposed’ to pass these ideas on to the top of the hierarchy.

Ideas which are handed in by employees are often perceived to be of little or no value. A manager, for example, investigating the value of the ideas of employees, came to the following conclusion:

“I asked randomly for twenty of these suggestions, that I examined... And these were suggestions you could have made” (Dietmar, former Head of Controlling).

Employee representatives feel that managers do not pay much attention to suggestions made by employees. Direct superiors are not taking the time to listen to these ideas, and as a result, some employees stopped putting ideas forward. Others communicate their ideas during working meetings to a larger group, but with similar outcomes:

“If one of the ordinary workers is reporting during works meeting, nobody cares. People sometimes feel that they have discovered something in their work place, but nobody takes them seriously” (Peter, trade union representative).

Employee representatives believe that managers failed to establish a culture to foster ideas from their employees. One of the representatives contrasts the culture of the airport with that established by the major domestic airline company doing business at the airport. The airline company encourages employees to submit ideas. As a result, employees compete about ideas and innovation. The airline company publishes successful stories of employee innovation in an internal journal. However, such a culture has not been established at the airport. Here, employees feel that their ideas and their know-how are not perceived as being valuable.

“And at some stage, the people say to themselves: Why should I think about it, when I don't get any attention anyway” (Peter, trade union representative).

By and large, managers believe that the employee suggestion system in accordance to the German Employees' Inventions Act (EIA) does not create value for the organisation. Rather, they believe that the EIA creates 'nuisance' and conflicts between employees and their direct superiors:

“This is a very difficult theme for us. Many submitted very small ideas. Where one has to say: The value is not very high, but we still rewarded it... and you have ideas, where the boss feels left out, and says: I don't accept it to look like a fool by my employees” (Ansgar, CEO).

“To expect innovation from them (employees)... I am really not the right person to talk to about it, because I have a very mixed attitude about it, mostly money is paid for something, which is anyway part of the duties of employees... The employee suggestion system was introduced for firms... which could save high payments to employees for their inventions” (Dietmar, former Head of Controlling).

While the majority of ideas from employees are not perceived as being of value for the organisation, there are a few initiatives which are supported by the CEO, who gives some employees the opportunity to take the initiative and pursue their ideas:

“I sometimes give a young person the chance to put himself into hot water and to prove himself in the long term. ... They work very hard, and want to try something difficult or ambitious, and I am prepared to take the risk and support them, and also to tolerate some mistakes” (Ansgar, CEO).

In this vein, Roland argues that the key for innovation is ‘individual engagement’:

“To give people the freedom, to live their creativity, and then they are innovative... by delegating responsibilities, creating leeway” (Roland, Senior Manager, Head of Controlling).

The example above shows that innovation is something which is the responsibility of selected individuals of the organisation. There is a small group of people who are given the chance to pursue their ideas in the first place. However, the majority have no channel through which to communicate their ideas. There are no systematic, standardised efforts to promote innovation from the bottom up. Managers do not feel that innovation and ideas of employees are crucial for the success of the organisation.

5.3.4.3 The role of the work council for innovation and change

The low degree of integration of employees in the organisational change process is also reflected by a relatively poor cooperation between the management team and the works council. The value of the activities of the works council is viewed with scepticism by the management team, and the managers doubt whether the influence of the works council adds value to the organisations. Managers argue that the works council is not working towards the goal to increase of welfare of the organisation, but rather focuses on pursuing the interests of the employees. They feel that worker participation does not contribute towards the success of the organisation and may even hinder its development:

“I am a supporter of good employee representation. But on the other hand, this German co-determination has gone too far. They (the employees) have too many rights, for example, to slow down the development of the organisation... We are losing a lot of energy with internal discussion, and additional value is not created” (Ansgar, CEO).

“[The law requires] that works council make decisions under consideration of the welfare of the organisation. Sometimes, they may not focus on this but rather on uncharacteristic goals” (Christine, Manager, legal department).

The managers do not believe that the works council does contribute to new ideas and constructive improvements. For example, the CEO answers the question of whether the council offers valuable ideas with the following:

“Unfortunately- no! Sadly- no. ... There is a lot of politics, self-interest, union interest influencing it... I would say, regarding new ideas almost nothing is put forward” (Ansgar, CEO).

Because the management team does not believe that the contribution of employees is important for the success of the company, working together with the works council is perceived as a burden rather than a potential opportunity, which becomes evident in the following quote:

“The works council has the function of ‘voice’... this can be seen positively or negatively. For us, it is imposed by the law, and therefore we have instinctively developed a defensive attitude against it. ... The ‘works council’ is, really, to be a bit sarcastic an interest group, paid by this firm but they make a lot of trouble... This is not a good start, to promote collaboration” (Dietmar, former Head of Controlling).

The quote above shows that managers believe that the value of the cooperation between managers and work council depends largely on whether the knowledge of employees is crucial for the success of the organisation. If the knowledge of employees is important for innovation, the firm has an incentive to promote voice and encourage employees to participate in change processes and innovation. The lack of opportunity for shop-floor innovation at the airport however, makes such integration unnecessarily.

5.3.5 Differences in the working environment between operational and innovative activities

Wage levels have changed since the restructuring. Under the new organisational culture, high performers are individually rewarded. The CEO argues that the organisation is increasingly using individual awards and incentives to motivate people to perform better:

“If we increase the rewards for the themes ‘performance’, and ‘personal ambitions’, if we reward this more and more visibly, the willingness will increase, to make a wholehearted effort for the organisation” (Ansgar, CEO).

Both managers and employees have a wage component based on results. The contracts for managers are individualised; but since 2008, employees receive also a variable component of their salary based on the results of the group and their division. The individualised contracts of the managers clearly provide more opportunity for wage improvement through individual performance. Regarding payment for employees, the union was concerned about two points, the loss of jobs und the deterioration of the working conditions for employees at the airport.

While the former fear was unjustified, the conditions for employees worsened as a result of the restructuring, something made clear by one of the trade representatives:

“Regarding job security, he (former CEO) said the truth, they remained. But the conditions for employees have significantly deteriorated since privatisation” (Peter, trade union representative).

The threat of the liberalisation of the baggage handling market exerted considerable pressure on wages for employees in operating areas. The CEO of the airport argued that reducing wages was necessitated by the threat of potential competition. Managers had no choice but to find ways to adjust the wages to more market oriented rates. Before the restructuring, the airport was legally obliged to pay public sector wages for all employees. As a consequence, wages for activities such as cleaning services were relatively high compared to those paid by competitors. At the airport, a potential competitor was not obliged to pay the rates of public service since the Directive of the European Council does not require minimum wages. It was clear that the services offered by the airport were too expensive compared to other offerings, and therefore not competitive. The former CEO described the situation.

“In the past employees were paid in accordance with the collective agreement of the public sector. ... they had an hourly wage of 21 DM (German Mark). The competitors, such as cleaning services, which operated in the market, paid around 13/14 DM. And as you can imagine our crowd was not very competitive. ... due to competition, this area could not survive” (Rüdiger, former CEO).

The management team believed that the airport could not compete with the new potential entrants because of the different wage levels. The competition of services such as cleaning and baggage handling was based mainly on price, and the management team did not see a way to compete with their existing structures because it was legally not possible to directly reduce the wages within the parent organisation. Significant differences in wages threatened the competitiveness of the airport.

Shifting jobs into the subsidiaries, where the rate of public service wages was no longer applicable, was a solution to this problem because it allowed the organisation to adjust the wage level to a different, lower pay rate. This was an opportunity for the parent organisation to circumvent the wages of the collective agreement of the public service sector, and to become more competitive. The former CEO explains:

“We had to outsource it, with a new wage rate, a wage level which was adjusted to cleaning services, and this made it possible to compete, and to survive. ... and this is part of the restructuring, to adjust wage rates to the competitive environment” (Rüdiger, former CEO).

“We are outsourcing the employment into independent organisations; we give them their own collective agreements” (Roland, Senior Manager, Head of Controlling).

With restructuring, wage levels between parent organisation and its subsidiaries significantly differ. A manager refers to the different wage levels at the airport as “two-class-payment in the companies”. The disadvantages for employees who had permanent positions were mitigated by the principle of ‘Besitzstandswahrung’, the protection of vested rights. They still received the wage they had while they were working within the parent organisation. However, newly employed people, with the exception of those employed in the IT area, were subject to a much lower collective wage agreement, as manager and employee representatives explain:

“Existing employees who were shifted into the subsidiaries enjoyed ‘Besitzstand’, ... Affected were those employed after the restructuring because they did not receive the same wage level” (Christine, Manager, legal department).

“Workload increased, pay rate with the exemption of the parent organisation became significantly lower... cleaning is not paid well. ... also the baggage handling services, the aviation services... compared to the older employees significantly less” (Simon, trade union representative).

“People trained in SAP, which was very costly, ... left the organisation later because they could earn more somewhere else. With our collective agreement we could not offer them a competitive rate. Now, we can offer them a higher wage rate. ... But this is the exception. Overall, it was an adjustment of the collective wage agreements further down...” (Ansgar, CEO).

The union representatives perceive the rules of competition under the Council Directive as being unfair due to its lack of protection for wages. They are not opposed to the introduction of competition in general, but they demand certain minimum standards for labour:

“New service providers do not need to comply with collective agreements... I would not mind a service provider who says ‘I follow the same legal conditions regarding labour. I allow a work council, and bargaining’... But if one comes, who is cheaper and does not fall under collective agreements, and there are no works council... it is a huge problem... Now, we look almost daily ‘Who is cheaper?’ And the ones who suffer are the employees” (Peter, trade union representative).

Newly founded firms without established collective agreements have a competitive advantage over established firms with such agreements in areas where the rules of competition are dominated by costs. Firms without collective agreements and works councils put pressure on the firms who have embraced these institutional features for their employees.

Employees of newly established firms are gradually setting up structures such as works councils and employee representation. Since such structures are typically not supported by the employer, employees have to work secretly at the outset to be successful. One of the trade union representatives explains how employee representation was established at a subsidiary:

“Management started with breadline wages... And the union said we can’t have this. They had not even established a works council. So we met in dark corners of the airport to talk about what we should do... The employees said, ‘we also want to have a Tarif agreement’. And the employer said: ‘You won’t get it!’”
(Peter, trade union representative).

Cultural changes and the relationship between employees and managers also occurred during the restructuring. The organisational culture changed from a collective towards a more individualistic culture. While in the past, all people employed at the airport felt as one unit, those working in different areas were now separated from each other in both structural and cultural terms. For the majority, the working environment deteriorated:

“In the past, there was a shared spirit. We felt that we all belonged together – we were all employees of the airport... We looked after all the employees... Today there is a division depending in which area one is working in. There are differences in the payment structure and in the ways of working together... Things have got worse. Today it is more important to fulfil economic goals”
(Simon, trade union representative).

The well-being of the employees is becoming less of a concern for managers, only their performance matters. The division is mainly between those employees who are responsible for change and innovation, and those who are performing operating activities. The working environment of employees responsible for daily business is becoming more demanding, and pressure to perform well is increasing. The responsibility of managers is to increase the productivity of employees:

“And then there was the goal to make them productive within 18 months but this is not realistic” (Dietmar, former Head of Controlling).

The working environment differs, however, for knowledgeable workers. Not only do they still receive a competitive salary, but the feel-good factor is an important element of the working environment. Managers are becoming increasingly aware that they need to provide an attractive working environment for qualified people. A manager argues that the airport aims to attract knowledgeable workers by providing a pleasant working atmosphere, including competitive wages and training opportunities:

“In 10 years, organisations will fight for qualified people. ... We created for employees... a working environment which is as pleasant as possible. In addition to the fact that they need to earn adequate wages, it is also important that they feel good here. ... The feel-good factor is extremely important” (Roland, Senior Manager, Head of Controlling).

While the managers aim to keep knowledgeable workers in the organisation, work contracts within subsidiaries become more flexible to adjust to fluctuating demands for labour. Within the operating activities, highly trained full-time staff are increasingly substituted by temporary workers on a part-time basis, who receive only a basic training.

“Workers [in the past] were all Lader or Oberlader [people who completed vocational and further training]. Today, there are much fewer of them. And all of them have a leadership responsibility to integrate the lower skilled workers, who are working on a temporary basis” (Simon, trade union representative).

The information provided indicates that the fluctuation of part-time work within the subsidiaries can be explained by the inclination to employ people within the operating areas based on actual needs. Because passenger numbers are fluctuating, the airport adjusts the number of employees to meet an irregular demand. Part-time workers within the operating areas are uncertain whether they will even have employment in the following year. During peak times, the airport needs a considerable number of additional part-time employees. However, during the off period, only a few are required. The use of part-time contracts helps to make the use of workers based more on demand, and consequently reduces the costs of personnel:

“If you hire them for eight hours, then you have people who can play a lot of chess. For precious money! We have to see, how we can design working hours more flexible. This was one of the points of the restructuring” (Christine, Manager, legal department).

“They would all prefer to be more cost efficient, to only employ people when their work is needed... you come at 6am, and have to stay until 8am, and then you can go home until 9.30am, and then you can come again” (Klaus, Head of air traffic and safety management).

A manager argues that increasing use of part-time workers and the reduction of employees in general resulted in a denser working time of the operating activities, which places much stress on the employees. For example, he explains that the size of the teams who service an aircraft is reduced, and the employees have to work more efficiently.

“The time left for cleaning is five minutes, maximum. Of course under very high quality standards... everything has to happen: pittering, fuel-refill, unloading and loading, and all these things... the available timeframe is constantly getting tighter. And the number of employees is at the same time constantly reduced due to the cost pressure” (Klaus, Head of air traffic and safety management).

At the same time, people who have not received the full training are working in the team, which means that the full-time workers have to take on the responsibility of monitoring the work of the less skilled. This puts additional stress on them.

While the people working in operating areas feel that they are working at their limit, managers of the parent organisation believe that the increasing pressure on employees of the subsidiaries reflects the reality of the market, and is inevitable. The stress which the employees of the operating activities are facing is even used to promote the airport. In their Annual report of 1999 (Airport 2, 1999), Airport 2 uses the following quote of one of their trainees, to put the hectic working environment in a positive light: “I like the flair of the airport, the international visitors, and I am also attracted by the stress” (Airport 2, 1999, p. 6).

Commitment to employment is decreasing. Subsidiaries are increasingly employing workers on limited term contracts, depending on the duration of the tendering. One of the union representatives believes that limited term contracts put much anxiety on employees:

“Contracts are awarded for five years. You can image, how the people feel in regards to their future. I doubt that somebody would like to build a house if he has only a perspective of five years. There is always an uncomfortable feeling when the five years come to an end, they are getting nervous” (Peter, trade union representative).

Another problem for workers is the increase of the retirement age to 67. As already mentioned under the former organisational structure, workers who were exhausted from the physical demanding work, such as those working in baggage handling were transferred to a different area, for example the security area. However, this practice is not feasible because activities are now performed in independent subsidiaries, and employees who cannot perform physically demanding work are made redundant. Employee representatives regret this:

“This is ok from a legal point of view. But in the past, this never happened, because it was possible to accommodate these people. This has changed. It’s gone” (Peter, trade union representative).

“In the past, exchange occurred between different areas of the organisation which is nowadays difficult to justify. ... In the [new] structure, each company needs to demonstrate its profitability and it is difficult to make others take on less productive employees” (Simon, trade union representative).

Commitment to providing long term employment has been reduced to decrease labour costs. However, concerns have been raised that the reduction of highly skilled full-time staff increases the risk of accident. For example, a trade union representative reports a recent incident related to the reduction of personnel. While the former law required two workers at the baggage line, only one person is now required:

“In the past, at the conveyer belt for the baggage transported into the aircraft, two people were required. Today, there is only one person, and a few weeks ago, we had a very bad accident, one of our Turkish colleagues was caught in the conveyer belt, and it almost tore his arm apart” (Peter, trade union representative).

A manager also argues that the reduction of staff in both qualitative and quantitative terms leads to a reduction of safety and quality:

“People are reduced number-wise, and also the quality is deteriorating. If I pay hourly rates of 7.38€, I cannot expect that I can obtain highly qualified and highly motivated personnel. But this is happening due to cost pressure” (Klaus, Head of air traffic and safety management).

Employees are receiving less training, which in turn results in a lower quality of services. This effect of cost pressure on quality is the subject of the next chapter.

5.3.6 The importance of training

The importance of training varies for different levels of the hierarchy in the organisation. Those involved in organisational change and innovation, namely the managers, have various training opportunities. The CEO reports that managerial training has become more important during the last years:

“We offer a lot [managerial training], and particularly during the last years. For the last three to four years, we established seminars for the first reporting level, ... We have every year a two-day seminar, ... to provide a foundation for our managers regarding the issues leadership, methodical decision making, and so on, ... last year we started to do the same for the next reporting level” (Ansgar, CEO).

Training for managers is highly individualised at the airport:

“These are individualised programmes. What I really like... individual attention can be paid to each person” (Roland, Senior Manager, Head of Controlling).

At the same time, training is becoming more specialised, focussing on managerial themes rather than on airport-specific peculiarities. A manager explains that people are no longer required to obtain full understanding of the operational processes of the airport, but are trained in their individual area:

“People like me are dinosaurs – they will be extinct. Nobody wants us now. The company doesn’t give young people a chance to understand how the airport works; how our organisation works. They are employed in HR, or in finance, and they stay there. They don’t understand how the airport works” (Klaus, Head of air traffic and safety management).

A manager explains that consultancy work in external projects is an instrument for individual personnel development at the airport:

“Airport Consulting enables us to bring people into projects ... those people want more than what they can achieve in their normal job. ... They want to be both trained and intellectually challenged. ... I am selecting somebody to work for a third party, for more money... to teach people ‘on the job’ new skills, and use those which they already have” (Roland, senior manager, Head of Controlling).

Employees involved in consulting work typically perceive this as a very good opportunity to further develop their skills. At the time of the interview, one person was employed full-time at the airport consultancy, and a few were employed on a part-time basis. Those involved in projects believe that they learn much from this kind of activity. However, it continues to be

the privilege of selected individuals, and cannot be relied on as a systematic instrument for personnel development.

The employees working in consulting receive a high reimbursement for their work: according to a manager, 600€ per day on top of their salary. However, as the director of the consultancy arm, it was very important for him that the direct superiors of those employees do not feel that they are exploited them.

“And we did put the price purposely relatively high. Because, I don’t want that the managers, the direct superiors, jump down my throat that I am exploiting our employees” (Roland, Senior Manager, Head of Controlling).

Managers often explicitly refer to training opportunities for managers when they are being asked about training opportunities:

“We do invest in [managerial training]... So that we specifically interest people within the organisation for management positions, and also develop them towards this” (Michael, Senior Manager, Centre Management).

The development of managers is an important theme and managers are generally satisfied with the training opportunities at the airport. In contrast, the training opportunities for employees working in operating areas are limited. The airport offers about 40 places for vocational training within the organisation. For further training, employees can participate in subsidised language courses and computer software training during their leisure time.

“So the organisation needs to offer opportunities, which one or two than privately take on, do it themselves, as said, further training, which we then do support” (Ansgar, CEO).

However, there is clearly a perceived lack of chances for further training for employees at the bottom of the hierarchy:

“The subject that you address here (training of employees) is something which I feel does suffer extremely in this organisation, training for employees is treated as an orphan... there are a few attempts to promote personnel development. But currently this is not really enough” (Roland, Senior Manager, Head of Controlling).

The quote above demonstrates that systematic training is not offered for workers; whether or not one receives the opportunity to develop his or her skills depends on the attitude of the direct superior. Part of this limited offer for training is rationalised by managers who claim employees of some areas are not willing to participate in training:

“The effects [of training] are in some specific areas simply enormous higher; because in certain areas, training is soaked up like a sponge. ... There are also other areas. This has something to do with the certain kind of people which you find in certain organisational units or systems. With them, you cannot achieve anything through training” (Roland, Senior Manager, Head of Controlling).

The participants of the study report that during the last decade the importance of training for employees performing operating activities clearly declined.

“And knowledge about the wider context is becoming of secondary importance- because people are not trained anymore, there is not time for it left, and it is also not favourable to pay people for it” (Klaus, Head of air traffic and safety management).

“It [training] has lost its importance which I regret, this airport has always been a role model in regards to in-house training. The people always had on opportunity to qualify themselves, including the perspective for their own development. But this has changed tremendously during the last 10 years” (Peter, trade union representative).

Two developments explain this inclination to some extent. Firstly, as pointed out earlier because of the perceived lack in innovativeness of the operating areas, managers cannot justify investments in training and resources for them. For example, Klaus believes that the main driver of the reduction of training is the increasing cost pressure. Secondly, the reduction of training for employees may be the result of the long-term objectives of the firms. In this vein, Peter argues that the reduction of training is influenced by the profit orientation of the parent organisation. As pointed out earlier, the shrinking margins of the operating areas put pressure on managers who aim to maximise the profits, and the airport does not intend to keep the ownership of the subsidiaries in the long-term. The CEO points out that the long-term plan is to completely outsource areas with limited know-how:

“Because I see the airport in the future as an organisation, which does really consist of very few people with a lot of know-how. We need very well trained people who have obtained broad experiences and knowledge which is necessary, to deal with the complexity inherit into our business” (Ansgar, CEO).

The vision of the CEO clearly indicates that low skilled workers within the group have no long-term employment perspective at the organisation. On the other hand, those who are receiving training and development of skills will likely be retained.

A logical consequence of the reduction of training, the cost pressure for the operating activities and the increasing workload, is a reduction of quality of the operational processes.

A manager points out:

“And everything results in an increasing number of small damages, accidents, inattentiveness; because the people just don’t pay so much attention anymore because they lack an understanding of the context” (Klaus, Head of air traffic and safety management).

Firstly, the reduction of training reduces quality. According to a manager, the increasing pressure from the market does affect the quality of the services

“We always tried to employ highly qualified people with a high degree of training. And if you have a high standard of training, you will be paid better. You will also do less damage. ... And this is becoming more difficult with increasing pressure from the market” (Christine, Manager, legal department).

Secondly, the reduction of personnel affects the quality. For example, managerial pressure within the operating areas is increasing with the reduction of personnel. A manager explains:

“So people have been reduced, [the workload] is getting more comprehensive. And after 10 to 11 hours, I stop working, and say “it is not going anywhere, now” but I need to work more and more- almost every weekend, and in the evenings” (Klaus, Head of air traffic and safety management).

The quality of the process is also reduced due because the processes have been divided among different service providers. As a result, the number of contact persons has increased. In the past, the responsibility for the processes was centralised, which the ramp agent, an employee of the airline organisation, having the clear responsibility of the correct handling of an aircraft. Today, multiple service providers are working on one aircraft.

“Things which are driving it [reduction of quality]: We have to deal more and more... with a number of service providers. Somebody for cleaning, somebody else for the physical loading of the airplane, somebody for the ramp-handling, for the paper-work... In the end, I have four to five contact persons for one airplane” (Klaus, Head of air traffic and safety management).

Furthermore, the people working together in teams are nowadays constantly rotated which increases coordination efforts and uncertainty for employees performing the activities:

“Work has become denser. Today, employees are working almost four to five hours on the apron area. They are running from one position to another” (Klaus, Head of air traffic and safety management).

The managers of the Airport 2 recently realised the decrease of quality. The CEO points out that the theme of quality is now getting more attention. Increasing the quality of the different areas is one of the annual goals for managers, as well as indirectly for employees. Both managers and employees receive financial incentives to increase quality.

5.4 Chapter summary and comparison between Airports 1 and 2

This section reviews the main differences and similarities between the organisational restructuring of the two airports. The within-case discussions illustrated that both airports underwent similar structural and cultural changes in the context of privatisation and liberalisation of the baggage handling services triggered by the Council Directive 96/67/EC. Nonetheless, there are also some areas for which notable differences between the strategies of the two airports have been revealed. The aim of this discussion is to compare and contrast how airports were affected by changes in their environment. In the following, the different themes, that have been discussed in more detail during the within-case analysis, and were important during the restructuring of both airports, will be outlined.

‘Triggers of the restructuring’ at both airports were related to the liberalisation of the baggage handling market and privatisation. Managers at both airports explained that shifting employment into legally independent subsidiaries was necessary because of competitive pressure resulting from the liberalisation. New entrants had considerable cost advantages with regard to established firms because they are neither bound to central collective agreements nor have established worker participation. As a result, new entrants had significantly lower labour costs than the established airport organisations, which were bound to the collective agreement of the public service and had well-established, well-functioning, co-determination. Consequently, the airports encountered disadvantages to competing within these services on the basis of cost.

Encountering this competitive disadvantage, airports found a creative way to discard their obligations from the past. Both airports had to respect established collective agreements for employees at the parent level. However, shifting employment into legally independent subsidiaries enabled them to break free from established collective bargaining agreements of the public service, to reduce worker participation and cut back on social benefits and training and development opportunities in order to achieve a reduction in labour costs.

Members of the trade unions point out that labour cost advantages for newly established firms tend to erode over time as employees establish a works council. Establishing a works council is usually followed by negotiating collective agreements for a firm. However, the new wage levels of the new collective agreement at the level of subsidiaries at both airports were relatively low compared to the collective agreement of the parent organisations. Restructuring was therefore undertaken in order to remain competitive. Competitive pressure was also an important means for both airports to justify the restructuring to employee representatives. Managers of both airports convincingly argued that they had no choice but to undergo restructuring to remain competitive.

The managers of Airport 2 were the first to implement organisational changes, even before competition entered the market. As a consequence, the model to establish independent subsidiaries for different activities of the supply chain is known as “City-X-model” within the German airport industry. Whereas Airport 1 initially resisted the introduction of organisational changes, and tried to lobby against the Council Directive to prevent competition, managers of Airport 2 saw an opportunity to introduce change. The restructuring of Airport 2 to establish subsidiaries proved the feasibility of restructuring to other airports. Subsidiarisation has become accepted practice.

The feasibility of the only alternative to restructuring being outsourcing was supported by highlighting the interests of private owners. Managers explained to employee representatives that they are obliged to serve the interests of private investors, who were expecting unprofitable segments of the airports to be outsourced. The threat of potential outsourcing was important to gain the acceptance of restructuring from employee representatives. By maintaining employment through restructuring, employees representatives ensured at both airports that the older generation of employees would still receive the same wages as before, in accordance with the public services of ‘Besitzstandswahrung’. However, even though both airports arrived at the same strategy they did so for different reasons, managers at Airport 1 shifting employment into subsidiaries as a result of actual competitive pressure, while managers at Airport 2 shifted theirs as a result of potential competitive pressure.

‘The level of competition for baggage handling services’ remained relatively low after the liberalisation at both airports, despite its centrality for legitimizing the restructuring. While managers at both airports argued that the restructuring was triggered by competitive

pressure as a result of the liberalisation of the baggage handling market, both airports still maintain significant market shares in that area. At both airports the third party handlers did at no time exceed a market share of more than 25% after the liberalisation. Also, at both airports, the third party handler at no time offered the full service spectrum. Both airports thus managed to maintain significant market shares.

‘Organisational structure’ changed at both airports as a result of subsidiarisation. While in the past, employment of all activities was embedded within one entity, representing a unified organisational structure, employment of different activities is now structurally separated. At both airports, managers and knowledgeable workers are still employed in the parent organisation, while the majority of people performing operating activities are now employed in subsidiaries. This separation of different activities is directly linked to the perception of how value is created. In the past, managers at both airports had an understanding that value was created collectively, while under the new organisational structure, managers believe that each activity is responsible for its outcome.

‘Working environments and organisational culture’ changed tremendously for the people employed in subsidiaries. In the past, both airports offered an inviting working environment to employees, including attractive wages, a range of social benefits and secured employment. After the restructuring, conditions of the working environment have deteriorated for employees in subsidiaries mainly as a result of reducing costs. Employees at subsidiaries are typically subjected to lower collective agreements compared to the parent organisation, and receive fewer social benefits than employees in the parent organisation, for example pension funds.

Employment security for people employed at the level of the subsidiaries has decreased at both airports. The commitment to providing long-term employment opportunities for workers has been reduced in favour of flexible employment based on actual needs. In the past, managers of both airports felt responsible for the continuation of employment, for those who experienced work-related health problems. Workers in the airport industry frequently experience musculoskeletal injuries of the back, neck, shoulder and knee. At both airports, people who could no longer perform demanding physical work, such as baggage handling services, because of injuries, were still offered continuing employment at the organisation in areas requiring less physical work, such as the security area. After the restructuring, employees who cannot perform a certain physical activity are no longer

provided with continuing employment, but made redundant. There is evidence that both airports increasingly employ people on a temporary basis. Also, both airports expect that the subsidiaries adequately contribute towards value creation for shareholders, and they are willing to completely outsource activities that financially underperform.

Working conditions for managers and knowledgeable workers employed in the parent organisation, on the other hand, are still very attractive. Both airports ensure that knowledgeable workers and managers are well taken care of in terms of financial and social benefits. For example, an increasing number of managers are now subject to individualised contracts providing an opportunity to significantly increase their annual income. Maintaining pleasant working conditions at the level of the parent organisation is connected to the next element, the motive of the restructuring.

‘Motives of the restructuring’ were also similar at both airports. Managers had a clear motive to shift employment of operating areas into subsidiaries, because it allowed them to maintain a people-oriented culture within the parent organisation, and they therefore directly benefitted from the restructuring. Concerning the liberalisation of the baggage handling services, the airports were increasingly pressured by airlines to reduce the prices for its services. While managers were reluctant to reduce prices for the services, they realised that they needed to accommodate customer demands. Separating areas under cost pressure from other areas proved to be a successful mechanism to channel competition away from the parent organisations. After the restructuring, the people employed at the subsidiaries absorbed the competitive pressure by accepting deteriorating working conditions. The restructuring thus made it possible to maintain a high profitability at the level of the parent organisation. Staying profitable at this level, in turn allowed the sustaining of a pleasant working environment within the parent organisation. The separation proved to be a way to maintain an attractive working environment, including social and financial benefits for those still employed within the parent organisation, including the managers.

Members of the trade unions believe that profits within the subsidiaries are minimised in order to realise greater profits within the parent organisation. Union members point out that subsidiaries need to rent overpriced facilities from the parent organisation, such as warehouses to store the facilities. The subsidiaries become a means of securing some of the monopoly rents of the parents.

It is important to note that the prices for services performed by subsidiaries, such as baggage handling, are centrally negotiated by the managers of the parent organisation at both airports. The manager's performance of the parent organisation, however, is not measured solely from this segment. If the baggage handling area earns the cost of the capital employed, the subsidiary fulfils the minimum requirements of the investors for its existence in the group. A return for investors, however, can still be created in other segments, to satisfy investors and enhance managers' performance.

'Training and further development' have changed since the restructuring, at both airports, and two trends have been observed. First, training and further development for managers and knowledgeable workers have become more important as a result of the stronger shareholder orientation and increasing importance of innovation for certain areas. Second, training and further development has decreased for the majority of workers with the increasing focus on efficiency and the decreasing focus on shop floor innovation. In the past, both airports maintained a highly skilled workforce throughout all hierarchical levels. At both airports the majority of employees had in the past a high standard of training. Employees traditionally underwent internal training programmes over several years. People who successfully acquire the qualification 'geprüfter Flugzeugabfertiger' (certified baggage handler) are considered to be skilled workers and paid adequately. After obtaining this, people have the opportunity to undergo further training to become master of baggage handling (Lademeister). Employees also had access to further training and development offerings at the airports. Unskilled workers were also employed, but only to a limited extent. As a result, the majority of people had a certain technical knowledge repertoire.

The evidence of the cases shows that managers of both airports are well aware that training is crucial to enable workers to carry out innovation. Within both cases, managers stressed that training enables innovation. Well-trained workers are more likely to innovate and identify areas for improvement than unskilled workers. With the high level of training, workers were empowered to engage in continuous improvements and innovation.

Since the liberalisation and privatisation, the majority of people performing operating activities are no longer required to obtain a relevant formal qualification, such as certified baggage handler, in accordance with the German vocational system. At Airport 1, the majority of workers performing operating activities, such as baggage handling and security services, have been shifted into subsidiaries. In these areas training has been reduced to the

legally required minimum. Similarly, managers at Airport 2 shifted employment of these activities into subsidiaries and only a minimum of training and development is provided. Competition provided incentives for airports to cut down training to reduce costs.

‘Quality of services’ has been negatively affected at both airports. The rules of competition changed within the industry because of the new entrants, who offer only a narrow range of services that lower customer comfort to some extent. For example, passengers serviced by the new entrants must disembark via stairs and not jet bridges. Advantages of using jet bridges include, for example, all-weather dry connection between the terminal and aircraft and easier access for passengers who have mobility impairments. While the airports still offer the full range of services, the service quality at both airports has been reduced, and some managers and union representatives expressed concerns that it will further deteriorate.

‘Objectives of the organisation’ shifted at both airports from a stakeholder towards a shareholder ideology. In the past, managers of both airports pursued multiple goals, including profitability as well as providing attractive employment opportunities throughout the organisation. Since the restructuring, organisational goals prioritise the interests of owners of the airport, and thus aim to increase profitability. Managers of both airports stress that only profitable areas can be maintained within the parent organisation.

However, changes in organisational objectives were triggered by different mechanisms at both airports. At Airport 1, changes towards the shareholder ideology were triggered mainly by the introduction of IFRS accounting and value-driven management principles in the context of the IPO. The goals of managers were aligned with those of shareholders through a variable wages component based on whether value for shareholders was created. In contrast, managers at Airport 2 embraced objectives of the shareholders as a response to an identity crisis of the core management team. The managers of Airport 2 perceived an identity crisis because of the low performance of the freight sector. To overcome this crisis, they wanted to prove that they can perform well and embraced a shareholder orientation. Similar to Airport 1, a performance-based variable wage component for managers was introduced reflecting the importance of shareholder value creation. Overall, the shift towards a shareholder ideology was an important prerequisite for restructuring and changing working environments at both airports.

However, at neither airport was the competitive pressure to introduce changes of any urgency. Change was not a matter of survival, but of choice. Both groups deliberately chose to introduce fundamental changes, rather than maintain the existing culture. At no time were they forced by external pressure to change.

‘New management practices’ were also introduced at both airports in the context of the privatisation and liberalisation from the private sector. First, both airports started to benchmark themselves with other organisations. The evidence revealed that Airport 1 started to benchmark their annual profits with internationally listed companies, while Airport 2 benchmarked landing fees for airplanes against other German airports.

Second, managerial wages at both airports were individualised and uncoupled from the collective agreements in the context of privatisation. Under the new wage regime, a variable salary component based on financial performance indicators was introduced at Airport 1 in order to align the performance of managers with the goals of the private shareholder. For the executive team, a stock-option programme was also introduced. Manager at Airport 2 also personally benefit, through a variable salary component from a good financial performance. Managerial compensation increased at both airports in the context of privatisation through variable salary components, the introduction of which was later extended to employees at the level of the parent organisation at each airport.

Third, the profit contributions of divisions and segments are now monitored individually at Airport 1 and Airport 2. Both require that the subsidiaries meet certain profit goals. The achieved profits of each segment also influence the individual reimbursement of the responsible managers. At both airports key strategic decisions of subsidiaries such as prices are still negotiated by managers of the parent organisation.

However, there are some management practices that were not adopted by both airports, and, some elements of divergence therefore exist. While managers at Airport 1 embraced a new accounting regime, managers at Airport 2 did not significantly change their accounting practices in the context of the privatisation. As a publicly listed company, managers of Airport 1 were legally required to adopt the IFRS accounting in 2005. However, the managers decided to embrace the new accounting standards earlier, in 2000, in the context of the IPO. The manager harmonised the internal and external reporting in 2004, which was not legally required. Also, managers at Airport 1 introduced value driven

management, which aligns the incentives of managers with shareholder interests. In contrast, at Airport 2 the major restructuring was undertaken before the partial privatisation, occurring while the airport was still a 100% publicly-owned entity. Nonetheless, managers of Airport 2 also embraced a stronger investor orientation after the partial privatisation.

While subsidiaries at both airports lack to some extent strategic decision-making power, the decision-making autonomy seems to be much lower for subsidiaries of Airport 2. It was argued that through the structural separation, the decision-making process became slower rather than faster. In some cases, basic decisions made by the parent organisation led to inefficient processes within the subsidiaries. Internal collaboration between the managers of the subsidiaries and of the parent organisation was poor, and decisions were often imposed upon the subsidiaries. At the same time, the former and current CEO of Airport 2 emphasised the importance of the autonomy of the units. Yet, this autonomy was not perceived by the subsidiaries, whose managers believe that they are tightly controlled by the parent organisation. Such problems were not reported at Airport 1. Another difference is the use of competitive tendering. Managers at Airport 2 introduced competitive tendering in order to create competitive pressure for their subsidiaries. Such a practice has not been reported at Airport 1.

From an outsider perspective, one could assume that the airports pursue very similar strategies since both carried out similar structural and cultural changes. Table 5.2 compares how they have implemented different themes.

Table 5.2: Restructuring at Airports 1 and 2

| | Airport 1 | Airport 2 |
|--|--|---|
| Reasoning for the restructuring | Competitive pressure | (Potential) competition |
| Adoption of new management concepts | Adoption of new accounting regime, value driven management | Competitive tendering; decentralisation |
| Performance management/ measurement | Set minimum profit goals | Goal to achieve positive profit |
| Performance monitoring | Quarterly reports of profits, ROI | Individual profit reporting |

Furthermore, Table 5.3 provides an overview over the concepts that have been affected by the restructuring of both airports.

Table 5.3: Similarities between the restructuring of Airports 1 and 2

| | Past | Present |
|--|--|---|
| Organisational structure | Unified structure | Subsidiarity; structural separation of core activities. |
| Value creation | Collectively | Individually |
| Goals | Multiple, equally important, goals such as | Goal hierarchy, shift towards a shareholder-strategy |
| | Achieve 'a' profit | Achieve excellence in profitability to satisfy owners |
| | Be a good employer | Corporate responsibility is becoming a theme |
| Employment for majority of workers in operating areas | Provide life-long employment | Flexible, short-term employment (Part-time work, temporary employment agreements) |
| | Wages based on tariff agreements of public service | Lower wages by establishment of new tariff agreements |
| | Focus on quality (Airport 1) | Increase operational efficiency, pressure to perform |
| | Offer training & development opportunities | Satisfy legal training requirement |
| | Provide social benefits such as company pensions | Reduction of social benefits |
| Employment for people working in innovative areas/on the level of the parent organisation | Same as above | Provide socially secured employment |
| | | Wages based on tariff agreements of public service, or similar attractive agreement |
| | | Offer training & development opportunities |
| | | Variable wage component based on performance |
| Innovators | Not clearly defined | Managers and selected skilled workers |
| Goals of managers | Balance different stakeholders' goal | Maximise value of the firm |
| Wages for managers | Based on tariff of public service | Individual contracts for managers |
| | | Variable wage component based on performance |
| | | Increase of wages |

There is a pronounced difference regarding how airports seek to sustain their competitive advantage. Airport 1 aims to maintain its competitiveness by maintaining a high quality standard of its services. Empirical evidence exists that the airport maintains an exceptionally high quality in terms of service quality of baggage handling compared to other European

airports (Templin, 2007). In contrast, Airport 2 strove mainly for cost savings. Recently, however, Airport 2 has adopted a goal of improving quality, but at the time of the interviews, had not achieved a position among the Top 20 European airports in terms of quality.

The different competitive strategies in turn also influence a particular element of the organisational culture, namely the perception about the value of 'Shop-floor innovation'. Even though both airports offer very similar elements of the supply chain, the managers of each have different perceptions about both the general feasibility and the value of shop floor innovation. Managers of Airport 1 believe that shop-floor innovations are generally feasible, and positively contribute towards competitiveness; they maintain certain HR practices that they believe foster shop-floor innovation. In contrast, managers of Airport 2 believe that shop floor innovation is of only little value, and little potential exists. With different competitive strategies, both airports have adopted different HR practices.

The managers at Airport 1 still maintain a participatory, people oriented culture that brings benefits for employees, and fosters commitment and trust on the level of the parent organisation. The managers argue that trust is a precondition for worker-initiated innovation, and it is important that employees still enjoy financial and social benefits. Elements of such a people oriented culture include the promise of life-long employment within the organisations, social benefits such as childcare, and health concerns for its people, as well as competitive wages and salaries. A highly skilled workforce is maintained by almost exclusively employing people who have successfully acquired qualification, and all people have access to a wide range of internal training and development. By establishing a people oriented culture and maintaining a highly skilled workforce, the managers of Airport 1 managed to achieve a high degree of worker motivation and ability to participate in innovation. Managers and union members alike raved about successful worker innovation carried out during the last years. A people oriented culture that fosters trust is considered to be an important prerequisite for innovation. In fact, these innovations are perceived to be central for the long-term competitiveness of the airport. Consequently, the HR practices between employees on the level of the parent organisation differ significantly from those that are employed on the level of the subsidiaries at Airport 1.

Different perceptions about the value of shop floor innovation for competitiveness influence whether employees are encouraged to carry out innovation or not. At Airport 1, managers actively encourage people employed within the parent organisation to share their

ideas and to engage in innovation. The organisation has established a support structure for entering ideas into a suggestion scheme. Employees are well aware of this scheme and proudly submit their ideas. However, managers at Airport 1 argue that the suggestion scheme is not suitable to exploit the full potential of shop-floor innovation. Many ideas are not patentable, and therefore, under the German law (EIA), do not fall under the legal definition of the suggestion scheme. Nonetheless, many of these non-patentable ideas provide a huge savings potential, or enhance the quality of processes. The airport therefore extended their suggestion scheme beyond the legal requirements. Employees who have very good ideas, and innovation that are not patentable, are also rewarded accordingly.

To achieve a culture that fosters shop-floor innovation, managers not only provide to employees financial incentives that go beyond the legal requirements of the EIA, but also publicly celebrate shop floor innovation within the organisation, to increase motivation within the workforce. The evidence of Airport 1 shows that in order to implement the suggestion scheme effectively, more is needed. It is important to communicate the need of worker-initiated innovation well, celebrate success, and facilitate trust- the prerequisite for people to share their ideas.

In contrast, Airport 2 has implemented a suggestion scheme in accordance with the German law. However, the managers of the airport believe that the submitted ideas are of little value. They perceive the obligation to maintain a suggestion scheme as a waste of resources, and the majority of managers do not actively encourage their staff to submit ideas. As a consequence, very little shop floor innovation takes place at the organisation. By reducing the number of submission, the managers minimise costs associated with the assessment. With the negative attitude of managers towards worker initiated innovation, a culture at Airport 2 has evolved in which employees are very reluctant to submit ideas. The few who did so were often disappointed that their contribution was played down by their superior. The suggestion scheme is thus of little value for the competitiveness of the firm. The competitive advantage of the airport results from other sources, such as managerial innovation and relatively low labour costs for operating activities.

Worker' participation has been established at both airports due to legal requirements in Germany. However, the evidence as to whether co-determination benefits the organisation is inconclusive. First, within the parent organisation of Airport 1 the influence of the works council on innovation is generally viewed as being very positive. Managers feel that while

co-determination has sometimes prolonged the decision making, it has improved the overall quality of the organisational change and contributed towards the competitiveness of the firm. Collaboration between managers and representatives of employees certainly facilitated trust amongst the members of the organisation, which indirectly has a positive impact on innovation. Finally, the co-determination also provides an opportunity to influence the learning and training programme of employees, that in turn affects the ability of workers to innovate. The influence of works council also positively influenced the training and further development opportunities. At both airports, there is evidence that co-determination contributed to the creation of new types of vocational training. However, the managers at Airport 2 believe that worker participation in general contributed very little to innovation and organisational change. Co-determination slowed down innovation at the organisations and the managers believe it to be a source of conflict that creates few benefits. Nonetheless, managers also agreed that co-determination hindered neither innovation nor organisational change.

To conclude, both airports underwent similar structural changes in the context of privatisation and market liberalisation. Both airports shifted employment of operating activities into legally independent subsidiaries to circumvent established collective agreements and to disrupt worker participation. The restructuring enabled them to overcome competitive disadvantages resulting from their institutional environment to maintain a major market share after the liberalisation of the baggage handling services. As a consequence of the restructuring, working conditions within the subsidiaries have markedly changed for newly employed staff.

Managers used the concept of competition in an instrumental way to channel the competitive pressure from the parent organisation to the newly established subsidiaries. Competition was the trigger of the changing, deteriorating, working conditions, and also the force that increased financial benefits for managers. Managers argued that these processes were out of their hands, and that the restructuring was unavoidable to ensure the survival of the organisation. The managers of both airports clearly benefitted from the restructuring because it was a mechanism to secure their financial benefits and the people-oriented, pleasant working environment within the parent organisation. Also, they are well regarded as managers because they could sustain a high profitability within the parent organisation. Managers of Airport 2 at no time actively tried to oppose liberalisation, but rather actively embraced the opportunity to introduce change.

CHAPTER 6: INTERPRETIVE ANALYSIS

6.1 Introduction

This chapter discusses theoretical implications of the empirical findings of the study in relation to existing literature. The research was guided by the following research question: *“How have traditionally stakeholder-oriented German organisations sustained their competitiveness in changing institutional environments?”.* The implications of different organisational responses are discussed against the backdrop of different streams of literature, those of institutional and competitive advantage theory. In the following, important themes that triggered the organisational change and influenced its direction are discussed against the backdrop of existing theory.

The chapter shows that both airports adopted management practices from the Anglo-Saxon context that facilitated changes of the strategy from a stakeholder toward a shareholder value strategy. The shift towards a shareholder value strategy also changed the definition of firms' competitiveness. In this vein, this chapter discusses how airports sustained their competitiveness within a changing institutional environment. The chapter further shows that pressure from market competition was important to legitimise the radical organisational change to employee representatives. Finally, the chapter highlights differences between the organisational choices of both airports in terms of employment practices, and discusses the implications of existing theory of these differences.

6.2 New management practices and shareholder value strategy

The data showed that both airports introduced new management practices during the last decade. Comparing the findings with the theoretical concepts discussed in Chapter 2, it becomes obvious that both airports adopted different managerial concepts, which will be discussed in detail in the following.

Airport 1 adopted managerial concepts that were enabled by institutional changes of the legal environment, namely IFRS accounting and executive stock options. Until 1998, German companies were not legally permitted to introduce a stock option programme for its

top managers (Sanders & Tuschke, 2007). Also, until 1998, German companies needed to prepare their financial statements in accordance with the HGB (German Gap).

After the IPO, the organisation encountered a new type of competition; it globally competes with listed companies in the value it creates for its shareholders. Shareholder value principles required by these investors have been defined by Strenger⁶. According to Strenger (1997 as cited in Vitols, 2000) firms need to adhere to the following principles in order to attract private investment capital, (a) define core areas offering high growth potential; (b) create investment matrix; invest in growth areas; (c) set minimum profit goals, monitor these goals and sell or close down underperformers; (d) tie a significant part of both managers' and employees' compensation to performance and (e) clearly communicate strategy, firm's performance and financial situation to investors, including regular meetings with analysts. Table 6.1 illustrates how these principles have been adopted by Airport 1, showing that the organisation aligned its corporate strategy towards the interests of the capital market.

Table 6.1: Shareholder value principles and their implementation at Airport 1

| PRINCIPLE | Adoption at Airport 1 |
|---|---|
| Define core areas offering growth potential | Four core segments defined: Ext. Activities, Ground Handling, Retail & Properties, Aviation |
| Invest in growth areas (e.g. acquisition) - sell other areas | (International) acquisitions and liquidation of subsidiaries e.g. security subsidiary was sold in 2008 leading to a reduction of over 10000 jobs e.g. International acquisition requirement: internal rate of return (IRR) at least 12% after tax |
| Set minimum profit goals | Segments needs to earn a 10% return on capital employed (before tax) after covering the capital cost |
| Monitor goals | Quarterly reporting of profits and return on capital employed |
| Sell/close down underperformers if necessary | All parts must create defined value e.g. Subsidiary need to achieve a profit by 2010 or will be sold |
| Tie compensation to performance | Introduction of stock option plan for executive team Variable part of compensation for all employees at group |
| Clearly communicate strategy & financial situations to investors | Establishment of Investor Relations Team Strategy communicated in Annual report, Visual fact books, etc. |
| Regular meetings with analysts | Investor Relations Team communicates with analysts |
| Harmonisation of accounting | Alignment of internal and external reporting structure in 2003 |

(Shareholder value principles adopted from Strenger, 1997; as cited in Vitols, 2000)

⁶ Strenger is currently member of the Supervisory board at Airport 1.

In 2004 managers at Airport 1 harmonised their external and internal accounting systems to ease the financial reporting, which also represents a commitment towards shareholder value strategy (Trapp, 2010). As a consequence, the internal structure is now aligned with the external reporting structure.

The implementation of IFRS accounting and value-driven management concepts in the context of the IPO, radically changed the corporate strategy of Airport 1. The adoption of IFRS accounting was legally not required until 2005. Since 2000, Airport 1 prepared its consolidated financial statements in accordance with IFRS accounting standards which triggered the radical change of the firms' strategy. Current literature is concerned mainly with how the introduction of IFRS affects the quality of financial reporting for investors (Haller & Eierle, 2004; Trapp, 2010). Jones and Luther (2005) point out that “[i]t is generally accepted that the IFRS system is fairly closely modelled on ‘Anglo-American’ financial accounting traditions and thus its adoption signals a market departure from German traditions” (p. 167). The authors speculate that the introduction of IFRS accounting will markedly change traditional management accounting practices of German firms. Empirical research as to how the shift towards the IFRS accounting affects organisational culture and strategy on the firm level is rare. The empirical evidence of this study shows how the implementation of IFRS accounting fundamentally altered the goals of the airport towards achieving excellence in financial performance, which also triggered changes in organisational values and culture.

A shift from a collective culture towards an individualist culture was also triggered by IFRS accounting. In the past, the stakeholder culture implied that value is created collectively, and pronounced interdependencies between different activities. Value creation was seen as the outcome of a complex system, and all activities in the value chain were perceived to be important for organisational success. The IFRS accounting fragmented the value chain of the airport. IAS 14 explicitly requires firms to cluster activities into segments and to report the profitability of each segment individually; each segment at the airport is now individually responsible for generating profit. The calculation of the financial results of each segment in accordance to IAS 14 is perceived to be rational, objective and fair. Because of its perceived objectivity, the concept of value driven management has proven to be powerful in legitimising cultural changes and the deterioration of benefits of those working areas, such as baggage handling, that are perceived as not adding enough shareholder value. The change of the accounting altered perception from an integrated model of value creation

towards a view that each segment needs to create value independently. The change towards external reporting can also be interpreted as a reorientation from the traditional ‘technically-oriented’ system common in the German context, which stresses interdependencies between different functions, towards the ‘financially oriented’ accounting common in the Anglo-Saxon context (Jones & Luther, 2006).

Managerial success is now greatly measured by external measures that are accepted and longed for by the stock market (Trapp, 2010). Under the stakeholder culture, managers needed to serve the interests of several stakeholders, and an important goal for them was to create and sustain employment for the region. Through the introduction of IFRS reporting, these goals have been downgraded. The performance of each segment is measured by the RoAirport similar to the EVA. As suggested by Strenger (1997; as cited in Vitols, 2000), minimum profit goals have been set for each segment and are monitored, to achieve at least 10% RoAirport. Segments that miss this goal may be sold or closed down. On the other hand, segments which create a high value for shareholders are financially rewarded. The airport has thus shifted towards a value-driven management concept which is commonly associated with a shareholder value strategy (Höpner, 2003). Prominent authors discussed whether strategy is dominated by the organisational structure (Hall & Saias, 1980) or whether “structure follows strategy” (Chandler, 1962). At Airport 1, it can be observed that structure and strategy follow accounting. The results of external reporting determine whether a business unit earns its right to exist within the organisation.

Long term investments in innovation under shareholder value strategy are harder to justify due to uncertainty. The parent organisation controls whether innovation will be carried out based on their potential to create shareholder value. Johnson and Kaplan (1987) provided evidence that a shift in U.S. firms from management accounting towards financial accounting has reduced their innovativeness and, over time, also their competitiveness. Kaplan and Norton (1992) also make the argument that the focus on financial results may hinder investments in continuous improvements and innovation needed for future competitiveness. The findings of this study somewhat confirm this observation. Through the adoption of external accounting, organisational strategy is dominated by short-term profitability, to some extent preventing innovation with a longer term horizon at Airport 1.

Airport 2 carried out organisational restructuring after an identity crisis of its managers, triggered by poor performance of the freight area. The proposed changes in the institutional environment, namely from the Council Directive, provided an opportunity for them to redeem themselves by demonstrating their capability of being successful managers. To embrace this opportunity, they introduced organisational change closely modelled on concepts of the New Public Management (NPM). It has been argued that the NPM ideology was adapted only to a relatively low degree in Germany, (Hood, 1995). However, Reichard (2003) argues that there was pressure neither from the national government nor from consultancies or academics, German managers adopted NPM “from the inside, from below and from the practitioners’ front” (p. 350). Klages and Löffler (1998) agree arguing that NPM in Germany occurred through a “bottom-up revolution”, and was not driven from the state level. The findings of this case confirm that the adoption of NPM was driven by the managers of Airport 2.

Table 6.2 illustrates basic assumptions and core elements of NPM identified by Diefenbach (2009), and how these principles have been adopted by Airport 2. Based on the framework developed by Diefenbach, it will be shown how managers have adopted elements in core areas of NPM to overcome their identity crisis.

Table 6.2: Core Elements of NPM and its implementation at Airport 2

| Area | Element | Discourse at Airport 2 | Observation at Airport 2 |
|--|--|---|--|
| Business environment & strategic objectives | Changing environment, external pressure | Competitive pressure through liberalisation | Very little competition evolved |
| | No alternative but to change strategy | Alternatives: change or outsourcing | Radical changes of culture and structure |
| | Market orientation | Need to provide better value for customers | Cost reductions for services; but lower quality |
| | Stakeholder orientation | Goals: lower service cost; increase shareholder value | Customers' and owners' interests gain importance; employees interest decrease |
| | Improve organisational efficiency | Pressure to improve operational efficiency | Reduction of labour cost, not smarter processes |
| | Cost reduction, downsizing, outsourcing | Pressure to lower cost/outsource | More flexible work, Subsidiarity, tendering |
| Organisational structures & processes | Decentralisation and re-organisation, flexible structures | Clear organisational structure, segments are responsible for outcome | Holding structure (profit and cost centres), but little decision-making-power of decentralised units |
| | Focus on processes, particularly faster decision-making processes | Faster decisions through autonomy of units | Longer decision making , disempowerment, less internal collaboration |
| Performance management & measurement system | Monitoring/assessment of performance through explicit targets | Orientation on market mechanism; subsidiaries accountable for performance | Profit/cost centres, clear goals for managers, but accountability without power of Subsidiarity |
| | Positive consequences for people, e.g. higher performance and motivation | People enjoy restructuring, have fun and like new responsibility | Positive consequences for managers (higher wages, prestige) but not for employees |
| | Managers carry out managerial functions | Managers are accountable for performance | Few, selected individuals responsible for innovation |
| Employees & corporate culture | Empowerment and subsidiarity, staff expected to become entrepreneurial | Responsibility of subsidiaries for results, establishing an entrepreneurial culture | Very little power to pursue new ideas; innovation from employees are perceived as being a nuisance |
| | New corporate culture | Business like culture | Radical changes of the culture |

(Core elements and areas adapted from Diefenbach, 2009, p. 894)

‘Business environment and strategic objectives’ at Airport 2 were significantly changed by managers following the logic of NPM as discussed by Diefenbach (2009). Managers convincingly argued that organisational change was necessary as a result of “strong external pressure”, i.e. the forthcoming liberalisation of baggage handling services. Using the concept of competition, managers argued that there was “no alternative but to change”. The finding that firms that followed the ideology of NPM made others believe that there was no alternative than to introduce change, confirms observations made by Diefenbach (2007; 2009).

Managers made the case that Airport 2 needed to become more *market-oriented*. Competitive tendering for the subsidiaries was introduced, so that subsidiaries had to compete with outsiders for performing services for the parent organisation. Subsidiaries were encouraged to improve operational efficiency in order to provide better value for customers. Profitability became a required goal for each division to be sustained within the holding, and social benefits were reduced to maintain it. The adoption of managerial principles from the private sector such as competitive tendering (Lane, 2005; Wollmann, 2000) is frequently advocated by the NPM in order to achieve greater efficiency (Christensen & Lægveid, 2007; 2001).

The findings also showed that ‘performance management and measurement systems’, including the introduction of explicit targets and performance goals, were implemented, as common in NPM (Diefenbach, 2009). Managerial wages are now aligned with financial performance, and achieving the of investors’ goals is a key to managerial success. This reorientation towards shareholder interests is not surprising, but rather a logical consequence of the partial privatisation of the airport.

‘Organisational structure and processes’ at Airport 2 were changed in accordance with the NPM. Diefenbach (2009) points out that NPM favours decentralised organisational structures and faster decision making processes. Managers of Airport 2 argued that the new organisational structure makes areas more accountable for their results, accelerates the decision-making process, and increases transparency and efficiency.

Viewing the facts, however, the data showed that subsidiaries were given only weak decision-making power and cannot be considered independent organisations. They lack decision-making power in hiring decisions or key market parameters. The parent organisation

dictates price and quality of certain input factors to their subsidiaries (supply-side monopoly). Also, the parent organisation is often the only, or at least the main, customer, and can exert pressure on prices for their services (demand-side monopoly). The parent organisation thus secures monopolistic rents. The findings confirm the argument made by Diefenbach (2009) that decision-making power in fact often remains centralised. Also, despite that NPM often promotes worker empowerment, the introduction of NPM does in reality lead not to greater autonomy, but to more bureaucracy (Diefenbach, 2009). Pollitt (1990) argues that under NPM, important activities usually remain centralised and only operating areas of low importance for the future direction of the firm are decentralised.

Although **both airports** implemented different management and employment practices, the outcome of these practices on organisational culture were very similar because they are based on a strikingly similar, underlying ideology. Both management concepts are adopted from the Anglo-Saxon context, and aim to align the goals of managers with those of the owners. They rest on the assumption of the principal-agent theory, which is also central for shareholder value strategy. The following were adopted at airports: ‘managerial ideologies’, ‘managerial reimbursement and status’, ‘managers’ attitude towards the restructuring’, and ‘career patterns and labour markets for managers’.

Managerial ideologies have changed significantly at both airports. The adoption of new managerial practice underpins a shift of the underlying belief system of both. In the past, both followed a stakeholder strategy, balancing the interests of different stakeholders, which was common practice in Germany (Jackson, 2001; Yoshimori, 1995). In the past, managers at both airports were committed towards the well-being of employees, and an important goal was the provision of good and secure employment. Neither airport strove to achieve excellence in financial performance by sacrificing employment or by deteriorating working conditions. Different areas worked closely together, and organisational output was perceived to be a collectively created team effort. Each airport had internalised all critical processes of the value chain irrespective of its financial contribution.

With new management practices, the standing of different stakeholders has changed within both airports. While the responsibilities of providing secure and attractive employment opportunities for employees decreased, investors’ interests have become more important. Such a change in strategy represents a fundamental change in the organisational culture and the underlying belief system. Both airports changed their understanding of the purpose of the

firm, providing evidence that a shift in the belief system of managers occurred (Witt & Redding, 2009). The existing literature revealed controversial discussion as to whether a shift towards shareholder ideology occurred in Germany. The findings of this study provide support for Höpner's (2003) finding, that German firms did adopt elements of this strategy. Both exogenous and endogenous forces led to the implementation of new managerial practices that radically changed both culture and organisational strategy.

A consequence of shareholder value strategy, managerial success, is now measured differently. The profit goal is implemented throughout the organisational hierarchy at both airports. Different activities are structurally separated, and each segment is exclusively responsible for its results (Airport 2), or needs to achieve a defined value contribution on the capital employed (Airport 1). Zugehör (2003) pointed out that the core idea of shareholder-oriented corporate management is to differentiate between activities that create and destroy shareholder value. According to Zugehör (2003), each activity of the firm needs to earn a defined return. Both airports adopted this core idea and are prepared to sell or close down underperforming areas. The two airports are prepared not only to lower working conditions for the lower hierarchical levels for the benefits of shareholders but also to pare down employment in order to sustain profits. Commitment to employees is no longer desired, and temporary workers are increasingly used. The changing perception of managers about the importance of different groups of stakeholders marks the shift from a stakeholder towards a shareholder paradigm (Rappaport, 1986).

Managerial reimbursement and status was an important theme at both airports. Managerial success is increasingly measured by excellence in financial performance, which is also reflected in managerial reimbursement, which has been aligned to the profit goal of investors. Managers have to prove that they can successfully manage the airport, and profit is the main indicator of their capabilities. The introduction of a variable salary component based on financial performance, as suggested by advocates of the principal agent theory, aligns the interests of managers with those of the owners (Jensen & Murphy, 1990; Kerr & Bettis, 1987).

While in the past organisational performance was considered the result of a collective effort, after the restructuring, the contribution of managers and knowledgeable workers is considered to be more important. This observation is consistent with existing literature suggesting that the introduction of NPM (Diefenbach, 2005) and shareholder strategy

(Höpner, 2001) not only measures managerial success more on financial performance indicators, but also legitimates rising managerial compensation. Managers and knowledgeable workers receive certain privileges, for example, individualised training and development opportunities at both airports. While no data was collected of the external perception of the managers, the findings indicate that a positive self-image of the managers was important for most of them. Managers at both airports proudly pointed out that they had achieved high returns for the owners of the airport during the last years.

The evidence from Airport 2 clearly indicates that the new organisational strategy was important to recover the managers' self-image. The shift towards a shareholder orientation not only increased financial rewards but also positively affected their image and status. Other authors have established that there is a link between shareholder orientation and managerial reputation. Höpner (2001) provides evidence that managers who implement a shareholder value strategy are likely to enjoy a better reputation. Other authors argue that the introduction of NPM positively affects the social status and increases the influence of managers (Deem & Brehony, 2005; Diefenbach, 2009).

Managers' attitude towards the restructuring was also generally positive, which is not surprising given the evidence that these personally benefitted from the adoption of the new managerial practices. Some authors have made similar observation that the adoption of management concepts such as the shareholder value strategy (Höpner, 2001, Vitols 2000), or the NPM (Diefenbach, 2009) was driven by managers themselves rather than forced upon them. For example, Höpner (2001) provides empirical evidence that board member compensation in Germany rose sharply in the late 1990s as a result of shareholder value orientation. Based on these findings, Höpner (2001) argues that managers benefit from both stock options and rising fixed remuneration, and therefore have an interest in introducing a shareholder value strategy.

Career patterns and labour markets for managers changed at both airports. In the past, managers typically underwent technical training, and therefore had a good understanding about the specific value creation of airports. Employing managers with a technical background and practical expertise had been considered a typical feature of the traditional German model (Child et al., 1983; Lawrence, 1980). At both airports there is evidence that a deep understanding of airport functioning is becoming less relevant for a managerial position, reflecting a departure from the traditional German model. Before the restructuring, managers

at the two airports were often promoted internally. Nowadays, the airports increasingly hire managers from outside the industry. There is evidence that there is a departure from the traditional “closed labour market for managers” prevailing in Germany (Aguilera & Jackson, 2003), and a greater number of managers is recruited from the general labour market. At both airports, there is a mix of managers hired externally and internally. Concerns have been raised from the managers and union representatives, that managers who are not trained internally lack an understanding of the operational processes. Again, changing career patterns reflect a change in the norms of the traditional German model.

To summarise, the evidence of the airports indicates that managers had a personal interest to push through the restructuring. At both, top managers introduced cultural change by embracing new managerial concepts, namely IFRS accounting (Airport 1) and NPM (Airport 2). The introduction of new neo-liberal managerial practices indicates organisational isomorphism; both airports share the belief that a shift towards shareholder ideology is “appropriate” (Greenwood et al., 2002). Pressure on the firm level to introduce change was also exerted from exogenous forces, namely changes at the supranational level, i.e. the Council Directive. Similarly, the introduction of IFRS accounting (Airport 1) was fuelled by a changing institutional environment. It can thus be argued that the organisations adapted to the incentives of a changing market and institutional environment. As a consequence, both airports radically broke free from the norms and values of the national corporate governance system.

6.3 Organisational change and competitive advantages

Liberalisation and privatisation was seen by both airports as an opportunity to introduce change that radically broke with the German model. Meyer et al. (1990) argued that institutional change is often triggered by “jolts”, such as industry regulation. Both airports used these jolts to re-orient their strategy towards a shareholder model. The findings provide further empirical evidence that changes of competitive pressure triggered processes of deinstitutionalisation and re-institutionalisation.

The definition of firm competitiveness changed. From the stakeholder view, this is defined by how well a firm fulfils the demands of different groups of stakeholders. Such a view includes a variety of dimensions such as achieving profits, providing an attractive

product and service offering, and employment. In the past, both airports followed this definition of competitiveness when their managers shared an understanding of competitiveness that aimed to balance the interests of different stakeholders.

This perspective stresses the centrality of customer needs for firms' competitiveness. Competitive pressure on the market level gives firms incentives to develop valuable resources or specific competencies (Barney, 1991; Porter, 1991) in order to sustain competitive advantages. Existing literature highlights the importance of organisational learning for firms embedded in changing market environments (Argyris & Schön, 1978; Cohen & Levinthal; 1990; Nonaka, 1994). Existing theory suggests that increasing competition provides incentives for firms to invest into organisational learning including the training and learning of their workforce (D'Aveni et al. 2010; Lam, 2010; Nonaka, 1994). Also, HR practices, such as training programmes, are increasingly becoming an important source of competitive advantage (Pfeffer, 1994).

The emphasis on developing resources and specific competencies has significantly decreased at both airports for operating areas after the liberalisation of the baggage handling. As a consequence, the importance of tacit knowledge that is important for innovation (Nonaka, 1994; Reed & DeFillippi, 1990) decreased for operating activities. In the past both airports engaged in organisational learning throughout all hierarchical levels to improve the quality of their service offerings. However, this changed after the liberalisation of the baggage handling market. Airports departed from HR practices that aimed to maintain a highly motivated, loyal and highly skilled workforce in order to increase shareholder value. They adopted practices that put emphasis on saving labour costs. Thus, the findings reject the assumption of the literature that firms strive to sustain competitive advantages with an increasingly competitive environment.

The training offered by both airports to workers performing operating activities on the level of subsidiaries has been highly standardised in accordance with legal requirements, and therefore drastically reduced. The majority of the workers in baggage handling are no longer required to acquire a relevant qualification in accordance with the German vocational training, as in the past. Knowledge is reduced and as a result, differences between the services offered by airports and competitors are diminishing. Both airports seek to achieve cost advantages rather than differentiation advantages (Porter, 1980; 1991). Innovation has become more selective, focussing on managerial innovation that is directly measurable

regarding its shareholder value contribution. As a result, both airports increasingly rely for operating activities on a temporary workforce that is dissatisfied and distant with their workplace. These findings are similar to observations of Pfeffer (1994) who argues, based on evidence from the U.S., that firms are increasing their reliance on part-time and temporary work, despite opportunities to build up competitive advantage through a more highly skilled and committed workforce.

In the newly liberalised environment, the two airports perceive firm competitiveness differently. Airports adopted a definition of *firm competitiveness* that fit the neo-liberal ideology; firm competitiveness is now measured by how much value is created for shareholders (Friedman, 1970). Firm competitiveness at the product and market level, on the other hand, has become a means of increasing shareholder value.

Beckert (2009) argues that markets are embedded in society, and firms may sustain a competitive advantage by adhering to societal norms and values. On the other hand, actions that not adhere to institutional incentives may not be seen as legitimate, and may negatively impact a firm's competitiveness (Dacin et al., 2007). Departing from the incentives of the institutional system, namely those of the German model, would reduce competitive advantage from an institutional perspective. However, recent institutional reforms, such as the Council Directive, changed both airports' interpretation of their environment (Streck, 2009). They believe that subsidiarisation and changes in employment practices and working conditions are now acceptable, suggesting a shift towards convergence of the wider institutional environment of the German model towards the Anglo-Saxon.

The fundamental change in the purpose of the airports triggered various processes of de-institutionalisation and re-institutionalisation on the firm level. The findings indicate that airports embedded in a changing institutional environment perceived that breaking free from the incentives of the German model would provide a competitive advantage in terms of value creation for shareholders. Both airports anticipated that blind compliance to the institutional environment would reduce the competitiveness to generate shareholder value over time. By shifting employment into newly established subsidiaries, both circumvented the regulatory obligation of the German model that limited or even risked this competitiveness from the shareholder's point of view. Thus the organisations exercised strategic choice within the boundaries of institutional norms (Child, 1997). Neither expected that they would lose legitimacy by introducing change; they expected that customers and investors would reward

them for it, and they would increase their legitimacy. Restructuring was thus supported by institutional changes on the supranational level.

Workers' participation and collective bargaining has been weakened by both airports through the restructuring to increase firm performance in terms of shareholder value. With the disruption of worker participation and collective bargaining, costs of training, and financial and social benefits for workers, were significantly reduced. Both airports radically departed from the established norms and values of the traditional German model based on trust and commitment, described in recent literature by different researchers (Börsch, 2007; Hall & Soskice, 2001) in order to increase shareholder value, and remain competitive. The airport carried out an organisational innovation to increase its competitiveness in capital markets. According to the Oslo Manual (OECD, 2005), "an organisational innovation is the implementation of a new organisational method in the firm's business practices, workplace organisation or external relations" (p. 153).

The evidence shows that managers decided to circumvent existing institutions of the German model rather than lobby for institutional change at the macro level. By shifting employment into legally independent subsidiaries, Airport 2 successfully undermined established collective bargaining agreements which would have constituted a competitive disadvantage under the shareholder value strategy. Fligstein (1997a) suggests that actors may circumvent parts of the institutional environment that constitute a disadvantage for them, or to use them in an unintended way if this serves their interests. Fligstein's (1997a) argument can be taken one step further. In the case of the collective bargaining agreements, non-compliance with the institutional incentives led directly to a competitive advantage. By non-compliance with established collective bargaining agreements, Airport 2 achieved a temporary competitive advantage compared to other airports. The airport achieved considerable cost advantages by breaking free from the normative incentives of the classical German model compared to those who still complied with it. Airport 2 encountered a disincentive to introducing institutional change that would align the institutional incentives of the German model with their organisational practice. In other words, Airport 2 was not interested that other airports would follow its example to shift employment into subsidiaries, because this would erode their competitive advantage.

However, over time, Airport 1 adopted a structure similar to that of Airport 2, mimicking its organisational structure and strategy. DiMaggio and Powell (1983) argue that organisations may mimic each other in times of ambiguous or conflicting goals. According to the authors, mimicking other successful organisations in their industry avoids decisions being influenced by a particular internal group which could increase internal conflicts. Managers at Airport 1 had a conflicting perception about the purpose of the organisation. While the older manager generation tended to balance the interests of different stakeholders, the younger was more inclined to believe creating value for shareholders to be of uppermost importance. The managers' ambiguous of the purpose of the organisation may have favoured the adoption of a structure that had previously proved to be "successful" and "legitimate" by another in the industry. Competitive advantage was not sustainable. The practice of shifting employment into subsidiaries is known as the 'CityX- model' within the German airport industry because it enjoys industry wide legitimacy.

Skill levels necessary to perform operating activities changed with the liberalisation. Customers demanded a cheaper service-offering carried out by a lower-skilled workforce. While managers at Airport 2 soon introduced changes to reduce labour costs, managers and representatives at Airport 1 were initially resistant to cutting down on training. After increasing pressure, the latter also reduced training and further development on the level of the subsidiary to capitalise on cost. The changing perception of customers and airports regarding the required level of training can be explained by existing theory. Beckert (2009) argued that through the definition of certain standards, products and services become more easily classifiable for customers. As a consequence of standardisation, objective criteria, including price are becoming more important for buying decisions. With the Council Directive, the requirements for performing baggage handling activities were legally specified, including the training requirements for the workers, so that the processes for baggage handling have become more standardised and homogenised. As suggested by Beckert (2009), due to the standardisation, cost became increasingly important for customer buying decisions over more standardised services. At the same time, a legal definition of the demanded skill level of workers in baggage handling in the Council Directive was an important means of legitimizing the use of lower-skilled workers.

Current literature argues that agents do not blindly follow the institutional environment, but deliberately choose strategies to respond to a certain institution, or even circumvent institutional change by finding unanticipated ways to respond to pressure (Beckert, 1999; Hancké & Goyer, 2005). Because both organisations adopted over time very similar strategies in terms of the employment conditions within their subsidiaries, it can be argued that both airports shared a similar logic about what strategy is appropriate. Mimetic behaviour implies a very strong institutional pressure from the cultural-cognitive pillar in terms of what strategy is commonly accepted in a certain context (Scott, 2008). The mimetic behaviour of both airports reflects a change in the wider institutional environment towards a more liberal model, as pointed out by Streeck (2009), and customers also put pressure on airports to shift towards those work practices that are common in the Anglo-Saxon context in order to reduce cost. Both airports fulfilled the normative expectations of their customers and of the wider institutional environment. In Scott's (2008) definition, airports encountered normative pressure to adopt a shareholder value strategy.

It can be concluded that the deregulation of markets and the resulting increase of competitive pressure neither motivated firms to develop sustainable competitive advantages nor provided incentives to carry out innovation, and consequently to up-skill employees as the literature assumes (Dierkes, 2001; Dosi et al., 2006). The opposite happened - both airports shifted resources into areas that encountered less competitive pressure. As a result, the capabilities to carry out product and process innovation drastically decreased in areas that encountered increasing competition. The introduction of competition changed the strategy of firms from focussing on innovation towards operational efficiency and provided incentives to reduce training and education in certain areas. Although to different degrees, the quality of the services such as baggage handling deteriorated at both airports. Hence, cost competition has been the driving force for convergence toward HR practices that are more oriented towards the liberal model of corporate governance. Nonetheless, while both airports adopted similar strategies on the subsidiary level, there are also some differences as to how the two airports responded to institutional incentives, namely on the level of the parent organisation. Differences between firms' choice are the subject of the next section.

6.4 Institutional change, market competition and legitimacy

From the perspective of discursive institutionalism, fundamental institutional change can be explained with ideas (Blyth, 2003). In times of crisis, actors may challenge the existing institutional framework, and become passionate about new ideas. It can be argued that German managers embraced ideas and managerial concepts of the Anglo-Saxon context during the privatisation and liberalisation of the airport industry because they believed these concepts would increase the airports' competitiveness. Managers at both airports adopted practices that were already commonly accepted by their international counterparts during the restructuring, including the benchmarking of managerial wages and organisational structures.

Sanders and Tuschke (2007) argue that organisational practices are globally diffused through the adoption of widely accepted practices by another environment. The observable success of these concepts in different environments helps to overcome barriers of legitimacy (Scott, 2008) in a different context. Sanders and Tuschke (2007) use the example of how stock-option pay for executive managers was legitimised in German firms to illustrate this process. This study supports this argument made by Sanders and Tuschke (2007) that practices enjoying legitimacy in different environments are likely to be adopted in other contexts. Both the shareholder value strategy and NPM had been proven successful globally before they were adopted by Airports 1 and 2 respectively. Today, the perception about the fair value distribution at both airports is now largely influenced by the shareholder value ideology that underpins both management concepts.

Nonetheless, while managers of both airports actively embraced norms and values of the Anglo-Saxon context, their implementation and the resulting restructuring on the firm level does not justify that these practices are superior to existing managerial practices of the German model. Managers introduce institutional change while hiding their true motives using the concept of competition.

Potential competitive pressure on the product and service market legitimized the de-institutionalisation of norms and values of the traditional German model. Creating the perception of competitive pressure was a powerful concept to overcome barriers to legitimise the significant reduction of employee benefits and training. Surprisingly little oppositions on behalf of the employee representatives occurred over the restructuring. It is not feasible that employee representatives would have accepted the restructuring without perceiving it to

unavoidable. Managers of both airports convincingly argued that competitive pressure resulting from the deregulation of baggage handling services forced them to carry out the restructuring to sustain the airports' competitiveness. With the new entrants, the potential for differentiation based on quality diminished. Furthermore, by comparing the cost structures for labour with those of the new entrants, it was argued that labour costs needed to be reduced in order to compete on cost. Building on Porter's theory of competitive advantage (1985; 1991) managers convincingly argued that there was no alternative than to introduce change that fundamentally broke free from established norms of the German model.

Employees have a general interest in maintaining the competitiveness of the organisation (Dilger, 2002; as quoted in Stracke & Nerding, 2010), and in Germany members of the works council are legally bound to act in the interest of the organisation (The Works Constitutes Act, §2). Compromising firms' competitiveness would result in outsourcing of operating activities. Managers successfully convinced employee representatives that the changing institutional environment had eroded the possibility of maintaining secure and good working conditions and a highly skilled workforce. Competition and privatisation served as a central mechanism to conceive, communicate, and to justify organisational change on the firm level.

Fair treatment of employees was an integral part of the traditional German model. Managerial success was also assessed by whether these normative expectations were met. However, liberalisation of markets changed this norm, and made it acceptable to fundamentally break with normative expectations. The findings are consistent with Streeck's (2009) observation that during privatisation, collective bargaining agreements of former state-owned firms were dissolved in Germany, and employment of civil servants was replaced with "casualized low-wage employment under much more demanding working conditions" (p. 73). Streeck (2009) provides evidence that in Germany a lower number of workers are covered by collective bargaining as a result of changing membership patterns in unions and employer associations. The findings of this study provide further evidence on how firms can actively retreat from agreements made in the past by employer associations, namely by subsidiarisation, contributing to understanding why collective bargaining decreases.

The liberalisation also legitimised the deskilling of workers because the Council Directive, which was transposed into German law with the BADV, legally defined requirements for performing baggage handling services. The norms of the traditional German

model implied that firms should strive for a highly skilled workforce (Streeck, 1988). Both airports adhered to these norms in the past maintaining that workforce within all areas. For example, the majority of employees underwent specific vocational training, such as certified training for baggage handling. Relying on a highly skilled workforce was a taken for granted practice, and enjoyed cultural-cognitive legitimacy (Scott, 2008).

The newly introduced legal requirements by the BADV are lower for the training of workers compared to established practices in the German airport industry because not all staff are required to undergo the vocational training. Because workers who have not obtained formal qualification need to be supervised by a skilled person, regulatory legitimacy was provided to use lower skilled workers. New entrants proved that deskilling was feasible by performing services with a lower skilled workforce. Over time, the practice was adopted in the industry, and is now considered to be appropriate. The evidence of both cases indicates that skilled employment has declined since the deregulation of baggage handling services. Through the Council Directive, institutional change in the legal environment was introduced. Over time, changes in legal institutions triggered changes in the normative pillar of legitimacy defined by Scott (2008). Both airports changed their perception of a highly skilled workforce being desirable. Airports now adhere to legal requirements rather than rely on social norms and institutionalised practices established in the past defining how things should be done.

Deskilling of the workers was important to justify cuts in wages and social benefits for the workforce. In the German model, it is still expected, and to some degree also legally required through collective agreements, to pay adequate wages for skilled workers. Paying low wages to unskilled workers, however, is an accepted norm in the German model. The reasoning that increasing competition puts pressure on wages for lower skilled workers is commonly accepted. Slaughter and Swagel (1997) point out that it is a widely held belief that global competition put downward pressure on the wages of low-skilled employment in advanced economies. At the same time, competition justified increasing benefits for managers because of their high skill levels. Managerial wages increased at both airports based on the argument of changing rules of competition in markets for managers. To attract the best managers who maximise the firms' value, firms need to pay higher wages.

The study provides evidence that the consequences of competition enjoy their own legitimacy, which can explain the low resistance from employee representatives towards the changes. Consequences of competition gained cultural-cognitive legitimacy in accordance to Scott's definition (Scott, 2008); the consequences of competitive pressure from the market level that necessitate organisational change are not questioned. Managers and employment representatives accept that competitive mechanisms in the market lead to the following outcomes: (a) competition will lead to the best outcome for the stakeholders of the firms; it sets incentives to innovate and to increase efficiency, it increases the welfare of society in the longer run; (b) increasing competition increases the spread between wages of lower-skilled and highly skilled employees; (c) increasing competition puts pressure on firms to reduce labour costs of unskilled workers; and (d) firms which fail to embrace the rules of competition vanish, so change is inevitable.

By using the concept of competition and subsidiarisation, both airports could maintain their image as a good employer even though they broke with some social norms in regard to providing attractive and secure workplaces. Competition was utilised to demonstrate that the airport had no choice but to introduce change. Due to the organisational fragmentation, subsidiaries had initially not established collective bargaining, which reduced the transparency of organisational practices to outsiders.

Airport 1 established an image of social responsibility by providing attractive working conditions on the level of the parent organisation, and communicating these to outsiders. The perception of outsiders is reflected in a recent award of the German Government to the airport for providing a family-friendly working environment for its employees. Despite this, the real degree of corporate social responsibility of the airport has declined in the context of privatisation, reflected by deteriorating working conditions within subsidiaries, putting stress on workers and their families. These conditions are not reflected in the image of the airport. This finding challenges Scott (2008)'s argument that legitimacy is not transferable. According to Scott, legitimacy is a fundamental concept to explain why firms need to act in accordance with different types of institutions. Scott (2008) argues that legitimacy is not just a specific kind of resource it shows how an organisation is embedded within its environment:

“[L]egitimacy is not a commodity to be possessed or exchanged, but rather a condition reflecting perceived consonance with relevant rules and laws, normative support, or alignment with cultural-cognitive frameworks. ... legitimacy is ... a symbolic value to be displayed in a manner that it is visible to outsiders” (Scott, 2008, pp. 59-60).

By reducing the transparency, and maintaining a good image on the surface, legitimacy has been successfully commoditised at all levels of Airport 1. Legitimacy gained through the behaviour within the parent organisation has been displayed in a way that the airport as a whole enjoys a good reputation.

Given that the threat of competition was an important concept in gaining legitimacy for the restructuring, surprisingly little competition evolved within the liberalised areas. Within the area of baggage handling, the market share of new entrants remained very low. The definition of market power of the GWB [(German) Act against Restraints of Competition], §19 (3) assumes market power if a firm's market share is at least one third. The within-case discussions revealed that both airports managed to maintain a market share of more than two thirds despite competition. In 2009, the market share of the third-party provider of baggage handling services at Airport 1 had dropped to 12.4% (Airport 1, 2009), whereas the third party provider at Airport 2 announced its cessation. From this perspective, both airports possess significant or even absolute market power within the area of baggage handling. At no time, did significant competition evolve, and the market environment remained relatively stable. Both airports established dominant market positions.

Considering that substantial competition did not evolve, it is not convincing that cost cutting was necessitated due to competitive pressure. Rather, managers used the concept of competition in an instrumental way to put pressure on wages and social benefits of unskilled workers. The increase of uncertainty after liberalisation was perceived by both airports as an opportunity to introduce change. They convincingly communicated to employees that a departure from the institutional incentives became necessary to maintain the airports' competitiveness. Fligstein (1997b) made the point that actors can introduce change by convincingly making a case for it. Employees seemed to blindly trust managers with their judgment, which implies that established trust in the past under the traditional system, enabled change towards the shareholder model. Competition was the institutional forces that triggered restructuring.

Perceived competitive pressure was a powerful force to legitimise radical organisational change, and at the same time maintain legitimacy within the German context. Given the centrality of competition for firm strategy in the literature, the role of competition as a mechanism in bringing about organisational change is not surprising. Competition often refers to how (potential) behaviour of other actors impacts on firm strategy (Baumol, 1982; Nelson & Winter, 1982). Here, competitors are actors. While competition is not an institution as such, consequences of competition can very well be institutionalized.

To recapitulate, the study provides empirical evidence of how convergence towards the Anglo-Saxon system occurred, and confirms the argument made by Streeck (2009) that recent institutional change occurred in Germany. The shift towards a shareholder value strategy on the firm level was actively driven by the two airports who embraced managerial concepts from the Anglo-Saxon context. Airport managers had a direct interest to introduce change because it increased their status and financial rewards. The importance of changing interests of actors to drive change has been highlighted by Blyth (2003). To overcome barriers for institutional change of employee representatives, competitive pressure from the market environment was a suitable concept to justify the restructuring. However, considerable competition never evolved, and therefore the ‘idea of competitive pressure’ proved to be a powerful mechanism to introduce institutional change. The findings are aligned with the assumption of discursive institutionalism that actors use ideas to overcome institutional barriers and alter the existing framework (Crouch & Farrell, 2004; Schmidt V. A., 2008). Because the effects of competition are institutionalised, managers expected that breaching with the incentives of the traditional German model would incur little sanction from stakeholders of the airport, including employees and customers.

6.5 The German model and employment practices

The aim of this section is to determine how the institutional domains of the German model governing the relationship between the organisation and its employees influence the competitiveness of airports. The literature suggests that employment practices are influenced by the institutional environment (Aguilera & Jackson, 2003). Also, it is expected that employment practices influence the competitive advantages of firms (Becker & Gerhart, 1996). Both airports need to comply with the formal institutions of the German corporate

governance system to achieve regulatory legitimacy (Scott, 2008), and have implemented legally required employment practices including employee representation through the Works Constitution Act and the Codetermination Act, collective bargaining agreement through the Collective Agreements Act, and the establishment of an employee suggestion scheme through the German Employee Invention Act (EIA) (Arbeitnehmererfindergesetz).

Institutional theory suggests that both airports are well motivated to follow the informal incentives of the German corporate governance system (Scott, 2008). A high degree of normative legitimacy can be achieved by providing life-long employment opportunities to their workforce and maintaining a highly skilled workforce. However, the evidence of this study shows that both airports exercised choice with regard to normative institutional incentives, and therefore the degree of compliance differs between Airports 1 and 2.

Both airports adopted very different employment practices as a result of strategic choice and competitive strategies, which in turn, have implications for shop floor innovation. The findings provide evidence that the traditional German model is suitable to establish a working environment that fosters shop floor innovation. The starting point for the implementation of employment practices that facilitate worker initiated innovation is the perception as to whether managers believe that such innovation contributes towards firms' competitiveness. This perception plays a crucial role as to whether the managers provide opportunities for employees to contribute towards organisational change and innovation. Airport 1 still retains the collective culture of the classical German model based on worker participation and collaboration on the level of the parent organisation. In contrast, Airport 2 departed from the participatory model of the German model.

According to the EIA, organisations are required to implement a suggestion scheme for employees inventions, and also to reward them for successful ideas. In the HR literature, common tools for providing opportunity for employees to participate are team work and suggestion schemes (Gerhart, 2005). Due to legal institutions of the German model, both airports need to provide opportunities for worker-initiated innovation. However, as the evidence of both cases indicates, the suggestion scheme that provides financial incentives is by itself not sufficient to exploit the full potential of shop floors.

Existing theory suggests that not only extrinsic but also intrinsic factors are important, such as recognition for achievement and responsibility to motivate employees (Herzberg et al., 1959). For example, Purcell et al. (2003) argue that not only pay satisfaction but also satisfaction with the overall working conditions are important for employee motivation. According to Purcell et al. (2003), it is important for the latter that they are committed to the organisation and satisfied with their employment. These employees are keen to work for a longer period within the organisation, and are proud to work for this particular company.

The findings of this study confirm existing theory and show that both extrinsic and intrinsic factors are combined at Airport 1 to exploit the full potential of shop floor innovation. Extrinsic or dissatisfaction-avoidance factors that were important in motivating workers to innovate included performance-based pay, training and further development opportunities, social benefits such as job tickets, child care, and company pensions, and overall working conditions. Intrinsic factors that were important were opportunities to undergo training and further development for personnel satisfaction as well as recognition for innovation. A participatory culture fostering trust in commitment between managers and workers has been successfully established at Airport 1. Stracke and Nerdinger (2010) have argued that product and process innovation are easily implemented in an organisational environment that secures the interest of workers and provides training opportunities that empower workers to adapt to changing demands of the workplace. The findings of this study showed that a participatory culture not only helps to implement innovation, but actively facilitates innovation from the shop floor.

From a human resource management perspective, wages play an important role in motivating employees to perform. Wages in Germany are based on central collective bargaining agreements. The findings of the study suggest that the German model based on collective bargaining agreements is suitable to support firms that are seeking either quality or cost advantages. Firms that seek quality advantages, such as the parent organisation of Airport 1, do not encounter competitive disadvantages due to central collective bargaining agreements. Firms have the opportunity to extend wages on the firm level, for example through a variable wages component for employees. On the other hand, firms that seek cost advantages can successfully circumvent obligations of central collective bargaining agreements. Comparing the institutional setting with other European countries, the central collective agreement that is applied in Germany in fact is very suitable for firms that seek

cost advantages because unlike in other countries, firms embedded in the German context can in fact avoid minimum wages. Under the German collective agreements, firms have considerable flexibility regarding their wage structure.

Another feature of the German model that provides opportunity for employees to participate in innovation is the co-determination and the works councils; even so innovating does not automatically fall under the responsibility of the works councils (Stracke & Nerdinger, 2010). The research findings provide evidence that co-determination did not hinder innovativeness at either airport. Other empirical studies somewhat confirm these findings. Kraft et al. (2009) compared the number of patents granted to firms over the periods 1981-1990) and 1971-1976. Their sample included 148 firms, 61 of them subject to co-determination. Their findings indicate “co-determination has no negative impact on innovativeness. If anything at all a positive effect can be estimated” (Kraft et al., 2009, p. 23).

It cannot be established whether co-determination enhances a firm’s competitiveness. The research findings suggest that its benefits depend on the beliefs of the managers and the direction of the business level strategy. For areas that seek to achieve operational efficiency, a works council is typically seen as a disadvantage because of associated cost (Airport 2). However, for firms that aim to foster shop floor innovation, co-determination is an important feature to facilitate trust that indirectly impacts on innovation (Airport 1). A works council supports a constructive relationship between managers and workers that may positively influence shop floor innovation. This observation is consistent with findings of a study conducted by Stracke and Nerdinger (2010). Based on interviews with works council members, the authors found evidence that the councils can facilitate trust important to overcoming barriers of employees to share ideas.

Equally important for the ability of workers to innovate is the training and further development one has experienced. It is widely accepted in the literature that both internal and external training positively affect the firm’s ability to innovate (Laursen & Foss, 2003). The importance of prior knowledge for innovation has indeed been stressed by several authors. For example, Cohen and Levinthal (1990) argue that the absorption of knowledge depends on the “the prior possession of relevant knowledge and skill” (p. 130). Prior knowledge, however, can be acquired by work experience or by training and further development (Shepherd & DeTienne, 2005), and play a critical role in innovation. The data clearly show that training is a pre-condition for workers’ ability to carry out shop floor innovation.

Continuous improvements and incremental innovation are part of the profession of skilled workers.

Workers trained under the classical German vocational system possess both firm-specific and industry-specific skills (Estevez-Abe, Iversen & Soskice, 2001). It has been argued that workers trained in the German model support firms in competing on quality (Streeck, 1988). Under the Works Constitutes Act, firms have a legal obligation to provide employees with the opportunity to undergo internal and external vocational training, while at the same time considering firm's interests (BetrVG § 97 § 98). The findings suggest that the competitive strategy determines whether organisations exploit potential benefits of the highly-skilled workforce. The classical training system is supportive for firms seeking to reap benefits of shop floor innovation, as the evidence of Airport 1 shows. However, the findings also show that airports that are pursuing a cost advantage are not encountering disadvantages resulting from the institutional environment, since the newly established works council of the subsidiaries failed to enforce the provision of more attractive training opportunities.

The traditional German model is based on the understanding that employees who acquire firm specific skills enjoy benefits of employer commitment to providing long-term employment opportunities (Börsch, 2007). In the past, workers at the airport underwent a very intensive training programme to acquire specific skills necessary to perform activities, and in turn, managers generally provided employees with the option of life-long employment within the airport. Nowadays, both airports still rely heavily on employees who underwent specific training. However, the commitment towards employees working in operating areas has been replaced by an exit model. New employees in these areas often need to acquire the necessary skills before they are formally employed. In fact, the employment is conditional based on passing a test. The cost and the risk of acquiring firm-specific skills have been shifted from the organisation to the individuals who are hoping to obtain employment. It is important to stress that the training is highly specialised, and the acquired skills are not transferable to a different context.

The practice of acquiring skills outside the boundaries of the firm is common in the Anglo-Saxon system. In this context, people can acquire general skills that are transferable to different kinds of employments. The airport managers now impose the acquisition of highly specialised skills on people who are not employed with the airport. The risk of acquiring

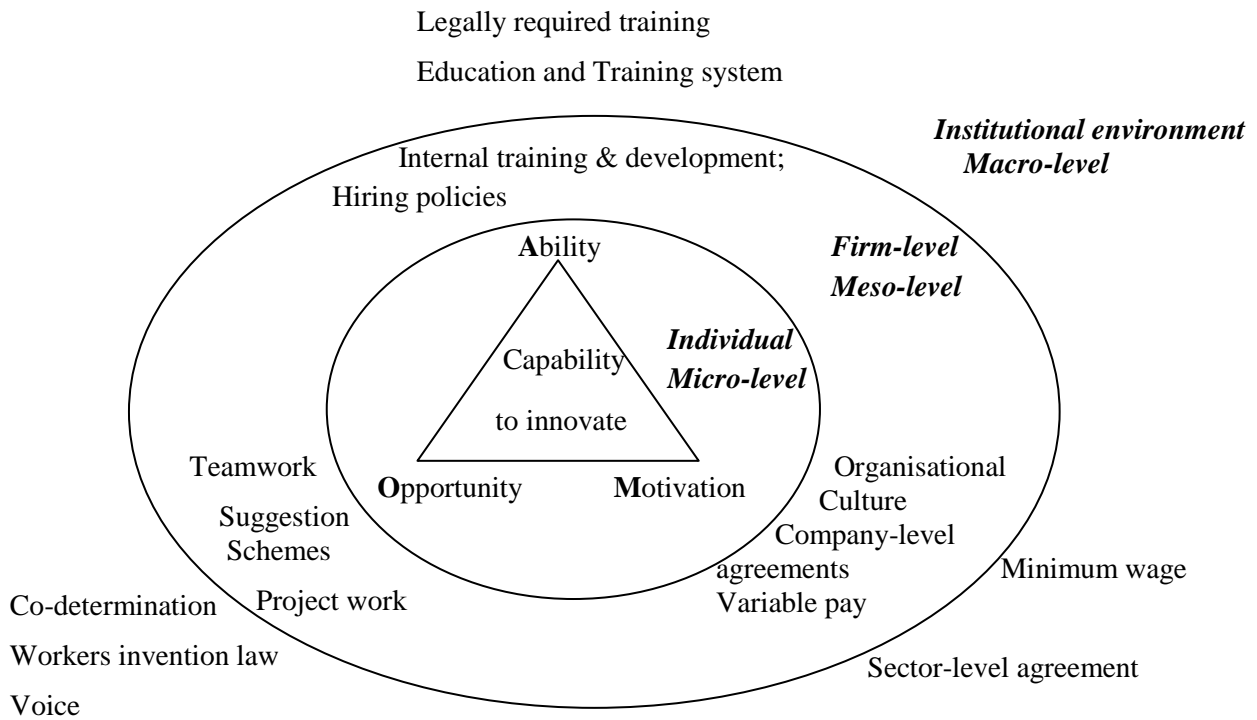
highly specialised skills is thus shifted to the private domain. The firms are getting the best of both worlds, not bearing the risk of training, but still obtaining highly specialised workers.

In the human resource management literature, different authors have stressed that employment practices work more effectively when they are “bundled” together (Boxall, 2003; Ichniowski et al, 1996). The evidence of this study confirms this observation, showing that to foster shop floor innovation, Airport 1 has established a people culture based on commitment and trust that embraces different employment practices. It is important that, all employment practices fostering shop-floor innovation return to one underlying concept, that of trust. The evidence revealed that workers are willing to share their ideas only if they are treated well within the organisation and believe that they will be offered employment in the future. It is commonly accepted that a people oriented culture (Pfeffer, 1994) and trust (Nijhof, Krabbendam & Looise, 2002) facilitate worker initiated innovation.

In the past, the norms of the German model facilitated such a people oriented culture. For example, employers traditionally were concerned with providing life-long employment to all workers; this had normative legitimacy (Scott, 2008). Institutional features of the German model such as ‘co-determination’ and ‘voice’ lead to constant improvements of overall working conditions, and contributed towards that people-oriented organisational culture. Finally, under the German model, firms which had established firm-level collective agreements were legally bound to pay all workers according to these agreements, which usually ensured pay satisfaction amongst workers. People who acquired a certain qualification and were employed, thus enjoyed satisfactory wages. Adhering to the incentives of the traditional German model seems to facilitate both trust and worker ability to innovate, fostering shop floor innovation.

Figure 6.1 illustrates how the institutional domains of labour of the German model influence employment practices at the firm level. The model stresses the importance of the institutional environment (outer layer) and the strategic choice of firms to actively embrace certain HR practices (middle layer) for workers ability to carry out innovation. By combining the strategic choice perspective with institutional theory, the model adopts an approach that has been advocated by prominent researchers in the field of employment relations (Bamber & Lansbury, 1998). It is further guided by the AMO framework that has been used for the study of how employment practices influence firm performance (Appelbaum, Bailey, Berg, & Kalleberg, 2000; Boxall & Purcell, 2003; Purcell et al., 2003).

Figure 6.1: Workers' AOM to innovate and the institutional environment



It can be established that the institutional incentives of the German model potentially motivate employees to engage in shop floor innovation. However, the decision whether employees are in fact encouraged to participate in innovation depends on a firms' choice. Compliance with the institutional incentives of the German model is likely to provide firms with certain competitive advantages, specifically shop floor innovation. In contrast, firms that adopt a very low level of compliance, i.e. legal compliance, encounter compliance cost without reaping its specific benefits. On the other hand, non-compliance can result in different advantages that may generate greater benefits. The airports are seen to pursue different competitive strategies.

To summarise, the institutional domains of the German model still provide advantages for firms that are seeking quality advantages. However, organisations can break free from the institutional incentives of the German model without losing legitimacy. Both airports followed the incentives of supranational institutions to seek cost advantages in certain areas. Breaking free from the institutional forces of the German model did in fact increase the competitiveness of the airports. The findings suggest that the German model serves well those firms that aim to sustain cost or quality advantages.

6.6 Concluding remarks

The chapter discussed the implications of the findings for existing theory in the area of national corporate governance systems and the market environment. A key finding is that the exogenous changes in the wider institutional environment provided incentives to airports to implement neo-liberal managerial practices. Managerial ideologies changed as a result of both endogenous and exogenous forces. Airport 2 adopted NPM primarily because of endogenous forces, specifically the identity crisis of managers. The adoption of NPM, however, was advocated by the business environment, indicating that changes were supported by the wider institutional context. Airport 1 implemented the IFRS accounting as a response to legal changes in supranational institutions, and therefore because of exogenous pressure. The newly implemented management concepts resulted in a departure from a stakeholder towards a shareholder ideology. Managers' changing perception of the purpose of the airports was a pre-requisite to the enabling of organisational restructuring. Managers departed from the German model that provided fair working conditions for employees, by disrupting existing collective bargaining agreements and worker participation. Both airports adopted a shareholder value strategy.

The study showed the importance of the concept of competition in legitimising the changes to workers' representation and collective bargaining. It has been shown that pressure on wages for lower skilled workers is an institutionalised outcome of competition. At the same time, under the German model it is required that adequate wages be paid to skilled workers. In order to achieve legitimacy for reducing wages, managers had to lower demands on the skill levels of the workforce. By relying on a lower skilled workforce, restructuring could be introduced without encountering major resistance from existing employee representatives. Disempowering of the operational workforce was a necessary precondition for reducing wages and social benefits. Through subsidiarisation, managers successfully blocked avenues for worker participation. Newly established subsidiaries had no functioning structure for workers participation, eroding opportunities for collective bargaining and workers participation.

The study reinforces the view that firms will creatively respond to incentives from their institutional and market environment. These incentives are not clearly defined, subject to change and may even conflict (Blyth, 2003). For example, the Council Directive challenged established institutions in many ways. Organisations aim to interpret these

institutions to their advantage and are prepared to outwit institutions that may negatively impact on their competitiveness.

The findings show that the traditional German model provides incentives for firms to engage in worker participation and shop floor innovation. Whether a firm will follow these incentives depends on the nature of market competition. Firms seeking cost advantages are not benefitting as much from the institutional incentives of the German model as their counterparts striving for quality advantages. The German model provides leeway with regard to institutional compliance, and is therefore most suitable for firms that seek cost advantages.

CHAPTER 7: CONCLUSION

7.1 Introduction

In the context of institutional theory, firm heterogeneity is often explained by their strategic choice. Firms can, to an extent, be selective about the institutional incentives with which they comply. On the other hand, from the strategic management literature, firms' heterogeneity is often explained by their innovative activities carried out in their pursuit of competitive advantages. My study contributes towards the discussion on firms' heterogeneity by investigating how different forces from the institutional and competitive environment affect firm strategy. It discusses the organisational restructuring in the German airport industry as a result of endogenous and exogenous forces. The changing strategies and practices of German airports also altered the relationship between the airports and their different groups of stakeholders. This chapter summarises the empirical findings and discusses the main contributions of this study.

7.2 Summary of the research findings

This study investigated the organisational restructuring of two German airports in the context of industry liberalisation. This had been triggered by privatisation activities and the Council Directive of the EU "on access to the ground-handling market at Community airports" aiming at establishing fair competition in the ground handling areas in order to reduce cost and, at the same time, to improve the quality of the baggage handling services. These aims were only partially achieved. Most importantly, notable competition in the area of ground handling did not evolve, and both airports still maintained a significant (Airport 1) or even absolute (Airport 2, after 2009) market share. Despite this failure to introduce market competition, the Council Directive triggered, as part of a series of institutional changes on the supranational level, cultural and organisational change at the two German airports towards a more liberal model of governance.

In the context of industry liberalisation, both airports adopted neo-liberal management practices which changed the underlying belief system of managers from a stakeholder towards a shareholder ideology. However, these changes were achieved through different routes. Whilst Airport 1 adopted IFRS accounting and shareholder-value oriented management concepts, Airport 2 adopted the managerial principles of NPM. These

management practices were already widely accepted within the Anglo-Saxon environment and enjoyed legitimacy within the international business community, which facilitated their introduction in German firms. The introduction of the new management practices resulted in three major changes, namely the separation of activities, an increase of the perceived importance of managers and the definition of a unified goal. Different airport activities were structurally separated and the value creation of the airports was no longer perceived to be a collective effort. As a consequence, each segment had to individually create shareholder value, while the perception of the importance of managers for the value creation of the airport grew and managerial benefits increased. Managers thus increased not only their status but also their financial rewards.

Under the shareholder ideology, a unified goal was created for all segments of the airports, that of increasing shareholder value. Firms' competitiveness is now directly defined by how much value a firm generates for its owners. This competition goes beyond the boundaries of industries; managers are now globally competing as to how much value they produce in the short term compared to other firms. The global competition for shareholder value defines the financial goals for each segment at the airports. To fulfil these goals, managers of both airports perceived that they needed to break free from the established norms of the German corporate governance system in some areas in order to stay competitive under the new shareholder ideology. Managers were presented with a paradox: firm competitiveness can be increased by investment in worker skills that facilitate innovation, or by de-investment into skills and benefits for workers that result in cost advantages.

First, airports aimed to increase shareholder value by pursuing innovation in certain areas. Airport 1 seeks to increase its competitiveness by fostering shop floor innovation within its parent organisation in a wide range of activities. In order to realise shop floor innovation, it still retains features of the traditional German model on the level of the parent organisation. However, the features are not retained to maintain the balance between the interests of different stakeholders as it was in the past, but because of its capability to facilitate shop floor innovation as a means to generate profits. Investment decisions in innovation are based on their potential financial contribution to shareholder value in the short term.

Second, airports increased shareholder value by reducing financial and social benefits for employees in some areas. Under the shareholder ideology, the redistribution of organisational value from employees to shareholders is also a way to increase firms' competitiveness in terms of shareholder value. Maintaining an attractive working environment could only be justified if the benefits of doing so outweighed its cost. This study shows that providing fair and attractive working conditions facilitates innovation and can positively affect the profitability of a firm because it is a pre-requisite to exploiting the full potential of shop floor innovation. Under the shareholder ideology, attractive working conditions are provided only to highly skilled workers who are concerned with innovative activities. For workers responsible for operating activities, who perform more standardised activities, attractive working conditions are no longer justifiable. Shareholder value is increased in these areas by minimising labour cost, which also influences the provision of training, participation and commitment.

At both airports, restructuring was driven by both endogenous and exogenous forces, although to varying degrees. There is a clear difference between the perception of Airports 1 and 2 about the benefits of the classical German model. Managers of Airport 1 associated a certain advantage, namely the realisation of shop floor innovation, with embracing the peculiarities of the German model, including worker participation and commitment. As a result, the managers tried to maintain these features in certain areas to sustain a competitive advantage, while responding to exogenous pressures to converge towards a more liberal model in other areas. In contrast, managers of Airport 2 departed more radically towards a liberal model. Changes were driven more endogenously by managers because of their perception that changes were necessary to sustain competitiveness.

Changes in the working environment for employees performing operating activities were achieved by subsidiarisation which disrupted established employee participation and collective bargaining agreements at both airports. Managers minimised the resistance of employee representatives by arguing convincingly that the only alternative to subsidiarisation would be to outsource these activities. They successfully instrumentalised the market competition in order to exert pressure on wages. Employees' representatives believed not only that they sustained the competitiveness of the airports by agreeing to subsidiarisation, but also maintained employment under the more attractive conditions for existing employees.

Liberalisation and privatisation encouraged firms to put a greater focus on their financial performance. Institutional change that facilitated the adoption of new managerial and employment practices was an important means of increasing the competitiveness of German firms in terms of shareholder value. Embracing the changing norms of their institutional environment, both airports are now highly competitive from the perspective of the capital market.

7.3 Theoretical contribution

7.3.1 Making a case for discursive institutionalism

The study makes two important contributions to theory. First, its findings provide an important insight into institutional theory. It demonstrates how changes in the institutional environment triggered a shift from a stakeholder to a shareholder ideology on the firm level. I argue that using discursive institutionalism was critical in documenting these firm-level processes, because it allowed the integrating of different schools of new institutionalism. Hay and Wincott (1998) argued that it is problematic to bring together rational choice and sociological institutionalism because of fundamentally different ontological assumptions. However, the integration of these particular schools was crucial to understanding the process of this shift towards the shareholder ideology.

I argue that sociological institutionalism is more suitable for explaining the stakeholder ideology, whereas rational choice institutionalism is more appropriate to explain the shareholder ideology. Firstly, from this perspective of sociological institutionalism, organisational procedures and practices reflect cultural norms of their environment. Organisational behaviour is influenced by societal appropriateness, and not necessarily based on rational goals from an economic perspective, such as efficiency (Hall & Taylor, 1996).

The stakeholder ideology is best researched through sociological institutionalism. Under the stakeholder ideology, managers pursued multiple goals trying to balance the interests of different stakeholders. Managerial behaviour is not guided by formalised rules that define measurable goals in an objective way, but by more general principles representing societal norms and values. All stakeholders shared a similar understanding of the organisational purpose; namely to serve the interests of its stakeholders. Consequently, managers were measured by whether or not they fulfilled this purpose, including achieving a

profit for shareholders returns and offering attractive and secure employment. Not all of these managerial goals were clearly operationalised, and therefore objectively measurable. To a degree it was trusted that managers would act in the best interests of the organisation and its stakeholders. For example, the commitment to provide long-term employment is not considered rational because it conflicts with the self-interest of the organisation to maximise profitability. However, under stakeholder ideology, long-term commitment to its employees was expected and therefore considered “socially appropriate”.

In contrast, under the shareholder ideology, organisational goals were implemented that are both rational and objective. Managerial interests were aligned with the interests of investors, such as that of earning a defined interest rate on the capital employed. Also, managerial goals have been reduced to one universal, clearly measurable goal, that of creating shareholder value. The definition of a unified, measurable goal also enables the monitoring of managers. Under both rational choice institutionalism and shareholder ideology, it is assumed that managers pursue self-interest, and therefore need to be monitored. At the same time, it can be argued that managers are required to act in the interests of shareholders, not in their “self-interest” (nor in the interests of any other stakeholder group). The new managerial goals are based on the laws of markets rather than on norms and values of the wider society. The shareholder ideology can thus be much better explained from the perspective of rational choice institutionalism.

Shifting from the stakeholder towards a shareholder ideology replaced organisational practices guided by societal norms and values, with practices oriented on economic and financial performance. The shift of the ideology on the firm level about the appropriate governance strategy implies that the dominating logic of institutionalism changed; therefore, to explain the shift towards shareholder ideology one needs to combine insights from both sociological and rational choice institutionalism.

The ideological shift was enabled partially by trust between employees and managers established under the stakeholder ideology. New practices were implemented by instrumentalising the consequences of competition. Employee representatives, not critically evaluating whether competition evolved, did not contest the restructuring because they trusted that it was necessary to secure the survival of the organisation. Nonetheless, constantly low market shares of the third party show that serious competition never evolved. Under the shareholder ideology, organisations no longer govern behaviour by the logic of

sociological institutionalism, namely by trust and appropriateness, but by the logic of rational choice institutionalism, that of relying on a measurable and unified goal. Managers of both airports traded trust for impersonal market exchange in order to increase shareholder value. Overall, this study showed that to explain institutional change one needs to rely on insights of both rational choice and sociological institutionalism.

7.3.2 Co-existence of divergence and convergence on the firm level

The second theoretical contribution is related to both institutional theory and the convergence and divergence debate. Existing institutional theory often assumes a high degree of homogeneity between firms that are embedded within the same institutional environment. In particular, the perspective of the “diversity of capitalism” argues that different corporate governance systems provide incentives to firms to compete in a certain way, thus implying that firms embedded within the same institutional environment behave similarly in terms of how they seek competitive advantage. Whilst organisations can exercise strategic choice within their environment they can also choose the environment in which they are operating (Child, 1972). This view would imply that firms strategically respond to incentives of a predefined environment. However, it is assumed that firms still need to correspond to certain norms and values of their environment to gain legitimacy (DiMaggio & Powell, 1983; Scott, 2008).

My study extends the concept of strategic choice by examining it in the context of institutional ambiguity. The study found that firms can choose to seek legitimacy from different sets of institutions in times of institutional upheaval. Firms can follow the incentives of their national environment, i.e. the German model, or those of their supra national level environment, i.e. the policy making from the EU. Both of these institutional sets enjoy legitimacy in their own right; even so they are somewhat incompatible. In fact, they often co-exist despite contradicting incentives. Compliance to one set of institutions means non-compliance to the other, and firms can build competitive advantage by making a deliberate choice about which institutional framework to comply with in different areas. However, the choice is not exclusive because firms can strategically respond to incentives of both sets of institutions to gain legitimacy; they do not choose between different environments, but they can creatively choose the elements of different environments with which they comply.

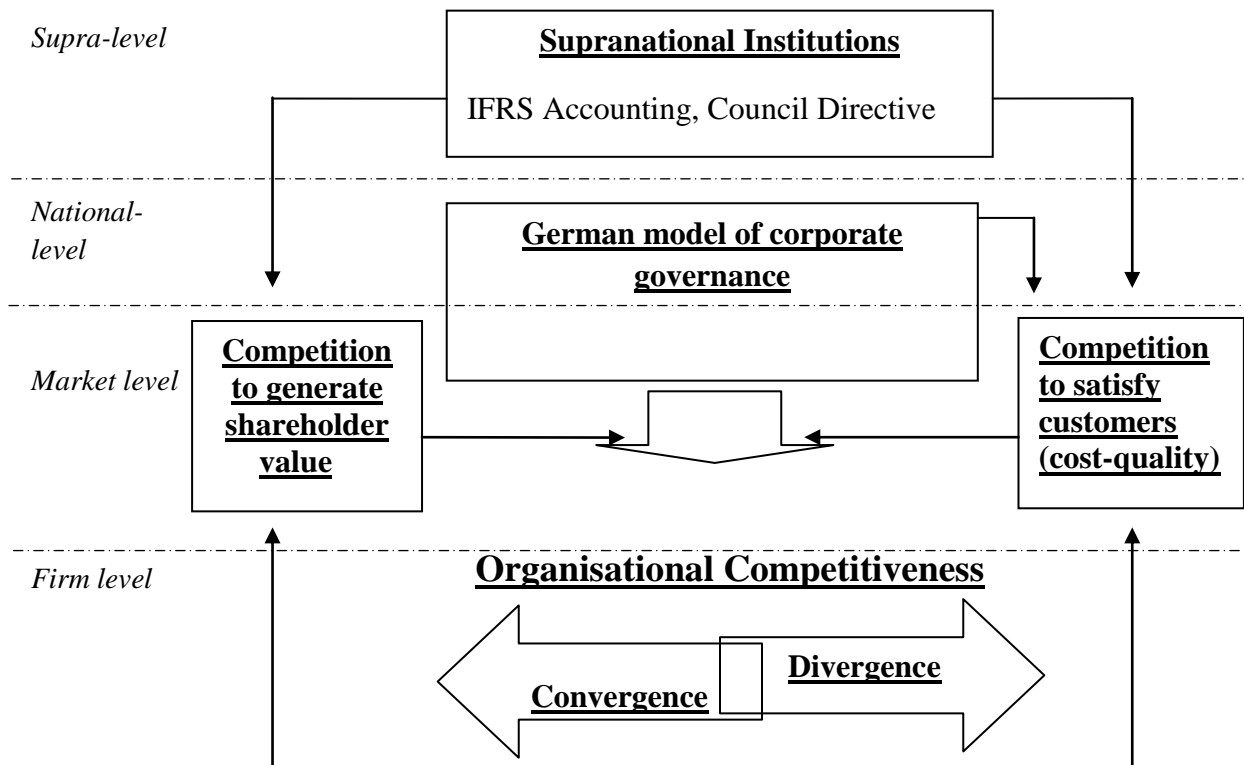
Second, firms can still exercise strategic choice within a chosen institutional framework, triggering processes of divergence and convergence on the firm level. In some cases, firms may share a similar understanding about the incentives of their institutional environment. The liberalisation of the airport industry exogenously triggered organisational change on the firm level. Both airports shared the perception that following the institutional incentives of the German model in certain areas would compromise firm competitiveness. As a result, both firms circumvented these national institutions for certain areas, including collective bargaining agreements and workers participation, by subsidiarisation. Such similar behaviour implies that both firms perceived that following the incentives of supranational institutions would be advantageous. As a result of subsidiarisation, functional convergence occurred, resulting in homogeneity. At the same time, however, one airport perceived compliance to the national system in other areas as being advantageous. On the level of the parent organisation, it chose to comply with the incentives of the German model by maintaining worker participation and established collective bargaining. The institutional incentives are thus perceived differently within the same organisation in different areas; convergence remains, resulting in heterogeneity. The different strategic choices of firms result into heterogeneity and homogeneity.

The interplay between institutional ambiguity and strategy choice increases complexity in compliance logic. Firms tend to follow very different approaches in different areas, actively choosing to which incentives they will comply with and which they will circumvent by complying with a different set of institutions in order to remain competitive. Firms can comply creatively in choosing the institutional framework as well as their action within this framework (creative compliance). Institutional ambiguity provides firms opportunity for creative compliance. The dichotomy of compliance and non-compliance is not useful to explain creative compliance; rather it is a choice as to what institutions consider and respond to in the first place. Non-compliance to one set of institutions is a consequence of this decision. Different forces of various sets of institutions are overlapping, providing very different, sometimes conflicting incentives for firms. The endogenous forces on the firm level that pursue creative compliance are therefore decisive as to whether convergence will occur.

The possibility of creative compliance further contributes to the convergence and divergence debate by providing insights as to what conditions are likely to foster processes of convergence or divergence on the firm level. One stream of literature assumes that divergence between different national systems remains, regardless of global pressure of convergence. Others argue that supranational institutions, including the policy making from the European Commission, triggered processes of convergence. My study provides empirical evidence that creative compliance enabled the co-existence of convergence and divergence on the firm level. Firms will continue to choose institutions that are advantageous for them, and therefore, on the firm level processes of divergence and convergence can co-exist. Divergence occurs in areas in which managers perceive that the firm will achieve certain advantages by retaining the features of the German model. However, the different strategies of the two cases show that organisations perceive incentives from institutional forces differently. Features of the traditional German model are retained only in one organisation.

To understand firm-level processes, it becomes necessary to take into account competitive forces from the product and service market. Figure 7.1 illustrates how forces from both the market and institutional environments influence firms' decisions as to whether to adopt a model different from the German model. Institutional change triggered by supranational forces, including the EU liberalisation and implementation of the IFRS accounting, initiated processes of organisational change towards convergence in some airport areas. The changes of the institutional environment changed the perception of both airports about the nature of competition, which also affected the relationship between the airport and different groups of stakeholders. In the past, organisations defined competitiveness on the market level as to how well a firm met customer needs. Through the introduction of the new management concepts, firms' competitiveness is now defined as how much value is created for shareholders.

Figure 7.1: Processes of divergence and convergence triggered by institutional change



The structural separation of different activities that requires separate accounts for certain areas triggered processes of both divergence and convergence at the firm level. In their pursuit of competitive advantages, firms adopted different strategies in regard to the incentives of their national system. German firms adopted managerial and employment practices from the Anglo-Saxon model (convergence) in areas in which they were seeking cost advantages. In contrast, in areas in which firms were striving for quality advantages, features of the German model have been retained (divergence). Against the backdrop of this framework, firms' choices of suitable employment practices of different areas are influenced by the type of competition an area faces. The study showed that different competitive strategies on the market level can explain why convergence and divergence can co-exist at the firm level.

The traditional German model provides incentives for firms to seek quality advantages through shop floor innovation. Germany's comprehensive training system of facilitates the development of tacit knowledge on the shop floor which is, in turn, important for innovation. Firms embedded within the German model therefore have incentives to exploit available tacit knowledge to sustain competitive advantage through shop floor

innovation. Also, the traditional German model based on collective bargaining agreements and worker participation, to some extent prevents competition based on lowest labour cost. Because firms encounter similar labour costs for workers with similar skill sets, the potential to compete on cost is limited. In order to sustain a competitive advantage, firms have therefore an incentive to compete based on innovation and quality.

My study provides evidence that in areas where German firms aimed to sustain their competitiveness in terms of quality advantages, processes of divergence were observed. One of the organisations retained the peculiarities of the German model on the level of the parent organisation, including worker participation, a culture that fosters trust through long-term commitment to employment of workers, a high standard of training and further development. Some managers believe that maintaining features of the classical model, including worker participation and co-determination, will result in competitive advantage on the market level through shop floor innovation, as it did in the past. For this firm, being embedded within the German model constituted a competitive advantage, and they consequently adopted a divergence strategy in this area (namely compliance to the German model).

On the other hand, the study showed that exogenous forces including the EU liberalisation triggered processes of convergence on the firm level in operating areas. Through liberalisation, competition emerged that was not bound to existing collective bargaining agreements of the industry, and had not established functioning worker participation. Also, the Directive legally allowed the use of a relatively unskilled labour force by explicitly defining the training requirement for people performing baggage handling services. Through the Council Directive, deskilling was legitimised because not all workers were required to undergo a formal training, thus providing an opportunity to increasingly compete on cost. The increasing cost competition, in turn, put pressure on existing organisations to restructure. Organisations perceived that sufficient value for shareholders could be achieved only by significantly reducing labour costs, which was achieved by subsidiarisation that disrupted established employee representation and collective agreements.

Following the traditional German model was perceived by both organisations to be incompatible with realizing cost advantages, which became important in a changing institutional environment dominated by cost pressure. Firms perceived that convergence towards a more liberal model was the dominant strategy to sustain cost advantages, and adopted management and employment practices from the Anglo-Saxon context in these areas. Increasing competition was a driving force to legitimize convergence from the classical German model towards a more neo-liberal approach. The traditional German model based on worker participation and co-determination is not competitive in terms of minimising labour cost, and the standardisation of the processes provided disincentives to carrying out quality innovation. To overcome the disadvantages of the traditional German model for these areas, firms found creative ways to circumvent constraints of their institutional environment.

7.4 Implications for policy makers and managers

The findings of this study have implications for policy makers, who often believe that institutions that support the competitiveness of firms will inevitably benefit society. For example, it is widely assumed that competitive and profitable firms will provide attractive working opportunities for employees. However, while this relationship is often true under stakeholder ideology, this is no longer the case under shareholder ideology. Whether a firm will choose to provide this environment depends on its perception about its importance for the firm's future profitability and thus its competitiveness in terms of shareholder value. The findings of this study provide evidence that there is no direct link between the profitability of a firm and the provision of good working conditions. Despite high EBIT-margins, both airports cut down on social and financial benefits for workers on lower hierarchical levels, while at the same time taking advantages of government subsidies for employment. Policy makers need to be cautious that even highly profitable firms may take advantage of opportunities to shift employment costs to society. The central collective bargaining agreements cannot be relied on to ensure fair wages because of possibilities that firms may circumvent these agreements. The findings of this study indicate that a general minimum wage would be a first step to providing fairer wages for employees. Other European countries have already established a general minimum wage.

General or industry-wide minimum wages would ensure that organisations are not competing on the basis of the lowest wages and social benefits. A minimum wage would not only be a first step for fair competition but would also provide incentive for firm to carry out innovation. A minimum wage would ensure that firms can no longer seek to sustain a competitive advantage based on lower wages and benefits for workers compared to their counterparts in their industry. In order to differentiate themselves from competition, firms would be encouraged to carry out innovation that benefits customers. Competition based on innovation rather than on lower cost would have positive effects on society since innovation would benefit a range of organisation over time, and increase the prosperity of an economy in the long term.

Finally, there are some managerial implications of this study. The study confirms existing knowledge that trust is a key concept to facilitate shop floor innovation. However, the evidence suggest that in order to exploit the full potential of shop floor innovation trust needs to be facilitated by adopting a wide range of different HR practices that are well orchestrated. The objective of HR practices should be to establish a culture that signals to employees that the organisation appreciates them and is truly committed to the well-being of its workforce. Such a culture comes at considerable cost for the organisation, but can be justified if the benefits of explorative innovation are higher than the cost of maintaining a people oriented culture. On the other hand, organisations which aim to achieve both explorative and exploitative activities should therefore structurally separate the activities from each other. This allows the organisation to establish HR practices and organisational culture in a way that is most suitable to support activities. The evidence of this study shows that it is almost impossible to solve the paradox between exploration and exploitation within the boundaries of the same organisational entity.

By separating activities, a firm can establish the most suitable employment practices for a particular goal. For areas in which the firm aims to innovate, investments need to be made in a people oriented culture that fosters commitment and trust. In contrast, for areas that are competing over costs, such a people oriented culture is not desirable because the cost outweigh possible benefits. A firm should adopt employment practices based on competition and exit. By structurally separating activities in accordance with their competitive strategy, a firm can achieve the best fit between organisational culture and structure and strategy.

7.5 Future research

This study has been conducted within the airport industry. The findings suggest that a change in the wider socio-economic environment has triggered processes of divergence and convergence at the firm level in this industry. Future research in different industries would contribute to a better understanding about how German firms restored their competitiveness within a changing institutional environment. This future research should consider different industries or make a cross-industry comparison.

The study shows that the adoption of new management practices, such as the New Public Management and IFRS accounting, radically changed the understanding of the purpose of the German airports that have been studied, and altered the relationship between airports and different groups of stakeholders. Until now, research on how IFRS accounting impacted on the organisational culture and strategy of firms is rare. At Airport 1, the change of accounting standards triggered radical cultural changes within the organisation that are expected to significantly impact on both the competitiveness and the innovativeness of the airport in the long term. Since IFRS accounting is compulsory for all European firms listed on the stock market, more research is needed to understand better the consequences of the IFRS accounting for organisational practices and strategy in European listed companies. A survey investigating how IFRS accounting affected organisational culture and strategy, can provide interesting insights into whether its introduction triggered convergence towards the shareholder ideology of listed firms across Europe.

The findings of this study are specific to the German context. It would be beneficial to study similar processes on the firm level in different EU countries, to understand better the interplay between national and supra national institutions as well as institutions from the market environment. Studies in different EU countries could follow a design very similar to this study. A study in Anglo-Saxon countries would increase our understanding as to whether processes of convergence towards a coordinated market model on the firm level exist. Considering that specific features of the German model provide advantages for the creation of innovation, a study of highly innovative firms in the Anglo-Saxon context would be interesting.

7.6 Final thoughts

My study showed that the direction of organisational change is influenced by both exogenous and endogenous forces. Exogenous forces of the EU liberalisation triggered a shift of both airports to a more liberal model. However, differences between the airports remained because of different endogenous forces on the firm level, leading to firm-level divergence in some areas. Peculiarities of the German model were retained at Airport 1 because of existing relationships between employee representatives and managers. Not only had managers and employee representatives established good working relationships over time, but the older generation of managers still believed that compliance to the traditional German model would result in certain advantages. There is evidence however that the forces that facilitated convergence on the firm level are transient. I argue that an important mechanism that enabled the departure from the classical German model is the separation of members of the organisation in different groups. The study provides evidence that during the shift towards a more liberal model the relationship between managers and employees is increasingly alienated because of new educational pathways for managers and models of compensation.

Educational backgrounds of managers and employees are increasingly separated, which facilitates a greater tolerance for inequalities. In the past, many German managers underwent the traditional apprenticeship, and worked their way up the ranks to a managerial level. These managers were less inclined to put pressure on their inferiors because they considered them to be their peers. In the liberalised model, managers and employees undergo very distinct pathways of training, leading to a disruption of the congenial relationship and solidarity between managers and employees.

Individualised contracts for managers further separate the group of managers and employees. In the past, managers were, at least in the case of airports, covered by collective bargaining of unions, and benefitted to a degree from each collective bargaining renegotiation. Nowadays the wages of managers and employees are not only independent from each other, but managers often directly benefit financially from reducing the wages of the workforce, because their bonus is coupled to shareholder value creation of the firm. Providing attractive working conditions is seen to conflict with firm competitiveness and therefore reduce managerial benefits.

Secondly, employees performing different activities are structurally separated. The working conditions are largely determined by how much shareholder value a certain activity creates. Employees, including managers, working in innovative activities that are associated with a high value contribution, typically enjoy very attractive working conditions. Those who are performing standardised activities that require only little training are working in environments characterised by cost pressure.

There is a trend to standardise activities under the neo-liberal ideology compared to the German model. The demands on skill levels of workers have decreased because of the Council Directive, which explicitly specified the requirements for workers to perform baggage handling services. The standardisation of the job description thus fostered pressure on wages. Firms were less inclined to invest in training to increase the knowledge of these workers because of these clear specifications of required skills, which would however, increase available tacit knowledge and the potential for innovation. The creation of different groups of employees leads to a separation of airport employees, which in turn, reduces mutual solidarity. It can be expected that the alienation of managers and employees through different educational and payment models, will continue to widen the separation between these groups. As a consequence, the relationship between these groups will decreasingly be coordinated not by mutual trust, but by market principles. The relationship between managers and employees is changing from congenial towards impersonal understandings, fostering the convergence towards a more liberal model.

From the perspective of society, there are both advantages and disadvantages resulting from the shareholder orientation of organisations. By breaking with certain norms and values of the German corporate governance system, such as providing life-long employment to its workers, both airports managed to sustain a competitive profitability not only within the industry but compared to globally listed firms. Employment in Germany has risen because of institutional change indicating that the country has restored its competitiveness in a global market. The stakeholder groups that mainly benefit from these changes are managers and investors. Both groups are realising higher financial benefits, and their interests are more prioritised than in the past.

Restoring the competitiveness of firms came at a cost. Employment offered at the investigated organisations is at the lowest end of the pay scale, barely above social benefits. Despite high profitability, firms take advantage of government subsidies for employment, and

burden society with the cost for training to further increase their profitability. Commitment to providing on-going employment to workers who experience significant damage to their health as a result of their work, has vanished under the shareholder value ideology. For these employees the chance to obtain employment in the future is very limited, and they will likely be excluded from the workforce. As a consequence of these changing organisational practices, not only do these individuals encounter hardship, but society encounters negative externalities, providing social welfare for these workers, and bearing costs of training for new employees. Whether the benefits of the restored competitiveness of firms for society outweigh its cost in the long term remains to be seen. The study shows that a positive relationship between a profitable, competitive firm and the well-being of all its stakeholders is not guaranteed.

APPENDIX I – THE INTERVIEW GUIDE

Semi-Structured Interview Guide for the PhD Research project: Organisational responses to institutional change- evidence from the liberalised German airport industry

Introduction

Please, could you describe your position in the organisation?

Innovation/Competitiveness (since privatisation/or last years)

Which areas of the organisation have changed most? How? Which are innovative?

What factors have influenced change or innovation?

What factors have been crucial for the success of the organisation?

Regulation of the market

Is your organisation subject to a specific regulation? If yes, how does it affect your organisation?

Could you think of an alternative form of regulation that would be desirable? Why?

Could you please describe the relationship between your organisation and the (local) government?

Market and Customers

How has the market changed? How has this affected the organisation?

How have the cost- and income-structures changed?

Can you think of some critical events that have influenced the organisation?

Is your company operating in new markets since privatisation?

Who are your main competitors?

How does competition influence your organisation?

Who are your main customers?

How do your customers influence your company?

Can you think of any benefits for customers from privatisation?

Corporate Governance

How has the corporate governance structure changed since privatisation (new code, structure management board, supervisory board)?

How has the relationship between the organisation and its stakeholders changed?

Investors

Can you think of any benefits for your private investors from privatisation?

Have private investors influenced change/innovation during privatisation? How?

How important is private capital for growth?

Employees

Have employees actively influenced change/innovation during privatization? How?

Can you think of any benefits for employees from privatisation?

Have the demands for skills changed? How?

What skills are essential for employees?

How important is training and learning for employees for the organisation?

Managers

How have managers carried out change/innovation during privatisation?

Have the demands for skills changed? How? What skills/training are essential for managers?

Are there benefits for managers to innovate?

Can you think of any advantages for managers from privatisation?

Do you have any comments or thoughts?

APPENDIX II – PARTICIPANT INFORMATION SHEET (Organisation)

[CEO, organisation Name and address]

Participant Information Sheet (Organisation)

Working title: Privatisation and innovation: evidence from the airport industry

Dear [CEO's name]

My name is Antje Fiedler. I am a PhD student at The University of Auckland in the Department of Management and International Business. I am studying how privatisation is influenced by national systems of corporate governance. The main purpose is to investigate how national systems of corporate governance have influenced the evolution of firm capabilities in the airport industry after privatization. The research is focussing on airport organisations in Germany which have been privatized during the period from 1997-2001.

Your organisation is invited to participate in my research and I would appreciate any assistance you can offer me. As part of my research, I would be grateful for the permission to interview key managers along with yourself within your organisation – but neither you nor your employees are under any obligation at all to be interviewed.

Overall each interview would take about 75 minutes and at the convenience of a participant. A participant may decline to answer any particular question(s) without giving a reason. None of the questions will be of a personal nature. To ensure accurate collection of information I would like to audio-tape the interview. A participant may ask for the tape to be turned off at any time during the interview process without giving a reason. Participants can withdraw the information provided within four weeks after the interview.

The outcome of the study will be used for this research and academic publications arising from this research project. All information provided to me will be treated in a confidential manner, and the identity of individual participants will not be revealed. While the identity of individuals will not be revealed, participants and/or the investigated organisation may be identified due to the small industry population.

All information gathered, including consent form, audio tape and any transcript, will be separated and securely stored on university premises, and destroyed after six years.

If you agree to your organisation participating please let me know by filling in the attached Participant Consent Form and email it to me.

A summary of the results will be provided to all participants.

Thank you very much for your time and help in making this study possible. If you have any queries or wish to know more please email me, phone me, or write to me at the address below:

Yours faithfully,

Antje Fiedler
PhD Student

My contact details are as follows:

Antje Fiedler; Email: a.fiedler@auckland.ac.nz

Address in New Zealand: The University of Auckland, Private Bag 92019, Auckland Mail Centre 1142



NEW ZEALAND

Te Whare Wānanga o Tāmaki Makaurau

Department of Management and
International Business

The University of Auckland

Private Bag 92019

Auckland, New Zealand

Facsimile 64 9 373 7477

Email: a.fiedler@auckland.ac.nz

You are also welcome to contact my supervisor, Dr. Liliana Erakovic. She can be contacted at the following.

My supervisor is:

Dr. Liliana Erakovic
Department of Management and International
Business
The University of Auckland
Private Bag 92019
Auckland
Telephone: 3737999 ext. 86855

My Head of Department is:

Dr. Marie Wilson
Department of Management and International
Business
The University of Auckland
Private Bag 92019
Auckland
Telephone: 3737999

For ethical concerns you may contact:

The Chair, The University of Auckland Human Participants Ethics Committee,
The University of Auckland, Private Bag 92019, Auckland,
Telephone 3737999 ext. 87830

APPROVED BY THE UNIVERSITY OF AUCKLAND HUMAN PARTICIPANTS ETHICS COMMITTEE
on 15th of August 2007 for 3 years. (Ref. 2007 / 256).

APPENDIX III – PARTICIPANT INFORMATION SHEET (Individual)

[Participant Name and address]

Participant Information Sheet

Working title: Privatisation and innovation: evidence from the airport industry

Dear [Participant Name]



Te Whare Wānanga o Tāmaki Makaurau
Department of Management and
International Business
The University of Auckland
Private Bag 92019
Auckland, New Zealand
Facsimile 64 9 373 7477
Email: a.fiedler@auckland.ac.nz

My name is Antje Fiedler. I am a PhD student at The University of Auckland in the Department of Management and International Business. I am studying how privatisation is influenced by national systems of corporate governance. The main purpose is to investigate how national systems of corporate governance have influenced the evolution of firm capabilities in the airport industry after privatisation. The research is focussing on airport organisations in Germany which have been privatised during the period from 1997-2001.

You are invited to participate in my research and I would appreciate any assistance you can offer me. As part of my research, I would like to interview you in order to understand better how different stakeholders of the company have influenced the changes during privatisation. Your CEO has given his permission for employees to respond to the questions in this study.

Overall the interview would take about 75 minutes and be at your convenience. You may decline to answer any particular question(s) as long as you not want to. None of the questions will be of a personal nature. To ensure accurate collection of information, and with your permission, I would like to audio-tape the interview. You may ask for the tape to be turned off at any time during the interview process without giving a reason. You are under no obligation at all to participate. You also can withdraw the information you provided within four weeks after the interview.

The information you provide will be used for this research and academic publications arising from this research project. If information you do provide is reported/published, this will be done in a way that does not identify you as its source. While the identity of individuals will not be revealed, participants and/or the investigated organisation may be identified due to the small industry population.

All information gathered, including consent form, audio tape and any transcript, will be separated and securely stored on university premises, and destroyed after six years.

A summary of the results will be provided to all participants.

Thank you very much for your time and help in making this study possible. If you consent to an interview, please fill in a consent form and email it to me or phone me. If you have any queries or wish to know more please email me, phone me, or write to me at the address below:

Yours faithfully,

Antje Fiedler
PhD Student

My contact details are as follows:

Antje Fiedler, Email: a.fiedler@auckland.ac.nz, Address: The University of Auckland, Private Bag 92019, Auckland Mail Centre 1142

You are also welcome to contact my supervisor, Dr. Liliana Erakovic. She can be contacted at the following.

My supervisor is:

Dr. Liliana Erakovic
Department of Management and International
Business
The University of Auckland
Private Bag 92019
Auckland
Telephone: 3737999 ext. 86855

My Head of Department is:

Dr. Marie Wilson
Department of Management and International
Business
The University of Auckland
Private Bag 92019
Auckland
Telephone: 3737999

For ethical concerns you may contact:

The Chair, The University of Auckland Human Participants Ethics Committee,
The University of Auckland, Private Bag 92019, Auckland,
Telephone 3737999 ext. 87830

APPROVED BY THE UNIVERSITY OF AUCKLAND HUMAN PARTICIPANTS ETHICS COMMITTEE
on 15th of August 2007 for 3 years. (Ref. 2007 / 256).

APPENDIX IV – CONSENT FORM (Participant)



Te Whare Wānanga o Tāmaki Makaurau
Department of Management and
International Business
The University of Auckland
Private Bag 92019
Auckland, New Zealand
Facsimile 64 9 373 7477
Email: a.fiedler@auckland.ac.nz

CONSENT FORM

THIS CONSENT FORM WILL BE HELD FOR A PERIOD OF SIX YEARS

Working Title: Privatisation and innovation: evidence from the airport industry

Researcher: Antje Fiedler

- I understand that the CEO has given his permission that employees may respond to researcher's question
 - I have had an opportunity to ask questions and have them answered.
 - I understand that I am free to withdraw the information provided within four weeks after the interview without giving a reason for doing so.
 - I understand that if information I provide is reported/published, it will be done in a way that does not identify me as its source.
 - I understand that the outcome of the study will be used for this research and academic publications arising from this research project. While the identity of individuals will not be revealed, participants and/or the investigated organisation may be identified due to the small industry population.
 - I understand that audio and photography recordings may be made of the interview, and that at any time I can request that the recording devices be turned off.
 - I understand that copies of such records will be made available to me if I request them up to five working days after the recording is made.
 - I understand that all information gathered, including consent form, audio tape and any transcript, will be separated and securely stored on university premises, and destroyed after six years.
 - I understand that if transcripts are transcribed by someone other than the researcher a confidentiality agreement will be signed.
-
- I agree/ do not agree to take part in this research.
 - I agree/do not agree to being audio-taped and understand that, even if I agree, I may choose to have the recorder turned off at any time without giving a reason.

Name of the participant: _____

Date: _____

Signature: _____

APPROVED BY THE UNIVERSITY OF AUCKLAND HUMAN PARTICIPANTS ETHICS COMMITTEE
on 15th of August 2007 for 3 years. (Ref. 2007 / 256).

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