



# State Capacity, Minority Shareholder Protections, and Stock Market Development

Administrative Science Quarterly  
1–36  
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DOI: 10.1177/0001839215601459  
asq.sagepub.com  
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## **Abstract**

We investigate how state capacity—the administrative ability to formulate and implement policy—affects the institutional adoption of new policies and the decoupling of those policies from their original purpose in the face of pressures from professions, multilateral agencies, and imitation among countries. We expect state capacity to reduce the effect of professional and imitation influences, to increase the impact of coercive effects by multilateral agencies, and to lessen decoupling between policies' adoption and desired outcomes. We tested these predictions using a unique longitudinal dataset on the adoption of minority shareholders' legal protections and the development of the stock market in 78 countries between 1970 and 2011. We found evidence consistent with the moderating effects of state capacity on institutional adoption and on lessening policy–practice decoupling. Our findings suggest that the strength of state capacity influences which policy models policymakers select and adopt, whether they implement them effectively, and what the consequences of such adoption are.

**Keywords:** institutional adoption and decoupling, cross-national diffusion, minority shareholder rights, state capacity

Over the past three decades, organizational researchers have examined in detail the adoption of economic practices and policies and the possibility that such adoption may become decoupled from its original purpose. Much of this work has used the neoinstitutional perspective proposed by DiMaggio and Powell (1983), which in the context of international adoption focuses on the normative influence of the professions, the coercive effect of multilateral agencies such as the International Monetary Fund (IMF), and the possibility of imitation among countries (Henisz, Zelner, and Guillén, 2005; Polillo and Guillén, 2005; Dobbin, Simmons, and Garrett, 2007; Kogut and Macpherson, 2008; Weber, Davis, and Lounsbury, 2009). Research has also found evidence of

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institutional decoupling in the wake of adoption (Weber, Davis, and Lounsbury, 2009; Zelner, Henisz, and Holburn, 2009). In spite of decades of research, the role of the state in institutional adoption, coupling, and decoupling has not been fully elucidated. Previous research has examined the normative characteristics of states (Jepperson and Meyer, 1991) and the position of states in global networks to explain which practices and policies they adopt (Guler, Guillén, and Macpherson, 2002; Henisz, Zelner, and Guillén, 2005; Polillo and Guillén, 2005; Weber, Davis, and Lounsbury, 2009; Zelner, Henisz, and Holburn, 2009). But most of the existing literature on institutional diffusion has treated the state itself as a black box, implicitly assuming that all states are similar in their internal ability to adopt or to influence adoption and in the consequences of such adoption in terms of decoupling.

A wealth of case-study research conceptualizes and illustrates the ways in which states have shaped diffusion processes (e.g., Fourcade-Gourinchas and Babb, 2002; Dobbin, Simmons, and Garrett, 2007). Scholars from the world-society perspective have argued persuasively that “nation-states are more or less exogenously constructed entities—the many individuals both inside and outside the state who engage in state formation and policy formulation are enactors of scripts more than they are self-directed actors” (Meyer et al., 1997: 150). This approach highlights the extent to which state actors are effective at adopting new practices and policies. As world-society scholarship has suggested, though not systematically pursued, state capacity is central to any process of institutional adoption because states differ in terms of the “resources and organizational capacity to adopt” (Meyer et al., 1997: 155). A state with more administrative ability has the means to establish itself as the legitimate authority to pursue new opportunities, innovate when old policies fail, identify and evaluate alternatives, and build coalitions in support of new policies (Weaver and Rockman, 1993). Thus the bureaucratic apparatus of the state is an administrative machine for identifying, assessing, and selecting new models, policies, or templates in response to new needs or past policy failures. We argue that the chances of a country adopting new scripts or practices relate to the state’s capacity to formulate and implement policy (Campbell, 2004). This paper examines how the capacity of the state affects processes of institutional adoption and whether it has any effects on the degree of decoupling between adoption and outcomes. The adoption of legal minority shareholder protections by different countries is the empirical setting we use to explore how state capacity shapes the effects of professions, multilateral agencies, and cross-national imitation. Over the last three decades, many countries have increased the level of minority shareholders’ legal protection under the assumption that protecting the rights of small investors would help develop the stock market (La Porta et al., 1998, 2000; O’Sullivan, 2003). We also analyze the impact of state capacity on the effectiveness of institutional adoption when it comes to producing the intended outcomes. We study whether the state’s capacity increases or decreases decoupling between policies and outcomes, i.e., whether the adoption of minority shareholder protections translates into greater development of the stock market.

State capacity can be broadly defined as the administrative and organizational ability of the state to identify, evaluate, formulate, and implement policies. It is important to distinguish between state capacity and state goals or policy priorities (North, 1981; Levi, 1988). State capacity is “the ability of state

institutions to effectively implement official goals" (Hanson and Sigman, 2013: 2) or "the institutional capacity of a central state, despotic or not, to penetrate its territories and logistically implement decisions" (Mann, 1993: 59). It is the administrative infrastructure that enables states to pursue certain goals or priorities, to implement policy, and to get things done (Mann, 1984; Tilly, 1990). As Skocpol (1985: 17) put it, states have "capacities" related to their "territorial integrity, financial means, and staffing," and these capacities enable them to incorporate new models or practices. State capacities can also be conceptualized in terms of the extent to which state structures exhibit the characteristics of the Weberian ideal-type of legal-rational, or bureaucratic, rule (Evans and Rauch, 1999). In this vein, "sheer sovereign integrity and the stable administrative-military control of a given territory are preconditions for any state's ability to implement policies. . . . Loyal and skilled officials and plentiful financial resources are basic to state effectiveness in attaining all sorts of goals" (Skocpol, 1979: 16). State capacity ultimately involves "the ability of the permanent machinery of government to implement policies, deliver services and provide policy advice to decision-makers" (Polidano, 2000: 805).

These definitions imply that states equipped with a stronger administrative apparatus will tend to insulate policymakers from specific normative models, with important consequences for the process of model selection and adoption (Fourcade, 2009). State capacity will also enable policymakers to borrow selectively from the models adopted by peer states without necessarily following a template that has already become institutionalized (Westney, 1987). Finally, state capacity will help policymakers with the implementation of their chosen model in general and with the process of aligning interest groups in support of their preferred model in particular (Carruthers and Ariovich, 2004). We develop these arguments and their implications for institutional adoption and decoupling in the case of the global adoption of minority shareholders' legal protections.

## STATE CAPACITY AND THE PROTECTION OF MINORITY SHAREHOLDERS

Until the 1970s, only the Anglo-Saxon countries had adopted a legal framework highly protective of minority shareholders' rights. Over time, the "common law" legal tradition resulted in large equity markets and widely dispersed stock ownership (La Porta et al., 1998, 2000). Meanwhile, continental European, East Asian, and Latin American countries evolved very different models of the corporation and its relationship to shareholders, often emphasizing the roles of large controlling shareholders, banks, employees, and other stakeholders (Roe, 1993; Kester, 1996; Aguilera and Jackson, 2003; O'Sullivan, 2003; Aguilera and Dencker, 2004). In the early 1980s, however, the global map of shareholder protections began to change. The spread of legal protections over the following three decades was driven by a specific yet evolving set of policies implemented by states, including market reforms, deregulation, and privatization driven by power-related, ideological, and normative factors (Lazonick and O'Sullivan, 2000; Fiss and Zajac, 2004).

When adopted, minority shareholder protections are typically justified on the basis of economic, financial, and legal theories whose origins can be traced back historically to the separation of corporate ownership from control (Berle and Means, 1932; Coffee, 1989; Bradley et al., 1999; Hansmann and Kraakman, 2004; Davis, 2009). Over the last three decades, scholars and

policymakers have argued that widely dispersed share ownership is beneficial to the development of the stock market and even to economic growth. This approach has focused attention on minority shareholders' interests, prompting the adoption of legislation and regulations aimed at protecting their rights against the actions of large shareholders and managers (La Porta et al., 1998, 2000; Davis, 2009).

The adoption of minority shareholder protections outside the Anglo-Saxon countries was part of a wider process inspired by the normative belief that stock markets allocate capital efficiently and to the benefit of the economy at large. From this perspective, the state should protect minority shareholders' rights as a way to help companies raise capital. Market liberalization and deregulation became the core program of economic policymaking in many countries starting in the late 1970s (Fourcade-Gourinchas and Babb, 2002; Cohen and Centeno, 2006; Dobbin, Simmons, and Garrett, 2007), leading to changes such as central banks' independence from the political power (Polillo and Guillén, 2005), the privatization of state-owned enterprises (Murillo, 2002; Henisz, Zelner, and Guillén, 2005), and the founding of stock markets in countries that did not yet have them (Weber, Davis, and Lounsbury, 2009). These and other state policies transformed the economic and corporate landscape, tilting the balance in favor of the primacy of financial markets as the key institutions in the economy and the ultimate arbiters in the allocation of capital and distribution of rewards. The worldwide adoption of minority shareholder protections is of more than historical interest. It has acquired new significance in the wake of the global financial crisis of 2008, as various countries had to deal with corporate scandals and lost shareholder wealth affecting not just rich households but also pensioners and small investors.<sup>1</sup>

Over the years, a number of institutions have protected minority shareholder rights, including formal laws and regulations, codes of good corporate governance, taken-for-granted assumptions about the appropriate role of the various stakeholders, and other informal norms of behavior sanctioned by tradition or practice (Roe, 2002; Aguilera and Jackson, 2003). We focused our analysis on the role of the "regulative" institutions embedded in the national legal system and enacted by states. Such institutions, including those associated with corporate governance, are not just constraints but are also elements that support and empower actors (Scott, 2001: 50–54; Schnepfer and Guillén, 2004). Most of the regulative institutions underpinning shareholder capitalism and minority shareholder protections are found in the domains of corporate law and emphasize the importance of mandatory rules (Coffee, 1989). As Fligstein (2002) and White (2002) cogently argued, the market economy is constituted as such through rules, expectations, and norms guiding behavior, including those related to property rights (Carruthers and Ariovich, 2004).

The adoption of legal provisions protecting the rights of minority shareholders has taken place in a highly institutionalized global system. Institutional theory highlights the importance of specifying the boundary conditions of adoption

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<sup>1</sup> The spread of shareholder capitalism in general, and the adoption of minority shareholder protections in particular, is a separate and often different process than the rise of the "finance conception of control" (Fligstein, 1990). Instead of focusing on the conflict between shareholders and other stakeholders, this paper deals with the adoption of institutions meant to address the conflicts of interest between large and small shareholders and between shareholders and managers.

processes (Scott, 2001: 80–81). Here we incorporate state capacity explicitly as a variable in the classic model of institutional adoption to ascertain the dynamics of adoption and decoupling at the cross-national level of analysis. In so doing, we consider the state as an actor whose influence over adoption and decoupling depends on its intrinsic organizational attributes and how they interact with the effects of the professions, multilateral agencies, and imitation.

Three aspects of state capacity have direct consequences for institutional adoption. First, state capacity provides the foundation for the government's decision-making authority, making it possible for policymakers to insulate themselves from the influence of specific normative models. Second, state capacity enables policymakers to create their own definitions of problems and opportunities and to identify and assess alternative courses of action, independent of what other states in the global system do. And third, state capacity allows policymakers to align interest groups in the country in support of their preferred policies, especially when confronted by coercive forms of adoption. We also use the concept of state capacity to assess the extent to which policy implementation is effective at producing the desired or intended outcomes, thus addressing the issue of institutional decoupling.

### **Institutional Adoption**

The normative mechanism of adoption relates to the professions, which identify, frame, and solve problems in specific ways inspired by their own history, tradition, culture, and technical knowledge (DiMaggio and Powell, 1983). Professions can become "epistemic communities" that transcend national borders, i.e., "a network of professionals with recognized expertise and competence in a particular domain and an authoritative claim to policy relevant knowledge within that domain or issue-area" (Haas, 1992: 3). Epistemic communities share a series of beliefs concerning problem definition, cause–effect relationships, criteria and procedures for validating knowledge, and a toolkit of policies or practices. They can participate in the political process as principals, i.e., as interest groups or as agents of interest groups (Fourcade-Gourinchas and Babb, 2002; Fourcade, 2009). In the case of the adoption of minority shareholder protections, we would expect the presence of a strong and vibrant economics profession in a given country to promote the adoption of legal protections for minority shareholders, just as previous research has found this normative effect when it came to the adoption of privatization policies (Kogut and Macpherson, 2008) and the founding of stock markets (Weber, Davis, and Lounsbury, 2009).

State capacity, however, should moderate the normative influence of the professions. Following group affiliation theory, we argue that state capacity makes policymakers less susceptible to the influence of specific professional groups. The more developed and sophisticated the state bureaucracy, the harder it is for the state to be influenced by specific group affiliations, including professional affiliations. As Carruthers (1994: 22–24) argued, "external control [over the state] may be counteracted by processes that diminish external social identities or enhance organizationally based identities" on the part of state officials and policymakers. The development of a strong policymaking bureaucracy through "the cultivation of an esprit de corps, the existence of significant rites of passage or other forms of organizational resocialization . . . can help to

sustain organizational autonomy by extracting persons from their external loyalties," such as professional affiliations. In other words, "an organization possesses cultural autonomy when it is able to define and interpret 'problems' and their 'solutions' . . . and when it can construct a chain of means (policies) and ends (goals and subgoals)."

These dynamics between professional group affiliations and state capacity have been documented in historical case studies of economists and their influence over policymaking. This professional group is central to the analysis of minority shareholders because most policies and regulations protecting them are predicated on theories and principles drawn from mainstream economic analyses of the role of property rights in the economy (La Porta et al., 1998; Hansmann and Kraakman, 2004; La Porta, Lopez-de-Silanes, and Shleifer, 2008). Moreover, the economics profession has become enormously influential in government and policy circles over the last four decades. As Fourcade (2009: 247) argued in her historical study of the global economics profession, "the relationship between economic knowledge and state power defines in large part the field's social purpose and the distinctive identity of its practitioners."

Historical research based on case studies, however, has found considerable variation across countries in terms of the extent to which the economics profession influences policymaking. In the UK and the U.S., economists exert much more influence over the state in terms of problem definition and policy evaluation and selection than in other countries. Chile and Mexico are also mentioned in historical case studies as countries in which economists have come to play a major policy role (Centeno, 1990; Babb, 2001; Fourcade-Gourinchas and Babb, 2002). By contrast, in France, one of the state bureaucracies with the most capacity and autonomy in the world, "the state accords even less deference to the independent technical expertise of university economists, denying them any monopoly on the production of legitimate economic knowledge" (Fourcade, 2009: 250). A similar pattern is found in Japan, which also has a strong state administration.

State capacity is a prerequisite for government officials to "formulate and pursue goals that are not simply reflective of the demands or interests of social groups, classes or society" (Skocpol, 1985: 9). It is the "bedrock upon which bureaucratic autonomy in relation to political principals is forged" (Addison, 2009: 4). As the historical literature documents, the reason economists are more influential in Chile, Mexico, the UK, or the U.S. than in France or Japan relates to the administrative characteristics of the state (Fourcade, 2009). Given that state capacity represents the foundation for the state's insulation from external group affiliations, including professional affiliations, we expect that a stronger state administrative apparatus will reduce the influence of economists over the adoption of key ideas and practices concerning minority shareholder protections. Thus we predict:

**Hypothesis 1:** The greater the state capacity, the smaller the normative influence of the economics profession on the adoption of legal protections of minority shareholder rights.

State capacity also moderates mimetic adoption. In this case, however, state capacity acts not as a constraint but as an alternative to it. Mimetic



behavior refers to the imitation of practices deemed to be the most legitimate or effective within a certain field in which actors mutually recognize each other's presence and actions (DiMaggio and Powell, 1983; Tolbert and Zucker, 1983). Field participants look at one another when they have difficulty assessing cause-effect relationships or there is ambiguity as to the ultimate sources of success (Davis and Greve, 1997; Greve, 1998; Lieberman and Asaba, 2006). Shared experiences boost the legitimacy of the practices (Abrahamson and Rosenkopf, 1993; Scott, 2001). In addition to peer-to-peer, frequency-based imitation, research has documented the importance of trait-based imitation of actors perceived as being leaders, high performers, more prestigious, or more legitimate (Haveman, 1993; Rogers, 1995; Haunschild and Miner, 1997; Strang and Soule, 1998; Rao, Monin, and Durand, 2005; Lieberman and Asaba, 2006). Comparative-historical case research has shown that successful countries provide a role model for others to imitate (Cole, 1985; Westney, 1987; Kenney and Florida, 1993; Guillén, 1994). In the case of minority shareholder protections, we would expect frequency-based and trait-based imitation to lead to the adoption of legal protections for minority shareholders following the patterns documented in previous research on, among other phenomena, the founding of stock markets (Weber, Davis, and Lounsbury, 2009).

State capacity, however, moderates mimetic influences. Research demonstrates that state capacity helps policymakers overcome the uncertainty and ambiguity that institutional mimicry is meant to address. The world-society tradition has tackled the issue of the adoption of models pioneered in other countries, arguing that states play much more than a passive role in the process. External models "cannot simply be imported wholesale as a fully functioning system" (Meyer et al., 1997: 154). For instance, during the Meiji period around the turn of the twentieth century, Japanese government officials carefully studied and evaluated different models of organization of the police and the postal system before deciding which ones to implement. Rather than engage in servile imitation, they drew selectively from foreign models (Westney, 1987). Similarly, several European countries created specific state agencies during the 1910s and 1920s to examine American organizational practices that might help the country's firms increase their productivity, discriminating among alternatives (Guillén, 1994). A bureaucratic state apparatus is in a better position to discern which specific aspects of existing models, policies, and templates are best suited for adoption, without reverting to frequency-based or trait-based imitation. More-capable states have less need to follow the crowd or follow the leader. They can see and evaluate for themselves what policies are best to attain the goals they want to pursue. Therefore we expect that states equipped with a stronger administrative apparatus will be less prone to adopt policies consistent with minority shareholder protections just because other countries have adopted them. We hypothesize:

**Hypothesis 2:** The greater the state capacity, the smaller the effect of imitation of other countries on the adoption of legal protections of minority shareholder rights.

The coercive effect of multilateral agencies such as the IMF on the policy-making process is well documented, although the capacity of the state has not yet been incorporated as a moderator variable (Henisz, Zelner, and Guillén, 2005; Polillo and Guillén, 2005; Weber, Davis, and Lounsbury, 2009). The

internal structure of the focal state tends to enhance the coercive pressures coming from abroad. Though state capacity insulates policymakers from the normative effect of the professions and lessens the impact of frequency-based and trait-based mimicry, it tends to support coercive-driven adoption, because of another important aspect of capacity as an organizational attribute of the state. In addition to the ability to identify, evaluate, and select alternatives, state capacity includes the ability "to establish and maintain priorities among multiple and contradictory demands" (Weaver and Rockman, 1993). The adoption of new regulatory institutions concerning corporate governance, property rights, and protections for minority shareholders is inherently controversial, given that they are likely to alter the balance of power inside the corporation and across the entire economy (Roe, 1993; Kester, 1996; Carruthers and Ariovich, 2004). For instance, the adoption of the various policies and practices sponsored, and in many cases mandated, by the Marshall Plan in Western Europe after World War II was shaped to a very large extent by the ability of governments and state agencies to manage the redistribution of power across industrial sectors, corporations, and professional groups (Djelic, 1998). Thus the effectiveness of the state when mediating or intervening in such highly contentious situations will depend greatly on its capacity "to implement official goals, especially over the actual or potential opposition of powerful social groups or in the face of recalcitrant socioeconomic circumstances" (Skocpol, 1985: 9).

The role that state capacity plays in the presence of coercive pressures to adopt has not been explored in the existing literature. In the cross-national context, organizational scholars have documented the coercive effect of multilateral organizations such as the IMF on the adoption of privatization policies (Henisz, Zelner, and Guillén, 2005; Kogut and Macpherson, 2008), central bank independence (Polillo and Guillén, 2005), and stock markets (Weber, Davis, and Lounsbury, 2009). Loans from the IMF harbor a potential for coercive adoption because they make countries "dependent upon a single (or several similar) sources of support for vital resources" (DiMaggio and Powell, 1983: 155). In addition, countries dependent on a powerful actor such as the IMF are more likely to adopt formal structures or practices to enhance, or at least maintain, their status and legitimacy within the international community (Meyer et al., 1997).

Corporate governance in general, and minority shareholder rights in particular, help illustrate the dynamic under which state capacity becomes a relevant moderator in the presence of coercive adoption. Reforms of corporate governance, including minority shareholder rights protections, became part of the IMF's policy agenda in the wake of the so-called "Washington Consensus," a term coined in 1989 by economist John Williamson to refer to a set of policies aimed at helping Latin America avoid its recurrent financial crises and achieve faster, steadier economic growth (Williamson, 1990). The Washington Consensus was adopted by the IMF and the World Bank as the quasi-official recipe for overcoming financial crises and fostering economic development around the world. It has been recently described as the combination of market fundamentalism and institutional fundamentalism, i.e., the belief that countries can prosper if they make reforms that enable the free unfolding of market forces supported by strong institutions to protect property rights and keep corruption in check (Rodrik, 2006). In particular, the IMF has routinely required



countries under financial duress to adopt legal protections of minority shareholder rights in exchange for loans.<sup>2</sup>

International coercive pressures, such as those coming from the IMF, however, need the government of the country receiving the loan to have enough capacity to be able to overcome the domestic resistance that the reforms might provoke. IMF loan agreements are frequently contested by societal interests negatively affected by their terms, which tend to be very onerous and may require domestic actors to absorb costs (Zelner, Henisz, and Holburn, 2009). It is actually quite common for countries to ignore, delay, or otherwise undermine reforms mandated by the IMF due to internal sources of resistance. In particular, research has documented that legal protections of minority shareholder rights undermine the autonomy of managers and the interests of large shareholders such as banks (Roe, 1993; Kester, 1996; Aguilera and Jackson, 2003; O'Sullivan, 2003; Schnepfer and Guillen, 2004). The affected interest groups may have enough influence to delay, water down, or derail reforms, even if they were mandated by a powerful external agent like the IMF (Henisz, Zelner, and Guillén, 2005).

State capacity can improve the chances that the multiple and conflicting agendas of different interest groups within the country become aligned with the terms of the IMF loan program through persuasion, compromise, or force. As the political science literature on the state has emphasized, the administrative capacity of the state to reduce societal tensions, streamline interests, and build coalitions is essential to policy adoption (Skocpol, 1985; Weaver and Rockman, 1993). In general, we expect countries under external coercive pressures, such as an IMF loan program, to be more likely to adopt when state capacity is strong enough to make the affected domestic interest groups acquiesce to the demanding conditions of such external pressures. Thus we predict:

**Hypothesis 3:** The greater the state capacity, the greater the effect of coercive pressures by multilateral agencies on the adoption of legal protections of minority shareholder rights.

### State Capacity and Institutional Decoupling

The adoption of new policies is intended to produce certain desirable outcomes. In the case of minority shareholder rights protections, the motivation is to provide the foundations for the stock market to attract a wide range of investors. The protection of property rights is supposed to make investments in stocks more attractive by reducing the possibility of expropriation by either the incumbent management or large investors (La Porta et al., 1998, 2000). Thus the process of adopting minority shareholder protections may be more or less coupled or decoupled with the purpose of promoting the development of the stock market. The law-and-finance research tradition in economics has provided cross-sectional evidence that countries with greater protections for minority shareholders tend to have more developed stock markets (La Porta,

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<sup>2</sup> Several of the letters of intent of countries agreeing to the terms of IMF loan financing include provisions about improving minority shareholder provisions: Indonesia and South Korea in 1998, Latvia in 1999, Ukraine in 2000, and Turkey in 2002. The URLs of these letters are available from the authors upon request (accessed December 7, 2014.)

Lopez-de-Silanes, and Shleifer, 2008). Thus our baseline hypothesis concerning the effect of the protection of minority shareholder investors is as follows:

**Hypothesis 4:** The greater the legal protection of minority shareholder rights, the greater the development of the stock market in terms of capitalization, traded stocks, and turnover.

The adoption of new institutions such as legal protections, however, does not necessarily produce its intended effects. Decoupling occurs when the relationship between adoption and outcomes becomes tenuous. The world-society approach casts doubt on functionalist institutional arguments by observing that modern states are characterized by a widening gap between formal structure and outcomes. The result is that “the world as a whole shows increasing structural *similarities of form* among societies without, however, showing increasing *equalities of outcomes* among societies” (Meyer and Hannan, 1979: 3). Nation-states are seen as exhibiting convergent structural similarity although there is a “decoupling between purposes and structure, intentions and results” (Meyer et al., 1997: 152; see also Meyer and Rowan, 1977). For instance, the adoption of the shareholder view of the firm in certain countries was ceremonial or ritual in character (Westphal and Zajac, 2001), or it unfolded irrespective of other local realities that rendered it less effective (Tilcsik, 2010).

Bromley and Powell (2012) distinguished between two types of institutional decoupling: means–ends and policy–practice decoupling. Means–ends decoupling occurs to the extent that the means chosen to achieve ends are not appropriate or there are cause–effect uncertainties, ambiguities, or disconnects. In the context of the adoption of minority shareholder protections, means–ends decoupling would challenge the validity of the argument in the law-and-economics literature that protecting minority shareholder rights translates into the development of a larger and more vibrant stock market. Empirically, means–ends decoupling would occur if the main effect of legal minority shareholder protections failed to be positive and significant, as predicted by hypothesis 4.

Though this first type of decoupling is not necessarily affected by state capacity, the likelihood of the second type—the potential gap between ritual or ceremonial adoption and actual implementation—is much higher when “there is weak capacity to implement policies” or “there is lack of external enforcement, especially legal” (Bromley and Powell, 2012: 14). Thus, even when there is a clear and discernible causal relationship between means and ends, decoupling can occur because of defective, ineffective, unsystematic, or otherwise incomplete implementation.

State capacity is fundamental to effective policy implementation. The state needs to “allocate resources in an optimal manner” in order to “guarantee an effective implementation of policies” (Weaver and Rockman, 1993: 446). Those expectations can be met only if the state has sufficient organizational resources and capacity to bring about the intended outcomes of policymaking. “The capacity to implement state-initiated policies depends on the ability to tax, coerce, and shape the incentives facing private actors, and make effective bureaucratic decisions during the course of implementation” (Geddes, 1996: 14). For each of these abilities, “effective bureaucratic organizations” are needed (Geddes, 1996: 14).

The corporate governance literature has emphasized defective enforcement as a potential source of decoupling in the adoption of legal provisions. The extent to which the state can guarantee effective implementation of formal legal provisions by enforcing them is seen as contributing to a greater effect of the formal *de jure* adoption of minority shareholder protections on the growth and development of the stock market (La Porta et al., 1998, 2000; La Porta, Lopez-de-Silanes, and Shleifer, 2008). To the extent that state capacity contributes to effective policy implementation and enforcement, it can close the gap between policy and practice. Controlling for the relationship between means and ends, *i.e.*, for the main effect regarding the effectiveness of legal protections for small investors, we expect state capacity to interact with policy adoption to increase the effect on the desired outcome, namely, stock market development. Thus we hypothesize:

**Hypothesis 5:** The greater the state capacity, the greater the effect of adopting minority shareholder protections on the intended outcome of stock market development in terms of capitalization, traded stocks, and turnover.

## DATA AND METHODS

### Dependent Variable for Adoption: Minority Shareholder Rights

We tested the impact of state capacity on adoption processes and decoupling with a unique cross-national and longitudinal dataset measuring the degree of minority shareholders' protection in 78 least-developed, emerging, and developed countries between 1970 and 2011. These countries accounted for over 95 percent of total world GDP in 2011, thus representing a very comprehensive slice of the global economy.<sup>3</sup> Previous literature has mostly relied on the cross-sectional measure constructed by La Porta et al. (1998) using legal information from the mid-1990s, which has been heavily criticized for its inconsistencies and inaccuracies as well as for its time-invariant character (Siems, 2008; Aguilera and Williams, 2009). Moreover, our coverage is more comprehensive. The only longitudinal measure available in the literature covers 25 countries between 1995 and 2005 (Lele and Siems, 2007; Siems, 2008), so the coverage of our sample is three times more comprehensive in terms of countries (78 versus 25) and nearly four times as extensive in terms of years (42 versus 11).

To code each country-year, we consulted the relevant body of corporate legislation, which in most countries contains hundreds of provisions in dozens of statutes, codes, decrees, directives, court rulings, and other types of legal material. If a country had different corporate codes by state or province, we used the location of the most important stock market as the reference, and for

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<sup>3</sup> The 78 countries included were Algeria, Argentina, Armenia, Australia, Austria, Bangladesh, Belarus, Belgium, Belize, Bhutan, Brazil, Bulgaria, Canada, Chile, China, Colombia, Costa Rica, Cyprus, Czech Republic, Denmark, Egypt, El Salvador, Finland, France, Georgia, Germany, Ghana, Greece, Guatemala, Honduras, Hong Kong, India, Indonesia, Italy, Japan, Jordan, Kazakhstan, Kenya, Kyrgyzstan, Latvia, Lebanon, Lithuania, Luxembourg, Malaysia, Mauritius, Mexico, Moldova, Nepal, Netherlands, New Zealand, Nicaragua, Nigeria, Norway, Oman, Pakistan, Panama, Peru, Philippines, Poland, Portugal, Russia, Singapore, Slovenia, South Africa, South Korea, Spain, Sweden, Switzerland, Tajikistan, Thailand, Turkey, Ukraine, United Arab Emirates, United Kingdom, United States, Uzbekistan, Venezuela, and Vietnam.

the United States we used the state of Delaware, following the usual practice in cross-national comparisons (Siems, 2008).

To construct a cross-national, comparative measure, we collected information on the ten key legal provisions identified by legal scholars as most relevant to the protection of minority shareholder rights (Lele and Siems, 2007; Siems, 2008): powers of the general meeting for de facto changes; agenda-setting power; anticipation of shareholder decision facilitated; prohibition of multiple voting rights; independent board members; feasibility of directors' dismissal; private enforcement of directors' duties (derivative suit); shareholder action against resolutions of the general meeting; mandatory bid; and disclosure of major share ownership. If present, each of these legal provisions provides minority shareholders with a comprehensive set of protections against the actions of large shareholders and/or management and in the event of a change in corporate control.

As detailed in table 1, we coded each legal provision between 0 and 1 depending on the nature and strength of the specific legal provisions contemplated in national legislation. The measures are not dichotomous because intermediate scores between 0 and 1 are possible. To code this information, we relied on a team of 52 legal scholars; each had a J.D. degree from his or her respective home country and was either attending the Master of Laws (LL.M.) program of the law school of a major research university or was a recent graduate of that same school. Each coder was an expert in the intricacies of corporate legislation in his or her country and could read the legal material in the original language. Thus we generated our shareholder rights scores independently from scratch. In about 20 percent of the cases, we found a disagreement among coders. We scrutinized those disagreements and made a final decision as to the correct coding to use in the analysis.

After each country's codes were calculated, a legal scholar with knowledge of multiple countries ensured that the data were coded according to uniform criteria across countries and over time. The dependent variable used in the analysis is the sum of the scores for each of the ten legal provisions, and it ranges from 0 to 10. In the case of newly independent countries, we included only the country-year observations since independence. For countries that had no stock ownership prior to the transition to a market economy, we included only the country-years since they passed corporate legislation. We report below robustness checks to ensure that this sample design did not generate any selection biases. We also make our dependent variable available to other researchers through this website: <https://whartonmgmt.wufoo.com/forms/guillencapron-shareholder-protections-index/>.

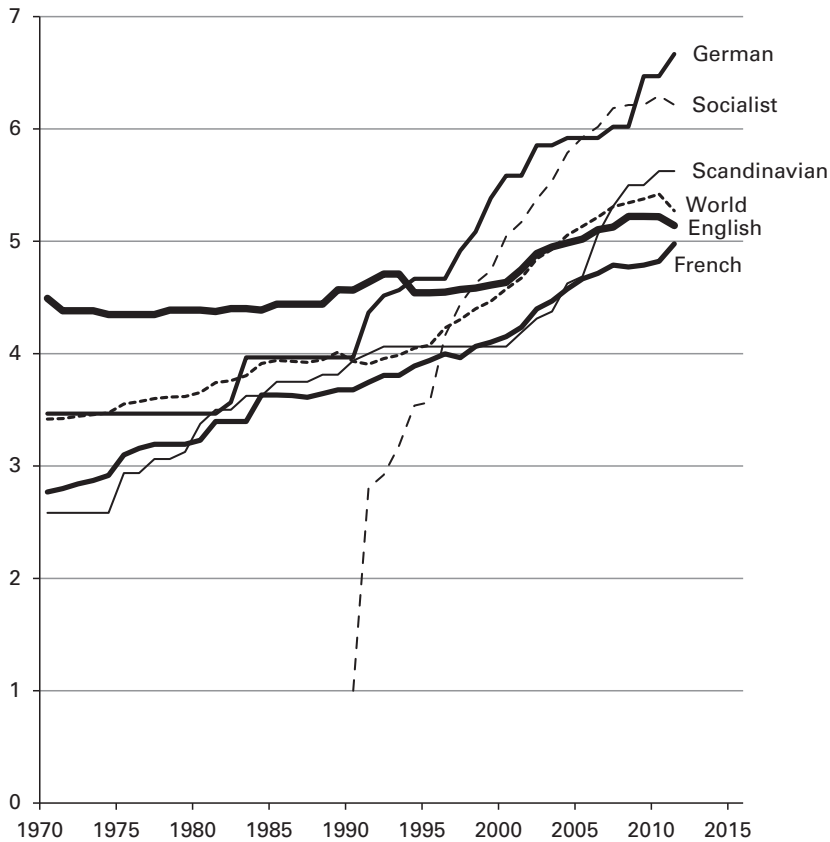
Figure 1 shows the evolution of the index of minority shareholder rights protections between 1970 and 2011, broken down by the five legal families proposed by La Porta et al. (1998). Clearly, differences across countries have shifted considerably during the last 40 years. During the 1970s and 1980s, minority shareholder protections were much greater in English-common-law countries (i.e., Britain and most of its former colonies, including the United States) than in any other part of the world. By the turn of the twenty-first century, however, only countries within the French legal tradition had indexes lower than those in the English-common-law countries. In the concluding section, we discuss the context and implications of the rapid rise of protections in the formerly Socialist countries shown in the figure.

**Table 1. List of Legal Provisions Protecting the Rights of Minority Shareholders\***

Legal provision	Description
1. Powers of the general meeting for de facto changes	Equals 1 if the sale of more than 50% of the company's assets requires approval of the general meeting; equals 0.5 if the sale of more than 80% of the assets requires approval; otherwise, it equals 0.
2. Agenda-setting power	Equals 1 if shareholders who hold 1% or less of the capital can put an item on the agenda; equals 0.75 if there is a hurdle of more than 1% but not more than 3%; equals 0.5 if there is a hurdle of more than 3% but not more than 5%; equals 0.25 if there is a hurdle of more than 5% but not more than 10%; otherwise, it equals 0.
3. Anticipation of shareholder decision facilitated	Equals 1 if (1) postal voting is possible or (2) proxy solicitation with two-way voting proxy form 27 has to be provided by the company (i.e., the directors or managers); equals 0.5 if (1) postal voting is possible if provided in the articles or allowed by the directors or (2) the company has to provide a two-way proxy form but not proxy solicitation; otherwise, it equals 0.
4. Prohibition of multiple voting rights (super voting rights)	Equals 1 if there is a prohibition of multiple voting rights; equals 2/3 if only companies that already have multiple voting rights can keep them; equals 1/3 if state approval is necessary; otherwise, it equals 0, except if there are several of these rules without total prohibition, in which case it equals 0.5.
5. Independent board members	Equals 1 if at least half of the board members must be independent; equals 0.5 if 25% of them must be independent; otherwise, it equals 0.
6. Feasibility of directors' dismissal	Equals 0 if good reason is required for the dismissal of directors; equals 0.25 if directors can always be dismissed but are always compensated for dismissal without good reason; equals 0.5 if directors are not always compensated for dismissal without good reason, but they could have concluded a non-fixed-term contract with the company; equals 0.75 if, in cases of dismissal without good reason, directors are compensated only if compensation is specifically contractually agreed; equals 1 if there are no special requirements for dismissal and no compensation has to be paid. Note: If there is a statutory limit on the amount of compensation, this can lead to a higher score.
7. Private enforcement of directors' duties (derivative suit)	Equals 0 if this is typically excluded (e.g., because of a strict subsidiarity requirement or hurdle which is at least 20%); equals 0.5 if there are some restrictions (e.g., certain percentage of share capital; demand requirement); equals 1 if private enforcement of directors' duties is readily possible.
8. Shareholder action against resolutions of the general meeting	Equals 1 if every shareholder can file a claim against a resolution by the general meeting; equals 0.5 if there is a threshold of 10% voting rights; equals 0 if this kind of shareholder action does not exist.
9. Mandatory bid	Equals 1 if there is a mandatory public bid for the entirety of shares in case of purchase of 30% or 1/3 of the shares; equals 0.5 if the mandatory bid is triggered at a higher percentage (e.g., 40% or 50%); also equals 0.5 if there is a mandatory bid but the bidder is only required to buy part of the shares; equals 0 if there is no mandatory bid at all.
10. Disclosure of major share ownership	Equals 1 if shareholders who acquire at least 3% of the companies' capital have to disclose it; equals 0.75 if this concerns 5% of the capital; equals 0.5 if this concerns 10%; equals 0.25 if this concerns 25%; otherwise, it equals 0.

\* Source: Siems, 2008: 116–119.

**Figure 1. Average index of minority shareholder rights protections for countries within the same legal tradition, 1970–2011.\***



\* The index ranges between zero and 10.

As figure 1 makes evident, the findings of the hundreds of empirical studies that used the cross-sectional measure of minority shareholder protections calculated by La Porta et al. (1998) based on legal information from the mid-1990s are problematic to the extent that they assumed that protections remained stable over time (for a review of empirical studies, see La Porta, Lopez-de-Silanes, and Shleifer, 2008). In particular, studies using the cross-sectional measure to explain patterns in other variables collected after 2000 have assumed that common-law countries continue to have the highest degree of protection of minority shareholder rights, something that has not been the case since the mid-1990s.

### Independent Variables for Predicting Adoption

We also gathered information on the independent variables for each country and year. Our key independent variable is state capacity, which we operationalized using the time-varying “capacity1” measure in the State Capacity Dataset version 0.9 developed by Hanson and Sigman (2013). This normalized index focuses on “core functions of the state” underpinned by “plentiful resources,



administrative-military control of a territory, and loyal and skilled officials." The index was calculated by Hanson and Sigman using latent-variable analysis on 24 indicators related to the state's ability to "reach their populations, collect and manage information," "preserve its borders, protect against external threats, maintain internal order," "develop policy, produce and deliver public goods and services," "enforce policy," and "regulate commercial activity" (Hanson and Sigman, 2013: 2–9).<sup>4</sup>

We included in all models indicators for each of the classic institutional variables of normative, mimetic, and coercive adoption. We measured the normative influence of the professions by counting the number of economics articles authored by residents of each country in each year, as reflected in the Institute of Scientific Information's Web of Science database, and dividing it by each country's population (in millions). Previous research measured this variable using the number and alma mater of members of the American Economic Association (Kogut and Macpherson, 2008) or a dummy if there was at least one international financial association headquartered in the country (Weber, Davis, and Lounsbury, 2009). Though our measure is available for each year, Kogut and Macpherson's indicator is available only for every four years until the late 1990s. Moreover, our measure is less skewed than theirs. In the cross-sections for which their measure is available, the correlation with our own indicator exceeds + 0.90. Relative to Weber, Davis, and Lounsbury's (2009) dummy variable, ours is more nuanced because it is continuous and also less skewed. Most importantly, our measure is based on the actual production of knowledge by economists in different countries as documented by their articles published in the world's most competitive and technical mainstream economics journals. This type of measure provides a very good proxy for the production of economic knowledge that may influence the policymaking process (Fourcade, 2009).

We measured mimetic behavior among countries using a time-varying count indicating how many countries within the same geographical region as the focal country increased their degree of protection of minority shareholder rights during the previous year. This variable is meant to capture frequency-based imitation. The corporate governance literature emphasizes the importance of regions in the adoption of similar institutions and practices (Enriques, 2006). The field of actors that mutually recognize each other tends to be defined at the regional level because nonprofit organizations such as the European Corporate Governance Network, the Latin American Corporate Governance Roundtable, and the Asian Corporate Governance Association provide forums for the discussion of key issues in the field among investors, academics, regulators, and policymakers. We grouped countries into the following regions: Middle East and North Africa, Sub Saharan Africa, Latin America, Western Europe (including Greece and Turkey), Eastern Europe (including the Baltics and Moldova), the former Soviet Republics (excluding the Baltics and Moldova), and South and East Asia. We left Australia, Canada, Mauritius, New Zealand,

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<sup>4</sup> The 24 indicators used by Hanson and Sigman (2013) are administration and civil service count, administrative efficiency, anocracy, bureaucratic quality, census frequency, civil service confidence, contract-intensive money, effective implementation of government decisions, efficiency of revenue mobilization, fractal borders, military personnel, military spending, monopoly on the use of force, mountainous terrain, political terror scale, quality of budgetary and financial management, quality of public administration, relative political capacity, statistical capacity, tax evasion, taxes on income, taxes on international trade, total tax revenue, and index of "Weberianess."

and the United States as the baseline category. Deleting these countries from the sample or reallocating the Baltics and Moldova to the former Soviet Republics bloc did not change the results reported below.

We measured trait-based imitation by calculating the year-on-year change in the degree of protection of shareholder rights in the United States, which has been generally proposed as the leader in terms of the development of shareholder capitalism (Useem, 1999; Aguilera and Jackson, 2003; Davis, 2009). As home to the world's largest and most liquid equity market, the United States has typically been the source of legal and organizational innovations related to protecting minority shareholder rights against the actions of managers and large shareholders (Roe, 1994; Davis, 2009). We also calculated a similar measure for Japan and Germany as the emulated countries, given the attention their corporate governance models attracted during our observation period. Imitation of Germany was not significant in our regression models, but imitation of Japan was significant and negative, meaning that other countries did the opposite of what Japan did, especially after 1990. To address whether countries might be imitating large economies, we also created a variable for the G7 (U.S., Japan, Germany, France, UK, Italy, and Canada), the G6 (i.e., the G7 excluding the U.S.), and the BRICs (Brazil, Russia, India, and China). The G7 and G6 variables were not significant, but the BRICs variable was negative and significant, meaning that these countries did not seem to provide a role model to imitate. Imitation of the U.S. continued to exert a positive and significant effect in fully specified models.

Following previous research (e.g., Henisz, Zelner, and Guillén, 2005; Weber, Davis, and Lounsbury, 2009), we measured the coercive effect of having entered into an agreement with the IMF with the amount of IMF credit as of the end of the year divided by the country's gross domestic product (GDP) as reported in the World Development Indicators database (World Bank, 2014). We also used a period dummy to account for the Washington Consensus, coded as 1 after 1989 and zero otherwise.

We included three time-varying control variables. The first addresses the possibility that countries with higher foreign equity inflows have a higher degree of protection of shareholder rights. To control for this competitive kind of adoption, we included the annual inflows of foreign direct investment as a percentage of GDP in all analyses, as reported by the World Bank (2014). The second control variable eliminates the effect of a country's level of development and was measured on an annual basis by the GDP per capita in constant 2005 dollars (World Bank, 2014). The third controls for the nature of the polity with the 21-point scale of democratic freedoms in the Polity IV database (Marshall, 2012). This time-varying measure of the polity is the result of subtracting the autocracy score from the democracy score, both measured on a 10-point scale. Thus the polity variable ranges between -10 and 10. The scale reflects the extent to which political participation is competitive, recruitment to the executive branch is open and competitive, and there are constraints (i.e., checks and balances) on the executive branch. This variable is an important control because the literature associates democratic freedoms with the protection of property rights, of which minority shareholder rights represent a prominent instance (Olson, 1993; Carruthers and Ariovich, 2004).

### Dependent Outcome Variable: Stock Market Development

To test for the possibility of decoupling between adoption and desired outcomes, we used a battery of different measures as the dependent variable, following the economics literature (Yartey, 2008). These variables, obtained from the World Bank (2014), included stock market capitalization as a percentage of GDP, the value of stocks traded as a percentage of GDP, and stock turnover ratio (see also Weber, Davis, and Lounsbury, 2009). Principal-component factor analysis revealed that the three variables loaded onto a single factor of stock market development, with rotated-factor loadings of .79, .96, and .71, respectively (chi-squared = 1772.41,  $p < .0001$ ), and Cronbach's alpha of .75. We used the predicted factor scores as the dependent variable in the analysis of institutional decoupling, and we also report results for each of the three indicators separately.

### Independent Variables for Predicting Outcomes

We predicted stock market development with the level of minority shareholder rights, treating it as an endogenous variable, as we explain below. The main effect of this variable addresses the issue of means–ends decoupling. We also used state capacity and the interaction of state capacity with minority shareholder rights to test for policy–practice decoupling. In addition, we included four time-varying control variables for assessing the growth and development of stock markets, following well-established practice in economics (Yartey, 2008): the annual growth rate of GDP to control for the business cycle, and the real interest rate, the annual consumer price index, and the national savings rate as a percentage of GDP to correct for credit conditions. We obtained all of these controls from the World Bank (2014).

### Estimation Methods

We estimated the models to test hypotheses 1–3 using two different methods to check for robustness. The first was fixed-effects linear regression using ordinary least squares (OLS) with robust standard errors. To control for time-invariant sources of unobserved heterogeneity, we included country fixed effects in all regressions, which account for static characteristics of countries such as colonial histories and regimes, legal traditions, culture, religion, and world-system position. These time-invariant variables have been found to be correlated with patterns of economic and financial development in general and of equity markets in particular (La Porta et al., 1998; Acemoglu, Johnson, and Robinson, 2001; Weber, Davis, and Lounsbury, 2009). In a pooled cross-national time-series dataset, fixed effects also correct for serial correlation (Beck, 2001). A Hausman test revealed that the null hypothesis that the random-effects model is efficient was rejected ( $p < .001$ ), indicating that the fixed-effects model is preferred. The inclusion of country fixed effects means that all cross-sectional variation is absorbed by the constant term, and the results are driven only by the longitudinal variation in the sample. Thus the regression coefficients must be interpreted as the unit change in the dependent variable brought about by a one-unit change in the independent variable, holding all other variables in the model constant.

We estimated all OLS models with heteroskedasticity-consistent (robust) standard errors using the Huber–White Sandwich method, given that the

variance of the error term may be different across countries (Beck, 2001). In fact, a Breusch–Pagan/Cook–Weisberg test revealed significant heteroskedasticity ( $p < .05$ ). In any event, the statistical significance of the results we obtained without robust standard errors was similar to that reported below.

Our dependent and independent variables do not always grow over time. For instance, the dependent variable grows from one year to the next in 8.3 percent of the sample of country-year observations, and it decreases in 1.1 percent of the sample. The independent variables also exhibit country-years in which they grow and country-years in which they decrease. Thus our dataset is heterogeneous in terms of the direction of change from one year to the next.

Still, we used a second estimation method to address potential concerns related to the evolution of our key variables over time, which involves using the concept of the latent growth curve. As figure 1 clearly indicates, the initial conditions of minority shareholder rights protection at the beginning of our period of observation in 1970 differ massively depending on the legal tradition of each country, as the existing literature had already established (La Porta et al., 1998). Moreover, different countries increased (or in some cases decreased) their degree of protection of minority shareholder rights at different rates between 1970 and 2011. Therefore countries in our sample differ in terms of both the original level and the effect of the independent variables on the rate of change (i.e., the slope). Most importantly, figure 1 indicates convergence between 1970 and the mid-1990s and divergence thereafter.

To incorporate the dynamics of the latent growth curve into our analysis, we estimated a multilevel mixed-effects regression model in which we predicted the intercept for each country with a random-effects model including the French, German, Scandinavian, and formerly Socialist legal dummies as regressors (thus using the Common Law dummy as the reference category) and using the hypothesized and control variables described above as the predictors of minority shareholder rights to calculate the slopes within a fixed-effects specification. We estimated this model with the default restricted maximum likelihood method in Stata. Using maximum likelihood produced similar results to those obtained with OLS, as we report below.

We estimated the models to test hypothesis 4 on the development of the stock market using OLS with robust standard errors and country fixed effects. To correct for the endogeneity of minority shareholder rights protections, we used the two-stage residual inclusion method (2SRI), which is equivalent to two-stage least squares (2SLS) if the second stage is linear (Hausman, 1978).

To reduce the impact of multicollinearity when many different interaction terms are included, we centered the main effects of continuous variables before calculating the interactions (Jaccard and Turrisi, 2003). We used this transformation for the analysis of both the adoption of shareholder protections and its impact on stock market development.

## Sample for Analysis

Table 2 reports the descriptive statistics and correlations for the unbalanced panel sample of 2,163 country-year observations, covering 74 countries. The dataset is unbalanced because several countries became independent during the period of observation. The correlations between pairs of variables are generally low. The regression results reported below are not sensitive to the

**Table 2. Adoption Sample Descriptive Statistics and Correlations (N = 2,163)**

Variable*	Min.	Max.	Mean	S.D.
1. SHR	0	8.25	4.42	1.83
2. Economics articles	0	52.17	4.49	8.14
3. Regional mimicry count	0	6	0.90	1.27
4. USA SHR change	-1.00	0.75	0.03	0.17
5. IMF	0	28.77	1.28	3.02
6. State capacity (SC)	-1.47	2.86	0.69	0.91
7. Econ articles × SC	-76.41	112.61	7.97	16.15
8. Reg mimicry count × SC	-5.57	14.26	0.86	2.01
9. USA SHR chg × SC	-1.21	2.08	0.02	0.18
10. IMF × SC	-20.33	8.22	-22.09	1.85
11. Washington	0	1	0.64	0.48
12. FDI inflows	-12.21	36.43	2.45	3.41
13. GDP per capita	185.13	67804.55	11966.25	13562.88
14. Polity	-10	10	4.75	6.55

Variables in levels <sup>†</sup>	1	2	3	4	5	6	7	8	9	10	11	12	13
1. SHR													
2. Economics articles	.26												
3. Regional mimicry count	.08	.21											
4. USA SHR change	.11	.02	.20										
5. IMF	-.07	-.22	-.04	.08									
6. State capacity (SC)	.24	.67	.22	.02	-.40								
7. Econ articles × SC	.20	.85	.12	.03	-.04	.32							
8. Reg mimicry count × SC	-.05	.18	.40	.03	-.03	.10	.19						
9. USA SHR chg × SC	.02	.11	.05	-.06	-.10	.12	.10	.16					
10. IMF × SC	-.01	-.13	-.03	-.05	-.79	-.02	-.18	-.05	.05				
11. Washington	.30	.11	.34	.20	.10	.02	.14	.11	-.01	-.07			
12. FDI inflows	.17	.20	.14	.04	.04	.14	.18	.11	.00	-.06	.32		
13. GDP per capita	.15	.77	.28	.02	-.32	.81	.51	.24	.13	-.10	.06	.08	
14. Polity	.11	.39	.18	.03	-.15	.48	.17	.04	.01	-.04	.14	.02	.48

Variables in annual changes <sup>‡</sup>	1	2	3	4	5	6	7	8	9	10	11	12	13
1. SHR													
2. Economics articles	-.00												
3. Regional mimicry count	.00	-.04											
4. USA SHR change	-.01	-.01	.08										
5. IMF	.01	-.00	-.01	.03									
6. State capacity (SC)	-.02	-.04	.04	.00	-.10								
7. Econ articles × SC	-.02	-.17	.09	-.01	-.00	.19							
8. Reg mimicry count × SC	-.00	.07	.00	.00	-.00	-.07	-.06						
9. USA SHR chg × SC	-.03	-.01	.00	.14	.00	.08	-.07	.13					
10. IMF × SC	.05	.01	-.00	.00	-.23	.00	-.01	-.04	.04				
11. Washington	.08	.09	-.01	-.02	-.03	-.06	-.03	.03	-.00	-.03			
12. FDI inflows	-.06	.01	-.04	-.04	-.04	.01	.10	-.01	-.00	.00	.03		
13. GDP per capita	.00	.08	.04	-.03	-.05	.10	.03	.05	.04	.06	-.01	.11	
14. Polity	-.01	-.01	-.03	-.03	-.00	-.01	.01	-.01	.00	-.02	-.04	.03	-.04

\* Independent variables are not centered.

† Independent variables are centered and lagged.

‡ Independent variables are centered, lagged, and recalculated as year-on-year changes, as in the fixed-effects regression analyses.

**Table 3. Outcomes Sample Descriptive Statistics and Correlations (N = 950)**

Variable*	Min.	Max.	Mean	S.D.
1. Market development	-1.00	5.57	0.06	1.06
2. Market capitalization	0.02	328.88	57.06	56.43
3. Stocks traded	0	434.87	38.28	57.25
4. Stocks turnover	0	580.60	56.36	62.08
5. SHR	0	8.25	4.96	1.63
6. State capacity (SC)	-1.27	2.86	0.93	0.88
7. SHR × SC	-6.68	20.75	4.97	5.17
8. Economics articles	0	52.52	6.87	10.50
9. Regional mimicry count	0	6	1.27	1.41
10. USA SHR change	0	0.75	0.06	0.18
11. IMF	0	28.77	1.04	2.86
12. Econ articles × SHR	0	300.40	37.35	61.68
13. Reg mimicry count × SHR	0	43.50	6.11	7.45
14. USA SHR chg × SHR	0	6.19	0.27	0.93
15. IMF × SHR	0	172.61	4.41	12.95
16. GDP growth	-17.95	37.48	3.87	3.98
17. Real interest rate	-71.21	97.47	6.77	9.88
18. Consumer price index	-1.41	7481.66	15.78	245.39
19. National savings rate	-13.51	53.20	22.67	10.0

Variables in levels <sup>†</sup>	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18	
1. Market development																			
2. Market capitalization	.81																		
3. Stocks traded	.97	.71																	
4. Stocks turnover	.72	.24	.67																
5. SHR	.32	.28	.28	.23															
6. State capacity (SC)	.51	.49	.48	.30	.26														
7. SHR × SC	.24	.22	.22	.14	.38	.26													
8. Economics articles	.48	.39	.50	.28	.19	.68	.26												
9. Regional mimicry count	.12	.04	.12	.15	-.09	.21	-.08	.15											
10. USA SHR change	-.00	.00	-.00	-.00	.03	-.01	.04	-.01	.15										
11. IMF	-.21	-.23	-.22	-.05	-.18	-.37	-.00	-.23	-.05	.07									
12. Econ articles × SHR	.19	.15	.21	.10	.29	.28	.70	.52	-.11	-.03	-.05								
13. Reg mimicry count × SHR	.11	.06	.09	.15	.36	.01	.24	-.04	-.15	.06	.01	.09							
14. USA SHR chg × SHR	.08	.08	.06	.06	.23	.10	.08	.01	.03	.33	-.09	.06	.21						
15. IMF × SHR	-.16	-.09	-.12	-.22	-.31	-.02	-.46	-.06	.09	-.06	-.21	-.28	-.19	-.01					
16. GDP growth	-.01	-.01	-.02	-.01	.01	-.19	-.04	-.24	-.12	-.00	.01	-.11	-.01	-.03	.04				
17. Real interest rate	-.18	-.16	-.18	-.12	-.09	-.15	-.06	-.17	-.04	.02	.18	-.06	-.02	-.01	.04	-.06			
18. Consumer prices	-.05	-.05	-.04	-.04	-.02	-.06	-.02	-.04	-.03	-.02	.04	-.01	-.00	-.00	.00	-.09	-.14		
19. National savings rate	.30	.27	.25	.23	.24	.34	.06	.15	.10	-.02	-.31	-.07	.06	.07	-.05	.15	-.21	-.02	

\* Variables are not centered.

† Independent variables are centered and lagged.

(continued)



**Table 3. (continued)**

Variables in annual changes <sup>‡</sup>	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15	16	17	18
1. Market development																		
2. Market capitalization	.65																	
3. Stocks traded	.90	.37																
4. Stocks turnover	.70	.07	.61															
5. SHR	-.03	.00	-.03	-.03														
6. State capacity (SC)	.01	.03	-.01	.01	-.04													
7. SHR × SC	-.00	.03	-.02	-.02	.09	.29												
8. Economics articles	-.07	-.01	-.10	-.05	-.04	-.05	-.01											
9. Regional mimicry count	-.02	-.01	-.03	-.00	.04	.08	.01	-.01										
10. USA SHR change	-.01	-.01	-.02	.02	.00	.00	.02	-.01	.11									
11. IMF	-.01	-.01	-.01	.00	.04	-.12	-.18	.02	.04	.02								
12. Econ articles × SHR	-.06	-.01	-.08	-.04	.16	-.03	-.12	.17	-.02	-.04	.10							
13. Reg mimicry count × SHR	-.06	-.03	-.07	-.03	.12	.01	.04	-.02	.28	.07	.02	-.20						
14. USA SHR chg × SHR	-.03	.01	-.04	-.02	-.05	.02	-.05	-.02	.08	.37	.01	-.23	.25					
15. IMF × SHR	-.01	-.03	.00	.00	.02	-.12	-.44	.03	.02	.01	.43	.27	.06	.07				
16. GDP growth	-.01	-.08	.02	.04	-.01	.09	.09	-.01	-.02	-.01	-.22	-.08	-.02	-.01	-.16			
17. Real interest rate	-.00	-.00	.01	-.02	.01	.06	.02	-.02	.04	.03	-.08	.00	.01	.01	.02	-.01		
18. Consumer prices	-.00	-.00	.00	-.01	.01	-.03	-.00	.01	.01	.00	.05	.00	.00	-.00	.00	-.07	-.48	
19. National savings rate	.02	.00	.03	.00	-.01	.01	-.03	.01	-.05	-.04	.05	-.02	.00	-.04	.02	.17	-.18	.04

<sup>‡</sup> Independent variables are centered, lagged, and recalculated as year-on-year changes, as in the fixed-effects regression analyses.

exclusion of variables that display high correlations with other variables, and it should be taken into account that the regressions are fixed-effects or mixed-effects models. Thus they consider changes from one year to the next, not levels. For the analysis of the growth and development of stock markets, data on the dependent variables are available only since 1988. Therefore the sample is restricted to 950 country-years and 62 countries; see table 3. We report two kinds of correlation coefficients: the first uses the pooled cross-section time-series data, and the second uses the data transformed by calculating first the year-on-year changes in each variable. Given that we estimate models with country fixed effects, the second set of correlation coefficients is more relevant. For instance, the correlation between GDP per capita and state capacity, the key variable in our analysis, is +0.81. But after calculating year-on-year changes, the correlation drops to just +0.10. The dramatic difference between the two coefficients is due to the fact that our sample contains more countries (78) than years (41). The two coefficients converge as the number of years in any one pooled sample approaches infinity while the number of panels (countries) remains fixed.

## RESULTS

### Adoption of Shareholder Protections

Table 4 presents regressions testing the moderating effect of state capacity on the adoption of minority shareholder rights protections. Model A reports the

baseline fixed-effects OLS model with the classic institutional effects and the control variables. Frequency-based imitation at the regional level and trait-based imitation of the United States are positive and significant. The effects of economics articles and of IMF credit do not reach significance. All of the control variables are positive and significant, as expected. The main effect of state capacity is not significant, which lends support to our main theoretical point that state capacity is a moderator variable, not one that drives protections of minority shareholders.

Model B includes the interaction terms between state capacity and each of the adoption effects. As state capacity increases, the normative effect of economics articles decreases, as predicted by hypothesis 1. By contrast, as state capacity increases, the mimetic effect of the number of regional peers that changed their level of protections and imitation of the U.S. does not change. Thus we find no support for hypothesis 2. Finally, as state capacity increases, the coercive effect of IMF credit becomes larger, as predicted by hypothesis 3. Note that in this fully specified model the main effects of economics articles and IMF credit are positive and significant. The main effect of state capacity is significant in this model, perhaps because states with a more developed administrative machinery can obtain more information and consider more alternatives.

Models C and D provide robustness checks confirming each of the results reported above. Model C uses mixed-effects instead of fixed-effects estimation. The pattern of significance of the hypothesized effects is similar to model B, except that state capacity now reduces the effect of the regional count of countries, thus providing some support for hypothesis 2. In model D we used a two-stage estimation technique to control for potential sources of sample-selection bias. In the first stage we predicted whether a country-year was included in our sample for analysis using GDP per capita and four dummy variables denoting countries with English, French, German, and Socialist legal frameworks. Each of these variables was positive and significant in a regression using 6,984 country-year observations for 181 countries between 1970 and 2011. Our rationale was that, controlling for legal frameworks, countries with a higher GDP per capita would have a higher probability of ending up in our sample for analysis because they have better statistics. We entered the inverse Mill's ratio from this estimation in model D as an additional regressor. This variable is significant, meaning that there is evidence of sample selection bias. The parameter estimates and standard errors for our hypothesized variables remained remarkably stable (comparing model D with model B). The pattern of support for our hypotheses remains the same as in model B. These results indicate that our results are not subject to sample selection bias due to missing data on either the dependent or the independent variables: the results are robust to the inclusion of a control for sample selection bias as well as to estimation method (fixed versus mixed effects).

We ran a battery of additional robustness checks. First, we took the logarithm of the dependent variable. Second, we removed the lower and upper bounds on the dependent variable by using a logit transformation of the measure of shareholder rights. Third, we removed the one-year lag in the independent variables. Fourth, we used a two-year lag on the independent variables. Lastly, we used a dummy variable instead of a count of countries to assess the effect of imitation at the regional level (see table A1 in the Online Appendix,

**Table 4. Regressions Predicting the Protection of Minority Shareholder Rights\***

Variable	Fixed effects A	Fixed effects B	Mixed effects C	Two-stage fixed effects D
Economics articles	.0128 (.0080)	.0933*** (.0177)	.1195*** (.0109)	.0921*** (.0175)
Regional mimicry count	.0673** (.0220)	.0599** (.0223)	.0425 (.0235)	.0593** (.0223)
USA SHR change	.2654* (.1121)	.2362* (.1103)	.3362* (.1495)	.2417* (.1108)
IMF	.0216 (.0115)	.0794*** (.0198)	.0437 (.0243)	.0780*** (.0199)
State capacity (SC)	.0539 (.0930)	.0142 (.0932)	.4288*** (.0693)	.0392 (.0950)
Economics articles × SC [H1]		-.0773*** (.0103)	-.0553*** (.0077)	-.0762*** (.0103)
Regional mimicry count × SC [H2]		-.0121 (.0211)	-.0693** (.0235)	-.0142 (.0211)
USA SHR change × SC [H2]		-.0101 (.1031)	.1540 (.1620)	-.0072 (.1038)
IMF × SC [H3]		.0550** (.0160)	.0489* (.0205)	.0539** (.0161)
Washington Consensus period	.6204*** (.0533)	.5907*** (.0520)	.6437*** (.0626)	.5889*** (.0522)
FDI inflows	.0325*** (.0092)	.0330*** (.0091)	.0444*** (.0087)	.0327*** (.0091)
GDP per capita <sup>†</sup>	.6250*** (.1010)	.8510*** (.1150)	.1220 (.0662)	2.5790*** (.5890)
Polity	.0248*** (.0052)	.0163** (.0053)	.0105 (.0063)	.0161** (.0053)
Inverse Mill's ratio				20.6121** (7.3993)
Intercept	3.8514*** (.0470)	4.3065*** (.0728)	4.6976*** (.0826)	-18.6423* (8.2371)
Model F	108.76***	82.33***		88.26***
R-squared	.7546	.7618		.7720
Log-likelihood			-3393.00	
Wald chi-squared			1528.88***	

\*  $p < .05$ ; \*\* $p < .01$ ; \*\*\* $p < .001$ ; two-tailed tests.

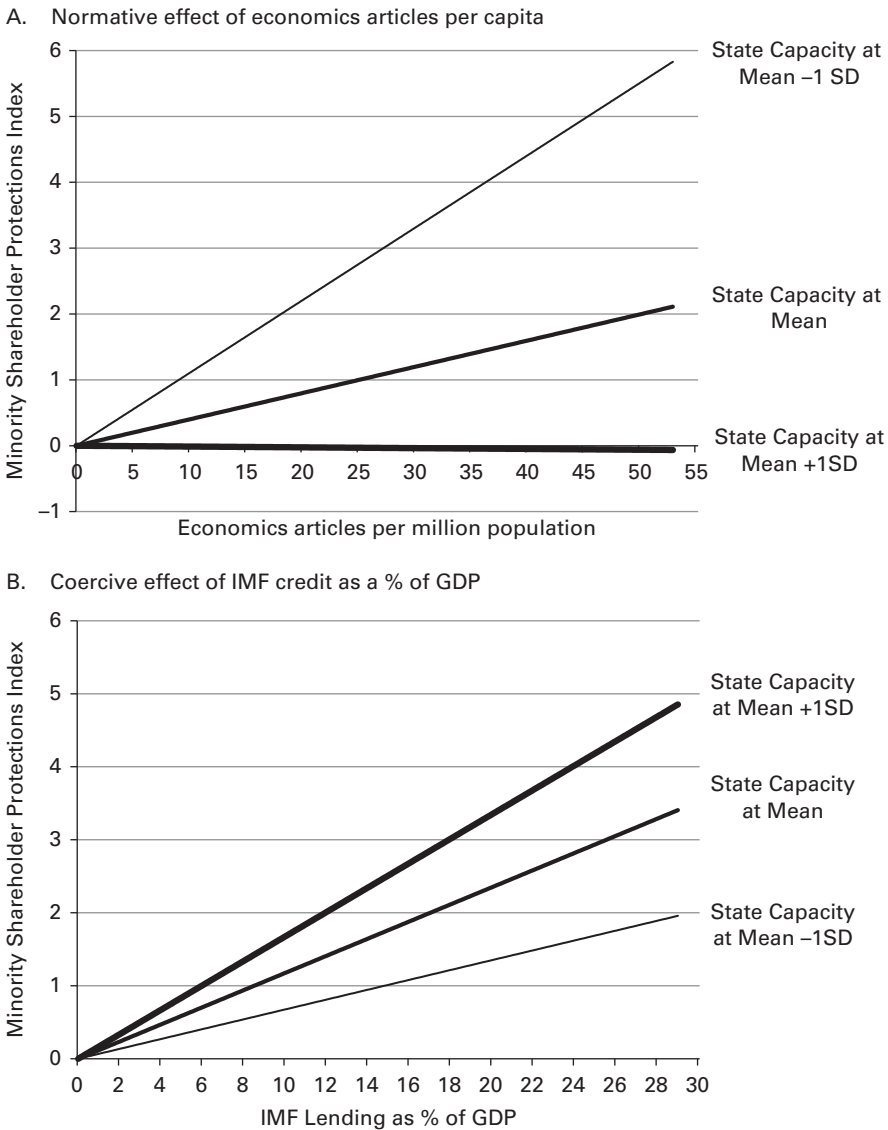
\* Robust standard errors are reported in parentheses beneath regression coefficients.  $N = 2,163$  country-years, 74 countries, 1970–2011. All variables are lagged and centered.

<sup>†</sup> Coefficient and standard error are multiplied by 10,000.

<http://asq.sagepub.com/supplemental>). In each of these additional tests, the results consistently supported hypotheses 1 and 3 but not hypothesis 2.

The regression coefficients for the moderating effects of state capacity reported in table 4 are not only statistically significant but also large in magnitude. Using the estimates from model B, which are easier to interpret, we display in figure 2 the effects of the two significant variables that are continuous at different levels of state capacity. We show the effects at a value of state capacity at the mean plus one standard deviation (e.g., South Korea in the mid-1990s), the mean (Turkey), and the mean minus one standard deviation (Kenya). Model B predicts a flat effect of economics articles on minority

**Figure 2. Normative and coercive effects at different levels of state capacity.\***



\* Based on the estimates from model B of table 4.

shareholder protections when the value of state capacity is set at the mean plus one standard deviation, meaning that state capacity at such a high level almost completely erases the positive impact of economics articles. Increasing economics articles has a larger effect at lower levels of state capacity (hypothesis 1). The coefficients for the main and the interaction effects of economics articles are significantly different ( $p < .001$ ). The model predicts a modest effect of IMF credit when the value of state capacity is set at the mean minus one standard deviation and a much larger effect as state capacity increases

(hypothesis 2). The coefficients for the main and the interaction effects are also significantly different ( $p < .03$ ).

### Impact on Stock Market Development and Decoupling

Table 5 presents the results regarding institutional decoupling. The dependent variable is the predicted scores for each country-year resulting from the factor analysis of stock market capitalization, stocks traded, and stocks turnover ratio. Model A includes the control variables and the index of minority shareholder rights protections. To correct for potential endogeneity, we also added the residuals from model B in table 4 as a separate regressor. The index exerts a positive and significant effect on stock market development, indicating that there is no evidence of means–ends decoupling, in support of hypothesis 4. To the contrary, the adoption of legal provisions protecting minority shareholders increases the development of the stock market. Model B adds the main effect of state capacity, which is not significant. Finally, model C tests hypothesis 5 by estimating the interaction between the index of minority shareholder rights protections and state capacity. As predicted, it is positive and significant. This result shows that state capacity reduces the potential for policy–practice decoupling, in support of hypothesis 5.

Given that the existing literature has found a decoupling effect associated with coercive adoption in the wake of an IMF loan (Weber, Davis, and Lounsbury, 2009; Zelner, Henisz, and Holburn, 2009), we also report a model in which each adoption effect is interacted with the index of minority shareholder protections as a robustness check to see if policy–practice decoupling is still at play. Like previous research, we found a decoupling effect of coercive adoption because the interaction term between IMF credit and minority shareholder protections is negative and significant (see model D in table 5). The main effect of minority shareholder protections continues to be positive and significant, and the interaction term between this variable and state capacity continues to be positive and significant, in support of hypotheses 4 and 5.<sup>5</sup> Thus we can safely conclude that there is no evidence of means–ends decoupling in our sample and that state capacity reduces the potential for policy–practice decoupling, even when decoupling at the level of each adoption effect is controlled for through a series of interaction terms.

We also report in table 5 fully specified models predicting each of the three indicators of stock market development separately. In models E and G we used stock market capitalization and the stock turnover ratio as the dependent variables, respectively. Though we obtain support for hypothesis 4, the interaction between minority shareholders' rights and state capacity fails to reach significance. Both hypotheses are supported in model F, which uses the value of stocks traded as the dependent variable. The interaction between minority shareholder rights and IMF loans is significant in models E and F but not model G.

The regression coefficients for the moderating effects of state capacity on decoupling reported in table 5 are large in magnitude. Using the estimates from model D, we display in figure 3 the effect of minority shareholder rights

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<sup>5</sup> The main effect of economics articles was also significant in model D.

**Table 5. Fixed-effects OLS Regressions Predicting Development of the Stock Market\***

Variable	Dependent Variable						
	Stock market development				Market cap	Stocks traded	Stock turnover
	A	B	C	D	E	F	G
SHR protections [H4]	.3472*** (.0448)	.3472*** (.0444)	.3285*** (.0446)	.2556*** (.0490)	8.1571*** (1.7797)	14.6533*** (3.2074)	12.4322*** (2.8052)
State capacity (SC)		.1520 (.0896)	.1162 (.0889)	.1140 (.0909)	21.1076*** (4.8181)	.5590 (5.0813)	-8.6897 (6.7242)
SHR protections × SC [H5]			.1006*** (.0278)	.0583* (.0293)	2.1484 (1.3264)	3.7531* (1.7948)	1.7786 (2.0173)
Economics articles				.0252** (.0094)	1.0605** (.3817)	1.4436* (.6305)	.8819* (.4463)
Regional mimicry count				-.0083 (.0168)	-1.8384* (.7304)	-.0129 (.9887)	1.0005 (1.2219)
USA SHR change				-.0007 (.0762)	2.3357 (3.7949)	.8609 (4.2738)	-4.7458 (6.4344)
IMF				.0081 (.0142)	-.5412 (.4873)	-.8127 (.4252)	3.5666 (2.2427)
Economics × SHR				-.0029 (.0041)	-.4601** (.1665)	-.0162 (.2736)	.1115 (.2179)
Reg mimicry count × SHR				.0088 (.0085)	-.3613 (.3603)	.4497 (.5237)	1.3981* (.6121)
USA SHR change × SHR				-.0066 (.0446)	3.7810 (2.1909)	-2.1786 (2.5821)	-2.8697 (3.6808)
IMF × SHR				-.0142** (.0044)	-.5359* (.2238)	-.4884* (.2130)	-1.1099 (.5876)
GDP growth rate	.0181** (.0056)	.0182** (.0056)	.0186** (.0056)	.0235*** (.0065)	1.0021** (.3183)	1.1964** (.3567)	1.0357** (.3984)
Real interest rate	-.0016 (.0021)	-.0015 (.0021)	-.0023 (.0020)	-.0019 (.0019)	-.1910* (.0908)	-.0729 (1.054)	.0263 (1.1365)
Consumer price index <sup>†</sup>	-.0312 (.2800)	.0778 (.2980)	-.0767 (.2740)	-.0185 (.2810)	-33.2070* (14.6470)	21.0880 (11.400)	7.7620 (18.7850)
National savings rate	.0061 (.0058)	.0047 (.0057)	.0016 (.0058)	-.0042 (.0060)	-.3970 (.3087)	-.1727 (.3073)	.0529 (.5186)
Residuals from first stage	-.2093*** (.0520)	-.2109*** (.0520)	-.2202*** (.0525)	-.1748** (.0562)	-2.9482 (1.9257)	-11.7142** (3.6872)	-9.3478** (3.3050)
Intercept	-.0760** (.0262)	-.1086** (.0321)	-.1367*** (.0347)	-.1278*** (.0358)	48.2844*** (1.7135)	27.6864*** (2.0538)	51.5395*** (2.4392)
Model F	16.84***	14.99***	13.19***	8.00***	12.84***	5.73***	5.58***
R-squared	.6659	.6670	.6718	.6797	.7373	.6177	.6110

\*  $p < .05$ ; \*\*  $p < .01$ ; \*\*\*  $p < .001$ ; two-tailed tests.

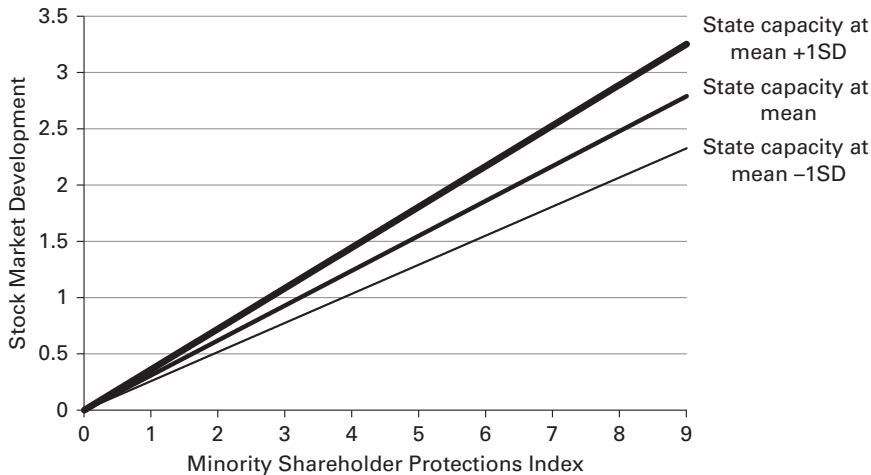
\* Robust standard errors are reported in parentheses beneath regression coefficients. N = 950 country-years, 62 countries, 1988–2011. All variables are lagged and centered.

<sup>†</sup> Coefficient and standard error are multiplied by 10,000.

protections on stock market development at different levels of state capacity. An increase in legal protections has twice the effect on stock market development in a country with state capacity at the mean plus one standard deviation as in a country at the mean minus one standard deviation. The coefficients for the main and interaction effects of shareholder protections are significantly different ( $p < .001$ ). Thus state capacity enhances means–ends coupling.



**Figure 3. The effect of minority shareholder rights protections on stock market development at different levels of state capacity.\***



\* Based on the estimates from model D of table 5.

## DISCUSSION AND CONCLUSION

This paper demonstrates the importance of considering state capacity as a moderator in the study of institutional adoption and decoupling at the cross-national level of analysis. Using a unique time-varying dataset and correcting for different potential sources of endogeneity, we found that state capacity sets limits on the influence of normative models, dampens the effect of mimetic forces, and facilitates the alignment of interests and priorities in the wake of coercive influences. We also showed that, though we found no evidence of means–ends decoupling, state capacity can close the gap between policy and practice, thus reducing this second type of decoupling.

State capacity is a concept widely used in the political science literature, but its potential applicability in institutional theory has been neglected. Although institutional theorists have long pointed out the consequences of different organizational configurations of the state (Jepperson and Meyer, 1991) and of its internal structures (Campbell, 2004), research has not specified exactly how state capacity plays a role in institutional adoption and decoupling. This paper represents a first step in that direction by considering the cross-national level of analysis. When it comes to modeling states adopting certain scripts or practices, our theoretical and empirical analyses show that state capacity affects each adoption mechanism in a different way. It tends to shield policymakers from the influence of group affiliations, including professional affiliations (Carruthers, 1994). Thus our findings concerning normative adoption and state capacity resonate with case-study evidence showing that state capacity mediates the relationship between professional knowledge and policymaking (Fourcade, 2009). State capacity tends to reduce the effect of mimetic adoption because a capable state bureaucracy engages in innovation, not just servile imitation, another effect documented in historical case studies (Westney, 1987).

Finally, state capacity helps align interests and priorities when coercive adoption is at play, another effect documented in case studies (Djelic, 1998).

Our results concerning the relationship between institutional adoption and actual outcomes speak to the classic issue of decoupling. We provide a novel empirical analysis on both means–ends and policy–practice decoupling (Bromley and Powell, 2012: 26–27). We found no evidence of means–ends decoupling. Correcting for endogeneity, the adoption of minority shareholder rights protections increased stock market development, controlling for standard economic explanations. We found robust evidence indicating that state capacity mediates in the translation of policy adoption into practice, thus reducing the potential for this second type of decoupling. States with more capacity are simply better at implementing policy, ensuring that institutional adoption produces the intended results.

We also found evidence of policy–practice decoupling at the level of specific adoption mechanisms, showing that the adoption of shareholder protections driven by IMF conditional lending reduces stock market development. We found two sources of policy–practice decoupling at the cross-national level: the first was the lack of state capacity to effectively implement policy, and the second was coercive pressure leading to ceremonial adoption, as previous research had suggested in other contexts (Weber, Davis, and Lounsbury, 2009; Zelner, Henisz, and Holburn, 2009). We found evidence of decoupling after controlling for endogeneity, however, unlike previous research in economics (e.g., LaPorta et al., 1998; La Porta, Lopez-de-Silanes, and Shleifer, 2008) and management (Weber, Davis, and Lounsbury, 2009).

Our theoretical analysis and empirical results fill a gap in the literature on Weberian-style rationalization of state structures and practices (Meyer et al., 1997). This line of argument constitutes a cornerstone of contemporary comparative economic sociology and macro-organizational theory. Our contribution to this body of research relates to the role that state capacity plays as a moderator of institutional pressures on the adoption of practices and policies.

Our theory and results also speak to the dynamic of market building (Fligstein, 2002), which in our study was mainly driven by the impact of normative frameworks (e.g., professional knowledge) and by the agency of relevant actors (e.g., coercion by powerful actors, peer imitation within fields, and emulation of the leading country in the field). Perhaps the most important implication of the paper is that the theory of country-level resilience to globalization pressures needs to be revised and enriched (Guillén, 2001; Campbell, 2004). In particular, our findings show considerable institutional convergence when it comes to legal protections and some large and significant effects on outcome measures, especially when state capacity is high. Thus theories of path-dependency and convergence at the global level need to continue exploring the boundary conditions of similarity across countries and over time.

Given the time period covered in this paper, our findings concerning normative effects corroborate the conclusions of case studies emphasizing the role of civil society in shaping economic transitions and market reforms (e.g., Stark and Bruszt, 1998), and our results regarding coercive effects resonate with the argument in previous research highlighting the role of political, economic, and technocratic elites (e.g., Centeno, 1990; Przeworski, 1991; Babb, 2001; Fourcade, 2009). We therefore conclude that the sociology of property rights, and economic sociology in general, should focus on different mechanisms of

change and on different state structures to successfully account for the diversity of patterns of economic organization observed around the world (Carruthers and Arioovich, 2004), especially when assessing the impact of institutional adoption on outcomes.

Our theoretical and empirical analyses help us understand how the road to the current economic and financial crisis was paved. The rise of shareholder capitalism during the late twentieth century created the conditions for the various financial crises and corporate scandals of the first decade of the twenty-first century. The fact that so many countries around the world continue to experience severe economic and financial distress, corporate scandals, and rogue behavior by managers and traders is paradoxical because all of these problems have proliferated at a time when corporate governance rules, including shareholder rights protection, have presumably been "improved" around the world. It is interesting to note that in 1970, the United States, the United Kingdom, Canada, and Australia had the highest degrees of protection of shareholder rights in the world. By 2010, however, the highest scores were found in countries such as Kazakhstan, Russia, Uzbekistan, South Korea, Mauritius, and Poland. Though corporate scandals and significant minority shareholders' wealth losses have occurred in the United States, they pale by comparison in scale and scope with those that occurred in some of these countries, especially Russia (Guriev and Rachinsky, 2005). Yet we found that the positive impact of minority shareholder rights protections on stock market growth and development predicted by hypothesis 4 also held in the subsample of formerly Socialist economies, although the regression coefficient is about half as large as in the full sample. These paradoxical findings invite further research.

Future research ought to examine whether shareholder protection by itself, or in combination with state capacity, prevents financial crises or makes their resolution easier or less painful. Perhaps the most promising line for future research along this dimension is whether institutional convergence, as in the case of shareholder protection, raises the potential for systemic disruption, given that institutional diversity across countries enables them to specialize in different activities, pursue different opportunities, and cope with crisis in different ways, as societal advantage theory has proposed (Biggart and Orrù, 1997; Biggart and Guillén, 1999). When all countries adopt similar institutional structures, they are affected by problems in the same way, making it harder for each of them to find a way out of the problem. Future research could test whether periods of institutional convergence in the world are associated with more frequent economic and financial crises, as appears to have been the case with the events that unfolded beginning in 2008.

Our study represents a first step in assessing the dynamics and the consequences of the global adoption of corporate governance practices, which the literatures in law, finance, economics, and organizational theory have identified as relevant and impactful. Our theoretical and empirical analyses also speak to research questions pursued by organizational strategy scholars, such as the impact of national governance systems on the firm's scope, governance effectiveness, restructuring, and performance (Oxley, 1999; Henisz, 2000; Kogut, Walker, and Anand, 2002; Schnepfer and Guillén, 2004; Fiss and Zajac, 2004; Crossland and Hambrick, 2007; Capron and Guillén, 2009).

The analysis in this paper also has implications for the sociological theory of power. As Weber (1978: 926) once noted, ". . . the structure of every legal

order directly influences the distribution of power, economic or otherwise, within its respective community." The legal order institutionalizes power, thus reproducing the power structure over time (Pfeffer, 1981; Coleman, 1982). As Fligstein (2002: 36) has more recently put it, ". . . a system of rules is also a system of power." Corporate governance scholars have identified the property and entity views as two competing conceptions of the corporation (Allen, 1992; Roe, 2001). According to the property view, the purpose of the corporation is defined by the owners' property rights. Thus management should be required to put its fiduciary duty to shareholders ahead of other interests. In contrast, the entity view proposes that the purpose of the corporation is to maximize the value that it creates in the long term, even if the gains are not captured by current shareholders. As documented in this paper, over the last four decades many countries in the world have promoted the property view of the corporation with their policy and legislative initiatives, obtaining less-than-ideal results, to say the least. Perhaps the time has come to give the entity view of the corporation a chance.

### Acknowledgments

We thank the Wharton-INSEAD Alliance and the Center for Leadership and Management Change at the Wharton School for their financial support.

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