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OBJECTIVES OF FINANCIAL DISCLOSURE REGULATION

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This Article explores the objectives of financial disclosure regulation as they have evolved in the legislative history and academic debate of the United States, Switzerland, and Germany. The Article reviews traditional purposes such as investor protection, market efficiency, and corporate governance, as well as broader public policy considerations. By paying particular attention to characteristic elements of national corporate and financial sectors, and to national regulatory models, the study attempts a first step toward an "integrated" view of the objectives of financial disclosure rules.

1. Introduction

Problems of corporate financial disclosure and its governmental regulation are widely and vigorously discussed in the United States as well as in European countries, yet the focus of the debates seems to move in different directions. U.S. economists and, more recently, legal commentators have increasingly challenged the theoretical foundation of the U.S. securities act's disclosure scheme [1]. Their broadened attack even may have had its impact on the regulatory process itself [2]. This widespread academic criticism has, on the whole, no equal in the European discourse [3]. Regulators in Europe, stimulated partly by the EEC's efforts to harmonize the corporate laws of its members [4], still tend to tighten up their rules on corporate information.

As far as their regulatory objectives are concerned, financial disclosure requirements in the U.S. and European countries differ in remarkable ways [5]. The most significant difference results from the broader range of public policy goals underlying the European acts. While the U.S. disclosure acts have addressed the needs of investors and capital markets exclusively, European rules often reveal a concern for other corporate constituencies, in particular, creditors and employees, and for the general public. The discrepancies between various disclosure laws, however, decrease gradually when analyzed within a narrower shareholder and market-oriented perspective. U.S. and European regulators alike have considered fairness and corporate governance

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related aspects, with the intention of enhancing the efficiency of their national securities markets [6].

Since countless studies have already been made comparing U.S. and European disclosure rules [7], this Article has another aim. It attempts to take a first step toward an "integrated" view of the regulatory objectives of financial disclosure regulation by assessing, from a transnational point of view, the theoretical debate on mandatory disclosure rules. For this reason, it will investigate the comparative empirical and logical support for the various objectives of disclosure requirements. Due to the constraints of space, U.S. disclosure regulation and academic criticism of it will be contrasted with disclosure principles of only two European countries, Germany and Switzerland. Furthermore, an inquiry is made into the extent to which the arguments depend upon particular institutional features of national corporate and financial sectors and upon national governmental regulatory models. Both inquiries may also allow some general insights into the operation and effectiveness of corporate financial disclosure as a regulatory tool.

At the same time, this Article will examine the broad range of objectives of disclosure rules as they evolved under a historical and theoretical perspective. Thus, in Section 2, it will examine investor, shareholder, and capital market oriented goals with respect to the familiar legislative concerns for investor protection, market efficiency, and corporate governance. In Section 3, it will review broader public policy objectives by asking which role financial disclosure rules may play in connection with informing the general public and creditors and employees, respectively, as specific corporate constituencies. In Section 4, the Article concludes with some tentative hypotheses and a summary of its major findings.

2. Investor-, Shareholder-, and Capital Market-Oriented Objectives

2.1. Protection of Investors

2.1.1. Investor Protection as a Policy Goal for Disclosure Rules

One may ask if the investor is an appropriate subject of legislative concern under a social policy perspective. The question has been answered in the negative by some commentators, particularly with respect to disclosure regulation for investments chosen by affluent and experienced investors [8]. In modern capital markets, however, a large majority of investment forms seem to be open (directly or indirectly) to smaller investors in a position akin to consumers needing governmental protection [9]. Moreover, capital markets play an important role under a social policy inquiry because they absorb substantial amounts of the "average" investors' private savings [10].

Although investor protection may be, therefore, a legitimate policy goal, protective objectives are apparently of a minor and decreasing significance in the modern discussion of financial disclosure regulation. Germany and Switzerland only recently have enacted indirect legislative protection of investors' interests in their corporate laws [11]. Academic comments on the regulation of capital markets recognize protective considerations, but are often cautious as to a precise articulation of the policy objective [12]. The U.S. practice and debate move in a similar direction. Some commentators even have questioned whether investor protection was historically a real concern of legislators enacting the securities laws [13]. The SEC itself has made an important shift away from a fairness- and towards an efficiency-oriented disclosure concept [14]. This emphasis on information rather than protection of investors was overwhelmingly welcomed in the academic community [15].

In view of the decline in importance of investor-protection as a goal of disclosure rules, three issues must be addressed in order to determine whether policymaking should concern itself at all with investor protection. First, one must inquire whether disclosure rules actually affect fraudulent practices in the securities field. Secondly, one must ask whether investor protection is an adequate standard for disclosure rules. Thirdly, one must ask whether disclosure requirements are always an adequate regulatory tool to protect individual investors.

2.1.2. Reduction of Fraudulent Practices by Disclosure Rules

Although there is no general definition of the investor protection objective, the most common definition states that "investor protection" aims at the deterrence of fraud on small and uninformed investors [16]. These investors are especially regarded as needing protection from fraudulent practices in connection with the issuance of new securities [17].

Whether disclosure rules are the proper device for preventing such fraud has always been hard to conclusively demonstrate. This is so not only because protective disclosure operates only indirectly to achieve its purpose [18], but also because fraud undeniably continues to occur even with established mandatory disclosure schemes [19]. Nonetheless, a series of U.S. studies conducted by governmental agencies between 1941 and 1980 shows that fraudulent actions have occurred much more frequently in connection with issuers not covered by mandatory disclosure requirements [20]. The studies also indicate that more effective disclosure rules would have made the execution of the fraudulent schemes very difficult, if not impossible [21]. In addition, practical experience seems to suggest that some fraudulent conduct simply does not get off the ground because of the existence of a mandatory disclosure process [22]. Both empirical results and experience support the thesis that the financial disclosure regulation of new securities issues can

reduce although not prevent fraudulent practices detrimental to small investors.

2.1.3. Investor Protection as a Standard for Disclosure Rules

The traditional investor-protection oriented concept assumes that because "average" investors are actively involved in the interpretation of financial data, mandatory disclosure rules accordingly should be tailored to these recipients [23]. It is, however, an accepted truth that this model of the informed layman is largely an ideological fiction [24]. The "active investor" model is inconsistent not only with the working of real investment processes but also with the very structure of disclosure regulations in organized capital markets [25]. Modern theories of finance, furthermore, suggest that prices in organized capital markets reflect a large amount of publicly available information [26]. The arguments are convincing that small investors can take a free ride on the information produced by the market, and that market prices are remarkably effective protection instruments [27]. More importantly, the informational function performed by disclosure rules may be impaired by a protectively oriented disclosure standard. For instance, the SEC has, for a long time, prohibited the disclosure of forward-looking information, stressing its misleading nature for small investors and thereby precluding the availability of important information for investment decisions [28].

One caveat remains with respect to a disclosure scheme that addresses "average" investors. In not-organized capital markets, which are still of a major economic significance in European countries, small investors cannot rely on market prices as a device for consumer protection [29]. Although this shortcoming can be offset by the use of professional advisors analyzing technical financial data [30], a large and reliable investment advice system may not be available in every securities market. Under such conditions, the argument for disclosure rules tailored to the needs of small investors becomes more tenable [31].

2.1.4. Investor Protection by Disclosure Concepts

Even with respect to not-organized capital markets, however, the effectiveness of investor protective disclosure regulations is debated. Since the early days of U.S. federal securities regulation, there have been supporters of a market control scheme beyond mere information rules, emphasizing that disclosure is not ideally suited to guarding small investors [32]. This argument has almost been forgotten in the modern American system focused on corporate disclosure in highly organized national markets. But it is interesting to note that it has, in some ways, reappeared in the European debate on regulation of not-organized capital markets. Critics of the German proposal for a new investment act [33], for instance, questioned a regulatory approach based primarily on mandatory disclosure rules, arguing that it would not

provide sufficient protection of investors [34]. Their postulate for substantive corporate law provisions seems convincing [35]. Thus, substantial doubt exists whether traditional financial disclosure is an effective regulatory device for the protection of investors in not-organized capital markets [36].

2.2. Promotion of Efficiency

2.2.1. Promotion of Efficiency as a Policy Goal for Disclosure Rules

Efficiency-based policy rationales for disclosure rules aim to strengthen the functioning of the market as an economic institution. In view of the social and economic benefits produced by capital markets [37], the promotion of their efficiency is, in European countries as well as in the U.S., an undisputed policy goal [38]. The only controversy is whether governmental regulation promotes greater efficiency.

Capital markets often are analyzed under the separate aspects of institutional, operational, and allocational efficiency [39]. Although there may be a positive correlation between disclosure regulation and operational efficiency [40], this section focuses on the most significant principle, allocational efficiency. Under that principle, mandatory financial disclosure is believed desirable because more accurate investment decisions by informed investors should lead to more efficient allocation of capital resources [41]. The efficiency-related objective of disclosure rules, however, has been seriously questioned, in particular by U.S. economists. The first of the following three sections reviews briefly the empirical counter-evidence of U.S. economists. The second and third sections try to determine whether any theoretical arguments in favor of a mandatory disclosure concept remain tenable under the modern theory of finance [42].

2.2.2. The Empirical Evidence

In the last two decades, influential U.S. economists have conducted a series of quantitative empirical studies based on modern methods of security price research. These economists have concluded that the disclosure rules of the securities acts had no significant beneficial impact on capital markets [43].

Yet, such findings are not determinative. Security price research itself apparently has inherent limits in connection with the evaluation of mandatory disclosure rules. As Professor Beaver puts it, "In sum, the absence of price effects is not necessarily an indictment of a regulation, and the presence of price effects is not sufficient to confirm the value of the regulation" [44]. Specifically, the U.S. empirical studies were not apt to detect benefits for the investor because they relied on statistical figures of returns [45]. Insofar as they compare the pre- and post-1933/34 markets, another flaw of the findings lies in the fact that the institutional structures of capital markets have considerably changed since the enactment of the securities acts [46]. These and

other problems of empirical tests led two prominent commentators to the conclusion that "there may not be any accurate method to ascertain the gross benefits of mandatory disclosure today other than by abandoning some or all of the disclosure system and observing the long-term effects..." [47].

2.2.3. Market Efficiency and Disclosure Regulation

The most prominent theoretical framework under which to analyze corporate disclosure is the modern theory of finance. Among other things, this theory postulates the Efficient Capital Market Hypothesis (ECMH), which asserts in a semi-strong form that capital markets are perfectly efficient in the sense that they reflect all available public information to the point of anticipating new information prior to its public announcement and dissemination [48]. At face value, the ECMH contradicts the allegation that beneficial effects result from mandatory disclosure rules on allocational market efficiency. That is, because significant information is instantly and continuously reflected in market prices, regulation of financial disclosure may be seen as superfluous [49].

As with any hypothesis of economic theory [50], though, one must caution against accepting wholesale the direct regulatory implications of the ECMH [51]. Professor Beaver may be right in surmising that "the concept of market efficiency by itself is not sufficiently rich to warrant inferences regarding institutional structure" [52]. The ECMH, for example, does not measure the peculiar economic and social value of mandatory disclosure rules [53]. Assessment of those values in regard to efficiency requires a consideration of factors other than the amount and speed of the information's reflection in market prices.

It has been stressed repeatedly that even in the U.S., only about ten percent of the corporations registered under the Securities Exchange Act are regularly followed by analysts, and for the remaining ninety percent, the market is presumably less efficient [54]. It is important to recall that empirical studies of market efficiency rely largely on the New York Stock Exchange. Whether their efficiency assessments can be generalized for other "sub-markets", in particular for the over-the-counter market and other stock exchanges, seems doubtful [55]. Insofar as these sub-markets are less efficient, governmental disclosure requirements may improve the allocation of capital resources, because public information does not always reach them in advance of the mandatory disclosure data [56]. This beneficial effect on resource allocation is even more significant in the European markets. German and Swiss commentators generally agree that the stock exchanges in their countries do not show an efficiency comparable to that of the U.S. stock markets [57]. The relatively few empirical tests indicate that these markets cannot anticipate all of the available information [58]. The contrast with U.S. markets is even more striking for Europe's not-organized capital markets, which are, by definition, not efficient [59]. At

least for Germany and Switzerland, the conclusion seems unavoidable that mandatory disclosure rules can supply the capital markets with new information and enhance their allocational efficiency [60].

2.2.4. Disclosure Regulation in Efficient Markets

Even within efficient capital market segments, disclosure regulation may have beneficial effects. One must recognize, for instance, that securities information has hybrid characteristics and is at least partly a public good [61]. It is well known in the economic theory of externalities that public goods tend to be underproduced because producers are unable to charge all potential users and beneficiaries of the goods [62]. One can identify, therefore, a lack of private profit incentives to provide the socially desirable amount of securities information [63]. In particular, information intermediaries (especially analysts) do not engage in enough search activity to fill the gap between information desired and information provided. This problem could be alleviated by mandatory disclosure rules. The disclosure rules would reduce the cost for intermediaries, which would result in an increase in the aggregate amount of securities research [64].

The production of information by investors and intermediaries may be viewed as redundant, to the extent that these groups gather the *same* sets of information [65]. Disclosure regulation, by making securities data publicly available would not only prevent these groups from developing too little, but also from undertaking too much informational activity. By creating a central information repository, governmental regulation would reduce wasteful duplication of search activities [66]. Mandatory disclosure requirements, therefore, may be regarded as a regulatory alternative that provides corporate data "at a lower cost than would be incurred by the private sector's information network in seeking the same information and reflecting it in prices" [67].

Disclosure regulation also may reduce the overall costs of information search and analysis because it requires all corporations to publish standard financial statements [68]. This allows investors and intermediaries to analyze securities data more quickly and less expensively. At the same time, the aggregate informational value of essentially standardized and therefore comparable financial statements seems to be higher [69]. Moreover, mandatory disclosure rules may neutralize the negative external effects any publication of internal information can cause [70]. As long as all corporations must "disclose financial... data, none would get an unfair advantage on balance" [71].

Even though disclosure regulation may have socially beneficial effects on the information markets, the question remains whether its use can be justified as well with respect to investment decisions of individual investors in efficient markets. Under the modern theory of finance, the Portfolio Theory asserts that investors may eliminate a great deal of the risks they assume when acquiring individual securities by holding a diversified portfolio [72]. Yet, even

though diversification may reduce investors' demand for firm-specific information [73], it does not necessarily follow that mandatory disclosure rules are superfluous [74]. As Professor Coffee recently has shown [75], mandatory disclosure rules may benefit ordinary investors in two ways. First, because most investors do not fully diversify their *securities* portfolios in order to hold diversified *investment* portfolios, disclosure (primarily of line of business data) enables them to minimize the variance in their overall investment portfolio by purchasing negatively covariant securities [76]. Secondly, the disclosure of financial information may be relevant for the investors' decisions concerning portfolio revision since the information allows the investors to better estimate the Beta values [77] of individual securities [78].

Another argument often made in connection with the governmental regulation of financial disclosure is the so-called "confirmation effect" [79]. This argument asserts that a higher quality, rather than higher quantity, of financial information is produced under mandatory disclosure rules. Such a conclusion is plausible because, even if mandatory disclosure rules do not provide new information, they still can operate as a check on previously disseminated corporate data [80]. That is, they can "serve ex ante to verify information already released to market professionals through less formal channels" [81].

One last efficiency argument for mandatory disclosure played a major role in the enactment of the U.S. securities acts. It was asserted that disclosure regulation would enhance investors' confidence in capital markets [82]. Today it is still widely held that capital formation, disclosure rules, and investor confidence are closely interrelated [83]. The correlation is rooted in the financial theory of risk aversion which states that an "investor who believes the market is a fair game puts more in equities and spends less investigating" [84]. The argument's persuasiveness depends on the ability of disclosure requirements to make markets a fairer game. As previously shown, disclosure rules do enhance fairness because they reduce fraudulent practices in capital markets [85]. The investor confidence argument, then, stands at the crossroad of efficiency and fairness considerations, indicating that a regulatory system for protecting investors may, under certain circumstances, concomitantly promote an efficient allocation of financial resources [86].

3. Promotion of Corporate Governance

3.1. Promotion of Corporate Governance as a Policy Goal for Disclosure Rules

The corporate governance objectives of financial disclosure regulation relate to the institutional power structure of the modern corporation. They are aimed at providing reliable monitoring of managers in the interest of shareholders. Corporate governance as a policy objective is not disputed in either the U.S. or

Europe [87]. Once more, opinions differ regarding the question of whether (and which) regulatory intervention is required to attain the goal [88]. On a very general level, American and European advocates of a mandatory disclosure scheme agree that it could improve the operation of the corporate governance system [89]. There is considerable difference, however, with respect to the precise function *financial* disclosure regulation is thought to serve.

3.2. Promotion of Shareholder Voting

Assuming for the purposes of this article that shareholder participation is a desirable goal, it is difficult to dispute that the dissemination of corporate data promotes both a more frequent and effective use of the shareholder franchise. Disclosure rules have a beneficial impact on voting rights because better informed shareholders are supposed to make more intelligent voting decisions [90]. Yet, financial disclosure regulations do not enhance all aspects of the shareholder franchise. On the one hand, financial information is clearly material to shareholders when fundamental corporate changes or other matters of financial significance must be voted on [91]. On the other hand, although European commentators hold otherwise [92], financial data seems of dubious relevance to shareholders making board elections. While it is true, as discussed in the following section, that financial statements may give some indications of management's performance [93], they do not disclose the kind of information shareholders need the most in order to make a diligent choice of corporate directors [94]. More helpful would be information about individual members, composition, structure, and functioning of the board [95].

Financial disclosure regulation serves a peculiar function in European stock company laws because shareholders there vote on the distribution of corporate benefits [96]. It is obvious that financial data are indispensable for dividend decisions [97]. But the European disclosure rules in this context do not simply protect shareholders' individual dividend rights. Because the reallocation of internal capital resources is at stake, they have an equally important impact on the allocational function of capital markets [98]. When informed shareholders vote for a distribution of benefits, they increase the portion of the total capital formation which is allocated by the external capital markets [99].

3.3. Promotion of Management Monitoring

In support of disclosure rules, European commentators traditionally have pointed out a relationship between financial disclosure rules and the direct control of management's performance by shareholders [100]. The argument is certainly plausible that financial statements provide data which are useful to evaluate the corporation's and, therefore, management's success. But the direct monitoring effect should not be overestimated [101]. Financial statements, for

structural reasons, do not include all the information necessary to assess how management has run the corporation [102]. Moreover, it is difficult for individual shareholders to determine the contribution of management or even specific corporate officers to overall corporate performance by examining figures on financial statements [103].

Mandatory financial disclosure rules may play a more prominent role in enhancing two control devices which indirectly operate in the interest of shareholders. In the first case, the capital market improves the performance of managers because low stock prices threaten managers' often substantial personal interests in the corporation's stock and the corporation's ability to raise new capital [104]. In the second case, the market for corporate control stimulates better performance because low stock prices encourage outsiders to seek control. In the belief that they can run the corporation more efficiently, outsiders attempt to acquire the corporation and to replace the incompetent managers [105]. Financial disclosure regulation enhances the effectiveness of both of these indirect disciplinary mechanisms. In that they lead to more accurate stock prices [106], the requirements concomitantly improve the function of stock prices as a monitoring instrument [107]. Mandatory disclosure requirements are also particularly important in tender offer situations because they reduce management's inclination to manipulate information for its own benefit in a battle for corporate control [108]. In European countries, however, their importance to tender offer situations is less significant because tender offers themselves are infrequently used in these countries for hostile takeovers [109].

Another question is whether financial disclosure regulation not only helps shareholders to monitor management performance, but also actually promotes management's adherence to its fiduciary duty to shareholders, especially their duty of loyalty [110]. The general ability of disclosure to deter self-dealing and other questionable practices has been widely recognized in the U.S. as well as in Europe [111]. Yet, opinions differ regarding the precise role financial disclosure requirements play in this context. While American writers for the most part explicitly or implicitly assert that only specific transaction related information can prevent breaches of the duty of loyalty [112], the European literature evinces a widespread belief that mandatory financial statements secure a more responsible and less selfish management [113]. The European position, however, seems untenable. Admittedly, disloyal behavior may be indicated by financial data when the behavior affects the overall performance of the corporation [114]. Financial disclosure regulation may also reduce fraudulent practices in connection with the issue of new securities [115]. It is doubtful, however, whether shareholders generally can detect questionable management practices by analyzing financial statements [116]. Much more useful for that purpose is mandatory information which relates directly to management's integrity [117]. For the same reasons, financial disclosure regu-

lation can hardly be expected to monitor loyalty violations in capital markets and the market for corporate control. Both indirect control mechanisms are ill-suited to sanction the self-dealing of management [118].

4. Broader Public Policy Objectives

4.1. Informing the General Public

4.1.1. Informing the General Public as a Policy Goal for Disclosure Rules

The argument for informing the general public represents a broader policy goal which correlates corporate disclosure with an informational need of the public aside from the need of investors and shareholders. It has played a major role in the historical development of, and the academic debate over, European disclosure rules [119]. Generally, the argument is compelling that the general public has a legitimate claim to be informed about large corporations having a manifold impact on the economy and society [120]. Yet, it remains unclear whether a reference to the interests of the general public is *necessary* to provide a satisfactory disclosure regulation. To put it differently: why and when are financial disclosure legislators induced to invoke a broader public interest transcending investor, shareholder, and capital market based arguments?

The interest put forth by commentators as the general public's seems to be a residual concept used to justify disclosure rules [121] when investor, shareholder, and capital market based concepts are unable to reach the socially desirable coverage of business enterprises, in particular the disclosure of financial data by large corporations. Whether this residual category is in fact necessary to realize sufficient coverage of these larger enterprises depends upon the institutional and legal structure of the national corporate sector and upon the basic regulatory approaches of national disclosure rules. For instance, U.S. registration rules trigger disclosure requirements for all corporations which have exchange listed securities, and for all corporations which have a class of equity securities with more than five hundred shareholders and more than three million dollars in total assets [122]. The registration rules are, in accordance with the general regulatory concept of the securities acts, basically capital market oriented [123]. These rules are able to cover most enterprises exceeding a certain size because most larger business entities are organized as corporations, and their securities are either listed on exchanges or traded among more than five hundred shareholders in the over-the-counter market [124]. Hence, there is no immediate need to refer to broader public policy considerations to realize the socially desirable coverage of mandatory financial disclosure rules in the United States.

The situation looked quite different in Germany prior to the enactment of the Publicity Law [125]. Big enterprises were under a disclosure obligation

only as long as they were organized as stock companies [126]. Yet, of the thousand largest industrial entities at that time, less than half were incorporated as stock companies [127]. The obviously insufficient coverage of large enterprises caused the enactment of the Publicity Law [128]. Because an investor, shareholder, and capital market based disclosure concept could not justify expanding the disclosure requirements [129], the legislators had to invoke the interest of a general public to reach their objective [130].

Switzerland experienced yet another situation. Large Swiss enterprises are all incorporated as stock companies [131]. Partly because the vast majority of smaller businesses organize as stock companies as well, the legislators did not enact any mandatory disclosure requirements at all [132]. Without a fundamental shift of the regulatory approach, a reform aimed at mandatory disclosure rules for larger corporations cannot be founded on shareholder and investor related arguments [133]. Insofar as capital market criteria do not realize the desirable coverage, the legislators again have to refer to broader public policy considerations.

This comparison leads to the conclusion that informing the general public as a policy goal may be necessary to guarantee a satisfactory financial disclosure regulation, especially with respect to an adequate inclusion of larger enterprises. Two questions remain open and will be discussed briefly in the following sections. The first question is whether interests of the general public can justify requiring financial data different from that required by investors. The second investigates the functions the disclosure rules for the general public are thought to exercise.

4.1.2. Additional Financial Data for the General Public

Insofar as mandatory disclosure rules provide corporate data for shareholders and investors, the general public is informed as well and can take a free ride on the information disseminated to others. Legislators, therefore, do not need to refer to broader policy considerations to require the release of the same information to a general public [134]. It does not follow, however, that the general public's interest may not call for the dissemination of additional financial data. The argument is conceivable that "shareholders might not demand as much information as the public would wish, because shareholders cannot capture the externality (a 'better run economy') the information provides" [135].

It is doubtful that there are many situations in which the public's need for financial [136] data could be higher than the investors' need. Capital market and shareholder based disclosure and disclosure regulation, as the U.S. system impressively shows, is so effective in producing a broad range of detailed financial information that it is difficult to determine any substantial additional demand required to benefit the public interest [137]. Moreover, the public, insofar as it is thought to exercise specific functions in connection with

corporate financial disclosure [138], seems to demand the same kind of financial data as investors and shareholders for information and control purposes. This conclusion is supported by Germany's experience with its Publicity Law [139]. This legislation, clearly based on broader public policy considerations, only requires disclosure of the same financial information that is disseminated under shareholder and investor oriented stock company law [140].

4.1.3. Functions of Disclosure Rules for the General Public

The question of what function financial disclosure rules serve for individuals outside the investor oriented information system, in particular the general public, has been extensively discussed in European literature. The commentators allege three functions. First, financial disclosure requirements supply the public with relevant data about the corporation (information function) [141]. Secondly, they enhance the public's knowledge of, and consequently its confidence in, the corporate sector (confidence function) [142]. Finally, the dissemination of financial data enables the public to evaluate corporations' performances and to monitor management behavior (control function) [143].

The arguments supporting the significance of the first two functions, information and confidence, clearly are persuasive. Disclosure regulation ensures the dissemination to the public of financial information that is probably otherwise unavailable. Moreover, it allows the representatives of the public opinion, most notably the mass media, to promote discussion of the data and to debate its issuers' performances [144]. A better informed public would be less suspicious of individual interprises, especially large enterprises, and the entire corporate sector. More confidence may be placed, therefore, in the economy as a whole.

Doubts persist as to the third of the alleged functions, namely that financial disclosure regulation would enable the general public to control corporate and managerial activity. Disclosure, by its very nature, is not a direct but an indirect monitoring technique [145]. Its effectiveness depends upon the existence of a reliable feedback mechanism [146]. Such a responsive structure is institutionally implemented in information systems addressing investors, shareholders, and capital markets. One must seriously question, however, whether public opinion, even when set forth by the media and special interest groups, effectively influences corporations and managers [147]. These doubts are particularly significant because financial disclosure pertains to the *economic* performance of the corporation, which is not usually the area where the social pressure of public opinion is likely to be generated [148]. A second reservation exists concerning the inherent limitations of financial statements for evaluating corporate management. Their monitoring effects as to management's performance are seriously limited [149]. Furthermore, one should recall that financial disclosure regulation is ill-suited for deterring disloyal and

unlawful managerial behavior [150]. The public is thus in no better position than shareholders in the detection and prevention of ineffective and questionable practices of management through the reading of financial statements [151].

4.2. Information Needs of Other Constituencies

Another public policy objective of financial disclosure rules is to inform corporate constituencies, other than investors and shareholders, that have specific economic ties to the corporate entity. This objective has influenced the European debate in which disclosure was often related to creditors' and employees' "right to know" [152]. The next two sections will briefly review the German and Swiss views on disclosure requirements as they are meant to serve these two constituencies.

4.2.1. Informing Creditors

The question whether financial disclosure rules are or should be based on creditors' informational demands is vigorously debated, particularly in Germany [153]. The argument itself may have some force in that disclosure regulation supplies creditors with information they need to evaluate the debtors' economic situation and to assess their own risks [154]. There are, however, two objections against such a creditor oriented justification for disclosure requirements. First, it is asserted that creditors need not depend on mandatory disclosure to protect their interests because they have contractual alternatives. This is true for financial institutions and other larger creditors with considerable bargaining power. Yet, smaller creditors are scarcely able to inform themselves by means of contractual disclosure devices [155]. More compelling is a second objection that creditor based arguments tend to cause excessive coverage of the corporate sector by financial disclosure requirements. It is indeed hard to see why creditors of enterprises which are subject to mandatory disclosure rules should be in a better position than creditors of unregulated business entities. A creditor protection oriented rationale, taken seriously, would lead to the mandatory disclosure of everyone who is doing business [156].

A reference to the creditors' demand for disclosure by debtors is irrelevant when a capital market, investor, or shareholder related regulation provides the financial information. Creditors may then play the role of a free rider. The same is true if disclosure is required with respect to the interests of the general public. On the whole, creditors apparently need similar financial data. Their informational interest covers the basic particulars of the debtors' overall economic situation and therefore parallels to a considerable extent the demand of investors and shareholders [157].

Proponents of a disclosure regulation scheme which focuses on the interests of creditors assert that there are two functions served by mandatory require-

ments [158]. First, they provide the information necessary to evaluate debtors' financial condition and, secondly, they protect creditors from unexpected insolvencies of their debtors. The informational rationale is conclusive. Small creditors, especially, may receive information which is useful for an estimation of the debtor's economic situation and which they cannot get otherwise. The alleged prophylactic purpose, however, is more doubtful. Even if financial statements were effective indicators of impending insolvencies, their ability to protect all creditors would be uncertain [159]. Yet, more important is the fact that financial statements are relatively crude and unreliable instruments from which to predict insolvencies [160]. The prophylactic end of creditor based disclosure rules seems therefore to be attainable only within specific limits.

4.2.2. *Informing Employees*

An employee's "right to know" in connection with financial disclosure regulation is no less controversial than that of creditors [161]. On a general level, there is a powerful argument that workers and their representatives have a legitimate claim to be informed about their employers' economic situation [162]. Nevertheless, two potential objections remain. First, employees may not need corporate information because their interests are protected by the collective bargaining process between unions and employers [163]. A contractual regulation of labor relations may provide more timely and specific information to employees. On the other hand, mandatory disclosure rules can improve the informational background of workers' representatives and thereby perfect the collective bargaining process [164]. The second objection is that, like a creditor related purpose, a strictly labor oriented rationale for disclosure rules should include a general disclosure obligation for all business entities because there is no compelling reason to prefer employees of enterprises subject to a mandatory information scheme [165].

In regard to the relevance and practical effect of labor based motives for financial disclosure regulation, a reference can be made to what has been said in connection with other, broader public policy objectives. Like creditors and the general public, workers can take a free ride on information which is disseminated for investors, shareholders, and capital markets [166]. Moreover, employees generally need the same information because, as far as financial disclosure is concerned [167], they are, like creditors and the general public, mainly interested in the overall economic situation of their employers [168].

Advocates of a labor oriented disclosure regulation impute three functions to disclosure rules [169]. They assert that a mandatory concept guarantees the release of information about employers' financial situation, promotes confidence in the relationship between labor and employers [170], and makes employment more secure by protecting workers against sudden insolvencies [171]. Once again the arguments advanced for the information and confidence functions may be convincing. Disclosure regulation supplies workers and

unions with detailed financial data about an employer's general economic position and performance. In addition, better informed employees and labor representatives may put their trust in the other bargaining party sooner. Information requirements thereby can improve the bargaining mechanisms. More doubtful is again the alleged prophylactic and protective purpose of financial disclosure rules. They can scarcely provide the informational basis for a reliable prediction of employers' insolvency and of other financial or operational difficulties. "The probability that a company or any one of its plants will offer continued employment at any given level... cannot be determined from financial statements" [172]. Workers and their representatives face the same limits as creditors in foreseeing financial and other problems of corporations simply by interpreting financial statements [173].

5. Conclusion

This Article attempts a first step towards an "integrated" view of financial disclosure regulation by analyzing, under a comparative perspective, the objectives underlying different national disclosure rules and proposals in the transnational academic debate. From the outset, the Article has ascribed a particular significance to two aspects. The first related to characteristic elements of national corporate and financial sectors as well as national regulatory models which may play a crucial role in estimating mandatory disclosure rules. The second concerned the comparative evidence as to the five alleged purposes of financial disclosure regulation.

It is neither new nor surprising that peculiar features of national enterprises, markets, and regulations considerably influence an evaluation of mandatory disclosure rules. Two groups of factors may be distinguished. One group refers to characteristics of national capital markets. It makes a significant difference if disclosure requirements address organized or not-organized capital markets. It is also important to know whether capital markets and their segments are "perfectly" efficient or not. The second group includes individual features of national corporate sectors and of their regulation. Of particular importance are institutional and legal structures of specially large enterprises, basic regulatory concepts of disclosure rules, and specific elements of corporate laws. When and why all these factors are relevant can best be recalled by summarizing the results of the investigation of the objectives of mandatory disclosure requirements.

Financial disclosure rules are beneficial to investors because they reduce fraudulent practices in connection with the issuance of new securities. Nevertheless, investor protection is a dubious standard for disclosure rules in organized capital markets because such a standard tends to impair the informational function. Not-organized capital markets, as they chiefly exist in

European countries, may require a shaping of disclosure requirements for smaller investors. Yet, it remains debatable whether, under these market conditions, a traditional disclosure concept is an effective regulatory tool to protect the investor community.

It is clear that financial disclosure regulation promotes the efficiency of not "perfectly" efficient capital markets because it supplies them with new information. This seems to be important for most of the European capital markets, but possibly also relevant for some segments of the U.S. capital market. Mandatory disclosure requirements have a beneficial impact even on efficient capital markets. They improve the information market by increasing the aggregate amount of securities research, by reducing wasteful duplication of search activities, and by other advantageous effects related to the externalities of corporate disclosure. Moreover, they can be helpful for individual investors making specific portfolio decisions. Finally, they may provide a better quality of information and promote capital formation by giving investors more confidence in the capital markets.

Corporate governance based financial disclosure rules are probably not very important for board elections, but remain meaningful when shareholders vote on fundamental changes or other matters of financial significance. In addition, such rules exercise a particular function in European corporate laws when shareholders decide upon the distribution of dividends and thereby upon the external market allocation of internal funds. Also, financial disclosure regulation plays a role in monitoring managerial activity. Although financial statements have a limited value for direct management control by individual shareholders, disclosure requirements can support market forces in serving as indirect disciplinary mechanisms. However, purely financial information is not well-suited for the monitoring of managers' loyalty.

A comparative analysis indicated that the interest of the general public is a residual category for justifying mandatory disclosure and is put forth when other objectives do not guarantee the socially desirable coverage of large corporations by the mandatory disclosure scheme. For instance, the institutional and legal structure of their enterprises as well as the regulatory concept of their disclosure rules prevented both Germany and Switzerland from reaching all their larger enterprises by a disclosure scheme exclusively addressed to shareholders and investors. Insofar as disclosure regulation provides corporate data for these traditional constituencies, the general public has probably no need for much additional financial information. Disclosure rules serving the general public may supply it with useful information and even enhance its confidence towards corporations and the economy. But it remains doubtful that the rules, as often alleged, facilitate the public's control of enterprises and managers.

The public policy argument for informing creditors and employees faces the fundamental problem that, taken to its logical extreme, the concept would

demand mandatory disclosure requirements for all business entities. Creditors and employees can take a free ride whenever information is mandated for other corporate constituencies. Their demand for financial data is not fundamentally different from the demand of investors, shareholders, or the general public. Disclosure rules drafted especially for creditors and employees may serve informational purposes, but these two corporate constituencies can rely on financial statements for prophylactic protection against insolvencies or other major financial and operational difficulties of the debtors or employers only within specific limits.

Notes

[1] For a comprehensive presentation of the economic debate and in particular the pioneering investigations of Professors Stigler and Benston, see I. Friend, Economic and Equity Aspects of Securities Regulation (1982) (Working Paper No. 7-82, Rodney L. White Center for Financial Research, University of Pennsylvania); Mendelson, *Economics and the Assessment of Disclosure Requirements*, 1 J. Comp. Corp. L. & Sec. Reg. 49 (1978). Recent legal studies include Coffee, *Market Failure and the Economic Case for a Mandatory Disclosure System*, 70 Va. L. Rev. 717 (1984); Easterbrook & Fischel, *Mandatory Disclosure and the Protection of Investors*, 70 Va. L. Rev. 669 (1984); R. Karmel, Regulation by Prosecution 257–71 (1982); H. Kripke, The SEC and Securities Disclosure (1979); S. Phillips & J. Zecher, The SEC and the Public Interest 27—52 (1981); Wolfson, *A Critique of the Securities and Exchange Commission*, 30 Emory L.J. 118 (1981).

[2] *See* Seligman, *The Historical Need for a Mandatory Corporate Disclosure System*, 9 J. Corp. L. & Sec. Reg. 1, 3–4 (1983).

[3] It should be noted, however, that the European economic literature has recently begun to investigate more critically the regulatory foundation of mandatory disclosure requirements. *See, e.g.*, H. Reuter, Aktienmarkt und Aktieninformationsmarkt (1980); Schmidt, *Rechnungslegung als Informationsproduktion auf nahezu effizienten Kapitalmärkten*, 34 Zeitschrift für betriebswirtschaftliche Forschung [ZfbF] 728 (1982); D. Schneider, Investition und Finanzierung 517–65 (1980); Wagner, *Zur Informations und Ausschüttungsbemessungsfunktion des Jahresabschlusses auf einem organisierten Kapitalmarkt*, 34 ZfbF 749 (1982).

[4] Of particular interest is the Fourth Directive of 1978. For an overview of background, objectives, and content, see Forster, *Coordination of Accounting Law in Europe*, 24 Die Aktiengesellschaft [AG] 1 (1979); Hulle, *The EEC Accounting Directives in Perspective: Problems of Harmonization*, Common Mkt. L. Rev. 1 (1981); Nobes, *The Harmonization of Company Law Relating to the Published Accounts of Companies*, European L. Rev. 38 (1980); E. Whinney, The Fourth Directive: Its Effect on the Accounts of Companies in the EEC (1979).

[5] For a recent historical restatement, see Meier-Schatz, *Disclosure Rules in the U.S., Germany and Switzerland*, 34 Am. J. Comp. L. 271, 273–81 (1986).

[6] *Cf. id.* at 281–84.

[7] This is particularly true for the presentation and discussion of the U.S. disclosure scheme by European writers. *See, e.g.*, H. Kronstein & C. Claussen, Publizität und Gewinnverteilung im neuen Aktienrecht 30–57 (1960) (for an older study); Hopt, *Vom Aktien- und Börsenrecht zum Kapitalmarktrecht?*, 140 Zeitschrift für das gesamte Handels und Wirtschaftsrecht [ZHR] 200, 203–15 (1976) (for a more recent study). For a direct comparison of the U.S. and European legislations, see Die Rechnungslegung in den Ländern der Europäischen Gemeinschaft und in den USA (W. Busse von Colbe & M. Lutter eds. 1979).

[8] *Cf.* H. Kripke, The SEC and Corporate Disclosure 108 (1979). The issue was broadly discussed in the context of so-called "depreciation companies" and their regulation in Germany. These are usually speculative business partnerships with outside investors as limited partners. Investors receive tax advantages due to the possibility of utilizing tax losses and deductions of the partnership to offset personal income from other sources. The argument stated that regulation is not adequate because it protects wealthy individuals who are at arm's length with management. *See* Koch and Schmidt, *Ziele und Instrumente des Anlegerschutzes*, 33 Betriebswirtschaftliche Forschung und Praxis 235 (1981); Mertens, *Inwieweit empfiehlt sich eine allgemeine gesetzliche Regelung des Anlegerschutzes*, in 2 Verhandlungen des 51, DJT 10, 14 (1976). *But see* Kohl, Kübler, Walz & Wüstrich, *Abschreibungsgesellschaften, Kapitalmarkteffizienz und Publizitätszwang-Plädoyer für ein Vermögensanlagegesetz*, 138 ZHR 1, 15–16 (1974).

[9] The parallel is also emphasized by Koch & Schmidt, *supra* note 8, at 235; Kübler, *Transparenz am Kapitalmarkt*, 22 AG 85, 87 (1977); Schoenbaum, *The Relationship Between Corporate Disclosure and Corporate Responsibility*, 40 Fordham L. Rev. 565, 576 (1972).

[10] German writers stress that fact particularly with respect to the U.S. capital markets because the U.S. social security system is comparatively less developed than that of European countries. Nevertheless, the argument remains valid for the latter as well. *See* Kübler, *supra* note 9, at 87–88; F. Kübler, Gesellschaftsrecht 368 (1981).

[11] For a historical review of investor and capital market oriented disclosure rationales in the two countries see Meier-Schatz, *supra* note 5, at 276–81.

[12] *See* Mertens, *supra* note 8, at 13–18 (expressing reservations about a *general* regulatory goal of investor protection); Kohl, Kübler, Walz & Wustrich, *supra* note 8, at 15–16 (linking investor protection to other policy goals); Koch & Schmidt, *supra* note 8, at 235–38; Kübler, *supra* note 9, at 87–90 (giving efficiency considerations a much greater weight).

[13] *See* Morton & Booker, *The Paradoxical Nature of Federal Securities Regulations*, 44 Den. L.J. 479, 480–85 (1967) (advancing the thesis that the legislators did not intend to protect investors, but rather to promote capital formation); *see also* R. Karmel, *supra* note 1, at 45–46 (1982) (interpreting the history similarly); SEC Disclosure to Investors, A Reappraisal of Federal Administrative Policies under the 1933 and 1934 Acts 49–59 (1969) [hereinafter cited as Wheat Report]; *cf.* Knauss, *A Reappraisal of the Role of Disclosure*, 62 Mich. L. Rev. 607, 614 (1964) (citing the contemporary literature).

[14] The most important elements of the policy shift are the integration of the two disclosure statutes (with decreasing weight on the rather protectively administered Securities Act) and the change in the area of "soft" information. *See* Anderson, *The Disclosure Process in Federal Securities Regulation: A Brief Review*, 25 Hastings L.J. 311, 342–47 (1974); R. Stevenson, Corporations and Information 89–91 (1980). *See also* Report of the Advisory Committee on Corporate Disclosure to the Securities and Exchange Commission, 95th Cong., 1st Sess. 305–10 (Comm. Print 1977) [hereinafter cited as Report of the Advisory Committee]. The Advisory Committee's recommendation is focused exclusively on the informational role of mandatory disclosure. Investor protection is accorded a low rank in the hierarchy of policy objectives. *Id.*

[15] For a general assessment under the dual perspective of the informational and protective functions, see Anderson, *supra* note 14, at 342–44; R. Stevenson, *supra* note 14, at 91–92; Beaver, *Current Trends in Corporate Disclosure*, 45 J. Acct. 44, 44–46 (1978) (stressing the informational and stewardship functions).

[16] *See* S. Phillips & J. Zecher, The SEC and the Public Interest 8 (1981); Coffee, *supra* note 1, at 751; Knauss, *supra* note 13, at 614; Morton & Booker, *supra* note 13, at 484–87; Schoenbaum, *supra* note 9, at 575–76; Note, *Disclosure of Payments to Foreign Government Officials under the Securities Acts*, 89 Harv. L. Rev. 1848, 1854 (1976). For a broader view of fairness related issues, some of which are discussed here in another context, see G. Benston, Corporate Financial Disclosure in the UK and the USA 104–23 (1976) [hereinafter cited as Corporate Financial Disclosure]; Benston, *Required Disclosure and the Stock Market: An Evalua-*

tion of the Securities Exchange Act of 1934, 63 Am. Econ. Rev. 132, 134–36 (1973) [hereinafter cited as *Required Disclosure*].

[17] *See* Seligman, *supra* note 2, at 1, 18–36. *See also* Kohl, Kübler, Walz & Wüstrich, *supra* note 8. In Germany, most of the fraudulent schemes in early corporate law history were related to dubious formations of new corporations. The newest fraud wave occurred in the unregulated segments of the capital market through the issuance of new securities.

[18] The effect is indirect because disclosure is thought to deter behavior that is dependent on secrecy for its success. *See, e.g.*, Anderson, *supra* note 14.

[19] This argument has been advanced by critics of mandatory financial disclosure to deny that there are any positive prophylactic effects on fraudulent behavior. *See* Benston, *Required Disclosure, supra* note 16, at 135; Benston, *Required Periodic Disclosure, the Securities Acts and the Proposed Federal Securities Code*, 33 U. Miami L. Rev. 1471, 1481 (1979) [hereinafter cited as *Required Periodic Disclosure*]; Easterbrook & Fischel, *supra* note 1, at 692–93; Kripke, *supra* note 1, at 130–31; Manne, *Economic Aspects of Required Disclosure under Federal Securities Laws*, in The Charles C. Moscowitz Lectures Number XV, Wall Street in Transition 21, 64–65 (1974).

[20] *See, e.g.*, Seligman, *supra* note 2, at 34–36.

[21] For a presentation and evaluation of the studies, *see* Seligman, *supra* note 17, at 34–36. *See also* Seligman, The Transformation of Wall Street 562 (1982) (for a similar conclusion relying partly on the same empirical studies); I. Friend, *supra* note 1, at 8–9.

[22] *See* Fiflis, *Economic Analysis as one Phase of Utilitarianism*, in Corporations at the Crossroads: Governance and Reform 70, 95–96 (D. de Mott ed. 1980) (citing observations of securities lawyers).

[23] *See* Beaver, *supra* note 15, at 47; Note, *Disclosure of Corporate Payments Abroad and the Concept of Materiality*, 4 Hofstra L. Rev. 729, 732–33 (1976). The SEC has partly relied on this approach in the concept of differential disclosure providing more detailed, more technical information to the professional and shorter, less technical information to the small investor. *See* Beaver, *supra* note 15, at 50 (citing important sources); *see also* Wheat Report, *supra* note 13, at 51–54.

[24] Due to his inability to analyze sophisticated financial statements and because of his competitive inferiority to professionals, a rational small investor is not directly involved in the process of security price formation. *See* Kripke, *The SEC, the Accountants, Some Myths and Some Realities*, 45 N.Y.U.L. Rev. 1151, 1164–73 (1970); Note, *The Efficient Market Hypothesis, Economic Theory and the Regulation of the Securities Industry*, 29 Stan. L. Rev. 1031, 1070–71 (1977).

[25] *See* Beaver, *supra* note 15, at 48 (the historical analysis is compelling that the SEC has, from "the outset... implicitly relied upon the existence of a professional community in order to justify its apparatus as an effective means of disclosure"); Gilson & Kraakman, *The Mechanisms of Market Efficiency*, 70 Va. L. Rev. 549, 640–41 (1984). For a review of the German literature, see H. Reuter, *supra* note 3, at 231–33.

[26] *See infra* note 48.

[27] *See* Easterbrook & Fischel, *supra* note 1, at 694; Kripke, *supra* note 24, at 1164–73; Kripke, *Fifty Years of Securities Regulation in Search of a Purpose*, 21 San Diego L. Rev. 257, 272–73 (1984); Note, *supra* note 24, at 1071. *See also* W. Beaver, Financial Reporting: An Accounting Revolution 167 (1981); Report of the Advisory Committee, *supra* note 14, at 313. The same conclusion is reached by European writers analyzing organized capital markets. *See* Reuter, *supra* note 3, at 234–37; Wagner, *supra* note 3, at 757–63.

[28] *See* Beaver, *supra* note 15, at 47–48; Stevenson, *supra* note 14, at 89–92; Note, *supra* note 24, at 1072–73.

[29] Hopt. Inwieweit empfiehlt sich eine allgemeine gesetzliche Regelung des Anlegerschutzes?, Gutachten für den 51, DJT 26 (1976). The article stresses the importance of distinguishing organized and non-organized capital markets for the evaluation of mandatory disclosure rules.

"Not-organized capital market" is a general term relating to all capital investments other than those in the stock of corporations registered on a stock exchange. *See* Koch & Schmidt, *supra* note 8, at 238; *cf.* Wagner, *supra* note 3, at 749.

[30] For the general argument, see Beaver, *supra* note 27, at 166–67; Beaver, *The Nature of Mandated Disclosure*, in Report of the Advisory Committee, *supra* note 14, at 618, 633; Easterbrook & Fischel, *supra* note 1, at 694–95.

[31] *See, e.g.*, Mertens, *supra* note 8, at 30–31 (opposing a detailed prospectus regulation with the argument that the not-organized capital market in Germany has no sufficiently sophisticated professional advisory structure and that therefore the disclosed information has to be comprehensible for small investors); Kohl, Kübler, Walz & Wüstrich, *supra* note 8, at 32–33 (stressing similar problems). *But see* Hopt, *supra* note 29, at 89.

[32] For an advocacy of regulation beyond disclosure, see Joslin, *Federal Securities Regulation From the Small Investors' Perspective*, 6 J. Pub. L. 219 (1957); Wright, *Correlation of State Blue Sky Laws and the Federal Securities Acts*, 26 Cornell L. Q. 259, 262 (1941). *See also* Morton & Booker, *supra* note 13, at 491–96.

[33] For an overview, see Steder, *Zum Entwurf eines Gesetzes über den Vertrieb von Anteilen an Vermögensanlagen*, 23 AG 173, 175–86 (1978). Such provisions were suggested by the early promotors of the legislation. *See* Hopt, *supra* note 29, at 89–92; Kohl, Kübler, Walz & Wüstrich, *supra* note 8, at 32–35.

[34] *See* Loistl, *Zur Regulierung des grauen Kapitalmarktes*, 30 ZfbF 815 (1978); Schneider, *Sonderrecht für Publikumspersonengesellschaften*, 142 ZHR 228 (1978). *See also* Ulmer & Dopfer, *Anlegerschutz und Gesellschaftsrecht*, 33 BB 461, 461 (1978) (also asking the adequacy question).

[35] Loistl, *supra* note 34, at 821–38 (calling for a more restrictive regulation of the formation act of public limited partnerships); Schneider, *supra* note 34, at 249–58 (preferring a special corporate law for public limited partnerships); *see also* Mertens, *supra* note 8, at 32–33 (proposal for an internal monitoring instrument).

[36] For a similar general assessment see Koch & Schmidt, *supra* note 8, at 243; H. Kripke, *supra* note 1, at 127–28 (indicating that mandatory disclosure rules outside a public market are not effective).

[37] For a short description of the economic function, see Friend, *The SEC and the Economic Performance of Securities Markets*, in Economic Policy and the Regulation of Corporate Securities 185, 187–92 (H. Manne ed. 1969). For the German literature, see K. Hopt, *supra* note 29, at 47–48; K. Hopt, Der Kapitalanlegerschutz in Recht der Banken 366 (1975) (both emphasizing the broader aspects of economic and social policy).

[38] As mentioned earlier, one notices a shift away from a fairness and towards an efficiency oriented foundation of disclosure rules. *See supra* notes 12–15 and accompanying text.

[39] The trichotomy is frequently used in the German capital market law literature. *See* Hopt, *supra* note 29, at 48; Kohl, Kübler, Walz & Wüstrich, *supra* note 8, at 16–18; Kübler, *supra* note 9, at 89–90 (referring to U.S. sources).

[40] For the American literature, see Schoenbaum, *supra* note 9, at 577. European commentators stress a potential reduction of transaction costs. *See* Kübler, *supra* note 10, at 368; F. Kübler, *supra* note 9, at 89; Schmidt, *supra* note 3, at 746. Yet, the evidence of a beneficial influence of disclosure rules on transactional costs seems to be mixed and rather weak. *See* Friend, *supra* note 37, at 192–94 (similarly critical); *cf.* H. Kripke, *supra* note 1, at 134–35.

[41] For the U.S. literature, see Anderson, *supra* note 14, at 329; Brudney, *Insiders, Outsiders, and Informational Advantages under the Federal Securities Laws*, 93 Harv. L. Rev. 322, 334 (1979); Mundheim, *Selected Trends in Disclosure Requirements for Public Corporations*, 3 Sec. Reg. L.J. 3 (1975); Van Valkenberg, *Corporate Disclosure under the Securities Act of 1933 and the Securities Exchange Act of 1934: A Historical Perspective*, in Report of the Advisory Committee, *supra* note 14, at 556, 562. For the European literature, see Hopt, *supra* note 7, at 415; Kohl, Kübler, Walz & Wüstrich, *supra* note 8, at 35; Kübler, *supra* note 9, at 90.

[42] The question of whether the traditional financial statements (particularly balance sheet and profit and loss statement) are well-suited as information instruments to serve informational purposes is not discussed here. For earlier critical evaluations in the German literature, see A. Ciesielski, Unternehmensberichterstattung zur Fundierung von Anteilseignerentscheidungen 91–97 (1975); Hax, *Der Bilanzgewinn als Erfolgsmassstab*, 34 ZfbF 642 (1964); Moxter, *Die Grundsätze ordnungsmässiger Bilanzierung und der Stand der Bilanztheorie*, 18 ZfbF 28 (1966); A. Moxter, Bilanzlehre 383–93 (1974) (hereinafter cited as Bilanzlehre); *see also* K. Maul, Grundfragen der Rechnungslegung bei Publikumsaktiengesellschaften 91–97 (1968) (broader analysis). For more recent critical statements, see D. Schneider, *supra* note 3, at 561–65; Wagner, *supra* note 3, at 157–63.

[43] *See, e.g.*, Benston, *Required Periodic Disclosure, supra* note 19; Benston, *The Costs and Benefits of Government-Required Disclosure: SEC and FTC Requirements: An Appraisal*, in Corporations at the Crossroads: Governance and Reform 37 (D. de Mott ed. 1980); Jarrell, *The Economic Effects of Federal Regulation of the Market for New Securities Issues*, 24 J. L. & Econ. 613 (1981); Stigler, *Public Regulation of the Securities Markets*, 37 J. Bus. 117, 124 (1964).

[44] W. Beaver, *supra* note 27, at 199–200.

[45] For a detailed analysis, see Easterbrook & Fischel, *supra* note 1, at 709–14; Gilson & Kraakman, *supra* note 25, at 736–38; *see also* Coffee, *supra* note 1, at 734–35.

[46] *Cf.* Gilson & Kraakman, *supra* note 25, at 640–41 (providing a list of factors which may have diminished *or* enhanced the gross informational benefits of disclosure rules); Coffee, *supra* note 1, at 744.

[47] Gilson & Kraakman, *supra* note 25, at 641; *see* R. Stevenson, *supra* note 14, at 86; R. Karmel, *supra* note 1, at 268.

[48] *See generally* T. Copeland & J. Weston, Financial Theory and Corporate Policy 196–248 (1979) (general review of theory and evidence of the ECMH); Fama, *Efficient Capital Markets: A Review of Theory and Empirical Work*, 25 J. Fin. 383 (1970); Jensen, *Capital Markets: Theory and Evidence*, 3 Bell J. Econ. & Mgmt. Sci. 357 (1972); J. Lorie & M. Hamilton, The Stock Market: Theories and Evidence 70–98 (1973). For a recent comprehensive statement of the ECMH providing full references to the literature, see Gilson & Kraakman, *supra* note 25.

[49] *See* Barry, *The Economics of Outside Information and Rule 10b–5*, 129 U. Pa. L. Rev. 1307, 1333 (1981); R. Karmel, *supra* note 1, at 258; Weiss, *Disclosure and Corporate Accountability*, 34 Bus. Law. 575, 576 (1979); Note, *supra* note 24, at 1062.

[50] *Cf.* Buxbaum, *Corporate Legitimacy, Economic Theory, and Legal Doctrine*, 45 Ohio St. L. J. 515 (1984) (elaborate discussion of the problem in broader context).

[51] *See* J. Gordon & L. Kornhauser, *Efficient Markets, Costly Information and Securities Research*, in Law and Economics Workshop Series Number WSVI-6, at 1–5 (1983); Levmore, *Efficient Markets and Puzzling Intermediaries*, 70 Va. L. Rev. 645, 649–50 (1984); *cf.* Beaver, *supra* note 27, at 167–70 (list of nonimplications).

[52] W. Beaver, *supra* note 27, at 169.

[53] *See* Barry, *supra* note 49, at 1350–51; W. Beaver, *supra* note 30, at 647; W. Beaver, *supra* note 27, at 170; H. Kripke, *supra* note 1, at 106–07. For the German literature, see H. Reuter, *supra* note 3, at 187–90; Schmidt, *supra* note 3, at 733–34; Wagner, *supra* note 3, at 763.

[54] *See* Coffee, *supra* note 8, at 731–32; *see also* Report of the Advisory Committee, *supra* note 14, at XVIII-XIX (figures are mentioned). Some say these figures may be too low. *See* H. Kripke, *supra* note 8, at 126–28. But the determination of the exact number is rather a question of degree than of substance.

[55] Barry, *supra* note 49, at 1348–49; Fiflis, *supra* note 22, at 93; W. Beaver, *supra* note 27, at 154–56 (cautious remarks).

[56] *Cf.* Barry, *supra* note 49, at 1350–51 (reaching a similar conclusion).

[57] *See* H. Reuter, *supra* note 3, at 167–68; Schmidt, *supra* note 3, at 747 n.66; Wagner, *supra* note 3, at 759; *cf.* Pratt & Behr, *Entwicklung von Grundsätzen der Rechnungslegung und*

Rechnungsprüfung, 55 SAG 72, 77–78 (1983) (discussing the structural differences between the U.S. and Swiss capital markets).

[58] For the German tests, see H. Berndsen, Unternehmenspublizität – Eine empirische Untersuchung zur Messung des Publizitätsverhaltens grosser börsennotierten Aktiengesellschaften und der Auswirkungen auf die Anlageentscheidungen am Aktienmarkt 272–97 (1979); E. Brandi, Informationswirkungen der Jahresabschlussveröffentlichung auf Entscheidungen am Aktienmarkt 125–71 (1977); H. Schulz, Kapitalerhöhungen aus Gesellschaftsmitteln 160–62 (1972); *cf.* Guy *The Behavior of Equity Securities on the German Stock Exchange*, 1 J. Bank. & Fin. 71 (1977). There appear to be no empirical tests for the Swiss stock market.

[59] For the relationship between disclosure rules and allocational efficiency in not-organized capital markets, see, e.g., K. Hopt, *supra* note 29, at 51–52.

[60] With this statement, nothing is said about the portion of the total capital formation which is allocated by external capital markets. This perspective may make the disclosure rules for informational purposes less influential in the overall allocation of financial resources. For the German literature, see Wagner, *supra* note 3, at 764–65. For the U.S., see H. Kripke, *supra* note 1, at 134–39.

[61] It is true that securities information is not entirely a public good because its value is quickly exploited in the market by trading. *See* Manne, *supra* note 19, at 42–43. Yet, that is not to say the public good perspective is flawed in the disclosure context. On one hand, there are externalities outside the investment process because competitors of the issuers may use the data for production decisions. *See* C. Benston, Corporate Financial Disclosure, *supra* note 16, at 141–42. On the other hand, even information for investment decisions "seldom can be confined to a single user because many people have a motive to leak it." Coffee, *supra* note 1, at 725. For characterization as a "hybrid" good see Barry, *supra* note 49, at 1327–28.

[62] In the disclosure context, there are two main externalities that prevent potential benefits from being captured. The first is that investors who are not actual shareholders may use the information for investment decisions. The second relates to the fact that other firms, particularly competitors, may benefit from data signaling productive opportunities. *See* Beaver, *supra* note 30, at 626–28; Easterbrook & Fischel, *supra* note 1, at 697; R. Stevenson, *supra* note 14, at 87.

[63] For the public good aspect, see Beaver, *supra* note 30, at 626–28; Easterbrook & Fischel, *supra* note 1, at 680–85; Fiflis, *supra* note 22, at 106; Gordon & Kornhauser, *supra* note 51, at 52–53; Mendelson, *supra* note 1, at 53–54; Seligman, *supra* note 2, at 17; R. Stevenson, *supra* note 14, at 87; *see also* Schmidt, *supra* note 3, at 742. For a discussion of the related problem of the inherent difficulties in contracting for securities research; compare Coffee, *supra* note 1, at 727–7.

[64] *See* Coffee, *supra* note 1, at 725–33.

[65] *See, e.g.*, Easterbrook & Fischel, *supra* note 1, at 681.

[66] *See* Beaver, *supra* note 30, at 634–36; Coffee, *supra* note 1, at 733–34; Easterbrook & Fischel, *supra* note 1, at 681–82; Gilson & Kraakman, *supra* note 25, at 638; R. Stevenson, *supra* note 14, at 87–88.

[67] W. Beaver, *supra* note 27, at 199. The argument of relative cost savings is also stressed in the German literature. *See* Kübler, *supra* note 10, at 368; F. Kübler, *supra* note 9, at 89 (discussing operational efficiency).

[68] Social benefits of standardization are also mentioned in Benston, *Required Periodic Disclosure*, *supra* note 19, at 1476; Easterbrook & Fischel, *supra* note 1, at 700–01; Longstreth, *The SEC's Role in Financial Disclosure*, 7 J. Acct., Auditing & Fin. 110, 112 (1983).

[69] The advantages of standardized financial statements are stressed in the European literature. *See, e.g.*, Schmidt, *supra* note 3, at 746–47. For the U.S. literature, see G. Benston, Corporate Financial Disclosure, *supra* note 16, at 142; Fama & Laffer, *Information and Capital Markets*, 44 J. Bus. 289, 298 (1971); *see also Ng, An Information Economics Analysis of Financial Reporting and External Auditing*, 53 Acct. Rev. 910 (1978) (broader analysis).

[70] *See* Foster, *Externalities and Financial Reporting*, 35 J. Fin. 521 (1980) (theoretical discussion of externalities). For an older but still important German study of the issue, see A. Moxter, Der Einfluss von Publizitätsvorschriften auf das unternehmerische Verhalten (1962).

[71] G. Benston, Corporate Financial Disclosure, *supra* note 16, at 143. He is right in limiting the conclusion by considering the extent to which "large, diversified corporation are able to hide or bury information more effectively than their small, single product competitors..." *Id.*

[72] For a succinct description of the theory of portfolio management, see W. Beaver, *supra* note 27, at 33–39; Langbein & Posner, *Social Investing and the Law of Trusts*, 79 Mich. L. Rev. 72, 77–83 (1980); *see also* J. Lorie & M. Hamilton, *supra* note 48, at 171–256 (more complete discussion).

[73] For a critical review of the SEC's disclosure concept from the portfolio management perspective, see Kripke, *supra* note 1, at 91–93; Kripke, *A Search for a Meaningful Securities Disclosure Policy*, 31 Bus. Law. 293, 305–07 (1975).

[74] *See* Beaver, *supra* note 30, at 642–44; Beaver, *supra* note 15, at 46–47; *cf.* Seligman, *supra* note 12, at 4–5 n.23; Report of the Advisory Committee, *supra* note 14, at XL–XLI.

[75] Coffee, *supra* note 1, at 747–51.

[76] *Id.* at 748–49.

[77] For a short description of the significance of the Beta Coefficient, see H. Kripke, *supra* note 1, at 89–91.

[78] *See* Coffee, *supra* note 1, at 747–51 (for an elaborate description of the technical arguments).

[79] *See* G. Benston, Corporate Financial Disclosure, *supra* note 16, at 137; Mendelson, *supra* note 1, at 55. Other commentators speak of a "disciplining effect." *Cf.* Fiflis, *supra* note 22, at 93; Report of the Advisory Committee, *supra* note 14, at XLVI.

[80] For the American literature see Barry, *supra* note 49, at 1351; R. Karmel, *supra* note 1, at 270; Fiflis, *supra* note 22, at 93; Mendelson, *supra* note 1, at 55; Sommer, *Financial Reporting and the Stock Market: The Other Side*, Fin. Executive, May 1974, at 36, 38. Similar arguments are emphasized in the German literature. *See* H. Reuter, *supra* note 3, at 148–50, 178; Schmidt, *supra* note 40, at 746. Even such an outspoken critic of disclosure regulation as Professor Benston concedes that "there is some reason to believe that published financial data are useful to investors to confirm what they have learned from other sources." G. Benston, Corporate Financial Disclosure, *supra* note 16, at 140.

[81] Gilson & Kraakman, *supra* note 25, at 641; *see* H. Reuter, *supra* note 3, at 150 (describing the correction of anticipating errors as one of the essential functions of disclosure rules).

[82] *See* Meier-Schatz, *supra* note 5, at 275 (with references to the literature). The motive reappeared during the debate of the 1964 amendments. *Cf.* Seligman, *supra* note 2 at 51–52 (citing contemporary sources).

[83] The argument has a prominent position in the German capital market law debate. *See* K. Hopt, *supra* note 29, at 50; Koch & Schmidt, *supra* note 8, at 236; F. Kübler, *supra* note 10, at 368, Kübler, *supra* note 9, at 9; *cf.* H. Kronstein & C. Claussen, *supra* note 7, at 24 (early statement). For the U.S. literature, see Easterbrook & Fischel, *supra* note 1, at 692–93 (criticizing the viewpoint); Manning, *Comment*, in Economic Policy and the Regulation of Corporate Securities 81, 85–87 (H. Manne ed. 1969); Seligman, *supra* note 21, at 562 (qualified endorsement); Seligman, *supra* note 2, at 51–53 (qualified endorsement).

[84] Easterbrook & Fischel, *supra* note 1, at 693; Seligman, *supra* note 2, at 52–53; Koch & Schmidt, *supra* note 8, at 236–37.

[85] *See supra* notes 16–22 and accompanying text. It is significant that most critics of the investor confidence argument believe that disclosure regulation has not been shown or may be theoretically unable to prevent fraud. *See* Easterbrook & Fischel, *supra* note 1, at 693; H. Kripke, *supra* note 1, at 28–31; Benston, *Required Disclosure, supra* note 16, at 150–51. Benston has rejected the argument empirically by comparing the purchases of new securities prior to, and after

the enactment of, the securities acts. *Value of the SEC's Accounting Disclosure Requirements*, 44 Acct. Rev. 515, 517–19 (1969) [hereinafter cited as *Value of Accounting*]. Yet, this test seems to have serious flaws. *See* Becker, *Comments on "The Value of SEC's Accounting Disclosure Requirements"*, 44 Acct. Rev. 533, 536–37 (1969). Other studies have demonstrated salutary effects. *See, e.g.*, Goldschmidt, *Registration under the Securities Act of 1933*, 4 Law & Contemp. Probs. 19, 28 (1937).

[86] The interrelationship between investor protection and market efficiency is stressed in the German literature. *See, e.g.*, K. Hopt, *supra* note 29, at 54–55; Koch & Schmidt, *supra* note 8, at 237–38.

[87] *See, e.g.*, Corporate Governance and Directors' Liabilities (K. Hopt & G. Teubner eds. 1985) [hereinafter cited as Hopt & Teubner] (an illustrative collection of articles on various topics of corporate governance written by both European and U.S. scholars).

[88] The literature is too voluminous to be quoted. For representative statements on the controversy, see generally Coffee, *Beyond the Shut-Eyed Sentry: Toward a Theoretical View of Corporate Misconduct and an Effective Legal Response*, 63 Va. L. Rev. 1099 (1977); M. Eisenberg, The Structure of the Corporation (1976); Fischel, *The Corporate Governance Movement*, 35 Vand. L. Rev. 1259 (1982); Hetherington, *When the Sleeper Wakes: Reflections on Corporate Governance and Shareholder Rights*, 8 Hofstra L. Rev. 183 (1979). For correlated German studies, compare Bresser & Kirchner, *Reformansätze für eine Verwaltungsmachtkontrolle von Grossunternehmen*, 22 AG 146 (1977), with Ch.-M. Ridder-Aab, Die moderne Aktiengesellschaft im Lichte der Theorie der Eigentumsrechte (1980). The U.S. debate has recently been intensified by an influential ALI project. *Compare* Scott, *Corporation Law and the American Law Institute Corporate Governance Project*, 35 Stan. L. Rev. 927 (1983) *with* Weiss, *Economic Analysis, Corporate Law, and the ALI Corporate Governance Project*, 70 Cornell L. Rev. 1 (1984).

[89] For representative statements from both sides, see Loss, *Disclosure as Preventive Enforcement*, in Hopt & Teubner, *supra* note 87, at 327, 328–30; and Bresser & Kirchner, *supra* note 88, at 154–58.

[90] For a discussion of the purpose of the American proxy regulation, see E. Aranow & H. Einhorn, Proxy Contests for Corporate Control 89–91 (2d ed. 1968); Kennedy, *Proxy Regulation*, 20 Bus. Law. 273, 274–75 (1965); Sowards & Mofsky, *Federal Proxy Regulation: Recent Extension of Controls*, 41 St. John's L. Rev. 165, 165–67 (1966); Comment, *The Public Corporation – A New Theory for Federal Proxy Regulation*, 60 Nw. U. L. Rev. 349, 352–53 (1965). It is also universally recognized in the European literature that disclosure is *conditio sine qua non* for the exercise of shareholders' participation rights. *See* Beste, *Aus Geschichte und Gegenwart der Publizität im Aktienwesen*, in Gedenkschrift zur 150. Wiederkehr des Gründungsjahres der Friedrich-Wilhelm Universität zu Berlin 174, 175–76 (1960); von Caemmerer, *Publizitätsinteressen der Oeffentlichkeit und Gesellschaftsrecht*, in Das Frankfurter Publizitätsgespräch 142–56 (1962); H. Kronstein & C. Claussen, *supra* note 7, at 15–18; F. Kübler, *supra* note 10, at 245; M. Richter, Die Sicherung der aktienrechtlichen Publizität durch ein Aktienamt 18–20 (1974) (German); R. Schindler, Die Publizitätsvorschriften bei der Rechnungslegung der AG 24–31 (1967) (Swiss).

[91] Oft-quoted examples are mergers and offers of bonus or stock option plans. *Cf.* M. Richter, *supra* note 90, at 18–19; A. Conard, Corporations in Perspective 296 (1976).

[92] *See, e.g.*, Kronstein & Claussen, *supra* note 83, at 16; M. Richter, *supra* note 90, at 18; Schindler, *supra* note 90, at 26–27.

[93] *Cf. infra* notes 100–03 and accompanying text.

[94] This seems to be a common belief in the U.S. literature. *See, e.g.*, Weiss, *supra* note 49, at 590, ("the requirement that financial results be reported accurately has not vitalized the electoral process"). In any event, it is surprising that there are no statements on the regulatory purpose of providing *financial* statements as part of the proxy information while other disclosure items are vigorously debated. Compare the purely formal treatment of the subject in E. Aranow & H. Einhorn, *supra* note 90, at 235–37; T. Hazen, The Law of Securities Regulation 324–26 (1985); and Sowards & Mofsky, *supra* note 90, at 193–94. *But see* W. Cary & M. Eisenberg, Corporations 272 (5th ed. 1980).

[95] *See* E. Aranow & H. Einhorn, *supra* note 90, at 90. These disclosure items are at the core of the debate on the regulatory reform of board election related information. *See* Staff of Senate Comm. on Banking, Housing and Urban Affairs, 96th Cong., 2nd Sess., Report on Corporate Accountability 69–95 (Comm. Print 1980) [hereinafter cited as SEC Staff Report]; Weiss, *supra* note 49, at 591–94; Weiss & Schwartz, *Using Disclosure to Activate the Board of Directors*, Law & Contemp. Probs., Summer 1977, at 63, 85–114; *cf.* Feis, *Is Shareholder Democracy Attainable?*, 31 Bus. Law. 621 (1976) (reviewing several proposals to provide more open board elections).

[96] The accounting literature consequently distinguishes an "information function" and a "distribution function" of financial disclosure rules. *See* A. Ciesielski, *supra* note 42, at 79–97; K. Maul, *supra* note 42, at 46–188; A. Moxter, Bilanzlehre, *supra* note 42, at 51–63.

[97] *See* H. Kronstein & C. Claussen, *supra* note 83, at 16; F. Kübler, *supra* note 10, at 245; M. Richter, *supra* note 90, at 18; R. Schindler, *supra* note 90, at 28–29. It is interesting to note that financial theorists attribute an increasingly significant weight to the distribution function as opposed to the information function. *See* Schmidt, *supra* note 3, at 748; Schneider, *supra* note 3, at 565; Wagner, *supra* note 3, at 765–68.

[98] *See* F. Kübler, *supra* note 10, at 245.

[99] *See supra* note 60. Consider the proposal for a regulatory reform that would improve the distribution function of disclosure rules. Wagner, *supra* note 3, at 767–68. In addition to the beneficial impact on capital markets, he stresses the importance of more effective monitoring of management by shareholders through the use of the distribution of benefits, such as the withholding of internal capital resources, to sanction bad management. *Id.*

[100] *See* Beste, *supra* note 90, at 175–76; J. Kraske, Die Publizitätspflicht der Grossunternehmung 76 (1962); M. Richter, *supra* note 90, at 27–28; R. Schindler, *supra* note 90, at 26–27.

[101] *See* Weiss, *supra* note 49, at 590 (skeptical view).

[102] The limits of financial statements in connection with the monitoring of management are also generally acknowledged by the U.S. accounting literature. *See, e.g.*, S. Davidson, C. Stickney & R. Weil, Financial Accounting 226 (1982); G. Welsch, C. Zlatkovich & J. White, Intermediate Accounting 1010–11 (1976); *cf.* Financial Accounting Standards Board, Objectives of Financial Reporting and Elements of Financial Statements of Business Enterprises 43–44 (1973) [hereinafter cited as Financial Accounting Standards Board].

[103] For a description of control problems caused by the limited informational value of financial statements, see Bresser & Kirchner, *supra* note 88, at 154–55; M. Richter, *supra* note 90, at 28–29; *see also* G. Benston, Corporate Financial Disclosure, *supra* note 16, at 147–48 (discussing the problem in the context of the public's and employees' "right to know").

[104] *See, e.g.*, Fischel, *supra* note 88, at 1263–64; Weiss, *supra* note 49, at 584; Werner, *Management, Stock Market and Corporate Reform: Berle and Means Reconsidered*, 77 Colum. L. Rev. 388, 402–05 (1977). *See also* Ch.-M. Ridder-Aab, *supra* note 88, at 110–12 (German view).

[105] The market for corporate control was first described in the seminal article of Professor Manne, *Mergers and the Market for Corporate Control*, 73 J. Pol. Econ. 110 (1965). In recent years, it has been a core issue in the debate on corporate law theory. *See, e.g.*, Easterbrook & Fischel, *The Proper Role of a Target's Management in Responding to a Tender Offer*, 94 Harv. L. Rev. 1161, 1165–68 (1981); Easterbrook & Fischel, *Corporate Control Transactions*, 91 Yale L. J. 698, 705–08 (1982); Gilson, *A Structural Approach to Corporations: The Case Against Defensive Tactics in Tender Offers*, 33 Stan. L. Rev. 819, 841–45 (1981). Skeptics do not question that it may have *some* effectiveness as an accountability mechanism but doubt that it has *sufficient* disciplinary power. *See, e.g.*, Buxbaum, *supra* note 50, at 525–37; Coffee, *Regulating the Market for Corporate Control: A Critical Assessment of the Tender Offer's Role in Corporate Governance*, 84 Colum. L. Rev. 1145, 1199–1200 (1984); Meier-Schatz, *Managermacht und Marktkontrolle*, 149 ZHR 76, 95–108 (1985) (European view).

[106] *See supra* notes 48–60 and accompanying text.

[107] *See* Anderson, *Conflicts of Interest: Efficiency, Fairness and Corporate Structure*, 25 UCLA L. Rev. 738, 790 (1978); Weiss, *supra* note 49, at 589.

[108] Professor Coffee stresses that a mandatory disclosure system alleviates the problem because it may subsidize the search costs of bidders and activate some degree of shareholder activity. *See* Coffee, *supra* note 1, at 747.

[109] The fact that low stock prices and the related threat of takeovers can have a disciplinary effect on management has been increasingly recognized. *See, e.g.*, Grossfeld, *Zur Stellung des Kleinaktionärs im Wirtschaftssystem*, 30 AG 1, 4–5 (1985); Wagner, *supra* note 3, at 764; *cf.* Meier-Schatz, *supra* note 105, at 93–103; Meier-Schatz, Unternehmenszusammenschlüsse mittels ubernahmeangebot, 38 Wirtschaft und Recht (1986) (forthcoming); Ridder-Aab, *supra* note 88, at 112–25.

[110] For a recent restatement of the distinction between the monitoring for performance and loyalty in legal as well as in economic terms, see Brudney, *Corporate Governance, Agency Costs, and the Rhetoric of Contract*, 85 Colum. L. Rev. 1403, 1430–42 (1985).

[111] *Cf.* Meier-Schatz, *supra* note 5, at 283.

[112] *See id.* at 275–76 (referring to the relevant literature).

[113] *See* Gessler, *Der Bedeutungswandel der Rechnungslegung im Aktienrecht*, 75 Jahre Deutsche Treuhand-Gesellschaft 1890–1965, 129, 163 (1965); K. Maul, *supra* note 42, at 3–17; F. Oesch, Der Minderheitenschutz im Konzern nach schweizerischem und amerikanischem Recht 197–98 (1971); R. Ott, Unternehmenspublizität, Analyse eines Rechts und wirtschaftsinstruments 64–66 (1973).

[114] Disloyal or illegal behavior, however, rarely leads to negative financial consequences which, because of its extent, shows itself directly in financial statements. This has been widely recognized and discussed in connection with the "materiality" standard of disclosure in the SEC's "questionable payments" campaign. *See, e.g.*, Comment, *Disclosure of Corporate Payments Abroad and the Concept of Materiality*, 4 Hofstra L. Rev. 729 (1976); Note, *Disclosure of Corporate Payments and Practices: Conduct Regulation through the Federal Securities Laws*, 43 Brooklyn L. Rev. 681 (1977).

[115] *See supra* notes 16–22 and accompanying text.

[116] It is also doubtful whether *financial* disclosure requirements can impede insider trading. *See* G. Benston, Corporate Financial Disclosure, *supra* note 16, at 122. *But see* Brudney, *supra* note 41, at 335.

[117] For an overview of U.S. jurisdiction and rules concerning management integrity disclosure, see generally Longstreth, *supra* note 68; Steinberg, Corporate Internal Affairs 73–132 (1983).

[118] This deficiency of the market mechanism is generally recognized. *See* Coffee, *supra* note 105, at 1201–02; Scott, *supra* note 88, at 938–39; Werner, *supra* note 104, at 441. *But see* Gilson, *supra* note 105, at 840.

[119] *See* Meier-Schatz, *supra* note 5, at 276–81, 287 (reviewing the U.S. and German literature).

[120] *See id.* at 284, 287 (reviewing the U.S. and German literature).

[121] This formula does not mean that broader public policy considerations have no independent and autonomous value *within* investor, shareholder, or capital market founded disclosure schemes. The issue is discussed only as to whether they are *necessary* to ensure that all larger enterprises are covered by the mandatory disclosure scheme.

[122] *See* Securities Exchange Act of 1934, § 12, 15 U.S.C. § 781 (1982). (I do not consider in this context the special section 15(d) of the Securities Exchange Act.)

[123] This is not directly evident for the second of the mentioned criteria. But because the modest asset requirement is almost meaningless, the key is the shareholder figure element. Here the legislative history of the 1964 amendments reveals that it was thought to have a direct relationship to the corporation's position in the over-the-counter market. *See, e.g.*, Comment, *supra* note 90, at 362–65 (citing the influential Report of Special Study of Securities Markets). *See generally* Meeker, *Extending Disclosure to Nonlisted Companies*, 20 Bus. Law. 265 (1965); Sowards, *The Securities Acts Amendments of 1964; New Registration and Reporting Requirements*, 19 U. Miami L. Rev. 33 (1964).

[124] One should recall, however, that there are some privately held U.S. corporations which rank among the largest and which are under no duty to disclose financial information. *See* R. Stevenson, *supra* note 14, at 185. Their number may grow if the current trend of "going private," in particular by management buyouts, continues. For a general analysis of the phenomenon, see Lowenstein, *Management Buyouts*, 85 Colum. L. Rev. 730 (1985).

[125] *See* Meier-Schatz, *supra* note 5, at 276–78 (historical presentation).

[126] *See id.* at 278.

[127] *See* Castan, *Publizitätspflicht für alle Grossunternehmen?*, 21 Der Betrieb [DB] 515, 518 (1968). Many larger enterprises seem to have intentionally evaded mandatory disclosure rules by choosing another legal form. *See* Rittner, *Rechnungslegungs-Publizität für Grossunternehmen*, 99 Juristische Blätter 393, 394–95 (1977).

[128] For the motives behind the Publicity Law, see Rittner, *supra* note 127, at 394–95.

[129] Most of the large enterprises not incorporated as stock corporations were companies with limited liability having no freely transferable shares or limited partnerships. *See* Castan, *supra* note 127, at 278–79.

[130] *See* Meier-Schatz, *supra* note 5, at 278–79.

[131] Newer statistical figures are presented in Botschaft über die Revision des Aktienrechts 3–12 (1983).

[132] *See* Meier-Schatz, *supra* note 5, at 280–81.

[133] This is true because such a reform would cover small corporations as well.

[134] Even advocates of a broader public policy concept recognize that it has no particular significance when the information is provided by capital market or stock company disclosure rules. *See* E. Schwark, Anlegerschutz durch Wirtschaftsrecht 179 (1979).

[135] G. Benston, Corporate Financial Disclosure, *supra* note 16, at 147–48.

[136] The situation is entirely different with respect to non-financial, in particular social responsibility disclosure.

[137] *See* G. Benston, Corporate Financial Disclosure, *supra* note 16, at 147–48.

[138] *See infra* text accompanying notes 141–51.

[139] *See generally* Meier-Schatz, *supra* note 5, at 278–79.

[140] *See. e.g.*, F. Kübler, *supra* note 10, at 246; *cf.* Pruhs, *Der Regierungsentwurf eines Publizitätsgesetzes* 14 AG 173, 218–22 (1969) (more elaborate discussion). Early promotors of a broader public policy concept of disclosure on the whole listed the same disclosure items that were already regulated in the stock company laws. *See* E. Boetcher, Unternehmensverfassung als gesellschaftspolitische Forderung 197–99 (1968); Kunze, *Die Publizität des Grossunternehmens*, in Festschrift für O. von Nell-Breuning 292, 319–20 (1965); P. van Ommeslaghe, Le régime des sociètés par actions et leur administration en droit comparé 568 (1960).

[141] R. Huhs, Die Funktion der öffentlichen Rechnungslegung 163–67 (1973); H. Kronstein & C. Claussen, *supra* note 7, at 22; R. Ott, *supra* note 113, at 92–98; Rittner, *Die handelsrechtliche Publizität ausserhalb der Aktiengesellschaft, Gutachten für den*, 46 DJT 141–42 (1964) G. Scherrer, Die Ausweitung der Rechnungslegungspublizität auf alle Grossunternehmen 162–76 (1968); Schilling, *Publizität, Aktienrechtsreform und Unternehmensrecht*, 46 DB 1497, 1498 (1962); R. Tschäni, Funktionswandel des Gesellschaftsrechts 196 (1978).

[142] *See* Huhs, *supra* note 141, at 170–71; H. Kronstein & C. Claussen, *supra* note 7, at 22–23; Rittner, *supra* note 147, at 142–43; G. Scherrer, *supra* note 141, at 162–63.

[143] *See* Huhs, *supra* note 141, at 167–69; P. van Ommeslaghe, *supra* note 140, at 267–71; R. Ott, *supra* note 113, at 94–96, Rittner, *supra* note 141, at 141–42; G. Scherrer, *supra* note 141, at 167–76; R. Tschäni, *supra* note 141, at 196–97.

[144] The mediation and transformation of corporate data by the mass media and other representatives of public opinion is widely noted. *See* Rittner, *supra* note 141, at 141; G. Scherrer, *supra* note 141, at 165–66; Schilling, *supra* note 141, at 1498.

[145] *Cf.* Bresser & Kirchner, *supra* note 88, at 154.

[146] *See generally id.*; C. Ott, Recht und Realität der Unternehmenskorporation 183 (1977).

[147] For similarly skeptical statements, see Krüger, *Oeffentliche Elemente der Unternehmensverfassung*, in Planung V 19, 44 (1971); H. Steinmann, Das Grossunternehmen im Interessenkonflikt 191–92 (1969); and Schilling, *supra* note 141, at 1498. *But see* R. Huhs, *supra* note 141, at 168–69; J. Kraske, *supra* note 100, at 69; P. van Ommeslaghe, *supra* note 140, at 567; R. Ott, *supra* note 113, at 94–95. The reservations remain valid with respect to the argument that disclosure rules serve the purpose of demonstrating to the public the existence of an internal control. *See* Wietholter, *Das Publizitätsinteresse der Anteilseigner*, in Das Frankfurter Publizitatsgesprach 33, 48–54 (1962). As far as disclosure is only a documentary demonstration, it is not an external control device. As far as it is meant to trigger external monitoring activities, the problem of its effectiveness remains.

[148] It is clear that the mechanism of politicizing corporations is not the same for economic, as opposed to social, performance. *See* Stevenson, *The Corporation as a Political Institution*, 8 Hofstra L. Rev. 39, 45–51 (1979).

[149] *See supra* notes 100–03 and accompanying text. Some commentators believe that disclosure rules benefit the general public because they reduce the danger of corporate insolvencies. *See, e.g.*, R. Ott, *supra* note 113, at 96–97; G. Scherrer, *supra* note 141, at 28–36. This argument is discussed *infra* notes 159–60 and accompanying text.

[150] *See supra* notes 110–18 and accompanying text.

[151] It is still widely held that financial disclosure requirements deter questionable practices in the interest of the general public. *See, e.g.*, R. Huhs, *supra* note 141, at 169; P. van Ommeslaghe, *supra* note 140, at 267; G. Scherrer, *supra* note 141, at 118.

[152] The argument of creditor protection was stressed throughout the legislative history of the stock company laws. *See generally* Meier-Schatz, *supra* note 5, at 276–81. Employee-related aspects appeared particularly in connection with the "enterprise law" debate. *See id.* at 287.

[153] Promotors of creditor related disclosure motives are, for example, von Caemmerer, *supra* note 90, at 158–59; R. Huhs, *supra* note 141, at 141–58; F. Kübler, *supra* note 10, at 248; M. Richter, *supra* note 90, at 20–22; G. Scherrer, *supra* note 141, at 137–52. Critics include R. Ott, *supra* note 113, at 74–79; Rittner, *supra* note 127, at 155–56; Schwark, *Probleme der Unternehmenspublizität im Lichte der 4. und 7. Gesellschaftsrechtlichen EG-Richtlinien*, 23 AG 269, 271–72 (1978); *cf.* R. Schindler, *supra* note 90, at 50–51. The issue has been intensively discussed in connection with the reform proposals for a new German law affecting companies with limited liability. *See also* R. Huhs, *supra* note 141, at 141–43; *cf.* Hoffman, *Rechnungslegung und ihre Publizität im Regierungsentwurf eines GMBH-Gesetzes im Hinblick auf die Rechtsentwicklung in der EWG*, in Festschrift für H. Kaufmann 213, 225–27 (1972) (citing relevant literature). The question has lately become important with respect to the Fourth Directive, which requires mandatory rules for companies with limited liability. These rules can, aside from public policy considerations concerning large business entities, only be legitimized by the argument of creditor protection.

[154] *See* von Caemmerer, *supra* note 90, at 158–59; F. Kübler, *supra* note 10, at 248; M. Richter, *supra* note 90, at 20–22.

[155] *See* R. Huhs, *supra* note 141, at 156–58; J. Kraske, *supra* note 100, at 105–07; G. Scherrer, *supra* note 141, at 150–52.

[156] The argument was advanced early on by critics concerned with having mandatory disclosure rules for companies with limited liability. *See, e.g.*, H. Fassbender, Gründung und Publizität bei einer Reform der Gesellschaft mit beschränkter Haftung 73 (1961); Köhler, *Zur Pflichtprüfung und Publizitätspflicht der Gesellschaften mbH*, 47 Rundschau für GmbH 113, 115 (1956), *cf.* Würdinger, *Zur Publizität der GmbH im nationalen und europäischen Bereich*, 55 GmbH-Rundschau 151, 154 (1964) (criticizing a different treatment of larger and small companies for reasons of consistency).

[157] For more details on the specific informational needs of creditors, see L. Bernstein, Analysis of Financial Statements 2–4 (1984); Financial Accounting Standards Board, *supra* note 102, at 10–12; W. Kenley & G. Staubus, Objectives and Concepts of Financial Statements 46–48 (1972). For the German literature, *see* R. Huhs, *supra* note 141, at 157–58; K. Maul, *supra* note 42, at 25–26.

[158] *See supra* note 154; Castan, *supra* note 127, at 516. There are, however, commentators who doubt that creditor oriented disclosure rules may attain even their informational purposes. *See, e.g.*, Rittner, *supra* note 127, at 155–56; Rittner, *supra* note 127, at 399; Schwark, *supra* note 153, at 271–72.

[159] Some creditors may overreact and thereby even promote insolvencies. *See* Strobel, *Publizitätspflicht und Haftungsbeschränkung*, 36 BB 1762, 1749–50 (1981). In addition, large creditors with individual inspection rights have informational advantages as compared with small creditors who depend on mandatory financial disclosure.

[160] The crucial issue in this context is the well known question of whether financial ratios compiled from financial statements can predict corporate failure or bankruptcy. There is a considerable body of empirical research studies on this subject. *Cf.* Scott, *The Probability of Bankruptcy: A Comparison of Empirical Predictions and Theoretical Models*, J. Bank. & Fin., Sept. 1981, 317–44; G. Gebhardt, Insolvenzprognosen aus aktienrechtlichen Jahresabschlüssen (1980). These results, however, do not change the fact that the prediction of bankruptcy on the basis of financial statements faces substantial structural limitations. For U.S. accounting literature, see S. Davidson, C. Stickney & R. Weil, *supra* note 102, at 224–25; D. Hawkins, Corporate Financial Reporting 10 (1977); E. Spiller, Financial Accounting 643 (1977). A particularly illuminating analysis can be found in the German treatise, of 1 A. Moxter, Bilanzlehre, at 86–91 (1984).

[161] For supporting statements, see Castan, *supra* 127, at 516–17; R. Huhs, *supra* note 141, at 120–41; M. Richter, *supra* note 90, at 22–24; Schwark, *supra* note 153, at 271. For a skeptical evaluation, see Kraske, *supra* note 100, at 78–85; Ott, *supra* note 113, at 79–81.

[162] The argument often uses the principle of equal rights of shareholders and workers to legitimize itself. *See* G. Benston, Corporate Financial Disclosure, *supra* note 16, at 148 (questioning the principle); Kraske, *supra* note 100, at 78; M. Richter, *supra* note 90, at 22; *cf.* R. Huhs, *supra* note 141, at 129–33 (referring to principles of democracy and human rights).

[163] *See, e.g.*, Ott, *supra* note 113, at 80.

[164] *See* F. Kübler, *supra* note 10, at 248. The majority of commentators hold that financial disclosure rules for employees have not become superfluous because of the codetermination law. *See* Castan, *supra* note 127, at 516–17; Huhs, *supra* note 141, at 133–41; M. Richter, *supra* note 90, at 23–24; Schwark, *supra* note 153, at 271.

[165] *See* Scherrer, *supra* note 141, at 137.

[166] It does not follow that a labor related objective for financial disclosure rules has no independent and autonomous value even though the rules primarily address investors and shareholders.

[167] The situation is obviously different with respect to social responsibility disclosure, e.g., information about workplace safety.

[168] *See* Maunders, *Employee Reporting*, in Developments in Financial Reporting 171, 176–80 (T. Lee ed. 1981) (comparison between investors' and employees' informational demands for financial data). One important disclaimer has to be made: while investors are mainly interested in financial information about the corporation as a legal entity, employees often need disaggregated data based on their individual plant. *See, e.g.*, Cooper & Essex, *Accounting Information and Employee Decision Making*, 2 Acc. Org. & Soc. 201, 210 (1977).

[169] *See supra* note 161.

[170] This aspect is emphasized particularly in the Swiss literature. *See* Dober, *Die Publizität der Unternehmen-Publizitätsempfänger und Publizitätstrager*, 37 SAG 105, 108–09 (1965); R. Schindler, *supra* note 90, at 57–58.

[171] *See* R. Huhs, *supra* note 141, at 141; R. Ott, *supra* note 113, at 79; M. Richter, *supra* note 90, at 22; Scherrer, *supra* note 141, at 135–36.

[172] G. Benston, Corporate Financial Disclosure, *supra* note 16, at 148.

[173] *See supra* notes 159–60 and accompanying text.