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Institutional Investors in French and German Corporate Governance: The Transformation of Corporate Governance and the Stability of Coordination

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Abstract

This paper examines the transformation of the system of corporate governance of France and Germany from the mid-1990s to early 2007. I focus on the rise of foreign ownership as a key indicator of shifts in corporate governance. The empirical data presented in this paper on the investment portfolios of short-term institutional investors, namely actively managed mutual funds, shows a marked preference for the French market over that of Germany. The case of American and British-based hedge funds serves as a supporting comparative case study. I argue that the firm-level institutional arrangements of workplace organization constitute the most significant variable to account for this difference – the concentration of power in top executives in France fitting better with the preferences and investment strategies of short-term oriented institutional investors. I do not want to suggest that the institutional characteristics of workplace organization constitute the only investment driver of actively managed mutual funds. I also analyze the shortcomings of three alternative co-varying explanations – degree of internationalization, ownership structure of companies, and background of corporate executives. I demonstrate how key notions of the Varieties of Capitalism theoretical perspective – institutional interaction, institutional latency, and the distinction between institutional framework and the mode of coordination that follows from these institutions – provide important theoretical insights to assess the implications of causal complexity phenomenon. In particular, this mid-range level theoretical perspective illuminates how necessary and/or sufficient conditions operate and vary across advanced capitalist economies.

Introduction [1]

This paper examines the transformation of the system of corporate governance in France and Germany from the mid-1990s to early 2007, a period of tremendous change in European finance. The topic of corporate governance – the system by which firms are controlled and operated, the rules and practices that govern the relationship between managers and shareholders, and the overall process by which investment capital is allocated -- has become an important issue for policy makers and scholars in recent years in the wake of financial scandals in Europe and in the United States.[2] The increasing importance of corporate governance in Europe, however, goes beyond the advent of recent acts of corporate malfeasance. It reflects the importance of critical trends with serious political implications for advanced European capitalist economies.[3] Tremendous changes have pushed these systems toward the adoption of greater shareholder value in the strategy of companies in recent years.[4] Will the globalization of finance and investment lead to convergence across European systems of corporate governance along the lines of the American model?

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[1]Paper presented at the 2006 meeting of the Council of Europeanists Conference, Chicago. I wish to thank Suzanne Berger, Frieda Fuchs, Peter Gourevitch, Peter Hall, Bob Hancké, Martin Hoepner, Andy Martin, and David Soskice for their comments. Interviews with fund managers at Fidelity and State Street were highly insightful. The usual disclaimer applies.

[2]Good overviews of the causes and dynamics of recent corporate scandals in Europe and the United States are explored in John Coffee, "Understanding Enron: It's About the Gatekeepers, Stupid," *Business Lawyer* 57, 4 (August 2002): 1403-20; and John Coffee, "A Theory of Corporate Scandals: Why the USA and Europe Differ," *Oxford Review of Economic Policy* 21,2 (Summer 2005): 198-211.

[3]Excellent analyses of the political dimensions of the transformation of national systems of corporate governance are Peter Gourevitch and James Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance* (Princeton: Princeton University Press, 2005); and Mark Roe, "Political Preconditions to Separating Ownership from Corporate Control," *Stanford Law Review* 53,3 (December 2000): 539-606.

[4]For comprehensive overviews of the rise of shareholder value practices in France and Germany, see Jurgen Beyer and Anke Hassel, "The Effects of Convergence: Internationalization and the Changing Distribution of Net Value Added in Large German Firms," *Economy and Society* 31,3 (August 2002): 309-332; Ben Clift, "Debating the Restructuring of French Capitalism and Anglo-Saxon Institutional Investors: Trojan Horses or Sleeping Partners?" *French Politics* 2,3 (December 2004): 333-46; Ben Clift, "French Corporate Governance in the New Global Economy: Mechanisms of Change and Hybridization within Models of Capitalism," forthcoming in *Political Studies* (2007); Richard Deeg, "The Comeback of Modell Deutschland?" *German Politics* 14,3 (September 2005): 332-53; Peer Fiss and Edward Zajac, "The Diffusion of Ideas over Contested Terrain: The (Non) Adoption of a Shareholder Value Orientation among German Firms," *Administrative Science Quarterly* 49,4 (December 2004): 501-534; Michel Goyer, "The Transformation of Corporate Governance in France," in Pepper Culpepper, Peter Hall, and Bruno Palier, eds., *Changing France: The Politics that Markets Make* (London: Palgrave Macmillan, 2006); Martin Hoepner, "Corporate Governance in Transition: Ten Empirical Findings on Shareholder Value and Industrial Relations in Germany," Discussion Paper #01/5 (Cologne: Max Planck Institute, 2001); Gregory Jackson, "Corporate Governance in Germany and Japan: Liberalization Pressures and Responses during the 1990s," in Kozo Yamamura and Wolfgang Streeck, eds., *The End of Diversity? Prospects for German and Japanese Capitalism* (Ithaca NY: Cornell University Press, 2003); Mary O'Sullivan, Contests for Corporate Control: *Corporate Governance and Economic Performance in the United States and Ger-*

The research question of this paper on France and Germany is two-pronged: to account for the different patterns of transformation of the two systems of corporate governance, and to assess its implications for their respective national models of capitalism. I focus on the rise of short-term foreign ownership as a key indicator of shifts in corporate governance. The empirical question of this paper revolves around the greater attractiveness of French firms over their German counterparts to short-term, impatient investors. Actively managed mutual funds, a prominent category of institutional investors with short-term trading strategies, were about twice as likely to invest in France than in Germany on the basis of several indicators between 1997 and early 2007.[5] The investment gap took place in a context where Germany has been the world's largest exporter of goods for the last four years despite poor macroeconomic performance at home.[6]

France and Germany constitute ideal candidates to assess the causes and effects of the development of financial markets and the arrival of impatient Anglo-American institutional investors as major shareholders of domestic companies. They are characterized by the extensive deregulation of their financial systems, the removal of barriers on capital mobility, European Union membership and their participation in the EMU, and their active involvement in M&A activities in the United Kingdom and the United States. Moreover, state officials in the two countries have been very public in their criticism of the demands made by Anglo-American institutional investors on domestic companies as shareholder value has come to be associated with layoffs and short-term thinking that privileges the next quarter's financial results over the long-term competitiveness and social responsibility of the firm. The exclusion of foreign buyers for Aventis, the large French pharmaceutical firm, and the depiction of Anglo-American institutional investors as "locusts" by Franz Münterfering, the former German Social Democratic Party Chairman, in the wake of the forced resignation of the CEO of Deutsche Börse, represent striking examples of the rather hostile reception to this new American export.

Two critical methodological considerations serve as motivation for the research question of this paper. First, how does one assess the advent of institutional change in corporate governance? As Campbell (2004) reminds us, we often mistake evolutionary shifts for more revolutionary developments and vice versa.[7] The absence of an analytical framework to distinguish between patterns of institutional change leaves us powerless to distinguish between them and to understand their consequences. Changes in corporate governance might be a more recent development in continental Europe, but advanced capitalist economies underwent substantial institutional change in many areas in

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many (New York: Oxford University Press, 2000); Sigurt Vitols, "Negotiated Shareholder Value: The German Variant of an Anglo-American Practice," *Competition and Change* 8,4 (December 2004): 357-374; and Nicholas Ziegler, "Corporate Governance and the Politics of Property Rights in Germany," *Politics and Society* 28,2 (June 2000): 195-221.

[5]The corresponding ratio for American and British-based hedge funds, another category of short-term oriented institutional investors, was 1.6 to 1 in favor of the French market on the basis of publicly available information (see tables A and B of annex 1).

[6]Mark Landler, "Germany's Export-Led Economy Finds Global Niche," *New York Times,* April 13, 2007.

[7]John Campbell, *Institutional Change and Globalization* (Princeton: Princeton University Press, 2004).

the last twenty-five years without resulting in either internally revolutionary transformation or in cross-national convergence.[8] Second, the current interest in accounting for institutional change is understandable given the predominant consensus that institutions do matter for economic, political, and social outcomes.[9] The design of institutional frameworks is seen by scholars and policymakers as the key variable for important public policy issues.

What accounts for the greater propensity of short-term oriented, actively managed mutual funds to invest in the French market as compared to that of Germany? The argument presented in this paper is the following. First, I draw on notions of the institutionally based Varieties of Capitalism (VoC) theoretical perspective to understand both institutional transformation and the maintenance of differences between contemporary capitalist economies. The VoC perspective emphasizes the critical importance of patterns of institutional complementarities across the various sub-spheres (finance and corporate governance, industrial relations, innovation system, inter-firm relations) of the economy that lead to diverging forms of behavior on the part of economic actors. The key insight is that the impact of institutional change cannot be studied in isolation as the effects of new developments are mediated by their interaction with other features of the national institutional framework, therefore implying that different types of institutional fit are possible.[10] In other words, national institutional frameworks engender interaction effects that shape in different ways the behavior of economic actors according to the particular combination of institutions found in the national setting. The outcome is that advanced capitalist economies are distinguished by their specific configuration of interdependent institutions.[11] These national institutional configurations of interlocking and interdependent institutions reinforce each other, thereby often proving resistant to change.[12] Finally, the VoC perspective contends that superior economic performance and the de-

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[8]The case for divergence is best asserted in Suzanne Berger, "Introduction," in Suzanne Berger and Ronald Dore, eds., *National Diversity and Global Capitalism* (Ithaca NY: Cornell University Press, 1996); Suzanne Berger, *How We Compete: What Companies Around the World Are Doing to Make It in Today's Global Economy* (New York: Doubleday 2005); and Peter Hall and David Soskice, "An Introduction to Varieties of Capitalism," in Peter Hall and David Soskice, eds., *Varieties of Capitalism: The Institutional Foundations of Comparative Advantage* (New York: Oxford University Press, 2001).

[9]See John Campbell, *Institutional Change and Globalization*, pp. 1-9; and Douglass North, *Understanding The Process of Economic Change* (Princeton: Princeton University Press, 2005).

[10]The classic statement on the Varieties of Capitalism theoretical perspective is Peter Hall and David Soskice, "Introduction: Varieties of Capitalism," pp. 1-71.

[11]Hall and Soskice (2001) identify two dominant clusters of interdependent institutions: liberal market economies (LME) and coordinated market economies (CME). These two clusters constitute different ways to solve coordination problems faced by firms – market instruments being predominant in the former while a greater range of institutional arrangements such as peak associations, network monitoring based on the exchange of private information, and relational contracting constitute the hallmarks of adjustment processes for the latter.

[12]Insightful analyses of the durability effects of institutional frameworks and patterns of institutional complementarities are Paul Milgrom and John Roberts, "Complementarities and Systems: Understanding Japanese Economic Organization," *Estudios Economicos* 9,1 (January-June 1994): 3-42; and David Soskice, Robert Bates and David Epstein, "Ambition and Constraint: The Stabilizing Role of Institutions," *Journal of Law and Economic Organization* 8,3 (October 1992): 547-60.

velopment of competitive advantage result from the extent to which patterns of institutional complementarity support the development of firm competencies.[13] In other words, each institutional feature fits with the others and makes them more effective than they would be on their own. The notion of competitive advantage is institutionally based as firm performance lies in the achievement of a proper fit between their organizational features and the requirements associated with specific market niches. The presence of institutional complementarity constitutes a source of economic efficiency as it contributes to solve coordination problems since the actions a firm takes in one sphere of the economy is contingent on the action of others in different spheres.[14] As a result, different patterns of institutional fit across nations should be good at excelling at different types of activities, thereby leading to different types of specialization.[15]

Second, I argue that the firm-level institutional arrangements of workplace organization constitute the most significant variable to account for the diverging ability of French and German firms to attract funds from actively managed mutual funds and, on the basis of publicly available information, hedge funds. There are many other reasons why these two categories of institutional investors proceed to invest in a single company – the two most prominent being macroeconomic conditions and the ownership structure with its associated set of legal rights for minority investors – but none of these alternative explanations can satisfactorily account for the disparity in their investment portfolios in the two countries. Actively managed mutual funds and hedge funds possess short-term investment strategies and time horizons. They also exhibit firm-specific preferences since the performance of their portfolio is shaped by the behavior of a smaller number of companies than it is the case for passively managed mutual funds and pension funds who primarily seek diversification through an index-based investment strategy. The argument presented in this paper stresses the importance of portfolio companies implementing shareholder value strategies of corporate restructuring that generate corporate earnings within a rather specific time frame. The degree of fit between the preferences of short-term oriented, actively managed mutual funds (and hedge funds) and the firm-level institutional arrangements of advanced capitalist economies reflects the ability of the CEO and top managers to reorganize the workplace in a unilateral fashion. The institutionally embedded corporate decision-making process in France, which is management-led and excludes the workforce, provides for a great match. French firm-level institutions are characterized by the concentration of power in the CEO that, in turn, allows for a rapid reorganization of the workplace under the guidance of a small num-

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[13]See Peter Hall and Daniel Gingerich, "Varieties of Capitalism and Institutional Complementarities in the Macroeconomy: An Empirical Analysis," Discussion Paper #04/5 (2004), Max Planck Institute, Cologne; and David Soskice, "Divergent Production Regimes: Coordinated and Uncoordinated Market Economies in the 1980s and 1990s," in H. Kitschelt, P. Lange, G. Marks, and J. Stephens, eds., *Continuity and Change in Contemporary Capitalism* (New York: Cambridge University Press, 1999).

[14]An excellent analysis of the problem of economic coordination in regard to the question of training is Pepper Culpepper, *Creating Cooperation: How States Develop Human Capital in Europe* (Ithaca NY: Cornell University Press, 2003).

[15]Peter Hall and David Soskice, "Introduction: Varieties of Capitalism," pp. 36-44.

ber of corporate officials.[16] The strategies and preferences of actively managed mutual funds and of hedge funds, in contrast, do not fit as well with the firm-level institutions found in Germany. Firm-level institutions impose several constraints on the ability of management to develop and implement strategies in a unilateral fashion. Several institutional and legal obstacles stand in the way of a rapid and unilateral reorganization of the shop floor. Adjustments to external pressures in Germany are the result of negotiation between management and employees.[17] Large companies in these two countries have proceeded to adjust to changes in capital and product markets, but in different ways. As a result, actively managed mutual funds and hedge funds – two categories of short-term, impatient capital – displayed a marked preference for France over Germany as an investment site.

The implication of the above argument is that an assessment of the consequences associated with the rise of foreign ownership and the growth of securities markets in France and Germany requires a sophisticated differentiation between investors. The rise of foreign ownership in the form of institutional investors pushing for a greater shareholder value orientation cannot by itself constitute a radical transformation of European corporate governance. I distinguish primarily between pension funds, index-based/ passively managed mutual funds, actively managed mutual funds, and hedge funds. Pension funds constitute long-term investors which acquire an equity stake in corporations primarily for diversification purposes; index-based mutual funds represent a category of medium to long-term investor whose investment managers aim at producing a return that matches that of a benchmark index; actively managed mutual funds represent a category of short-term oriented investors that seek to maximize assets under their management as they possess a shorter term horizon and operate under competitive pressures to beat market benchmarks; hedge funds are mostly unregulated, short-term oriented institutional investors that at achieving absolute returns on managed funds trough a variety of techniques not available to other categories of investors. The importance of this distinction between different types of investors is primarily driven by its implication for the mode of coordination of firms. As Hall and Soskice (2001) have argued, access to patient capital constitutes a key feature of coordinated market economies, as opposed to liberal market economies that rely on short-term, impatient capital. The investment strategies and time horizons of actively managed mutual funds/hedge funds and index-based mutual funds/pension funds have different implications for the sustainability of national models of European capitalism

[16]Excellent analyses of patterns of adjustment in French firms are Bob Hancké, *Large Firms and Industrial Adjustment: Industrial Renewal and Economic Restructuring in France* (New York: Oxford University Press, 2002); and Vivien Schmidt, *From State to the Market? The Transformation of French Business under Mitterrand* (New York: Cambridge University Press, 1996). For the more specific case of corporate governance, see Antoine Rebérioux, "European Style of Corporate Governance at the Crossroads: The Role of Worker Involvement," *Journal of Common Market Studies* 40,1 (March 2002): 111-34.

[17]The key readings on the negotiated process of firm-level adjustment in Germany are Wolfgang Streeck, *Social Institutions and Economic Performance* (London: Sage Publications, 1992) and Kathleen Thelen, *Unions of Parts: Labor Politics in Postwar Germany* (Ithaca NY: Cornell University Press, 1991).

Third, I argue that the institutionally-based VoC is best conceptualized as a middle range theory whereby differences in institutional frameworks across advanced capitalist economies shape what is a necessary/sufficient condition in a specific setting. The analysis of the investment strategies of institutional investors in France and Germany constitutes an ideal testing ground for the issue of complexity in qualitative methods. It is highly revealing of the nature of causation in social sciences. This study faces the typical problem of the comparison of observed cases limited in both their diversity and in relation to the number of potential explanatory variables. Moreover, many of the variables relevant to the research question of this paper potentially co-vary, thereby heightening the difficulties associated with the process of logical inference. I compare the VoC perspective with two alternative explanations – namely the degree of internationalization of companies and the ownership structure of portfolio companies.

Firm-level institutional arrangements of work organization account for the greater attractiveness of France over Germany, but do not constitute the sole factor driving the investment strategies of mutual funds – consistent with the Hall and Soskice (2001) stressing of the central position of (institutional) structure in conditioning the strategy of actors, but not in fully determining it.[18] The Varieties of Capitalism theoretical perspective illuminates how necessary and/or sufficient conditions vary across the advanced capitalist economies. The evidence presented is that the presence of co-variation in the French case does not travel to the German case. The presence of high degrees of internationalization of firms and the dispersion of ownership constitute co-varying features for the investment portfolio of actively managed mutual funds in France, but not in Germany. The intuitional arrangements of workplace organization in Germany act as a "missing" variable.

The VoC theoretical perspective, however, has come under attack in recent years. The broad line of criticism is that the tools developed by comparative political economists in the last twenty years have provided us with a better understanding of institutional resiliency, but have not been as helpful in accounting for institutional transformation.[19] The theoretical insights of the concept might be quite useful in accounting for stability, but they are far too static to account for institutional discontinuity. This theoretical challenge to the VoC perspective is comprised of several elements. First, processes of incremental and continual institutional change can lead to significant discontinuity without requiring dramatic disruptions.[20] Rather than radical change breaking current patterns of institutional complementarity and reshaping the preferences of actors, the process of

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[18]Hall and Soskice, "An Introduction to Varieties of Capitalism," p. 15.

[19]The broadest theoretical critiques of the Varieties of Capitalism perspective are Colin Crouch, *Capitalist Diversity and Change: Recombinant Governance and Institutional Entrepreneurs* (New York: Oxford University Press, 2005); Chris Howell, "Varieties of Capitalism: And Then There Was One?" *Comparative Politics* 36,1 (October 2003): 103-24; and Glenn Morgan, "Institutional Complementarities, Path Dependency, and the Dynamics of Firm," in Glenn Morgan, Richard Whitley, and Eli Moen, eds., *Changing Capitalisms? Internationalization, Institutional Change, and Systems of Economic Organization* (New York: Oxford University Press, 2005).

[20]The thesis of significant transformation via incremental processes of change is best provided in Wolfgang Streeck and Kathleen Thelen, "Introduction: Institutional Change in Advanced Political Economies," in Wolfgang Streeck and Kathleen Thelen, eds., *Beyond Continuity: Institutional Change in Advanced Political Economies* (New York: Oxford University Press, 2005).

institutional transformation often results from ongoing and accumulating dynamics that involve small adjustments. Thus, institutional transformation frequently is an evolutionary process that unfolds in an incremental manner and without major disruptions over long periods of time, resulting in profound change.[21] Second, and related to the previous line of criticism, the transformation of the dynamics found in capitalist societies can take place without formal institutional change. A process of functional conversion, whereby institutions are redirected to new purposes, can occur in the presence of formal institutional stability.[22] In other words, the practices associated with an institution can change without a similar transformation in its formal structure. Major changes in institutional practices are coupled with stability in institutional structures.[23] The implication of the mechanism of functional conversion is that the link between institutional form and firm behavior is less tight than originally conceived in VoC.[24] Third, the environment faced by firms is increasingly characterized by the presence of institutional hybridization, with the consequence that advanced capitalist economies might no longer fit neatly into a single model. This process of hybridization can result from firms borrowing from the features of different models, as the process of institutional adoption tends to be piecemeal rather than full-scale.[25] Fourth, the sustainability of institutional frameworks can-

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[21]This theoretical perspective of institutional change constitutes an explicit criticism of punctuated equilibrium models whereby prolonged periods of institutional stability are interrupted suddenly by critical exogenous shocks that result in a conflictual period of transition until a new pattern of institutional complementarity is established, thereby resulting in a new stable equilibrium.

[22]See Ronald Gilson, "Globalizing Corporate Governance: Convergence of Form or Function," *American Journal of Comparative Law* 49, 2 (spring 2003): 329-57; and Kathleen Thelen, "How Institutions Evolve: Insights from Comparative Historical Analysis," in James Mahoney and Dietrich Rueschemeyer, eds., *Comparative Historical Analysis in the Social Sciences* (New York: Cambridge University Press, 2003).

[23]An example of this process of function conversion is the evolution of industrial relations in Germany. First, the institutions of labor representation have changed in relative importance while conserving their original form. The increasing volatility of markets and the need to adjust quickly has increased the prominence of firm-level works councils and reduced the importance of national unions – under a stable institutional framework. Second, the institutions of Codetermination have experienced a substantial change in their function and activities despite the stability of their institutional forms. From being an element of the postwar social democratic consensus, the institutions of Codetermination are increasingly serving as a mechanism for maintaining the ability of firms to succeed in areas of incremental innovation as well as to facilitate adjustment in light of new capital market pressures. See Gregory Jackson, 2005, "Contested Boundaries: Ambiguity and Creativity in the Evolution of German Codetermination," in Wolfgang Streeck and Kathleen Thelen, eds., *Beyond Continuity: Institutional Change in Advanced Political Economies* (New York: Oxford University Press, 2005); and Kathleen Thelen, *Union of Parts: Labor Politics in Postwar Germany*.

[24]For an insightful account of loosely coupled institutional arrangements, see Michael Mayer and Richard Whittington, "Strategy, Structure and 'Systemness': National Institutions and Corporate Change in France, Germany and the UK, 1950-1993," *Organization Studies* 20,6 (November 1999): 933-959.

[25]On the concept of hybridization, see Jan Nederveen Pieterse, "Globalization as Hybridization," in Mike Featherstone, Scott Lash, and Roland Robertson, eds., *Global Modernities* (London: Sage Publications, 1995); and Marino Regini, "Between Deregulation and Social Pacts: The Responses of European Economies to Globalization," *Politics and Society* 28,1 (March 2000): 5-33.

not be assumed to occur in an automatic fashion simply because it is economically efficient. Instead, it requires active maintenance by actors in order for institutions to adapt to environmental changes.[26] Institutions are often born of historical struggles in which actors fight over the design and content of institutions, but dominant social groups are likely to influence the building of one set of institutions located in the issue area in which they are located rather than trying to shape all of the institutions in a given framework.[27] These four lines of criticism constitute a serious challenge. If the VoC perspective's ability to explain institutional change is less successful than its account of divergence, its theoretical contribution would be seriously weakened.

What does my analysis of the investment patterns of institutional investors in France and Germany entail for the VoC theoretical perspective? The argument presented in this paper testifies to the importance of national institutional frameworks and of the theoretical insights of the VoC perspective for the study of institutional change. First, the features of existing institutional arrangements exert tremendous influence on the transformation of corporate governance in France and Germany. Domestic institutions interact to complement each other and consequently cannot be studied in isolation regardless of whether one is analyzing the presence of stability or the occurrence of change in the broader institutional framework. The effects of a single institutional variable vary according to the presence of other institutions in the economy.[28] This is particularly true since institutional change is almost invariably piecemeal rather than full-scale, thereby highlighting the importance of the interaction between the new institutions and those already in place. I recognize that processes of institutional conversion and hybridization can, and do, occur. Nonetheless, their occurrence still requires an argument to assess whether institutional conversion or hybridization constitutes a revolutionary or evolutionary transformation. The notion of interaction among the various elements of an institutional framework represents a highly helpful indicator to assess the consequences associated with the process of institutional transformation. The importance of institutional interaction for the Varieties of Capitalism theoretical perspective enables it to provide significant insights for causal complexity phenomenon, the outcome of a given variable

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[26]See Richard Deeg, "Change from Within: German and Italian Finance in the 1990s," in Wolfgang Streeck and Kathleen Thelen, eds., *Beyond Continuity: Institutional Change in Advanced Political Economies* (New York: Oxford University Press, 2005).

[27]Bruno Amable, *The Diversity of Modern Capitalism* (New York: Oxford University Press, 2003), pp. 66-73. Instances of this piecemeal institutional focus by interest groups are numerous. For example, trade unions are more likely to care about institutions related to labor-market policies and wage bargaining than those related to the ownership structure of companies and the legal rights of shareholders, despite the interactive complementarity between industrial relations and corporate governance. This focus on specific institutions results from the fact that actors do not possess a perfect vision of all of the interdependencies between institutions. See also Martin Hoepner, "What Connects Industrial Relations and Corporate Governance? Explaining Institutional Complementarity," *Socio-Economic Review* 33,2 (May 2005): 331-57.

[28]This argument is best developed in Peter Hall, "Central Bank Independence and Coordinated Wage Bargaining: Their Interaction in Germany," *German Politics and Society* 31 (Spring 1994): 1-23; and Peter Hall and Robert Franzese, "Mixed Signals: Central Bank Independence, Coordinated Wage Bargaining, and European Monetary Union," *International Organization* 52,3 (Summer 1998): 505-35.

being driven by several factors. It highlights the perils associated with piecemeal institutional reforms given that the impact of a single institution depends on the configuration of other institutions within that setting.

Secondly, institutions are characterized by an element of latency, their effects and importance changing over time. In the case of France, for example, the firm-level institutional arrangements that are (currently) proving highly attractive for short-term, impatient capital cannot be held solely responsible for the inability of companies to access long-term finance since they have been largely stable over the last three decades. The present attractiveness of firms to short-term, impatient investors is a recent phenomenon but the institutionally-based concentration of power in the CEO is not something new. Prior to the mid-1990s, the CEO's power correlated with the provision of long-term, patient capital in the form of bank loans since policymakers impeded the development of direct (bonds and stocks) finance, fixed interest rates at low levels, and implemented preferential credit policies.[29] The concentration of power in French firms, as embodied in the institutional arrangements of workplace organization, came to be conducive to short-term capital in the second half of the 1990s because of the deregulation of the banking system and the decision of long-term domestic shareholders to sell their holdings – as well as the advent of the international strategy of institutional investors. International shifts came to have a substantial impact after internal changes in corporate governance.

Finally, and perhaps most importantly, I highlight in this paper the need to distinguish between institutions and the mode of coordination which follows from these institutions.[30] I argue that the divergent patterns of investment of institutional investors are deeply influenced by differences in firm-level institutional arrangements of workplace organization reflecting the power structure of French and German companies. But power concentration (diffusion) has been a stable feature of French (German) firms at the same time as tremendous changes in several institutional spheres took place. It is important to note that while institutions have undergone tremendous change in the two countries, the effects of this change on a key aspect of the mode of coordination of large blue-chip firms in the two countries have been marginal. [31] In particular, the process by which large French and German firms develop and sustain their innovative capabilities

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[29]See Michael Loriaux, *France After Hegemony: International Change and Financial Reform* (Ithaca NY: Cornell University Press, 1991) and John Zysman, *Governments, Markets, and Growth*: *Financial Systems and the Politics of Industrial Change* (Ithaca NY: Cornell University Press, 1983), pp. 99-169, for historical analyses of the French financial system.

[30]The original thesis is Peter Hall and Kathleen Thelen, "Institutional Change and the Varieties of Capitalism," paper presented at the APSA annual meeting, September 1-4, 2005, Washington DC.

[31]A good example of this dichotomy between coordination and institutional change is the transfer of Japanese methods of production (just-in-time, teamwork) in France and Germany in the last twenty years. In France, the introduction of such methods served as an additional means of control for management as well as constituting a source of added productivity. In Germany, the same organizational change strengthened the position of the *Meister* and the central role of training in the production process. See Peter Doeringer, Edward Lorenz, and David Terkla, "The Adoption and Diffusion of High-Performance Management: Lessons from Japanese Multinationals in the West," *Cambridge Journal of Economics* 27,2 (March 2003): 265-86; and Mari Sako, "Training, Productivity and Quality Control in Japanese Multinational Companies," in Masahiko Aoki and Ronald Dore, eds., *The Japanese Firm* (New York: Oxford University Press, 1996).

has remained largely unchanged despite important changes in corporate governance.[32] The coordination of activities in French firms is characterized by the vesting of unilateral authority in top managers and senior technical staff. The bulk of the workforce does not contribute to the development of the organizational capabilities of the firm.[33] In the coordination of activities in German companies, by contrast, authority is shared with the bulk of the workforce to a high degree. The development of innovative capabilities takes place on the basis of the long-term contribution of skilled employees through institutionalized career paths.[34] This stark divergence in the development of innovative capabilities remains stable despite impressive changes in both corporate governance and industrial relations. Thus, the presence of institutional hybridization and the occurrence of functional conversion are not sufficient to conclude that countries and firms are experiencing revolutionary developments that will undermine their nationally specific capacities for strategic coordination.

The roadmap for this paper is the following. First, I provide an overview of the changes in the external financial environment in which French and German companies are embedded. Second, I empirically analyze the transformation of these two systems of corporate governance by highlighting the differences in the nature of foreign capital attracted by domestic companies in the two countries. Third, I highlight the critical importance of the institutions of workplace organization to account for the direction of change of corporate governance. Fourth, I review alternative potential explanations for the investment patterns of actively managed mutual funds (and hedge funds) in France and Germany. I analyze the potential theoretical insights provided by macroeconomic oriented views of capital flows, the influence of the ownership structure of listed firms and their associated nationally-based legal arrangements of shareholder protection, and the educational background and career patterns of top executives on the decision making of investment allocation of actively managed mutual funds and of hedge funds. Without rejecting the importance of these three perspectives, I nevertheless conclude that they do not provide as much insight for understanding the diversity of investments by actively managed mutual funds and, on the basis of publicly available information, of hedge funds in France and Germany as compared to a Varieties of Capitalism institutionally-

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[32]For an analysis of the continuing differences in the processes by which institutions of workplace organization enable large firms to develop their innovative capabilities in France and Germany, compare David Marsden, A *Theory of Employment Systems* (New York: Oxford University Press 1999); Marc Maurice, Francois Sellier, and Jean-Jacques Silvestre, *The Social Foundations of Industrial Power: A Comparison of France and Germany* (Cambridge MA: MIT Press, 1986); Arndt Sorge, *The Global and the Local: Understanding the Dialectics of Business Systems* (New York: Oxford University Press, 2005); and Richard Whitley, "The Institutional Structuring of Organizational Capabilities: The Role of Authority Sharing and Organizational Careers," *Organization Studies* 24,5 (June 2003): 667-95.

[33]See Robert Boyer, "Wage Austerity and/or an Education Push: The French Dilemma," *Labour* 9 (special issue 1995): 19-65; and Pepper Culpepper, "Individual Choice, Collective Action, and the Problem of Training Reform: Insights from France and Eastern Germany," in Pepper Culpepper and David Finegold, eds., *The German Skills Machine: Comparative Perspectives on Systems of Education and Training* (New York: Berghahn Books, 1998).

[34]See Arndt Sorge, *The Global and the Local: Understanding the Dialectics of Business Systems*, chapter 5; and Richard Whitley, "The Institutional Structuring of Organizational Capabilities: The Role of Authority Sharing and Organizational Careers," pp. 667-95.

inspired perspective on workplace organization. I rely on the logic of necessary conditions to discriminate between theoretical perspectives while acknowledging that the investment strategies of actively managed mutual funds (and hedge funds) represent a causally complex phenomenon. Fifth, I conclude by presenting the theoretical implications for the analysis of institutional change that emerges from the study of French and German corporate governance.

I. Structural Changes in European Finance

The French and German systems of corporate governance have experienced an important transformation resulting from a series of cumulatively externally-based and far-reaching changes. These developments have decreased the importance of debt finance as a source of external finance and have heightened the importance of stock markets for domestic firms. Three features previously characterized the two systems of corporate governance. First, corporations had a high debt-equity ratio, i.e., bank loans were more important than stock issues as a source of external finance.[35] Product market share was often more important for managers than the stock market capitalization of companies. Second, the ownership structure of blue-chip companies was highly concentrated in the hands of friendly cross-shareholdings among companies, a large owner in the form of a family firm, banks' direct share and proxy voting in Germany, and extensive public sector in the French case.[36] Third, as a result of the previous factors, the market for corporate control was fairly restricted.[37] In particular, hostile takeovers were a rarity.

The bank-based financial system of corporate governance of the two countries crumbled under the impact of several factors. First, their financial systems underwent a massive process of deregulation: the use of credit ceilings as a means of controlling inflation has been replaced by the discipline of central bank independence and of high real interest rates, capital controls have been removed under pressure from the EMS and the suspension of the dollar's convertibility into gold, and access to the bond market has been deregulated.[38] Moreover, the liberalization of financial markets has created an environment that not only raised interest rates as banks were forced to compete for deposits with new competitors, but also removed the impediments on the developments of direct finance that led to the introduction of new financial instruments for raising capital.

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[35]John Zysman, *Governments, Markets, and Growth*: *Financial Systems and the Politics of Industrial Change*, pp. 69-75.
[36]See Jeremy Edwards and Klaus Fisher, *Banks, Finance and Investment in Germany* (New York: Cambridge University Press, 1994); and François Morin, *La Structure Financière du Capitalisme Français* (Paris: Calmann-Lévy, 1974).
[37]Julian Franks and Colin Mayer, "Corporate Ownership and Control in the U.K. Germany, and France," *Journal of Applied Corporate Finance* 9, 4 (Winter 1997): 30-45.
[38]See John Goodman, "Monetary Policy and Financial Deregulation in France," *French Politics and Society* 10,4 (Fall 1992): 31-40; Michael Loriaux, *France After Hegemony: International Change and Financial Reform*; John Goodman and Louis Pauly, "The Obsolescence of Capital Controls? Economic Management in an Age of Global Markets," *World Politics* 46,1 (October 1993): 50-82; and Jonathan Story, "Finanzplatz Deutschland: National or European Response to Internationalization?" *German Politics* 5, 3 (December 1996): 371-94.

Second, the transformation of corporate governance in France and Germany is the result of developments that have raised the importance of equity capital. Three key factors account for the rise in importance of the stock market capitalization of firms. In the first place, the removal of capital controls by European policymakers enabled investors to pursue a strategy of international diversification of their assets. The assets managed by American pension funds experienced substantial growth, from $868 billion in 1980 to $7.87 trillion in 2001.[39] Moreover, a significant segment of this growth has been allocated to international equities – the average percentage of total assets held in international stocks by the twenty-five largest American pension funds increased from 7.7 percent in 1993 to 17.5 percent in 2000.[40] The assets managed by hedge funds experienced a significant increase from an estimated $38.9 billion in 1990 to nearly US$ 1 trillion by mid-2006.[41] The most important category of institutional investor, however, remains mutual funds. The assets under their management grew from $150 billion in 1980 to a little over $8 trillion in late 2005.[42] The resulting impact of these developments on the strategy of large companies should not be underestimated. Anglo-Saxon institutional investors have expressed clear preferences for the adoption of shareholder value practices that maximize return on equity. Moreover, the rise of foreign ownership often came at the expense of domestic cross-shareholdings among large domestic firms as patterns of cross-shareholdings – especially in the French case – collapsed in the late 1990s.[43]

Another development that has increased the importance of securities markets is the changing conditions associated with the successful completion of a takeover bid in the United States in the last decade. The importance of equity swap, whereby companies issue additional stocks to pay for the shares of the target firm, has increased dramatically. In 1988, nearly 60 percent of the total value of deals over $100 million in the United States was paid for entirely in cash. The similar figure for deals paid in stock was less than 2 percent. By contrast, about half of the value of large deals in 1998 was paid entirely in stock – and 17 percent was solely financed in cash.[44] What is the significance of the changing characteristics of takeover activity in the United States on the transformation of European systems of corporate governance? The importance of takeover activity in the United States for European corporate governance is intimately related to the process by which firms build their innovative capabilities. Large French and German firms are

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[39]Conference Board, "Financial Assets and Equity Holdings: Patterns of Institutional Investment and Control," *Institutional Investment Report* 5,1 (March 2003): 37, p. 14.
[40]Conference Board, "Equity Ownership and Investment Strategies of US and International Institutional Investors," *Institutional Investment Report* 4, 2-3 (May 2002): 1-45, pp. 41-42.
[41]William Fung and David Hsieh, "Hedge Fund Replication Strategies: Implications for Investors and Regulators," *Financial Stability Review* 10 (April 2007): 55-66, p. 56; Filippo Stefanini, Investment Strategies of Hedge Funds (Hoboken NJ: John Wiley & Sons, 2006), p. 4.
[42]Robert Radin and William Stevenson, "Comparing Mutual Fund Governance and Corporate Governance," *Corporate Governance* 14, 5 (September 2006): 367-376, p. 367.
[43]See Martin Hoepner and Lothar Krempel, "The Politics of the German Company Network," *Competition and Change* 8,4 (December 2004): 339-356; and François Morin and Eric Rigamonti, "Evolution et Structure de l'Actionnariat en France," *Revue Française de Gestion* 28,141 (November/December 2002) : 155-81.
[44]Alfred Rappaport and Mark Sirower, "Stock or Cash? The Trade-offs for Buyers and Sellers in Mergers and Acquisitions," *Harvard Business Review* 77,6 (November-December 1999): 147-58.

engaged in a process of institutional arbitrage.[45] They have sought to gain access to radical types of innovation through the acquisition of companies in the United States via takeovers. Firms with higher stock market capitalization possess a substantial advantage in the global merger marketplace in using equity swap as a means of payment.[46] The issue of additional stocks to pay for the shares of the target company is reserved for firms with substantially higher stock market capitalization. A concern for the valuation of the value of equity capital has become a necessary condition if French and German companies want to be able to acquire others.

A final important development in the environment of French and German firms is the proliferation of financial techniques and commercial valuation models through which corporate and managerial performance are disclosed and modeled: economic value added, cash flow return on investment and many others.[47] These newly created financial metrics are important since they allow for a comparison and ranking of performance. The ability to compare corporate performance does not entail that the French and Germans are now subject to the dictates of Anglo-American institutional investors. The influence of these financial matrixes depends not so much on their adoption by companies, but rather on the scrutiny and the effects of knowing that one is being examined and evaluated.[48] A central concern of corporate executives is to avoid surprising financial markets with unexpected bad news.[49] Corporate executives do not want their actions to be misrepresented. Getting the right expectations into play enables managers to secure access to external finance at reasonable costs if needed, and avoid exposing the firm to potential unwanted takeover activities following a sharp drop in its stock market capitalization. But taking seriously the new financial techniques and commercial valuation models, in turn, can contribute to shape the subjectivity of the finance directors and other highly placed corporate executives, thereby potentially channeling and sustaining shareholder value oriented demands from external investors. There is a difference between creating shareholder value and managing the indicators of that value, but the justification of corporate activities is increasingly taking place through a reference frame influenced by the financial considerations of Anglo-American institutional investors.

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[45]Peter Hall and David Soskice, "Introduction: Varieties of Capitalism," p. 57. Data on the distribution of activities of French and German firms between their home base and their American subsidiaries is presented in John Cantwell and Odile Janne, "Technological Globalisation and Innovative Centres: The Role of Corporate Technological Leadership and Locational Hierarchy," *Research Policy* 28,2-3 (March 1999): 119-44; and Manuel Separio and Donald Dalton, "Globalization of Industrial R&D: An Examination of Foreign Direct Investments in R&D in the United States," *Research Policy* 28,2-3 (March 1999): 303-16.

[46]John Coffee, "The Future as History: The Prospects for Global Convergence in Corporate Governance," *Northwestern University Law Review* 93,3 (1999): 641- 708.

[47]Julie Froud, Colin Haslam, Sukhdev Johal, and Karel Williams, "Shareholder Value and Financialization: Consultancy Promises, Management Moves," *Economy and Society* 29,1 (February 2000): 80-110.

[48]See John Roberts, Paul Sanderson, Richard Barker, and John Hendry, "In the Mirror of the Market: The Disciplinary Effects of Company/Fund Manager Meetings," *Accounting, Organizations and Society* 31,3 (April 2006): 277-94.

[49]John Hendry, Paul Sanderson, Richard Barker, and John Roberts, "Owners or Traders? Conceptualizations of Institutional Investors and their Relationship with Corporate Managers," *Human Relations* 59, 8 (August 2006): 1101-1131, p. 1119.

II. The Transformation of French and German Corporate Governance: An Empirical Evaluation

The previous section highlighted changes in the external financial environment of French and German firms. A structural transformation has taken place in the form of the declining important of debt finance and the rise in prominence of equity capital. The incentives of French and German managers have changed in the last decade – the adoption of shareholder value enhancing strategies having become more attractive. Moreover, the greater mobility of capital and the strategy of international diversification of Anglo-American institutional investors have been associated with a rise of foreign ownership. Foreign investors have become important shareholders in the capital structure of blue-chip companies in France and Germany (see Tables 1 and 2). Anglo-American institutional investors are operating in a new European financial environment that is characterized by the importance of stock market capitalization for blue-chip companies.

Table 1. Foreign Ownership Selected French Blue Chip Companies
(in % of equity capital) (2002 unless otherwise indicated)

Accor 51.7	Air Liquide 37.1	Alcatel 50.0 (*)	Alstom 48.0
Aventis 60.6	AXA 80.0	BNP-Paribas 67.0	Cap Gemini 63.9
Danone 42.0	Lafarge 54.9	Lagardere 48.1	L'Oreal 20.0 (*)
LVMH 17.5	Michelin 47.0	Publicis 59.4	SocGen 50.8 (*)
St-Gobain 40.5 (*)	Total 64.0	Vivendi 53.4 (*)	Vivendi. Envi. 27.0

Source: annual report of companies, various years. *= data are for 2000

Table 2 Foreign Ownership Selected German Blue Chip Companies,
(in % of equity capital) (2002 unless otherwise indicated)

Adidas 57.0	Allianz 32.0	Altana 20.0	BASF 35
Bayer 39.0 (2001)	Commerzbank 35.0	Daimler-Chrysler 29.9	Deutsche Bank 46.0
D. Telekom 59.0	E.ON 57.9 (2000)	Fresenius 49.1	Linde 60.0
Lufthansa 29.1	MAN 19.0 (2001)	Munich Re 37.0	RWE 15.0 (2001)
SAP 57.6	Schering 52.0 (2003)	Siemens 54.0 (2000)	Volkswagen 23.1 (2001)

Source: annual report of companies, various years.

These developments in French and German finance, however, mask substantial divergence in regard to the composition of foreign ownership in the two countries. First, the growth of securities markets in France has been far more impressive than that of Germany. The traditional measure of the importance of securities markets in an economy is the aggregate market capitalization of domestic companies divided by the gross domestic product. These figures on stock market capitalization are presented in Table 3. Equity finance was marginal in continental European countries associated with an insider model of corporate governance until the mid 1990s. The rates of growth of the stock market capitalization among advanced industrialized countries in the second half of the 1990s did not exhibit a common trajectory. France experienced a bigger explosion of its securities markets than did Germany and Japan during the bull market of 1995-2001. More-

over, the relative decline of stock markets between 2000-01 and 2003, and the reversal of this trend since 2003, also put France in a very favorable position. However, it is important to note that the growth of stock markets does not constitute the research question of this paper. The focus is on the composition of foreign ownership of French and German companies under a new financial environment of heightened importance for the level of their stock market capitalization.

Table 3. Evolution of Market Capitalization as Percent of GDP, 1980-2004

	1980	1985	1990	1995	1999	2001	2002	2003	2004
FRANCE	8	15	26	35	105	103	68	93	110
GERMANY	9	29	22	28	68	61	35	54	62
JAPAN	36	71	99	81	102	73	52	74	N/A
UNITED KINGDOM	37	77	87	98	198	166	114	148	178
UNITED STATES	48	57	56	78	181	152	106	134	150

Source: World Bank, *World Development Indicators*, various years; and Christoph Van Der Elst, "The Equity Markets, Ownership Structures and Control: Towards an International Harmonization?" in Klaus Hopt and Eddy Wymeersch, eds., *Capital Markets and Company Law* (New York: Oxford University Press, 2003), p. 11.

Second, an analysis of financial markets in Europe requires a nuanced understanding of the preferences and strategies of investors. Theoretical inferences cannot be drawn simply from the growing importance of capital mobility across borders.[50] Anglo-American institutional investors, moreover, do not constitute a monolithic bloc, thereby requiring a greater sophistication in the analysis of their preferences and tactics. I distinguish primarily between passively managed mutual funds/pension funds versus actively managed mutual funds/hedge funds. These four categories of investors possess preferences and time horizons that can clash or fit with the institutions of European companies. Pension funds constitute long-term investors that acquire an equity stake in corporations primarily for diversification purposes. The incentives for managers of pension funds lie in the generation of a certain minimum amount of revenues required to cover regular payments to retirees. Actively managed mutual funds, in contrast, possess a shorter term horizon as they face greater liquidity concerns -- funds under their manage-

[50]The growing importance of institutional investors in Europe undoubtedly results in growing pressures placed on managers to adopt shareholder value enhancing strategies, but whether these new shareholders are able to change in a fundamental ways the strategy of portfolio firms remains to be seen. The growth of institutional investors in the United States in the 1980s and 1990s, for example, did not lessen the degree of control of managers over the allocation of corporate resources. The incentives of American managers might have changed in the last two decades, but their control over the types of investments firms make and how returns from these investments are distributed has remained largely intact. The ability of institutional investors to translate shareholder ownership into corporate power remains an empirical issue. For a discussion of these issues, see Peter Gourevitch, "The political economy of institutional investors in corporate governance: Some comparative problems," paper presented at the annual meeting of the American Political Science Association, August 31-September 3, 2006, Philadelphia PA; and Mary O'Sullivan, *Contests for Corporate Control: Corporate Governance and Economic Performance in the United States and Germany*.

ment being redeemable on demand by investors. Investment managers of seek to outperform financial benchmarks by picking firms undervalued in financial markets. Passively managed mutual funds, on the hand, do not seek to surpass financial benchmarks despite the funds under their management being also redeemable on demand. Instead, the composition of the investment portfolio of passively managed mutual funds reflects that of a benchmark index. The strategy of these funds is top attract (and keep) investors via the delivery of constant, long-term returns while minimizing the various costs (equity research, securities trading, managerial compensation fees) associated with the operation of an investment company. Finally, hedge funds are largely unregulated limited partnerships characterized by arbitrage strategies, high turnover and aggressive trading, and heightened managerial incentives to maximize absolute returns. They collect funds from wealthy and more sophisticated investors willing to assume higher levels of risk for potentially superior returns.

The growth of foreign ownership in France and Germany has been characterized by substantial divergence in regard to its composition. First, large firms in the two countries have been a favorite destination for the international diversification strategy of pension funds (see Table 4). France and Germany are consistently among the top foreign destinations for pension fund investment. This reflects the fact that corporate law in the two countries provides an acceptable level of financial transparency, a sufficient level of protection for minority shareholders, and that the quality of law enforcement is excellent.[51]

Another feature of the investment strategy of pension funds is that the size of the French portfolio for the pension funds listed in Table 4 is superior to that of the German portfolio by 70 percent. France appears to be leading Germany as an investment destination for large U.S. pension funds. However, the data presented in Table 4 do not provide support for the validity of this conclusion. The percentage of assets directly managed by pension funds has substantially diminished in the last twenty years, reflecting their increasing reliance on external money managers. Hedge and (particularly) mutual funds have become important actors as external money managers for pension funds and derive substantial revenues from their management of corporate benefit plans. For example, U.S. pension funds in 1999 managed only 42 percent of assets they collected, with the rest being delegated to other institutional investors.[52] The figures presented in Table 4 represent all assets managed both internally and externally by pension funds. Thus, it is not possible to assert whether the French dominance over Germany constitutes an outcome driven by the preferences of pension funds or the investment strategies of external money managers – or both. The annual reports of pension funds present data on internally versus externally managed funds on an aggregate basis without distinguishing by country of investment. Moreover, securing data on the assets directly managed by pen-

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[51]See, e.g., Mark Roe, “Corporate Law’s Limits,” *Journal of Legal Studies* 31,2 (June 2002): 233-71 and Mark Roe, “Legal Origins, Politics, and Modern Stock Markets,” *Harvard Law Review* 120,2 (December 2006): 462-527.

[52]Conference Board, “Financial Assets and Equity Holdings,” *Institutional Investment Report* 4,1 (November 2000): 43. Moreover, the bulk of the assets of pension funds are managed by mutual funds, not hedge funds. In 2005, only 0.8 percent of the assets of the 200 largest American defined benefit plans were managed by hedge funds (William Fung and David Hsieh, “Hedge Fund Replication Strategies: Implications for Investors and Regulators,” p. 56).

sion funds for their French and German portfolios might not entail substantial promise for the analysis of institutional change in comparative corporate governance. Data on the investment patterns of short-term oriented hedge and mutual funds are likely to be more interesting since access to long-term, patient capital has traditionally been a key feature of these two continental European economies. The investment strategies and time horizons of mutual/hedge and pension funds have different consequences for the sustainability of national models of European capitalism. By contrast, the relatively new presence of long-term oriented American and British pension funds with their demands for financial transparency and respect for the rights of minority shareholders is highly compatible with the institutional arrangements of German Codetermination that allow for substantial workers' involvement.[53]

Third, the empirical issue in this paper revolves on the differences in the allocation of financial assets by actively managed mutual funds. This category of institutional investors has chosen France over Germany in a proportion of about 2 to 1 as a site for investment in continental Europe. The investment portfolios of short-term oriented American and British-based hedge funds, on the other hand, have also exhibited a preference for the French market in a proportion of 1.6 to 1. I argue in the next section that the firm-level institutional arrangements of workplace organization constitute the most significant variable to account for the above differences in investment allocation, but without being the only reason why actively managed mutual funds (and hedge funds) invest in a single company. The fit between the investment strategies of these two categories of investors and the firm-level institutional arrangements of advanced capitalist economies depends on the ability of the CEO and top managers to reorganize the workplace in a unilateral fashion. The firm-level institutional arrangements with their associated decision making and adjustment processes in France, which is management-led with the exclusion of the workforce from the decision-making process, constitute a great match with the preferences and investment strategies of these two types of institutional investors. Workers possess fewer opportunities to block managerial initiatives.[54] French firm-level institutions are characterized by the concentration of power in the CEO that, in turn, allows for a rapid reorganization of the workplace under the guidance of a small number of corporate officials. The strategies of mutual and hedge funds, in contrast, do not fit well with the firm-level institutions found in Germany. Those institutions impose several constraints on the ability of management to develop and implement strategies in a unilateral fashion. The process of adjustment in Germany is the result of negotiation between management and employee representatives.[55]

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[53]See Martin Hoepner, "Corporate Governance in Transition: Ten Empirical Findings on Shareholder Value and Industrial Relations in Germany," pp. 27-33.
[54]See Bob Hancké, *Large Firms and Industrial Adjustment: Industrial Renewal and Economic Restructuring in France,* pp. 57-87; and Vivien Schmidt, *From State to the Market? The Transformation of French Business under Mitterrand*, pp. 393-416.
[55]See Kathleen Thelen, *Unions of Parts: Labor Politics in Postwar Germany*, pp. 25-104.

Table 4. Percentage of International Portfolio Invested in France and Germany by Pension Funds (%)

Fund	% of International Portfolio Invested in France	France's International Rank	% of International Portfolio Invested in Germany	Germany's International Rank
CalPERS	7.8	Top 3	5.8	Top 6
General Electric (2004)	13.0	3	5.2	5
New Jersey (08/2005)	14.3	3	6.1	6
NY State & Local (2003)	6.1	Top 3	2.9	Top 8
NY State Teachers (2005)	10.9	3	6.8	5
North Carolina (07/2005)	10.2	3	6.1	5
Ohio Public (07/2005)	7.9	3	5.8	4
Ohio Teachers (2003)	9.8	3	6.4	5
Texas Teachers (2005)	8.4	NA	5.6	NA
Washington State (2005)	8.6	3	6.1	4
Wisconsin (2004)	12.2	3	10.9	4

Source: Annual Reports, various years

Moreover, it is also important to note that my argument on the importance of firm-level institutional arrangements for the investment strategy of actively managed mutual funds is not contingent on the status of institutional activism. I remain agnostic in this paper on the debate over the activist nature of institutional investors. The ability of institutional investors to translate shareholder ownership into corporate power remains an empirical issue. The debate pits those who view institutional activism as an essential mechanism by which to monitor companies against those who assign a strong element of passivity to institutional investors.[56] For the former perspective, the primary goal of actively managed mutual funds investing in France is to convince the CEOs of the value of specific strategic changes. This is because the implementation of restructuring policies requires, almost exclusively, the CEO's approval as employees have no means of intervention.[57] Moreover, the overall weakness of employees reduces the ability of French CEOs to claim that they are constrained in the elaboration and implementation of firm strategy and that they are unable to make concessions. The concentration of power in the top management of French firms increases the size of the win-set of the CEO in his negotiations with Anglo-American institutional investors, but diminishes the strength of his bargaining position. In this two-level game, autonomy from internal pressures translates

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[56]For a view that supports the importance of institutional activism in the governing of corporations, see Jayne Elizabeth Zanglein, "From Wall Street Walk to Wall Street Talk: The Changing Face of Corporate Governance," *DePaul Business Law Journal* 11, 1 (Fall/Winter 1998): 44-122. For a position that emphasizes the overall passivity of institutional investors, see Bernard Black, "Shareholder Activism and Corporate Governance in the United States," in Peter Newman, ed., *The New Palgrave Dictionary of Economics and the Law* (London: Macmillan Reference, 1998).

[57]This is the position adopted by Antoine Rebérioux, "European Style of Corporate Governance at the Crossroads: The Role of Worker Involvement," p. 125.

into a weaker position with external investors.[58] For the latter perspective, in contrast, short-term institutional investors cannot afford to engage in activist tactics. The process of portfolio building requires the identification of companies that are likely to implement strategies of corporate restructuring that will generate corporate earnings and that will boost the market capitalization of the firm within a specific time frame. French firms are attractive to activist institutional investors since the elaboration and implementation of a new strategy can be undertaken quickly and in a unilateral fashion. The decision to pursue shareholder value strategies remains a managerial prerogative that is not dictated by actors on financial markets, but the ability of French corporations to pursue these shareholder-value-friendly strategies is greatly facilitated by the relative weak position of employees. The reverse logic applies for the German case – the entrenched position of employees limits the ability of CEOs to conduct the strategy in a unilateral fashion and, moreover, increases the CEO's bargaining position with institutional investors.[59]

The rest of this section is divided in three parts. First, I provide an overview of the differences between these three groups of investors. Second, I discuss the nature of the activism by institutional investors. Third, I present data on the presence of mutual and hedge funds in the two countries.

A) Hedge, Mutual and Pension Funds

Anglo-Saxon mutual and pension funds share two basic common features despite different sets of regulation governing their operation. They are subject to the highest standard of care and prudence, i.e., the fiduciary standard. There are trustees who are committed to invest the funds of the contributors according to the fiduciary standard.[60] Anglo-American institutional investors, however, have little else in common.

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[58]On the notions of win-set and two-level games, see Robert Putnam, "Diplomacy and Domestic Politics: The Logic of Two-Level Games," *International Organization* 42,3 (Summer 1988): 427-60.

[59]At the same time, however, the preferences and strategies of actors cannot by themselves account for the different patterns of investment by hedge and mutual funds. Institutional frameworks constrain even the most enthusiastic actors. See the discussion on pp. 78-80 of this paper.

[60]Hedge funds, in contrast to other institutional investors, are largely unregulated since they are not subject to the regulatory constraints of the Investment Act of 1940. They do not have to register with the SEC and are exempt from the disclosure requirements facing mutual (and pension) funds, such as reporting results and disclosing the composition of their portfolios. Hedge funds are traditionally set up as limited partnerships limited to a restricted number of wealthy individuals (500) with personal assets of at least $5 million who are willing to adopt highly risky short-term strategies and borrow on financial markets in exchange for high return potential. They cannot engage in public solicitations for their services. Hedge funds are otherwise similar to other mainstream mutual funds in several dimensions: defined contribution scheme, heightened managerial remuneration, short-term trading, and the absence of the actuarially mandated minimal financial returns – thereby prodding fund managers to achieve as high financial returns as possible by picking undervalued companies. Hedge funds are also subject to antifraud provisions of the federal securities laws in the United States. Examples of charges brought against hedge funds in the United States include misappropriation of assets, misrepresentation of portfolio performance, falsification of past returns, and misleading disclosure regarding claimed trading strategies. For the purpose of this paper, hedge and mutual funds constitute two forms of short-term, impatient

Four critical features set them apart with systemic consequences for comparative corporate governance: mode of collecting funds and issuing payments, time horizon and liquidity constraints, remuneration and managerial incentives, and process of picking portfolio companies. First, a key difference between these types of institutional investors lies in their mode of collecting funds and issuing payments "held in trust" for the beneficiaries. Defined benefits schemes (DB) guarantee the level of benefits the fund will pay and the method of determining those benefits, but not the amount of the contributions. DB schemes guarantee a fixed payment in the future. The level of contributions in the current period is determined actuarially on the basis of the benefits expected to be paid to the retirees who contributed to the fund and the assumed rate of return. Defined contribution schemes (DC), on the other hand, specify the level of contributions but not the amount of benefits to be paid. The amount available to the beneficiaries results from both the portfolio performance and the amount initially invested.

The existence of an almost perfect correlation characterizes the relationship between the method of collecting funds and the type of institutional investors. Pension funds – public and private alike – rely, to a substantial extent, on a DB scheme to collect and distribute assets.[61] The assets of the two types of mutual funds, by contrast, are managed almost exclusively on a DC scheme.[62] This is not surprising, since mutual funds are investment companies that pool funds from individuals and corporations with the provision that the money invested is redeemable on demand. In the case of actively managed mutual funds, moreover, the funds paid to investors are dependent on the market performance of the mutual fund.[63] Finally, it is also important to note that pension funds do manage directly only a small percentage of the assets collected by them – mutual funds serving as external fund managers. The pension fund industry is increasingly dominated by reliance on mutual fund managers for asset management since 401(k) plans allow corporations to more easily outsource direct contribution pension plans to external DB fund managers.[64]

Second, in spite of the shared fact that their salaries are based on a percentage of assets under management, the incentives facing hedge, mutual and pension fund manag-

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capital. For overviews, see Stephen Brown and William Goetzmann, "Hedge Funds with Style," Working Paper #8173 (2001), National Bureau of Economic Research, Cambridge MA; and William Fung and David Hsieh, "Empirical Characteristics of Dynamic Trading Strategies: The Case of Hedge Funds," *Review of Financial Studies* 10,2 (Summer 1997): 275-302.

[61]*Pensions &Investments*, January 26, 2004: 16.

[62]Robert Pozen, *Mutual Fund Business* (Cambridge MA: MIT Press, 1998), pp. 397-423.

[63]Hedge funds are also managed on a DC scheme with investors uncertain to recover their investment since fund managers are typically given mandates to make an absolute return target regardless of the market environment. See William Fung and David Hsieh, "Empirical Characteristics of Dynamic Trading Strategies: The Case of Hedge Funds," p. 276.

[64]However, pension funds do retain some form of control by issuing specific guidelines on investment decision to external money managers. They often change external money managers that deviate from investment guidelines by taking excessive risks even for superior financial performance. See Diane Del Guercio and Jennifer Hawkins, "The Motivation and Impact of Pension Fund Activism," *Journal of Financial Economics* 52, 3 (June 1999): 293-340; and Diane Del Guercio and Paula Tkac (2001), "Star Power: The Effect of Morningstar Ratings on Mutual Fund Flows," working paper #2001-15, Federal Reserve Bank of Atlanta, pp. 525-30.

ers are strikingly different. Increases in the level of the financial compensation of fund managers can come from maximizing the value of assets under management or from attracting new investors to the fund. In other words, managerial remuneration is based on the volume of assets under management and on the performance of the portfolio. Public pension fund managers, however, face constraints that deter them from maximizing the value of their portfolio despite incentives associated with the increase of assets under management. The first constraint consists of state regulations that impose caps on the salary of managers.[65] In other words, the link between compensation and size of assets under management does not hold above a certain level – thereby resulting in overall lower salaries for public pension fund managers in relation to their hedge/mutual fund and private pension fund counterparts. Moreover, the number of beneficiaries in public fund schemes is limited by the size of the contributing workforce – a factor over which public pension fund managers have no control. The second constraint on public pension fund managers lies in the absence of any financial incentives tied to fund performance. The primary objective of DB public pension funds is to generate a certain minimum amount of revenues through the management of the assets under their control. Contributions are determined actuarially on the basis of the level of the benefits expected to become payable to the retirees. The payouts to beneficiaries are independent of the funds' endowment. Fund managers earn a civil service salary and would not receive proportional extra rewards for achieving returns beyond the mandated averages.[66] Performing below the market index, on the other hand, is a sure cause for dismissal since the risks are borne by the pensioners. Finally, public pension fund managers are elected state officials or political appointees facing different types of pressure than their hedge/mutual fund counterparts do.[67] Pension fund managers have to consider the demands of powerful interest groups that often clash with the interests of their fiduciaries. [68]

The incentives faced by actively managed mutual funds (and hedge funds) stand at the opposite end of the spectrum from those of their public pension fund counterparts. In the first place, compensation for mutual fund managers is based on a percentage of assets under management without any caps.[69] Moreover, the behavior of investors in actively managed mutual funds exhibits a marked tendency to flock to "winners." Funds displaying high returns during an assessment period will experience an inward surge of

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[65]See Tracy Woidtke, "Agents Watching Agents? Evidence from Pension Fund Ownership and Value," *Journal of Financial Economics* 63,1 (January 2002): 99-131.

[66]Robert Monks and Nell Minow, *Corporate Governance* (Cambridge MA: Blackwell Business, 1995), p. 125

[67]An excellent analysis of the political motivations of pension fund officials is provided in Roberta Romano, "Public Pension Fund Activism in Corporate Governance Reconsidered," *Columbia Law Review* 93,4 (May 1993): 795-853.

[68]Private pension fund managers face a hybrid situation. Because the salaries have no caps, managers' compensation can reflect the total value of the fund. The average base salary for private pension fund managers is 33 percent higher than that of their public pension fund counterparts. See Tracy Woidtke, "Agents Watching Agents? Evidence from Pension Fund Ownership and Value," p. 103. However, managers who outperform an index will not experience an inward flow of new funds, as entry is often limited. For example, the number of beneficiaries of the General Motors retirement plan is limited by the size of its workforce.

[69]See Edwin Elton, Martin Gruber, and Christopher Blake, "Incentives Fees and Mutual Funds," *Journal of Finance* 58,2 (April 2003): 779-804.

new investment inflows in the fund in subsequent periods. In particular, capital inflows are highly correlated with a fund outperforming a market benchmark.[70] In other words, managerial remuneration depends on the relative performance of the fund vis-à-vis that of others. As a result, mutual fund managers desirous of increasing the value of the fund – and boosting their compensation – face highly powerful incentives to maximize the volume of assets under management by attracting inflows of new investment. This strategy invariably entails the revision of the composition of the portfolio.[71] As well as being relative to the performance of other funds, moreover, the compensation of managers of actively managed mutual funds is also driven by internal performance and rankings. Numerous investment companies are using a ranking system to evaluate their managers. At Fidelity, for example, each manager's returns are compared to benchmarks reflecting the risk specificity of the particular fund he or she manages.[72] Fund managers outperforming benchmarks at Fidelity are rewarded with higher rankings vis-à-vis their own colleagues, more generous financial compensation, and faster internal progression.[73]

The incentives and trading strategies of managers of index-based/passively managed mutual funds differ substantially from those of their actively managed counterparts. Mutual funds that are passively managed are composed of a selection of stocks that are as representative as possible of an index. The aim is to enable investors to access financial markets while diversifying their risks. The marketing strategy of passively managed mutual funds for attracting investors lies in the provision of constant returns without incurring the costs inherent to the operation and investment strategy of actively managed mutual funds. Managers of index-based mutual funds do not seek to select individ-

[70]Diane Del Guercio and Paula Tkac (2001), "Star Power: The Effect of Morningstar Ratings on Mutual Fund Flows."

[71]Mutual fund managers whose fund's performance lags behind rivals at the midpoint of an assessment period are likely to shift the composition of their portfolio by investing in a greater number of riskier companies, thereby increasing the volatility of the fund but also the probability of increasing its performance. See Keith Brown, W.V.Harlow, and Laura Starks, "Of Tournaments and Temptations: An Analysis of Managerial Incentives in the Mutual Fund Industry," *Journal of Finance* 51,1 (March 1996): 85-110; Judith Chevalier and Glenn Ellison, "Risk Taking by Mutual Funds as a Response to Incentives," *Journal of Political Economy* 105,6 (December 1997): 1167-1200.

[72]Ian McDonald, "Fidelity Managers Gets Ranked," *Wall Street Journal Europe*, January 21, 2003: M5

[73]This process of internal ranking entails profound consequences for fund managers and corporate governance that are well illustrated by the case of Fidelity. The foreign segment of the Boston-based mutual funds amounts to only ten percent of its overall stock portfolio. The French market only represents 0.5 percent of its stock portfolio. See Commission des Opérations de Bourse, "Les Critères d`Investissement des Grands Gestionnaires de Fonds Internationaux dans les Entreprises Françaises," Bulletin COB # 322 (1998): 1-31. Nonetheless, managers of the European (or French) funds of Fidelity possess the same types of financial incentives as their counterparts managing bigger funds comprised of American companies. Financial compensation and progression within Fidelity require fund managers to outperform benchmarks whether their particular fund is composed of American, European, or other types of funds. This point also illustrates the lack of creativity of actors in this outside-in perspective on the transformation of French and German corporate governance. The size of these two markets is insufficient to warrant a change in the strategy and tactics of fund managers from those that prevail in the domestic market.

ual stocks, but rather match the composition of an index – thereby saving on the costs of research analyses and of trading securities. Moreover, the compensation fees paid to managers of index-based mutual funds are usually a lower fixed percentage of the assets under management – and sometimes as a declining percentage of assets under management – than what prevails at actively managed mutual funds. The importance of recruiting fund managers with truly extraordinary expertise and genuine market-beating skills in stock selection making is not really an issue for index-based mutual funds. Finally, the lower turnover rates of passively managed mutual funds – investment manager buying and selling according to changes in the composition of an index – implies that capital gains associated with the sale of securities are more likely to be taxed at the lower long-term gains rate.

The incentives of hedge fund managers, as for the managers of actively managed mutual funds, are also highly heightened by important financial considerations. As their mutual funds counterparts, managers of hedge funds are also compensated on the basis of the volume of assets under management and are given mandates to achieve the highest possible returns, regardless of the market environment. The financial incentives of hedge fund managers, moreover, differ in one fundamental way from those prevalent at mutual funds. Their total compensation comprises both the amount of assets under management as well as substantial incentives fees, the latter being paid only when hedge fund managers make a positive return. The typical remuneration contract of hedge fund managers is characterized by 1 to 2 percent of assets under management and 5 to 25 percent of profits realized.[74] Thus, financial incentives shape in diametrically opposite ways the pressures faced by hedge, mutual and public pension fund managers.

Third, the time horizon of institutional investors diverges considerably in regard to their patterns of trading. The annual average turnover rate of American public pension funds in 1997 was 19.3 percent.[75] The similar figure for mutual fund managers and external money managers was 42.5 percent.[76] The time horizons of the largest mutual funds, in particular, are considerably shorter.[77] The average amount of time a share is held for Fidelity (actively managed mutual fund) was 2.63 years in 1999.[78] By contrast, most public pension funds have longer-term horizons, as witnessed by their turnover rates: Florida state (12.5 years) and California State Teachers (7.6 years).[79] Pension funds do not face similar liquidity constraints as mutual funds and external money managers, since payments to retirees are regular and predictable. Mutual funds managers do have liquidity concerns, as the funds provided by investors are redeemable on demand.

[74]Stephen Brown and William Goetzmann, "Hedge Funds with Style," p. 2.
[75]Conference Board, "Turnover, Investment Strategies, and Ownership Patterns," *Institutional Investment Report* 2,2 (August 1998): 1-51.
[76]Ibid.
[77]See Daniel Bandru, Stéphanie Lavigne and François Morin, "Les Investisseurs Institutionnels Internationaux: Une Analyse du Comportement des Investisseurs Américains," *Revue Économie Financière* 61 (2001): 121-37.
[78]Ibid, p. 125
[79]Ibid, p. 126

Hedge funds also display reliance on short-term trading, albeit in a different way from actively managed mutual funds.[80] The investment strategies of hedge funds entail high turnover and aggressive trading on short-lived information, but not because of similar liquidity concerns such as those faced by mutual funds. Investors typically face an initial lock-up period of one year, and subsequent restrictions to quarterly intervals, during which they are not allowed to liquidate their investments.[81] Instead, the short-time horizon of hedge funds results from their characteristics of their investment strategies.[82] Hedge funds practice statistical arbitrage that involves balancing positions in

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[80]For an overview of the investment strategies of hedge funds, see Carl Ackermann, Richard McEnally, and David Ravenscraft, "The Performance of Hedge Funds: Risk, Return, and Incentives," *Journal of Finance* 54,3 (June 1999): 833-74; Steven Drobny, *Inside the House of Money: Top Hedge Fund Traders on Profiting in the Global Markets* (New York: John Wiley & Sons, 2006); Filippo Stehanini, *Investment Strategies of Hedge Funds*; and Securities and Exchange Commission, "Implications of the Growth of Hedge Funds," staff report to the United States Securities and Exchange Commission, Washington DC, September 2003).

[81]The termination of the lock-up period is usually seen as a target for hedge fund managers to terminate their stake in specific stocks in order to capture capital gains – otherwise an outflow of funds is seen as probable. Although the investment portfolios of hedge funds can remain secret for as long as they want if the securities are bought on the over the counter markets, the typical one year lock-up period means that investment managers possess incentives to trade for periods of less than twelve months. The managers of hedge funds do not want to be caught short by withdrawals of capital in the managed funds. I thank Bill Fung for his comments on this issue.

[82]There is an additional reason why hedge funds rely on short-term trading – a feature that distinguishes them from all other types of institutional investors. Hedge funds are allowed unrestricted access to short selling – the U.S. Investment Act of 1940 making it almost impossible for mutual and pension funds to sell securities they do not own. Short selling refers to the acquisition and sale of securities through futures, options, and other derivative contracts with the aim of later repurchasing them at a lower price. The act of short selling involves borrowing securities from a broker and immediately selling them on the market with the provision of delivering them back to the broker at a later date, after buying the same amount of shares on the open market. The hedge fund earns a profit if the repurchasing price is lower than the initial selling price, the outcome of the transaction being contingent on the manager's stock picking ability and market timing. Besides the traditional market risk – profits being reaped only if the fund manager correctly anticipates the process movements of the securities – the use of short selling involves a liquidity risk. The broker has the right to call in the lent securities at any time, thereby highlighting the dangers of a liquidity squeeze and the premium placed on short-term trading. The issue for hedge funds managers consists not only in correctly predicting the price movements on securities, but also in covering themselves against liquidity squeeze. Hedge funds could suffer if the price of the borrowed securities has not fallen below that of their original price.

I do not analyze short selling in this paper; I focus on the investments of hedge/mutual funds in buying undervalued securities that are expected to grow in value and selling overvalued stocks (that they own) that are expected to lose value. Short selling, the practice of selling shares one does not own, does not require any disclosure requirements – thereby making it impossible to know with precision the exact holdings composition of hedge funds. However, the results presented in this paper are not affected by the lack of disclosure requirements associated with short selling. First, mutual funds (the world's biggest asset managers) and other institutional investors cannot short sell shares they do not own. Second, most of short selling activities would have not been computed in this paper even if they were available, since I require a one-month holding period for an investment to be recorded (see p. 31). Third, short-selling requires fund mangers to identify firms that are expected to fall sharply in value. In several instances, the act of short

assets (equity, government bonds, and national currencies) that are believed to be undervalued against others that are expected to fall in value. Hedge funds operate on the notion of contracts, i.e., putting bets that an asset will go above a designated target or will fall below it. Managers tend to follow strict procedures for selling stocks, i.e., fixing target prices constituting a threshold that, once reached, leads to the sale of the stocks. This practice is shaped both by their compensation scheme, whereby managers get paid only in the event of a positive return. Hedge funds tend to sell their positions in assets quickly once these threshold targets have been reached, thereby further accounting for their propensity to rely on short-term trading strategy.[83]

Finally, the criteria and processes by which actively managed mutual funds versus pension funds/passively managed mutual funds select companies for investment also differ, thereby resulting in a different composition of the stock portfolio. The composition of the stock portfolio for public and private pension funds and passively managed mutual funds is essentially based on an index strategy. By late 1995, the percentage of assets managed on an index by American pension funds had risen to 60 percent and was climbing.[84] This figure is even higher for some of the most activist funds. For example, around four-fifths of the stock portfolio of CalPERS was indexed in 1997.[85] The growing recourse to indexing by pension funds and passively managed mutual funds reflects their assessment that active management of the equity portfolio produces results inferior to market indexing. These institutional investors often lack the firm-specific knowledge needed to take actions aimed at transforming the strategy of portfolio companies.[86]

Actively managed mutual funds, by contrast, do not acquire an equity stake in a corporation because it is part of an index. Managers are in stiff competition with other funds for the assets of investors which, in turn, can be redeemed at any moment. The structural characteristics of the mutual fund industry compel managers to achieve high returns, not simply match an index. Investment managers behave like stock pickers and

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selling is often associated with firms suffering an important crisis and likely to experience a major downturn in their fortunes. The focus of this paper deals with institutional investors purchasing stocks hoping the price will rise so that they can sell it at a profit. Finally, regulatory issues associated with the dangers of short selling are closer to the interests of international political economists interested in systemic risks in the financial system. The use of leverage can have serious repercussions throughout the system if markets moved against the investments of hedge funds by the time they were forced to meet their margin calls. The concern of this paper, in contrast, focuses on the implications of the investments of short-term, impatient investors on the system of corporate governance and model of capitalism of France and Germany.

[83]The most famous embodiment of this investment strategy was George Soros's Quantum Fund and the devaluation of the British Pound in 1992. This hedge fund placed a bet on the devaluation of the British Pound on September 11 and took it off on September 22 after the devaluation became effective, thereby experiencing a gain of 25.5 percent for that month and gaining more than $1 billion in a single day. William Fung and David Hsieh, "Empirical Characteristics of Dynamic Trading Strategies: The Case of Hedge Funds," p. 293.

[84]Commission des Opérations de Bourse, "Les Critères d`Investissement des Grands Gestionnaires de Fonds Internationaux dans les Entreprises Françaises," p. 15.

[85]Diane Del Guercio and Jennifer Hawkins, "The Motivation and Impact of Pension Fund Activism," p. 302

[86]Ibid, pp. 305-306

are in many ways the mirror image of DB pension funds.[87] Finally, the compensation of hedge funds managers derives from the amount of assets under management and, to a substantial extent, from incentive fees. These incentive fees are paid only in the event of the returns on the portfolio exceeding pre-established benchmarks.[88] The raison d'être of hedge funds is to pursue flexible and aggressive strategies that entail above-normal risks and potentially high returns under a framework of limited government oversight. As a result, it is not uncommon for hedge (and mutual) funds to spend significant amounts of money to acquire firm-specific information.

Table 5: Weight of Top Ten Holdings in Selected Funds

Pension Funds			Mutual Funds		
Name of Institution	**Fund Type**	**%**	**Institution**	**Fund Type**	**%**
California Teachers	Domestic	14.2 (2003)	Fidelity Growth	Domestic	23.7 (2004)
Illinois Teachers	Domestic	10.8 (2003)	Fidelity Magellan	Domestic	28.0 (2004)
New York State Teachers	Domestic	14.2 (2003)	Fidelity UK	Continental Europe	24.3 (2003)
Ohio Public	Domestic	5.3 (2002)	Gartmore UK	Europe	28.0 (2003)
Ohio Teachers	International	7.0 (2003)	Henderson UK	Europe	32.0 (2003)
Pennsylvania Teachers	Domestic	12.3 (2002)	Ivory Sime UK	Domestic	46.5 (2003)
Pennsylvania Teachers	International	12.6 (2002)	Janus Growth	Domestic	43.8 (2004)
Texas State Employees	Domestic	17.4 (2002)	Janus Worldwide	International	30.5 (2004)
Texas Teachers	International	12.3 (1999)	Vanguard Capital Value	Domestic	30.0 (2004)

Source: Annual Reports

The importance of specific firms for the overall financial performance of a specific fund also illustrates the differences in the composition of the portfolios of actively managed mutual funds and pension funds. The use of an index as an investment strategy by pension funds entails that their aim is to reproduce as closely as possible the economic profile of a sector/country. The investment strategy of actively managed mutual funds, in contrast, aims at picking undervalued firms that are likely to outperform the market in the short-term. These different investment strategies, in turn, entail diverging degrees of dependence on the performance of specific portfolio companies. The top portfolio companies for actively managed mutual funds account for a greater percentage of their overall investment than the top portfolio companies for pension funds. I present in Table

[87]Robert Monks and Nell Minow, *Corporate Governance*, p. 163; and Robert Pozen, "Institutional Investors: The Reluctant Activists," *Harvard Business Review* 72,1 (January-February 1994): 140-149.

[88]See Stephen Brown, William Goetzmann, and James Park, "Careers and Survival: Competition and Risk in the Hedge Fund and CTA Industry," *Journal of Finance* 56,5 (October 2001): 1869-1886.

5 the relative weight of the top ten holdings for selected mutual and pension funds.[89] For pension funds, I report that percentage accounted for by the top ten holdings in either their domestic or international portfolios. Mutual funds, on the other hand, manage several dozens of funds: thus I selected the most important funds in regard to assets under management for some of the biggest institutions. As Table 5 demonstrates, the financial returns of actively managed mutual funds are more dependent on the performance of a selected number of top portfolio companies than they are for their pension fund counterparts.

B) Institutional Investor Activism and its Implications for Corporate Governance

The decision-making processes and the preferences of institutional investors differ in important ways. The resulting variation in the investment strategies of institutional investors implies different sets of fit with the national institutions of the countries in which they invest. The preferences of institutional investors in corporate governance issues take place along a continuum from market-wide institutional concerns to firm-specific strategy related issues.[90] The associated shareholder activism of mutual and pension funds exhibits striking variation, thereby implying different types of fit.

The type of shareholder activism displayed by pension funds is directly connected to their preferences.[91] Their strategies are aimed at the transformation of the national institutions of corporate governance of a recipient country. They have economy-wide concerns. The tactics followed by these DB funds consist of the adoption of measures designed to affect the value of their entire portfolio. Pension funds do not have an overarching interest in improving the profitability of a single corporation. Improvement of

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[89]Hedge funds do not have to reveal the composition of their portfolio and materials distributed to investors is often available on a restricted basis and published at irregular intervals. The low profile and secretive nature of hedge funds is designed to minimize regulatory and tax oversight (William Fung and David Hsieh, "Empirical Characteristics of Dynamic Trading Strategies: The Case of Hedge Funds," p. 301). As a result, it is impossible to acquire credible data on the holdings of hedge funds and to compare them with mutual and pension funds. On the other hand, however, financial regulation in the European Union obliges shareholders to disclose an equity stake above the five percent threshold. Thus, it becomes possible to track the investment targets of hedge funds when their equity stake exceeds this threshold. Data on the presence of hedge funds in France and Germany is provided in the next section.

[90]Bernard Black, "Agents Watching Agents: The Promise of Institutional Investor Voice," *UCLA Law Review* 39 (1992): 811-893.

[91] The following discussion on the differences in the nature of activism by institutional investors should be seen in the context of a small minority of funds being active participants on questions of shareholder activism. The reluctance of the great majority of institutional investors to confront management extends across hedge, mutual and pension funds. The differences between these categories of institutional investors, however, lie in the association between specific types of funds and certain types of tactics of shareholder activism, with potential implications about the fit with different models of capitalism. See Peter Gourevitch, "The Political Economy of Institutional Investors in Corporate Governance: Some Comparative Problems"; Marcel Kahan and Edward Rock, "Pension Fund Hedge Funds in Corporate Governance and Corporate Control," *University of Pennsylvania Law Review*, 155, 5 (May 2007): 1021-1093; Roberta Romano, "Less is More: Making Shareholder Activism a Valuable Mechanism of Corporate Governance," *Yale Journal on Regulation* 18,2 (Summer 2001): 174-251.

the performance of a single company through extensive monitoring is likely to come at the expense of unmonitored portfolio firms. Pension funds have developed a set of guidelines for targeted companies that are institutional in nature and applicable to the entire portfolio: removal of anti-takeover devices, selection of independent directors, confidential voting, limits on executive pay, and linkage between managerial compensation and firm performance. Many issues arise in a similar manner for portfolio companies, thereby eliminating the costs associated with developing a new formula for each underperforming corporation. As Bernard Black argues, "specialized knowledge is needed to assess whether a company should build a new plant, but is not needed to decide whether the company should redeem its poison pill."[92]

Moreover, the size and composition of the portfolio of pension funds militate against firm-specific measures since they hold a small equity stake in a great number of companies. They cannot properly monitor every portfolio corporation in which they hold an equity stake. The transaction costs of monitoring would cancel the benefits of diversification associated with an indexed portfolio, since they hold a small equity stake in a great number of companies managed primarily on an index basis. Finally, the activism of pension funds is not linked to their investment decisions. They do not tend to divest from targeted firms even in the case of non-compliance.[93] Index-based activist pension funds react to bad performance by shifting external money managers taking excessive risks rather than modifying the composition of their portfolio.[94] The constraints associated with an index-based strategy entail that activist pension funds pursue tactics aimed at boosting the performance of the overall portfolio. Pension funds avoid submitting resolutions that require developed, firm-specific knowledge.[95] Managers of pension funds do not want to micromanage individual corporations and do not have the expertise to accomplish the task.[96] They freely admit that they do not possess the competence needed to decide on the day-to-day operation of firms and whether portfolio companies are pursuing a sensible business strategy. Nonetheless, it is also important to note that preferences do not always translate into activism. The undertaking of activism by pension funds – in the form of shareholder resolutions that challenge management, the elaboration of good corporate governance codes of behavior, and the public targeting of underperforming portfolio companies – has been associated with a dozen public pension funds. The large bulk of private and public pension funds do not engage in activism. Shareholder activism in the United States is the product of DB pension funds managed on an index basis where the election of fund managers is often surrounded by political overtones.[97]

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[92]Bernard Black, "Agents Watching Agents: The Promise of Institutional Investor Voice," p. 853.
[93]Diane Del Guercio and Jennifer Hawkins, "The Motivation and Impact of Pension Fund Activism," p. 331; and Sunil Wahal, "Pension Fund Activism and Firm Performance," *Journal of Financial and Quantitative Analysis*, 31,1 (March 1996): 1-23.
[94]Diane Del Guercio and Paula Tkac, "The Determinants of the Flow of Funds of Managed Portfolios: Mutual Funds vs. Pension Funds," *Journal of Financial and Quantitative Analysis* 37,4 (December 2002): 523-57.
[95]Diane Del Guercio and Jennifer Hawkins, "The Motivation and Impact of Pension Fund Activism," pp. 305-6
[96]Bernard Black, "Agents Watching Agents: The Promise of Institutional Investor Voice," p. 853.
[97]See Roberta Romano, "Public Pension Fund Activism in Corporate Governance Reconsidered."

The preferences and strategy of actively managed mutual funds and of hedge funds, in contrast, lie in influencing the business strategy of large corporations in which they hold an important stake. The institutions of corporate governance of a country are not as important to them since their concerns are more firm-specific. The strategy of portfolio firms stands at the heart of their concerns. These two categories of institutional investors can own larger equity stakes in a smaller number of corporations. However, they do not acquire a significant equity stake in a corporation because it is part of an index. They spend significant amounts of money to acquire firm-specific information, therefore behaving more like stock pickers and being the mirror image of DB pension funds.[98] Mutual and hedge funds focus on underperforming companies as investment opportunities since they have greater room for improvement and hence higher trading profits. Moreover, the money managers of these funds are expected to surpass the index (actively managed mutual funds) or achieve high absolute returns (hedge funds) – if not, fund trustees could simply hire index-based mutual funds. As a result of these factors, actively managed mutual funds and hedge funds are more risk tolerant than DB pension funds/index-based mutual funds. Finally, it is also interesting to note that hedge funds occasionally acquire high stakes in order to become activist rather than becoming involved only ex post when companies are underperforming.[99]

A similar gap between preferences and activist tactics also applies to mutual funds. The presence of preferences in regard to portfolio management does not mean that institutional investors will engage in corporate governance activities with a goal of improving corporate performance. In fact, critics have been quite severe on the monitoring role performed by mutual funds. It has been argued that this category of investors has been invisible in solving problems of accountability in corporate governance in the United States.[100] The overall reluctance of actively managed mutual funds to challenge management via public tactics of shareholder activism is shaped by a conflict of interest. Mutual funds also serve as external money managers for pensions and, thereby, derive substantial revenues from their management of corporate benefit plans. The risk of alienating corporate clients and losing substantial management fees has been considered more important than the opportunity to increase portfolio value through corporate governance activism.

The above criticism of mutual funds does indeed point to a substantial difference from their hedge/pension fund counterparts. The latter constitute single-purpose firms that do not have multiple sources of income leading to potential conflict of interest. Nonetheless, the preferences of mutual funds do matter for issues of comparative corporate governance, despite their overall reluctance to engage in shareholder activism even in the United States. First, the positive relationship between the volume of pension

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[98]See Robert Monks and Nell Minow, *Corporate Governance*, p. 163; and Robert Pozen, "Institutional Investors: The Reluctant Activists."

[99] Marcel Kahan and Edward Rock, "Pension Fund Hedge Funds in Corporate Governance and Corporate Control."

[100]See Gerald Davis and E. Han Kim, "Would Mutual Funds Bite the Hand that Feeds Them? Business and Proxy Voting," forthcoming in *The Journal of Financial Economics*; and Peter Gourevitch, "The Political Economy of Institutional Investors in Corporate Governance: Some Comparative Problems."

business and the propensity to vote with management does not extend to investment decisions. There is no relationship between levels of ownership and client relationships. The decision by mutual funds to invest in a company is independent of whether or not it serves as an external money manager for that particular firm.[101] The role of mutual funds as external money managers influences their willingness to publicly challenge management, but has no bearing on the composition of their portfolio. The differences in the volume of investment by mutual funds in France and Germany cannot be accounted for by conflicts of interest resulting from their role as external money managers. Second, the lack of shareholder activism of mutual funds does not automatically extend to continental Europe precisely because they do not have significant business relationships as external money managers. Fidelity and other mutual funds can take a highly activist stance in Europe and display a willingness to confront management as a strategy to improve corporate performance.[102] The pay-as-you-go retirement systems of France and Germany mean that there are fewer opportunities for mutual funds to earn fees by managing corporate pension accounts. Third, the unwillingness of mutual funds to confront companies publicly for which they earn substantial fees as account managers does not mean that they do not engage in some form of behind-the-scenes activism in the United States. The most frequent tactics used by mutual funds are direct discussions with management over changes in the business strategy of the firm – informal jawboning.[103] The content of their demands focuses on measures that are directly related to the market capitalization of portfolio firms – with demerger and focus on a limited number of core business activities the most prevalent ones. It is also interesting to note the division of labor that takes place between mutual and pension funds.[104] The early 1990s in the United States witnessed a wave of institutional activism that saw several CEOs resign after pressures from institutional investors. Pension funds, with CalPERS in the forefront, played a central role in raising critical issues by identifying the problems that plagued under-performing companies. However, they were unable to issue specific recommendations beside corporate governance resolutions and their individual stake in troubled corporations was too small to force company officials to resign. Instead, giant mutual funds like Fidelity and Wall Street investment firms like JP Morgan did make recommendations about strategic issues and used their financial clout to force out CEOs and other company officials.

C) Presence of Mutual and Hedge Funds in France and Germany

I computed data on the presence of actively managed mutual funds in France and Germany with the use of several indicators. The first indicator is related to the disclosure requirements of listed companies. EU regulation requires shareholders owning 5 percent or more of the outstanding equity capital of a corporation to notify the national securi-

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[101]Gerald Davis and E. Han Kim, "Would Mutual Funds Bite the Hand that Feeds Them? Business and Proxy Voting."
[102]See David Reilly, "Across Atlantic, Fidelity's Voice is Loud, Public," *Wall Street Journal*, October 28, 2003, p. C1.
[103]Tracy Woidtke, "Agents Watching Agents? Evidence from Pension Fund Ownership and Value," p. 101. See also Robert Pozen, "Institutional Investors: The Reluctant Activists," for an overview of the activist tactics of mutual funds.
[104]See Robert Monks and Nell Minow, *Corporate Governance*, pp. 372-385, for a review.

ties regulations authorities.[105] I recorded data on equity stake above the 5 percent threshold from September 1997 to January 2007 for the sixty largest firms by stock market capitalization in both France and Germany.[106] Large European companies with high trading volumes and high degrees of free float are said to be the primary focus of actively managed mutual funds. Fluctuations in price following market transactions are likely to be more compressed for these firms than for smaller companies or those with lower amounts of shares available for purchase. I recorded every instance of acquisitions of equity capital over the 5 percent threshold by hedge and mutual funds under the following conditions. First, my sample is composed of domestically based firms in France and Germany. Second, I discarded movements of capital above and below the 5 percent threshold within a thirty-day period. Some funds have adopted a policy of automatic sale of stocks if their equity stake goes above the mandatory disclosure requirement. Moreover, movements above and below the 5 percent threshold might reflect a share buyback program by a portfolio corporation rather than an intended strategy by an institutional investor. Third, I selected equity capital in a firm rather than voting rights as the indicator of movement of capital above the five percent threshold. Fourth, I discarded holdings held by sub-custodians firms such as State Street and Brown Brothers Harriman. The 1940 Investment Act in the United States requires mutual funds to place their funds with sub-custodian firms for issues of shareholder protection. Thus, the holdings of such financial agents simply reflect holding the financial asset of mutual funds clients rather than a strategic investment decision.

Fifth, acquisitions of an equity stake above the five percent threshold by a mutual fund organization for firms that were successfully targeted as part of a takeover bid are also discarded from the sample. The reason is that one of the most consistent findings in finance theory is that target companies in M&A deals are sold at a premium that has fluctuated between 30 and 50 percent in the United States. The corresponding figures for foreign targets have averaged between 20 and 50 percent. [107] In other words, the shareholders of targeted firms stand to experience substantial financial gains in the event of a successful acquisition of their company. The implication is that mutual funds acquiring a large equity stake in these types of firms reflect an assessment about capital gains associated with the completion of a takeover, not an investment decision driven by judgments about the implementation of corporate restructuring measures that would result in greater corporate earnings. As a result, I discard equity stakes above the 5 percent level that occurred twelve months before the formal completion of what turned out to be a successful takeover bid. Finally, I crosschecked the data collected by relying on two national business directories: DAFSA *Annuaire des Sociétés* for France and Rudiger Liedtke's

[105]Investments below the 5 percent threshold by hedge/mutual funds are not of interest for this study. I do not seek to understand why these two groups of institutional investors would acquire, let's say, 1 percent of the equity capital of a French or German firm. Such an investment is usually associated with the diversification strategy of pension funds. The focus of this paper is on the ability of hedge/mutual to achieve substantial returns on their investment via strategic and concentration investment stakes. See the discussion on pages 30-32.
[106]I collected data from the two official governmental databases of the financial regulation authority of the two countries: www.amf-france.org and www.bawe.de
[107] For example, see William Bratton, "Hedge Funds and Corporate Governance Targets," Law Working Paper # 80/2007 (Brussels: European Corporate Governance Institute, 2007), pp. 16-17.

Wem Gehört die Republik for Germany.[108] These two annual publications provide a full list of shareholders of listed companies and serve as useful reliability check mechanisms.

Data on the presence of actively managed mutual funds – a category of short-term, impatient institutional investors – in France and Germany reveal striking patterns of divergence (see Table 6). The attractiveness of France over Germany is evident, as mutual funds have invested massively in the former, as measured by the overall number of stakes over the five percent threshold. Table 6 lists the largest French and German blue-chip companies that are part of the top 1000 European firms by stock market capitalization. For the top sixty French firms by market capitalization, thirty-three of them recorded sixty-four instances of investment over the 5 percent threshold by short-term Anglo-Saxon institutional investors. Because a firm can receive more than one investment from a single institutional investor, the number of investments is always higher than the number of companies receiving investment. For the top sixty German firms by market capitalization, only twenty-three of them recorded thirty-five instances of investment over the five percent threshold by Anglo-Saxon institutional investors. For blue-chip companies, therefore, the total overall number of acquisitions in French firms was a little under twice those recorded for German companies.[109]

The data on the acquisition of a stake superior to the five percent threshold of the equity capital of large listed French and German firms provides a useful indicator of the presence of actively managed mutual funds in the two countries. Such concentrated positions in companies are highly revealing of the motivations of institutional investors. The assumption is that the increase in share price between the time of purchase and sale of the targeted stock is superior to the price decline associated with selling an important percentage of the equity capital of the company. Index-driven, diversified institutional investors do not face this issue since their average holding in a portfolio company is very small.

However, additional triangulated measures must complement this indicator in order to fully capture the preferences of institutional investors. First, mutual funds have different objectives and investment strategies reflected in the turnover rate of managed funds. The turnover rate is defined as the percentage of the portfolio's holdings that have changed in the previous year. Fund managers with high turnover rates trade actively, holding stocks for shorter periods. For example, a turnover rate of 100 percent indicates that the manager changes the entire portfolio within a year. Differences in turnover rates reflect fund managers' assessment of the content and speed of corporate restructuring in portfolio companies. Being able to restructure themselves in a rapid fashion, portfolio companies force actively trading managers to turn over their portfolio quickly in order

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[108]Dafsaliens, *Annuaire* DAFSA (Paris: Editions Dafsa), annual publication; and Rudiger Liedtke, *Wem Gehort die Republik?* (Frankfurt: Eichborn), annual publication.

[109]The greater attractiveness of French firms to mutual funds is not limited to blue chip companies. A similar divergence characterizes the investment of Anglo-Saxon institutional investors in the two countries outside the top sixty blue-chip company category (see Annex 1). Moreover, the preference for the French market also extends to hedge funds. The French corporate sector recorded sixty-seven instances of an investment stake above the five percent threshold from American/British-based hedge funds according to publicly available information. The corresponding figure for Germany was 41 (see annex 1).

to capture the potential changes in share price following restructuring. A full appreciation of a concentrated equity stake in a selected firm must be viewed jointly with the assessments made about the nature of internal changes in the company.

Second, the quasi-totality of funds does not stand alone, but rather form a family of funds organized under a management company. Mutual funds are comprised of several individual funds with different objectives. For example, Fidelity Spar International is a passively managed fund focused on European stocks with a turnover of just six percent in 2005. In contrast, Fidelity Europe is also focused on European stocks but is a growth oriented fund that had a turnover of 99 percent in 2005. Thus, the same firm can appear in mutual funds categorized with different styles. The analysis of bottom-up indicators – from a specific fund of a mutual fund organization to a given portfolio company – must complement the use of top-down measurement, from the shareholding structure of the targeted company back to a mutual fund organization. Third, portfolio holdings below the five percent equity stake threshold are not entirely composed of diversification seeking, passively managed mutual funds. Some short-term oriented mutual funds with high turnover rates also collectively constitute important shareholders of European companies but shunned from acquiring more than 5 percent of any one security for both disclosure and foreign exposure reasons.

Table 6: French and German Companies in the top 1000 European Index, Market Capitalization on December 17, 2003 (Overall European Rank) (Number of Investments above the 5 Percent Threshold by Mutual Funds)

France	Germany
1) Total (5) (1) 1997: Fidelity Turnover Rate: >50%	1) Siemens (16)
2) BNP-Paribas (20) (1) 1997 : Templeton Turnover Rate : <50%	2) Deutsche Bank (24)
3) Aventis (29) (1) 1997 : Templeton Turnover Rate : <50%	3) Deutsche Telekom (25)
4) Societe Generale (34)	4) Allianz (30)
5) Carrefour (39)	5) E.ON (33)
6) AXA (43)	6) Daimler-Chrysler (36)
7) L' Oreal (50)	7) SAP(38)
8) Sanofi-Synthelabo (51)	8) BASF (44)
9)Vivendi(52) (2) 2004 : Fidelity Turnover Rate: >50% 2004: South East Asset Mgt Turnover Rate : <50%	9) Munich Re (57)
10) France Telecom (53)	10) Bayer (65) (1) 2005: Capital Group Turnover Rate: <50%
11) Danone (59)	11) BMW (83)
12) LVMH (67)	12) RWE (100)
13) Alcatel(73) (3) 1997: Fidelity Turnover Rate: >50% 2002: Brandes Turnover Rate : <50% 2004: Fidelity Turnover Rate: >50%	13) Volkswagen (104) (2) 2004: Brandes Turnover Rate: <50% 2004: Capital Group Turnover Rate: <50%
14) Suez (74)	14) Schering (129)
15) Credit Agricole (75)	15) Hypo Bank (130) (1) 2004: Capital Group Turnover Rate: <50%

16) Air Liquide (77)	16) Commerzbank (131) (1) 2006: Capital Group Turnover Rate: <50%
17) Saint-Gobain (78)	17) Thyssen Krupp (152)
18) Renault (87) (2) 1997 : Templeton Turnover Rate : <50% 2006 : Capital Group Turnover Rate : <50%	18) Deutsche Post (153)
19) Schneider (92) (2) 2000: Janus Turnover Rate: >50% 2005: Capital Group Turnover Rate : <50%	19) Infineon (165) (4) 2003: Capital Group Turnover Rate: <50% 2003: Fidelity Turnover Rate: >50% 2006: Brandes Turnover Rate: <50% 2006 Dodge & Cox Turnover Rate: <50%
20) Lafarge (95) (1) 2002: Putnam Turnover Rate: <50%	20) Deutsche Borse (172) (2) 2003: Fidelity Turnover Rate: >50% 2004: Capital Group Turnover Rate: <50%
21) Accor (134) (3) 2003: Putnam Turnover Rate: >50% 2004 : Templeton Turnover Rate : <50% 2005: Capital Group Turnover Rate : <50%	21) Metro (178)
22) Peugeot (138)	22) Continental (204) (1) 2004: Capital Group Turnover Rate: <50%
23) Lagardère (158) (2) 1997 : Templeton Turnover Rate : <50% 2006 : Fidelity Turnover Rate : >50%	23) Altana (211)
24) Bouygues (160) (3) 1998: Schroders (UK) Turnover Rate: >50% 2002: Putnam Turnover Rate: <50% 2005: Capital Group Turnover Rate: <50%	24) Henkel (214)
25) Pinault Printemps Redoute (161)	25) Porsche (220)
26) Arcelor (168)	26) Adidas-Salomon (223) (1) 2000: Templeton Turnover Rate: <50%
27) VivendiEnvironment (182) (2) 2002: Putnam Turnover Rate: <50% 2005: Capital Group Turnover Rate: <50%	27) Linde (253) (1) 2006: Capital Group Turnover Rate: <50%
28) Michelin (184) (2) 2000: Templeton Turnover Rate: <50% 2006: Capital Group Turnover Rate: <50%	28) T-Online (264)
29) Vinci (187)	29) Lufthansa (294)
30) CapGemini (190) (1) 2006 : Goldman Sachs Turnover Rate : >50%	30) MAN (306)
31) Pernod Ricard (197) (2) 2000: Silchester (UK) Turnover Rate: NA 2001: Fidelity Turnover Rate: >50%	31) Beiersdorf (331)
32) Essilor International (198) (1) 2001: Amvescap (UK) Turnover Rate: NA	32) Depfa Bank (340) (1) 1998: Janus Turnover Rate: >50%
33) Thomson (217) (2) 2006: Brandes Turnover Rate : <50% 2006: Templeton Turnover Rate: <50%	33) Puma (348) (1) 2003: Fidelity Turnover Rate: >50%
34) Pechiney (231) (2) 1997 : Templeton Turnover Rate : <50% 2002 : Fidelity Turnover Rate : >50%	34) TUI (368)
35) Publicis (236) (2)	35) Heidelberger Cement (382)

2001 : Putnam Turnover Rate : >50% 2004 : Harris Associates Turnover Rate : <50%	
36) TF1 (247) (2) 1997: Sanford Bernstein Turnover Rate: >50% 2001 : Putnam Turnover Rate : >50%	36) Fresenius (390)
37) Casino (265)	37) Merck (409) (3) 2002: Tweedy Browne Turnover Rate:<50% 2004: Capital Group Turnover Rate: <50% 2004: Fidelity Turnover Rate: >50%
38) Unibail (294) (1) 1997 : Templeton Turnover Rate : <50%	38) Hypo Real Estate Holding (439) (1) 2005: Capital Group Turnover Rate: <50%
39) Christian Dior (287)	39) MG Technologies (462) (1) 2003: Capital Group Turnover Rate: <50%
40) Sodexho (327)	40) Stada Arzneimit (487)
41) Valeo (329) (2) 2001 : Templeton Turnover Rate : <50% 2005: Brandes Turnover Rate: <50%	41) Celanese (498) (1) 2003: Fidelity Turnover Rate: >50%
42) Thales (342) (1) 2006: Capital Group Turnover Rate: <50%	42) Celesio (523)
43) Dassault Systèmes (346) (1) 2004: Fidelity Turnover Rate: >50%	43) MLP (547) (2) 2006: Fidelity Turnover Rate: >50% 2006: Harris Associates Turnover Rate <50%
44) Wanadoo (347) (1) 2002: Goldman Sachs Turnover Rate: >50%	44) Pro Siebensat (552)
45) Autoroutes Sud France (353)	45) Wella (558)
46) Business Objects (374) (3) 2001: Fidelity Turnover Rate: >50% 2004: Fidelity Turnover Rate: >50% 2005: MA Financial Services Turnover Rate:>50%	46) Epcos (565) (2) 2002: Capital Group Turnover Rate: <50% 2006 Dodge & Cox Turnover Rate: <50%
47) Eurotunnel (378) (1) 2002: Oppenheimer Funds Turnover Rate: >50%	47) Suedzucker (572)
48) Technip-Coflexip (381) (5) 1997: Fidelity Turnover Rate: >50% 2000: Putnam Turnover Rate: >50% 2004: Oppenheimer Funds: <50% 2006: Capital Group Turnover Rate: <50% 2006: Trademarks NWQ Turnover Rate: <50%	48) Hannover Ruck (577)
49) CNP Assurances (411)	49) Medion (597) (2) 2004: Fidelity Turnover Rate: >50% 2004: Jupiter (UK) Turnover Rate:<50%
50) Sagem (418)	50) IKB DT Industriebank (603)
51) Air France (430)	51) Douglas (608)
52) Atos (434) (1) 1998: Fidelity Turnover Rate: >50%	52) Singulus Technologies (621)
53) Hermes (436)	53) Bilfinger Berger (632) (1) 2005: Fidelity Turnover Rate: >50%
54) Genica (438)	54) Karstadtquelle (643)
55) Neopost (446) (3) 1999: Fidelity Turnover Rate: >50% 2003: Harris Associates Turnover rate:<50% 2006: Jupiter (UK) Turnover Rate: <50%	55) Kali & Salz (K&S) (658) (1) 2004: Fidelity Turnover Rate: >50%

56) Havas (457) (3) 1999: Putnam Turnover Rate: >50% 2002: Putnam Turnover Rate: <50% 2003: Fidelity Turnover Rate: >50%	56) Frankfurt Airport (714) (2) 2006: Capital Group Turnover Rate: <50% 2006: Julius Bauer Turnover Rate:>50%
57) Imerys (469)	57) Heidelberger Druckmaschinen (723) (2) 2004: Brandes Turnover Rate:<50% 2004: Fidelity Turnover Rate: >50%
58) Natexis Bank (471) (1) 1997: Sanford Bernstein Turnover Rate: >50%	58) AAreal Bank (737) (1) 2004: Capital Group Turnover Rate: <50%
59) BIC (490) (4) 2001 : Templeton Turnover Rate : <50% 2002 : Oppenheimer Funds Turnover Rate : <50% 2002: Amvescap (UK) Turnover Rate: NA 2002: Silchester (UK) Turnover Rate: NA	59) IVG Immobilien (776)
60) Zodiac (509)	60) Hugo Boss (785)

The second source of data concerning the presence of short-term institutional investors is taken from the analysis performed by Morningstar, Inc., the Chicago-based rating agency. Morningstar Inc. is the leading provider of independent research on American mutual funds and is highly influential with investors, reflected in the fact that an improvement in the rating of a fund is associated with significant new inflows of capital.[110] Data on the importance of mutual funds in France and Germany is collected from *Morningstar Funds 500*, an annual publication that evaluates the performance of the 500 biggest funds in the United States. Most of the funds covered in this annual publication have assets invested in domestic stocks and bonds.[111] Between about seventy-five and one hundred listed funds per year are involved in international equity. For each of these internationally oriented funds, *Morningstar Funds 500* lists the top countries of exposure, the turnover rate, and the top twenty holdings in the fund's portfolio.

I compiled data on the importance of the French and German markets for mutual funds with the additional following indicators. First, I computed the number of times they appear among the top three foreign investment destinations of individual mutual funds, and highlight those investments that are part of a portfolio whose turnover is superior to 50 percent. I also collected for comparability purposes data for the United Kingdom, a liberal market economy with a system of corporate governance similar to that of the United States.

Second, and as previously mentioned, the annual report of Morningstar lists the top twenty holdings in the portfolio of every mutual fund it covers. I compute from this source the number of times French and German firms from table 6 – i.e. the top sixty listed companies in the two countries – are listed as being part of the top twenty holdings in these funds' portfolios. This strategy constitutes a bottom-up approach that enables one to retrace an investment stake from a specific fund of an investment company to a listed portfolio firm. I also collect data on the number of French and German firms that are part of the top twenty holdings of a fund whose turnover rate is above 50 per-

[110]Diane Del Guercio and Paula Tkac (2001), "Star Power: The Effect of Morningstar Ratings on Mutual Fund Flows."
[111]Morningstar, *Morningstar Funds 500* (Hoboken NJ: John Wiley & Sons), annual publication.

cent. The aim of the selection of an indicator for the turnover rate of a funds' portfolio is to discriminate between actively managed and index-based mutual funds. The original motivation for a fund to acquire a stake in a listed firm is fully exposed through this indicator.

The selection of a turnover rate superior to 50 percent is designed to capture short-term capital mobility. Turnover rates over 50 percent indicate that fund managers change the entire portfolio within two years. This figure is about twice as high as the turnover rates of passively managed mutual funds. [112] The selection of this turnover rate is also designed to take into account the presence of barriers to external flexibility that makes short-term dismissals in France and Germany relatively difficult. The top executives of these two European economies face stringent employment protection regulations in comparison to their counterparts in the liberal market economies. The option of using collective redundancies as a strategy to deal with fluctuations in the economy is severely constrained. Lengthier procedural notices, higher severance pay schemes, and the implementation of social/training measures constitute key components of any important collective dismissal plans in the two countries. Firm-level works councils can delay the implementation of job cuts, but cannot block them provided that companies have followed the appropriate procedures. The choice of an indicator of a turnover rate of 50 percent and above is designed to capture the preferences of French and German managers for the enactment of collective dismissals as a period of twenty-four months is sufficient for the implementation of administrative and legal procedures related to this type of dismissals.

Finally, the selection of this turnover rate is also justified by associated lower rates of taxation on capital gains. Levels of taxation constitute an important source of costs for mutual funds and the IRS code provide tax-sensitive investors with heightened incentives to hold onto their holdings for more than a year – the rates on capital gains resulting from the sale of stocks held less than a year being a little over twice as high than for the realization of capital gains for positions held for more than twelve months.[113] Nonetheless, mutual funds investing in American companies face a trade-off – the capital gains on stocks held for less than a year might be higher, but an additional waiting period for the sale of portfolio stocks might risk missing the capture of the apex of what was an undervalued security. The greater level of short-term flexibility of the American economy implies that the implementation of corporate restructuring strategies, and the incorporation of these changes by financial investors, is likely to occur faster than in continental Europe. This trade-off is largely absent in France and Germany since the extent and nature of corporate restructuring of domestic firms is slower in the short-term than that of American companies. This being said, however, continental European economies do not constitute a monolithic bloc and provide for different degrees of fit with the strategies of actively managed mutual funds. The concentration of power in top management in French companies provides a better match with short-term oriented mutual funds.

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[112] Mark Mobius, *Mutual Funds* (Hoboken, NJ: John Wiley and Sons, 2007), p. 80.
[113] For example, see David Swensen, *Unconventional Success:: A Fundamental Approach to Personal Investment* (New York: Free Press, 2005), pp. 24-29.

The results are presented in Tables 7 and 8. The attractiveness of the French market over Germany for short-term oriented mutual funds is confirmed. First, investment in France is almost three times as important as Germany in regard to the country of exposure of internationally oriented American mutual funds (see table 7). Second, French firms are more attractive for short-term oriented mutual funds with a turnover rate superior to 50 percent as compared to their German counterparts (see table 8).

Table 7: Number of times countries appear among the top three foreign investment destinations of individual mutual funds (of which turnover rate of the portfolio is superior to 50%)

Year	Germany	France	UK
1997	9 (4)	24 (12)	38 (16)
1998	22 (17)	37 (25)	55 (36)
1999	7 (4)	26 (16)	47 (29)
2000	10 (8)	30 (20)	52 (35)
2001	11 (8)	22 (17)	50 (34)
2002	5 (4)	30 (17)	45 (21)
2003	8 (6)	20 (5)	51 (21)
2004	8 (5)	23 (9)	53 (21)
2005	3 (1)	18 (5)	51 (19)
2006	7 (4)	25 (6)	57 (19)
Total 1997-2006	90 (61)	255 (132)	499 (251)

Source: Morningstar, *Morningstar Funds 500*, various years.

Table 8: Number of times top 60 French and German firms appear among the top 20 holdings of individual mutual funds (of which turnover rate of the portfolio is superior to 50%)

Year	France	Germany
1997	73 (43)	42 (18)
1998	111 (79)	68 (47)
1999	99 (65)	34 (16)
2000	89 (70)	45 (29)
2001	103 (78)	54 (36)
2002	101 (55)	39 (26)
2003	83 (26)	37 (13)
2004	95 (46)	51 (32)
2005	99 (37)	52 (30)
2006	109 (34)	62 (19)

Source: Morningstar, *Morningstar Funds 500*, various years.

Finally, the selection of an indicator of a turnover of above 50 percent also highlights the different nature of the investment stake over the five percent threshold as listed in table 6. The acquisition of a large equity stake in a listed firm is the ultimate bet of mutual funds – i.e. the assessment that measures of corporate restructuring would be significant enough to result in higher stream of corporate earnings and level of stock market capitalization that will compensate for any decline in share price when the fund liquidates its position. However, the acquisition of a significant stake in a company does not in itself reveal the nature and speed of corporate restructuring. Therefore, I identify the turnover rate (s) of the mutual fund organization that took a significant equity stake in French and German corporations. The greater attractiveness of French firms for short-

term oriented institutional investors is further confirmed. Twenty-seven of the sixty-four instances of investment over the 5 percent threshold by mutual funds in France were part of an investment portfolio whose turnover rate was above 50 percent. By contrast, only twelve cases out of the thirty-five instances of investment above the five percent threshold in Germany were associated with a turnover rate superior to 50 percent.

III. Argument: The Centrality of Firm-Level Institutions in France and Germany

The argument of this paper is that the variations in the firm-level institutional arrangements of workplace organization of French and German companies constitute the single variable that mattered most crucially to account for the greater propensity of actively managed mutual funds to invest in the former. I do not wish to argue that differences in the firm-level institutions of French and German companies constitute the only investment criterion for this category of short-term, impatient capital. The investment decisions of fund managers are best understood as a process of causal complexity – several factors accounting (jointly or separately) for the specific outcome of portfolio investment in a given country. We can identify two broad investment strategies, each with their own subsets of niche strategies.[114]

First, institutional investors can pursue a top-down investment strategy whereby fund managers build their portfolios based on the analysis of macroeconomic factors associated with different countries and/or regions.[115] Geographical allocation is decided first, and only then would the fund manager select which stocks to invest in. Top-down managers seek to anticipate evolving market trends and of price changes on capital markets. The statistical analysis of the timing of economic cycles, rates of GDP growth, balance of trade, exchange rates, and the state of public finance constitute key variables in the investment making-process of top-down fund managers.

Second, institutional investors can pursue a bottom-up investment strategy whereby fund managers behave as stock pickers, i.e., selecting the companies to buy (and sell) after an examination of their fundamentals. The research undertaken at mutual funds organizations seek to discover undervalued stocks with potential higher returns than securities in the same category. The bottom-up approach to investing by mutual funds is usually divided into two analytical steps. The first one is based on quantitative analyses that aim at uncovering historical patterns in prices and volumes on stock trading in order to predict the evolution of a firm's stock in the future. These types of quantitative analyses enable research analysts to develop large lists of candidate stocks for considera-

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[114]Moreover, institutional investors invest in many asset classes beside equities. They also invest in bonds, commodities, currencies, and diverse fixed income instruments. The argument presented in this paper focuses solely on equities, the logic and argument associated with the investment strategies of hedge and mutual funds being a different asset class. For example, fund managers contemplating an investment in municipal bonds will actively research the state of public finance of the issuer, economic cycles and any recent piece of news that could affect its solvency. These criteria are obviously largely unconnected to issues raised by an institutional perspective such as Varieties of Capitalism.

[115]Good reviews of the investment strategies of actively managed mutual funds are Lee Gremillion, *Mutual Funds Industry Handbook* (Hoboken NJ: John Wiley & Sons, 2005), and Robert Pozen, *The Mutual Fund Business*.

tion. The second one is based on more qualitative research techniques designed to reduce the list of potential stocks to a selected group that fits with the investment strategies and goals of the fund manager. Examples of qualitative techniques are on-site visits, interviews with top management, review of the trade literature, and an evaluation of the ability of senior corporate executives to implement strategies that will generate substantial corporate earnings. The importance of institutionally-based varieties of capitalism in France and Germany – concentration of power in top management in the former and diffusion of power among diverse stakeholders in the latter -- is most critical at this juncture. The argument is that various events in the life of a company – reorientation of its strategy, focus on core competencies and disposal of non-core units, mergers and acquisitions, distribution of cash flows to shareholders through dividends or share buybacks, and many others – can drive upward or downward the price of its stock towards a new value.[116] The type and probable speed of corporate restructuring measures that managers are able to implement shape the extent to which the above income generating strategies are likely to see the light of day. The investment decisions of fund managers, in turn, rest on a bottom-up analysis in the sense that a good knowledge of the activities of firms constitutes the bulk of the investment analysis. The fund manager seeks to predict the outcome of potential corporate decisions, as well as the best time to invest in specific companies. The value of an investment portfolio can erode if a substantial investment stake took place and the predicted corporate event does not.

I argue in this paper that the varieties of firm-level institutional arrangements – with the associated divergence in the degree of power concentration in the firm – constitute the most important factor to account for the important aggregate investment gaps between France and Germany. This divergence occurs despite the presence of multiple causal paths to portfolio investment. What is the relationship between firm-level institutional arrangements and the process of strategic investment of short-term, impatient capital? The overall aim associated with the investment decisions of any type of funds – long-term oriented pension funds as well as short-term driven hedge and mutual funds – is to generate capital gains (and/or secure company dividends) for their financial contributors. Fund managers seek to build an investment portfolio that will experience an increase in value over time. This is done through buying what are perceived to be un-

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[116]The analysis of this second analytical step of the bottom-up investment strategy is further divided into two sub-categories: frequent corporate events that managers have to confront on a regular basis versus special situations that arise out of extraordinary corporate events. The decision to pay dividends at the annual general meeting of the company constitutes an example of the former; the acquisition of highly depressed stocks of distressed companies in the expectation of a price rebound represents an example of the latter. An institutionally-based, middle-range theory such as Varieties of Capitalism is better suited to provide significant insights on bottom-up investment strategies dealing with regular corporate events. Its strength lies in the analysis of how institutional frameworks enable firms to coordinate their activities and to develop their innovative capabilities. By contrast, the identification of companies that are destroying substantial shareholder value and of those on the verge of, in the middle of, or emerging from bankruptcy requires different types of bottom-up analyses for which the institutionally-based Varieties of Capitalism perspective does not seek to contribute. Such analyses, for example, would focus on the identification of the types of companies belonging to a distressed sector negatively affected by internal/external changes or those whose management lies to its shareholders through the pursuit of aggressive accounting practices and other similar tactics.

dervalued stocks and selling overvalued ones. Thus, institutional investors share a preference for shareholder value strategies, i.e., managers making decisions that will spur the price of the company's equity higher. Institutional investors, however, have little else in common. Their shared preference for shareholder value strategies does not translate into similar investment strategies. In particular, the time horizons of actively managed mutual funds (and hedge funds) result in preferences not only for shareholder value strategies, but for those that bring rather immediate results. Three key features of the mode of operation of mutual funds/hedge funds entail critical implications for their investment strategies.

First, fund managers are driven by performance concerns. They possess heightened incentives to surpass financial benchmarks (mutual funds) or reap as high as possible absolute returns (hedge funds), not just achieving targeted mandated minimum returns – the situation prevailing for pension funds. This focus on relative performance for mutual funds (and on absolute performance for hedge funds) flows from two factors. The first results from the competitive environment for the management of the equity investment business of pension funds and individual savers. Investors can shift their assets across many funds. The second factor is the importance of variable pay for fund managers. Managerial remuneration is based on the volume of assets under management and the returns on investment associated with the composition of the portfolio. The presence of high profile league tables and the importance of variable pay entail that fund managers face both constraining scrutiny and enabling inducement to achieve as high as possible returns.

Second, the holding period for actively managed mutual funds (and hedge funds) is considerably shorter than that of their pension counterparts given higher liquidity constraints. The issue of payments to investors takes place on an irregular basis since funds are more redeemable on demand, in comparison to the situation that prevails for pension funds. Their preference for managerial actions that seek to boost the stock price is accompanied by a focus on shareholder value strategies that bring greater dividends in the short term. The appreciation in the value of the investment portfolio might be a common concern for both short-term driven and long-term oriented institutional investors, but the preferred time horizon associated with its realization differs sharply.

Thirdly, and following from the previous two features, senior fund managers primarily conceptualize their role as financial traders, not as shareholders.[117] They see themselves as professional share traders who compete with each other for managing investors' funds and achieving high returns on their investment strategy. Their ownership stake in a company is viewed as the result of their trading. Their interests are divorced from those of long-term shareholders. Hedge and actively managed mutual funds do sometimes engage in activist tactics, but the gains associated with extensive monitoring

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[117]See John Hendry, Paul Sanderson, Richard Barker, and John Roberts, "Owners or Traders? Conceptualizations of Institutional Investors and their Relationship with Corporate Managers," pp. 1109-14.

are considerably lessened if they are to occur in the medium or long run given the short-term horizon of their trading.[118]

What is the relationship between the preferences of short-term, impatient investors and the institutional arrangements of workplace organization of French and German firms? Why is France a privileged destination of investment for actively managed mutual funds? The relevance of firm-level institutions is best seen through the lens of the relationship between shareholders and portfolio companies. The rise in importance of institutional investors as major shareholders constitutes a novel development in French and German corporate governance. The large equity stake of these investors provides them with the right set of incentives to monitor companies, but without the propensity to extract benefits at the expense of minority shareholders – a phenomenon present in many common law economies with important blockholders.[119] However, the ability of institutional investors to translate shareholder ownership into corporate power remains an empirical issue. The debate pits those who view institutional activism as an essential mechanism by which to monitor companies against those who assign a strong element of passivity to institutional investors.[120]

Anglo-American institutional investors do sometimes monitor extensively portfolio firms in France and Germany. Several instances anecdotal evidence testifies to the activism of investors on various issues ranging from executive pay to the presentation of codes of "good" corporate governance practices. The shareholder activism of short-term, impatient investors fits well with the organization of French companies. The primary goal of activist mutual and hedge funds investing in France is to convince the CEOs of the value of specific strategic changes. This is because the implementation of restructuring policies requires, almost exclusively, the CEO's approval, as employees have no means of intervention.[121] Moreover, the overall weakness of employees reduces the ability of French CEOs to claim that they are constrained in the elaboration and implementation of firm strategy and that they are unable to make concessions.

However, shareholder activism by institutional investors, more often than not, does not represent the "normal" state of affairs in corporate governance. Several studies have highlighted the underdevelopment of shareholder activism in the interactive relationship between institutional investors and top management, as well as the lack of financial

[118]Moreover, it is interesting to note the separation of tasks in the organizational structure of funds. The monitoring functions are carried out by an organizationally separate team of governance specialists. The stock pickers (i.e., traders) of a fund share little in common with these governance specialists. See John Hendry, Paul Sanderson, Richard Barker, and John Roberts, "Owners or Traders? Conceptualizations of Institutional Investors and their Relationship with Corporate Managers," p. 1112.
[119]A good summary of these issues is provided in Peter Gourevitch, "The Political Economy of Institutional Investors in Corporate Governance: Some Comparative Problems," paper presented at the annual meeting of the American Political Science Association, Philadelphia PA, August 31-September 3, 2006; and Peter Gourevitch and James Shinn, *Political Power and Corporate Control.*
[120]See note 56.
[121]This is the position adopted by Antoine Rebérioux, "European Style of Corporate Governance at the Crossroads: The Role of Worker Involvement," p. 125.

consequences associated with instances of shareholder activism.[122] As previously mentioned, the short-term trading strategy of actively managed mutual funds (and hedge funds) can substantially erode the gains associated with extensive monitoring.[123] The equity stake of these investors in portfolio companies is often considerably shorter than the amount of time required for shareholder activism to bear its fruits. Short-term institutional investors conceptualize their primary role as being traders, not owners of companies. In fact, the personnel at mutual funds that are involved in activism are usually not the one involved in stock picking. Moreover, mutual funds in the United States face a conflict of interest that results from their multiple sources of income.[124] Funds derive their income from managing a firm's pension plan as well as maximizing the value of their stock portfolio, thereby presenting them with opposite strategies in regard to shareholder activism.[125] Finally, institutional investors in advanced capitalist economies face a trade-off.[126] In countries where the degrees of legal protection for minority shareholders are high, ownership is diffused, thereby leading to a "free rider" problem – namely, the financial gains associated with extensive monitoring are unlikely to be fully captured by the activist investor and likely to be widely distributed among the totality of the shareholder base. In countries with lower degrees of legal protection for minority investors, in contrast, concentrated ownership provide the incentives for large owners to monitor – but at the potential expense of minority shareholders who are vulnerable to insider exploitation.

Nonetheless, firm-level institutional arrangements of workplace organization remain crucial in understanding the investments of hedge/mutual funds in France and Germany even in the absence of institutional activism. The argument presented in this paper is not contingent on the status of activism by institutional investors. Differences in the degree of power concentration – as embodied in the firm-level institutional arrangements of workplace organization – constitute the crucial mid-level variable that mediates broader endogenous and exogenous developments. In particular, firm-level institutional arrangements characterized by top managerial power concentration make it easier to translate quickly preferences for shareholder value into practice. The process of investment selection of short-term, impatient institutional investors requires the identification of companies that are likely to quickly implement changes that will boost its stock market capitalization. French firms are attractive to hedge and mutual funds since the elaboration and implementation of a new strategy can be undertaken in a unilateral fash-

[122]See Bernard Black, "Shareholder Activism and Corporate Governance in the United States"; and Roberta Romano, "Less is More: Making Shareholder Activism a Valuable Mechanism of Corporate Governance."

[123]John Hendry, Paul Sanderson, Richard Barker, and John Roberts, "Owners or Traders? Conceptualizations of Institutional Investors and their Relationship with Corporate Managers."

[124]See Peter Gourevitch, "The Political Economy of Institutional Investors: Some Comparative Problems."

[125]This argument, however, is more applicable to the case of the relationship between mutual funds and American companies. It does not automatically extend to continental European portfolio companies since the pay-as-you retirement system in this region of the world limits the ability of institutional investors to act as external money managers for pension funds.

[126]See Peter Gourevitch, "The Political Economy of Institutional Investors: Some Comparative Problems," p. 6.

ion. The decision to pursue shareholder value strategies might remain a managerial prerogative that is not necessarily dictated by portfolio investors, but the ability of French corporations to implement these shareholder value strategies is greatly facilitated by the relative weak position of employees. The reverse logic applies for the German case – the entrenched position of employees limits the ability of CEOs to conduct the strategy of the firm in a unilateral fashion.

The rest of this section is organized in the following manner. First, I identify the institutional arrangements of firm-level organization that stand prominently in illustrating the concentration of power at the top of French companies and the constraints on managerial autonomy in Germany. I discuss four areas of firm-level organization – legal rights of firm-level works councils, skill certification and formation, segmentation of activities, and the autonomy of employees in problem solving tasks. Second, I analyze how these institutional arrangements shape the adjustment process of companies which, in turn, provides for different degrees of fit with the preferences and strategies of different categories of institutional investors.

A) Legal Rights of Employees

Substantial cross-national differences in the institutional and organizational features of firm governance and labor representation are shaped by the distribution of legal rights at the firm level. This distribution ranges from information, consultation, codetermination, and unilateral worker control over various issues with substantial variation among OECD countries in regard to their presence and distribution.[127] The distribution of legal rights presents management with constraints and opportunities in the elaboration and implementation of the strategy of the firm. The influence of labor in the national system of corporate governance is related to the extensiveness and comprehensiveness of their legal rights. In some cases, these legal rights provide employees with veto power (or quasi veto power) over important strategic decisions of the company. The German case is characterized by the presence of extensive and comprehensive legal rights for employees that provide them with several (quasi) veto powers. These (quasi) veto powers are extremely important for labor since its legally protected position does not rely on implicit contracts.[128] Corporate governance in Germany is a long-term iterated game since employees do not have to take into consideration whether it is in the interests of management to include them in the decision-making process. These legally secured rights provide labor organizations with multiple opportunities to intervene since consensus is almost required for adjustment. By contrast, the French case is characterized by the presence of extensive (but not comprehensive) legal rights for employees that do not result in the provision of (quasi) veto power. The legal rights of works councils in France pro-

[127]See Herman Knudsen, *Employee Participation in Europe* (London: Sage Publications, 1995); and Eddy Wymeersch, "A Status Report on Corporate Governance Rules and Practices in Some Continental European States," in Klaus Hopt, Hideki Kanda, Mark Roe, Eddy Wymeersch, and Stefan Prigge, eds., *Comparative Corporate Governance: The State of the Art and Emerging Research* (New York: Oxford University Press, 1998), pp. 1135-1151.
[128]Katharina Pistor, "Codetermination: A Sociopolitical Model with Governance Externalities," in Margaret Blair and Mark Roe, eds., *Employees and Corporate Governance* (Washington DC: Brookings Institution Press, 1999).

vide for employee expression in the workplace, but not for effective voice. The outcome of the underdeveloped legally-based veto rights of French employees is one where unilateral employer prerogative is widespread.[129]

The overarching feature of the German system of labor relations is the detailed legal status of the actors and of their rights and responsibilities with the associated mandatory structures that provide for a strong foothold for employee involvement irrespective of managerial openness. The relationship between employees and other parties is bound by law, which severely reduces the ability of management to opt out of agreements. The legally-based veto points of German employees are embedded in the system of Codetermination that operates at two levels: the representation of employees on the board of directors and the legal rights provided at the company level through the works councils. The 1976 law on Codetermination provides for equal representation of employees and shareholder-elected directors on the supervisory board. Employees and shareholder representatives each possess one vote – with the chairman appointed from the shareholder side casting the deciding ballot in the event of a tie. The major function of the supervisory board is to appoint, supervise and replace members of the management board. The selection of managers requires a two-thirds majority, thereby insuring a veto power for labor. Hard-line managers who are unable to get along with labor are virtually excluded from the board.[130] In addition, the approval (single majority) of the board of directors is required for numerous corporate actions: approve accounts and profit allocation, authorize the issue of stock options and of new shares, and approve the erection of takeover defenses.[131]

The second aspect of Codetermination rights refers to an overall extensive system of labor participation in corporate affairs through the works councils. Workers in any enterprise (or plant) employing more than five employees are entitled by law to elect every three years a works council to represent their rights at the firm level. The entire workforce of an establishment elects work councilors, not only union members. While works councils are prohibited to engage in strikes and constitute a distinctive legal entity from

[129]Michel Goyer and Bob Hancké, "Labour in French Corporate Governance: The Missing Link," in Howard Gospel and Andrew Pendleton, eds., *Corporate Governance and Labour Management* (New York: Oxford University Press, 2005); and Rebecca Gumbrell-McCormick and Richard Hyman, "Embedded Collectivism? Workplace Representation in France and Germany," *Industrial Relations Journal* 37,5 (September 2006): 473-491.

[130]Klaus Hopt, "Labor Representation on Corporate Boards: Impacts and Problems for Corporate Governance and Economic Integration in Europe," *International Review of Law and Economics* 14,2 (June 1994): 203-214, p. 207.

[131]At the same time, however, one must not overstate the influence of labor associated with codetermined seats on the board of directors. The monitoring of the actions of management by the supervisory board has not been extensive. In fact, it is precisely because of the institution of Codetermination that German managers and shareholders have prevented the supervisory board from evolving into an important governance institution. Thus, while codetermined boards insure that management cannot introduce unilaterally new measures at the expense of employees, it does not give labor adequate means to influence the conduct of the business strategy of the firm. For a full discussion, see Mark Roe, "Codetermination and German Securities Markets," in Margaret Blair and Mark Roe, eds., *Employees and Corporate Governance* (Washington DC: Brookings Institution Press, 1999).

union members, the great majority of councilors are elected on lists affiliated to the DGB – Germany's biggest unions.[132] The head employee representative on the supervisory board also sits on the works councils. Moreover, the legal rights of works councils are both comprehensive and extensive that provide a strong foothold for employees and inhibit exclusionary strategies on the part of management (see Table 9). Overall, the legal participation rights of works councils are strong in social matters, weaker over personal issues, and modest in economic and financial matters. The legal veto rights of works councils on issues of job and bonus rates, overtime and the allocation of working hours, use of technical devices designed to monitor employees' performance, or the introduction of new payment methods prevent German managers from acting unilaterally. In fact, the importance of works councils has substantially increased in recent years. The heightened volatility of markets and the need to adjust quickly has raised the prominence of firm-level works councils and reduced the importance of national unions. The greater flexibility of decentralization of collective bargaining has shifted the locus of collective bargaining, but did not result in unilateral managerial control over firm strategy.[133] Works councils have become "co-managers" of the firm in the implementation of painful restructuring measures and the elaboration of new strategic business decisions.[134]

In addition to their legally defined rights, works councils have been able to project their influence in two other ways. First, works councils have strategically used their veto power in some areas through linkage to other issues where they have weaker Codetermination rights.[135] Works councilors have often refrained from exercising their legal rights in areas where they are strong in exchange for greater influence on questions covered only by information rights. For example, the works council at Volkswagen's Braunschweig plant did use its Codetermination rights on working times and wage grades to demand expanding the skills and training funds for affected workers in the 1980s.[136] The second way through which works councils have exercised their influence at the firm level is through wage bargaining. The centralization of wage bargaining at the industrial level is supplemented by informal negotiation at the firm level through works councils – resulting in a substantial wage drift. The effect of centralization of initial wage bargaining combined with the role of works councils at the final stage has prevented German

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[132]See Kathleen Thelen, *Unions of Parts: Labor Politics in Postwar Germany,* p. 80.

[133]Harry Katz, "The Decentralization of Collective Bargaining: A Literature Review and Comparative Analysis," *Industrial and Labor Relations Review* 47,1 (October 1993): 3-22; and Kathleen Thelen, "West European Labor in Transition: Sweden and Germany Compared," *World Politics* 46,1 (October 1993): 23-49.

[134]Walter Muller-Jentsch, "Re-assessing Co-determination," in Walter Muller-Jentsch and Hansjorg Weitbrecht, eds., *The Changing Contours of German Industrial Relations* (Munich: Rainer Hampp Verlag).

[135]See Herman Knudsen, *Employee Participation in Europe,* p. 40; and Walter Muller-Jentsch, "Germany: From Collective Voice to Co-Management," in Joel Rogers and Wolfgang Streeck, eds., *Works Councils: Consultation, Representation and Cooperation in Industrial Relations* (Chicago: University of Chicago Press, 1995).

[136]See Kathleen Thelen, *Unions of Parts: Labor Politics in Postwar Germany,* p. 213.

corporations from pursuing a low wage strategy.[137] Large companies have been forced to compete in non-price competitive market segments capable of sustaining high wages.

Table 9. Rights of the German Works Council According to the Works Constitution Law of 1988

	Co-Decision (cd), Consultation (cons), & Information (inform) Rights of the Council
SOCIAL MATTERS	
Conduct of Employees	Cd
Working Hours	Cd
Wage Payment Procedures	Cd
Holiday Planning	Cd
Installation of Electronic Surveillance Equipment	Cd
Regulations regarding Accident Prevention	Cd
Social Services and Amenities	Cd
Employee Housing	Cd
Wage Scales	Cd
Piece Rates	Cd
Suggestion Schemes	Cd
PERSONNEL MATTERS	
Planning of Structuring of Jobs, Operations,	Cons
and Working Environment	Cd
Alterations in Jobs, Operations, or Working	
Environment	Cons
Personnel Planning	Cd
Personnel Questionnaires*	Cd
Written Employment Contracts*	Cd
Recruiting and Selection Standards*	Cons
Establishment of In-Plant Vocational Training Facilities	Cons
Introduction of Vocational Training Programs	Cd
Implementation of Vocational Training	Cd
Hiring, Classification, Transfer, Redeployment**	Cd
Dismissals ***	
ECONOMIC MATTERS	
Economic Conditions of the Company, Production	Inform
Situation, Production Program, Financial Situation,	
Marketing Situation, Investment Program,	
Rationalization Plans, New Work Methods,****	Cons
Reduction or Close-Down of the Company, Transfer of	
the Plant, Mergers, Changes in the Organization and	Cons
the Business Purposes	
Mass Layoff	
Social Consequences of Operational Changes and Mass Layoff	

* Full Veto Power.
**These rights hold only for firms with at least twenty employees. Only in specific cases is the works council entitled to hiring, classification, transfer, and redeployment.
***Only in specific cases is the works council entitled to object to a dismissal.

[137]See Wolfgang Streeck, *Social Institutions and Economic Performance*; and Kathleen Thelen, *Unions of Parts: Labor Politics in Postwar Germany* pp. 155-179.

****Consultation rights regarding the social, personnel, and economic consequences of new work methods on employees.
Source: Stefan Prigge, "A Survey of German Corporate Governance," in Klaus Hopt, Hideki Kanda, Mark Roe, Eddy Wymeersch, and Stefan Prigge, eds. *Comparative Corporate Governance: The State of the Art and Emerging Research* (New York: Oxford University Press, 1998), p. 1013.

The composition and workings of the works councils have significantly contributed to its limited role in France. The works councils are composed of fifteen elected councilors for companies with over 1000 employees, one representative from each union organization present in the firm, the CEO, and two members of management. The CEO controls the agenda of the meeting and has veto power over its direction – thereby contributing to its lack of credibility for employees.[138] Moreover, the power and influence of the works councils in France remain limited despite their extensive information rights. In fact, these rights are more extensive than in Germany since they cover several spheres (see Table 10). But the legislation on works councils assigns no veto rights that might encourage bargaining and serious discussion.[139] French employees have no opportunity to link their information rights to other issues where they could block change. Finally, the information provided by management is often delivered late and is of little usefulness. The fulfillment of legal requirements imposed on management is characterized by formalism and has forced work councilors to sue management on numerous occasions.[140]

Table 10. Legal Rights of Works Councils

	INFORMATION & CONSULTATION				
	Economics	**Socio-Occupational**	**Health & Safety**	**Welfare & Cultural Activities**	**Claims**
FRANCE Works Council	•	•	•	•	(•)
GERMANY Works Council	•	•			
U.K. Shop Stewards	•	•	•		•
SWEDEN Shop Stewards	•	•	•		

Source: ETUC (2001), *Benchmarking Working in Europe*, p. 66.

[138]See Robert Tchobanian, "France: From Conflict to Dialogue?" in Joel Rogers and Wolfgang Streeck, eds., *Works Councils: Consultation, Representation and Cooperation in Industrial Relations* (Chicago: University of Chicago Press, 1995).
[139]See Gérard Desseigne, *L'Evolution du Comite d'Entreprise* (Paris: Presses Universitaires Françaises, 1995); and Adelheid Hege and Christian Dufour, "Decentralization and Legitimacy in Employee Representation: A Franco-German Comparison," *European Journal of Industrial Relations* 1,1 (March 1995): 83-99, p. 91.
[140]Gérard Desseigne, *L'Evolution du Comite d'Entreprise,* p. 30.

B) Training and the Building of Firm Competencies

The second key firm-level institutions are those related to the process of skill formation and certification of the workforce, i.e., training. The matching of jobs and worker competencies in the two countries shapes, in different ways, the ability of management to implement restructuring measures in a unilateral manner. The German economy is organized around the presence of a majority of employees with certifiable skills as a strategy for firms to develop their capabilities. By contrast, French companies build their competencies around mid-level management and technical specialists rather than investing in the improvement of the skills of the bulk of the workforce.

The divergent method of coupling tasks and competencies is first reflected in the role of vocational training in the two countries. Vocational training, in particular, is prominent in Germany and relatively neglected in France. The German system of occupational training is both prominent and autonomous – all in contrast to the French situation.[141] A substantially higher proportion of workers in Germany have received some vocational training. In 1995, the average number of trainees for large German firms (over 500 employees) was six per 100 workers, with a retention rate of 85 percent.[142] The corresponding figure for large French companies was 2.2 per hundred workers in 1996, with a retention rate of 35 percent.[143]

The different patterns by which competencies and jobs are matched in the two countries are also visible throughout the entire career of employees – and are not simply limited to vocational training. The qualification of German employees determines the definition of jobs. The access to a majority of jobs in large firms is based upon the holding of a recognized diploma or qualification – most often acquired as part of a vocational or on the job training program. Training is invariably a prerequisite for employment and promotion.[144] The influence of firm-level works councils is paramount, as they have consistently insisted that specific types of occupations should be associated with corresponding levels of skills. Managers cannot move employees within the firm without prior appropriate training. It is also interesting to note that mid-level managers and foremen must also undergo specific training in order to be appointed and promoted. As a result, the promotion process in German firms reflects the acquisition of the required technical expertise and completion of the relevant training. This process ensures that the authority of projects managers rests on technical competence, not based on their access to higher levels of managerial authority. By contrast, French employers use their own criteria to define jobs to which employees adapt either in training programs (blue-collar) or through the obtaining of university diplomas (white collar), the promotion system of French firms being a reflection of a change of status unilaterally decided by top manage-

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[141]The most comprehensive analysis of vocational training in Germany is David Soskice, "Reconciling Markets and Institutions: The German Apprenticeship System," in Lisa Lynch, ed., *Training and the Private Sector: International Comparisons* (Chicago: University of Chicago Press, 1994).
[142]Pepper Culpepper, "Individual Choice, Collective Action, and the Problem of Training Reform: Insights from France and Eastern Germany," p. 286.
[143]Ibid, p. 301.
[144]See Marc Maurice, Francois Sellier, and Jean-Jacques Silvestre, *The Social Foundations of Industrial Power: A Comparison of France and Germany* (Cambridge MA: MIT Press, 1986), pp. 65-73.

ment rather than through the acquisition of technical expertise. The relationship between training and promotion is reversed in France. Management selects workers to be promoted and then provides them with the appropriate training.[145] French firms provide in-house training for employees who usually have substantial experience at the firm. Attempts by state officials to impose the recognition of training (vocational or on-the-job) as a prerequisite for holding jobs have encountered strong opposition from employers.[146]

The German training system, moreover, is well established and autonomous from managerial interference – in addition to being prominent. The presence of a majority of workers with certifiable skills in the German economy is legally based and protected from outside intervention.[147] First, a high number of jobs require certifiable skills that are acquired in vocational training programs. Second, industrial or regional chambers must certify the training programs of firms, and any change in the content of training certification – the modification of an existing certification or the introduction of a new one – requires the approval of a body of experts in which national industrial unions (not works councils) occupy half of the seats. In turn, works councils have been instrumental in setting training standards as well as overseeing the implementation of training programs in the firm. The veto power of employees on the board of the industrial and regional training commissions prevents significant modifications of the system and ensures a stable demand for certified employees. Third, firm-level works councils possess full veto power over hiring, thereby constraining managerial ability to rely on outside experts.[148] New jobs must be offered first to the current members of the workforce. The inability of German employers to rely on external labor markets in their restructuring strategy – i.e., fire current workers, hire new ones – originated in a deal struck between the German labor movement and employers in the early 1980s. German employers were compensated for the closure of the external labor markets, as works councils took the lead in designing and implementing programs of internal flexibility in the firm.[149] In other words, the position of organized labor and the works councils in the training system has enabled them to impose significant constraints on hiring new employees when a company scaled back its activities to a few core competencies: since new training programs have to be approved by an expert body in which organized labor holds half of the seats, they have de facto veto power over these programs. The institutions of training constrain management on several fronts: skills are a prerequisite for jobs, management

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[145]Ibid, p. 77.

[146]Pepper Culpepper, "*Individual Choice, Collective Action, and the Problem of Training Reform: Insights from France and Eastern Germany,*" pp. 277-80; and David Marsden, *A Theory of Employment Systems* (New York: Oxford University Press, 1999), p. 98.

[147]See Pepper Culpepper, ibid., pp. 276-7; and Walter Muller-Jentsch, "*Germany: From Collective Voice to Co-Management.*"

[148]Michel Goyer, "The Transformation of Corporate Governance in France and Germany: The Role of Workplace Institutions," p. 26; Wolfgang Streeck, "Successful Adjustment to Turbulent Markets: The Automobile Industry," in Peter Katzenstein, ed., *Industry and Politics in West Germany: Toward the Third Republic* (Ithaca NY: Cornell University Press, 1989), p. 129

[149]See Wolfgang Streeck, "Neo-Corporatist Industrial Relations and the Economic Crisis in West Germany," in John Goldthorpe, ed., *Order and Conflict in Contemporary Capitalism* (New York: Oxford University Press, 1984), pp. 303-310.

must provide the relevant training to employees, the content of these programs must be certified by an outside body where labor possesses a veto, and the hiring of new employees with the requisite skills is subject to the approval of works councils.

By contrast, the development of the core competencies of French firms is not based on the skills of the bulk of the workforce. The educational system remains the primary mechanism by which employees are assigned to skilled positions, with vocational and on-the-job training occupying an inferior status.[150] The French case is characterized by the absence of legal requirements to assign specific jobs to workers with certifiable skills. First, attempts by state officials to impose the recognition of vocational training as a prerequisite for holding specific jobs have been successfully opposed by French employers.[151] Managers use their own criteria to define jobs to which employees adapt either through participation in training programs (blue-collar) or through obtaining university diplomas (white-collar). The content of training and the place of employees in the production process represent areas of pure managerial prerogative.[152] Second, boards of experts (business associations and employee committees) on training play a simple consultative role.[153] At the firm level, works councils possess only information rights as employers must specify how funds raised from tax levies will be spent. In the case of vocational training, moreover, it is the Ministry of Education that is responsible for the elaboration of the standards. Third, firm-level works councils possess limited information rights on the hiring of new staff – not full veto power that could prevent employers from replacing current workers with new employees.[154] Relying on outside experts has, in fact, proven to be a privileged strategy of adjustment for French companies.[155]

C. Work Organization and the Segmentation of Activities

The third major difference between the organization of the workplace in France and Germany concerns the extent to which activities are segmented, i.e., the degree of managerial control over the organization of the production process, especially in regard to how employers rely on the bulk of the workforce in organizing and carrying out tasks.[156] The French case is characterized by the segmentation of production activities and responsibilities between blue-collar employees and managers, a rather rigid but flexible

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[150]David Marsden, *A Theory of Employment Systems*, pp. 121-38.

[151]Ibid, p. 98.

[152]A good analysis of the reorganization of the practices of work floor organization in France is Danièle Linhart, *La Modernisation des Entreprises* (Paris: La Découverte, 1994). See also Marc Maurice, François Sellier and Jean-Jacques Silvestre, *The Social Foundations of Industrial Power: A Comparison of France and Germany*, pp. 74-79.

[153]Pepper Culpepper, "*Individual Choice, Collective Action, and the Problem of Training Reform: Insights from France and Eastern Germany,*" p. 278.

[154]Michel Goyer, "The Transformation of Corporate Governance in France and Germany: The Role of Workplace Institutions," p. 25.

[155]See Bob Hancké, *Large Firms and Industrial Adjustment: Industrial Renewal and Economic Restructuring in France*, pp. 57-82

[156]Richard Whitley, *Divergent Capitalisms: The Social Structuring and Change of Business Systems* (New York: Oxford University Press, 1999), pp. 38-44.

system of rules, and an emphasis on narrow and specialized skills.[157] Firms rely on the presence of rules that regulate the nature of the tasks to be accomplished – rather than the functions to be performed – to organize the production process.[158] The implementation of the business strategy is accomplished through numerous sets of carefully defined rules designed to specify the terms of exchange among parties. The organization of work is divided into fragmentary tasks. Highly qualified engineers elaborate the conception of products and employees carry out the tasks following instructions.[159] The organization of the workplace in France results in a high supervisor-to-worker ratio and a strict division of authority between management and employees.[160] The separation between planning and execution limits the ability of blue-collar employees to participate in the conduct of the business strategy of the firm, since they possess a limited view of its operations. This limitation, in turn, contributes to the concentration of power at the top of the managerial hierarchy.

The initial rationale for this specific organization of the workplace in France is best explained by Crozier's notion of the avoidance of face-to-face relationships and Hofstede's classification of France as a country in which individualism ranks high as a value.[161] The French propensity for uncertainty avoidance, combined with the antagonistic nature of industrial relations, led firms in the first three postwar decades to adopt mechanisms designed both to prevent the involvement of employees in the conduct of the strategy of the firm as well as to protect them from unpredictable and unwarranted intrusion. However, the advent of firm-level flexibility and the increasing importance of microprocessor technology in the late 1970s did raise the costs associated with the maintenance of this separation between elaboration and implementation of tasks. The need for companies to adapt quickly to a changing environment requires a change of attitude by workers.[162] Employees must enter into a dialogue with management and different functional departments in order to achieve flexibility, quality and speed. The avoidance of face-to-face dialogue is no longer sustainable in this context. Consequently, greater participation by employees in the modification of their environment has taken place inside large French companies in the last twenty years.[163] Employees are given a greater choice of tasks by management. They have become more involved in problem solving

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[157]See Danièle Linhart, *La Modernisation des Entreprises*, pp. 57-64; David Marsden, *A Theory of Employment Systems*, pp. 131-2; Arndt Sorge, "Strategic Fit and the Societal Effect: Interpreting Cross-National Comparisons of Technology, Organization and Human Resources," *Organization Studies* 12,2 (1991): 161-190.

[158]See David Marsden, *A Theory of Employment Systems*, pp. 103-104; Marc Maurice, François Sellier, and Jean-Jacques Silvestre, *The Social Foundations of Industrial Power: A Comparison of France and Germany*, pp. 60-65.

[159]See Marc Maurice, François Sellier, and Jean-Jacques Silvestre, ibid., pp. 59-120.

[160]Marc Maurice, François Sellier, and Jean-Jacques Silvestre, ibid., pp. 69-80; Arndt Sorge, *The Global and the Local: Understanding the Dialectics of Business Systems*, pp. 160-62.

[161]Michel Crozier, *Le Phénomène Bureaucratique* (Paris: Le Seuil, 1963); and Geert Hofstede, *Culture's Consequences: International Differences in Work Related Values* (London: Sage Publications, 1980).

[162]For an analysis of the implications of the concept of flexibility for workplace organization, see Wolfgang Streeck, "The Uncertainties of Management and the Management of Uncertainty," *International Journal of Political Economy* 17,3 (Fall 1987): 57-87.

[163]See Danièle Linhart, *La Modernisation des Entreprises*, pp. 23-47.

and contribute in monitoring and evaluating performance, as more is expected of them from management.[164] Nonetheless, the separation between planning and execution is still predominant in France and the organization of work has not lost its key fordist component.[165] Shop-floor restructuring in the last fifteen years might have provided for greater employee involvement in monitoring and evaluating performance, but does not allow for their influence over what tasks they perform and the conditions under which work takes place. Hierarchical relationships are still predominant inside French firms, despite the greater involvement of employees.[166]

The organization of work in Germany, on the other hand, is more straightforward and characterized by the application of rules to broad functions, rather than by trying to predict all contingencies on the shop floor through heavy reliance on explicit instructions.[167] The predominance of employees with certifiable skills and the subsequent reliance of management on the bulk of the workforce as a strategy to develop the capabilities of the firm constitute critical factors that have bridged the gap between conception and implementation in Germany.[168] The role of training is particularly important in this process, as employees are grouped according to the types of qualifications they possess, and tasks are organized according to their skill requirements.[169] The outcome is in which the institutional arrangements of the workplace are characterized by blurred organizational boundaries and reduced segmentation, the delegation of control over the nature of work processes resulting in the involvement of employees in many tasks, and low reliance on formal rules in evaluating performance.[170]

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[164]See Danièle Linhart, "The Shortcomings of an Organizational Revolution That Is Out of Step," *Economic and Industrial Democracy* 14,1 (February 1993): 49-64.

[165]Pepper Culpepper, "*Individual Choice, Collective Action, and the Problem of Training Reform: Insights from France and Eastern Germany,*" pp. 274-80; Danièle Linhart, *La Modernisation des Entreprises*, pp. 48-64; and Arndt Sorge, *The Global and the Local: Understanding the Dialectics of Business Systems,* pp. 180-82.

[166]The dual nature of this development – change in practices of workplace organization combined with stability in power relationships – testifies to the importance of the distinction between institutional framework and the mode of coordination that follows from these institutions. See Peter Hall and Kathleen Thelen, "Institutional Change and the Varieties of Capitalism," for an analysis of this crucial distinction.

[167]Peer Hull Kristensen, "National Systems of Governance and Managerial Prerogatives in the Evolution of Works Systems: England, Germany, Denmark Compared," in Richard Whitley and Peer Hull Kristensen, eds., *Governance at Work: The Social Regulation of Economic Relations* (New York: Oxford University Press, 1997); Marc Maurice, François Sellier, and Jean-Jacques Silvestre, *The Social Foundations of Industrial Power: A Comparison of France and Germany,* pp. 65-73; Arndt Sorge and Malcolm Warner, *Comparative Factory Organization: An Anglo-German Comparison of Manpower and Management in Manufacturing* (Gower: Aldershot: 1986); and Richard Whitley, "Firms, Institutions and Management Control: The Comparative Analysis of Coordination and Control Systems," pp. 509-512.

[168]See Richard Whitley, "The Institutional Structuring of Organizational Capabilities: The Role of Authority Sharing and Organizational Careers," pp. 669-679.

[169]David Marsden, *A Theory of Employment Systems*, p. 38.

[170]Carl Kester, "Industrial Groups as Systems of Corporate Governance," *Oxford Review of Economic Policy* 8,3 (Autumn 1992): 24-44; and Arndt Sorge, "Strategic Fit and the Societal Effect: Interpreting Cross-National Comparisons of Technology, Organization and Human Resources," p. 166.

D. The Autonomy and Competencies of Workers in Problem-Solving Tasks

The fourth firm-level institutional difference between France and Germany deals with the degree of autonomy for employees on the shop floor. I distinguish between the separation of task execution and implementation (covered in the previous subsection) on the one hand, from the extent to which workers exercise discretion over how tasks are performed and their ability to contribute to problem solving for two reasons. First, as noted by Kumazawa and Yamada, institutional arrangements in large Japanese firms enable employees to have some influence over the standardization process, but remain powerless to shape the conditions under which work takes place once job tasks are standardized.[171] A similar argument has been made for France. The greater involvement of employees has not been match by a corresponding willingness of management to share authority.[172] Second, the ability of employees to contribute to problem solving is not independent of the development of their organizational careers. The narrow skills of French employees limit their contribution to problem solving and the fulfilment of the organizational goals of the firm, despite greater managerial expectations.

The autonomy and competencies of employees in problem solving tasks in large companies also sharply contrast between the two countries. The institutional arrangements of workplace organization in Germany provide for substantial autonomy in the definition of tasks and autonomy in their implementation.[173] High levels of authority sharing, and the involvement of workers beyond the managerial hierarchy in the elaboration of the strategy of the firm link the fate of employees to that of management.[174] Skilled employees possess strong incentives to develop problem solving capabilities, given the firm-specific stakes of their organizational career development. Moreover, the capabilities of German employees are shaped in a profound manner by the content of their skills. The involvement of employer associations in the certification process ensures that skills would be relevant to their strategic needs. The involvement of national union representatives in the certification process ensures that skills will be of general character and fit with broad job description.[175] The content of the skill certification of employees is not tightly connected to specific jobs. National unions, and IG Metall in particular, have been adamant in insisting that skills should be broad rather than narrowly task-

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[171]Makoto Kumazawa, Makoto and Jun Yamada, "Jobs and Skills under the Lifelong Nenko Employment Practice," in Stephen Wood, ed., *The Transformation of Work?* (London: Unwin Hyman 1989).

[172]See Danièle Linhart, *La Modernisation des Entreprises*, pp. 48-64; and Arndt Sorge, *The Global and the Local: Understanding the Dialectics of Business Systems,* pp. 180-82.

[173]Peer Hull Kristensen, "National Systems of Governance and Managerial Prerogatives in the Evolution of Works Systems: England, Germany, Denmark Compared," pp. 18-25, 29-30; Marc Maurice, François Sellier, and Jean-Jacques Silvestre, *The Social Foundations of Industrial Power: A Comparison of France and Germany,* pp. 90-100; and Arndt Sorge, "Strategic Fit and the Societal Effect: Interpreting Cross-National Comparisons of Technology, Organization and Human Resources," pp. 168-176.

[174]Richard Whitley, "The Institutional Structuring of Organizational Capabilities: The Role of Authority Sharing and Organizational Careers," pp. 669-679.

[175]See Wolfgang Streeck, "Successful Adjustment to Turbulent Markets: The Automobile Industry," pp. 131-132.

connected. Finally, the use of job rotations enhances the degree of polyvalence of German employees, thereby increasing their capabilities to engage in problem-solving tasks.[176] Job rotation allows companies to rely on employees with broad skills to tackle shifts in work demands.[177] German employees are open to job rotations across departments and divisions since their career development is linked to their ability to contribute to the success of the firm.[178] The degree of polyvalence of workers is high since the organization of the workplace favors the acquisition of broad based skills.[179]

The institutional arrangements of workplace organization in France, by contrast, do not contribute in a significant manner to the development of the firm-specific problem solving capabilities of employees. First, job rotations in French enterprises are lower than in Germany.[180] The working life of employees tends to be associated with specific tasks, therefore leading to substantial segmentation of work roles and greater functional specialization. Second, job demarcations are stricter. The segmentation of the activities of the firm between elaboration and execution and the narrow skills of French employees entail that they possess a limited view of the totality of the operations of the firm and rely on top management for coordination. Their ability to develop firm-specific problem solving capabilities are seriously limited since they have a limited view of the operations of the firm.[181] The process of problem solving is management-led with the involvement of a few highly qualified technical specialists.

E. Firm-Level Institutional Arrangements and Paths of Adjustment

The firm-level institutional arrangements of German firms place serious constraints on the ability of managers to conduct the business strategy of the firm in a unilateral manner. Nonetheless, companies have exhibited flexibility in adjusting internally to shifts in demand on world markets – although not in a manner that fits well with the preferences of actively managed mutual funds (and hedge funds). German firms have traditionally responded to the volatility of markets by redeploying the capabilities of employees to new uses – instead of relying on firings and other types of market-based adjustments.[182] This adjustment process is possible because the skills of employees are

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[176]Marc Maurice, François Sellier, and Jean-Jacques Silvestre, *The Social Foundations of Industrial Power: A Comparison of France and Germany,* pp. 79-84; and Arndt Sorge, "Strategic Fit and the Societal Effect: Interpreting Cross-National Comparisons of Technology, Organization and Human Resources," pp. 168-176.

[177]David Marsden, A *Theory of Employment Systems*, p. 133.

[178]Richard Whitley, "The Institutional Structuring of Organizational Capabilities: The Role of Authority Sharing and Organizational Careers," p. 674.

[179]See Marc Maurice, François Sellier, and Jean-Jacques Silvestre, *The Social Foundations of Industrial Power: A Comparison of France and Germany,* pp. 69-73; and Wolfgang Streeck, *Social Institutions and Economic Performance,* pp. 36-40.

[180]David Marsden, *A Theory of Employment Systems*, pp. 130-131; and Marc Maurice, François Sellier, and Jean-Jacques Silvestre, *The Social Foundations of Industrial Power: A Comparison of France and Germany,* pp. 79-84.

[181]See Arndt Sorge, "Strategic Fit and the Societal Effect: Interpreting Cross-National Comparisons of Technology, Organization and Human Resources," pp. 168-176.

[182]A key reading on the mixture of incentives and constraints provided by the institutional arrangements of workplace organization in Germany is Wolfgang Streeck, *Social Institutions and*

broad enough to accomplish a wide range of tasks in a context where labor laws make it difficult to proceed to dismissals. Broad skills and blurred organizational boundaries provide employees a fairly complete view of the operations of the firm. There is substantial scope for the involvement of skilled workers in problem-solving activities.[183] Training curricula and regulations are broadly defined to avoid overspecialization in narrow skill assignments and the blurring of boundaries and responsibilities allows employees to switch between different functions. The skills of employees shape their ability to solve problems that, in turn, present management with opportunities to reorganize the production process. The volatility of markets punishes firms where the skills of the workforce cannot be applied to a wide range of rapidly changing and previously unknown tasks. The possession of broad skills by employees provides German companies with the capacity for retooling in response to new market demands.[184]

This strategy, however, does not fit well with the preferences and tactics of actively managed mutual/hedge funds. The redeployment of the skills of employees to new economic circumstances involves a process of experimentation to ensure that the certified skills are relevant to the production needs of companies. This learning-by-doing strategy is unlikely to be accomplished as rapidly as external mechanisms of adjustment that rely on dismissals and other types of market-based adjustment. This is particularly true in times of rapid product and technology change that require a radical transformation in skill content. The German system is plagued by important short-term rigidities. The introduction of a new product or technology invariably gives rise to jurisdictional disputes between various employees.[185] The respective role to be performed by each of the skill category in the introduction of new products must be bargained out.[186]

The centralized and functionally differentiated work organization of large French firms, on the other hand, militates against experimentation with skill redeployment. It instead entails a separation between categories of workers: a small number of highly qualified employees sealed off from the implementation process, and the bulk of the workforce composed of low-skilled workers with narrowly specialized tasks that cannot

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Economic Performance; and Wolfgang Streeck, "Beneficial Constraints: On the Economic Limits of Rational Voluntarism," in J. Rogers Hollingsworth and Robert Boyer, eds., *Contemporary Capitalism: The Embeddedness of Institutions* (New York: Cambridge University Press, 1997).

[183]See Richard Whitley, "The Institutional Structuring of Organizational Capabilities: The Role of Authority Sharing and Organizational Careers," pp. 669-679.

[184]See Arndt Sorge, "Strategic Fit and the Societal Effect: Interpreting Cross-National Comparisons of Technology, Organization and Human Resources," p. 170; and Wolfgang Streeck, *Social Institutions and Economic Performance,* pp. 36-40.

[185]For a discussion of the problems engendered by the constant modification to the codes of training practices, see Gary Herrigel and Charles Sabel, "Craft Production in Crisis: Industrial Restructuring in Germany During the 1990s," in Pepper Culpepper and David Finegold, eds., *The German Skills Machine: Comparative Perspectives on Systems of Education and Training* (New York: Berghahn Books, 1999).

[186]For example, thirty-one new occupations were defined and ninety-seven were updated and modernized between 1996 and 1999. See Jill Rubery and Damian Grimshaw, *The Organization of Employment: An International Perspective* (London: Palgrave MacMillan, 2003), p. 130.

be redeployed with unpredictable shifts in demand.[187] The importance of the failure of state officials to impose the recognition of training as a prerequisite for holding specific jobs becomes apparent in this context. Differences in training between France and Germany are not simply a quantitative issue – i.e., more workers possessing certified skills in the latter. Despite state regulation that imposes a legal obligation on French firms to spend a percentage of their wage bill on training, flows of funds have been concentrated on managerial staff with already high levels of skill, not for the improvement of the general skills of the majority of employees.[188] The sharp segmentation of production activities and responsibilities between blue-collar employees and managers, a rigid system of rules, and the emphasis on narrow and specialized skills limit the ability of workers to participate in the conduct of the business strategy, thereby lessening the dependence of management on the skills of the bulk of the workforce.[189]

IV. Alternative Explanations: Causal Complexity and Qualitative Methods

The analysis of the investment strategies of institutional investors in France and Germany constitutes an ideal testing ground for the issue of complexity in qualitative methods. It is highly revealing of the nature of causation in social sciences. This study faces the typical problem of the comparison of observed cases limited in both their diversity and in relation to the number of potential explanatory variables. Moreover, many of the variables relevant to the research question of this paper potentially co-vary, thereby heightening the difficulties associated with the process of logical inference. But qualitative research methods are also well placed to deal with these issues, having highlighted the importance of complex causation, i.e., the analysis of outcomes in terms of several combinations of intersections and conditions. Quantitative and statistical methods, especially in low "n" cases, might be less well suited to tackle phenomena resulting from multiple causes since these events are not combinatorial.[190]

The research design of this paper is composed of the following elements. The study variables are the differences in the strategic investment portfolio of actively managed mutual funds in France and Germany (dependent variable) and the firm-level institutional arrangements of workplace organization (independent variable). I divide the control variables into two groups. First, I refer to five constant background variables: European Union membership, adoption of the single currency, removal of capital controls, size of the national economy, and a political climate quite hostile to the introduction of non-negotiated shareholder value strategies. These five potential explanations failed to

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[187]Wolfgang Streeck, "Training and the New Industrial Relations," in Marino Regini, ed., *The Future of Labor Movements* (London: Sage Publications, 1992), p. 256.
[188]Pepper Culpepper, *Creating Cooperation: How States Develop Human Capital in Europe,* p. 57.
[189]See Marc Maurice, François Sellier, and Jean-Jacques Silvestre, *The Social Foundations of Industrial Power: A Comparison of France and Germany,* pp. 59-90; and Arndt Sorge, *The Global and the Local: Understanding the Dialectics of Business Systems,* pp. 160-162.
[190]However, the monopoly of qualitative studies for patterns characterized by causal complexity is somewhat artificial. Causal complexity constitutes an ideal problem for statistical methodology if viewed through the lens of the relative importance of conjunctural causation versus that of substitutability. For an analysis of causal complexity through the use of statistical methods, see Bear Braumoeller, "Causal Complexity and the Study of Politics," *Political Analysis* 11, 3 (Summer 2003): 209-233.

co-vary with my dependent variable – thereby opening the way for them to be discarded. Second, I analyze three alternative explanations that co-vary with my dependent variable: degree of internationalization of firms, legal protection of minority shareholders and ownership structure of companies, and the educational background and career development of German top executives. The presence of co-variation among these three alternative explanations and my dependent variable requires a research design that accounts for complex causation phenomena. The results of the qualitative research design of this paper highlight that firm-level key institutions of workplace organization constitute the single most important variable to account for the differences in the ability of French and German firms to attract funds from short-term, impatient investors – even if this is not the only cause for why short-term oriented institutional investors acquire an equity stake in a listed company. To show convincingly that institutions matter, this exercise requires the specification of both causal effects as well as the dynamics of the interaction among these institutional variables. In particular, I argue that institutional differences between France and Germany impact on the dynamics of logical inference. Institutional frameworks shape what is a necessary/sufficient condition in a specific setting – with differences being observed across countries. The outcome is the achievement of analytical leverage whereby variation on the values of my key independent variable results in a large variance on the values taken by my dependent variable, illustrating the important explanatory power of this framework.[191] What drives the investment strategies of actively managed mutual funds? The organization of this section of the paper is divided in four parts. First, I present the features of the qualitative research design of this paper. There are five building blocks to my qualitative research design: method of difference, control for the spurious effects on my independent variable, the impact of the institutionally-based varieties of capitalism perspective on conjunctural causation and substitutability, methodology of necessary conditions, and most likely case components. In the following three sections, I compare the insightfulness of my varieties of capitalism institutionally inspired argument with three co-varying alternative explanations: degree of internationalization of firms, legal protection of minority shareholders and ownership structure of companies, and the educational background and career development of German top executives.

A) Qualitative Research Design

1) Method of Difference

The first methodological building block of the qualitative research design of this paper is the method of difference. This investigative strategy is characterized by the comparison of cases with similar and constant background features on a first set of control variables combined with changing values taken by the dependent and independent variables.[192] The method of difference is well suited to the presence of fairly uniform back-

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[191]Gary King, Robert Keohane, and Sidney Verba, *Designing Social Inquiry: Scientific Inference in Qualitative Research* (Princeton: Princeton University Press, 1994), pp. 29-31; Steven Van Evera, *Guide to Methods for Students of Political Science* (Ithaca NY: Cornell University Press, 1997), pp. 17-18.

[192]For excellent analyses of the role of the method of difference in qualitative studies using a small number of cases, see James Mahoney, "Nominal, Ordinal, and Narrative Appraisal in Macro-

ground characteristics between cases since it reduces the number of candidate causes. The study variables of this paper are the differences in the investment portfolio of actively managed mutual funds in France and Germany (DV) and the firm-level institutional arrangements of workplace organization (IV). The similarities of the background characteristics of these two cases are European Union membership, adoption of the single currency, removal of capital controls, size of the economy, and the rather hostile political opposition to foreign takeovers and short-term movements of capital associated with shareholder value demands that translate into painful firm restructuring. European Union and Euro zone membership control for competition, trade, and interest rate policies;[193] removal of capital controls serves to eliminate the role of policymakers in regulating capital flows;[194] the comparable size of the two economies is associated with a similar degree of exposure to foreign trade; and the political climate of these two countries is such that fund managers must take into consideration the fact that the pursuit of company strategies for the sole interests of shareholders is highly unpopular as compared to the United Kingdom and the United States.[195]

The essence of the method of the difference is about the identification of invariant patterns of association.[196] The presence of variation on the dependent variable cannot be accounted by stability (or incongruent variations) on the values taken by the alternative explanations, thereby enabling the researcher to investigate a congruent cross-case difference that causes the above variation. The method of difference performs a useful role by introducing parsimony to the qualitative analysis – the lack of covariance between the values taken by the dependent variable and the background alternative explanations allows for a process of elimination to operate. The validity of the logical inference between the dependent and independent variables is strengthened by the elimination of similar background characteristics for the two cases. The method of difference, however, is plagued by three shortcomings that necessitate that its use in qualitative strategy be complemented with other tools. First, the method of difference is always open to the criticism that important explanatory variables were not included in the analysis. I deal with this objection through the examination of three other alternative explanations: legal perspective and the ownership structure of companies, degree of internationalization, and

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causal Analysis," *American Journal of Sociology* 104,4 (January 1999): 1154-1196; and Steven Van Evera, Ibid., pp. 23-24, 50-55.

[193]See Jeffry Frieden, "Invested Interests: The Politics of National Economic Policies in a World of Global Finance," *International Organization* 45,4 (Autumn 1991): 425-451; Jeffry Frieden, "Making Commitments: France and Italy in the European Monetary System, 1979-1985," in Barry Eichengreen and Jeffry Frieden, eds., *The Political Economy of European Monetary Integration* (Boulder CO: Westview Press, 2001); David Soskice, "Macroeconomics and Varieties of Capitalism," in Bob Hancké, Martin Rhodes, and Mark Thatcher, eds., *Beyond Varieties of Capitalism: Conflict, Contradictions, and Complementarities in the European Economy* (New York: Oxford University Press, 2007); and Stephen Wilks, "Competition Policy," in Helen Wallace, William Wallace, and Mark Pollack, eds., *Policy-Making in the European Union* (New York: Oxford University Press, 2005).

[194]See Rawi Abdelal, *Capital Rules: The Construction of Global Finance* (Cambridge MA: Harvard University Press, 2007); and John Goodman and Louis Pauly, "The Obsolescence of Capital Controls? Economic Management in an Age of Global Markets."

[195]See Mark Roe, "Political Preconditions *to* Separating Ownership from Corporate Control."

[196]James Mahoney, "Strategies of Causal Inferences in Small-N Analysis," *Sociological Methods and Research* 28,4 (May 2000): 387-424.

the educational background and career development of German top executives. This issue also serves as a reminder that the methodological insights of the method of difference are best captured when combined with a rich narrative analysis that provides a detailed and nuanced understanding of the dependent variable.[197]

Second, the method of difference has a deterministic understanding of causation. The relationship between the independent and dependent variables is understood as one of necessary and sufficient condition given the congruence between their changing values – and the rejection of alternative explanations with constant values. The method of difference is not well suited to processes of complex causation.[198] The strategy of identifying invariant patterns of association provides a significant contribution to qualitative strategies of causal inference, namely by enabling the researcher to demonstrate that invariant alternative explanations cannot constitute necessary causes. The uniform case conditions on five key dimensions – European Union membership, adoption of the single currency, removal of capital controls, exposure to trade, and political opposition to unmediated shareholder value – make it highly unlikely that they could in themselves serve as a key causal variables. But it does not imply that the firm-level institutional arrangements of workplace organization (IV) constitute a necessary and sufficient condition to account for the differences in the investment strategies of hedge and mutual funds in France and Germany. The conceptualization of causation as a necessary and sufficient process creates two problems for the method of difference: the dependent variable could be either present or absent in the event of a sufficient cause being absent; the dependent variable could be either present or absent in the event of the necessary cause being present.[199] The method of difference, therefore, needs to be complemented by an analysis of necessary and sufficient conditions.

Third, the acknowledgement of complex causation is not sufficient for the validity of the strategy of causal inference associated with the method of difference. As previously mentioned, I argue that short-term, impatient institutional investors can pursue a top-down investment strategy whereby fund managers build their portfolio based on the analysis of macroeconomic factors associated with different countries or a bottom-up investment strategy whereby the characteristics of firms play a fundamental role in their decisions to buy and sell. The acknowledgment of the multiplicity of investment strategies fits well with my argument, namely that that the firm-level institutional arrangements of workplace organization constitute the most significant variable to account for the variation on my dependent variable. I do not seek to account for all of the instances of investment by hedge and mutual funds; I aim at accounting for "most" of the variation.[200] However, this concession is still insufficient since it gives rise to a double stan-

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[197]The pioneer work combining the method of difference and a rich narrative analysis remains Theda Skocpol, *States and Social Revolutions: A Comparative Analysis of France, Russia, and China* (Cambridge: Cambridge University Press, 1979).
[198]See Charles Ragin, *The Comparative Method: Moving Beyond Qualitative and Quantitative Strategies* (Berkeley: University of California Press, 1987), pp. 36-42.
[199]James Mahoney, "Strategies of Causal Inferences in Small-N Analysis," pp. 392.
[200]A similar strategy is used by Thomas Ertman in his analysis of the development of early modern states in Europe. See Thomas Ertman, *Birth of the Leviathan: Building States and Regimes in Medieval* and *Modern Europe* (Cambridge: Cambridge University Press, 1997).

dard: how can I reject alternative explanations by arguing that they cannot fully explain the variation on the dependent variable while preserving my own independent variable?[201]

2) Control of Spurious Effects

A central concern for qualitative social scientists is to control for the possibly spurious effects of other variables when establishing causal inference. How could I evaluate objections claiming that my argument of the importance of firm-level institutional arrangements of workplace organization is spurious due to omitted variable(s)? Two criteria have been suggested for assessing the presence of bias due to omitted variable(s).[202] First, the absence of a correlation between the control variables and the independent variable lessens considerably the danger of spuriousness on the latter. The independent variable is therefore not likely to be the byproduct of an alternative omitted explanation. The emphasis placed in this paper on the importance of firm-level institutional arrangements is further strengthened by their historical position in the two varieties of capitalism. The question of capital mobility in the form of Anglo-American institutional investors might be a recent phenomenon but the institutionally-based concentration (dispersion) of power in the French (German) CEO is not something new. The process by which large French and German firms develop and sustain their innovative capabilities has remained largely unchanged for the last thirty years despite important transformations in corporate governance and industrial relations.[203] The coordination of activities in French firms is characterized by the vesting of unilateral authority in top managers and senior technical staff. The bulk of the workforce does not contribute to the development of the organizational capabilities of the firm.[204] In the coordination of activities of German companies, by contrast, authority is shared with the bulk of the workforce to a substantial degree. The development of innovative capabilities takes place on the basis of the long-term contribution of skilled employees through institutionalized career paths.[205] These long-term differences in the values taken by the key independent variable substantially reduce the risks that the three alternative explanations – degree of internationalization, legal perspective and ownership structure, and educational background and career development of German top executives – could account for the origins of these critical firm-level institutional arrangements.[206] Moreover, the absence of

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[201]See James Mahoney, "Nominal, Ordinal, and Narrative Appraisal in Macrocausal Analysis," pp. 1170-1175.

[202]See Gary King, Robert Keohane, and Sidney Verba, *Designing Social Inquiry: Scientific Inference in Qualitative Research,* pp.168-176.

[203]See note 32.

[204]See Robert Boyer, "Wage Austerity and/or an Education Push: The French Dilemma"; and Pepper Culpepper, "Individual Choice, Collective Action, and the Problem of Training Reform: Insights from France and Eastern Germany."

[205]See Arndt Sorge, *The Global and the Local: Understanding the Dialectics of Business Systems*, chapter 5; and Richard Whitley, "The Institutional Structuring of Organizational Capabilities: The Role of Authority Sharing and Organizational Careers," pp. 667-695.

[206]However, I do not wish to argue that the institutional features that support the nationally-specific distribution of power in French and German firms have remained stable over the last twenty years. The character of coordination of firms must be distinguished from the institutional framework that supports it. Change in the latter does not entail a modification in the former.

spuriousness between variables is also driven by the absence of compelling logical arguments: internationalized multinationals display different modes of internal organization;[207] similarities in managerial orientation (financial/functional) can be associated with differences on the institutional structures of the decision-making process and vice-versa;[208] and the broad historical similarities in the protection of minority shareholders in French and German corporate law have been associated with continuing differences in the organization of work.[209] The consideration of the three alternative explanations – degree of internationalization, legal protection of minority shareholders and ownership structure, and educational background and career development of German top executives – also allows for a partial control of potentially spurious effects on my key independent variable.

The second criterion for controlling spuriousness effects requires that the omitted variables have no effect on the dependent variable. This criterion is hard to sustain – the degree of internationalization of firms, the extent to which France and Germany protect minority shareholders, and the educational background and career development of German top executives – co-vary with the investment choices of hedge and mutual funds. Therefore, I need to tackle phenomenon of causal complexity and issues of necessary and sufficient conditions in order to demonstrate the insightfulness of my argument about the importance of firm-level institutional arrangements.

3) Causal Complexity

The third methodological building block of the qualitative research design of this paper is the institutionally contingent nature of the necessary or sufficient conditions associated with the independent variable and the alternative explanations of this study. I rely below on some of the newly elaborated procedures for testing hypotheses about necessary and sufficient causes. However, and to anticipate the empirical results, the presentation of such techniques is theoretically embedded in a context where the institu-

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[207]See Suzanne Berger, *How We Compete: What Companies Around the World Are Doing to Make It in Today's Global Economy;* and Glenn Morgan, "Understanding Multinational Corporations," in Stephen Ackroyd et al., eds., *The Oxford Handbook of Work and Organization* (New York: Oxford University Press, 2005).

[208]See Ruth Aguilera and Gregory Jackson, "The Cross-National Diversity of Corporate Governance: Dimensions and Determinants," *Academy of Management Review* 28,3 (July 2003): 432-446, pp. 457-59.

[209]For corporate law in France and Germany, see Rolf Birk, "Germany", in Arthur Pinto and Gustavo Visentini, eds., *The Legal Basis of Corporate Governance in Publicly Held Corporations: A Comparative Approach* (London and Boston: Kluwer Law International, 1998); James Fanto, "The Role of Corporate Law in French Corporate Governance," *Cornell International Law Journal* 31,1 (Winter 1998): 31-91; Katharina Pistor, "Fiduciary Duty in Transitional Civil Law Jurisdiction: Lessons From the Incompleteness of Law Theory," in Curtis Milhaupt, editor, *Global Markets, Domestic Institutions: Corporate Law and Governance in a New Era of Cross-Border Deals* (New York: Columbia University Press, 2003); Mark Roe, "Corporate Law's Limits"; and André Tunc, "A French Lawyer Looks at American Corporation Law and Securities Regulation," *University of Pennsylvania Law Review* 130,4 (April 1982): 757-774. For an analysis of the differences in the institutional arrangements of workplace organization between France and Germany, see note 32.

tionally based varieties of capitalism theoretical perspective matters for the operationalization of the logic of inference across advanced capitalist economies. The implication of the importance of different institutional frameworks is that what is a necessary or sufficient condition differs across national settings. In other words, the nature of the interaction between variables in a complex causation process is contingent on the institutional context.

What is causal complexity?[210] Formal definitions are often lacking because of the slippery nature of the concept. The analysis of causal complexity in qualitative methods is characterized by the dominant use of two separate dimensions: conjunctural causation and substitutability.[211] Conjunctural causation refers to a situation whereby only the combination of multiple conditions will produce a specific outcome: X1 and X2 produce Y. The impact of one institution or variable depends on the presence of others. Ragin refers to conjunctural causation as cases where "an outcome results from the combinations of conditions."[212] A first implication of conjunctural causation is that the independent variables are necessary without ever being sufficient. A second implication is that there are multiple paths to the non-occurrence of the dependent variable since only the combination of X1 and X2 has a causal impact.[213] A third implication is that a change on the value taken by one variable can have dramatic consequences, the absence of one factor being sufficient for the occurrence of a different value on the dependent variable. For the varieties of capitalism literature, the process of conjunctural causation conceptualizes institutional arrangements as interacting to complement each other. As a result, the presence of stability or the occurrence of change in the broader institutional framework of countries cannot be inferred from change in any one institution.[214] The varieties of capitalism perspective highlights the pitfalls associated with piecemeal institutional change given that the effects of a single institutional variable on the overall operation of the political economy vary with the presence of other institutions that are already in place.

Substitutability, in contrast, refers to the multiple and independent paths to a common outcome: X1 or X2 produces Y. The concept of substitutability highlights the presence of multiple and independent causal paths. It resonates well with Merton's concept of functional equivalency.[215] Different institutional clusters can result in a similar outcome. A first implication is that the key individual independent variables are always sufficient, but never necessary. A second implication is that there are multiple paths to the occurrence of the dependent variable since the presence of either (or both) X1 and X2

[210]The pioneering work on the use of qualitative methods for the study complexity in social sciences is Charles Ragin, *The Comparative Method: Moving beyond Qualitative and Quantitative Strategies*. See also Bear Braumoeller, "Causal Complexity and the Study of Politics"; and Gary Starr and Harvey Goertz, eds., *Necessary Conditions: Theory, Methodology, and Applications* (Lanham MD: Rowman and Littlefield Publishers, 2002).
[211]Bear Braumoeller, "Causal Complexity and the Study of Politics."
[212]Charles Ragin, *The Comparative Method: Moving Beyond Qualitative and Quantitative Strategies*, p. 20.
[213]Bear Braumoeller, "Causal Complexity and the Study of Politics," p. 212.
[214]For a full discussion of the macro effects of interaction between institutions in different spheres, see Peter Hall and Robert Franzese, "Mixed Signals: Central Bank Independence, Coordinated Wage Bargaining, and European Monetary Union."
[215]Robert Merton, *Social Theory and Social Structure* (New York: Free Press, 1968).

has a causal impact.[216] A third implication is that a change in the value taken by one of the independent variables does not necessarily entail dramatic consequences, the presence of one factor being sufficient for the occurrence of a different value on the dependent variable. The extent to which a change in one independent variable impacts on the dependent variable decreases as the value taken by the other independent variable increases (and vice versa).[217] For the Varieties of Capitalism literature, the concept of substitutability calls for a greater theoretical sophistication between the character of coordination and the institutional framework that supports it.[218] Variation in the latter does not necessarily entail change in the former.

4) Testing Procedures for Necessary and Sufficient Conditions

The phenomenon of complex causation requires specific methodological tools for causal and descriptive inference that enable the researcher to test for necessary and sufficient conditions. A surge of publications in the last ten years has addressed the methodological implications of necessary and sufficient conditions – two often overlooked concepts whose properties are apparently self-evident.[219] These methodological tools operate in two stages. First, the researcher seeks to establish whether a variable is a necessary or sufficient condition for an outcome to occur. Second, and in the presence of co-variation between the tested variable and the outcome, the focus shifts to establishing whether the tested variable is trivially necessary or trivially sufficient. Triviality implies that the variable possesses little or no importance to account for the presence (or absence) of the dependent variable. Several techniques exist to tackle these issues.

First, the use of "typological theory" provides for an assessment of whether variables are systematically matched in a pattern of correspondence consistent with necessary or sufficient causation.[220] Assume a 2x2 matrix with the different cells representing the different values (absent=0; present=1) taken by the dichotomous tested variable (X) and the dependent variable (Y). The use of typological theory enables the investigator to credibly argue that a given variable (X) is not necessary for an outcome if it is both present and absent among a group of cases where the dependent variable is present. In other words, the distribution of observations in cells III and IV of figure 1 would provide the significant insight that X is not a necessary condition since the dependent variable is always present no matter the value taken by X. Likewise, the researcher would be in a strong position to conclude that a given variable (X) is not sufficient for an outcome if it is present in both cases where the dependent variable is present and absent. In other words, the distribution of observations in cells II and IV of figure 1 indicates that the constant occurrence of X is not always associated with Y being present.

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[216]Bear Braumoeller, "Causal Complexity and the Study of Politics," pp. 218-19.
[217]Ibid, p. 211.
[218]See Peter Hall and Kathleen Thelen, "Institutional Change and the Varieties of Capitalism," pp. 30-37.
[219]An excellent analytical review of these issues is provided in James Mahoney, "Comparative-Historical Methodology," *Annual Review of Sociology* 30 (2004): 81-101.
[220]The concept of "typological theory" is from Alexander George and Andrew Bennett, *Case Studies and Theory Development in the Social Sciences* (Cambridge MA: MIT Press, 2005).

Second, the process by which the researcher concludes that a variable is a necessary condition for an outcome to occur is greatly facilitated if one clearly establishes its specific theoretical properties and empirical implications. Braumoeller and Goertz present two procedures for assessing the notion of necessity.[221] The first proposition conceptualizes X as a necessary condition for Y if X is always present when Y occurs (see figure 2). The presence of Y in the absence of X would seriously shatter the necessary character of the latter. The second proposition conceptualizes X as a necessary condition for Y if Y does not occur in the absence of X (see figure 2). In other words, the absence of X is sufficient for Y to be absent.

Figure 1

x Y	X=0	X=1
Y=0	I	II
Y=1	III	IV

The above discussion generates three implications for the testing of necessary conditions. The first implication is that the probability of cases falling into the third cell (X=0, Y=1) should be close to zero in statistical terms for necessary conditions. The second implication is that the collection of observations from cell II (X=1, Y=0) is unneeded from the perspective of testing for necessary conditions, thereby illustrating the mistake in the utilization of data from the four cells. The third implication, which follows from the previous two, stipulates that the bulk of the observations found in cells I and IV (X=0, Y=0; X=1, Y=1) confirms the hypothesized relationship of necessity between X and Y.

Figure 2

Proposition 1

Y \ X	0 Low	1 High
Low 0	------	------
High 1	0%	100%

Proposition 2

Y \ X	0	1
0	100%	------
1	0%	------

Source: Bear Braumoeller and Gary Goertz, "The Methodology of Necessary Conditions," *American Journal of Political Science* 44,4 (October 2000): 846.

Third, the empirical evaluation of necessity requires an additional step – namely whether X is trivially necessary. The concept of trivialness refers to the degree of impor-

[221]Bear Braumoeller and Gary Goertz, "The Methodology of Necessary Conditions," *American Journal of Political Science* 44,4 (October 2000): 844-858.

tance of a necessary condition. The low (or absence of) importance of a trivial necessary condition lies in its inability to account for the values taken by the dependent variable. Braumoeller and Goertz refer to a trivial necessary condition as one being present in all cases in the universe of analysis – both in the presence or absence of the dependent variable. The distribution of observations associated with a trivial necessary condition would fall in either two sets of cells: lack of variation on the independent variable (II and IV of figure 1) or lack of variation on the dependent variable (I and II of figure 1). In other words, the occurrence of a trivial necessary condition follows from the fact that one the variable does not vary in statistical terms. Trivialness becomes more likely as the number of cases in either cell I and IV of figure 1 (X=0, Y=0; X=1, Y=1) decreases toward zero. To put it differently, the absence of trivialness requires significant variation in both the distributions in the Y=0 and Y=1 rows (problem of the lack of variation on the independent variable) and in the X=0 and X=1 rows (problem of the lack of variation on the dependent variable). Finally, it is also important to note that trivialness constitutes an empirical, rather than theoretical, concept. It refers to the inability of X to account for the values taken by Y, not that there is no logical connection between the two variables. Therefore, the notion of triviality is to be distinguished from the concept of irrelevancy whereby Y never occurs no matter the value taken by X.

5) Most-Likely Case Components

A final dimension of the qualitative research design of this paper is the use of critical case studies for casting doubts on the explanatory power of alternative variables. This concept was developed by Harry Eckstein, who sought to build case studies that would provide definitive evidence for testing a theory.[222] I focus in this paper on the notion of most-likely case components – a specific dimension of critical case studies. Most-likely cases are designed around the notion that the values taken by an independent variable strongly posit a specific outcome – and that evidence contrary to the predicted outcome cannot simply be considered deviant or due to chance. The assumption is that the validity of alternative explanations depends on the extent to which the test the theory has failed is arduous. Therefore, most likely cases are tailored to cast doubts on a theory – the absence of the predicted outcome being sufficient to seriously impugn the causal mechanism by which the hypothesized independent variable is assumed to operate.

The use of critical case studies in social sciences has been controversial. The debate is centered on whether a case study constitutes a single observation or not. If it does, then the usefulness of critical case study is said to be seriously diminished since few explanations depend upon only one causal variable.[223] I avoid this issue in this paper by emphasizing some of the most likely components of alternative explanations. I do not seek to unambiguously reject alternative explanations by building critical case studies tailored to cast fatal doubts on them. The investment strategy of actively managed mutual funds is characterized by motivational multiplicity with several factors influencing the decision to invest – but firm-level differences in the institutions of workplace organization

[222]Harry Eckstein, "Case Studies in Political Science," in Fred Greenstein and Nelson Polsby, eds., *Handbook of Political Science*, Volume 7 (Reading MA: Addison-Wesley, 1975).
[223]Gary King, Robert Keohane, and Sidney Verba, *Designing Social Inquiry: Scientific Inference in Qualitative Research*, pp. 208-212.

constitute the most significant variable to account for the differences in their investment portfolio in France and Germany. I emphasize some key most-likely components of alternative explanations that make it unlikely that their relative explanatory importance would be superior to that of the firm-level institutional arrangements of workplace organization. First, the degree of internationalization of German firms in terms of sale is superior to that of their French counterparts – thereby highlighting their lower degree of dependence on their slow-growth domestic market. Thus, the expectation is that of greater investment in Germany by mutual funds if the degree of internationalization of firms is the key driving factor. Second, the use of deviations to the one share-one vote principle is substantially greater in France than in Germany, thereby preserving the ability of large owners to control the strategy of the firm without compromising on their ability to raise equity capital. Moreover, the size of the private benefits of control is also higher in France, implying that large owners also enjoy gains other than those associated with the stock market capitalization of the firm. Thus, the primacy of the legal perspective emphasizing ownership structure as a key criterion for investment would imply that hedge and mutual funds would prefer Germany over France as an investment site. I tackle these two issues in the next two following sections.

b) Macroeconomic Variables and the Investment Strategy of Hedge and Mutual Funds

The first alternative, co-varying explanation under consideration highlights the importance of macroeconomic conditions in regard to the investment strategies of institutional investors. Fund managers can build their portfolio by deciding first on the geographical allocation (country/region) of the assets under their management, and only then selecting which stocks to invest in. Top-down investment strategies are characterized by a focus on evolving market trends and rates of economic growth rather than firm-level features.

However, the explanatory power of a top-down investment perspective to account for the differences in the investment patterns of short-term, impatient institutional investors in France and Germany is limited by two sets of factors. First, the comparison of France and Germany entails for a contingent generalization of the findings. The explanation for investment differences in France and Germany is not likely to travel well to other cases that do not share key elements of background similarities between these two countries. The variables that account for outcomes in these two advanced capitalist economies are likely to be different from those operating in different countries.[224] In particular, the rates of economic growth in these two advanced capitalist economies are more likely to be constrained than those found in some developing or transition countries since total productivity growth cannot be generated from the movement of their workforce away from agriculture and from other factors. Emerging economies with underdeveloped stock markets possess greater opportunities to grow. Moreover, the presence in the Euro zone of economies with traditionally lower degrees of commitment to fighting inflation than France and Germany has resulted in higher interest rates that are

[224]For an example of the differences in the effects of corporate law reforms in advanced civil law capitalist economies versus transition/developing economies, see Mark Roe, "Corporate Law's Limits." and Mark Roe, "Legal Origins, Politics, and Modern Stock Markets."

warranted for the latter two.[225] The French economy might have achieved slightly higher overall growth than Germany between 1998 and 2005, but the key issue is that firms in these two countries cannot count on favorable macroeconomic factors to raise their profitability.[226]

Second, the strategy of internationalization of French and German firms also contributes to the inability of macro explanations to fully account for the investment flows of actively managed mutual funds. The process by which firms in the two countries develop their innovative capabilities remains embedded in their specific variety of capitalism, but their profitability is no longer as tightly linked to their domestic market. During the past twenty years, large companies have made considerable steps towards the internationalization of their profile. For French firms, the process of European integration has been central to their strategy of internationalization.[227] The crisis in the *dirigiste* model of policymaking in the early 1980s highlighted the increased inability of state officials to rely on demand-side policies to significantly shape the competitiveness of companies. An important dimension of the subsequent restructuring of the French corporate sector took place through an ambitious M&A program – a strategy that enabled firms to tackle problems related to their size and innovative capabilities.[228] The process of the completion of the internal market not only enabled the shopping spree to take place, but it also led French top management to recognize that the only way to compete was to penetrate markets in Europe and elsewhere. For German firms, the process of internationalization reflected a search for the most suitable institutional framework to complement their domestic strength.[229] The comparison of German domestic investment with German FDI reveals sharp differentiations in the type of jobs performed at home and

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[225]Bob Hancké and David Soskice, "Wage-Setting and Inflation Targets in EMU," *Oxford Review of Economic Policy* 19,1 (Spring 2003): 149-160.

[226]The rate of GDP growth in constant prices for France was 15.6 percent between 1998 and 2005. The corresponding figure for Germany was 9.2 percent. The growth of GDP of these two economies put them below the EU average with only Italy achieving lower rates than both of them. Source: OECD, *National Accounts of OECD Countries: Detailed Tables* (Paris: OECD, 2006). Moreover, the inability of national macroeconomic conditions of France and Germany to account for the investment strategies of hedge/mutual funds is further reinforced by a geographical shift. Top-down fund managers increasingly use a European portfolio, national funds being discontinued (See Commission des Opérations de Bourse, "Les Critères d`Investissement des Grands Gestionnaires de Fonds Internationaux dans les Entreprises Françaises"). Finally, the inability of macroeconomic explanations to contribute significantly to our understanding of the investment allocation of hedge and mutual funds is further damaged by France being the top continental European countries for American mutual funds. See Morningstar, *Morningstar Funds 500,* various years.

[227]See Vivien Schmidt, *From State to the Market? The Transformation of French Business under Mitterrand,* pp. 347-368; and W. Rand Smith, *The Left's Dirty Job:* The *Politics of Industrial Restructuring in France and Spain* (Pittsburgh: University of Pittsburgh Press, 1998).

[228]See Lise Dervieux, "L'Accélération de l'Internationalisation des Grands Groupes Français entre 1997 et 2002," *Economie et Statistique* 363-365 (2003): 207-234; and Mary O'Sullivan, "Acting Out Institutional Change: Understanding the Recent Transformation of the French Financial System," *Socio-Economic Review* 5,3 (July 2007): 389-436.

[229]Matthew Allen, "Is German Direct Investment a Substitute for Domestic Investment?" *German Politics* 11,1 (April 2002): 125-146.

abroad: radical innovation and low skilled jobs taking place in foreign subsidiaries, highly skilled blue-collar related activities occurring in Germany. The institutions of workplace organization do not create a zero-sum game between the domestic and foreign investment of companies.

Finally, and perhaps more importantly, the internationalization of the activities of French and German firms, realized through M&A, was not strategy neutral. Their process of internationalization was characterized by two features. The first one deal with the motivations of companies going abroad through M&A. Demand factors emphasize the need to meet the needs of local customers; supply side factors highlight the enhancement of the innovative capabilities of the firm by taking advantage of the recipient country knowledge base. The process of internationalization of companies was largely undertaken as a strategy to enhance their capabilities. For instance, French and German firms are among the top foreign owners of R&D facilities in the United States.[230] Thus, foreign subsidiaries are not simply local points of sales, they also contribute to the process by which the parent firm increases its knowledge base and develop a position of competitive advantage. The second feature of this process of internationalization deals with its impact on the overall specialization profile of companies. French and German firms achieved a critical mass status through a focus on their core technologies in their strategy of international diversification. Their acquisitions in foreign markets concentrated on a selected number of existing fields of strength which are supportive of domestically-based core businesses.[231] Starting with a relatively low degree of internationalization in the late 1970s, firms in the two countries broaden their geographical base by drawing on activities and technologies to support their core business strength rather than proceeding through a diversification of their activities in unrelated fields. The outcome of this process of internationalization consists not only in the reduction of their exposure to their slowly growing domestic markets, but the strengthening of their core business activities has substantially improved their competitive position relative to that of their major rivals.

What is the impact of the strategy of internationalization of companies on the investment strategy of actively managed mutual funds? The degree of internationalization of French and German companies is operationalized with the ratio of domestic/foreign sales as percentage of total sales – the most common measure of internationalization in the international business literature.[232] Data on the degree of internationalization is pre-

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[230]See Walter Kuemmerle, "The Drivers of Foreign Direct Investment into Research and Development: An Empirical Investigation," *Journal of International Business Studies* 30,1 (January-March 1999): 1-24; Manuel Separio and Donald Dalton, "Globalization of Industrial R&D: An Examination of Foreign Direct Investments in R&D in the United States."

[231]See John Cantwell and Rebecca Harding, "The Internationalisation of German Companies' R&D," *National Institute Economic Review* 163 (January 1998): 99-115; and John Cantwell and Usha Kotecha, "The Internationalization of Technological Activity: The French Evidence in a Comparative Setting," in Jeremy Howells and Jonathan Michie, eds., *Technology, Innovation and Competitiveness* (Cheltenham: Edward Elgar, 1997).

[232]See Daniel Sullivan, "Measuring the Degree of Internationalization of a Firm," *Journal of International Business Studies* 25, 2 (June 1994): 325-342; John Stopford and John Dunning, *The World Directory of Multinational Enterprises 1982-83* (Detroit: Gale Research Company, 1983). Another indicator of internationalization is the share of total patenting of domestic firms to research that is

sented in Tables 11 and 12. I report for 2003, a relatively recent year in my analysis, the percentage of sales generated in the domestic market. These results shed serious doubts on the ability of macro, top-down explanations to account for the diverging investment patterns of mutual funds. A first preliminary issue concerns the higher overall degree of internationalization of German companies. The overall percentage of sales generated in the domestic market was 39.03 percent. The corresponding figure for French firms was 47.79 percent. In other words, German companies are less dependent on their slow-growth domestic market than are their French counterparts on their basically equivalent low-growth home base. This divergence would lead macroeconomic explanations to erroneously predict the greater attractiveness of Germany for short-term, impatient institutional investors.

Another, and more interesting, aspect of the data presented in Tables 11 and 12 concerns the distribution of internationalization according to whether or not firms were targeted by mutual funds. The relatively low importance of the domestic market for French (35.73 percent) and German (38.72 percent) companies targeted by mutual funds suggests that geographical diversification is not an irrelevant condition. The inclusion of firms not targeted by these two groups of institutional investors, however, adds to the complex contingent nature of the internationalization variable. The degree of dependence on the home market of non-targeted French firms (46.05 percent) is significantly higher than that of their German counterparts (37.78 percent). In other words, the degree of internationalization of French firms co-varies with investments by mutual funds; but the relatively low dependence by German firms on their domestic market is not a sufficient condition for attracting funds from short-term, impatient investors.[233] This divergence in outcome highlights the explanatory power of the institutionally-based Varieties of Capitalism theoretical perspective for causally complex phenomenon. The impact of the geographical diversification variable is contingent upon its institutional context. The German case illustrates a "missing" factor; the positive effects of the low degree of dependence on the home base are constrained by the diffusion of power in the firm. The issue of the degree of internationalization of French firms, in contrast, highlights its position in a causally complex process.

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attributable to research performed in foreign subsidiaries. Empirical data testify to the prominence of the internationalization of the technological activities of French and German firms – research undertaken in their foreign subsidiaries contributing for a large proportion of their patents (see John Cantwell and Rebecca Harding, "The Internationalisation of German Companies' R&D"; and John Cantwell and Usha Kotecha, "The Internationalization of Technological Activity: The French Evidence in a Comparative Setting"). The data are unfortunately presented at the aggregate level of the economy and thus do not allow for analysis at the firm level.

[233]I do not wish to argue that the degree of internationalization of German companies is irrelevant to the investment strategies of short-term, impatient institutional investors. Rather, I argue that its explanatory value for the German case is limited given the lack of variation – the degree of internationalization of firms being rather high whether or not they have been targeted by hedge/ mutual funds. The German case highlights its potentially trivial nature since it is present in all cases in the universe of analysis – both in the presence or absence of the dependent variable.

Table 11: Percentage of Sales (2003) in Domestic Market for French and German Companies Targeted for Investment by Mutual Funds

FRANCE			GERMANY		
European Market	**Capitalization (Rank)**	**% turnover in France**	**European Market**	**Capitalization (Rank)**	**% turnover in Germany**
1) Total	(5)	19.8	1) Bayer	(65)	13.7
2) BNP-Paribas	(20)	55.1	2) Volkswagen	(104)	30.0
3) Aventis	(29)	13.0	3) Hypo Bank	(130)	52.2
4) Vivendi	(52)	45.2	4) Commerzbank	(131)	NA
5) Alcatel	(73)	12.7	5) Infineon	(165)	24.9
6) Renault	(87)	35.5	6) Deutsche Borse	(172)	29.0
7) Schneider Europe	(92)	48.0	7) Continental	(204)	33.0
8) Lafarge Western Europe	(95)	42.0	8) Adidas-Salomon Europe	(223)	54.0
9) Accor	(134)	34.4	9) Linde	(253)	22.9
10) Lagarere	(158)	31.8	10) Depfa Bank	(340)	36.0
11) Bouygues	(160)	72.0	11) Puma	(348)	32.1
12) Veolia	(182)	45.6	12) Merck Europe	(409)	42.0
13) Michelin (Europe)	(184)	52.5	13) Hypo Real Estate	(439)	NA
14) Cap Gemini	(190)	18.0	14) MG Technologies	(462)	18.6
15) Pernod Ricard	(197)	17.0	15) Celanese	(498)	32.8
16) Essilor International Europe	(198)	46.2	16) MLP	(547)	89.5
17) Thomson	(217)	24.0	17) Epcos	(565)	27.0
18) Pechiney	(231)	41.7	18) Medion	(597)	59.0
19) Publicis	(236)	10.4	19) Bilfinger Berger	(632)	43.4
20) TF1	(247)	97.1	20) K&S	(658)	24.3
21) Unibail	(294)	99.9	21) Frankfurt Airport	(714)	85.3
22) Valeo	(329)	23.6	22) Heidelberger Druckmaschinen	(723)	12.2
23) Dassault Systèmes	(346)	11.7	23) AAreal Bank	(737)	51.9
24) Thales	(342)	26.2			
25) Wanadoo	(347)	21.0			
26) Business Objects	(374)	12.9			
27) Eurotunnel	(378)	NA			
28) Technip-Coflexip Europe	(381)	24.2			
29) Atos	(434)	34.6			

European Market	Capitalization (Rank)	% turnover in France	European Market	Capitalization (Rank)	% turnover in Germany
30) Neopost	(446)	29.6			
31) Havas	(457)	19.0			
32) Natexis Bank	(471)	36.0			
33) BIC Western Europe	(490)	33.0			
Average		35.73	**Average**		38.72

Table 12: Percentage of Sales (2003) in Domestic Market for French and German Companies Not Targeted for Investment by Mutual Funds

FRANCE			GERMANY		
European Market	**Capitalization (Rank)**	**% turnover in France**	**European Market**	**Capitalization (Rank)**	**% turnover in Germany**
1) Société Générale	(34)	56.4	1) Siemens	(16)	23.0
2) Carrefour	(39)	50.7	2) Deutsche Bank	(24)	25.0
3) AXA	(43)	23.3	3) Deutsche Telekom	(25)	60.7
4) L'Oréal	(50)	14.7	4) Allianz	(30)	29.8
5) Sanofi-Synthelabo	(51)	58.3	5) E.O.N.	(33)	60.8
6) France Telecom	(53)	58.7	6) Daimler-Chrysler	(36)	17.4
7) Danone (2002)	(59)	33.1	7) SAP	(38)	23.7
8) LVMH	(67)	35.7	8) BASF	(44)	21.2
9) Suez	(74)	24.6	9) Munich Re	(57)	45.2
10) Crédit Agricole	(75)	65.2	10) BMW	(83)	25.5
11) Air Liquide	(77)	24.0	11) RWE	(100)	51.1
12) Saint-Gobain	(78)	28.6	12) Schering Europe	(129)	49.4
13) Peugeot	(138)	NA	13) Thyssen Krupp	(152)	35.0
14) Pinault Printemps Redoute	(161)	45.3	14) Deutsche Post	(153)	52.3
15) Arcelor	(168)	17.1	15) Metro	(178)	52.8
16) Vinci	(187)	60.7	16) Altana	(211)	18.9
17) Casino	(265)	79.6	17) Henkel	(214)	21.0
18) Christian Dior	(287)	17.5	18) Porsche	(220)	34.2
19) Sodexho	(327)	15.8	19) T-Online	(264)	90.7
20) Auto. Sud France	(353)	100.0	20) Lufthansa	(294)	50.1
21) CNP Assurances	(411)	95.9	21) MAN	(306)	27.9

European Market	Capitalization (Rank)	% turnover in France	European Market	Capitalization (Rank)	% turnover in Germany
22) Sagem	(418)	45.9	22) Beiersdorf	(331)	27.1
23) Air France	(430)	50.5	23) TUI	(368)	14.7
24) Hermès	(436)	20.1	24) Heidelberger Cement	(382)	12.4
25) Gecina	(438)	99.3	25) Fresenius Europe	(390)	39.0
26) Imerys	(469)	26.3	26) Stada Arzneimit	(487)	43.0
27) Zodiac Europe	(509)	50.0	27) Celesio	(523)	18.8
			28) Pro Siebensat	(552)	99.9
			29) Wella	(558)	26.5
			30) Suedzucker	(572)	32.0
			31) Hannover Ruck	(577)	13.0
			32) IKB DT Industriebank	(603)	33.0
			33) Douglas	(608)	60.6
			34) Singulus Technologies	(621)	10.1
			35) Karstadtquelle	(643)	72.2
			36) IVG Immobilien	(776)	55.3
			37) Hugo Boss	(785)	25.0
Average		46.05	**Average**		37.78

The inability of the macro-internationalization variable to fully account for the divergence in the investment portfolios of hedge/mutual funds is strengthened by further specifying the degree of internationalization of firms. I distinguish between low and high degrees of internationalization, with 50 percent of sales in the domestic market as the dividing benchmark, data above this figure constituting instances of low degree of internationalization (X=0). The selection of this benchmark reflects the lower degree of internationalization for the bulk of top French and German firms before the early 1990s.[234] The percentage of total sales in the domestic market for the majority of firms in the two countries was above the 50% mark. The dependent variable is computed by dividing firms according to whether (Y=1) or not (Y=0) they recorded an investment above the 5 percent threshold by mutual funds. The distribution of observations is presented in Figure 3. The use of "typological theories" enables the researcher to deduce that high degrees of internationalization in Germany are largely insufficient to result in a targeted investment from hedge/mutual funds. Moreover, the use of the logic of necessary conditions highlights the trivialness of the variable of internationalization for German firms given the concentration of observations in cells II and IV. The trivialness of the variable is accounted by two factors: it is rather hard to find cases of top German companies that are not internationalized; and the distribution of observations of high degrees of internationalization fall equally between cases of presence and absence of targeted investment.

Figure 3

France

		X: Low Int'l	X: High Int'l
Y	0	11	15
	1	5	27

Germany

		X: Low Int'l	X: High Int'l
Y	0	11	26
	1	6	15

c) Law and the Development of Financial Markets

What accounts for the divergence in the composition of foreign ownership of French and German companies? The development of securities markets and the transformation of ownership structure of listed companies have been critical issues for law and economics scholars. Their central concern focuses on the extent to which distant minority shareholders are legally protected. The critical precondition for the development of deep and liquid securities markets, whereby ownership and control are separate, requires the presence of a system of corporate law that is protective of the rights of small investors.[235] The willingness of minority shareholders to provide equity capital is contingent upon the extent to which their investments are protected from expropriation by managers or controlling investors. The implication is that the ownership

[234]See for example, Dafsa, *Annuaire des Sociétés*, Paris, annual publication.
[235]See Rafael LaPorta, Florencio Lopez-de-Silanes, Andrei Shleifer, and Robert Vishny, "Investor Protection and Corporate Governance," *Journal of Financial Economics* 58,1-2 (October-November 2000): 3-27; and Andrei Shleifer and Robert Vishny, "A Survey of Corporate Governance," *Journal of Finance* 52,2 (June 1997): 737-783.

structure of firms reflects the degree of legal protection provided by the national system of corporate governance – dispersed ownership structure with high degrees of free float highlighting the confidence of minority shareholders that they can recoup their investments.[236] The presence of ownership concentration constitutes an indicator of the failure of corporate law to provide sufficient guarantees for minority investors.

I analyze in this section the explanatory value of the legal perceptive to account for the divergence in the investment portfolio of mutual funds in France and Germany. The argument regarding the importance of ownership structures emphasizes how the presence of a dominant blockholder – or of a group of friendly shareholders – can act in various ways as a disincentive for these two categories of institutional investors to acquire an important equity stake in a firm. The prediction is that countries characterized by domestic firms with concentrated ownership will prove less attractive to institutional investors. Three different mechanisms act as a deterrent for prospective investors. First, a dominant shareholder can effectively outvote the efforts of institutional investors in introducing changes to the strategy of the company that would boost its stock market capitalization. The underlying assumption is that institutional investors engage in shareholder activism in order to ensure a sizable return on their investments. The implication is that the unlocking of shareholder value through activism from investors is unlikely to happen in the presence of a large, controlling shareholder who can resist their efforts to introduce reorganizations though his voting power.[237]

Second, the interests of Anglo-American institutional investors can differ substantially from that of a dominant shareholder. The main issue is that the benefits and costs of holding controlling stakes – which entails a reduction in diversification risks – vary across advanced capitalist economies and are alleged to be driven by the degree of legal protection for minority investors. In countries with lower protection of shareholder rights, investors can prevent a violation of their rights by acquiring a controlling stake in a company (defensive move) and by taking advantage of their control over the strategy of the firm to extract private benefits of control (offensive action).[238] The notion of the private benefits of control refers to the aggregate value a controlling owner can extract from the company at the expense of minority shareholders.[239] It has long been observed that shareholders do not receive benefits in proportion to their equity stake in a corporation. Instead, large owners receive a disproportionate amount of corporate benefits. The right to control the corporate policy is valuable per se since large owners receive benefits

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236Rafael Laporta, Florencio Lopez-de-Silanes, and Andrei Shleifer, "Corporate Ownership around the World," *Journal of Finance* 54, 2 (April 1999): 471-517.

237Other arguments on the disincentives effects of ownership concentration, however, are not contingent on a state of high institutional activism.

238Marc Goergen and Luc Renneboog, "Why are the Levels of Control (so) Different in German and UK Companies? Evidence from Initial Public Offerings," *Journal of Law and Economic Organization* 19,1 (April 2003): 141-175.

239The key readings on the notion of the private benefits of control are Michael Barclay and Clifford Holderness, "Private Benefits from Control of Public Corporations," *Journal of Financial Economics* 25,2 (December 1989): 371-95; Tatiana Nenova, "The Value of Corporate Voting Rights and Control: A Cross-Country Analysis," *Journal of Financial Economics* 68,3 (June 2003): 325-51; and Luigi Zingales, "Why It's Worth Being in Control," in George Bickerstaffe, editor, *Mastering Finance* (London: Financial Times/ Prentice-Hall, 1998).

that are not shared with other shareholders.[240] Prospective buyers do not pay pro rata value for the stock if they lack confidence in the willingness of dominant owners to pursue friendly shareholder value strategies and, if the discount is deep enough, concentrated ownership persists since the latter decide not to sell.[241] The issue is critical since the dominant shareholder faces tradeoffs in countries with lower degrees of legal protection for minority investors – reaping the economic benefits of higher share prices through shareholder value enhancing policies but at the cost of giving up the private benefits of control. The empirical evidence also points to the reluctance of blockholders wishing to raise equity finance from the public at large to step in and provide legal protection and other safeguard mechanisms for minority shareholders.[242] Finally, the maintenance of a controlling stake in a company is less expensive in countries where deviations from the one share/one vote principle are prevalent. Large owners can maintain their control over the firm while raising additional equity from the greater public through unequal voting rights and non-voting shares.[243] Interestingly, the greater use of deviations from the one-share/one-vote principle by French firms constitutes another most likely component. [244]

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[240]What are the private benefits of control? The academic literature has identified two main types of private benefits of control. First, the position of dominance of a large owner might allow him to increase his stake in the company through dilutive share issues and minority freeze-outs. Second, private benefits result from the synergy benefits realized by the controlling shareholder. The information acquired by the dominant shareholder from the operations of the firm might provide him with potential opportunities in other areas. The controlling shareholder can use knowledge from the company he owns to exploit opportunities in other firms. The value associated with these opportunities constitutes a private benefit of control since minority shareholders do not reap the gains associated with these opportunities. For a full discussion, see Alexander Dyck and Luigi Zingales, "Private Benefits of Control: An International Comparison," *Journal of Finance* 59,2 (April 2004): 537-600; and Simon Johnson, Rafael LaPorta, Florencio Lopez-de-Silanes, and Andrei Shleifer, "Tunnelling," *American Economic Review* 90, 2 (May 2000): 22-27.

[241]See Mark Roe, *Political Determinants of Corporate Governance: Political Context, Corporate Impact* (New York: Oxford University Press, 2003), pp. 161-167.

[242]Peter Gourevitch and James Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance*, p. 97.

[243]Unequal voting rights and non-voting shares constitute two mechanisms by which large shareholders can create a gap between their ownership stake and their voting power. The use of unequal voting rights by an important number of continental European companies is characterized by granting investors who kept their shares for a pre-determined period of time with extra voting power. For example, French corporate law allows companies to give double voting rights to shareholders who have kept their shares for a period of two years. One of the intents of this by-law is to reduce the voting power of short-term investors such as hedge/mutual funds.

[244]The prediction is that hedge and mutual funds should have invested more in Germany than in France on the basis of the use of mechanisms to separate ownership from control. First, German legislation has deprived domestic companies of their ability to use unequal voting rights while their French counterparts still rely heavily on them (see Table 15 below). The issuing of multiple voting shares was outlawed in Germany as of May 1998, and the grandfather clause was phased out on June 1, 2003. Second, the control value associated with deviations from one share/one vote differs also differ substantially between France and Germany. French investors are willing to pay a premium of 28 percent for shares with higher voting rights in contrast to their German counterparts, which only add an extra 9 percent for shares with extra voting privileges (Source: Tatiana Nenova, "The Value of Corporate Voting Rights and Control: A Cross-Country Analysis," pp. 340-341). The gains associated with the ownership of shares with extra voting rights in Germany – which would presumably help an investor to become a controlling owner – seem more limited than in France. This outcome is consistent with the argument that power is largely diffused in German companies.

Third, the size of the free float of a listed company also plays a role in the investment decisions of funds. Free float is the proportion of shares not held by strategic shareholders and also not stock with sales restrictions. It constitutes an indicator of the degree of ownership concentration of the company, a lower free float indicating a higher degree of concentration. Why is the free float relevant to the investment decisions of investors? Recent studies have revealed the importance of home bias in the investment decisions of American and British funds despite the disappearance of barriers to international capital mobility across countries and the potential gains associated with greater diversification.[245] The domestic bias reflects the extent to which investors overweight the home market in their holdings. In other words, the share of the home market in their holdings is larger that the home market's share of total world market capitalization. The absolute increases in outflows by Anglo-American funds in foreign equities have been smaller than the growth of the market capitalization of foreign markets. Initial hypotheses on this Anglo-American home bias centred on differences in legal rights for minority investors around the world and on the lack of availability of large blue-chip companies. However, these hypotheses are incomplete for two reasons. First, the domestic bias is not limited to American and British investors, but to institutional investors in large emerging economies and in every advanced capitalist economy.[246] Second, the domestic bias of American and British institutional investors is affected by the fact that the bulk of foreign companies' shares are held by insiders and is thus not readily available to outside investors.[247] The degree of free float is often used as a rule of thumb by institutional investors. If the free float percentage is low, hedge and mutual funds will drive up the price per share when they attempt to acquire a significant number of stocks. The implication is that the investments of hedge and mutual funds in France and Germany could be driven by differences in degrees of free float.

What is the empirical evidence on the influence of the ownership structure of listed French and German companies on the investment strategies of mutual funds? Data on the ownership structure of large listed French and German firms is presented in Tables 13 and 14. Table 13 is comprised of the top companies that have received an investment stake above the 5 percent threshold by mutual funds. Firms are listed with their European stock market capitalization rank (on December 17, 2003), their ownership structure and their free float at the time of the investment stake by hedge/mutual funds. The classification of the ownership structure of com-

Table 15: Firms with Deviations to One-Share/One-Vote Principle (in %)

Exceptions to one-share, one-vote rule	France top 40 1996 1999 2001	Germany top 30 1996 1999 2001	France top 120 1996 1999	Germany top 120 1996 1999
Unequal Voting Rights	75 68 58	25 15 13	32 68	25 15

Source: Davis Global Advisors, *Leading Corporate Governance Indicators*, various years.

[245]Kalok Chan, Vicentiu Corvig, and Lilian Ng, "What Determines the Domestic Bias and Foreign Bias? Evidence from the Mutual Fund Equity Allocation Worldwide," *Journal of Finance* 60,3 (June 2005): 1495-1534; and Bong-Chan Kho, Rene Stulz, and Francis Warnock, "Financial Globalization, Governance, and the Evolution of the Home Bias," working paper #12389, (Cambridge MA: National Bureau for Economic Research, July 2006).

[246]See Kalok Chan, Vicentiu Corvig, and Lilian Ng, ibid., pp. 1501-1511.

[247]For example, the percentage of shares of American and British public traded companies that were owned by insiders in 2004 was respectively only 12.2 and 12.3 percent. The similar figure for the OECD zone was 38.4 percent. Bong-Chan Kho, Rene Stulz, and Francis Warnock, "Financial Globalization, Governance, and the Evolution of the Home Bias," pp. 41-42.

panies builds on prior research on the influence of ownership structures in order to heighten comparability. First, investigations focusing on the impact of management-controlled firms used a cutoff point of 5 percent as a measure of ownership dispersion.[248] The absence of a controlling shareholder owning more than 5 percent of the equity capital of the firm implies greater freedom of maneuver for managers. No single shareholder possesses the incentives to monitor executives. At the time, however, the absence of ownership concentration entails that the capital structure of the firm is vulnerable to speculations on financial markets – an issue of importance for executives since they are likely to lose their jobs in the event of the company being acquired. Firms in which no single shareholder (or group of friendly shareholders) own at least 5 percent of their equity capital are classified as being diversified (DIS). Second, studies on the impact of large owners with substantial control – i.e., whereby executives are under their close supervision – use the 20 percent threshold for labelling a firm as ownership concentrated.[249] An equity stake of 20 percent greatly contributes to insulate the firm from unwanted takeover bids on financial markets and, moreover, enables the large owner to exercise predominant control over the conduct of the strategy of the firm since major change in European corporations need a supermajority of two-thirds. In other words, an equity stake of at least 20 percent of the equity capital of the firm is very close to the 33 percent veto point threshold. Firms in which a single shareholder (or group of friendly shareholders) owns more than 20 percent of the equity capital are classified as high concentration (HC). Third, firms in which the largest shareholder (or group of friendly shareholders) owns between 5 and 20 percent of the equity capital are labelled as medium concentration (MC). Such firms are vulnerable to speculations of financial markets, but possess more options to delay and block unwanted takeover bids through deviations from the one share-one vote principle and other anti-takeover devices. Finally, and because a firm can record many investment stakes from institutional investors in different years, the number of data observations on ownership structure and free float can be higher than the number of firms.

Table 14 is comprised of firms that did not record an instance of investment stake above the 5 percent threshold by mutual funds. Firms are also listed with their European stock market capitalization rank. I recorded the status of their ownership structure and free float from the data found in their 2003 annual reports since they have not received an investment stake from mutual funds. I selected the 2003 report since reported data on ownership structure and free float are usually for late 2003 – which broadly corresponds to the sample date of large listed firms, namely December 17, 2003. The classification of the ownership structure is the same as for firms that recorded an instance of an investment above the 5 percent threshold.

The influence of the ownership structure – and the degree of free float – on the investment strategies of mutual funds reveals the importance of institutionally-based varieties of capitalism

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[248]Eric Gedajlovic and Daniel Shapiro, "Management and Ownership Effects: Evidence from Five Countries," *Strategic Management Journal* 16,6 (June 1998): 533-553; Donald Hambrick and Sidney Finkelstein, "The Effects of Ownership Structure on Conditions at the Top: The Case of CEO Pay Raises," *Strategic Management Journal* 16,3 (March 1995): 175-193; and *Richard* Whittington and Michael Mayer, *The European Corporation: Strategy, Structure and Social Science* (New York: Oxford University Press, 2000).

[249]See Luca Enriques and Paolo Volpin, "Corporate Governance Reforms in Continental Europe," *Journal of Economic Perspectives* 21,1 (Winter 2007): 117-140; Mara Faccio and Larry Lang, "The Ultimate Ownership of Western European Corporations," *Journal of Financial Economics* 65,3 (September 2002): 365-395; Peter Gourevitch and James Shinn, *Political Power and Corporate Control: The New Politics of Corporate Governance*, pp. 16-20.

differences in determining whether ownership structure constitutes a necessary and/or sufficient condition. A first angle of comparison focuses on the characteristics of firms that were targeted by short-term, impatient investors versus those that were not. For the 64 instances of investment above the 5 percent threshold by mutual funds in blue-chip French companies, thirty-two took place in firms characterized by high ownership concentration, nineteen in firms with a medium concentrated ownership structure, and the remaining thirteen occurred in ownership dispersed companies (see Table 13).[250] Moreover, of the twenty-seven French firms that did not receive an investment above the 5 percent threshold, twenty-one were characterized by high ownership concentration (see Table 14). The distribution of the observations on the ownership structure of French companies that were/were not targeted by hedge/mutual funds suggests two implications. First, the overall predominance of ownership concentration of the French corporate sector has not deterred mutual funds. Although a 2x2 typological comparison is not possible, the cases of French firms with ownership concentration that were targeted by short-term, impatient institutional investors come closest to representing the X=0, Y=1 cell – the occurrence of an investment stake despite the presence of ownership concentration. The statistical dominance of this cell casts serious doubts on the necessity of dispersed ownership structure as an independent variable. Second, the presence of ownership diffusion appears to co-vary with the investment strategies of mutual funds in France. There were only one firm with ownership dispersion and five firms with medium ownership concentration that did not record a targeted investment by hedge/mutual funds. The implication is that the growing diffusion of ownership in France could attract even more investments from short-term, impatient investors. Data from the German case, however, highlight the importance of institutionally-based varieties of organizational capitalism of the French case. There are thirty-five instances of investment above the 5 percent threshold in Germany with the following distribution: nineteen with high ownership concentration, seven with medium ownership concentration, and nine with ownership dispersion. The similar minority position of companies with ownership dispersion among those that have recorded an investment stake also testifies to the implausibility of dispersed ownership structure constituting a necessary condition. But in contrast to the French case, the characteristics of the companies that did not receive such an investment are sharply different. Of the thirty-seven firms that did not record an investment, eight of them were characterized by ownership diffusion – a much higher proportion than in France. The presence of ownership diffusion in Germany does not appear to constitute a sufficient condition to account for the investment patterns of mutual funds.

[250]The number of observations of investment over the 5 percent is greater than the number of firms that received such investment since the same firm can receive more than one investment.

Table 13: Ownership Structure and Free Float Rate of French and German Companies Targeted for Investment by Mutual Funds

France			Germany		
European Stock Market Capitalization (rank)	Ownership Structure	Free Float	European Stock Market Capitalization (rank)	Ownership Structure	Free Float
1) Total (5)	HC	NA	1) Bayer (65)	DIS	>95
2) BNP-Paribas (20)	HC	NA	2) Volkswagen (104)	HC/HC	68/68
3) Aventis (29)	HC	NA	3) Hypo Bank (130)	MC	82
4) Vivendi (52)	DIS/DIS	90/90	4) Commerzbank (131)	MC	88
5) Alcatel (73)	MC/MC/MC	89/86/87	5) Infineon (165)	MC/MC/DIS/ DIS	88/88/100/100
6) Renault (87)	HC/HC	~40/63	6) Deutsche Borse (172)	DIS/DIS	100/100
7) Schneider (92)	HC/DIS	NA/88	7) Continental (204)	MC	78
8) Lafarge (95)	DIS	100	8) Adidas-Salomon (223)	MC	NA
9) Accor (134)	MC/HC/MC	>75/84/85	9) Linde (253)	HC	69
10) Lagardere (158)	MC/MC	89/85	10) Depfa Bank (340)	HC	<35
11) Bouygues (160)	HC/HC/HC	NA/46/61	11) Puma (348)	DIS	100
12) Veolia (182)	HC/HC	NA/72	12) Merck (409)	HC/HC/HC	26/27/27
13) Michelin (184)	DIS/MC	97/92	13) Hypo Real Estate (439)	DIS	100
14) Cap Gemini (190)	MC	93	14) MG Technologies (462)	HC	60
15) Pernod Ricard (197)	HC/HC	NA/57	15) Celanese (498)	HC	7
16) Essilor International (198)	MC	90	16) MLP (547)	HC/ HC	57/57
17) Thomson (217)	MC/MC	88/88	17) Epcos (565)	HC/DIS	NA/100
18) Pechiney (231)	HC/HC	79/79	18) Medion (597)	HC/HC	45/45
19) Publicis (236)	HC/HC	55/68	19) Bilfinger Berger (632)	DIS	100
20) TF1 (247)	HC/HC	NA/57	20) K&S (658)	MC	90
21) Unibail (294)	HC	66	21) Frankfurt Airport (714)	HC/HC	36/36
22) Valeo (329)	HC/MC	71/90	22) Heidelberger Druck-maschinen (723)	HC/HC	57/57
23) Thales (342)	HC	54	23) AAreal Bank (737)	HC	54
24) Dassault Systèmes (346)	HC	49			
25) Wanadoo (347)	HC	16			
26) Business Objects (374)	DIS/DIS/DIS	100/100/100			
27) Eurotunnel (378)	DIS	100			

288) Technip-Coflexip (381)	HC/HC/MC/MC/MC	NA/66/93/ 88/88			
29) Atos (434)	MC	87			
30) Neopost (4446)	MC/ DIS/DIS	81/98/97			
31) Havas (457)	MC/DIS/DIS	88/100/100			
32) Natexis Bank (471)	HC	<20			
33) BIC (490)	HC/HC/HC/HC	45/55/55/55			

Table 14: Ownership Structure and Free Float Rate of French and German Companies Not Targeted for Investment by Mutual Funds

France			Germany		
European Stock Market Capitalization (rank)	**Ownership Structure**	**Free Float**	**European Stock Market Capitalization (rank)**	**Ownership Structure**	**Free Float**
1) Société Générale (34)	MC	69	1) Siemens (16)	DIS	94
2) Carrefour (39)	HC	71	2) Deutsche Bank (24)	DIS	100
3) AXA (43)	HC	61	3) Deutsche Telekom (25)	HC	57
4) L'Oréal (50)	HC	42	4) Allianz (30)	MC	83
5) Sanofi-Synthelabo (51)	HC	48	5) E.ON (33)	DIS	>95
6) France Telecom (3)	HC	57	6) Daimler-Chrysler (36)	MC	81
7) Danone (59)	MC	86	7) SAP (38)	HC	65
8) LVMH (67)	HC	40	8) BASF (44)	DIS	100
9) Suez (74)	HC	74	9) Munich Re (57)	MC	80
10) Crédit Agricole (75)	HC	42	10) BMW (83)	HC	53
11) Air Liquide (77)	DIS	98	11) RWE (100)	MC	89
12) Saint-Gobain (78)	MC	82	12) Schering (129)	MC	89
13) Peugeot (138)	HC	46	13) Thyssen Krupp (152)	HC	80
14) Pinault Printemps Redoute	HC	50	14) Deutsche Post (153)	HC	37
15) Arcelor (168)	MC	78	15) Metro (178)	HC	44
16) Vinci (187)	MC	86	16) Altana (211)	HC	61
17) Casino (265)	HC	39	17) Henkel (214)	HC	NA
18) Christian Dior (287)	HC	31	18) Porsche (220)	HC	NA
19) Sodexho (327)	HC	58	19) T-Online (264)	HC	20
20) Autoroutes Sud France (353)	HC	26	20) Lufthansa (294)	DIS	90

21) CNP Assurances (411)	HC	25	21) MAN (306)	DIS	100
22) Sagem (418)	HC	38	22) Beiersdorf (331)	HC	22
23) Air France (430)	HC	<65	23) TUI (368)	HC	69
24) Hermes (436)	HC	25	24) Heidelberger Cement (382) (09/2005)	HC	15
25) Gecina (438)	HC	50	25) Fresenius (390)	HC	49
26) Imerys (469)	HC	46	26) Stada Arzneimit (487)	DIS	100
27) Zodiac (509)	HC	57	27) Celesio	HC	42
			28) Pro Siebensat (552)	HC	36
			29) Wella (558)	HC	<40
			30) Suedzucker (572)	HC	34
			31) Hannover Ruck (577)	HC	49
			32) IKB DT Industriebank (603)	HC	51
			33) Douglas (608) (2004)	MC	82
			34) Singulus Technologies (621)	DIS	100
			35) Karstadtquelle (643)	HC	45
			36) IVG Immobilien (776)	HC	74
			37) Hugo Boss (875)	HC	21

There are two inherent and fundamental questions in this section. The first question is: what factors drive the investment strategy of mutual funds in France and Germany? The second question is: what accounts for the greater attractiveness of France over Germany for short-term, impatient investors? The notion of complex causation constitutes a useful methodological tool to deal with these two questions. First, the ownership structure of companies does not appear to be driving the investment strategies of mutual funds. The bulk of the investments of these two categories of investors took place in ownership concentrated firms – in contrast to the predictions of the legal theoretical perspective. The ownership structure of (both) French and German companies does not constitute a necessary condition. A potential objection to the institutionalist argument of the paper is that most companies in the two countries are characterized by ownership concentration – therefore, it is less surprising to find mutual funds investing in such firms. The comparison of France and Germany should take into account the fact that dispersed ownership companies do not represent the bulk of my sample, as they would if I were working with American and British companies. The ownership structure of companies might not constitute a necessary condition, but would ownership dispersion represent a sufficient condition? I discuss this issue below, but a fundamental question still remains: what accounts for the overwhelming selection of France over Germany as an investment site within the concentrated ownership group? Second, the issue of ownership dispersion potentially gives rise to a methodology problem of co-variation with my dependent variable. There are (slightly) more blue-chip firms with a dispersed ownership structure in France than in Germany in aggregate terms – i.e., by counting companies that were/were not targeted by mutual funds. Thus, both firm-level institutional arrangements of workplace organization and ownership diffusion (but not ownership concentration) co-vary with the investments of mutual funds. Qualitative methods provide important insights to resolve this issue. The typology theory of sufficient conditions are associated with two cells of figure 1; it has nothing to say for cases where X=0 (cells I and III). For cases of X=1, the observations should be found in cell IV (ownership dispersion and investment stake by mutual funds). Cell I (ownership dispersion and no investment stake) should be close to being emptied. But, as previously mentioned, the fact that the quasi-totality of dispersed ownership firms in France has recorded an investment above the 5-percent threshold does not entail that ownership dispersion constitutes a universal sufficient condition. A high proportion of German firms characterized by ownership dispersion did not receive such an investment. I do not want to suggest that the characteristics of the ownership structure of listed companies are unimportant, but that their impact depends on the presence of another key factor, namely, the degree of power concentration in the CEO. Firm-level institutional arrangements of work organization account for the greater attractiveness of France over Germany, but do not constitute the sole factor driving the investment strategies of mutual funds – consistent with the Hall and Soskice (2001) stressing of the central position of (institutional) structure in conditioning the strategy of actors, but not in fully determining it.[251] The Varieties of Capitalism theoretical perspective illuminates how necessary and/or sufficient conditions vary across the advanced capitalist economies. However, besides highlighting the importance of the national institutional framework, this perspective does not predetermine, nor exclude, the additional variables that operate through a process of complex causation.

c) Educational Background and Career Patterns of Top Executives in Germany

The educational background and career development of top managers exert considerable influence on their frame of reference – presenting them with taken-for-granted world views that, in turn, shape

[251]Hall and Soskice, "An Introduction to Varieties of Capitalism," p. 15.

the types of corporate actions undertaken.[252] Top executives with specific types of educational and working experiences direct their attention to certain types of innovation at the expense of others – thereby rendering them more (or less) open to learn and borrow from other countries.[253] The social environment of top executives constitutes a key factor in the arrays of competing visions on how to best manage the firm. This statement about the influence of educational background and career development is particularly relevant for this study – German managers have been praised for their high level of technical expertise, which results from their productionist, engineering-oriented focus.[254] A higher proportion of engineers have occupied top senior managerial positions. The role of the external labor market for German managers, moreover, has traditionally been limited because of the prominence of internal recruitment practices and of in-house careers (*Hauskarrieren*). The profile of top German executives stands in sharp contrast to that of their American and British colleagues, where the emphasis on finance has been dominant in the last twenty-five years.[255] The implication of this managerial functional orientation is that it can serve as an alternative explanation to account for the lesser attractiveness of Germany to short-term, impatient institutional investors. The cognitive models of governance of top German executives is likely to favor productionist objectives over financial ones, thereby implementing shareholder value practices less of a legitimate priority.

The managerial perspective presented above, however, cannot account for the different patterns of investment by mutual (and hedge) funds in France and Germany. First, the educational background and career patterns of executives of the largest German companies has changed in three fundamental ways in the last ten years: the percentage of executives who went through the German apprentice system has declined substantially, the proportion of university degrees held by top executives in the fields of law or economics is now more than twice that of science or technical subjects, the use of stock options increased rapidly after their formal legalization in 1998, and reliance on external labor markets has more than doubled.[256] These developments took place in a context of overall stability in regard to the educational background and career patterns of blue-collar employees.[257] Second, formal declarations of shareholder value advocacy often mask the inability of managers to implement strategic changes in the firm. In their studies of strategic change in large German companies, Fiss and Zajac found a substantial portion of firms engage in decoupling by espousing but not implementing a shareholder value orientation.[258] The symbolic (i.e., in name only) adoption of shareholder value prin-

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[252]For example, see Neil Fligstein, *The Transformation of Corporate Control* (Cambridge MA: Harvard University Press, 1990) for an analysis of the impact of managerial ideologies on the evolution of the dominant forms of control in American corporations.

[253]Wm. Gerard Sanders and Anja Tuschke, "The Adoption of Institutionally Contested Organizational Practices: The Emergence of Stock Option Pay in Germany," *Academy of Management Journal* 50,1 (February 2007): 35-56.

[254]See Gary Herrigel, *Industrial Constructions: The Sources of German Industrial Power* (New York: Cambridge University Press, 1996); and Peter Lawrence, *Managers and Management in West Germany* (New York: St. Martin's Press, 1980).

[255]See Mary O'Sullivan, *Contests for Corporate Control: Corporate Governance and Economic Performance in the United States and Germany* for the American case; see Richard Whittington and Michael Mayer, *The European Corporation:: Strategy, Structure and Social Science*, for an analysis of top executives in the United Kingdom.

[256]See Martin Hoepner, "Corporate Governance in Transition: Ten Empirical Findings on Shareholder Value and Industrial Relations in Germany," pp. 20-27.

[257]David Reimer and Reinhard Pollak, "The Impact of Social Origin on the Transition to Tertiary Education in West Germany 1983 to 1999," Working Paper 85 (Mannheim: Mannheim Centre for European Social Research, 2005).

[258]See Peer Fiss and Edward Zajac, "The Diffusion of Ideas over Contested Terrain: The (Non) Adoption of a Shareholder Value Orientation among German Firms," *Administrative Science Quarterly* 49,4 (December 2004):

ciples as a substitute for structural implementation is leaving internal power relations in the firm unchanged while at the same time enhancing organizational legitimacy.

Finally, the introduction of shareholder value strategies in German firms cannot be fully accounted for by the preferences of managers; they have also been mediated by the broader institutional context of the German system of corporate governance. The issue of managerial compensation illustrates quite well this dynamic. The adoption of stock options and other forms of variable pay vary considerably across firms in Germany – their award being inversely related to ownership concentration.[259] Stock-based incentive packages, moreover, tend to be significantly lower than they are in the United States and the criteria for their award are stricter – increases in the market valuation of the company do not result in stock options unless the gains in market value exceed those of other (domestic and foreign) firms in the sector.[260] This diversity presents a puzzle for a managerial perspective on corporate governance: why haven't all German firms adopted and heavily relied upon stock options and other forms of variable pay since these two forms of remuneration are added on top of the fixed managerial pay component? The preferences of managers cannot account for the nature of the spread of variable pay incentives. The introduction of these financial incentives was instead strongly mediated by two sets of factors: the ownership structure of companies and the legally entrenched position of power of employees. The presence of ownership concentration implies that there is an alternative mechanism to monitor top executives, namely a large shareholder. In other words, German companies with ownership dispersion are the ones with the greatest need to monitor top executives via variable pay schemes. The legally entrenched position of power of employees, on the other hand, enables the latter to co-determine the content of stock option plans. The German case illustrates the possibility of a transparency coalition whereby employees and minority investors can act against managerial opportunism.[261] Institutional frameworks constrain even the most enthusiastic actors. The issue is not to deny the influence of the educational background and characteristics of the career development of top executives on the implementation of strategies of shareholder value, but to highlight the importance of institutional frameworks in mediating managerial preferences.

Conclusions and Implications

The argument presented in this paper has several implications for the study of comparative corporate governance and national models of capitalism under conditions of financial globalization and increasing capital mobility across borders. The paper took a two-pronged approach to these issues by asking the following: what accounts for the diverging ability of French and German firms to attract capital from Anglo-Saxon institutional investors; and what are the consequences associated with the growth of foreign ownership? The issue of accounting for institutional change and its effects has become critical for comparative political economists, given that the field has long focused on using insti-

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501-34; and Peer Fiss and Edward Zajac, "The Symbolic Management of Strategic Change: Sensegiving via Framing and Decoupling," *Academy of Management Journal* 49,6 (December 2006): 1173-93.

[259]See Peer Fiss, "Social Influence Effects and Managerial Compensation: Evidence from Germany," *Strategic Management Journal* 27,11 (November 2006): 1013-1031; Anja Tuschke and Wm. Gerard Sanders, "Antecedents and Consequences of Corporate Governance Reform: The Case of Germany," *Strategic Management Journal* 24,7 (July 2003): 631-649.

[260]Martin Hoepner, "Corporate Governance in Transition: Ten Empirical Findings on Shareholder Value and Industrial Relations in Germany," pp. 28-29; Anja Tuschke and Wm. Gerard Sanders, "Antecedents and Consequences of Corporate Governance Reform: The Case of Germany," pp. 646-647.

[261]See Peter Gourevitch and James Shinn, *Political Power and Corporate Control: The New Global Politics of Corporate Governance*, pp. 160-167, for an overview.

tutions to account for divergence across countries. Critics have argued that institutional theories associated with the Varieties of Capitalism perspective do a better job at accounting for stability than institutional discontinuity. The argument of this paper, by contrast, has highlighted the continuing usefulness of taking domestic institutional frameworks seriously as an independent variable for middle-range theoretical projects. I argue that key institutions (workplace organization) constitute the single most important variable to account for institutional change in the specific case of ownership structure. This apparently paradoxical outcome, institutions to explain institutional change, is driven by three factors: importance of interaction among institutions, latency of institutional frameworks, and the distinction between institutional change and mode of economic coordination.

First, institutional arrangements interact to complement each other and consequently cannot be studied in isolation, whether analyzing the presence of stability or the occurrence of change in the broader institutional framework of countries.[262] The introduction of an important institutional change in the ownership structure of French and German companies does not annul the theoretical importance of institutions. Substantial institutional differences remain in other areas, and these persisting cross-national differences form a distinctive constellation that produces different outcomes across nations. The impact associated with institutional change on the overall operation of the political economy is dependent on the interaction of the new institutions with those already in place, as institutional change is almost invariably piecemeal rather than full-scale. This is a significant and worthy aspect of analysis, since the occurrence of institutional change is not sufficient in order to assess whether change is evolutionary or radical.[263] Different processes of change (abrupt and incremental) can both result in an evolutionary or radical transformation of the system.

Second, the institutions of workplace organization in the two countries have become more salient in the new context of financial globalization after having being characterized by an element of latency prior to financial deregulation.[264] The long-term cross-national differences in work organization contributed to the differences in the patterns of economic specialization of the two countries, but they had nothing to do with the ownership structure of large domestic companies, given the lack of international diversification of Anglo-Saxon investors prior to the early to mid-1990s. This last point about latency illustrates quite well the importance of the interactive effects associated with an institutional matrix. Prior to the mid-1990s, France and Germany were two bank-based financial systems with long-term patient capital despite differences in the institutions of workplace organization. The provision of patient capital in France was previously made possible through a combination of state regulation of the banking sector, which facilitated access to long-term capital through bank loans, and cross-shareholdings among large companies.[265] The deregulation of the banking sector and the decline of cross-shareholdings in France entail that the provision of long-term capital in the form of

[262]For a full discussion of the macro effects of interaction between institutions in different spheres of the economy, see Peter Hall and Robert Franzese, "Mixed Signals: Central Bank Independence, Coordinated Wage Bargaining, and European Monetary Union"; Peter Hall and David Soskice, "Introduction: Varieties of Capitalism," pp. 17-33; and Paul Milgrom and John Roberts, "Complementarities and Systems: Understanding Japanese Economic Organization."
[263]See John Campbell, *Institutional Change and Globalization,* for an analysis of the problem of measuring institutional change.
[264]For a discussion of the concept of latent institutions, see Kathleen Thelen and Sven Steinmo, "Institutionalism in Comparative Politics," in Sven Steinmo, Kathleen Thelen, and Frank Longstreth, eds., *Structuring Politics: Historical Institutionalism in Comparative Analysis* (New York: Cambridge University Press, 1992), pp. 16-8.
[265]See John Zysman, *Governments, Markets, and Growth*: *Financial Systems and the Politics of Industrial Change,* pp. 99-169.

debt finance is no longer available; it has instead been replaced by the presence of short-term, impatient capital. A key insight is that while the institutions of workplace organization have not fundamentally changed, the external environment in which they are embedded has. The concentration of power in top management was previously interacting with state policies and patterns of cross-shareholdings that enabled firms to have access to long-term capital. This outcome contrasts with the German situation. The provision of long-term capital in Germany resulted from concentrated ownership and the ability of shareholders to monitor companies via non-market mechanisms. The provision of long-term capital has not been affected by recent developments. The ownership concentration of large companies has remained intact despite the increasing importance of Anglo-American pension funds that are, moreover, themselves long-term owners.[266]

Third, the theoretical importance of the degree of power concentration associated with the institutions of workplace organization as an explanation of the ability of companies to attract foreign capital is contingent upon its resilience and its ability to sustain cross-national comparisons. The research design of this paper and the ability to draw causal inferences would be uncertain if both the power concentration inside companies and the ownership structure of large firms had changed in recent years, given the problem of over-determination. The degree of power concentration of large French and German companies, and the process by which they develop their innovative capabilities, have been both relatively stable and exhibited striking differences between the two countries for the last thirty years, despite changes in ownership structure. A key insight of this paper is that one must distinguish between the character of coordination of firms and the institutional framework that supports it.[267] Change in the latter does not entail a modification in the former. The sustainability of national models of corporate governance and capitalism cannot rest on the total absence of institutional change. The presence of institutional change does not imply inertia.[268] Instead, the central issue is whether the transformation of the ownership structure of large firms sustains their mode of coordination and the complementarities of the model.

The distribution of power of French and German companies has remained stable over a period of time in which their ownership structure underwent a significant transformation. The mode of coordination of the activities of large companies in the two countries is best understood by analyzing the process by which they develop and sustain their innovative competences. The development of innovative capabilities by firms requires the involvement of employees in complex problem-solving activities as well as the ability to develop a viable strategy that will enable them to compete in different sectors and technology. However, the nature of the integration of employees in the development of organizational capabilities varies quite sharply between France and Germany. The coordination of activities in large French companies is characterized by the vesting of unilateral authority in top managers and senior staff. The acquisition of new competences often takes place through the hiring of specialists on external labor markets. The bulk of the work force does not contribute to the development of the organizational learning capabilities of the firm. The hierarchical patterns of differentiation and the concentration of power inside French companies do not reflect only organizational politics,

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[266]See Pepper Culpepper, "Institutional Change in Contemporary Capitalism," *World Politics* 57, 2 (January 2005): 173-199 and Bruce Kogut and Gordon Walker, "The Small World of Germany and the Durability of National Networks," *American Sociological Review* 66,3 (June 2001): 317-335, for an analysis of the stability of ownership concentration in Germany.

[267]See Peter Hall and Kathleen Thelen, "Institutional Change and the Varieties of Capitalism," pp. 30-37.

[268]The original thesis of this argument is Kathleen Thelen, *How Institutions Evolve: The Political Economy of Skills in Germany, Britain, the United States, and Japan* (New York: Cambridge University Press, 2004).

but constitute the key mode of coordination by which they develop their competitive competences. The coordination of activities of large German firms, in contrast, involves high levels of authority sharing with the bulk of the workforce. The development of innovative capabilities takes place on the basis of the long-term contribution of skilled employees through institutionalized career paths. Continuing job rotations across functions as well as lateral coordination enable the bulk of employees to contribute to the improvement of the organizational problem-solving capabilities of firms. The rise of foreign ownership in France and Germany does not constitute a challenge to the mode of coordination of large domestic firms; it does contribute to reinforce the process of development of their innovative capabilities. I argue in this paper that the relative attractiveness of French and German firms for Anglo-American institutional investors is shaped by the different institutional arrangements of workplace organization and the power relationships embodied in them. The globalization of financial markets and the greater mobility of capital across borders have not undermined the institutions of work organization in France and Germany, a key feature of these two distinctive models of capitalism.

Annex 1

Table A: Equity Stake over 5 Percent, Germany

1997 (September-August)	Anglo-American Fund	Initial Equity Stake
Sinn Leffers	Tweedy Browne (MF)	5.53
Tarkett	Goldman Sachs (MF)	19.29
Vossloh	New Germany Fund (MF)	5.00
1998		
Data Modul	Invesco (MF)	9.0
DePfa	Janus (MF)	5.3
Deutsche Babcock Borsing	Fidelity (MF)	5.17
1999		
Kassbohrer	Schroeder (MF)	25.20
2000		
Adidas	Templeton (MF)	5.12
Holsten-Braverei	St James Place Capital (MF)	6.71
2001		
Beru	Henderson Global Ltd (MF)	7.19
Bowe Systec	Tweedy Browne Cie (MF)	5.0
Cargo Lifter	Henderson Investors (MF)	11.4
Rheinmetall	Wyser-Pratte (HF)	5.05
2002		
Bowe Systec	Global Value Fund Inc. (MF)	5.58
Epcos	The Capital Group (MF)	18.84
Kleindienst Datentechnik	Schroeder (MF)	43.62
Merck	Tweedy Browne Cie (MF)	10.26
Suss Microtec	Capital Group (MF)	6.49
Zapf Creation	Fidelity (MF)	5.73
2003		
Adphos Advanced Techno	Fidelity (MF)	91.4
Celanese	Fidelity (MF)	5.05
Deutsche Borse	Fidelity (MF)	5.1
Freenet.de	Fidelity (MF)	6.14
Infineon	Capital Group (MF)	5.06
Infineon	Fidelity (MF)	5.08
MG Technology	Capital Group (MF)	5.06
Pfeiffer Vacuum Technology	Harris Associates (MF)	5.04
Puma	Fidelity (MF)	5.02
Rhon-Klinikum	Capital Group (MF)	5.22
Software	Capital Group (MF)	5.20
Syzygy	BAT Trustees (MF)	10.22
Syzygy	Laxey Partners (HF)	12.12
Techem	Capital Group (MF)	5.16
Vossloh	Arnold Bleichroeder (HF)	5.20
2004		
AAreal Bank	Capital Group (MF)	5.23
Amadeus Fire	Fidelity (MF)	9.06
Amadeus Fire	Gartmore (MF)	5.22
Amadeus Fire	Parvus Asset Mgt UK (HF)	12.65
Artnet	Artis Capital Mgt (HF)	5.60
AWD Holdings	Fidelity (MF)	5.27

Bayerische Hypo Bank	Capital Group (MF)	7.40
Bijou Brigitte	Fidelity (MF)	5.02
BKN AG	Capital Group (MF)	7.40
Comtrade	FM Fund Mgt (HF)	29.57
Continental	Capital Group (MF)	5.13
Deutsche Borse	Atticus Capital (HF)	5.07
Deutsche Borse	Capital Group (MF)	5.01
Deutsche Borse	Children Investment (HF)	5.50
Deutsche Borse	TCI Fund Management (HF)	5.01
DSI Deutscher Services	Jupiter Asset Mgt UK (MF)	5.05
Eurobike	Small Cap World Fund (MF)	6.17
FJH	Fidelity (MF)	5.02
Greenleasing	Schroder (MF)	5.0
Heidelberger Druckmasch	Brandes Investment (MF)	10.11
Heidelberger Druckmasch	Fidelity (MF)	5.04
IFCO System	Aberdeen Asset mgt (MF)	6.7
ISRA Vision	Fidelity (MF)	7.21
IWKA	Schroder (MF)	5.05
IWKA	Wyser-Pratte (HF)	5.0015
Kali und Salz (K&S)	Fidelity (MF)	5.45
Mediclin	Henderson Global Inv. (MF)	5.64
Medion	Fidelity (MF)	5.34
Medion	Jupiter Asset Mgt. (MF)	5.0
Merck	Capital Group (MF)	5.01
Merck	Fidelity (MF)	5.25
MWG-Biotech	FM Fund Management (HF)	6.76
Paion	Fidelity (MF)	7.24
PC Specialist	Fidelity (MF)	5.85
Pfleiderer	Capital Group (MF)	7.31
Pfleiderer	Fidelity (MF)	5.48
Pfleiderer	Henderson Global Inv. (MF)	10.66
Pulsion Medical Systems	Fidelity (MF)	9.28
Senator Entertainment	Marathon Asset Mgt (HF)	8.39
SGL Carbon	K Capital Partners (HF)	5.22
SGL Carbon	Jana Partners (HF)	5.30
Techem	Jupiter Asset Mgt. (MF)	12.8
United Internet	Fidelity (MF)	5.02
Vivacon AG	Schroder (MF)	5.04
Volkswagen	Brandes Investment (MF)	6.15
Volkswagen	Capital Group (MF)	5.12
Wapme Systems	Fortune Management (HF)	13.46
Washtec AG	Henderson Global Inv. (MF)	7.89
Wedeco Water Technology	Fidelity (MF)	5.13
Wincor Nixdorf	Goldman Sachs (MF)	7.20
Wincor Nixdorf	Schroder (MF)	7.25
Zapf Creation	Fidelity (MF)	5.04
2005		
Augusta Technologies	Tragalfar Catalyst Fund (HF)	10.86
Augusta Technologies	Goldman Sachs Group (MF)	7.3
Augusta Technologies	Marathon Special Opportunity (HF)	7.2
Axel Springer	Tweedy, Browne (MF)	5.76

Balda AG	Cycladic Asset mgt (HF)	7.39
Bayer	Capital Group (MF)	5.03
Bilfinger Berger	Fidelity (MF)	5.18
Cash.life AG	Fidelity (MF)	5.02
Centrotec AG	Schroder (MF)	5.08
Cewe Color Holding	Fidelity (MF)	5.18
Cewe Color Holding	K Capital Partners (HF)	10.66
CTS Eventim	Fidelity (MF)	5.25
D+S Europe AG	Avenue Europe Int'l mgt (HF)	9.46
Deag AG	Fidelity (MF)	5.60
Deutz	Fidelity (MF)	5.20
Escada	Schroder (MF)	10.1
GFK AG	Fidelity (MF)	5.14
Hypo real estate	Capital Group (MF)	5.19
IWKA	Fidelity (MF)	5.61
IWKA	K Capital Partners (HF)	5.29
Kontron	Fidelity (MF)	10.16
Mobil.com	Henderson Global Inv. (MF)	5.67
MPC Capital AG	Fidelity (MF)	5.06
Pfeiffer Vacuum Tech	Arnold Bleichroeders (HF)	10.4
Phoenix	Trident European Fund (HF)	5.61
PSI AG	Fidelity (MF)	5.63
Re Power System	T Rowe Price (MF)	5.01
Rheinmetall	Atlantic Investment mgt (HF)	5.12
Rheinmetall	Perry Inv. Associates (HF)	6.39
Rhon Klinikum	Columbia Management (MF)	5.21
Schwarz Pharma	Schroder (MF)	5.0
Solar World	Fidelity (MF)	5.39
Solon	Fidelity (MF)	5.17
TAG Immobilien	Asset Value Investors (MF)	5.11
Technotrans	Gartmore (MF)	5.15
Tipp 24 AG	Fidelity (MF)	6.67
Uzin Utz AG	Henderson Global (MF)	6.48
Wavelight AG	Schroder (MF)	5.02
Zapf Creation AG	Schroder (MF)	9.77
2006 (January-May)		
ADVA AG Optical	Fidelity (MF)	5.01
ADVA AG Optical	GLG Partners (HF)	5.19
Borussia Dortmund	Absolute K Mgt Holdings (HF)	25.97
Caatoosee AG	Absolute K Mgt Holdings (HF)	20.75
Cash.Life AG	M&G Investment (MF)	5.02
CDV Software AG	Absolute K Mgt Holdings (HF)	22.83
Cewe Color Holdings	M2 Capital Group (HF)	5.36
Concord Effekten AG	Absolute K Mgt Holdings (HF)	9.94
Deutsche Borse	Lone Pine Capital (HF)	5.09
Deutsche Wohnen	Asset Value Investors (MF)	5.16
Deutsche Wohnen	Julius Baer Investment (MF)	5.10
Deutsche Wohnen	Newton Investment Mgt (MF)	5.88
Elephant Seven AG	Absolute K Mgt Holdings (HF)	22.15
Euromicro AG	Cycladic Capital Mgt (HF)	18.34
Fluxx AG	Fidelity (MF)	9.57

Frankfurt Airport	Capital Group (MF)	5.08
Frankfurt Airport	Julius Baer (MF)	5.09
Infineon	Dodge & Cox (MF)	5.07
Jack White Productions	Schroders (MF)	5.36
Jenoptik	Brandes (MF)	5.01
Klassik Radio ag	Absolute K Mgt Holdings (HF)	17.77
Mologen ag	Absolute K Mgt Holdings (HF)	15.61
mtv Aero Engines	Fidelity (MF)	5.0
Pixelpark ag	Absolute K Mgt Holdings (HF)	13.60
Praktiker Holdings ag	T Rowe (MF)	5.24
Praktiker Holdings ag	Eton Park K Mgt (HF)	6.61
Premiere ag	Capital Group (MF)	5.52
Premiere ag	Fidelity (MF)	5.01
Pulsion Medical Systems	Absolute K Mgt Holdings (HF)	7.52
Q-Cells ag	Fidelity (MF)	18.78
Schon & Cie ag	Absolute K Mgt Holdings (HF)	10.69
Shs Information Systeme	Absolute K Mgt Holdings (HF)	25.93
Sputz	Absolute K Mgt Holdings (HF)	20.45
tds Informations Technologie ag	gap-W Int'l (HF)	74.83
Techem	Fidelity (MF)	10.46
Wirecard ag	Avenue Asia Investment (HF)	7.83

Table B: Equity Stake over Five Percent, France

1997 (September-August)	Anglo-American Fund	Equity Stake
Alcatel	Fidelity (MF)	10.04
Avanquest Software	Amvescap (MF)	5.31
Aventis	Templeton (MF)	>5.0
Bail Investment	Templeton (MF)	>5.0
Bains de Mer Monaco	Fidelity (MF)	5.10
Banque Nationale de Paris	Templeton (MF)	5.01
Bazar Hotel de Ville	Silchester Int'l Investors (MF)	7.19
Billon	Schroder (MF)	>10.0
Bouygues Offshore	Templeton (MF)	5.56
Chargeurs	Baupost Group (HF)	>5.0
Chargeurs	Sanford Bernstein (MF)	7.5
Coflexip	Fidelity (MF)	5.20
COM 1	Fidelity (MF)	>5.0
Entrelec	Schroder Investment Mgt (MF)	>5.0
Eramet	Templeton (MF)	>5.0
Eramet	Fidelity (MF)	5.03
Etam Dévelopment	Henderson Int'l Investors (MF)	>5.0
Étam Dévelopment	Oceana Investment (MF)	>5.0
Europe 1 Communi.	Silchester Int'l Investors (MF)	7.56
Européenne de Casinos	Fidelity (MF)	5.43
Européenne Extincteurs	Henderson Global Inves. (MF)	>5.0
Faurecia	Henderson Financial (MF)	5.03
Fives-Lille	Templeton (MF)	>5.0
Galeries Lafayette	Sanford Bernstein (MF)	5.20
Galeries Lafayette	Templeton (MF)	>5.0
Gautier France	Schroder Investments (MF)	>5.0
Géophysique	Templeton (MF)	5.09
IMS	Henderson Int'l Investors (MF)	11.44
Jet Multimédia	Fidelity (MF)	>5.0
Stéphane Kélian	Fidelity (MF)	5.57
Kindy	Schroder Investments (MF)	>20.0
Alain Manoukian	Fidelity (MF)	>5.0
Marine Wendel	Templeton (MF)	>5.0
Métaleurop	Schroder Investments (MF)	6.36
Moneyline	Schroder Investments (MF)	>5.0
Montupet	Henderson Int'l Investors (MF)	7.05
Moulinex	Soros Fund Management (HF)	>5.0
Natexis-Credit National	Sanford Bernstein (MF)	8.75
Péchiney	Templeton (MF)	10.22
Renault	Templeton (MF)	5.40
SCOR	Templeton (MF)	10.69
SCOR	Putnam (MF)	5.31
Sécuridev	Henderson Int'l Investors (MF)	5.02
Servant Soft	Schroder Investments (MF)	>5.0
Simco	Sanford Bernstein (MF)	5.20
Stédim	Amvescap (MF)	>5.0
Strafor Facom	Wyser-Pratte (HF)	8.13
Taittinger	Wyser-Pratte (HF)	6.28
TF1	Sanford Bernstein (MF)	7.05

Total	Fidelity (MF)	>5.0
Unibail	Templeton (MF)	>5.0
Union Assurances Fédérale	Fidelity (MF)	5.03
Vallourec	Sanford Bernstein (MF)	9.30
1998		
Atos	Fidelity (MF)	5.07
Bouygues	Schroder (MF)	6.80
CERG Finance	Fidelity (MF)	5.73
D.M.C.	Fidelity (MF)	5.27
Europe 1	Harris Associates (MF)	5.03
Europe 1	Silchester Int'l Investors (MF)	7.27
Européenne de Casinos	Soros Fund Management (HF)	16.46
Expand	Odey Asset Management (HF)	6.47
Galeries Lafayette	Fidelity (MF)	5.20
Gaumont	Rothschild K Mgt (MF)	6.09
Guyenne et Gascogne	Wyser-Pratte (HF)	5.29
Interbail	Wyser-Pratte (HF)	5.43
ISIS	Templeton (MF)	5.38
LeGris Industries	Sanford Bernstein (MF)	5.38
Léon de Bruxelles	Amvescap (MF)	10.51
Pareil au Meme	Amvescap (MF)	5.43
Pareil au Meme	Henderson Int'l Investors (MF)	>5.0
Rue Impériale	Ivory & Sime Asset Mgt (MF)	10.40
Socamel-Recaset	Henderson Int'l Investors (MF)	5.79
Sorefico Coiffure (Proxidis)	Henderson Global Inv. (MF)	>5.0
Sucrerie Pithiviers	Sogen Int'l Fund Inc. (MF)	5.40
Sylea	Sanford Bernstein (MF)	5.18
Sylea	Templeton (MF)	5.02
1999		
Altran Technologies	Amvescap (MF)	5.39
Belvedere	Schroder (MF)	>5.0
Bongrain	Silchester Int'l Investors (MF)	5.04
Brice	Fidelity (MF)	5.26
Brit Air	Small Cap World Fund (MF)	5.67
Buffalo Grill	Henderson Int'l Investors (MF)	>5.0
CERG Finance	Amvescap (MF)	6.67
Chargeurs	Harris Associates (MF)	10.13
Chemunex	Fidelity (MF)	>5.0
Courir	Schroder Investments (MF)	5.09
Christian Dalloz	Schroder Investments (MF)	6.05
GFI Informatique	Schroder Investments (MF)	5.26
Groupe André	Dubin Swieca K Mgt (HF)	5.07
Groupe André	Wyser-Pratte (HF)	5.01
Groupe Darmon	Henderson Int'l Investors (MF)	18.72
Groupe Go Sport	Schroder Investment Mgt (MF)	>5.0
Guyenne Gascogne	Fidelity (MF)	5.84
Havas	Putnam (MF)	5.77
HF Company	Schroder (MF)	10.22
Infogramme Entertain-	Schroder Investments (MF)	5.21

ment		
Intertechnique	Wyser-Pratte (HF)	10.07
ISIS	Harris Associates (MF)	5.09
Lagardere	Templeton (MF)	5.12
LeGris Industries	Wyser-Pratte (HF)	5.50
Léon de Bruxelles	Fidelity (MF)	5.29
Néopost	Fidelity (MF)	10.39
Néopost	Egerton K Ltd Partners (HF)	5.39
N.S.C. Groupe	Harris Associates (MF)	5.01
Prosodie	Wyser-Pratte (HF)	5.25
R2i Sante	Schroder (MF)	10.08
Rue Impériale	Fidelity (MF)	5.17
Société du Louvre	Edelman Value Partners (HF)	8.68
Transciel	Henderson Int'l Investors (MF)	5.01
Transgene	Fidelity (MF)	5.06
Virbac	Henderson Int'l Investors (MF)	10.72
2000		
Aubay Technology	Amvescap (MF)	6.01
Avanquest Software	Fidelity (MF)	10.92
CEGID	Fidelity (MF)	5.11
Coflexip	Putnam (MF)	5.46
Elior	Fidelity (MF)	6.64
ESI Group	Schroder (MF)	5.09
Groupe André	Atticus Ltd (HF)	20.32
ILOG	Fidelity (MF)	5.43
Immobiliere Marseillaise	Ivory & Sime Asset Mgt (MF)	5.20
Lectra	Amvescap (MF)	5.09
Michelin	Templeton (MF)	5.07
Naf-Naf	Silchester Int'l Investors (MF)	8.37
Nicox	Amvescap (MF)	5.01
Nord-Est	Goldman Sachs (MF)	5.01
Orchestre Kazibao	Fidelity (MF)	5.65
Pernod-Ricard	Silchester Int'l Investors (MF)	5.04
Prologue Software	Amvescap (MF)	6.18
Schneider Electric	Janus (MF)	5.12
Sommer Alibert	Wyser-Pratte (HF)	5.01
Systar	Fidelity (MF)	5.41
Taittinger	Wyser-Pratte & Edelman (HF)	12.42
UBI Soft Entertainment	Amvescap (MF)	5.84
2001		
A Novo	Scroder (MF)	5.17
Alstom	Templeton (MF)	10.30
Audika	Amvescap (MF)	5.23
Bic	Templeton (MF)	7.17
Business Objects	Fidelity (MF)	5.44
Canal +	Goldman Sachs (MF)	5.08
Canal +	Centurus Alpha Master (HF)	7.74
CEREP	Fidelity (MF)	5.42
Chargeurs	Baupost Group (HF)	10.82
Cottin Freres	Ivory & Sime Asset Mgt (MF)	5.10
Crométal	1st Eagle Sogen Funds (MF)	5.19

J.C. Decaux	Henderson Int'l Investors (MF)	5.01
Essilor International	Amvescap (MF)	5.04
Euler	Fidelity (MF)	5.06
Européenne de Casinos	Hambro Capital Mgt (MF)	6.52
Expand	Centaurus Alpha Master (HF)	5.21
Galeries Lafayette	Scudder Investments (MF)	5.16
Genysys	Schroder (MF)	5.12
GFI Informatique	Putnam (MF)	5.01
Infovista	Fidelity (MF)	5.36
Lectra	Harris Associates (MF)	5.11
Nexans	Voltaire Asset Mgt UK (HF)	5.02
Nexans	K Capital Partners (HF)	5.07
Pernod-Ricard	Fidelity (MF)	5.03
Prismaflex International	Fidelity (MF)	9.9
Publicis	Putnam (MF)	5.16
Riber	Amvescap (MF)	7.97
Robertet	1st Eagle Sogen Funds (MF)	6.62
Simco	Henderson Int'l Investors (MF)	5.07
Somfy International	Silchester Int'l Investors (MF)	5.04
Taittinger	Edelman Value Fund (HF)	>10.0
TF1	Putnam (MF)	5.03
Valéo	Templeton (MF)	5.07
2002		
Alcatel	Brandes Investment (MF)	10.5
Altédia	Fidelity (MF)	5.02
Bains de Mer Monaco	Fidelity (MF)	5.41
BIC	Oppenheimer Funds (MF)	5.47
BIC	Amvescap (MF)	6.60
BIC	Silchester Int'l Investors (MF)	6.1
Bouygues	Putnam (MF)	5.06
Bouygues Offshore	Carlson Offshore Advisor (HF)	5.65
Canal +	K Capital Partners (HF)	5.88
Carbonne Lorraine	Arnold Bleichroeder (HF)	5.18
Chargeurs	Goldman Sachs (MF)	12.8
Club Med	Fidelity (MF)	5.73
Devoteam	Fidelity (MF)	5.03
Euler	K World Growth/Income (MF)	5.04
Eurotunnel	Oppenheimer Funds (MF)	6.61
Galeries Lafayette	Templeton (MF)	5.04
Générale de Santé	Lansdowne LP (HF)	5.08
Geophysique	Goldman Sachs (MF)	>5
Groupe Partouche	Fidelity (MF)	5.05
Havas	Putnam (MF)	10.01
Lafarge	Putnam (MF)	5.07
Linedata Services	Schroder (MF)	5.03
Nexans	Goldman Sachs (MF)	6.38
Nexans	Brandes Investment (MF)	5.23
Nexans	Tweedy Browne Cie (MF)	5.13
Nicox	Fidelity (MF)	5.10
Nicox	Oppenheimer Funds (MF)	9.62
NSC Groupe	1st Eagle Sogen Funds (MF)	10.40

Péchiney	Fidelity (MF)	6.27
SCOR	Templeton (MF)	7.86
SDR Bretagne	Goldman Sachs (MF)	7.16
Tessi	Schroder Investment Mgt (MF)	6.62
UBI Soft Entertainment	Oppenheimer Funds (MF)	10.94
Vivendi Environment	Putnam (MF)	5.05
Wanadoo	Goldman Sachs (MF)	8.6
2003		
Accor	Putnam (MF)	5.13
Fimalac	Fidelity (MF)	5.24
Gaumont	Arnold Bleichroeder (HF)	5.04
Groupe Bourbon	Schroder (MF)	5.36
Guyenne Gascogne	Schroder (MF)	5.27
Havas	Fidelity (MF)	10.01
Infogramme Entertainment	General Atlantic Partners (HF)	>5
IPSOS	Fidelity (MF)	10.37
Laurent Perrier	Arnold Bleichroeder (HF)	5.37
Legris Industries	Arnold Bleichroeder (HF)	5.06
Néopost	Harris Associates (MF)	5.38
Nicox	Goldman Sachs (MF)	5.01
Remy Cointreau	Arnold Bleichroeder (HF)	5.4
Rue Imperiale	Asset Value Investors (MF)	5.02
Sabeton	Arnold Bleichroeder (HF)	12.72
Stallergenes	Fidelity (MF)	5.03
Vet'Affaires	Henderson Global Inv. (MF)	5.15
Wendel Investissement	Arnold Bleichroeder (HF)	5.60
2004		
A Novo	Cycladic Capital Mgt (HF)	6.06
A Novo	Parvus Asset Mgt (HF)	8.69
Accor	Templeton (MF)	5.03
Alcatel	Fidelity (MF)	5.09
Altran Technologies	Gartmore (MF)	5.21
Au feminin.com	Oppenheimer Funds (MF)	7.26
Bacou Dalloz	Fidelity (MF)	5.01
Business Objects	Fidelity (MF)	>5
Business Objects	MA Financial Services (MF)	5.79
Cesar	Fidelity (MF)	5.03
Conflandey	Arnold Bleichroeder (HF)	>5
Dassault Systemes	Fidelity (MF)	5.04
Francarep	Asset Value Investors (MF)	5.68
Générale de Santé	Templeton (MF)	5.24
Ingenico	Wyser-Pratte (HF)	5.01
Lagardere	Highfields K Mgt (HF)	5.15
Latecoere	Fidelity (MF)	5.09
Lectra	Fidelity (MF)	5.02
LVL Medical Groupe	Schroders (MF)	5.11
Nexans	Dodge & Cox (MF)	5.03
Nexans	Fidelity (MF)	5.03
Nexity	Fidelity (MF)	5.19

Nicox	Federated Kaufmann (MF)	5.17
Nicox	QVT Financial (HF)	5.66
Orpea	Fidelity (MF)	5.13
Paris Orleans	Asset Value Investors (MF)	6.82
Pierre Vacances	Fidelity (MF)	5.04
Publicis	Harris Associates (MF)	>5
Rhodia	TIAA-CREF (MF)	5.3
Sodexho	Arnold Bleichroeder (HF)	5.02
Technip	Oppenheimer Funds (MF)	5.12
Tour Eiffel	Asset Value Investors (MF)	8.16
Vivarte	Atticus Funds (HF)	>20
Vivarte	Wyser-Pratte (HF)	>5
Vivendi	Fidelity (MF)	5.02
Vivendi	South East Asset Mgt (MF)	>5
2005		
Acanthe Development	Centaurus Capital (HF)	10.85
Acanthe Development	VHC Int'l Ltd (HF)	10.57
Accor	Capital Group (HF)	8.8
Altamir	Fidelity (MF)	5.68
Bail Inv. Fonciere	Centaurus Alpha Master (HF)	5.01
Belvedere	VHC Int'l (HF)	8.05
Bouygues	Capital Group (MF)	8.11
Buffalo Grill	Amber Fund Ltd (HF)	10.17
Bull	Jana Partners (HF)	5.64
Bull	Mellon Capital Partners (MF)	5.63
Carbonne-Lorraine	Columbia Wanger (MF)	5.59
Camaieu	Sandell Asset Mgt (HF)	7.24
Club Med	Oryx (HF)	5.58
Compagnie Alpes	M&G Investment Mgt Ltd (MF)	5.04
Eiffage	Fidelity (MF)	5.23
Elior	Dodge & Cox (MF)	5.29
Etam Development	GLG Partners UK (HF)	5.71
Euromedis Groupe	Fidelity (MF)	6.10
Finifo	Amber Funds (HF)	16.74
Gaumont	Arnold Bleichroeder (HF)	10.19
Generale de Sante	Amber Funds (HF)	5.59
Geophysique	Fidelity (MF)	10.17
Infovista	Fidelity (MF)	10.09
ITS Sema Groupe	European Small Cap Company (MF)	>5.0
Linedata Services	Amber Funds (HF)	6.31
Lisi	Fidelity (MF)	5.01
Medipep	Amber Fund Ltd (HF)	23.88
Mines Lucette	Asset Value Investors (MF)	5.12
Papiers Peints	Arnold Bleichroeder (HF)	>5
Poncins Yachts	Henderson Global (MF)	11.22
Saft Groupe	Kairos Fund Ltd (HF)	5.04
Saft Groupe	Threadneedle Asset Mgt (MF)	>5.0
Schneider Electric	Capital Group (MF)	5.14
Soitec	Fidelity (MF)	5.82
Spir Communication	Fidelity (MF)	5.29
Stedim	Fidelity (MF)	6.08

Technip	Lehman Brothers (MF)	6.06
Tessi	Goldman Sachs (MF)	5.07
Ubi Soft Entertainment	Fidelity (MF)	5.25
Valeo	Brandes Investment (MF)	5.16
Vivendi Environment	Capital Group (MF)	7.08
2006 (January-May)		
A Novo	Goldman Sachs Int'l (MF)	5.17
Amboise Investissement	Adelphi European Small Cap Fund (HF)	9.59
Amboise Investissement	Fidelity (MF)	10.86
Amboise Investissement	Schroders (MF)	7.78
Alten	Fidelity (MF)	5.10
Autoroutes Paris Rhin-Rhone	Elliot Management Corporation (HF)	10.03
Bongrain	Brandes Investment (MF)	5.06
Boursorama	Fidelity (MF)	5.02
Carrerre Groupe	Schroders (MF)	5.51
Dalet	Windcrest Partners (HF)	10.11
Elior	Goldman Sachs Int'l (MF)	5.01
Eramet	M&G Investment Mgt Ltd (MF)	5.01
Euronext	The Children's Trust (HF)	8.54
Generale de Sante	Amber Master Fund (HF)	15.12
Generale de Sante	Franklin/Templeton (MF)	10.62
Generale de Sante	Julius Baer Investment (MF)	5.26
Genesys	Tragalfar Asset Mgt Ltd (HF)	11.01
Icade	Fidelity (MF)	5.04
Infovista	Powe Capital Mgt Ltd (HF)	5.81
Ingenico	Fidelity (MF)	5.66
Kaufman & Broad	Fidelity (MF)	>5.0
Lagardere	Fidelity (MF)	5.03
Latecoere	Capital Group (MF)	5.68
Medipep	Lehman Bros (MF)	5.16
Michelin	Capital Group (MF)	6.46
Naturex	Fidelity (MF)	5.98
Rubis	Columbia Wanger (MF)	7.08
Saft Groupe	Schroders (MF)	5.39
Solving International	Fidelity (MF)	5.20
Store Electronic Systems	Schroders (MF)	10.16
Sword Groupe	Schroders (MF)	5.01
Sword Groupe	Threadneedle (MF)	5.03
Technip	Capital Group (MF)	5.34
Tessi	Parvus Asset Mgt (HF)	7.40
Vallourec	Lehman Bros (MF)	5.89
Zublin Immobiliere France	Asset Value Investors Ltd (MF)	5.16