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The rise of activist investors and patterns of political responses: lessons on agency

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This paper ventures an institutional explanation for distinct patterns of political contestation over the rise of activist investors such as private equity and hedge funds in Europe and North America. Taking issue with the dichotomous nature of the literature on varieties of capitalism (VoC) and the homogenizing assumptions of the literature on financialization, we argue that the specific patterns of politicization in the US, Germany and the Netherlands over the rise of activist investors result from the different institutional structurings of these countries' political economies. Although our observations fit the current (re)discovery of agency in the VoC debate, we argue that they point in the direction of a less voluntaristic view of agency than seems fashionable today.

Keywords: capitalism, varieties of, corporate governance, financial markets, financialization
JEL classification: G1 general financial markets, N2 financial markets and institutions, P1 capitalist systems

1. Introduction

On both sides of the Atlantic, there is increasing contestation over the rise of new activist investors such as private equity funds, hedge funds and—more recently—sovereign wealth funds. Especially in the UK and the US, but increasingly also in France, Germany and the Netherlands, they have become prominent financial players. In many countries, workers and managers, with parts of the political establishments following suit, watch the arrival of these new financial agents, often of Anglo-American origin, with growing suspicion. Highly publicized deals—such as the takeovers of AA by Permira in the UK, Chrysler by Cerberus in the US or the Dutch publisher PCM by Apax, as well as hedge fund activism in the case of Stork, ABN AMRO and Deutsche Börse—have

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raised the question as to what their wider social value is and how their activities could be checked.

From one perspective, it seems that the increasing criticisms that these new financial actors have drawn merely represent the political response by the remnants of organized labour and managerial elites to what is described by some as a new phase in the global capitalist system known as 'financialization'. Although the literature tends to disagree over the precise causal pathways, we nonetheless find a shared assumption that most Western countries are developing in a common direction, adopting some of the core features of financialized economies. This assumption thus supports the thesis of institutional convergence: in a context of rising financial markets, the creation of new financial products and the appearance of new border-crossing financial agents, the relevance of national institutional differences is diminishing.

However, this expectation is hard to reconcile with telling and enduring differences in the content as well as the vigour of the political responses to these developments. In Anglo-American countries, the policy response has been highly technocratic, oriented towards managing the further expansion of financialization while avoiding its destabilizing consequences. In other words, while the extent of intervention routinely displayed by the US government is hardly consistent with a pure model of neoliberal regulation, it occurs in a context of consensus over the desirability of ongoing financial expansion and has not sparked new patterns of political contestation. In Continental European countries, however, financialization does incite large-scale indignation and political outrage, leading to a re-politicization of some important institutional parameters of financial expansion. This is true for Germany as well as the Netherlands, and as such it fits the picture of contemporary capitalism painted by the literature on varieties of capitalism (VoC; Hall and Soskice, 2001). The big difference, as we will show, is that, in the Dutch case, the political contest for corporate control has remained rhetorical, whereas in the German case it is on the verge of resulting in new legislation. How are these similarities and dissimilarities to be accounted for?

We proceed to account for these similarities and differences in three steps. First, we present a quantitative and qualitative profile of public claims made as a response to the rise of hedge funds and private equity in the US, Germany and the Netherlands on the basis of a quick scan of the articles that have appeared in three representative newspapers between 2000 and 2007. Secondly, we contrast these public claims and the wider political climate that they reflect with examples of actual legislative initiatives in the three political economies. Finally, we zoom in on the institutional preconditions of political contestation and argue that they go far in explaining the similarities and dissimilarities between our three cases. The paper ends with

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a brief discussion of the lessons for the conceptualization of agency that can be drawn from our 'informal' comparison (Gerring, 2007).

2. Activist investors and public claims making

In order to enhance the empirical robustness of the observations that are the starting point of our study, we use a mapping procedure that is well known from collective action theory (Koopmans *et al.*, 2005). According to this approach, the pattern and nature of public claims made by interest groups in newspapers provides a lens through which to view the distribution of normative stances concerning specific issues in different groups within a society. Concretely, we have quantitatively and qualitatively mapped all reports on 'hedge funds' and 'private equity funds' in the *Süddeutsche Zeitung* (SDZ), *NRC Handelsblad* (NRC) and the *International Herald Tribune* (IHT) between 2000 and 2007. All three are general, high-quality newspapers and are situated in the broad middle of the political spectrum.[1] The period is chosen for reasons of expediency, starting a little before private equity and hedge funds made their first inroads on the European continent and including the aftermaths of the main 'events' triggered by activist investors in Germany (Deutsche Börse in 2005) and the Netherlands (Stork and ABN AMRO in 2006 and 2007).

On the basis of the VoC literature, we have a number of expectations concerning the extent of political contestation in the different political economies over the rise of activist investors in the three cases of our study. In light of the much wider extent of the financialization of the US economy (Krippner, 2005), we expect the number of reports on activist investors to be much higher in the US than in Germany or the Netherlands. Moreover, we expect their distribution over time to be much less linear in Germany and the Netherlands than in the US. Additionally, we expect the most vocal pleas for restrictive legislation to come from labour unions in Germany and the Netherlands and from Congress in the US. Finally, given the liberal stance of the IHT and the greater saliency of activist investors in the US, we expect the tone of the editorials in the IHT to be much more negative than that of the NRC and the SDZ.

Our first expectation is largely borne out. An electronic search for private equity generates 297 hits in the NRC, 891 in the SDZ and 2507 in the IHT. Regarding hedge funds, the picture is similar: 114 in the NRC, 289 in the SDZ and 2961 in the IHT. Clearly, the high concentration of hedge funds and private equity funds in the US, and the much longer presence they have in that

[1] We would have preferred to analyse the Frankfurter Allgemeine. Since it was not included in the LexisNexis Academic database we used, we opted instead for the SDZ, it being the only other high-quality, nationally available general newspaper included in the database.

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political economy, is reflected in the greater degree of acquaintance of the press and public with this topic. Nevertheless, even in the US, reporting on hedge funds and private equity funds in mainstream newspapers appears to be relatively recent. The reporting on hedge funds in the IHT (a co-production of the *Washington Post* and the *New York Times*) commences in 1993, reaches the figure of 66 articles in 1998, but gets a real boost only from 2003 onwards when it surpasses the 100 mark before doubling each year to reach 1404 articles in 2007. The reporting on private equity follows this pattern, suggesting that for the wider public, the rise of activist investors is closely linked to the financial boom of 2003–2007.

Our second expectation, too, is met. The increase in reporting on activist investors in the US contrasts sharply with the much flatter surges in the Netherlands and Germany (Figure 1). Moreover, Dutch reporting on hedge funds even declined somewhat after having reached its peak in 2005, which is striking in light of the attack on ABN AMRO in February 2007 by the London-based hedge fund TCI. Another telling difference between the US and the two European economies is the delay in the 'mainstreaming' of reports on hedge funds and private equity funds: whereas in the US those reports became regular fare in 2003 and 2004, in Germany and the Netherlands this has only been the case since 2006. The lumpiness in public claims making, this suggests, is borne out by the large share of articles that are related to high-profile events like the takeover battle

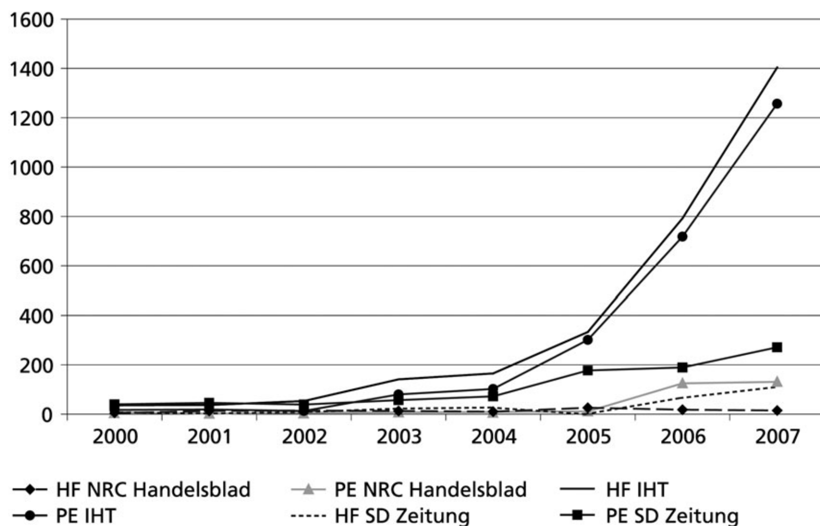

Figure 1 Number of newspaper articles on hedge funds and private equity funds, 2000–2007.

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over ABN AMRO in 2007 and the contest over strategic control of the Deutsche Börse, both set in motion by TCI, the infamous London-based, event-driven hedge fund. Of the 114 stories dedicated to hedge funds in the NRC, 17 dealt with the ABN AMRO takeover, while 10 reported on Stork, another high-profile contest for corporate control between Anglo-American hedge funds and an incumbent board of directors. Of the 289 articles on hedge funds in the SDZ, 30 dealt with the Deutsche Börse, while 27 reported on TCI. The same pattern is visible in the reporting on private equity. In the Netherlands, 18 articles dealt with Permira and its leveraged buyout of Vendex, a Dutch retail group, and 24 were about Apax and its takeover of PCM, the publisher of the NRC. In Germany, private equity reporting was dominated by the activities of Anglo-American funds in the German media industry. One in every eight articles (121) dealt with this issue. The reporting of the IHT, on the other hand, lacks such lumpiness, reflecting the much stronger degree of mainstreaming of investor activism in the US.

Our third expectation is also corroborated. In both the Netherlands and Germany, substantial numbers of public claims making come from labour unions. In the Netherlands, a total of 37 articles reported on claims made by unions. In Germany, the sum total was 78. While the number of articles on union claims making in the IHT was higher in absolute terms (106), in relative terms it was lower (2% compared with 10% in the Netherlands and 7% in Germany). Instead, the number of claims concerning activist investors originating from the US. Congress is almost three times as large (308), demonstrating that the corporatist organizations that play such an important role in socio-economic decision making on the European continent are largely absent in national politics in the US, as the VoC literature predicts. Congress appears to be the main political arena from whence public claims originate, suggesting a much stronger local concern over the rise of activist investors.

In order to determine the tone of the public debate on activist investors, we have selected a number of contributions to the op-ed pages of the three newspapers that explicitly deal with the rise of activist investors. It is striking that most op-ed articles in Germany and the Netherlands dealt with private equity funds, whereas in the IHT only eight editorials addressed private equity funds and 27 dealt with hedge funds. This suggests that private equity is much more mainstream in the US, that hedge funds are still a marginal phenomenon in Europe and that private equity Anglo-American style generates the most controversy in Europe.

The tone in the NRC concerning hedge funds is mixed. On the one hand, the editorials reproduce the pejorative similes often used to describe activist investors—locusts, parasites, gamblers, sharks—while at the same time the editors acknowledge that investor activism can have salutary effects and in most cases is provoked by weak management. Much less positive is the assessment

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of private equity. In one editorial, private equity funds are compared with pimps and human traffickers. In another, they are declared to be eponymous for 'ruthless profiteering'. And, in a third, they are accused of buying up the jewels of the Dutch economy. Remarkable is the extent to which public officials share this view. Officials from both the departments of Justice and of Economic Affairs have gone on record stating that the influx of private equity should be checked. This stands in stark contrast to the intervention of the Minister of Finance, Wouter Bos, who maintained that the benefits exceeded the costs and that more regulation was hence unnecessary.

In Germany, the discussion on hedge funds really started on April 16, 2005, when the chairman of the Sozialdemokratische Partei Deutschlands (SPD) Franz Müntefering first used his now-famous simile about activist investors behaving like 'locusts'. While this has since largely set the tone in Germany, the SDZ editors do stress the beneficial effects of hedge funds and private equity funds on the German economy, downplaying the excesses as being exceptions to the rule. The content of the editorials in the IHT, too, meets our expectations: across the board, the editorials are strongly negative about hedge funds and private equity funds. In striking contrast to Germany and the Netherlands, though, the bones of contention in the US are technical issues like financial market stability and fiscal fairness, whereas in the two European countries, concerns have to do with the loss of economic autonomy and employment.

3. Legal responses

Public claims making is, of course, only the first step in a longer policy-making process whose endpoint, ideally, is a legal response. In order to determine the extent to which there is any real political pressure behind public claims making, we have selected three recent policy initiatives that explicitly respond to the rise of activist investors. These are the Presidential Working Group initiatives on hedge fund regulation in the US, the Risk Limitation Law ('Risikobegrenzungsgesetz') in Germany and the proposals of the Monitoring Committee Corporate Governance Code (MCCGC or Frijns Committee) in the Netherlands. Below, we will briefly discuss these initiatives, before turning to an institutional explanation for the empirical observations presented in this and the previous section.

3.1 Hedge fund regulation in the US[2]

In the US, it was the 1998 bailout of long-term capital management (LTCM) that propelled the issue of hedge funds onto the political agenda. LTCM was a hedge

[2]This account draws strongly on Robotti (2007).

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fund which was based on Nobel Prize winning methods of mathematical analysis and risk management and which had been enormously successful for some time. But in the wake of the Russian crisis of 1998, the fund saw many of its positions go sour. Since the Federal Reserve viewed the collapse of the fund as a huge risk to the stability of the financial system, it organized a bailout. The clients of the hedge fund consisted exclusively of the very wealthy, who could hardly be said to need the kind of investor protection that is the rationale of much American financial regulation. The Fed's highly publicized intervention triggered a debate about the proper regulation of hedge funds.

In 1999, the President's Working Group on financial markets published its report *Hedge Funds, Leverage and the Lessons of Long-Term Capital Management*. Its conclusion focused primarily on ways to improve the functioning of financial markets and so served to define the problem as one amenable to purely technical solutions. Robotti (2007) distinguishes two phases in the public debate on hedge funds: one immediately following the publication of the report, which was dominated by legislative initiatives, and another following the Enron and Worldcom scandals and New York Attorney General Spitzer's investigations into insider trading practices on Wall Street, centred around the regulatory initiatives of the Securities and Exchange Commission (SEC).

The report paved the way for the introduction of two bills in Congress. The Hedge Fund Disclosure Act envisaged the imposition of an obligation on hedge funds to provide the Federal Reserve regularly with information on their operations. It would cover only the very largest hedge funds, and proprietary information was exempted (Robotti, 2007, pp. 15–16). Moreover, if passed, implementation would have been hindered by the fact that the Federal Reserve is not authorized to regulate firms covered by the provisions of the Investment Company Act in the first place (Robotti, 2007, p. 17). Furthermore, key actors like Federal Reserve chairman Alan Greenspan strongly opposed the regulation of hedge funds. Representative Baker, who sponsored the bill, called the legislation 'minimalist'.[3] The Derivatives Market Reform Act, in response, sought to expand the authority of the SEC to impose disclosure requirements on hedge funds. Despite their modest aims, both bills generated intense resistance from the financial services sector. Its lobby drew strength from the sentiment, widespread among American legislators, that self-regulation is preferable to public legislation and enforcement. The 106th Congress was allowed to end without either of the bills having been voted on.

The second phase began in 2003, when New York Attorney General Elliot Spitzer began his high-profile investigations into the fraudulent practices of Wall Street firms. This, in combination with the fact that hedge funds were

[3]http://commdocs.house.gov/committees/bank/hba63382.000/hba63382_0.HTM, p. 70.

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attracting growing numbers of investors of more average financial means, moved the SEC to adopt a tougher and more activist approach to the regulation of hedge funds, tightening its regulations on the registration of hedge fund investment advisers (Robotti, 2007, p. 23). This initiative, too, drew considerable opposition. Since the SEC has always been acutely aware that its regulatory capacities are limited unless it manages to secure co-operation from the financial services industry (Seligman, 2003), it quickly found itself in retreat over the proposed measure. In 2006, the SEC was found to have overstepped its legal mandate in seeking to broaden its oversight of hedge funds. Apparently seeking to add insult to injury, the hedge fund manager responsible for the earlier lawsuit is currently in the process of suing the SEC over its ban on advertising by hedge funds (Financial Times, 2008).

What this brief overview of legislative and regulatory measures since the LTCM crisis demonstrates is the ability of the financial sector to block attempts by legislators and regulators to impose measures that appear to disrupt its business. To a large extent, this ability derives from the fact that while the American public does not take kindly to the abuse of financial power, it has an abiding faith in the power of the marketplace to address its own problems. Promises of self-regulation have therefore always been an effective response to attempts to impose a regulatory regime. Robotti (2007) suggests that the capture of regulators and legislators by the financial services industry is so profound that it has given rise to the phenomenon of 'self-capture'.

3.2 The risk limitation law in Germany

The German regulatory response to the rise of activist investors came hard after the high-profile contest for corporate control over the Deutsche Börse in 2005, when the new 'grand' coalition of Merkel's Christlich Demokratische Union (CDU) and Steinmeier's SPD announced in its coalition agreement that legal improvements were required to limit the negative effects of the activities of hedge funds and private equity funds on German firms (CDU/CSU/SPD, 2005, p. 88). Given that hedge funds have only been permitted in German financial markets since the introduction of the new Investment Law in 2004 (Kamp and Krieger, 2005, p. 77), this agreement announced a marked shift in tone and direction.

The result has been a complete legal overhaul of important parts of current financial market regulation, which was framed by the Ministry of Finance as a 'three pillar-strategy', the first outlines of which circulated in the middle of 2007. The first pillar aims to enhance the provision of venture capital to German start-ups. The second pillar aims to ease the build-up of substantial shares of equity by private individuals and financial institutes in what is perceived

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as the backbone of the German economy, i.e. the 'Mittelstand'. Together, these two pillars make up the new law for the modernization of the basic conditions for private equity participation, which was due to become enacted by 2008 but has not yet been passed in parliament (BuFi, 2008).

While deemed to be too little too late by the private equity industry, it is the third pillar, the risk limitation law, that has become the real bone of contention. The risk limitation law aims to limit the corporate and financial market risks that result from investor activism. As such, it is a clear response to the public shock that reverberated through German society as a result of the battle for control over the Deutsche Börse between TCI and a number of other London-based hedge funds and the incumbent management (Kaserer, 2008, p. 2).

The most controversial changes concern the much stronger reporting duties it demands of investors. These are three fold. First, the definition of 'acting in concert' is extended from co-ordinated voting behaviour to co-ordinated share acquisition. If equity is simultaneously acquired, the German financial market watchdog will assume 'acting in concert' and will punish the acquirers with a temporary revocation of voting rights. Secondly, the threshold for mandatory reporting of block holding, currently at 3%, is lowered in the sense that the term 'possession' also includes indirect holdings through derivates. Thirdly, shareholders, if their holdings exceed a 10% threshold, must disclose their intentions within a time span of 20 days. This provision was included on the explicit request of share issuing corporations. While the underlying rationale, according to the accompanying elucidation, is the restriction of market and corporate risks, it is obvious from the nature of the changes that the actual aim is to enhance the power base of management *vis-à-vis* activist investors.

The consultation that came to a close with a public hearing on January 23, 2008, has generated a large number of (invited) comments from experts, interest groups and other stakeholders.[4] Foreign asset managers, such as Hermes, F&C, Lone Star, True Sale and NIBM, the Norwegian sovereign wealth fund, gave negative assessments, interpreting the proposed changes as a turn away from minority shareholder protection, while the Deutsche Börse merely stressed the practical difficulties of implementing the intended changes, as did the German Central Bank. Markedly positive were the responses of labour unions Deutscher Gewerkschafts Bund (DGB) and employer organizations Bundesverband der Deutschen Industrie (BDI). According to their comments, the intended legal changes were moves in the right direction, ensuring the corporate stability that is at the root of Germany's economic successes. The only remaining controversy was the extent to which works councils should be party to the battle for corporate control.

[4]See http://www.bundestag.de/ausschuesse/a07/anhoerungen/082/Stellungnahmen/for an overview.

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At the time of writing (March 18, 2008), the bill had not yet been passed in parliament. However, given the overwhelming support of corporate insiders to the spirit of the Act, we expect parliamentary discussion to end up bringing only minor legal changes, resulting in a legal framework that predominantly aims to protect corporations against activist investors, and as such goes against the grain of the legal changes that had been enacted in Germany since the mid-1990s.

3.3 The Frijns committee in the Netherlands

The immediate political response to the increasing visibility of activist investors in the Dutch economy was a parliamentary hearing, called for by the former Maoist Socialist Party (SP) in March 2007. During this hearing, members of parliament (MPs) from across the political spectrum interviewed representatives from the banking industry, the society of publicly quoted corporations, two private equity funds (Alpinvest, a joint venture of ABP and PGGM) and Cerberus, a fund of hedge funds (Theta Capital), and a well-known London-based hedge fund (Centaurus). While some MPs used strong terms to voice their concerns, the aim of the hearing was exploratory rather than judgmental.

The parliamentary debate that ensued resulted in Minister of Finance Wouter Bos' promise to ask the Frijns Committee for advice on some of the issues raised by the parliamentary hearings, i.e. (a) whether the reporting obligations for minority shareholders should be enhanced, (b) whether shareholders should make their intentions public, (c) whether or not boards of directors should have a longer 'response time' in the case of (hostile) takeover bids and (d) whether or not the number of shares that a shareholder must possess in order to be allowed to put items on the agenda of the general shareholders meeting (GSM) should be increased.

These concerns did not reflect so much a structural vision on the future of Dutch corporate governance, but rather were an *ad hoc* response to the high-profile case of ABN AMRO, which had just received a letter from TCI announcing that it wanted to propose to the GSM that ABN AMRO split itself up. Since TCI possessed a little over 1% of ABN AMRO, it had a legal right to make such proposals. Making the build-up of stakes in corporations by activist investors more transparent, forcing them to voice their intentions, and making it more difficult for small speculative investors to influence managerial strategies could, so it was hoped, prevent similar events in the future.

The Frijns Committee, which reported on these issues in the context of its periodic monitoring, proposed in May 2007 to accommodate most of these concerns, suggesting that while the primary goal should remain the enhancement of the attractiveness of Dutch corporations to (foreign) investors, some

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corrections on shareholder rights in light of recent events were in order. In the words of the report: 'that corporations become subject to the wantonness of short-term investors should be precluded' (MCCGC, 2007, p. 3). In particular, it argued that the thresholds for agenda setting and reporting should be, respectively, increased (to 3%) and lowered (to 3%); that each successive 1% change in the ownership stake should also be reported; and that investors should make their intentions public if their ownership stake exceeded 5%.

Currently, a bill is under consultation that largely follows the recommendations of the Frijns Committee (MvF, 2008). However, the bill also departs somewhat from some of the Frijns recommendations. Most notably, it suggests a higher threshold for making intentions public (10% instead of 5%), and it wishes to dispense with the recommendation that each 1% ownership change should be reported, primarily for the purpose of limiting the administrative burden. Moreover, it does not aim for a new, coherent legal package but instead pursues a number of minor legal amendments in four pieces of legislation, which are already in effect.

However, despite backtracking, even the measures now on the table are meeting substantial resistance. The most vocal detractors are organizations like the Vereniging van Effectenbezitters (VEB), the International Corporate Governance Network, and most importantly Eumedion, a non-profit organization that was set up in the mid-1990s by ABP and PGGM, the largest Dutch pension funds, to lobby the Dutch government for stronger minority shareholder protection and more shareholder activism in the Netherlands. According to Eumedion, it is unclear which 'problem' the 'solutions' are meant to solve. Moreover, they state that the measures are actually going to impede the type of beneficial investor activism that the earlier enhancements of shareholder rights—the legal changes in the structural regime of 2004 and the Code Tabaksblatt (De Jong *et al.*, 2005)—were meant to invite (Eumedion, 2008). At the time of writing, it is unclear which proposals will actually be put to the vote.

3.4 Conclusions

There are two sorts of conclusions that can be drawn from the above sections. First, in contrast to the VoC literature, the legal response in the Netherlands to the rise of activist investors is just as ambivalent as it is in the US. In the case of the US, political initiatives have failed to reach the legislative end stage, but instead have become bogged down in a slow and opaque legislative trajectory that is overlaid with conflicting aims and initiatives. In the case of the Netherlands, strong political emotions were channelled into a much more depoliticized legislative trajectory, resulting in only minor amendments to a set of legal arrangements which had just undergone major transformations in a more

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shareholder-friendly direction. Although the political science literature suggests that the causes differ—'regulatory capture' in the US (Levine and Forrence, 1990) and 'consensual politics' in the Netherlands (Van Waarden, 2002)—the outcomes are strikingly similar: no new regulation.

This situation stands in stark contrast to Germany. Against the background of a federal context that is known for its 'joint decision traps' (Scharpf, 1988), it is a measure of the power of the political impetus behind it that the government has, in such a brief span of time (2007–2008), succeeded in presenting an encompassing new framework for the regulation of financial markets in Germany, part of which is explicitly meant to protect corporate insiders against outsiders. While at the time of writing the bill was still subject to parliamentary revision, the proposals as such neatly fit the cross-class coalition of workers and managers that is at the root of the German corporate system.

Secondly, there are striking differences between the ways in which these issues are politically 'framed'. As was demonstrated by the editorials in the IHT, the dominant 'framing' of the rise of activist investors in the US is in terms of financial market stability. This implies a depoliticized perspective, since financial market stability is largely the reserve of the technocratic experts of the SEC and the Federal Reserve as well as experts from Congress, the financial services industry and academia. As such, the public regulation of financial market activities in the US can be seen to boil down to self-serving regulation by public means, which nicely defines 'regulatory capture'.

In Germany, the dominant discursive frame is that of 'protecting' the German model against foreign onslaught. Anglo-American activist investors are seen to disrupt the trust-based foundation of the German production system. That this need for protection has resulted in a new regulatory framework for the financial markets as such suggests that these markets and their intermediating agents are still perceived as 'other', foreign and exogenous, reflecting the still limited extent of financialization of the German economy and the German public's relative lack of familiarity with financial agents and financial products. Moreover, the perception that there is something worthwhile to protect reflects the newly gained self-confidence of the German political and economic elite as a result of improved macro-economic performance. This stands in sharp contrast to the mood of crisis of the late 1990s, which stood at the cradle of the corporate governance deregulations initiated by the Schröder government.

In the Netherlands, the concerns raised by activist investors have largely been framed as corporate governance issues. The political call for new regulations for hedge funds and private equity funds in response to a number of high-profile cases was thus deflected. Given the substantial overhaul of corporate governance rules in the Netherlands in recent years, the state effectively delegated the responsibility to a fractured corporate elite, resulting in regulatory minimalism.

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4. Financialization and changing political coalitions

In the following, we combine the literature on the institutional conditions of financialization with a typology of class coalitions in order to account for the similarities and dissimilarities between the countries. Since the story of the rise of finance is well known (Helleiner, 1994, p. 2003), we confine ourselves to its outlines. Financial interests have become more powerful political players, upsetting pre-financialization coalitions due to: (a) the elimination of restrictions on cross-border financial transactions, (b) the increasing dependence of households on financial debts and invested savings, (c) the growth of liquidity as a result of trade asymmetries, increased debts, saturated markets, rising oil prices and demographic shift, (d) the virtualization of financial markets and the digitization of financial transactions and (e) the rise of new econometrical pricing and risk assessment techniques.

Scholars have suggested that the extent of financialization is determined by three background conditions: (a) the availability of a sufficient amount of mobile capital, (b) the presence of a sufficient number of large and influential shareholder value-oriented investors and (c) an adequate level of managerial discretion over the extent and direction of factor mobility, capital as well as labour (Froud *et al.*, 2000, p. 105; Morgan and Kubo, 2005). In institutional terms, this suggests (a) the presence of a deep and liquid equity market, (b) a funded pension system or its functional equivalents (insurers, mutual funds) and (c) deregulated product and labour markets.

Since institutional arrangements are connected with class interests that have crystallized around them, we have to link these institutional conditions analytically to a typology of possible cross-class alliances concerning corporate control. A useful typology is the one Gourevitch and Shinn use in their work on corporate governance (Gourevitch and Shinn, 2005). This typology gives the possible coalitions in the battle for corporate control on the basis of three prime interests that are involved in these conflicts, i.e. workers (W), owners (O) and managers (M). This results in three possible actor coalitions: a coalition of owners and managers (O/M), a coalition of managers and workers (M/W) and a coalition of owners and workers (O/W). The first coalition is a traditional class-based one that results in class conflict. The second coalition results in a cross-class conflict, as does the third. In the second actor constellation (W/M), workers align with managers against outside owners, whereas in the third (O/M) they take on inside managers in alliance with outside owners. Class conflicts end either in victory for the capitalists (as occurred in the US and the UK) or in victory for the workers (as happened in Sweden in the 1970s). Cross-class conflicts result either in victory for the coalition of insiders (as happened in most corporatist economies during the 1950s and 1960s) or in a victory for

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outside owners. In the case of the second cross-class conflict, workers are pitted with outside owners against managers. The outcome is either a victory for the coalition of owners and workers [as is the case with the rise of pension fund activism (Drucker, 1976; Clark, 2000)] or for inside managers [as is the case in the classic Berle and Means model (Berle and Means, 1997) (see Table 1).

In the following, we link these actor constellations with the institutional conditions of financialization to explain the modes of political contestation we traced in the first part of this paper. We begin with a discussion of the US, followed by a discussion of Germany, and finish with a somewhat longer discussion of the Netherlands.

4.1 *Financialization and contestation in the US*

The American case seems to corroborate the claim that a high degree of financialization is premised on a liquid equity market and highly mobile investors. From the 1970s onward, financial expansion and deregulatory measures interacted to unravel what was already a comparatively weak version of the post-war Keynesian social compact between workers and managers, which facilitated a gradual institutional 'takeover' of the national economy by 'outside' financial agents (Brenner, 2006). While it can be said to fit the logic of Polanyian reversals, there was nothing automatic about this reinstatement of a financialized logic; rather, it involved a political contest over economic control that pinned workers anew against managers and owners, resulting, to use Gourevitch and Shinn's terms, in an 'investor coalition'.

This outcome revealed the structural weakness of organized labour in the US, the strategic strengths of the coalition between owners and managers and the

Table 1 Actor constellations

Coalition space	Winner	Coalition label	Example
Class conflict	OM	Investor model	US 1990s →
O/M—W	W	Labour model	Sweden 1970s
Cross-class conflicts	MW	Corporatist model	Germany/Netherlands 1950s, 1960s, 1970s
O—M/W	O	Oligarchic model	Private equity LBO?
Conflicts over voice	OW	Transparency model	Pension fund Engagement Shareholder activism Netherlands 2000s →
O/W—M	M	Managerial model	Berle and Means corporation 1932

Note: '?' depicts openness of future and uncertainty of whether development towards transparency coalition will actually occur in the Netherlands.
Source: Adapted from Gourevitch and Shinn (2005, p. 23).

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degree to which the American working class at large is itself a stakeholder in the capitalist market order. For what stands out in American financialization is the degree to which financial elites were able to mobilize popular support against managerial abuses (Moran, 1991). The case for the deregulation of financial markets in the 1970s was greatly advanced by several high-profile scandals that exposed the New Deal regulations as benefiting vested interests at the expense of the American public, while the deregulation of the banking sector was widely seen as liberating American banks from the constraints that prevented them from lending funds to deserving citizen-consumers. This set in motion a hesitant move away from 'managerialism' towards a 'transparency coalition'.

The US, of course, has a longstanding populist tradition, which evaluates the legitimacy of the financial system in terms of its contribution to public welfare (Konings, 2007). The force of such sentiments could be felt during the Enron and WorldCom scandals, and they provided Elliot Spitzer's war against Wall Street insider trading with substantial public backing. Typically, such episodes of popular discontent are directed not at the financial system as such but rather at its perceived malfunctioning. According to Gourevitch and Shinn, this is largely due to the huge extent to which the American public has become a stakeholder in the further expansion and deepening of financial markets, not only through pension funds and other saving vehicles, but also because the provision of welfare and protection in the US has largely taken the form of an impressive regulatory infrastructure that allows the American public to tap into the financial innovations that are being produced by the most aggressive American financial service providers. In a very true sense, Wall Street and Main Street are intricately connected through public law pipelines (Gourevitch and Shinn, 2005, pp. 241–259).

Although the current credit crunch and the public outcry over bankers' excesses indicate that the establishment of a transparency coalition is not a foregone conclusion, it remains the case that the strong sense of 'financialization of daily life' (Martin, 2002) has generated functional ties of interdependence between Wall Street and Main Street that are extremely hard to untie. This suggests a high degree of durability of the move towards a transparency coalition, pitting owners and workers against managers. Hence, our assessment of the American case closely follows that of Gourevitch and Shinn.

4.2 Financialization and contestation in Germany

An altogether different kind of drama was and is still being enacted in Germany. As the paragon of a Coordinated Market Economy, financialization is generally perceived as putting the German political economy under increasing strain (Streeck, 1997; Höpner, 2007). Initially, these strains were mainly felt in the interface between financial markets and corporate governance. Lacklustre economic

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performance and pressure from Anglo-American institutional investors forced the German government to initiate changes in the rules of the corporate governance game that severed the tight links between banks and corporations. As scholars at the Max Planck Institute for the Study of Societies in Cologne have emphasized, these attempts were by and large successful and have, since the late 1990s, gradually changed the corporate governance practices of large, publicly quoted firms in a more shareholder-friendly direction (Beyer and Höpner, 2003; Cioffi and Höpner, 2006).

Höpner has stressed that the politics of corporate governance deregulation did not fit the classic left–right divide. It was the German labour party that supported liberalization, while the Christian democrats took a more conservative stance (Höpner, 2007). Crucial to our understanding of the 'German party paradox' is the recognition on the side of the social democratic party and labour unions that the protection of management under the post-war corporatist German regime had gone too far, as indicated by an increase in the number of cases of managerial fraud, mismanagement and managerial self-enrichment in the 1990s. For this incited a realignment of worker interests with those of owners against managers, resulting in a movement towards a 'transparency-oriented model' in terms of Gourevitch and Shinn's actor constellation framework (Gourevitch and Shinn, 2005, pp. 160–167).

However, lacking a funded pension system, which would have transformed workers into owners and could have resulted in a more durable realignment of interests, the German 'transparency coalition' appears instead to be precarious and in danger of being replaced by the more traditional corporatist worker–manager coalition that preceded it. For the influx of Anglo-American institutional investors and activist shareholders in German capital markets, which has put German managers under increasing pressure to deliver Anglo-American rates of return, has given the more protective conservative stance towards financialization new legitimacy *vis-à-vis* modernizing social democrats. Under the new political constellation of the Merkel coalition, in which the German labour party serves a junior role, social democrats have strong incentives to prove their protective credentials, especially in light of the recent electoral successes of the new socialist party, 'Die Linke'. The current position of the social-democratic Minister of Finance, Peer Steinbrück, on the re-regulation of activist investors clearly fits this pattern.

Compared with the relatively 'liberal' expectations formulated by Gourevitch and Shinn (2005, p. 167), we read the latest twists and turns in the German debate over the rise of activist investors rather differently. Instead of a budding turn to a 'transparency coalition', which Gourevitch and Shinn project, we perceive a rather rapid return to the corporatist coalition of old. Whether this is a structural shift or a conjunctural one—which, for instance, could be easily reversed by the

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current fallout over the tax scandals delegitimizing the German corporate elite—it is too soon to tell. It is, however, unmistakable that the mood in Germany has shifted since the high tide of liberalization during the Schröder administration.

4.3 Financialization and contestation in the Netherlands

In the Netherlands, the starting point was different from both Germany and the US. At least two of the three conditions of financialization were met from the outset. Its highly concentrated, internationally oriented banking system, together with a well-developed pre-funded pension system and deep, liquid and sophisticated financial markets, resulted in a hybrid political economy which proved to be highly open to financialization, as demonstrated in Figure 2, which presents data on inward and outward foreign direct investment (FDI) as a proxy for financial openness.

As this figure demonstrates, the Netherlands clearly stands out from its European neighbours. In 1990, outward FDI in the Netherlands amounted to 35% of GDP, while it received 22% of GDP. In 2000, these figures read 81% versus 66% of GDP, respectively, and in 2005, 100% versus 74% of GDP. This is truly

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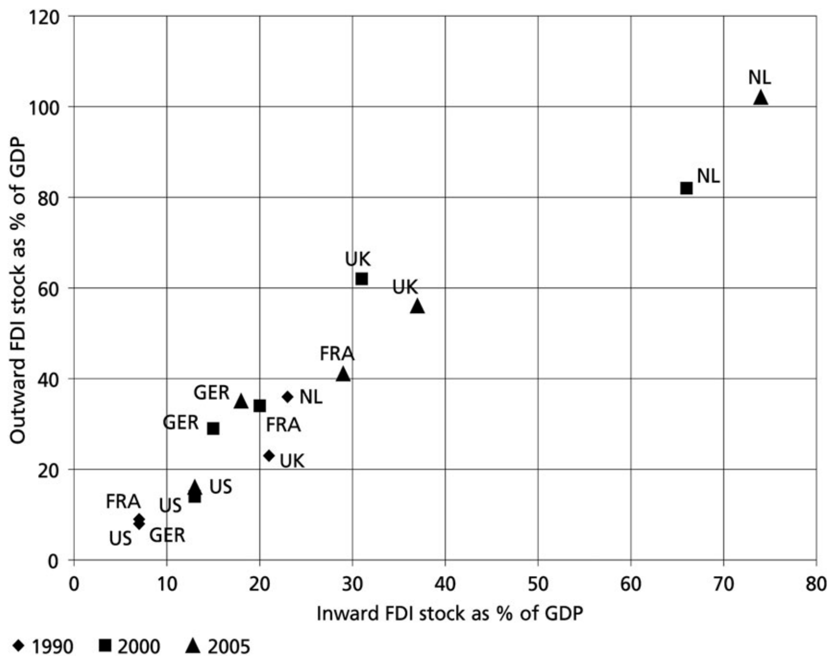

Figure 2 Inward and outward FDI stock relative to GDP in 1990, 2000 and 2005.

astonishing growth in merely 15 years, illustrating the strong embeddedness of the Dutch political economy in global capital markets.

Against this background, the overall institutional configuration of the Dutch political economy is expected to have travelled much further toward the liberal market economy pole of the VoC dichotomy than Germany. Indeed, from the mid-1980s onwards, a concerted cross-party attempt was made to enhance market flexibility, primarily to facilitate the growth of post-industrial employment. In practice, this meant easier dismissals, the casualization of employment contracts and an increasing emphasis on 'employability' over 'security' (Visser and Hemerijck, 1997).

Concerning product markets, in the early 1990s, the Department of Economic Affairs initiated an ambitious legislative programme that explicitly aimed to refashion the Dutch economy along American lines. To do so, a number of projects were started to create new markets (privatization), to diminish entry barriers to existing markets (liberalization) and to cut red tape (deregulation). Finally, as already noted, in the field of corporate governance, far-reaching changes were enacted, pushing the Netherlands further in the direction of Anglo-American corporate governance practices. According to Deminor, since 2004 Dutch corporate governance has undergone the greatest changes of any European economy, even in the sphere of takeover defences where the least movement has been observable (Wojcik, 2006).

While these changes all point in the direction of a logic of factor mobility and hence suggest that financialization has forced organized labour to accept adaptations in an American-style direction, these changes have hardly met resistance. The number of working days lost to strikes, arguably a good proxy for political contestation over labour market deregulation, is one of the lowest worldwide and has been stable for most of the 1990s and the early 2000, hovering between 14 600 lost working days in 1997 and 15 800 days in 2006 (ILO, 2008). Moreover, union membership in the Netherlands is declining and currently hovers around 20%. In the case of political contestation, one would expect both of these indicators of concern over the loss of protection to have risen.

This suggests either that workers have been compensated by other modes of protection, or that their preferences have changed. There is something to be said for both. Since the early 1990s, the Dutch political elite has emphasized the need to replace legal employment protection with more activating measures. Crucial were a number of high-profile government reports that framed employment policies in terms of work security instead of job security (WRR, 1987, 1990). This has resulted in a gradual decline in public spending on unemployment benefits from well over 3% of public expenditure in the mid-1980s to a little over 2% in 2005. This stands in sharp contrast to spending on active

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labour market policies, which, over the same period, increased from <0.5% to well over 1.5% of total public spending in the early 2000s (Figure 3). Currently, Dutch public spending on work security is comparable with that of Scandinavian countries (1.44% in the Netherlands *vis-à-vis* 1.38% in Denmark and 1.24% in Sweden), which have been the trailblazers of these policies (OECD, 2006).

The second interpretation suggests that this could well be due to changing preferences as a result of the growing pension savings of Dutch workers, which have gradually turned them into owners. Figure 4 demonstrates the striking growth of Dutch pension savings as well as the high extent to which these savings have become implicated in international capital flows. Moreover, the financial management of these savings, too, has increasingly shifted to foreign asset managers. Currently, over half of all externally managed pension capital is managed by Anglo-American asset managers such as Barclays, Merrill Lynch, Goldman Sachs and State Street, a further indication of the internationalization of Dutch savings (Bureau Bosch, 2007).

This suggests that since the mid-1990s, the corporatist settlement has given way to a new owner–worker coalition that increasingly contests the prerogatives of management. Of course, this raises important questions concerning the nature of these preferences (Hacker and Pierson, 2002). However, there are growing

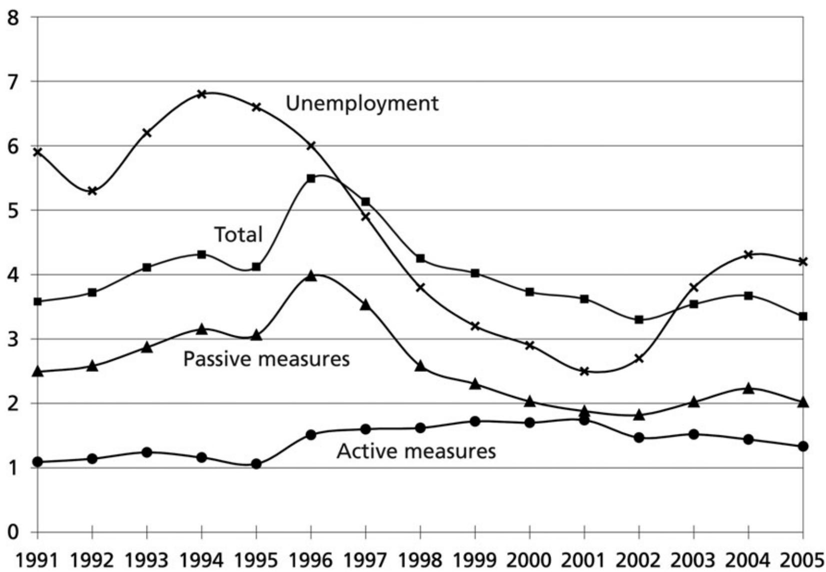

Figure 3 Public spending on active and passive employment policies in the Netherlands, 1991–2005 (percentages).

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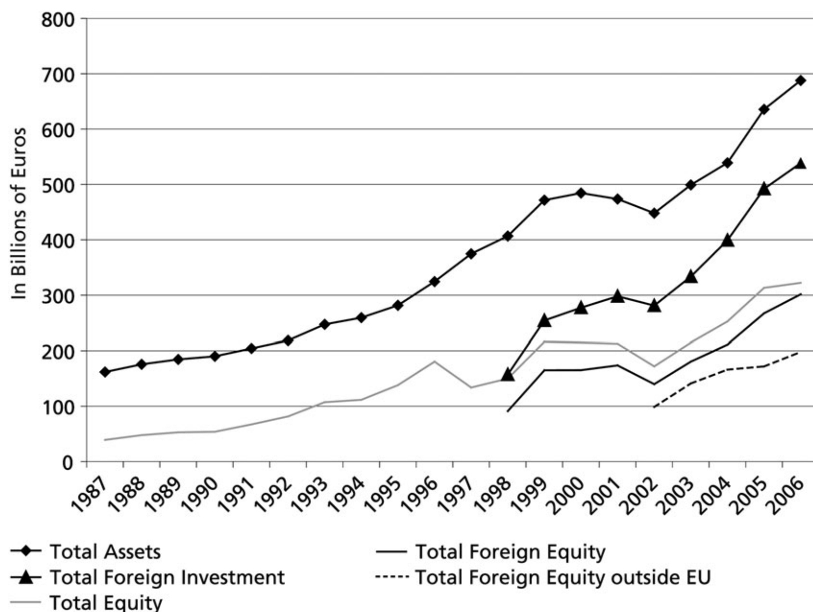

Figure 4 Dutch pension savings, 1997–2006.

indications that workers have actually become aware of their double role as investors. As systematic survey data are lacking, fund participants are increasingly voicing concerns over corporate governance and lack of transparency, making calls for socially responsible investments and even indicating that they are willing to forego higher investment returns in exchange for more say over investment (VB, 2007). In response, Dutch pension funds have increasingly taken up the role of activist investors, and, by doing so, have in fact brokered a new coalition between workers and owners against managers, calling for more openness and more transparency about corporate behaviour and voicing a growing concern over human rights abuses and the environment. This is indicated by the strong involvement of PGGM and ABP in Eumedion, which has evolved into one of the main protagonists of shareholders rights and investor activism. The imminent extension of the rights of the so-called 'participant councils' of Dutch pension funds is sure to enhance both the self-awareness of Dutch workers as capital owners as well as the willingness of Dutch pension administrators to take the preferences of their participants more seriously.

The flipside of this narrative is the declining power of the Dutch corporate elite. As has been stressed by Heemskerk, the internationalization of Dutch

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corporations has resulted in a gradual erosion of the so-called 'old boys network' that used to be a pillar of Dutch consensual decision-making (Heemskerk, 2007). Currently, a little over half (52%) of the members of the board of directors of the firms of the AEX-25 index are of non-Dutch nationality. It is obvious that the heterogeneity that this implies stands in the way of formulating and pursuing a unified class interest, as is indicated by the ruptures within the Dutch economic elite that have become visible in the standoff over managerial rewards (Fennema and Heemskerk, 2008).

Given this state of affairs, we claim that the Dutch actor constellation is in the process of shifting from a 'corporatist coalition' to a 'transparency coalition'. In contrast to Germany, this shift appears to be much more stable. Because Dutch workers have staked their long-term welfare on the ability of their pension funds to reap high returns on investment, Dutch workers have, in a very real sense, become minority shareholders who need protection against the agency costs of management. This brute fact, so we contend, lies at the root of the largely rhetorical nature of the Dutch political response to the rise of (foreign) activist investors. Although politicians, unions and managers do still wield the discourse of corporatism as an important rhetorical tool, given the dawning awareness that the realization of their preferences depends crucially on the ability of the Dutch economy to reap rentier rents, they increasingly fail to act on their rhetorical utterances.

Once more, our assessment differs from that of Gourevitch and Shinn. They maintain that the weak legal protection of minority shareholders in Dutch corporate law is an indication of the robustness of the corporatist settlement while it is simultaneously a cause of the outflow of Dutch pension savings to foreign capital markets. 'Stripped of voice', in the words of Gourevitch and Shinn, '(Dutch pension funds) exited' (2005, p. 186). Our reading of Dutch developments is different. First, Gourevitch and Shinn failed to anticipate the simultaneous weakening and transformation, respectively, of the two main groups supporting the corporatist settlement, i.e. managers and workers. As a result, they missed the most recent liberalizing transformations in Dutch corporate governance.

Gourevitch and Shinn also failed to consider functional reasons for the outflow of Dutch pension savings. Since Dutch pensions have now reached a level of well over 120% of Dutch GDP, while the total value of the equities (stocks as well as bonds) listed at the Amsterdam stock exchange has dropped to around 85% of GDP, Dutch financial markets are simply not deep enough to absorb Dutch savings. Moreover, prudent asset management requires techniques of risk diversification. As such, the internationalization of pension savings is a pattern that can be observed in most countries with pre-funded pension systems (IFSL, 2008), and hence has nothing to do with the blocked transparency coalition as suggested by Gourevitch and Shinn.

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5. Conclusions and implications

In this paper, we have given an institutional answer to the questions raised by the different modes of political contestation over the rise of activist investors on both sides of the Atlantic. We have sought to demonstrate that these differences can be explained as the effect of different actor constellations in the US, Germany and the Netherlands. Because of weak organized labour, managers and owners in the US have succeeded in finding a compromise between their respective preferences through the introduction of managerial remuneration schemes that turn managers into owners. An altogether different set of coalitions was traced in Germany. While the post-war settlement boiled down to a state-backed victory of managers and workers (i.e. corporate insiders) over owners, in the late 1990s the German government initiated a series of legal changes that were meant to transform the German corporatist model into a more American-style investor model. With the electoral victory of the Christian democrats over the social democrats in 2005, German opposition to further financialization has shifted to the political mainstream. We have argued that the return to a corporatist model has become so tempting because the alternative—a transparency coalition, built upon a stable compromise between workers and owners—was unavailable due to the absence of a funded pension system.

Here lies the crucial difference between the German and the Dutch political economy. While Dutch corporate governance has undergone a similar trajectory of change, the managerial abuses of the late 1990s and early 2000s were countered by a further move in the direction of the transparency model. Major forces behind this development are the largest Dutch pension funds (ABP, PGGM). Since, in a very important sense, Dutch workers are also owners, the transparency model has become a viable alternative to the return to corporatism. As a consequence of the extent to which the Dutch pension system and its financial intermediaries are integrated into international financial markets, Dutch workers and their political representatives have unintentionally become stakeholders in the same goals that activist investors pursue.

On a theoretical level, our analysis has demonstrated that the political responses to the rise of activist investors, which are seen by many to unsettle earlier coalitions, are themselves institutionally patterned. As such, our observations clearly contribute to the latest (re)discovery of agency in the VoC debate. After having spent two decades on the identification of differences between institutional configurations, the attention of the VoC community has recently shifted towards explaining institutional change. The growing sensitivity of VoC scholars to the different modes, speeds and directions of institutional change has resulted in increasing attention to its political dimensions and hence to the agents pursuing or initiating these changes (Hay, 2004; Jacoby, 2005; Streeck and Thelen, 2005).

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A paper by Mary O'Sullivan on the transformation of the French financial system and the role of the French managerial cadre in this transformation, which recently appeared in this journal, is a case in point (O'Sullivan, 2007). Also a case in point is Gourevitch and Shinn's suggestion that shifts in corporate coalitions represent cases of preferences overcoming institutions. Concerning the German case, in particular, they suggest that it raises interesting questions about the ability of preferences and interests to overcome the constraints of formal institutions (Gourevitch and Shinn, 2005, p. 167).

Despite their differences, both attempts run the risk of bending the stick too far in the direction of an unconstrained conceptualization of agency. As our paper has argued, there is 'method to (their) madness', in the sense that political reactions are institutionally pre-structured. This does not imply that preferences are static, though. As the Dutch case suggests, the growing salience of certain institutional arrangements, in this case the pre-funded pension system, could well transform the objective and subjective interests of agents over time and, as a result, unsettle earlier coalitions and the institutions they have built. But describing that as the prevalence of preferences over institutions is clearly an exaggeration.

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