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Change from Within: German and Italian Finance in the 1990s

Richard Deeg

It hardly needs to be stated that there have been tremendous changes in the European political economy over the last two decades. But just how profound are these changes? To put it in more theoretic terms, are we simply witnessing a period of relatively rapid evolution along old institutional trajectories (paths), or are we in fact witnessing a critical historical juncture that is launching nations onto new trajectories? How can we determine when an existing institutional path or trajectory is ending and being replaced with a new one? How does such a process take place? How can we distinguish between institutional innovation within an existing trajectory and a switchover to a new trajectory or path?

In this chapter, I explore these questions and illustrate my theoretical arguments by examining the pattern of institutional change in the German and Italian financial systems.[1] I draw on recent theoretical work on path dependency and institutional change to identify the mechanisms of institutional reproduction and institutional change in the two cases. The cases suggest that path dependency, or self-reinforcing positive feedback mechanisms, can be used to help explain the observed pattern of institutional innovation. Yet the cases also suggest that path dependency theory can be enhanced through further theoretical modifications.

The empirical focus of this chapter is on the financial system—understood to include the banking system, securities markets, and elements of the corporate governance system—which occupies a central position within the institutional complex of a national political economy. Thus fundamental changes in the financial system have direct and significant consequences for the nonfinancial sector. However, in this chapter, I deal only with the financial system and do not attempt to generate an account of change in the entire economy.[2] Studying the financial sector also enables us to see how economic and political actors respond jointly to incentives for change in a given institution or institutional complex. This is so because much of institutional change and reproduction in the financial sector is predicated on coordinated responses by actors outside the sector, notably but not exclusively in the form of government regulation.

I will argue that the German financial system has initiated a new path or trajectory by bifurcating in two heterogenous subsystems or subregimes. One subregime encompasses banks and firms continuing to operate in the traditional regime, while the other encompasses banks and firms who are now operating

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under a new regime. In both subregimes we see a hybridization process in which many of the institutions of the old path continue as before, some old institutions are transformed to new purposes (conversion), and new institutions are introduced (layering). Yet in one subregime institutional change is sufficiently radical to generate a new 'logic', as a result of which the incentive structures for key actors and patterns of strategic interaction among them within the sector have changed substantially.

The Italian case is less clear-cut. The Italian financial system as a whole has undergone many of the same formal institutional changes as the German system, though only in the banking system narrowly defined is there clear off-path institutional change. Since efforts to transform Italian finance began much later than in Germany, this may just mean that Italy is in an earlier stage of transition and will, like Germany, move onto a new path. On the other hand, comparison of the German and Italian cases suggest that both were subjected to more or less the same exogenous 'shocks', yet their respective financial systems changed in notably different ways and to notably different degrees. This reminds us that endogenous factors, which I will discuss in greater detail, matter to outcomes, and this is why Italy may continue to evolve in an on-path fashion.

My particular conception of a path and off-path change may diverge from that commonly assumed by other theorists of path dependence. But if one were to take the position that a new path can only be constituted by complete, radical change—as most theorists apparently do—then the concept is of rather limited use. If one were to take the position that a switch to a new path can only result from discontinuous change ('exogenous shocks'), that is, wars, revolutions, conquest, or natural disasters, then we would find relatively few cases to study (see also North 1991: 90–1). Assuming this was so, in my view it can only lead to one of two conclusions. The first is that, for all practical purposes, there is no true path change, that is, everything just evolves along its given path, and hence the concept of a path is tautological. The second is that a switch to a new path is always (or nearly so) an evolutionary process. I will, as already suggested, argue the second position.

Institutional stability and change

In a recent work Paul Pierson (2000*a,c,d*) has elaborated an enticing theory of path dependence which is more complete and precise than that is typically found in social science. Pierson (2000*a*: 74–7) argues that a path-dependent historical or temporal process is one characterized by a self-reinforcing sequence of events. Path dependence constitutes a particular kind of historical process with a number of distinctive characteristics. First, *when* a particular event happens in a sequence it is very important, because 'small' events early in a sequence can have disproportionately large effects on later events. Second, during the early stages of a sequence—what can be understood as the critical juncture—things are relatively open or permissive but get more restrictive as one moves down a path. Third, as

one moves further down the path change becomes 'bounded', that is, 'previously viable options may be foreclosed in the aftermath of a sustained period of positive feedback, and that cumulative commitments on the existing path will often make change difficult and will condition the form in which new branchings will occur (Pierson 2000*a*: 76)'. Path dependence thus involves three phases: the first is the critical juncture in which events trigger a move toward a particular path out of at least two possibilities; the second is the period of reproduction, that is, the period in which positive feedback mechanisms reinforce the movement along one path; and finally, the path comes to an end when new events dislodge the long-lasting equilibrium. Thus, for Pierson every path begins and ends with a critical juncture, or what has also been frequently referred to as a punctuated equilibrium, marked by specific triggering events.

Mahoney takes this point a step further by arguing that these initial events must be *contingent* in that they cannot be explained by prior events or initial conditions (Mahoney 2000: 507–8). This does not mean that events are completely random or without antecedent causes, but they are either events too specific to be explained by prevailing theories, such as the assassination of a political leader, or they are large random events like natural disasters (Mahoney 2000: 513). 'Analysts may also treat an outcome as contingent if it contradicts the predictions of a particular theoretical framework specifically designed to account for this outcome (Mahoney 2000: 514).' The contingent nature of initial events is a necessary and logical element of such a conception of path dependency, but I will suggest in my analysis that this condition is too restrictive theoretically and empirically difficult to sustain.

One of the most important contributions of Pierson to recent institutionalist debates is his effort to specify mechanisms of institutional reproduction, or, put simply, what keeps things moving along the same path. Borrowing from economics, Pierson argues that a specific path is promoted via positive feedback mechanisms or the realization of *increasing returns* to moving along this path (Pierson 2000*a,b*). A variety of feedback mechanisms could be at work here. One possibility is 'large set-up or initial costs'; once actors make a large investment in a particular institution they have an incentive to continue it in order to recover those costs. Another possibility is 'learning effects', that is, over time actors operating within the institutions that define a particular path become more adept and knowledgeable and use this to enhance the efficiency of the institutions. A third mechanism is 'coordination effects', in which the benefits accruing to one set of actors from engaging in a particular activity grow when other actors adapt their behavior to it. A related mechanism is 'adaptive expectations'. This is operative when actors *expect* other actors to adopt a particular option, so they themselves adopt that option in order not to be left behind.

Mahoney lumps the four mechanisms together into a 'utilitarian' explanation of institutional reproduction (Mahoney 2000: 516–18). It is based on the assumption that actors choose particular institutions and choose to reproduce them as long as they see it in their interest to do so, and this determination is based on

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a cost–benefit analysis of alternative choices. To it Mahoney adds other mechanisms of institutional reproduction, like the exercise of 'political authority' or 'power' in favor of a particular path. 'Legitimacy' can also produce positive feedback, since often acceptance among actors of something as legitimate or appropriate encourages others also to accept it as such.[3]

Important for my analysis is also the argument that it is not only single institutions that are subject to positive feedback effects, 'but configurations of complementary institutions in which the performance of each is affected by the existence of others (Pierson 2000*a*: 78). Complementarity among institutions can generate high increasing returns to the extent that the effectiveness of each is enhanced by the existence and functioning of the others. Financial systems fit this description since they are composed of a broader institutional complex involving, for example, banks, insurance firms, stock exchanges, corporate governance regimes, accounting regulations, tax laws, etc.

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One of the glaring (and surprising) gaps in this debate is that no one has attempted to explicitly define, let alone theorize, when one is no longer on the old path. How do we know when change is 'bounded change' within the old path, or when change is the start of a new path? Indeed, it seems obvious that if we cannot make a clear distinction between change within a path and change to a new path, then the concept itself is rather useless. Moving forward on this issue starts with a definition of institutions, a working definition of a path, and a 'measurable' conceptualization of path change. I will follow Hall (1986: 19) that institutions are 'the formal rules, compliance procedures, and standard operating practices that structure the relationship between individuals in various units of the polity and economy'. Of particular interest in this chapter is path dependency and change in institutional systems or regimes, that is, a configuration of institutions that are collectively structuring a specific sphere of activity. In this chapter, I argue that the *path* of an institutional system is not synonymous with the particular institutions which constitute it at a given point in time, but with the logic generated by their interplay, that is, the typical *strategies, routine* approaches to problems, and *shared decision rules* that produce predictable patterns of behavior by actors within the system (this draws on Zysman 1994). When actors are confronted with new situations, they will resort to these strategies, routines, and decision rules. Even if many institutions in a system change dramatically, so long as the logic of the system is preserved, this change represents on-path change. Conversely, even though many institutions in a system might remain unchanged over a period of time, changes in other institutions might be sufficient to generate a new logic and thus off-path change. This conception of path change draws our attention away from formal institutions and toward the behavior of actors.

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Financial systems, for instance, are often divided into two types exhibiting different logics. In *market-based* systems the logic is characterized by arms length, deal-based interactions among firms. Relationships are more likely to be based on explicit, contractually determined exchange and obligations. Banks reduce their market risks by maintaining distance with clients, limiting their financial exposure

to a given firm, and minimizing risk through diversification of exposures. Banks and other financial institutions often prefer to be pure financial intermediaries between savers and borrowers, carrying little risk themselves. Borrowing from Hirschman (1970), we might call this a *logic of exit*: financial firms limit their obligations to an individual firm to make exiting from the relationship relatively easy.

In *bank-based* systems, by comparison, longer-term, reciprocity-based interactions prevail. Relationships are more likely to involve implicit obligations and trust. Banks reduce their market risks through closeness to clients as maintaining a higher financial exposure places the bank in a position to monitor and influence client firms' management. Specifically, through mechanisms such as board seats and equity investments, banks gain the inside information necessary to manage their credit risks. This we might call a *logic of voice*: financial firms cooperate with clients and use their leverage over them to improve the relationship (see also Beyer 2002).

Starting from this conception of a path, I will advance three theoretical claims through an examination of institutional change in the German and Italian financial systems:

1. *Endogenous change.* The first claim is that, contrary to the theory of path dependence which asserts that only exogenous change can move actors off a current path, an exogenous shock is *not* the only way fundamental (off-path) institutional change is initiated. Endogenous sources of change include actions undertaken by actors within an institution or institutional system that result directly from mechanisms of path reproduction.[4] With this definition it becomes essential to identify these mechanisms exactly and show how their gradual, 'natural' evolution over time can lead to changes which undermine or alter these very mechanisms. Increasing returns may thus cease to increase or even turn into decreasing returns. This, in turn, induces actors to seek institutional changes that will either restore the old path (possibly through non self-reinforcing mechanisms of institutional reproduction, like power) or move to a new path. A logical corollary to this claim is that an event sequence involving a move to a new path may not necessarily follow from a contingent event, yet may nonetheless be driven by path-dependent increasing returns processes.[5]

2. *Path dependency as a mechanism of change.* Positive feedback or self-reinforcing mechanisms are usually viewed as mechanisms of institutional reproduction or stability. But they can also be mechanisms of change. The two cases examined later show how increasing returns to a new institutional path may gradually displace the old path. As self-reinforcing effects become stronger for a new path they weaken the self-reinforcing effects of the old and may, eventually, tip the balance in favor of the new. Another possibility is that the old path gets bifurcated in that the system develops into two heterogenous subregimes operating on different logics—one on the old logic, the other on a new one. Each path may be stabilized by self-reinforcing mechanisms. Of course not all instances of off-path change occur through self-reinforcing or path-dependent processes.

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3. *Cultivation of increasing returns*. This leads to my third theoretical claim: that increasing returns to social and political institutions must often, or perhaps normally, be cultivated by actors as they do not happen automatically. While this point is not necessarily inconsistent with much of the literature, it has not received sufficient attention. Cultivation takes the form of mobilization in the political arena on behalf of policy or regulatory change. It also takes the form of organizing collective action, often for the purpose of coalition building. Here power and ideas enter crucially into the institutional change process. If change in the financial system were simply a result of actors finding the most efficient institutional solution, then a simple functionalist explanation would suffice. But if, for instance, we take the fundamental choice confronting actors in the German and Italian financial systems between adapting the existing system or converting to a market-based system, the most efficient choice is not obvious. In the abstract neither system is clearly superior to the other, and the consequence of choosing one over the other is highly uncertain: sticking with the old could be slow demise, while choosing the new may be sudden death. In such situations actors deploy power, ideology, or both to promote their favored outcomes. As institutional change moves in a direction sought by key actors, we should see a declining need for cultivation as other actors independently adapt their behavior to reinforce the new path. In other words, over time positive feedback effects must become strong enough to become self-reinforcing.[6]

In the two case studies to follow, we shall see that endogenous factors are very important in explaining the extent of change in the German case, as well as the different degrees of change in the two cases. Similarly, the cases demonstrate the importance of cultivation by actors, showing in particular that broader and more concerted cultivation in Germany explains why a path change occurred here but not in Italy. Finally, in both cases increasing returns effects contribute to explaining change yet they appear to be weaker in Italy than in Germany. This difference is ascribed to the absence of endogenous pressures for change in Italy and weaker efforts at cultivation.

The German case

If the German financial system is not unambiguously suboptimal, why do they change it? How do they manage to do this if there are strong positive feedback effects that ought to keep Germans on the same path? My answer starts with the assertion that key actors come to see their interests as diverging from the existing path because of decreasing returns to them within it; first as a result of endogenous developments in the path and, later, exogenous changes. The movement to a new path in Germany may have begun small, in some sense, but it cannot be traced back to a single contingent event. Rather, it is a cumulative result achieved through an evolutionary process—*mostly* intended by actors—that is eventually driven forward by self-reinforcing mechanisms in what can be viewed as a critical

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juncture, that is, the mid-1980s to late 1990s. Paradoxically, it turns out that self-reinforcing mechanisms can be observed at work in simultaneously preserving the old path and promoting a new one. This is possible because the old system 'bifurcates' in a sense; part of the system (mostly comprised of smaller banks and firms) continues to evolve along the old trajectory—that is, on-path change—while another portion (mostly involving large banks and firms) develops a significantly new institutional path. Yet both parts remain constituent pieces of the German financial system and the evolution of each is conditioned by that of the other. In more theoretical terms, the operative mechanism of institutional change is bifurcation: because many actors continue to prefer the old system (path), actors seeking major institutional change achieve their aims by carving out a distinct subregime.

The existing path

It virtually goes without saying that the banking industry is widely recognized as a key ingredient of German industrial success. Much studied and debated is the historically close relationship between large banks and firms (e.g. Edwards and Fischer 1994). This relationship rests on several institutions and patterns: First, in comparative perspective German firms have not relied much on equity markets for external finance, instead relying on bank loans. Second, large banks frequently have substantial equity stakes in large firms (and vote shares of others they hold on deposit), giving them a voice in firm management. Moreover, ownership in large German firms tends to be concentrated in the hands of a few long-term shareholders, primarily families, other large nonfinancial firms, and, to a lesser extent, financial firms. And third, bank representatives have historically sat on a wide range of corporate supervisory boards, placing them in an unparalleled position to monitor and influence management. It has frequently been argued that this system lends certain comparative advantages to German firms, in particular the ability to rely on 'patient capital' and focus on long-term expansion rather than share price maximization (Porter 1992). Historically, small- and medium-sized enterprises (SMEs) have eschewed the stock market and instead relied heavily on long-term relations and loans from savings and cooperative banks (Vitols 2000).

The institutional path of the German system embodies an overall *logic of voice* with long-term cooperation founded on expectations of mutual reciprocity (see also Zysman 1983). Market actors following this logic seek to reduce risks and increase their own economic gains through cooperation. Following my earlier conceptualization of a path's logic, we can identify three dimensions of actor behavior that follow from this logic. First, the key institutions (formal rules) governing the financial system are developed through a consensual bargaining process involving the associations of the three major banking groups. When other groups' interests were affected, they too participated but the pattern of bargaining did not change. The *shared decisionmaking* system was therefore a corporatist (consensual) rule-making one within a tight-knit policy community. The state's

role in this process was largely to act as mediator and codifier of privately negotiated agreements, that is, establishing the statutory framework to govern extensive self-regulation by industry actors (Lütz 2000: 152–5).

The second dimension of the system's logic is reflected in the market strategies of individual actors. In the 'insider control' character of German corporate governance, insiders—major shareholders such as large banks, insurance firms, corporations, and families—control the strategies and decisions of large German firms (relatively free of the influence of stock markets or small shareholders; Ziegler 1995). This system rested on the corporate *strategies* of these insiders. The strategy of large commercial banks, for instance, focused on cultivating industrial development and competitiveness through a system of broadly negotiated industrial change (Zysman 1983). Part of this strategy involved investment in maintaining strong networks (both capital and human) among larger firms and the cultivation of long-term relationships with corporate customers. Another prominent strategic behavior is 'group competition' in which the savings and cooperative banks, through various kinds of cooperative strategies within their associational structures, attempt to compete as a group against the large commercial banks in all segments of financial business. This system meant that the *routine response* of corporate actors to common challenges—and frequently to challenges or problems facing an individual firm—typically involved some significant collective response.

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As with any complex set of institutions, there are many mechanisms that reinforced this system. One key *mechanism of reproduction* was the increasing returns accruing to the system as a whole due to the complementarity of institutions. For example, the strong, long-term links between banks and nonfinancial firms were connected to the specific organizational strategies of each, that is, reliable sources of long-term finance encouraged firms to develop business strategies with long-term investment horizons. This, in turn, created an interest on the part of nonfinancial firms in maintaining the existing financial system. Furthermore, the weakness of equity markets in Germany reinforced the reliance on bank loans as the key source of external finance. Relatively strong competition in commercial loan markets and state lending ensured competitively priced loans for firms, thus further encouraging heavy reliance on bank loans. The bankruptcy laws also encouraged bank borrowing over equity issues (Sauvé and Scheuer 1999: 70–7).

The insider system of corporate governance embodied another key mechanism in the form of *coordination gains*. Major gains include protection from unwanted takeovers, useful information about general industrial developments, and the assurance of reward for long-term success of the firm rather than the achievement of short-term financial targets. This insider system also encouraged a stakeholder approach to the management of German corporations, that is, firms were managed not only in the interest of owners but also other stakeholders such as employees, suppliers and customers, and society at large.

A final mechanism of reproduction was the relative parity and stable distribution of *power* among the three key banking groups. Parity meant that no single

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group could dominate the establishment and change of the rules. Stability rested on the fact that each banking group is economically significant, has powerful allies in the economy and the political party system, and draws from independent sources of *legitimacy*. This stable power distribution undergirded the consensual rule-making pattern and the cooperative logic of the system more generally.

The change to a new path

In line with my first theoretical claim, the process of moving to a new institutional path for the German financial system began endogenously. Key actors within the system, notably the large commercial banks, began to gradually see their interests as diverging from the status quo. They sought to confront their competitiveness problems in the 1970s through market strategies, but they ultimately started to focus on changing the higher level institutions or rules that govern the financial system as a solution to their problems. The internationalization of financial markets—an exogenous force—ultimately became a powerful source of pressure for change, but it did so only after endogenous developments initiated the movement to a new path.[7] Thus the internal dynamics of the system led to developments that altered the interests of key/central actors who initiated a series of institutional changes designed to serve their interests. This case suggests that a 'critical juncture' can emerge (at least partly) out of normal processes of change inside a path (also Schwartz 2001).

That said, the initial movements in the 1970s and early 1980s toward a new path might not have been consolidated but for the growing impact of internationalization on the interests and preferences of domestic actors. The initiation of the Single Market process in 1987 really becomes the vehicle through which the internationalization of financial markets begins to strongly impact domestic German developments. Nonetheless, change toward a new institutional path in Germany still required intensive cultivation by actors—in the late 1980s and early 1990s. Increasing returns effects become readily observable only in the 1990s, notably in the wake of the crucial decision at Maastricht in 1991—which can be understood as an intensification of the process begun by the SEA (Single European Act)—to establish monetary union a decade hence.

Left at this, my explanation could probably be viewed as entirely consistent with the Pierson (2000*d*) conception of path dependency, as he suggests that path-dependent processes are all based on such a threshold model in that a small event or movement acts as the trigger, that is, pushes a cumulative variable above a threshold point that unleashes more dramatic off-path change. While one could construct a plausible argument that the SEA was a contingent event, for this kind of path-dependent argument to work one has to assume that in the absence of the triggering event the cumulative variable would not move above the hypothetical threshold on its own. But the internationalization of financial markets—the cumulative variable of interest here—would clearly have continued to cumulate and sooner or later would have come to have similar determinative force over

Table 7.1 Market share of loans to firms and manufacturing industry by bank group (% of total)

Year	*Commercial banks*	*Big banks**	*Savings banks*	*Cooperatives*
Firms				
1968	35.4	15.7	31.3	12.9
1970	36.2	16.0	32.3	12.3
1972	36.7	15.4	33.2	12.9
1974	35.0	14.9	34.1	13.6
1977	31.8	13.2	34.6	15.1
1982	30.1	11.9	36.7	17.4
1986	27.0	10.7	35.9	16.1
Manufacturing industry				
1968	52.9	28.3	24.6	10.8
1970	54.6	29.6	24.7	10.4
1972	54.2	28.2	26.1	11.3
1974	53.2	28.4	25.8	12.2
1977	48.5	25.1	27.9	14.9
1982	38.8	18.2	33.2	17.5
1986	39.3	18.8	31.8	18.4

* Big banks are a subset of the commercial bank category. Loans to firms include the self-employed and mortgage loans on commercial property.

Source: Deutsche Bundesbank, *Statistische Beihefte zu den Monatsberichten der Bundesbank, Reihe 1, Bankenstatistik nach Bankengruppen* (various years); and Deutsche Bundesbank, *Deutsches Geld- und Bankwesen in Zahlen, 1876–1975* (Frankfurt: Deutsche Bundesbank and Paris: Banque de France, 1976), tables 1.10 and 2.05. Percentages are authors own calculations.

domestic institutional changes. Thus, we find evolutionary change within a path that ultimately becomes changed to a new path (marked by increasing returns) but without an *indispensable* triggering, contingent event.

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The 1950s and 1960s represent the postwar equilibrium phase for the German financial system. The large commercial banks grew and profited primarily from their close association with large industrial firms, though they also began to rapidly expand retail banking business during the 1960s. As can be seen in Table 7.1, in the late 1960s and early 1970s loan market shares among the bank groups were relatively stable. But beginning with the 1974 recession a rapid shift from the commercial to savings and cooperative banks can be observed. The shift is particularly stark in the category of loans to manufacturers—along the mainstay of commercial banks and especially the big three banks. With this shift the benefits (returns) to the major banks of the old path began to decline, thereby touching off a gradually intensifying search for institutional changes.

This shift can be attributed to two general endogenous developments. The first is the new aggressiveness and success, beginning in the late 1960s, of the savings and cooperative banks in commercial lending (see also Deeg 1999: 47–55).

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The second was the decline in borrowing by large firms that were the primary customers of the big commercial banks. Even though the late 1970s and early 1980s involved extensive economic restructuring, large firms as a whole decreased substantially their financial dependence on the banking system because they were able to self-finance at higher rates. Commercial lending by banks was further undermined by the expanding banking activities of many large nonfinancial firms, including lending to other enterprises.[8] The declining benefits to the banks of the existing system were likely further depressed by a steady and significant rise in corporate bankruptcies since the mid-1960s: This occurred despite the insider position of banks—resting on equity holdings, board seats, and proxy voting of shares held on deposit—which presumably gave them sufficient information and leverage to minimize such risks (Beyer 2002).

The decline in bank borrowing by large firms represents an endogenous factor because the reproduction of the existing path of the German financial system depended on a close, capital-based relationship between banks and firms. As this relationship began to change, the ability of the system to reproduce itself began to erode. It is also endogenous because in Germany dependence on bank borrowing reflected the preferences of the banks and industrial firms, that is, it was not a consequence of state-imposed restrictive regulations, as was the case in many 'repressed' financial systems such as France or Japan. In many of these systems bank borrowing by large firms also declined in this period but as a result of exogenous changes in state policies.[9]

This rapid decline in lending touched off a search by large commercial banks for a new, long-term market strategy. One response of these banks was to lend more aggressively to small and mid-sized firms. While they had some success in this effort, it was not enough. By the early to mid-1980s the big commercial banks determined that their best opportunities lay in financial activities related to capital markets, most importantly underwriting and trading. This shift in strategy coincided with rising concern among banks over growing competition from foreign financial institutions and centers. This concern became quite powerful in the wake of the sweeping liberalization of the London securities industry (the 'Big Bang') and the SEA, both of which occurred in 1986.

Given these endogenous and now increasing exogenous pressures, the large banks launched a concerted effort in the late 1980s to promote Germany's 'underdeveloped' securities markets through financial product innovation and market liberalization. Because German investors could not be expected to increase their demand for securities as rapidly as the banks needed, the strategy soon came to rest importantly upon wooing foreign institutional investors (Lütz 1998). Despite a firm belief in the effectiveness of the traditional German regulatory regime for capital markets, the pro-reform coalition found itself increasingly compelled to adopt many of the Anglo-Saxon market regulations and norms demanded by these investors (Deeg and Lütz 2000). Yet it is important to stress that when these exogenous pressures became important in Germany the big German banks were already moving in this direction.

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The chief movers behind the reforms were a 'Frankfurt Coalition'—the big three commercial banks and the DGZ bank (acting on behalf of the savings bank sector). The coalition drew steady support from the Land government of Hesse (home to Frankfurt, Germany's financial capital), the association of foreign banks, and with somewhat less conviction, the Bundesbank (Lütz 2001). During the 1990s many large nonfinancial firms also became supporters of efforts to cultivate the development of securities markets. No longer relying on bank loans for external funds, many firms instead preferred to see modern capital market products in Germany that could increase their financial flexibility (Deeg 1999: 88). But developing German securities markets required much more than a few liberalization measures. One of the main challenges confronting the Coalition was the costly and fragmented structure of the German stock exchange system. Thus in 1986 the Coalition began what turned into a long-term campaign for reorganizing the stock exchange system. Early efforts focused on developing electronic trading as a means to overcome institutional fragmentation. Amendments to the German stock exchange law in 1989 opened the door to the new German Futures Exchange in 1990. This same year also saw the passage of the first of four Financial Market Promotion Laws subsequently promulgated. All of these omnibus laws contained numerous and wide-ranging statutory additions and amendments intended to stimulate the supply and demand of securities. The 1990 law, for instance, eliminated various taxes considered hindrances to securities trading (see Deeg 1999; Ziegler 2000; Cioffi 2002; Goyer 2002; Jackson 2003).

Efforts to develop and promote securities markets in Germany became even more intense and focused in the early 1990s as the momentum for capital market integration and monetary union in Europe accelerated. But more importantly the German state itself now took an intense interest in these issues. The state was motivated by the fact that in international bodies engaged in financial market integration (the Basel Committee, International Organization of Securities Commissions, and the European Union (EU) itself) it was severely disadvantaged by its dearth of statutory authority and regulatory control over its own securities markets. The Germans feared that their inability to shape the terms of international financial market integration would severely handicap Germany economically (Lütz 1998). Thus in early 1992 the German Finance Ministry launched its *Finanzplatz Deutschland* campaign (Finance Center Germany).

One of the first successes of this campaign was the long-sought reorganization of the stock exchange system into a publicly traded company, the Deutsche Börse AG, in 1993 (Lütz 1998). The next success was the Second Financial Market Promotion Law in 1994 that harmonized the content and form of German regulation with international norms and EU directives. It also moved Germany away from the traditional self-regulation of securities markets and exchanges with the creation of an independent Federal Supervisory Office for Securities Trading. The new state agency, modeled after the American SEC (Securities and Exchange Commission), was charged with enforcing a new legal ban on insider trading and newly stringent information reporting requirements by issuers of securities and

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traders. The push for greater openness and transparency in reporting by public companies and in the markets represented a dramatic break with the past. It is also a good example of North's argument that changes in informal institutions often lag formal institutional change. This has certainly been true regarding German attitudes toward corporate openness and transparency in business deals and market transactions. However, over the course of the 1990s the new norms of transparency and openness clearly spread.

By the second half of the 1990s the need for reformists to cultivate institutional changes was declining, as the campaign for developing securities market achieved broad support and momentum among business, the public, and the political parties. This did not, of course, mean there were no significant disagreements over the details of specific reform initiatives. For example, the 1998 Law on Control and Transparency in Enterprises (*Gesetz zur Kontrolle und Transparenz im Unternehmensbereich, KonTraG*) was perhaps the most controversial reform legislation in the last five years. The law sought to support the growth of securities markets by increasing corporate transparency, management accountability, and protection for minority shareholders.[10] Not all of the initial proposals were embraced by the large banks and firms, but the Federal Demonstration Partnership (FDP), then coalition partner with the Christian Democratic Union (CDU) in government, pushed hard for the measure and gained support from the opposition Social Democratic Party (SPD) (and the unions as well). The FDP and SPD were motivated in particular by a desire to strengthen the ability of capital markets to put pressure on firms, that is, to undermine what they saw as excessive concentration of corporate power (Cioffi 2002; Höpner 2002). What this episode suggests is that self-reinforcing mechanisms were now quite strong—banks and financial firms had unleashed a process of institutional change toward a new market-oriented financial system that at times went even further in this direction than they preferred.

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Since coming to power in late 1998, the SPD has been an aggressive pro-market reform party and one that has on occasion taken the initiative ahead of the large banks and firms. The SPD sees these as part of a strategy to modernize and revitalize the German economy and a strategy that realizes a long-standing aim of the part—the deconcentration and 'democratization' of corporate power. Bolstered by the tremendous surge in stock markets in the late 1990s and the spectacular success of the *Neuer Markt*, a new electronic exchange for fast-growing technology firms introduced in 1997, the SPD guided numerous key reform efforts during its first term in office. In 1998 the Third Financial Market Promotion Law was passed. Also in 1998, a law to facilitate equity issues (*Kapitalaufnahmeerleichterungsgesetz*, KapAEG) was promulgated which, among other things, allows German firms to balance their books using the more transparent international (IAS) or American accounting standards (US-GAAP: Luetz 33).[11] The SPD put together a neo-corporatist commission (Cromme Commission) to develop a corporate governance codex. Published in 2001, the codex seeks to encourage firms to adopt 'good' corporate governance practices (with a strong emphasis on minority shareholder interests).

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While the German government was criticized for vetoing the European Commission's takeover directive in 2001, its own takeover law passed that same year is among the more liberal takeover laws in Europe. Finally, in 2002 the corporate governance codex—while it already had broad support—was given more authoritative status through the Corporate Sector Transparency and Publicity Act (TransPuG; Höpner 2002).

The late 1990s became the time when many of the reform efforts of the 1980s and early 1990s finally congealed and began to have a significant impact on the behavior of financial firms, large corporations, and German retail investors. It can be understood as marking the end of the critical juncture period during which the direction of institutional change was uncertain. Indeed, by this time the emergence of a subregime—a new path—becomes apparent. The new subregime follows a market logic, that is, an emphasis on shareholders, profits, and arms-length relationships. Most importantly, the cooperation and collective responses to market challenges of the old path is supplanted by individual responses and, increasingly, with more competition among firms as a market for corporate control slowly emerges. To put it in more theoretical terms, the gains from coordination have been eroding and along with this the ability of the old path to sustain itself. This change was stoked further by more general changes in the managerial strategies of many large German firms. For example, in the 1990s several large German firms began internationalizing their investor base (in part by listing on the New York Stock Exchange which better positioned them to make acquisitions in the United States). As a result the shareholder base of numerous large German firms has become more widely dispersed and internationalized, thus weakening domestic shareholder control and bank connections. Like the United States, institutional investors (e.g. pension funds and investment funds) and their preferences have become increasingly important in Germany.[12]

The internationalization of the investor base of many large German firms (and the big commercial banks too) is connected to a growing emphasis by such firms on shareholder value, that is, managing the company so as to maximize return on equity (as manifested in share prices and dividends; Jürgens et al. 2000: 15). In the past, German firms often focused more on expansion of the firm's revenues and market share while profitability, though important, was not the driving force of managerial decisions. This conventional focus was sustained by the fact that most large firms have been controlled by insiders who did not usually pressure management to pursue profit maximization as the foremost goal.[13] In this kind of shareholder-oriented (market and regulatory) environment corporate managers also face more pressure to sell-off divisions or close operations more quickly than they would have in the past if they are not generating sufficient return (Höpner 2000).

Relationship banking, that is, a mutual emphasis on a long-term relationship between a firm and its main bank(s) is being replaced by more market-based, transaction-oriented exchanges—from the logic of voice to the logic of exit. Since the 1970s, but especially during the 1990s, large German banks have generally reduced the size of their equity stakes in individual nonfinancial firms.[14] First, the

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banks were interested in reducing their exposure to the risks associated with large equity stakes in other firms. Second, like other large German firms, the banks are focusing on maximizing their own returns on equity and believe that many of their long-held equity investments 'locked up' in traditional relationships could be more profitably employed in other ways (*The Economist*, August 14, 1999; *New York Times*, August 13, 1999). As part of its broad program to modernize corporate Germany, in 2000 the Federal Government passed a Corporate Income Tax Law that made the sale of long-term equity stakes held by large firms and banks in other firms tax free after January 1, 2002 (Land, Mayhew, and Shackelford 2001). It is widely expected that a large-scale restructuring of the German corporate world will occur in coming years. Already banks and firms have accelerated their sell-off of big industrial shareholdings (Höpner 2001; Beyer 2002). This new direction represents a radical break from the old path in which banks and other large firms were long-term shareholders providing 'patient' capital and protecting firm management from unwanted outside influences and takeovers.

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Along with reducing their holdings, banks have been curtailing their traditional role in corporate governance, that is, the institutions and practices that regulate property rights and control of firm managers. In 1974 banks held 20 percent of the supervisory board seats in the 100 largest firms; by 1993 this percentage had shrunk to 6.3 percent.[15] All of the above changes mean that banks are playing much less of a monitoring role in large German nonfinancial firms, that is, creating managerial stability but also ensuring accountability. This role is presumably being taken over by the market.[16]

In sum, large banks in Germany have dramatically altered their strategies. They have tied their future prosperity to the growth and success of securities markets and a more open system of corporate governance. Their actions led to the emergence of a new subregime that adheres to a different logic than the old regime, thus constituting a new path. For example, firms in the new subregime are responding to current challenges by disentangling with each other (e.g. selling equity stakes): under the logic of voice of the old path they would have 'banded' together to confront problems in the market. Smaller banks, on the other hand, remain mostly rooted in the traditional system because smaller firms continue to rely on them. This system has also undergone noteworthy changes, especially through institutional layering. But these changes have been largely consistent with the cooperative or voice logic of the old path. As for nonfinancial firms, the pressures to adopt shareholder value and an 'Anglo approach' to corporate governance are significant but must be differentiated. As in the banking system, firms appear to be bifurcating between the relatively few yet very large firms that, for various reasons, embrace shareholder value and operate within the new subregime, and the greater number of firms who have shunned or only made weak efforts to adopt the shareholder approach (Jürgens et al. 2000; Ziegler 2000; Höpner 2001).

This points to the fact that even within the new subregime there are many institutions that were part of the old path. Social partnership, for example, is firmly rooted in Germany and organized labor has been an active participant in the

transformation into shareholder capitalism (Vitols 2000; Höpner 2001: 20). More generally, there is little evidence that any broader move to shareholder capitalism requires a reduction or elimination of worker participation institutions in Germany, and there appears to be little political interest in explicitly weakening these institutions (Ziegler 2000: 212). Many large German firms, even those that are emphasizing shareholder value, continue to believe that the interests of other stakeholders—employees, customers, and society in general—must still be balanced against shareholder interests.[17] What ultimately matters is the fact that the interplay of new and old institutions within the market-oriented subregime generates a different logic and thus represents a new path.

The Italian case

Similar to Germany, the Italian banking system is shared mostly among three types of banks; commercial (joint-stock), savings (and other public banks), and cooperative banks. But here much of the similarity ends. The central hallmark of the Italian postwar financial system was the heavy presence of the state. Public ownership was extensive; first through the Treasury that controlled several of the largest banks, and second through communal governments that controlled the extensive savings bank sector. Public banks accounted for the large majority of banking sector assets, deposits, and loans (Aiello, Silipo, and Trivieri 2000: 28). Many banks were highly politicized in terms of board appointments and credit decisions and often viewed by public authorities as having a public interest rather than market function. Restrictive regulation and segmentation of the financial system severely restrained competition ('The Transformation of . . . 1997'). The banking system was very decentralized, thus leaving Italy with relatively small, localized banks in international terms. Beside smaller firms in industrial districts, banks, and firms generally did not have close, long-term relations of the German type.

To a certain degree, postwar Italian capitalism can be divided into three models with banks having a distinctive role in each. The first is the state-dominated model. From the early 1930s onward the Italian state controlled a substantial portion of industrial capital—notably through its holding company, IRI. The second model or part of the economy was that of large, private firms. Such firms are comparatively few in Italy, though they are quite significant. Most of them, despite their large size, are family controlled (e.g. Fiat by the Agnellis).[18] Most of these firms were part of intricate interfirm networks cemented by alliances and strategic shareholdings. Pulling many of the strings in this system from the 1960s onward was Mediobanca, the Milan-based investment bank headed by Enrico Cuccia. The third model is that of small- and medium-sized (mostly family-owned) firms. Indeed, the Italian economy distinguishes itself from other advanced industrial economies by the high proportion of output accounted for by such firms, many of which are organized in industrial districts.[19]

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By international standards, debt finance by nonfinancial firms has been comparatively high while equity finance was low. A very high percentage of external

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debt is to banks, and a very high percentage of bank debt by firms is short-term (OECD 1995: 70–2). This is due largely to the fact that only special credit institutes were allowed to do medium- and long-term lending, and their lending was largely directed toward state-owned firms ('The Transformation . . .' 1997: 595; Amatori and Colli 2000: 12). As a result, few ordinary banks had the expertize to do long-term lending. The very large bond market has been overwhelmingly dominated by government debt.

Similar to Germany, the finance and corporate governance system of the large-firm private sector fit an insider rather than an outsider model, that is, followed a logic of voice. It was a system of corporate control dominated by private, informal arrangements and norms of reciprocity. Relationships were long-term and rested on cooperation for mutual gain. Many key industrial and finance decisions were made within a negotiated—and very opaque—set of personal relationships. Private firms, especially family-owned, sought to minimize state interference rather than engage in a corporatist process as found in Germany (Segreto 1997). Perhaps partly for this reason the private-sector corporate network was even more tightly connected than in Germany. Reflecting this logic, share ownership in Italy is highly concentrated. In the early 1990s, the top five largest shareholders in a large firm held, on average, 87 percent of its shares; more than half of listed firms were majority controlled by a single owner (OECD 1995: 60–1). The stock market itself was, not surprisingly, very narrow with just a relatively small number of firms accounting for most of its capitalization and turnover. Cross-shareholdings are extensive and frequently take the form of a pyramidal structure which enables one firm to control several others using relatively small direct equity stakes. With the notable exception of Mediobanca, since the 1930s banks have not had equity stakes in nonfinancial firms and therefore do not perform a monitoring role in corporate governance. This is due in part to the relatively small size of banks compared to the large nonfinancial firms and by tight restrictions on commercial banks holding equity and sitting on boards of nonfinancial firms (OECD 1995: 73). Thus most big companies face little external control/monitoring from either banks or the stock market.

The logic of the banking system per se and the state-owned corporate sector was a *logic of hierarchy* or authoritative control. Competition was suppressed in the banking sector in favor of the authoritative direction of capital along political and regional lines. The financial system changed relatively little during the postwar era and was reproduced largely through the exercise of state power and authority. While other mechanisms of reproduction, such as legitimacy, sunk costs, and the like were at work, the process of change in 1990s certainly affirms that the state's role was the most determinative within the financial system.

The path to change?

At first blush it appears that major changes in the Italian financial and corporate governance systems began in the 1980s. Large Italian firms entered the 1980s with

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high debt loads and, unable to sufficiently self-finance or borrow, turned to the equity market. The number of listed firms soared from 138 in the beginning of the decade to 217 by its end, while market capitalization rose from about 6 to 14 percent of GDP (Amatori and Colli 2000: 12; Aguilera 2001: 17–18). But this expansion of the stock market did not signify a major transformation of Italian finance and corporate governance. Most of the newly listed companies were spin-offs from the large industrial holding groups. This enabled them to raise new capital while retaining ultimate control over these firms through pyramidal or cascading shareholdings (and the generous use of nonvoting shares). Thus even in 1987 the nine largest industrial holding groups (mostly family-controlled) accounted for nearly all of the market's capitalization (Amatori and Colli 2000: 14). A central node and organizing force of this system—known as the 'Northern Galaxy'—was Mediobanca and its leader, Enrico Cuccia. While formally controlled by the three largest (and state-owned) banks in Italy, Mediobanca called its own shots. The institutional linkages among these firms were augmented by voting syndicates that protected them from hostile takeover and entrenched incumbent management and major owners (and trounced upon minority shareholder rights; McCann 2000: 19–21). Thus Italy entered the 1990s with its traditional model intact while substantial change was already underway in Germany.

The current transformation of the Italian financial and corporate governance systems, therefore, really begins in the early 1990s. The central object and instrument of this transformation has been the privatization of state-owned banks and firms. There were both internal and external pressures for change. Internally, the state's finances were in shambles due to massive public debt. Huge losses by state-owned firms added both to the debt and the declining legitimacy of state ownership. The Lira was pummeled out of the European Monetary System (EMS) and forced to devalue. The economy was in recession. The bribery scandal and demise of the Christian Democratic Party in 1992/3 no doubt added further impetus for major change. But all of these internal or domestic pressures for change were exogenous to the financial and corporate governance systems. Externally, the Single Market was nearing completion and Italian firms, especially banks, were unprepared for an integrated market. The Maastricht Treaty and its implications for stricter government finances added further pressure on Italy to get its finances in order.

Thus, at the beginning of the decade Italian reformers—mostly in the Bank of Italy and the Treasury—set out to overhaul Italian capitalism through privatization and the modernization of the financial system, including the revival of the stock market and the dispersion of corporate ownership in Italy (Amatori and Colli 2000: 24–6). Unlike Germany, then, in Italy the main actors cultivating institutional change were in the state. More generally, liberalizing reforms have been taken under the auspices of center–left governments during the 1990s responding to EU pressures but also utilizing these to unblock barriers to domestic reform.

The first key step in the state's strategy for promoting major change was to create new private-sector actors—notably privatized state banks—who would be

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committed to the state's strategy and themselves cultivate further institutional change. Partly for this reason the emergence of positive feedback effects came much later (and were less strong) in Italy. Furthermore, one of the key differences between the two cases is that large Italian firms and banks (such as they existed), unlike their German counterparts, were not early advocates of the development of a more open, Anglo-style financial and corporate governance system. Two factors appear to be important in explaining this difference. First, Italian firms were generally much less internationalized than German firms. Second, the interlocking networks in Italy were tighter and, by all appearances, continued to serve the interests of the firms participating in them. In other words, there was little incentive for large Italian firms to change the system and the single most potentially powerful actor for change—Mediobanca—was firmly committed to the old path from which it continued to profit. Another difference to Germany is that pressures for change are largely exogenous in the Italian case. Italy does not enter a critical juncture, that is, a period in which more than one path becomes viable, until the early 1990s. Once the critical juncture was initiated by European integration, the door was opened for certain actors to promote with success substantial change in the Italian financial system.

Sustained regulatory change and a program for systematic reform of the Italian financial system began in 1990 with the Amato law. Heavily shaped by EC directives, the law was promoted by the Bank of Italy and supported by most Italian banks. One of its most important elements was the conversion of all banks to joint-stock corporations. This paved the way for public banks (about eighty banks, mostly savings banks) to be privatized (which started in 1993) and thereby open up the banking industry to consolidation (though most public banks remained under public control through the vehicle of foundations which held the newly issued shares).[20] It was clearly passed in anticipation of financial market integration in Europe and the fear that large foreign banks would overrun much smaller Italian banks unless the latter consolidated extensively (Bank of Italy 1995: 174). In 1992 the government began laying the groundwork for the privatization of other state-owned firms with the transformation of all state holding into stock companies held by the Treasury. A second 1994 law was crucial in setting more specific rules for the allocation of shares and corporate governance. In this law the government aimed for broader share ownership in privatized firms while attempting to retain strategic influence through golden shares, the creation of noyeux durs, and the right of the Treasury to veto mergers or takeovers (Amatori and Colli 2000: 26).

The next major reform step was the comprehensive Banking Law passed in 1993. Like the Amato Law, it was heavily shaped by the need to transpose EC directives into Italian law, including the bank passport provisions, which significantly increased access of foreign financial institutions to Italy. This sweeping reform bill also reflected the desire among Italian financial officials to create a mixed- (or universal) banking system resembling that of Germany with its close, long-term relations between banks and firms (Cesarini 1994). Toward this end, the law ended

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decades of enforced market segmentation by permitting ordinary banks to issue bonds and extend medium and long-term credit, as well as to acquire stakes in nonfinancial firms.The Italian banking industry did not embrace many of these changes (at least in the early years), especially those intended to stimulate securities markets (Onado 1996: 100).

While there were further regulatory reforms during the mid-1990s, the most powerful source of change was the sweeping privatization program that included the major banks controlled by the Treasury. Because declining interest rates and state deficits (in order to qualify for European Monetary Union (EMU)) dramatically reduced the attractiveness of state bonds to Italian investors, shares in privatized state firms became an attractive alternative investment and thus a central driving force of the stock market's expansion in the late 1990s. Adding to the momentum, in late 1997 the Italian Stock Exchange (Borsa Italiana) was privatized. The Borsa, in turn, became a vocal proponent of further securities market reform and development (along with CONSOB, the securities market regulator, and the Treasury). Building on this momentum, but also frustrated by the persistence of concentrated control over Italian firms (even newly privatized ones) in 1998 the Treasury succeeded in guiding the passage of the Consolidated Law on Financial Intermediation (aka Draghi Law or Reform: Amatori and Colli 2000: 42–3). The overall goal of the Law is to make a significant push toward further modernization and development of the equity market through, among other things, improved protection for minority shareholders (including shareholder agreements), greater transparency of firms and market transactions (strict regulation of insider trading), increasing the number of IPOs (Initial Public Offerings), and a 'better' system of corporate governance in general. CONSOB was given considerable formal power to carry out this agenda. Similar to the German Finanzplatz Deutschland campaign, the Treasury created a committee named the 'Italian Financial Centre' to promote and coordinate further initiatives on the development of the market (Draghi 1998). The 1998 law was followed by the creation of self-conduct code for good corporate governance in 1999 drafted by university, business, and government representatives. In 1999 the Borsa also opened its own high-tech exchange, the Nuovo Mercato, and in 2001 a new exchange (STAR) for 'old economy' SMEs.

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In sum, a decade and more of reform brought substantial change to the Italian financial system and Italian capitalism more generally. But what does this all add up to? On the one hand, the capitalization (as did turnover) of the main exchange soared from 18.6 percent of GDP in 1995 to 70.2 percent of GDP at the end of 2000.[21] While much of this rise was due to share price appreciation, a significant amount of new equity was also issued during this time (mostly from privatizations).[22] Italian retail investors clearly also found much greater enthusiasm for investing in stocks. Though, as everywhere, that enthusiasm has been dampened (at least temporarily) by the end of the boom.[23] In Italy, as elsewhere, institutional investors have also become more important.[24] The growth of institutional investors is widely viewed as prerequisite to the sustained development of equity

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markets and, more broadly, to an equity culture.[25] Liquidity of the main exchange also improved and the market has broadened; as late as the mid-1990s the top five business groups accounted for 70 percent of the Milan exchange's capitalization (Pradhan 1995), but by mid-2000 the top five accounted for just under 40 percent of the market's capitalization (Euromoney, June 2000: 181).

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On the other hand, for all these indicators of a significant growth in securities markets and plans by the state to further strengthen them, it is not clear just how much Italian capitalism has so far changed. First, there appeared to be little change in firm financing patterns (Deeg and Perez 2000). Second, the efforts to expand the stock market had mixed success. The total number of firms listed on the main exchange increased only slightly during the 1990s (from 225 firms in 1987 to 237 at the end of 2001: www.borsaitalia.it). As elsewhere, the Internet/telecoms mania helped push up the Nuovo Mercato and stimulate excitement among Italians for stock trading.[26] But the bursting of the bubble has dramatically slowed new listings on the exchange and its capitalization has plummeted.

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There has been some increase in ownership transparency, but insufficient evidence to suggest that the intricate networks of shareholdings linking large private Italian firms have changed all that much. While concentration is declining by some measures, the use of shareholder agreements to control firms has grown, thus ensuring that insider control over firms remains high (Amatori and Colli 2000: 37–8; Aguilera 2001: 14).[27] There is, as yet, no open market for control over firms (Aguilera 2001: 13). Even though Olivetti managed to takeover Telecom Italia in a hostile bid during 1999 in accordance with the new institutional framework—which many interpreted as a sign that Italian capitalism had definitely changed—it occurred in a thoroughly Italian fashion: Olivetti used an elaborate pyramidal holding structure to gain control of Telecom while owning just 3.2 percent of its shares (Amatori and Colli 2000: 49; McCann 2001: 57)! Further demonstrating the vitality of the old system, two years later Pirelli and Benetton joined together to take control of Olivetti (and indirectly Telecom Italia) using complex investment vehicles and cascading holdings that shortchanged small investors and was viewed as destroying shareholder value ('Keeping it in the Family'. *Financial Times*, July 31, 2001; Philip Webster, 'Pirelli takeover of Olivetti destroys value, prompts concern on debt'. AFX Europe, July 31, 2001). Furthermore, the new corporate governance code and transparency rules are still eschewed by the vast majority of listed Italian firms (not to mention unlisted firms) and CONSOB remains a weak enforcer of the new rules (Financial Times, Onado 1998: 404; April 5, 2001). In short, in Germany we saw the new logic of exit evidenced by the deliberate reduction of linkages (directors seats, equity holdings, etc.)—creating more 'distance'—among firms in response to new market challenges. In Italy we see instead a reshuffling of alliances and linkages in response to market challenges, but no systematic reduction of such: The logic of voice prevails.

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Where there has been a move to a new institutional path is in the banking system narrowly understood (i.e. commercial and retail banking outside of securities markets) where the logic of (state) hierarchy has been replaced by a competitive market

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logic. As an owner, the state no longer dominates; in 1992 public-sector banks controlled 70 percent of bank industry assets, by the end of 1999 this was down to 12 percent (Bank of Italy 2000: 190). Many banks now considered private, including some larger ones, are still controlled by foundations which, in turn, are controlled by communal governments. Since foundation-controlled banks have grown through mergers, the influence of public bodies on the banking system remains substantial.[28] Nonetheless, even banks with significant public ownership (and cooperatives) are rapidly changing organizations. Instead of emphasizing support for social and political objectives, virtually all banks have been radically restructuring their operations and organizations, innovating new products, cutting costs, and making efficiency and profitability primary objectives. From the mid-1990s onwards the banking system has undergone a process of rapid consolidation that has been guided to a significant degree by the (sometimes heavy) hand of the Bank of Italy (The Banker, February 2001; Wilson, Ted. 'Middle Layer Hots Up in Italy.' *Acquisitions Monthly*, May 31, 2002; McCann 2001: 59). In mid-2002 the Bank announced that it considered the consolidation of banks on the national level essentially complete; the four largest banking groups—IntesaBCI, Sanpaolo-IMI, Unicredito, and Capitalia (formerly Banca di Roma)—now control about half of the sector's business ('Bank of Italy: Governor alludes to merger of MPS with BNL', *The Banker*, July 1, 2002).

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This notwithstanding, where there does not appear to be off-path change is in the broader Italian finance and corporate governance system. Despite many formal legal and regulatory changes promoting corporate transparency and the role of securities markets, large Italian firms have not gone nearly as far as many of their European counterparts toward 'shareholder value' practices (see also Amatori and Colli 2000). Small shareholders and foreign institutional investors still view the Italian corporate governance system as too opaque and run through backroom deals by insiders.

The story of Mediobanca provides an excellent illustration of both what has changed in Italy and what has not. During the late 1990s, Mediobanca's position eroded as foreign investment banks made significant strides in gaining the business of major Italian firms. The wave of privatizations during the 1990s further bolstered foreign investment banks that were given significant business by the Italian Treasury, which feared that too much business for Mediobanca would strengthen the banks' influence rather than open up the Italian system. As Mediobanca's influence waned, the 'glue' holding the Northern Galaxy together weakened and a process of reshuffling alliances among member firms (and several newly privatized firms) began. Mediobanca's two most important shareholders—Capitalia and UniCredito—have also became competitors. Capitalia, for example, expanded its own investment banking unit during 2002 by bringing in other large, influential Italian firms as shareholders (and allies), thus mimicking Mediobanca's own model of influence ('Capitalia throws down the gauntlet', *European Banker*, August 9, 2002). At the same time, IntesaBCI, Italy's largest bank and formerly supported by Mediobanca, announced a linkup with Lazard Italia—the

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nation's leader in M&A advising—in order to strengthen its own investment banking market power within Italy (Heather O'Brian, 'IntesaBCI, Lazard link in Italy'. *The Daily Deal*, September 10, 2002). Lazard had once been allied with Mediobanca. The struggle between the battered but still powerful Mediobanca and its own shareholders came to a climax in early 2003 when a group of banks, led by Unicredito and acting with the blessing of the Bank of Italy, were finally able to bring it under their control by ousting the long-time head of Mediobanca, Vincenzo Maranghi (Fred Kapner, 'An emerging generation of business leaders is promising to sweep away secrecy and cronyism'. *Financial Times*, April 7, 2003).

While it may be tempting to conclude that the occurrence of hostile takeovers and the rise of new challengers to Mediobanca are further proof that the very closed Italian system is beginning to open, at this point it still seems equally plausible that the assaults on Mediobanca spell not an end to the old system but more a reshuffling of who owns whom and who is allied with whom (see also McCann 2001). Nearly all major firms are still controlled by insiders through pyramids, shareholder alliances, voting pacts, and the like.

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The four new Italian 'Big Banks' also embody this ambiguity over the direction of change. On the one hand, these banks have generally been public advocates of a new, market- and shareholder-oriented financial system and they have developed the investment banking capacities to participate in securities markets. On the other hand, these banks have become increasingly involved in the old insider corporate networks by taking equity stakes and making large loans to the same clients. For example, Unicredito and Banca Intesa are large lenders to Telecom Italia and Pirelli in which they also have significant equity stakes. Indeed, following the logic of voice, banks have become overexposed to telecommunications, energy, and media firms (Fred Kapner, 'BoI presses banks to limit certain exposures'. *Financial Times*, February 8, 2002). In short, the new big banks appear to be acting like German big banks used to act as much as they are acting like German banks do now: the Italian banks seem to be trying to follow both the logic of voice and logic of exit simultaneously. But these logics are opposed and they will be forced to choose at some point.

Even though the state has greatly reduced its role in the economy, like the French state, it continues to attempt to steer the direction of change by retaining—and deploying—strategic levers of influence such as golden shares or its authority to vet mergers and acquisitions. It is also very unclear as to how much the cultural norms (informal institutions) shaping the Italian political economy have changed, as even state reformers sometimes appear to favor evolution toward a German-style stakeholder capitalism rather than a more radical Anglo-American stakeholder mode (Draghi 1998: 351). Corporate leaders too, including many presumed proponents of change, appear much less convicted of the need for real change. Thus, in Italy the shape of a new path, or whether it is moving to a new path, is less clear. Even with many of the same institutional changes as adopted in Germany, the logic—that is, the strategic behavior, decisionmaking rules, and routine responses—of the Italian finance and corporate governance system has not clearly changed.

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Comparing the cases

In Germany institutional change reaches a level whereby a distinctive subregime is created; a subregime that operates on a different logic than the previous financial system regime. In Germany's shareholder-oriented subregime, the logic of voice has been replaced by the logic of exit. In Italy many similar market-oriented institutions have been adopted but the logic of the old system has not been supplanted, nor has a distinct subregime emerged. One obvious indicator of this difference can be seen in the systematic and widespread disposal of cross-shareholdings and other large equity stakes by many of the key firms in Germany in order to free up capital to invest in core businesses—despite depressed share prices. Meanwhile, Italian firms continue to acquire major stakes in each other in order to build alliances and use as tools to outmaneuver rival domestic firms for control of other domestic firms. While some of these firms profess shareholder value, the effect of their actions is to sustain the old insider system of corporate governance. Going back to my earlier theoretical claim, what is common to both cases is the evidence that self-reinforcing or positive feedback effects have played an important role as mechanisms of institutional change: They are not limited to functioning merely as mechanisms of stabilization or reproduction.

First, the German financial industry has made huge *set-up* investments in the expansion of securities markets and the reorganization of the financial system around it. Much of this cost was incurred in the 1990s as the large German banks (and the savings and cooperatives too) began making huge investments in the requisite technology, organizational changes, and human capital for securities-related business. In Italy, in contrast, much of the banks' efforts and resources have been poured into domestic consolidation. While several of them have begun investing notable sums in developing investment banking and securities-related businesses, they began to do so just before securities markets began to take a nosedive. Thus they lag far behind their European competitors.

Learning effects are also evident. Well into the late 1990s even the big commercial German banks struggled with the new strategy. Their internal organization and culture was that of a commercial bank, not an investment bank, and the two cultures clashed for a long time. Put in another way, simply spending huge sums on the development of securities market-related business was in itself not enough to be successful. It took the banks many years to learn how to use these new capacities successfully. Italian banks, as one would expect, are at a much earlier point in this particular learning curve since they have only recently begun to make these same kinds of investments and efforts. There is, however, another dimension of learning in which most Italian banks have no doubt made substantial progress; that is, learning how to operate with a strong orientation to efficiency and profitability.

We also find *coordination effects* to be significant and quite essential to the development of the new German path. In the German case one can identify three axes of coordination which greatly facilitate the new path. The first axis is among

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the three major banking groups and individual banks. The goal of developing securities markets and benefits to actors who engage in them grow as other actors pursue this goal. While the increased attention to securities business by more and more banks increases competition among them, it has the effect of stimulating the growth of securities markets since each bank attempts to foster demand for its securities-related products and services. The second axis is between the suppliers and buyers of securities and capital market services, that is, between investors and issuers. That a balanced expansion of supply and demand is not automatic is readily evidenced by the fact that the growth of retail investment in shares by Germans—a key benchmark for the new strategy (and path)—did not really take off until the second half of the 1990s or roughly a decade after concerted reform efforts were initiated.[29] Once demand began growing rapidly all the previous reform efforts ensured that the system could supply it. The surprisingly rapid growth of the Neuer Markt is the prime example of this effect.[30] The third axis of coordination is that between market and political actors. During the 1990s key political actors (in the state and political parties) came to adopt the banks' capital market reform agenda as their own (Lütz 1998, 2001). As more and more political actors came to believe that Germany's economic success would increasingly depend on a more capital-market oriented economy, the pace and ease of reforms picked up.

In Italy we also find coordination effects pushing the system toward the new model though, again, the effects do not appear as strong as in the German case. First, there is a growing number of banks devoting resources to the development of securities markets. Without the same kind of national association structure and interbank cooperation that links savings and cooperative banks in Germany to national markets, however, smaller Italian savings and cooperative banks have developed comparatively little interest in promoting a financial system based on capital markets. Second, like Germany, there was successful coordination in the expansion of both the supply and demand for securities in Italy during the late 1990s. Increased supply came from privatized state firms while increased demand was stimulated by the decline of traditional investments in government debt. Finally, the relationship between market and political actors in Italy with regard to financial sector reform is much more muddled than in Germany. In Italy there is much less uniform commitment among banks and private firms—as well as key political actors—in promoting a capital—market-based financial system.

Adaptive expectations are also in evidence. In Germany we see this first in the debates within the savings and cooperative banking sectors during the 1980s and early 1990s. Each of these groups contained within it many actors with varying commitment and interest in developing the capital market-related capacities of the group as a whole (Deeg 1999: 58–67). But changes within each group were driven forward by the generally undisputed belief that securities business would be ever more important and their competitors would pursue it; thus, they must be successful there too if they were to survive. Adaptive expectations are also quite evident in the arguments used by German and Italian reformists throughout

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the 1990s; namely, that Europe and the world were all moving toward greater market control and capital markets and, therefore, Germany and Italy must do likewise if they are to remain competitive. Indeed, in Italy reform appears to be driven overwhelmingly by the fear of losing out to international competition.

Finally, in both cases we find evidence of substantial increasing returns effects being generated by coordinated and correlated changes in a wide range of complementary institutions that together configure the financial system in the broadest sense. In other words, the push to develop capital markets reaches far beyond changes in financial product regulation or the structure and supervision of the stock exchanges. It encompasses myriad changes in tax, accounting, and corporate laws, ranging from those covering shareholder voting rights to the use of stock options and stock repurchases. The four Financial Market promotion laws in Germany and the Consolidated Law in Italy are perfect embodiments of this positive feedback mechanism.

To be clear, though, these positive feedback effects are generally broader in scope and stronger in the German than the Italian case. So, how do we explain these observable differences between the two cases? My answer comes back to two other key theoretical claims: cultivation and endogenous sources or pressures for change. Supporting my contention that increasing returns needed to be cultivated, at least in the initial phases, is the fact that the payoffs from early reforms were not that great, even in the German case. To fully realize these returns reformists needed to achieve a critical level of institutional changes before the 'take off'. Thus in Germany we find a decade of continuous reform before there are enough accumulated changes on the demand and supply sides of the capital markets that the returns to the new path start pouring in. In Italy the cultivation of increasing returns mechanisms has come later and with less conviction and comprehensiveness than in Germany. Why? In Italy private market actors generally saw no need for change. There were no Italian equivalents to the big German banks to press for change. Large, private industrial firms were also deeply engaged in the old path and did not press for change. Cultivation in Italy had to start with state actors who had to first create private market actors and invigorate or create new organizational actors who, in turn, would have an interest in cultivating institutional change. In a sense, exogenous pressures for change in Italy were 'endogenized' as the former were used to create these 'new' actors.

This also means that Italy originally lacked endogenous sources of change within its financial system. Italian state actors were responding in large part to exogenous pressures to change their finance and corporate governance systems: namely, European capital market integration and, more generally, global financial integration and competition. These were the same exogenous pressures Germany faced, yet we see a marked difference between the two cases in terms of broader systemic change. The key difference is that Germany started on this path to a new market-oriented financial system because of endogenous changes in its old path: Italy did not. Thus exogenous pressures alone cannot explain the timing, pace, direction, or the extent of institutional change. This also explains why, despite

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similar kinds and levels of formal institutional changes, the strength of increasing returns mechanisms and actual changes in behavior by market actors in Italy are not as far-reaching as changes observable in Germany.

Some broader lessons

In summary, I believe these cases yield several lessons that carry beyond them and can inform research on institutional change.

First, the cases showed that the end of one path and transition to another can be initiated by developments endogenous to the old path, that is, it is not necessarily the case that an exogenous force must disturb an equilibrium before a path change can occur. As a given institutional path evolves its very own mechanisms of reproduction can undermine itself. In the German case we saw how the evolution of competition in banking and erosion of large firm dependence banks set in train a series of events which led to further erosion of the path and emergence of a new one. Further, when a path switchover occurs gradually as a result (at least partially) of endogenous factors and without a contingent, triggering event, then there may be no obvious event or point in time when institutional change was no longer an on-path but an off-path change. Indeed, it may be that it is only possible to determine retrospectively and with considerable lag time that there has been a change to a new path. The comparison between the two cases also suggests that when endogenous and exogenous pressures for change combine, an off-path change is more likely.

The second lesson is that increasing returns mechanisms can also facilitate the movement from one path to another without being preceded by a collapse of the prior path.[31] Indeed, the cases suggest the possibility that, beside exogenous shocks, a path subject to increasing returns effects may be more likely dislodged when the factors pressing for change are themselves subject to increasing returns effects. In both cases we saw numerous institutional changes introduced by actors which, over time, became self-reinforcing to varying degrees. This pattern of change also reflected a hybridization process in both cases in the sense that new institutions—such as Anglo-style rules on corporate transparency—were introduced or altered (layering and conversion) which changed the behavior of market actors in significant ways. However, following my conception of a path as logic, in the Italian hybrid system the old logic still dominates and thus only in the German case does this hybridization process lead to an actual path change. Moreover, it does so via the formation of a subregime. While they may share certain institutions, the two subregimes are nonetheless distinct (and constitute two institutional paths) because each encompasses a broad range of complementary institutions which generate different logics of behavior. Under what conditions is this particular outcome more likely?

Path change via formation of a subregime appears to result from three general conditions: The first is that the old system or path continues to be functional for a large number of actors within it and these actors are sufficiently powerful to

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defend this path. The second condition is that other powerful actors no longer sufficiently benefit from the old path and are able to establish new institutions and cultivate positive feedback mechanisms. The final condition is that the two subregimes are minimally compatible in that actors within one are not immediately disadvantaged by the existence of the other and can choose, to a certain degree, which subregime within which to operate. Thus in Germany we see the preservation of the old path (logic) in the continuation of strong bank-oriented system—defended vigorously by political powerful savings and cooperative banks and the SME business associations—which is sufficiently adapted to maintain its functionality (e.g. by creating new forms of equity provision for SMEs which do not involve public listing). Meanwhile, the new path/subregime emerges alongside the old one through the efforts of the major financial and industrial firms. Small firms can choose the new subregime by, among other things, seeking a public listing. Large firms can remain in the old path by, among other things, sustaining concentrated ownership.

The third lesson is that increasing returns effects may not be automatic. Instead they may require 'cultivation' by actors in that they must continue to accrue institutional changes until sufficient returns from the new path can be realized and captured by actors. The necessity to cultivate returns is likely to be the case when actors are being confronted with choosing new institutions and the benefits of choosing new institutions may be unclear or when the promised benefits of these institutions will be enjoyed only if there is further institutional change. As self-reinforcing mechanisms become stronger, cultivation should be less necessary. However, even as a new path becomes self-reinforcing some cultivation is likely to be necessary to sustain that path since, as noted above, the mechanisms of path reproduction can deteriorate. Thus actors will need to adapt the institutions of the path over time in order to maintain it.

Finally, I have used these cases to develop and illustrate a concept of 'path' that rests on the notion of an institutional logic, that is, a path is defined by the logic (predictable strategies, routines, and share decision rules) generated through the operation of a given institution or institutional system. In the case of financial and corporate governance systems, I divided them into those with a logic of voice and those with a logic of exit. The two logics are opposed in a theoretical sense, but they are not mutually exclusive. All financial (or nearly any institutional system, for that matter) systems incorporate both possibilities, that is, firms who use voice with each other often still do have exit options. The crucial distinction is that in bank-based systems the logic of voice is dominant and exit serves as a secondary option. In market-based systems the converse holds. As Hirschman argued, the dynamics of each mechanism will lead institutions and systems to rely heavily on one or the other (Hirschman 1970: 120–6). Thus a clear distinction can be made between the two types of systems based on the logic of voice versus exit. This also helps us understand why, in the German case, the formation of subregime was attractive—it allowed for the two logics to operate within the national economy by creating semiautonomous systems. While my notion

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of a path as logic could (and inevitably will) be improved upon, I believe it advances the debates over path dependence and institutional change by providing at least an initial conceptualization of a path that can be applied in analyzing any set of institutional changes.

Notes

1. I would like to thank the following individuals whose comments on this and prior versions of this chapter were very helpful to me: Suzanne Berger, Andreas Broscheid, Michel Goyer, Hans-Willy Hohn, Susanne Lütz, Janice Bially Mattern, Hudson Meadwell, Jonas Pontusson, and Herman Schwartz. I would also like to thank the editors of this volume, Wolfgang Streeck and Kathy Thelen, as well as my co-contributors and especially Colin Crouch, for their probing comments and questions.
2. The 'national varieties of capitalism' literature rests on the premise that national economic models are constituted by a broad set of complementary and mutually reinforcing institutions such as labor market, financial, training, and innovation (e.g. Hall and Soskice 2001). While I believe that there is a fundamental element of correctness in this argument, the case explored in this chapter suggests (as have some others, e.g. Regini 2000) that the coupling among these institutions may be looser than is commonly argued. This opens the door to the possibility that the financial system can change to a new institutional path without the same necessarily being true of the entire political economic model.
3. On power and legitimacy as sources of institutional reproduction, see Mahoney (2000) and Clemens and Cook (1999). Schwartz (2001) argues that power is not a form of increasing returns and is, in fact, a far more potent source for path stability than increasing returns effects.
4. I am indebted to Andreas Broscheid for suggesting a definition along this line.
5. North (1991: 89, 100) makes a powerful argument that institutional change is almost always evolutionary and the result of thousands of accumulated marginal changes in formal and informal constraints. Schwartz (2001) makes a related point that the impact of seemingly small events usually depends on much bigger structural conditions.
6. The importance of cultivation notwithstanding, we should also recognize that the pursuit of specific institutional changes by particular actors may not always result in their intended outcomes, but the unintended effects may nonetheless reinforce (or stymie) the move toward a new path. Additionally, it should be noted that not all worlds are possible: what actors can achieve through cultivation will be constrained by a variety of institutional and other factors.
7. Internationalization is treated as an exogenous factor because German economic and political actors did little to promote it during the 1980s, that is, they were responding to changes they did little to bring about (see Deeg and Lütz 2000).
8. Deeg (1999: 85–6). To be clear, bank debt was not being replaced with either equity or corporate debentures, as equity finance remained very low throughout the 1970s and early 1980s and total corporate bonds outstanding actually declined quite dramatically (see Deutsche Bundesbank 1984, 1992).
9. I am indebted to Michel Goyer for suggesting this point. For more on repressed financial systems see Lukauskus (1994).

10. The law placed some limits on bank ownership of industrial capital and, most importantly, abolished unequal voting rights in corporations. The law also allows German corporate managers to buy back their own shares and to pay their managers with share options; both are widespread practices in the United States but previously unknown in Germany. See Cioffi (2002) for more details.
11. To be clear, the SPD-Green government did not take power until late 1998, thus many of these legislative initiatives began well beforehand under the center-right government of Kohl. This makes clear that the movement toward a market-oriented system was not a narrowly partisan one.
12. Between 1990 and 1998 the investment funds' share of all German shares rose from 4% to nearly 13%. See Jürgens et al. (2000) and Höpner (2001).
13. Compare Höpner (2000) and Edwards and Nibler (2000). Jackson (2003) shows that during the 1990s the proportion of shares held by 'stable investors' (banks, insurance firms, corporations, and the state) declined from 60.2% to 52.8%; while shares held by individuals, institutions, and foreigners—who are much more likely to actively trade shares—rose from 39.8% to 47.1%.
14. Aggregate equity holdings by banks have remained stable while insurance firms have increased theirs (Jackson 2003). By other accounts the number of significant bank-held stakes (5% or greater) rose during the first half of the 1990s (Bebchuk and Roe 1999).
15. See Lütz (1998). From 1990 to 1996 the number of chairs held by bankers in the forty largest corporations was steady, at around 40%; from 1996 to 1999 the number dropped to less than 25% (Höpner 2001: 5).
16. Though Jackson (2003) has argued that declining bank monitoring is not being replaced with capital market monitoring because no real market for corporate control has yet emerged in Germany and, while institutional investors promote 'good' corporate governance practices in general, they are more likely to sell shares in a given firm than actively monitor management.
17. And a survey of top managers done in 2000 found that 72% put the interests of shareholders, employees, and the public interest on an equal footing, while only 7% espoused shareholder preeminence (Jackson 2003). Cioffi (2002: 26–7) has argued that the KonTraG—the first major reform of company law since the 1960s—did not alter the internal relations among corporate stakeholders because it upheld the key normative principles of codetermination and stakeholder capitalism.
18. In the early 1990s, 50.8% of all private firm assets were held by families; this compares to 27% in France, 16.9% in Germany, and 13.3% in the United Kingdom (Cobham, Cosci, and Mattesini 1999).
19. The analysis in this chapter applies only to the state and large-firm private sector models.
20. As of late 2001 only nine foundations had withdrawn completely from their banks and about one quarter of foundations continued to own at least 50% of their bank (The Economist, October 27, 2001: 70).
21. It slid back to 48.5% of GDP by the end of 2001 as a result of share price declines (www.borsaitalia.it).
22. In 1999, for example, 82% of new equity raised on the exchange was through privatizations (Bank of Italy 2000: 178).
23. Equities and investment fund units rose from 38% of household assets in 1996 to 51% at the end of 1999—though, again, much of this rise was due to share price appreciation

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(Bank of Italy 2000: 137)—but dropped to 36% by mid-2002 (Paul Betts, ' "BOTs" revert to old habits', *Financial Times*, August 12, 2002).

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24. From 1990 to 1997 the value of financial assets held by institutional investors rose from 13.4% to 53.2% of GDP (Aguilera 2001: 22).
25. Assets under management as a percent of household assets rose from 9.8% in 1990 to 34.1% in 1999; but at the end of 1998, equities still represented only 19% of total institutional assets, leaving Italy well behind the United States and the United Kingdom (Bank of Italy 2000: 153–7).
26. Private equity and venture capital investment also soared at the beginning in 1998 (Financial Times, December 11, 2000).
27. Also, concentration dipped during 1997 and 1998 because of large privatizations but rose again significantly during 1999 and 2000. For example, for all listed companies the average holding of the top three shareholders equaled 59.6% of capital in 1996; this declined to 40.8% by 1998 but rose to 50.9% in 2000 (Aguilera 2001: 23).
28. Most of the major commercial banks count banking foundations—there were 89 in 2002—among their significant owners. Since the mid-1990s market reformers have made repeated efforts—with some success—to reduce the role of the foundations in the banking sector (Aiello, Silipo, and Trivieri 2000: 31–7).
29. From 1992 to 1999 the number of German adults owning shares (directly or indirectly) grew some 25%, with virtually all of this growth taking place during 1998 and 1999. Though at just under 13% of the population, Germany remains far behind countries such as the United States, the United Kingdom, and Sweden (Deutsches Aktieninstitut 2000).
30. From 1983 to 1996, an average of 16 companies went public *each year*; in 1998, 78 firms went public and in 1999, 167 firms went public; the vast majority did so on the Neuer Markt (Hutter and Leppert 2000).
31. This is a distinct claim from the prior one in that path changes do not necessarily exhibit increasing returns effects, that is, not all paths are created or stabilized by positive feedback—there are other mechanisms for institutional stability.

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