

INSTITUTIONAL CHANGE IN CONTEMPORARY CAPITALISM

Coordinated Financial Systems since 1990

By PEPPER D. CULPEPPER*

Financial deregulation could be the string that unravels coordinated market economies.

—Peter Hall and David Soskice,
Varieties of Capitalism

INTRODUCTION

A large body of evidence suggests that national political economies have maintained their distinctive “varieties of capitalism,” rather than converging on the liberal market model epitomized by the United States.¹ The continued viability of this institutional diversity hinges on the ability of coordinated financial systems, such as those in Germany and Japan, to shield company managers from the short-term imperatives characteristic of liberal market economies.² Yet the opening of trade and financial markets in the 1990s led to the rapid growth of stock markets in many countries with systems of nonmarket coordination, with potentially destabilizing consequences. The growth of stock

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¹ Peter Hall and David Soskice, eds., *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (New York: Oxford University Press, 2001); Vivien Schmidt, *The Futures of European Capitalism* (New York: Oxford University Press, 2002); Kozo Yamamura and Wolfgang Streeck, eds., *The End of Diversity? Prospects for German and Japanese Capitalism* (Ithaca, N.Y.: Cornell University Press, 2003); Bruno Amable, *The Diversity of Modern Capitalism* (New York: Oxford University Press, 2003).

² Gregory Jackson, “Corporate Governance in Germany and Japan: Liberalization Pressures and Responses in the 1990s,” in Yamamura and Streeck (fn. 1).

market finance increases the incentive for company managers to raise funds on equity markets. The collective outcome of such individual choices, though, is increased dependence of companies on short-term measures of market performance, such as quarterly reports, that dispersed stock market investors use to monitor companies. This forces company managers to pay close attention to the price of their stock, in order both to maintain their access to financial markets and to avoid being acquired by other companies.³ It would seem, then, that the liberalization of financial markets is the force that could topple the stability of coordinated economies.

What happens when the unstoppable force of liberalization collides with the immovable object of national financial institutions? We currently have no answer to this question, because competing theories in comparative political economy rarely specify comparable, empirically observable criteria that indicate when an institution has indeed changed. As observed by Kozo Yamamura and Wolfgang Streeck in their study of German and Japanese institutions, this poses serious methodological risks: "If the only change recognized as fundamental is of a sort that is practically impossible, social systems are stable almost by definition."⁴ Without clear guideposts as to how to identify institutional change conceptually and operationalize it empirically, we cannot know whether theoretical propositions about the causes of institutional change and stability are disconfirmed by evidence. This article attempts to advance the study of institutional change by proposing ways of operationalizing it in the area of finance and corporate governance.

Institutions are jointly understood rules of the game.⁵ They may be either formal institutions (laws) or informal institutions (norms).⁶ Institutions, whether formal or informal, generate empirical regularities in behavior—this is what makes them analytically interesting.⁷ In the

³ Martin Höpner, *Wer Beherrscht die Unternehmen?* (Frankfurt: Campus, 2003).

⁴ Yamamura and Streeck (fn. 1), 42. For a good extended discussion of the problem of measuring institutional change, see John Campbell, *Institutional Change and Globalization* (Princeton: Princeton University Press, 2004).

⁵ Douglass North, *Institutions, Institutional Change, and Economic Performance* (New York: Cambridge University Press, 1990); Masahiko Aoki, *Toward a Comparative Institutional Analysis* (Cambridge: MIT Press, 2001).

⁶ Gretchen Helmke and Steven Levitsky, "Informal Institutions and Comparative Politics: A Research Agenda," *Perspectives on Politics* 2 (December 2004); Amable (fn. 1).

⁷ This definition is similar to that provided by Avner Greif and David Laitin: "Central to endogenous institutional changes are therefore the dynamics of self-enforcing beliefs and the associated behavior. An institutional change is a change in beliefs, and it occurs when the associated behavior is no longer self-enforcing, leading individuals to act in a manner that does not reproduce the associated beliefs"; see Greif and Laitin, "A Theory of Endogenous Institutional Change," *American Political Science Review* 98 (November 2004), 639.

case of contemporary capitalism, a central behavioral attribute of coordinated financial systems is the degree to which they promote the holding of large blocks of shares among companies as a means of blunting short-term market pressures on company managers. If they so choose, such blockholders can protect company managers from the possibility of a hostile takeover, thus freeing them from obsessive concern with short-term market indicators. This feature of coordinated financial systems—called “patient capital” by Hall and Soskice—is widely accepted as fundamental to nonmarket coordination in financial systems.⁸ By operationalizing patient capital, we can observe whether there are significant changes of the sort consistent with changing institutional rules of finance.

Patient capital is a core observable feature of coordinated market economies, but the relative importance of formal and informal institutions in sustaining strategic shareholdings is theoretically contested and empirically unresolved. On one side stand those scholars who emphasize that legal regulation provides the primary support for national patterns of blockholding.⁹ These legal supports may be narrowly conceived—as in the quality of corporate law thesis, which concentrates on the legal extent of minority shareholder protection¹⁰—or instead focused on the broader balance of forces among competing groups or ideologies within a society that establish a legal framework supportive of (or inimical to) patient capital.¹¹ Despite their substantial differences, these scholars all use measures based on formal legal rules as the determinants of real behavior in financial systems. On the other side of this discussion stand, *inter alia*, Hall and Soskice, who emphasize “the importance of informal rules and understandings to securing equilibria in the many strategic interactions of the political economy.”¹² While not denying the importance of formal institutions, such an approach underlines that shared beliefs among interdependent actors are foundational to their expectations of how others will act, and written laws are not the only (or even the primary) determinant of these shared understandings. In such an approach, the principal determinant of the stabil-

⁸ Yamamura and Streeck (fn. 1); Schmidt (fn. 1); Amable (fn. 1).

⁹ Peter Gourevitch and James Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance* (Princeton: Princeton University Press, forthcoming); Marco Pagano and Paolo Volpin, “The Political Economy of Corporate Governance,” *American Economic Review* (forthcoming).

¹⁰ Rafael La Porta, Florencio López-de-Silanes, Andrei Shleifer, and Robert Vishny, “Law and Finance,” *Journal of Political Economy* 106 (December 1998).

¹¹ Gourevitch and Shinn (fn. 9); Mark Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (New York: Oxford University Press, 2003).

¹² Hall and Soskice (fn. 1), 13.

ity of a system of patient capital is the extent to which beliefs about its functioning and benefits are widely shared among market participants.

These divergent explanations of the sources of stability in the political economy suggest different mechanisms of institutional change in finance. The formal institutional approach implies that legal change will precede and trigger behavioral change in the practice of patient capital in economies with coordinated financial systems: a coalition forms in favor of reform and adopts legislation that facilitates the growth of equity markets; this in turn leads to institutional change.¹³ I argue in this article that, although legal reform is often a necessary condition for institutional change in coordinated financial systems, such reform is not a sufficient condition because shared beliefs can persist in the face of formal legal change. Where coordinated financial systems depend primarily on the strategic interaction of large market players, institutions do not automatically change in response to legal reform. Rather, they change only when the central strategic actors within the system are persuaded, collectively, that their old cognitive maps are wrong and that they need to devise new ones. Although this model of change focuses on the informal institutions stressed by Hall and Soskice, it rejects their unraveling string metaphor: change does not begin incrementally at the margins of ownership networks and then unravel in a cascade that reaches the center. It is instead a process that depends on what actors at the center decide they believe (and what they believe others believe) about the costs and benefits of patient capital. In this model legal changes are not the primary determinants of these costs and benefits.¹⁴

The sufficient condition for institutional change in such an institution is thus one of changed ideas, with change occurring via a causal mechanism I call *joint belief shift*—the process by which actors use triggering events to coordinate their future expectations around the new rules of the game, that is, around new institutions. The mechanism of joint belief shift is both ideational and rationalist, and it builds on the pioneering work of North and Aoki to identify the cognitive mechanisms that lie behind institutional change.¹⁵

¹³ Gourevitch and Shinn (fn. 9); Roe (fn. 11); Pagano and Volpin (fn. 9); Raghuram Rajan and Luigi Zingales, "The Great Reversals: The Politics of Financial Development in the Twentieth Century," *Journal of Financial Economics* 69 (July 2003).

¹⁴ Ziegler has similarly argued that formal changes in the German legal system have had limited effects on practices of corporate governance because of the uncertainty of business leaders; J. Nicholas Ziegler, "Corporate Governance and the Politics of Property Rights in Germany," *Politics and Society* 28 (June 2000); cf. Bruce Kogut and Edward Walker, "The Small World of Germany and the Durability of National Networks," *American Sociological Review* 66 (June 2001).

¹⁵ North (fn. 5); Aoki (fn. 5).

To investigate this issue empirically, I explore changes since 1990 in the financial and corporate governance institutions of the three large Western European economies with the most concentrated patterns of corporate ownership: France, Germany, and Italy.¹⁶ These countries all opened their capital markets within the context of the European single market and adopted the single currency, and all experienced spectacular growth of their stock markets during the 1990s. These shifts in material conditions increased the opportunity costs to company managers of holding large blocks of illiquid capital in other companies, essentially tying up resources that they could otherwise use to pursue their focus on their own core business competencies, to protect other companies from hostile takeover and market pressures (without any assurance that these companies would continue to defend them against hostile takeover).¹⁷ To anticipate the findings of the article, France experienced sweeping change in the pattern of cross-shareholding, whereas Germany and Italy did not. This article documents and explains this variation.

The next section contrasts the expectations of the formal legal and joint belief shift mechanisms. The section that follows first discusses how to operationalize institutions and institutional change in the domain of finance and corporate governance and then proceeds to apply those operationalizations to assess what has changed since 1990 in these three countries. The next section considers the expectations of the formal legal and joint belief shift mechanisms against the evidence of institutional change and stability. And the final section concludes with a discussion of the sorts of institutions in which joint belief shift is likely to be necessary for institutional change and those where, on the contrary, formal legal change will be sufficient to induce institutional change.

DOES CHANGING LAWS CHANGE INSTITUTIONS?

The problem of institutional change is understanding what mechanisms lead social actors involved in a stable pattern of interaction to deviate from that predictable behavior.¹⁸ Within social science, the

¹⁶ Mara Faccio and Larry Lang, "The Ultimate Ownership of Western European Corporations," *Journal of Financial Economics* 65 (September 2002).

¹⁷ The joint use by companies of mutual shareholdings as an obstacle to hostile takeover is analogous to a nonenforceable contract. Thus, the opportunity costs of liquidity forgone cannot be counterbalanced by the increased attractiveness of protection from hostile takeover, because the former cost is certain, whereas the latter is uncertain (as it depends on the assessments of other actors). On the liquidity costs of ownership concentration, there is a large literature in corporate finance. See Patrick Bolton and Ernst-Ludwig von Thadden, "Blocks, Liquidity, and Corporate Control," *Journal of Finance* 53 (February 1998).

¹⁸ Campbell (fn. 4).

question of how institutions change has recently generated a burst of theoretical innovation from both rationalists¹⁹ and historical institutionalists,²⁰ particularly with respect to the relative importance of the endogenous and exogenous sources of institutional change. However, this theoretical work has sometimes ignored the interaction between formal and informal rules clearly identified by Douglass North: “The tension between altered formal rules and the persisting informal constraints produces outcomes that have important implications for the way economies change.”²¹ The question of whether changes in formal rules lead to changes in the behavior those rules are claimed to support is ultimately an empirical one, not a definitional one. The literature on comparative political economy provides fertile ground for examining this empirical question, because scholars using different analytical approaches have come to convergent findings about the behavioral practices that are central to different types of capitalism.²²

Although these scholars generally agree on the way actors behave in political economies, they disagree on why actors behave the way they do. This is potentially a source of conceptual confusion, since both the independent and dependent variables are “institutions,” which can change or not. We care about rules only inasmuch as they actually influence behavior systematically. Thus, the dependent variable in this article is operationalized as the systematic behavior that indicates the actual following of a rule by firms in the area of finance. It is this *behavior* that differs between liberal and coordinated financial systems, and we want to assess the extent of change in this behavior in order to see when financial institutions have changed. This behavioral practice is the institution of concentrated corporate cross-shareholding: do large companies in the economy hold each other’s shares in high concentration, such that they provide each other with patient capital?

It may be true that the causal mechanism responsible for behavioral change by companies in an economy is a change in the formal rules governing that institution. Thus, formal institutional (legal) change would be followed by change in the behavior that institution is said to regulate. This is, however, an empirical question: if formal rule change

¹⁹ Aoki (fn. 5); Greif and Laitin (fn. 7).

²⁰ Kathleen Thelen, *How Institutions Evolve* (New York: Cambridge University Press, 2004); Paul Pierson, *Politics in Time: History, Institutions, and Social Analysis* (Princeton: Princeton University Press, 2004); Wolfgang Streeck and Kathleen Thelen, *Beyond Continuity: Institutional Change in Advanced Political Economies* (New York: Oxford University Press, 2005).

²¹ North (fn. 5), 45. As pointed out by Helmke and Levitsky (fn. 6): “Informal rules have remained at the margins of the institutionalist turn in comparative politics. Indeed, much current literature assumes that actors’ incentives and expectations are shaped primarily, if not exclusively, by formal rules” (p. 725).

²² Hall and Soskice (fn. 1); Yamamura and Streeck (fn. 1); Amable (fn. 1); Schmidt (fn. 1).

is followed by no change in company behavior, then we have formal institutional change without actual (behavioral) institutional change. To avoid conceptual confusion, I refer throughout the article to institutional change as that change in institutions which is evidenced by *change in behavior*. Legal change is indeed (formal) institutional change, but the question examined in this article is whether or not legal change as an independent variable drives institutional change in financial systems.

Formal and informal institutions are often (though not always) complementary in their influence on behavior.²³ Our interest is to trace proximate chains of causation to determine whether changes in formal or informal institutions (laws or conventions) are more likely to drive behavioral change in the political economy. One can stylize the role of the two causal mechanisms in the following way. Most social scientists who write about the politics of corporate governance are in fact writing about the *formal* regulation of corporate governance, conflating regulatory and behavioral practice.²⁴ Their view is exemplified by Peter Gourevitch: "The regulatory system sustains the micro-institutional patterns of the economy. The regulatory systems are sustained, or changed, by choices made in a political process by policymakers."²⁵ It is surely true that the politics of institutional change has distributional consequences, and that competing coalitions will advocate an institutional solution closer to their preferred outcome.²⁶ It does not follow, however, that coalitional bargains are necessarily pushed through parliaments or regulators. This conflation of a "political" explanation with a "legal" regulatory one suggests that formal rules are the real rules holding coordinated economies together. This point should be investigated, not assumed.

The study of the political sources of corporate governance has been dominated by the view that coalitions act to pursue institutional change through parliament. Mark Roe first introduced to legal and economic scholarship the idea that the outcomes of corporate governance systems (such as the concentration of ownership) are determined by political coalitions.²⁷ Yet to test most of his propositions, Roe operationalizes the balance of power in society as the power of social democratic parties

²³ Cf. Helmke and Levitsky (fn. 6).

²⁴ Gourevitch and Shinn (fn. 9); Pagano and Volpin (fn. 9).

²⁵ Gourevitch, "The Macropolitics of Microinstitutional Differences in the Analysis of Comparative Capitalism," in Suzanne Berger and Ronald Dore, eds., *National Diversity and Global Capitalism* (Ithaca, N.Y.: Cornell University Press, 1996), 241.

²⁶ For a general exposition, see Jack Knight, *Institutions and Social Conflict* (New York: Cambridge University Press, 1992); and for an application to change in capitalist institutions, see Amable (fn. 1).

²⁷ Roe (fn. 11), 50–61. Roe's argument challenges the conventional orthodoxy in law and economics—that of La Porta et al. (fn. 10)—which tries to link differences in the extent of minority shareholder protection to legal traditions, with civil law countries producing lower shareholder protections than common law countries.

in parliament (which assumes that change primarily happens through that parliament). Political economists have launched several critiques of this approach, but all start from the premise that formal legal change is the proximate driver of institutional change in financial systems. Martin Höpner has argued that political parties do indeed drive political change but that parties of the left tend to oppose concentrated ownership and patient capital, rather than supporting it (as in Roe's argument).²⁸ Peter Gourevitch and James Shinn have recently criticized Roe's focus on social democratic dominance as the primary explanation of the difference in institutions of corporate governance, arguing that the interests of three groups in society—managers, workers, and owners—coalesce in various permutations, partly depending on the extent to which electoral institutions encourage majoritarian or proportional outcomes.²⁹ Managers and workers come together against owners in the corporatist compromise, whereas owners and workers ally against managers in a transparency coalition. Either way, the winning coalition determines the shape of financial institutions through its support of laws and regulations. At the heart of these arguments is the logically unnecessary conflation of coalitional politics with its embodiment in legal change: the causal driver of the difference in outcomes between systems of dispersed and concentrated ownership lies in the set of laws that facilitates that ownership structure.

An alternative model posits that behavioral change in domains governed primarily by informal institutions—that is, conventions—will take place through changes in beliefs that may well be unrelated to changes in formal rules. Douglass North famously observed that changes in relative prices occur all the time without leading to the institutional changes that rationalist theories would expect. North then rightly noted that “improved understanding of institutional change requires greater understanding than we now possess of just what makes ideas and ideologies catch hold.”³⁰ Existing rationalist theories of institutional change usually fail to explain how ideas come to be shared and thus to create common knowledge.³¹ As that is what happens when

²⁸ Höpner, “European Corporate Governance Reform and the German Party Paradox,” Harvard University Center for European Studies Working Paper 03.1 (Cambridge, 2003); Jürgen Beyer and Martin Höpner, “The Disintegration of Organised Capitalism: German Corporate Governance Reform in the 1990s,” *West European Politics* 26 (October 2003).

²⁹ Gourevitch and Shinn (fn. 9). Cf. Peter Gourevitch and Michael Hawes, “The Politics of Choice among National Production Systems,” *L'Année de la Régulation* 6 (2002); for a similar argument based on electoral systems, see Pagano and Volpin (fn. 9).

³⁰ North (fn. 5), 86.

³¹ An exception is Pauline Jones Luong and Erika Weinthal, “Contra Coercion: Russian Tax Reform, Exogenous Shocks, and Negotiated Institutional Change,” *American Political Science Review* 98 (February 2004); they develop a rationalist framework for explaining the emergence of a new tax code in Russia as a case of institutional change. These actors are not figuring out the new context of the

conventions change, we need to understand the mechanism by which this sort of shift in beliefs takes place. Masahiko Aoki has recently made an important contribution to rationalist theories of change by arguing that the process is above all experimental: if exogenous shocks change the payoffs of existing institutions, it is not immediately clear to actors how they should react. In other words, they lack cognitive maps to allow them to understand fully the new strategic possibilities.³² Several competing sets of beliefs may emerge and then operate simultaneously for a while, until one becomes dominant in the population and actors converge on the dominant model.

Aoki's insight about the experimental and cognitively uncertain character of institutional change is important, but incomplete. It fails to acknowledge the fundamentally social-relational character of institutional change in two respects. First, the impact of the behavior of some actors is more influential than that of others. And second, the stability of a new institution depends on a social process by which agreement is reached that the old convention has indeed died and been replaced. This happens not merely because, as in some tipping models, actors automatically update their information about the real world by observing the moves of other players.³³ Instead, I argue, this process of changing informal rules is akin to a collective discussion among social actors. These actors, rendered uncertain by the declining ability of their previous causal models to explain their experiences following an exogenous shock, use key events to convince each other of the validity of a common new roadmap—taking the events as evidence that the world has changed, but at the same time drawing confidence from their perception that the world has indeed changed because other actors are attributing this same evidentiary quality to them.

Joint belief shift constitutes the process by which actors use transformative events to establish a shared perception of the new causal models that underlie their strategic interaction. It is a process initiated by a structural shock, such as the increased opportunity cost of holding large blocks of capital brought on by expanding equity markets.³⁴ However,

world together, as in the joint belief shift mechanism, but are instead simply signaling a changed willingness to cut deals with each other. The insufficiency of the formal legal mechanism in explaining institutional change is underlined by their observation that some types of interdependence make changing laws useless absent a change in common knowledge.

³² Aoki (fn. 5), 233–44; cf. Pepper D. Culpepper, *Creating Cooperation: How States Develop Human Capital in Europe* (Ithaca, N.Y.: Cornell University Press, 2003).

³³ Susanne Lohmann, "Dynamics of Informational Cascades: The Monday Demonstrations in Leipzig, East Germany, 1989–91," *World Politics* 47 (October 1994).

³⁴ The joint belief shift mechanism explored in this article assumes an exogenous change in material conditions as the precursor to institutional change. This does not exclude the possibility that endogenous institutional change may happen through a similar causal mechanism, and in practice exogenous and endogenous sources of change often interact; Aoki (fn. 5).

structural conditions create the possibility for institutional change; they do not in most cases determine the outcome of the process. Following an argument made by William Sewell, actors use transformative events as a way to shift to new cognitive maps.³⁵ Most actors are jarred into reconsidering their basic causal models only when they see influential central actors begin to do the same, and thus begins a process of deliberation whose outcome is contingent. The process is joint (that is, shared) in two respects. First, individuals form their own new perceptions about models of the world, but their own perception depends partly on whether they think others have the same perceptions.³⁶ Second, their shared perception of a cognitive map *becomes* shared through their collective adoption of a coordinating event, to which they attribute a shared interpretation to justify changing their minds. The joint belief shift mechanism can be considered an attempt to understand the rationalist processes behind the construction of focal points identified by Schelling.³⁷ Focal points coordinate the expectations of individual actors, and joint belief shift is a process of coordinating changes in causal beliefs.

How does the joint belief shift mechanism yield observable implications about the process of change that are distinct from those of the formal-legal mechanism? First, the joint belief shift mechanism generates the expectation that legal change following an exogenous shock *will not be sufficient* to effect institutional change. If the joint belief shift mechanism functions as expected, institutions will not break down merely because they are under pressure from coalitions empowered by an exogenous shock to change relevant laws. Rather, they will break down only when social actors traverse an experimental period where they try to figure out the implications of alternative institutional arrangements. Institutional crisis, as summarized by Aoki, is a period when “the taken-for-grantedness of the old institution [is] called into question.”³⁸ We expect that institutional change is tentative, marked by uncertainty over the distributive outcomes of any new institutional choice. In such a period of uncertainty, collective actors look for cues from other actors about their beliefs concerning the world.

Under the mechanism of joint belief shift, an institutional crisis is triggered by a credible signal from a central actor that she is deserting

³⁵William Sewell, “Historical Events as Transformations of Structures: Inventing Revolution at the Bastille,” *Theory and Society* 25 (1996). I am indebted to Michèle Lamont for drawing my attention to the relevance of the work of William Sewell on transformative events. It has influenced my formulation of the causal role of events.

³⁶ Aoki (fn.5), 242.

³⁷ Thomas Schelling, *The Strategy of Conflict* (Cambridge: Harvard University Press, 1960).

³⁸ Aoki (fn. 5), 241.

the status quo. The centrality of the actor is fundamental. Such an actor has played by the existing rules of the game, and her actions are widely visible to other key players (in other words, to other members of her reference group). Thus, the signal of the central actor is significant because she is “one of us”: she is not an insurgent or an outlier but is one whose decision to desert is surprising because she has been playing the game by the established rules.³⁹ Without such a signal from an actor who is recognized by other actors at the center of the network as being part of their reference group, changes in an interest coalition are unlikely to lead to institutional breakdown. The outcome of this process is not foreordained either by declining efficiency of existing institutions or by the passage of laws that support those institutions; it is contingent on the decision of a central social actor and the response of other central social actors to her defection.

But why does the first actor decide to desert the existing set of rules? And do the reasons that she deserts not then constitute the heart of the explanation for everything that follows, such that the process of change is merely foam on the wave of changing material conditions? To demonstrate that what causes the first actor to desert the existing institution is not what causes the other actors to desert, I must show that the reasons for the first actor’s change are exogenous to any process of change that follows it. *The first actor’s change is important not for the forces that caused it but for the process that it catalyzes.* The signal from the first actor triggers a reconsideration of causal expectations by dint of its effect on institutional “taken for grantedness.” Other central actors take it as a signal to reconsider long-standing beliefs about the viability of existing institutions.

The formal legal mechanism and the joint belief shift mechanism yield different predictions about the progression of change. The legal mechanism becomes operative when an interest coalition forces a change in laws or regulations. If institutional breakdown is primarily a product of changing laws, it should occur in all cases where coalitions have put new laws into place and not elsewhere. If instead an institution breaks down through the mechanism of joint belief shift, we expect to observe a key event—the credible signal from a central actor (not a peripheral actor) that the world has changed. This act triggers

³⁹ Cf. Lohmann (fn. 33). Lohmann emphasizes the informational content of different sorts of actors engaging in costly behavior. Unlike Lohmann, I argue that this action by a central actor does more than reveal information that leads other actors mechanically to revise their estimates of how other actors will behave; it also jars them into reconsidering their own models of causation about the functioning of existing institutions.

institutional crisis but does not itself constitute institutional breakdown. Breakdown occurs only when other actors stop following the rules of the game, as exhibited by a failure to maintain past behavioral patterns. Thus, there will be a temporal lag between the credible signal and the breakdown; it is during this period that actors will reorient their expectations about the world. If the mechanism of joint belief shift is primary, we expect the period of institutional crisis to be characterized by experimentation and high uncertainty. We do not expect a sudden cascade of change, with everyone taking new information to update his or her payoff matrix mechanically. Rather, the “decisive” event will be the event of the initial signal, but its taken-for-grantedness is apparent only in retrospect: an event is designated as decisive only well after it happens, even if actors are party to an activity they perceive as momentous. Its momentousness is ratified only once they believe everybody else has also found it momentous.⁴⁰

EMPIRICAL CHANGE IN FINANCIAL SYSTEMS SINCE 1990

Systems of finance and corporate governance comprise the institutions by which investors and company managers monitor and coordinate the allocation of capital to companies. In this article I draw especially on the work of Hall and Soskice, for whom these institutions hang together with other institutions in the political economy in predictable ways to form distinct “varieties of capitalism.”⁴¹ I rely on this conceptual framework because its microfoundations are anchored in the choices of individual companies, linking widely observed differences in the macro-institutions of advanced capitalism with the choices that individual economic actors make to reinforce these macro-institutions. Empirically, though, theorists in other analytical traditions stress the same differences among capitalist systems and the way in which companies acquire capital and are monitored by the providers of capital.⁴²

⁴⁰ Sewell (fn. 35).

⁴¹ Hall and Soskice (fn. 1).

⁴² Amable (fn. 1), for example, provides probably the most extensive, empirically grounded statistical analysis of the distinctions among modern capitalist institutions. His analysis of financial systems shows that discernible gradations exist between systems of largely market-driven finance (including the U.S. and the U.K.) and the ideal “intermediated” financial systems (including France, Germany, and Italy). He describes finance in such systems as characterized by “a supposedly active involvement of intermediaries in firms’ monitoring and strategy making, diminishing uncertainty and allowing for the realization of long-term strategies by supplying ‘patient’ capital” (p. 253). Amable’s work supports the claim that these three countries lie at the opposite extreme from the market-based system of the LMEs. Schmidt (fn. 1), in her threefold typology of capitalisms, also identifies ownership concentration and strategic shareholding as core to both the German and the French models, even though she emphasizes that the French system of shareholding owes more historically to state policy than does its German counterpart (pp. 119–25).

In coordinated financial systems, concentrated shareholdings give blockholders large incentives to develop capacities to monitor companies, such that the share price is not the principal source of information about company prospects. Coordinated financial systems thus allow companies to make investment and hiring decisions with relatively lower concern for their immediate impact on share prices and quarterly earnings reports than do companies in liberal financial systems. To look for institutional change in a system of finance and corporate governance, we want to track changes in the rules of behavior that allow company managers to make decisions with substantially lower regard for short-term market pressures: patient capital.

The institution of patient capital depends on a set of companies holding significant concentrations of ownership in each other, as a barrier to hostile takeovers and to pressure managers to maximize (short-term) shareholder value. The exact form through which patient capital is effected may differ from one country to the next, and knowledge of the specific cases is essential to ensure that similar measures are tracking similar concepts. Generally, though, we want to track ownership concentration and identity as behavioral indicators. Patient owners of capital are patient only if they hold their large blocks of shares in a way that impedes hostile takeovers, giving management a longer time horizon to pursue its strategy.⁴³ Thus, the stability of ownership, as well as its concentration, is necessary for patient capital. If there is a change in the institutions of nonmarket coordination in finance and corporate governance, we should expect a significant drop in the level of patient capital observed in a country, as indicated by the stability of blockholdings.

Let us look at change since 1990. At the beginning of the decade France, Germany, and Italy all possessed systems of corporate governance and finance that gave companies in these systems patient capital. Their concentration of share ownership was much higher on average in than in the United Kingdom, a paradigmatic liberal market economy (LME). In an LME we expect dispersed ownership, and that is what we find in the U.K. In the early 1990s, only 16 percent of the 173 largest companies listed on the stock market in the U.K. had one shareholder holding 25 percent of its equity, and only 6 percent had a shareholder with more than a 50 percent stake. By comparison, in Germany in 1990, 85 percent of the largest 171 listed companies had a 25 percent ownership stake—which is sufficient to block a hostile takeover by law—and 57 percent of the companies had a majority shareholder. France (79 per-

⁴³ Tim Jenkinson and Alexander Ljungqvist, "The Role of Hostile Stakes in German Corporate Governance," *Journal of Corporate Finance* 7 (December 2001).

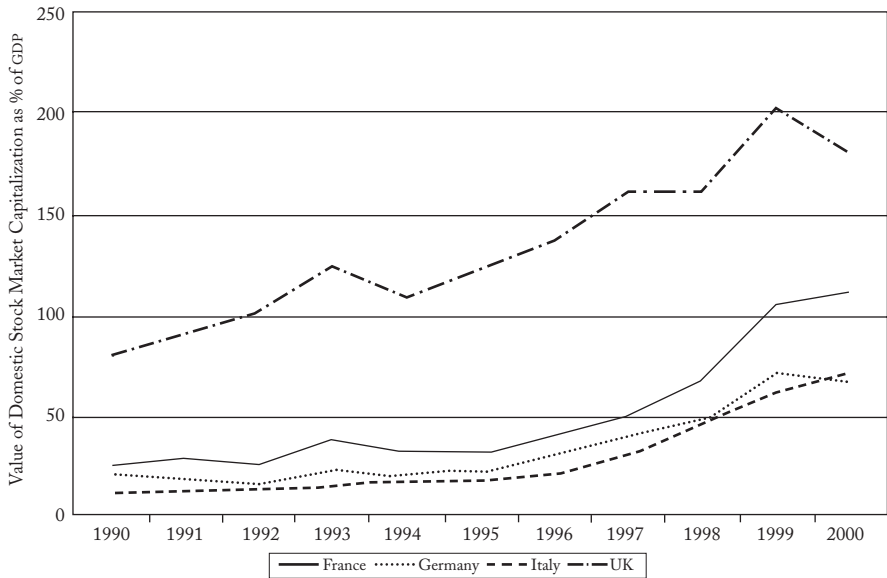


FIGURE 1
MARKET CAPITALIZATION AS A PROPORTION OF GDP
(1990–2000)

SOURCE: Global Financial Data, <http://www.globalfindata.com/>.

cent of companies with a 25 percent stake) and Italy (85 percent of companies with a 33 percent stake) had similarly high concentrations of capital in comparison with the U.K. liberal market economy.⁴⁴

As indicated in Figure 1, stock markets in all three countries grew by more than 200 percent over the course of the decade after 1990.⁴⁵ Their growth paralleled that of countries with more developed equity markets, such as the U.K. What, if anything, happened to the patient capital characteristic of these three economies in 1990 after the growth of equity markets?

To investigate this question, we need to focus on specific ways in which companies were afforded patient capital by the structure of own-

⁴⁴ Julian Franks and Colin Mayer, "Corporate Ownership and Control in the UK, Germany, and France," in Donald Chew, ed., *Studies in International Corporate Finance and Governance Systems* (New York: Oxford University Press, 1997), 283; Julian Franks and Colin Mayer, "Ownership and Control of German Corporations," *Review of Financial Studies* 14 (Winter 2001); Fabrizio Barca et al., *Assetti Proprietari e Mercato delle Imprese* (Bologna: Il Mulino, 1994), 2:184.

⁴⁵ In the two decades prior to 1990, stock market capitalization in these countries was almost stagnant: moving from 16 percent of GDP in 1970 in France to 26 percent in 1990; 16 percent in 1970 in Germany to 21 percent in 1990; and 5 percent in 1975 in Italy to 13 percent in 1990.

ership networks in these countries. In France a high level of state ownership had long coexisted with a system of state credit rationing and a system of recruitment of private chief executives from the ranks of state-trained elites.⁴⁶ Yet this system was curtailed following the privatizations of 1986–88, and the rightist government that conducted those privatizations had encouraged the reinforcement of existing patterns of corporate cross-shareholding, creating *noyaux durs* (hard-core ownership networks) whose design shielded companies from the pressures of financial markets and protected them from hostile foreign takeovers.⁴⁷ The centerpiece of this system was two keiretsu-style networks of companies that held each other's shares—one centered around Paribas and Société Générale (SocGen), the other centered around Suez and Banque Nationale de Paris (BNP). The German system, while not divided clearly into two keiretsu structures, involved a heavy component of stable cross-shareholdings among nonfinancial corporations, which held 41 percent of the outstanding shares in Germany in 1990.⁴⁸ Italian corporate governance is characterized by the prevalence of pyramidal ownership structures, which maximize control over a set of companies while limiting the amount of investment required to maintain that control.⁴⁹ Using such structures, a small set of capital holders—traditionally families—have long exercised effective control over the vast majority of Italian industry.⁵⁰

How do these networks of shareholding allow one or more blockholders to insulate management from concerns about their share price and the threat of hostile takeovers? First, pyramidal ownership can

⁴⁶ Vivien Schmidt, *From State to Market? The Transformation of French Business and Government* (New York: Cambridge University Press 1996).

⁴⁷ François Morin, "A Transformation in the French Model of Shareholding and Management," *Economy and Society* 29 (February 2000); Schmidt (fn. 1), 123.

⁴⁸ Jackson (fn. 2), 274–75. It is frequently argued that the German banking system constitutes a fundamental element of patient capital for the large firms in Germany. This appears on available evidence to be false. While financial firms certainly have significant holdings in other corporations in Germany, recent studies suggest that, throughout the period of the 1990s, banks did not play a role in German corporate governance distinct from that of other large shareholders. See Jeremy Edwards and Marcus Nibler, "Corporate Governance: Banks Versus Ownership Concentration in Germany," *Economic Policy* 30 (October 2000); Jenkinson and Ljungqvist (fn. 43); Paul Windolf, *Corporate Networks in Europe and the United States* (New York: Oxford University Press, 2002), 45. Thus, pace Jackson (fn. 2) and Höpner (fn. 3), changing strategies by German banks do not constitute a serious threat to the stability of the system of cross-shareholding in Germany, as long as they do not trigger a broader change in behavior among nonfinancial companies and individuals.

⁴⁹ Andrea Melis, "Corporate Governance in Italy," *Corporate Governance: An International Review* 8 (October 2000).

⁵⁰ Alexander Aganin and Paolo Volpin, "History of Corporate Ownership in Italy," European Corporate Governance Institute Working Paper 17/2003 (Brussels, 2003); Marcello Bianchi, Magda Bianco, and Luca Enriques, "Pyramidal Groups and the Separation between Ownership and Control in Italy," in Fabrizio Barca and Marco Becht, eds., *The Control of Corporate Europe* (New York: Oxford University Press, 2001).

TABLE 1
 PERCENTAGE OF LISTED COMPANIES IN ITALY CONTROLLED BY A
 SINGLE ENTITY

	<i>% Companies with 1 Controlling Shareholder</i>	<i>% of These That Are Non-Italian</i>
1996	83.8	4.0
2002	84.6	4.0

SOURCE: CONSOB, Annual Reports (2002, 2003). These data have been gathered by CONSOB, the Italian regulatory authority, only for the years since 1996.

allow current holders of capital to effectively *control* companies, in practice disenfranchising minority shareholders and allowing management to pursue its strategy without respect to quarterly results; this is the traditional Italian model. Second, one or more *noncontrolling* blockholders can maintain a large enough ownership stake to block hostile takeovers; this is the traditional French and German model. Since the latter strategy is exercised not through direct control but rather through strategic support, it depends on the identity of the owners of largest blocks of shares: who are they and what are their reasons for holding the shares?

The Italian case is straightforward. The growth of equity markets after 1990 did not lead to any decrease in the ability of a small number of large companies to control most of the companies on the Italian stock market.⁵¹ The largest change in the ownership structure of Italian capitalism during the 1990s was the drastic reduction of state shareholdings through privatization, which lowered the proportion of listed companies controlled by the state from around 15 percent in 1990 to below 5 percent in 2000.⁵² Yet neither the newly privatized companies nor existing ones were widely distributed. Given pyramidal structures and other measures of extended control, in 2002 a single controlling agent could be identified for more than *80 percent* of 240 Italian listed companies, as shown in Table 1. Moreover, only 4 percent of these controlling agents were non-Italian, a percentage that remained stable throughout the period of market expansion in Italy. A relatively small number of owners, few of them non-Italian, exercised effective control over most of the Italian listed companies throughout this time period. There is no evidence that the provision of patient capital to companies

⁵¹ CONSOB, "Relazione per l'anno 2002 della Commissione Nazionale per le Società e la Borsa" (Rome, 2003), 203; Richard Deeg, "Institutional Change and Path Dependency: The Transformation of German and Italian Finance," in Streeck and Thelen (fn. 20).

⁵² Aganin and Volpin (fn. 50).

TABLE 2
 AVERAGE PERCENTAGE OF SHARES CONTROLLED BY TOP TWO
 SHAREHOLDERS IN FRANCE AND GERMANY

	1993	2000	2003	% Change, T1-T3
France	50.4	32.0	nd	-36.5
Germany	42.9	43.7	41.1	-4.1

SOURCES: These data are for the thirty-eight largest publicly traded companies in France and Germany. The data on French ownership come from the Lereps Database of the University of Toulouse, and include six financial companies and thirty-two nonfinancial companies. The data on German ownership for 1993 and 2000 come from Bruce Kogut, who has collected them as part of his project on small worlds of ownership. The 2003 data on German ownership were drawn mainly from the German market regulator, BaFin, with additional data collected through Yahoo Finance and individual company annual reports. In order to make the least biased comparison of country samples possible, in terms of sectoral composition, I took as a comparison group the six largest German financial companies (three banks and three insurance companies) and the thirty-two largest nonfinancial companies (by revenue) from the small worlds dataset. Thanks to Bruce Kogut for making these data available to me for this project.

in Italy has changed at all since 1990, despite the growth of capital markets there.⁵³

Patient capital in France and Germany is exercised not through pyramidal structures allowing for control by a single company but by a small number of blockholders who can obstruct hostile takeovers. To examine the change in patient capital in these countries, I have relied on data on ownership concentration of the largest thirty-eight publicly traded companies in both France and Germany between 1993 and 2000. While the extent of the change in France between 1993 and 2000 is not widely contested, some scholars have argued that change began in Germany only after the year 2000. As a result, Table 2 presents additional data on the ownership of German companies in 2003, taking account of changes that might have happened after 2000, which is the final available point in the French data.

These data point to a sea change in ownership trends in France, where the proportion of shares held by the top two shareholders in the largest companies dropped by more than one-third between 1993 and 2000. In Germany during the same period, by contrast, ownership concentration was largely stable, increasing marginally between 1993 and

⁵³ CONSOB (fn. 51). Some journalists have pointed to the erosion of the position of Mediobanca, formerly at the center of Italian ownership networks, as a symbol of potential change in the Italian system; cf. Fred Kapner, "Italy's Reformers," *Financial Times*, April 7, 2003, 13. However, as Deeg has shown (fn. 51), Mediobanca never defected from the system of patient capital; its management was simply ousted. This managerial change had no effect on effective ownership concentration in Italy, as shown in Table 1.

2000 and then decreasing marginally between 2000 and 2003. The total figure changed by less than 5 percent over the entire decade. A similar trend can be observed by looking only at the shares held by the single largest shareholder. However one measures, the largest blockholders in the largest companies have reduced their shares in France and have kept them largely stable in Germany.⁵⁴

It is important to distinguish between the strategies of financial institutions (banks and insurers) and those of other, nonfinancial corporations. In the second half of the 1990s financial corporations in both France and Germany began to change their shareholding strategies, moving to become active players in European and global financial markets. In Germany the percentage of supervisory board representatives from financial firms fell continuously between 1996 and 1999, after having been stable (or even increasing slightly) earlier in the decade.⁵⁵ The number of substantial voting blocks of the top one hundred German listed companies held by financial firms similarly decreased between 1993 and 2003.⁵⁶ However, the proportion of large blockholdings held by *non*-financial firms remained stable over that period and the proportion held by individuals and families—the largest set of blockholders in Germany—grew at a faster rate than did the decrease in holdings of financial firms. In other words, German banks and insurers are now managing their assets more as portfolio holdings and less as strategic holdings,⁵⁷ but German families and nonfinancial companies appear to have reaffirmed the value of patient capital as a way of blunting hostile takeovers.⁵⁸ The net effect is no change in the extent of patient capital.

By way of contrast, the hard core of cross-shareholdings at the heart of French capitalism collapsed in 1998 and 1999, among both financial

⁵⁴ These data actually understate the difference in ownership concentration among large firms in France and in Germany, because Germany has many more large firms that are privately held instead of being publicly traded. Among global (non-American) privately held companies, fourteen of the largest thirty are German; only three of the largest thirty are French; “Largest Non-U.S. Foreign Companies,” *Forbes*, November 12, 2004.

⁵⁵ Höpner (fn. 3), 138.

⁵⁶ Dariusz Wójcik, “Change in the German Model of Corporate Governance: Evidence from Blockholdings, 1997–2001,” *Environment and Planning A* 35 (2003), 1445.

⁵⁷ Martin Höpner and Lothar Krempel, “The Politics of the German Company Network,” MPIfG Working Paper 03/9 (Cologne, 2003); Wójcik (fn. 56), 1445.

⁵⁸ Amable (fn. 1), 259–61. German industrial companies appear to value controlling shareholding heavily, as their stakes are much larger than those held by banks: “The median size of blocks held by industrial firms is 70 percent, which is substantially larger than for both individuals and banks (18 and 15 percent, respectively). This finding suggests that firms, banks, and individuals have very different motives in holding voting blocks. Firms appear to value majority control, while individuals generally own only a minority block. We find further that industrial firms control the largest percentage (26%) of all officially listed shares.” See Marco Becht and Ekkehart Boehmer, “Voting Control in German Corporations,” *International Review of Law and Economics* 23 (March 2003), 13.

TABLE 3
THE BREAKDOWN OF THE HARD-CORE NETWORKS OF
FRENCH CROSS-SHAREHOLDING^a

	1995	1996	1997	1998	1999	2000	% Change 1998–2000
BNP Network							
BNP	16.94	16.8	16.08	11.02	8.22	8.62	-21.8
St. Gobain	22.7	22.6	22.32	22.32	13.5	7.57	-66.1
Suez/ Lyonnaise							
des Eaux	9.02	8.44	8.44	8.44	1.69	1.4	-83.4
UAP/AXA	8.96	8.96	8.96	6.9	6.9	6.9	0.0
Vivendi	17.92	16.52	15.11	14.1	8.67	4.87	-65.5
SocGen Network							
AGF	2.77	4.48	5.6	6.04	2.5	2.5	-58.6
Alcatel	7.99	7.02	6.73	8.37	5.01	4.35	-48.0
Aventis	10.76	11.50	12.33	14.41	7.51	6.85	-52.5
SocGen	21.52	23.00	24.66	28.82	15.01	13.70	-52.5

SOURCE: SISIFE/Lereps Database, University of Toulouse.

^aFigures depict the proportion of a company's outstanding shares owned by other members of its hard-core network.

and nonfinancial firms. Table 3 shows the mutual cross-shareholdings held by companies in the two “hard core” shareholding groups collapsed by about half in 1998 and 1999, after remaining stable or increasing in 1995 and 1996.⁵⁹ These interlocking French shareholdings among large French firms were replaced by the growing weight of foreign (mostly British and American) institutional investors, which as of 2003 owned more than 40 percent of the outstanding shares in CAC-40 companies.⁶⁰

Illustrative of this speedy transformation is what happened at Saint Gobain, a glass and materials conglomerate that was one of the two manufacturing companies at the heart of BNP network of shareholding. Four other members of the network—BNP, Suez, Union des Assurances de Paris (UAP), and Vivendi—held more than 22 percent of Saint Gobain's shares at the beginning of 1997. By the end of 1999, however,

⁵⁹ Unless otherwise noted, all data on changes in French share ownership come from the Lereps Database of the University of Toulouse.

⁶⁰ Michel Goyer, “Corporate Governance, Employees, and the Focus on Core Competencies in France and Germany,” in Curtis Milhaupt, ed., *Global Market, Domestic Institutions: Corporate Law and Governance in a New Era of Cross-Border Deals* (New York: Columbia University Press, 2003). In 2001 foreign investors owned only 14 percent of equity in German listed companies and 6 percent of the equity in Italian listed companies. See Wójcik (fn. 56), 1443; CONSOB (fn. 51), 202. These data are not directly comparable to those on France, since they refer to listed companies generally and not merely to the largest companies.

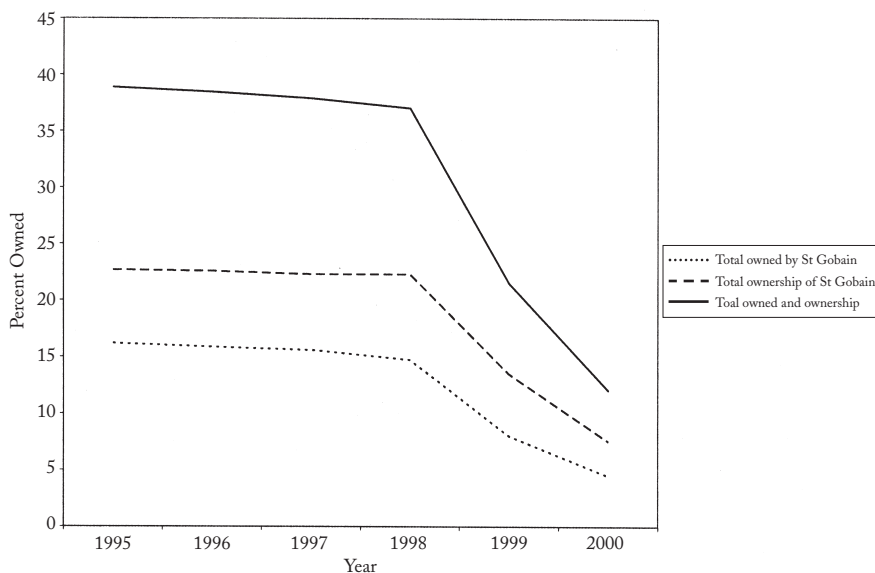


FIGURE 2
PATIENT CAPITAL CONNECTED TO ST. GOBAIN
(1995–2000)

SOURCE: SISIFE/Lereps Database, University of Toulouse.

those companies held less than 8 percent of the company—hardly a blocking minority. At the same time Saint Gobain unloaded most of its shares on the other members of the network. By the end of 2000 it held no more than 2 percent of the shares of any other member of its former network partners.⁶¹ The hard cores designed to protect French companies from hostile foreign takeovers were a dead letter by 2000, when 40 percent of Saint Gobain's shares were held by non-French owners, and one-quarter of its ownership was based in the U.K. or the U.S.⁶² (See Figure 2.)

This evidence does not demonstrate that French corporate governance practices are indistinguishable from those found in liberal market economies. French law continues to provide relatively little protection for minority shareholders, and French companies have successfully avoided disclosure requirements consistent with LME standards.⁶³

⁶¹ Gregory Vincent, "Beyond 'Crony Capitalism': Financial Change and Elite Coordination in France" (D. Phil. thesis, Oxford University, 2004).

⁶² Michel Goyer, "The Transformation of Corporate Governance in France and Germany: The Role of Workplace Institutions," *MPIfG Working Paper 02/10* (Cologne, 2002).

⁶³ *Ibid.*; La Porta et al. (fn. 10).

However, the empirical concern in this article is to assess whether or not French managers are able to use concentrated ownership to plot long-term strategies without worrying about a hostile takeover.⁶⁴ It appears from this evidence that this ability has been greatly curtailed since 2000. French firm managers report in interviews that “Americans and British have a very poor view of cross-shareholding” and that “it is impossible to escape the demands made by U.S. and British investors.”⁶⁵ Those investors are sensitive to fluctuations in share price in a way that old cross-shareholding partners were not. In this respect, it appears that we have significant change in both the extent of ownership concentration in France and the identity of those owners. These key indicators of patient capital have, by contrast, remained largely stable in Germany and Italy. Why?

MECHANISMS OF INSTITUTIONAL CHANGE

The opportunity costs of holding blocks of illiquid capital in other companies increased in all three countries during the 1990s, but only in France did this pressure result in institutional change. If the breakdown took place via the formal legal mechanism, we would expect to observe that the change was caused by a modification of the regulatory framework that supported a previously stable institutional arrangement. By contrast, institutional breakdown that takes place via the joint belief shift mechanism would be evident in lagged form: a credible signal from a central actor should trigger reconsideration of the value of maintaining the cross-shareholdings and then eventual abandonment of the practice *only* if each actor suspects the world has changed and that other actors believe that.

The formal legal mechanism should be easy to observe in practice, since it predicts legislative or regulatory change that will enshrine the deal among new members of a winning coalition of interests. Patient capital clearly favors managers over minority shareholders, and so we would expect a legal restructuring that undoes patient capital to improve the ability of minority shareholders to hold managers to account.⁶⁶ The most widely cited attempt to measure the degree of minority shareholder legal protection was devised by LaPorta et al. and

⁶⁴ Among large company deals (those where the deal price was above \$100 million), there were three successfully completed hostile takeovers in France between 2000 and 2004; two of those deals involved purchases by foreign (British and Canadian) companies. During the same time period, there was one large hostile takeover in Germany (by an Italian company) and none in Italy; SDC Platinum Database of Worldwide Mergers and Acquisitions, 2005, http://www.tfsd.com/pdfs/sdcplatinum_pg.pdf. Thanks to Mauro Guillén and William Schneper for suggesting this data source.

⁶⁵ Morin (fn. 47), 49.

⁶⁶ Gourevitch and Shinn (fn. 9).

TABLE 4
CHANGE IN ANTIDIRECTOR INDEX
(1990–2002)^a

	1990	2002	Year of Change	Change, 1990–2002
France	3	4	2002	+1
Germany	2	3	1998	+1
Italy	1	5	1998 ^b	+4

SOURCES: Pagano and Volpin (fn. 9). The data from Pagano and Volpin begin in 1993; I gathered the data on the years between 1990 and 1992.

^aHigher scores denote better minority shareholder protection, following LaPorta et al. (fn. 10).

^bItaly changed from 1 to 4 in 1998 and then to 5 in 1999.

called the antidirector index.⁶⁷ The index measures a variety of legal devices that insulate a company's management from the aggregated power of small shareholders; the higher the score, the better the protection of shareholders' rights.⁶⁸ Pagano and Volpin have extended and corrected the data for the antidirector index to 2002, and the changes in the three countries since 1990 are summarized in Table 4.⁶⁹

If the formal legal mechanism is a necessary and sufficient cause of institutional change, these scores on the antidirector index would lead us to expect no change in France until 2002, moderate change in Germany after 1998, and extreme change in Italy after 1998. In actual fact, we observe extreme change in France and no apparent change in Germany and Italy. It is certainly possible to argue that the changes of 1998 in both Germany and Italy will take a longer time to have an effect on the provision of patient capital; but there is no evidence of that change as of this writing, seven years after the passage of those laws. And without question, there is no proximate legal change that would account for the institutional breakdown observed in France. It appears therefore that the formal legal mechanism is an inadequate explanation for the observed institutional change.

We saw in the previous section that the breakdown of patient capital in France occurred through the rapid unwinding of the hard-core cross-shareholding networks in 1998 and 1999.⁷⁰ What exactly hap-

⁶⁷ LaPorta et al. (fn. 10).

⁶⁸ In LaPorta et al.'s (fn. 10) initial rankings, the United States and the United Kingdom had the highest antidirector indices (5), while Belgium had the lowest (0).

⁶⁹ Pagano and Volpin (fn. 9).

⁷⁰ There is no evidence of anything happening before 1995 that triggered the change in France. Indeed, the OECD's interpretation of France in 1994 was one of stable cross-shareholdings. See Richard Deeg and Sofia Perez, "International Capital Mobility and Domestic Institutions: Corporate Finance and Governance in Four European Cases," *Governance* 13 (April 2000), 129.

pened that led to this breakdown? The death of the cross-shareholding networks is now widely attributed to the decision of the management of the AXA group, following its merger with the insurance group UAP in 1997, to reevaluate its shareholding strategy: "Breaking with its previous habits, the managing team of the new group deliberately put aside its capacity for coordination and regulation of economic activities. Only some [financial] assets would still be considered as truly strategic. . . . The rest of its holdings would henceforth become part of the portfolio of assets of the group that would be managed financially according to the Anglo-Saxon norms of profitability."⁷¹ AXA was already an important player in France in 1996, but the company was unusual in that its CEO, Claude Bébéar, had professed an unwillingness to engage in long-term strategic shareholding since at least 1993.⁷² Yet the company's decision to buy UAP—which sat at the center of the BNP network of cross-shareholding—meant that AXA had purchased a place at the very heart of the cross-shareholding network.⁷³ What caused UAP to shift its strategy was its takeover by AXA, not any shift in general material conditions. Bébéar sent his public signal that AXA/UAP was abandoning the system of cross-shareholding in January 1997, saying that the company "had no intention of becoming the godfather of the French economy" and initiating a token drop in its holdings of BNP, the bank at the heart of one of the two shareholding networks.⁷⁴

It was the prospect of AXA/UAP's defection, more than the actual material effect of dumping its hard-core shares, that triggered the reconsideration by other companies of the value of the hard-core system. The costs of French companies in immobilizing capital through cross-shareholding had been clearly recognized since the early 1990s.⁷⁵ Yet Bébéar's announcement sent a signal that a central member of the network no longer perceived a strategic value in holding shares of other companies in the hard-core network. This announcement did not trigger an immediate selling of shares by other companies. Instead, it stimulated a set of discussions among other managers in the hard-core networks about the effectiveness of cross-shareholding as takeover protection, and experimentation with alternative modes to construct a hard core of ownership. For example, two of the members of the BNP net-

⁷¹ François Morin, "Le Modèle Français de Détention du Capital: Analyse, Perspective et Comparaisons Internationales" (Paris: Ministère de l'Économie, des Finances et de l'Industrie, 1998), 22; Vincent (fn. 61).

⁷² Schmidt (fn. 1), 382.

⁷³ Cf. Vincent (fn. 61).

⁷⁴ Ibid.

⁷⁵ Schmidt (fn. 1).

work—Suez and Lyonnaise des Eaux—merged in March 1997, establishing hard-core shareholders in Groupe Bruxelles Lambert and Crédit Agricole that replaced the eventual loss of AXA-UAP.⁷⁶ Clearly, the abandonment of the hard-core shareholdings was not a foregone response to AXA's signal. AXA itself did not actually make any major sales of its nonfinancial shares until the end of 1997 (when it sold its small holdings in Alcatel) and near the end of 1998 (when it dropped its holdings in St. Gobain and Vivendi).⁷⁷ The major fall in shareholding in the second hard-core network, which clustered around Société Générale, did not occur until 1999 (see Table 3). Yet Bébéar's statement is widely regarded (retrospectively) as the moment the system broke down, even though talk is cheap. Frédéric Lordon echoes the general sentiments of French businesspeople when he identifies AXA's takeover of UAP as "the shock . . . that overturn[ed] . . . the organization of French capitalist control which, by stabilizing the ownership of capital, had in fact allowed for resistance against outside ownership. The bipolar structure [of French capitalism], essentially inherited from the days of Pompidou and built around the constellations of Suez and Paribas, found itself dismantled in a single blow."⁷⁸

It is important to note that AXA's move to sell blocks of shares in the hard cores was not unprecedented, at least for AXA. Early in 1996, the year before it bought UAP, AXA had significantly reduced its holdings in two large French companies in the hard cores: Alcatel and Suez. That sale of shares had had no effect on the behavior of other companies at that time, because AXA was not then a central member of the cross-shareholding network. It was only when it bought UAP and threatened to liquidate its shareholdings in 1997 that the other companies in French shareholding networks began to respond.⁷⁹ No change in government policy drove large French companies to sell their shares. Instead, the actions of AXA/UAP led them to reevaluate the idea (and costs) of using cross-shareholding as mutual takeover protection.

⁷⁶ Vincent (fn. 61). In gathering information about the breakdown of the *noyaux durs* following AXA's acquisition of UAP, I have benefited from several exchanges with Gregory Vincent, whose research on the process of breakdown provides the best empirical evidence I have seen about this episode.

⁷⁷ AXA/UAP's combined shareholdings in nonfinancial companies in its network were all relatively minor (below 5 percent of their outstanding shares). As such, selling those shares alone would not have destabilized the existing network, absent selling by other shareholders. AXA/UAP's shares of financial companies were more substantial, as it held blocks larger than 10 percent of the shares of both BNP and of Paribas. BNP merged with Paribas in 1999; cf. Vincent (fn. 61).

⁷⁸ Frédéric Lordon, "La 'Création de Valeur' Comme Rhétorique et Comme Pratique," *L'Année de la Régulation* 2000 4 (2000), 151.

⁷⁹ Vincent (fn. 61).

The process that followed the AXA takeover of UAP triggered institutional change in the French corporate governance system, as assessed by measures of patient capital. Yet an event that was viewed by some observers as similarly momentous for German finance—the 2000 takeover of Mannesmann by the British company Vodafone—did not trigger a similar sell-off of cross-shareholding in German capitalism, as the data in Table 1 make abundantly clear.⁸⁰ As previously noted, the large German financial institutions (Deutsche Bank and Allianz) have been unwinding their shareholdings since about 1997, but this trend has been compensated for by an increase in the blockholdings of non-financial companies and individuals.

Why did the Mannesmann takeover not become an event that led to joint belief shift in Germany? Notably, Mannesmann was unusual in the German context: its shares were highly dispersed, with 60 percent of them held by foreign investors, and two-thirds of those British or American.⁸¹ Neither its ownership structure nor the identity of its owners was of the sort that could provoke other managers at large German companies to rethink their strategies, because their ownership structure was typical of large American companies, not large German ones. Whereas AXA/UAP sat at the heart of French capitalism, Mannesmann was an outlier and, as such, incapable of convincing other actors that the world had changed.

CONCLUSION

Changes in material conditions sometimes lead to institutional change, yet they often do not. In order to better understand the causal processes that underlie institutional change, I have argued that we need to increase our analytical focus on the way in which collective actors jointly change their minds about how the world works and thus about how their interests can best be pursued. This is not to say that what is happening is only in their minds. As I have stressed throughout this article, institutional change is made possible by changing external conditions—in this case, by an increase in the opportunity costs of immobilizing blockholdings given the liberalization and growth of financial markets. Such a change in turn leads actors to start questioning the viability of existing institutions. However, this questioning is only the beginning of

⁸⁰ Cf. Martin Höpner and Gregory Jackson, “An Emerging Market for Corporate Control? The Mannesmann Takeover and German Corporate Governance,” *MPIfG Working Paper* 01/4 (Cologne, 2001).

⁸¹ *Ibid.*, 25.

the process, not the end. While some change in material conditions clearly drives institutional change, we currently do not understand why many changes in material conditions do *not* lead to institutional change.⁸² The mechanism of joint belief shift highlights that the behavior of central social actors is a large determinant of whether institutions adjust marginally or instead shift dramatically after an exogenous shock.

The joint belief shift mechanism generates distinctive expectations about the process of institutional breakdown. Institutional breakdown takes the following form: a central actor sends a credible signal that it is deserting the status quo; this signal can lead other central actors to ratchet up their skepticism about their current cognitive models (or not), part of which involves watching how other actors are responding to the initial signal. This highly experimental stage involves actors puzzling over how the world works and how everybody else thinks the world works. Actors will try to use events—key occurrences whose import is symbolic rather than legally binding on the other actors—to agree that causal models underlying their interaction have indeed changed. Once this happens, institutions have broken down.

An examination of change in the institutions of corporate governance and finance in France, Germany, and Italy has facilitated a structured comparison of why, facing similar structural shifts, institutions sometimes change and sometimes do not. Patient capital in France broke down between 1997 and 2000, while the German and Italian institutions studied remained stable, despite regulatory changes in those countries. Formal legal change—which is what many political scientists emphasize in studies of institutions and institutional change⁸³—appears not to be a sufficient condition for change in the practice of holding patient capital. In each case the expectations of the joint belief mechanism were compared with those of the more parsimonious formal legal explanation, and in each case the evidence was most consistent with the joint belief shift mechanism. The finding that legal change of shareholder protections is not sufficient to engender changes in the ways in which large shareholders exercise control in national systems of capitalism significantly challenges current ways of measuring corporate governance. It undermines the influential claim in the law and economics literature that the real degree of minority shareholder protection is effectively operationalized through a classification of existing laws.⁸⁴ But if legal changes do not trigger real changes in the economy, construct-

⁸² North (fn. 5).

⁸³ Helmke and Levitsky (fn. 6).

⁸⁴ LaPorta et al. (fn. 10); Pagano and Volpin (fn. 9).

ing legal indices is a seriously misleading way to classify the practice of minority shareholder protection.

The universe of cases in which we expect joint belief shift to be sufficient for institutional change comprises those in which the value of one actor's payoffs depends largely on the action of other actors. In those cases in which payoffs are not highly interdependent, the formal legal mechanism is sufficient to generate institutional change. One such case, in the area of industrial relations institutions, lies in the shift from coordinated to uncoordinated wage bargaining. Individual companies can shift their strategies immediately in response to a change in bargaining rules, because the rule change is itself sufficient to transform the bargaining relationship into a bilateral one between firm and worker. In finance, by contrast, the changing opportunity cost of holding other companies' capital depends largely on what those other companies decide to do with the capital they are holding. When the coordinative element of the payoff is high, legal changes will not be sufficient to trigger institutional change. The interdependent actors have to signal to each other whether they believe that the rule change has altered their understanding of how the world works.

As with all social scientific theory, the ultimate validity of this mechanism must be assessed against what it helps us understand about the world. In this case, what have we learned about the character of change and stability in contemporary capitalism? The period since 1990 was highly turbulent for institutions of corporate governance, given the phenomenal growth of equity markets in the advanced capitalist countries. It may be that, as Chou Enlai said of the French Revolution, it is too early to tell about the future of finance in Germany and Italy. If the expectations generated by the joint belief shift mechanism are valid, though, we should *not* expect change to occur in the German financial system through an unraveling of blockholdings by companies at the periphery of the German corporate network. A credible signal of desertion—the kind that can trigger actors collectively to revise their understanding of how the world works—seems likely to come only from the heart of the corporate network. The creation of seismic shifts requires events to which many key actors can attribute symbolic importance. This was the power of the signal sent by AXA in France. It is from such disruptive events, and not from formal legal change alone, that joint belief shift is likely to take place and change long-standing behavioral patterns.