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When borders seem irrelevant:  
Global finance and the limits  
of capitalist variety



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## Abstract

The varieties of capitalism (VoC) framework holds that more organized forms of capitalism are characterized as bank-dominated as opposed to market-dominated in the case of more liberal market economies. Yet in light of the financial crisis, and significant failures of financial institutions within the so-called coordinated-market economies (CMEs) and/or the revelation of complicity on the part of CME financial institutions, it is important to consider whether the theorization of finance and financial systems within the VoC framework maintains empirical validity. It is shown, analyzing the quintessential CME Germany, that the German financial system and German firm financing has changed in contrast with the expectations of theory; moreover, the behavior of specific financial institutions, even those that do not rank among the large private banking groups, is not specific to that expected of institutions in a CME. Ultimately, this paper considers the problems with analyzing global finance from an approach based on methodological territorialism, arguing instead that attention should be placed on financial institutions and firms, and their multi-scalar practices. It is also argued that more focus is needed concerning similarities rather than differences.

# When Borders Seem Irrelevant: Global Finance and the Limits of Capitalist Variety

## 1 Introduction

As the global financial crisis gained speed in 2007 and 2008, the media was awash with voices proclaiming the end of unfettered *Anglo-Saxon/Anglo-American* financial capitalism. Leaders in Continental Europe, particularly French President Nicolas Sarkozy and German Chancellor Angela Merkel, called for a reformulation of global capitalism along models of capitalism espoused in Europe. For instance, Nicolas Sarkozy proclaimed in one speech 'The crisis was a product of the Anglo-Saxon model, I want for the world the victory of the European model, which has nothing to do with the excesses of financial capitalism'.<sup>1</sup> Merkel, likewise, in a speech to the World Economic Forum proclaimed that the social market economy is a good model, which can show the way forward.<sup>2</sup>

To be sure, the excesses of the financial crisis originated in the financial centers of New York and London on the back of massive under pricing of risk in housing markets and their obfuscation with complex financial products (Clark, Dixon and Monk 2009). As a result, referring to the financial crisis in particular and reckless financial capitalism in general as *Anglo-Saxon/Anglo-American* seems reasonable and empirically valid. It is easy, then, to be tempted into thinking that significantly different models of capitalism exist in Continental Europe (Engelen and Grote 2009; Dupuy, Lavigne and Nicet-Chenaf 2010; Engelen, Konings and Fernandez 2010). Yet, should such proclamations to the differences among political economies in relation to global financial markets and flows be accepted without skepticism? Do not the complex and vast inter-linkages extant in the global economy in general and the world of finance in particular limit the degrees of difference among political economies, particularly those European political economies referred to by Sarkozy and Merkel?

In academic scholarship the proclamations of political leaders such as the above find their continued expression in heterodox political economy, particularly the comparative political economy research associated with the 'Varieties of Capitalism' (VoC) approach (Hall and Soskice 2001b; Hancké, Rhodes and Thatcher 2007; Hall and Gingerich 2009; Hall and Thelen 2009). With a tradition stretching back decades to the works of scholars such as Andrew Shonfield and his *Modern Capitalism* of 1965, this research has provided interesting theoretical and empirical accounts of the differences among advanced capitalist economies. This body of scholarship in aggregate has maintained that the United States and its Anglo-Saxon counterparts, particularly the United Kingdom, espouse a more liberal form of capitalism, whereas continental European countries tend more toward organized or rather coordinated forms, particularly Germany, which tend to be more egalitarian and less prone to speculative short-term excess (Pontusson 2005).

Regarding finance specifically, the varieties of capitalism framework holds that more organized forms of capitalism are characterized as bank-dominated as opposed to market-dominated in the case of more liberal market economies (Zysman 1983; Deeg 1992; 1999; Vitols 2005; Deeg 2009). Yet in light of the financial crisis, and significant failures of financial institutions within the so-called coordinated-market economies (CME) and/or the revelation of complicity on the part of CME financial institutions, it is important to consider

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<sup>1</sup>/. Author's translation of speech of Nicolas Sarkozy made in Toulon – La Seyne-sur-Mer, December 1, 2009.

<sup>2</sup>/. Angela Merkel speech to the World Economic Forum in Davos, Switzerland of January 30, 2009.

whether the theorization of finance and financial systems within the VoC framework maintains empirical validity. Indeed, some of the most notable casualties at the beginning of the subprime mortgage crisis were German financial institutions; like other European countries, the German government created a EUR 480 billion fund, the *Sonderfonds Finanzmarktstabilisierung*, to bailout financial institutions affected by the crisis. Such major contagion suggests that the separation between political economies is not very significant. As such, that a high degree of diversity exists among different national political economies is contestable (Clark and Wójcik 2007; Peck and Theodore 2007; Dixon forthcoming).

If European financial institutions were so affected by the fallout of US housing markets, it begs the question of whether alternative European models exist, at least in the area of finance, or even if they can exist in the current global political-economic framework and in post-industrial affluent democracies. The primary objective of this paper is to critically examine the theorization of finance and financial systems of CMEs, as offered by comparative political economists, particularly the VoC framework. Following an overview of the VoC framework and its treatment of the financial system in the next section, the paper proceeds with an empirical assessment in two steps that focuses specifically on the case of Germany. Firstly, in section three, I discuss major trends in corporate financing making use of aggregate data from the German national accounts contrasted with comparable data on US firms. Secondly, in section four, I examine the restructuring of the German banking system, particularly focusing on the restructuring of public Landesbanken and the consequences of the financial crisis.

The empirical focus of this paper is Germany, given it figures as the most ideal-typical CME in the VoC framework and other accounts of non-liberal capitalism. Germany is thus the most appropriate for testing theoretical validity. It is shown that the German financial system has changed in contrast with the expectations of theory; moreover, the behavior of specific financial institutions, even those that do not rank among the large banking groups like Deutsche Bank, is not specific to that expected of institutions in a coordinated market economy. The concluding section of the paper considers the problems with analyzing global finance from an approach based on methodological territorialism, arguing instead that attention should be placed on financial institutions and firms, and their multi-scalar practices. It is also argued that more focus is needed concerning similarities rather than differences.

## 2 Theorizing Finance in ‘Varieties of Capitalism’

Before examining the treatment of finance and financial systems in the VoC approach, it is important to review the fundamental concepts of the VoC framework; it should be mentioned that this framework shares considerable similarities with other comparative political economy frameworks, such as Regulation Theory (Amable 2003; Boyer 2005). The VoC framework, following Hall and Soskice (2001a), is a firm-centered approach that regards firms as key actors in a capitalist economy. The framework takes a relational view of the firm, whereby the firm’s capacity to develop and exploit its core competencies in the process of profitable production and distribution of goods and services rests critically on the quality of the relationships the firm maintains both internally with employees and externally with a range of actors that include trade unions, suppliers, clients, government, business associations and other stakeholders. These relations fall into five spheres: industrial relations, vocational training and education, corporate governance (firm finance), inter-firm relations (supply-chain relations), and employee relations. The framework contends that *national* political economies can be distinguished by the way firms resolve coordination problems in production and distribution via these five institutional spheres, of which the quality of the latter is determined by historically-contingent formal and informal rules and cultures that actors follow.

The framework distinguishes national political economies typologically as either *liberal market economies* (LMEs) or *coordinated market economies* (CMEs). In the former, firms are hypothesized to coordinate their activities via hierarchies and competitive market arrangements; arm's length exchange and formal contracting subject to price signals offered on the competitive market characterize such arrangements. In the latter firms are hypothesized to solve coordination problems through complementary non-market relationships (Crouch *et al.* 2005; Höpner 2005a; 2005b), which involve more incomplete contracting and monitoring via the exchange of private information inside these network relationships; constructing competencies of the firm relies, therefore, on collaboration rather than competition. Germany has been considered as representing the quintessential CME, whereas the United States has been considered as representing the quintessential LME.

In terms of corporate strategy, the framework predicts systemic differences between LMEs and CMEs as firms take advantage of the specific opportunities offered by the institutional environment of the national political economy; strategy follows institutional structure. At the level of the political economy as a whole, the framework contends that institutional complementarities further reinforce differences between LMEs and CMEs. In a CME, for instance, institutions of one sphere can be expected to support analogous forms of coordination in another institutional sphere. Combined, the institutional spheres provide what the framework considers *institutional comparative advantage* in terms of international economic competitiveness. The framework contends, moreover, that the institutional environment of a particular political economy is path dependent, as the actors are expected to find greater efficiency and certainty by maintaining the status quo. Defection is expected to be minimal, as the benefits to following the 'rules of the game' outweigh the costs of not doing so (Pierson 2004; Thelen 2004).

## 2.1 The market for corporate governance

Now that we have established the fundamentals of the VoC framework, we can turn specifically to a presentation of the institutional framework of the financial system, which can be labeled also as the market for corporate governance. According to the framework, the primary difference between liberal and coordinated market economies in the area of finance is the existence of 'patient capital', which is hypothesized to be present to a large extent in the latter and limited in the former (Amable, Ernst and Palombarini 2005; Culpepper 2005; Gourevitch and Shinn 2005; Goyer 2006). The existence of patient capital in CMEs allows firms to invest in projects that produce returns only in the long run and to retain a skilled workforce through economic downturns. Patient capital depends crucially on investors having access to inside information concerning the operation of the firm. As such, finance does not depend on balance sheet criteria, as is the case in a LME.

The provision of information concerning the progress of firms in CMEs occurs through dense networks that link managers and technical personnel of a firm to counterparts in other firms and industry associations. Information sharing also occurs through networks of cross-shareholding, where different firms are represented on the boards of other firms. Firm strategies in CMEs also rely on tax provisions and securities regulations that limit the scope for hostile takeovers, thus reducing a firm's sensitivity to short-term profitability. Firms in LMEs, in contrast, are under pressure to maximize shareholder value in the short term (Hall and Soskice 2001a).

A key distinguishing characteristic between CMEs and LMEs in the framework is that the financial system of the former is a bank-based system, in contrast to a market-based system in the latter. The key difference between a bank-based system and a market-based system is that the former mediates the flow of savings and investment through close relationships between the lender and the borrower. In the latter, on the contrary, capital mediation occurs through arm's length transactions (Allen and Gale 2000).

In bank-based systems banks are significant providers of loans to non-financial firms, of which they also typically participate in the firms' governance and strategy through large equity holdings and board membership; as such, bank loans represent a large portion of corporate liabilities. Banks in bank-based systems, while also being important nodes in the nexus of corporate governance relations, also play an important role in influencing other parts of the financial services sector, such as stock markets and investment firms. Another key characteristic of bank-based systems is that households place a large proportion of their savings in bank deposits.

A characteristic of the German banking system that has sustained the VoC view of German banking has been the concept of the *Hausbank* (Deeg 1998; Schmidt and Tyrell 2004; Elsas 2005). As most SMEs have no public equity, banks are unable to wield the same degree or type of influence as with large firms with public equity. In effect, bank influence rests solely on the lending relationship with the firm. The concept of the *Hausbank* holds that although SMEs may acquire finance from a variety of sources and banks, a firm will maintain a highly proximate relationship with one bank: the *Hausbank*. The firm's relationship with the *Hausbank* is an informationally intense relationship, which allows the latter to perform an insurance function for the firm. The *Hausbank* is also typically a provider of senior secured lending to the firm. If the firm experiences economic difficulty, which leads to a downgrade in the firm's credit quality and subsequently the reduction of credit from other lenders, the *Hausbank* then steps in to fill the void.

In market-based systems, in comparison, non-financial firms receive financing largely from equity markets and corporate bond markets, though bank lending is still a part of the overall mix. However, this only applies to large firms or firms with significant growth potential. Household savings in market-based systems is placed largely in securities markets, often through occupational pension funds or individual retirement accounts. As such, the market capitalization to GDP ratio is very high in LMEs.

### 3 Continuity or Change in Corporate Finance?

As late as 1994, 80 percent of corporate borrowing in Germany was by means of banks, while only 10 percent occurred through securities markets (Prowse 1996). Categorizing Germany as a bank-based financial system was a clear-cut task. However, beginning in the early 1990s important systemic reforms have driven financial market development, ultimately expanding the range of financing options for non-financial firms. Part of this development has coincided with Germany's attempt, like other advanced and emerging political economies, to capture an increasing share of global GDP related to financial services, which London and New York have long cornered (Rajan and Zingales 2003; Faulconbridge 2004). Accordingly, reforms were initiated to raise the status of Frankfurt, and thus German financial services providers, as a global financial center under the name of *Finanzplatz Deutschland* (Story 1996). As the major financial centers operated on market logics with vast product offerings and forms of financing, coupled with important investor protections, German regulation would have to converge in that direction.

#### 3.1 A changing financial landscape

Four significant legislative reforms were passed beginning in 1990 for the promotion of financial markets: the *Erstes* (1990), *Zweites* (1994), *Drittes* (1998) and *Viertes* (2002) *Finanzmarktförderungsgesetz*. According to Vitols (2005), the second of these legislative agendas was the most significant. Effectively, the Second Law adopted US-style financial regulation, manifested in particular in the establishment of the Federal Securities Trading Commission (*Bundesaufsichtsamt für den Wertpapierhandel*). The new trading commission was set up to enforce US securities market traditions of protecting minority shareholder rights and transparency in trading.

This was not simply an endogenous effort; European legislation, in conjunction with the Financial Services Action Plan of 1999 and the Single European Act of 1986, was moving already toward the creation of a single market for financial services, primarily along the lines of a more market-based system (Lütz 1998; 2000).

The reasons for protecting minority shareholder rights are twofold. Firstly, limited protection of minority shareholders restricts the ability to attract foreign firms to list their equity on the domestic stock exchange. Foreign firms are more likely to list in markets that are deeply liquid, yet increasing liquidity requires increasing the pool of potential investors, both domestic and foreign. Yet without protection of minority rights, investors are less likely to invest in such markets. Secondly, in the process of protecting minority shareholder rights the potential investor pool for domestic firms increases, as it becomes necessary to ensure that the domestic market provides sufficient liquidity and opportunity for domestic firms, which face fewer constraints in listing and raising capital in foreign markets. In other words, limiting defection of domestic firms to foreign markets requires providing similar conditions extant in other potentially more liquid markets, such as New York and London (Clark and Wójcik 2007).

In addition to securities market regulations financial transformation has been driven through corporate governance reform, beginning with the 1998 company law reform the *Gesetz zur Kontrolle und Transparenz im Unternehmensbereich*. This legislation extended the liability of supervisory and management boards, as well as that of accountants, as a means of increasing corporate transparency and ultimately to protect outsiders' interests. The legislation abolished unequal voting rights and placed limits on banks use of proxy voting. This legislation also allowed firms to provide compensation through stock options as well as conduct share buy-backs (Cioffi 2002; Deeg 2005). In effect, firms were allowed (or forced) to follow practices similar to those available in Anglo-American jurisdictions.

The major shift of corporate governance in practice manifested itself in the large private universal banks, particularly Deutsche Bank, Commerzbank and Dresdner Bank<sup>3</sup>, divesting their equity stakes in large German firms (Höpner 2001; Beyer 2003). Up to the 1990s the large private universal banks were the principal lenders to and played extensive roles in the governance of large German firms, holding blocks of shares and seats on corporate boards across industries. As significant owners of corporate equity – a legal impossibility in most market-based financial systems such as the United States (Roe 2003) – the large universal banks also dominated stock markets, thus shaping any potential hostile struggles for corporate control. Indeed, as Franks and Mayer (2001) report, the post-war period was characterized by a paucity of hostile takeovers, given high ownership concentration. Banks' equity ownership was not actually that significant in comparison to other large shareholders, yet banks were influential through the exercise of proxy voting rights and because of voting restrictions. The proportion of shares of large German firms that were widely held was often held with banks, to which the banks were granted depositary-voting rights.

Whereas hostile takeovers had previously been both legally and institutionally difficult, the hostile takeover of Mannesmann AG by Vodafone plc of the UK in 1999/2000 for more than EUR 150 billion marked the end of an era, bringing the market for corporate control that swept US and UK markets in the 1980s and 1990s home to Germany (see Höpner and Jackson 2006). Although a voluntary takeover code existed from 1995, a more formal takeover law, *Gesetz zur Regelung von öffentlichen Angeboten zum Erwerb von Wertpapieren und von Unternehmensübernahmen*, was introduced in 2002. This law is modeled after the London City Code, though with some modifications that gave supervisory boards some power to defend against hostile bids (Kirchner and Painter 2002).

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<sup>3</sup>/. Dresdner Bank was acquired by Commerzbank in December 2009.

In combination with the large private bank divestment, Anglo-American institutional investors began to enter the German market in greater numbers in the 1990s, as part of global portfolio diversification strategies (Wójcik 2002). The entrance of large portfolio investors was important as it offered large firms new sources of financing, while also making German firms more prone to market pricing and thus market discipline. Many large German firms began to dilute local ownership concentration in favor of dispersed national and international ownership comparable to their corporate counterparts in Anglo-American markets. Given the constraints and informational asymmetries of investing at a distance, institutional investors brought with them certain expectations of corporate governance and corporate performance, which corporate managers are incentivized to support in place of broader stakeholder interests (Clark and Wójcik 2007). Coupled with the harmonization of accounting standards at the European and international levels, common expectations of governance and corporate transparency along the lines expected by global institutional investors has been further institutionalized (Dixon and Monk 2009). Accordingly, the insulated world of German corporate governance and finance began to look increasingly Anglo-Saxon in scope and practice.

A related factor in financial transformation has been the German government's effort to promote the expansion of so-called *new economy* high-tech industry. Indeed, the bank-based system, in theory and in practice, was seen as an impediment to the emergence of innovative and high-tech firms, given bank-based systems tend to favor low-risk long-term investment at the expense of high-risk but potentially very innovative new investment. Unlike the United States and the United Kingdom, Germany had a very small venture capital and private equity industry to finance high-risk firms and start-ups (Sunley *et al.* 2005). As a result, federal and regional governments began co-financing investment in endeavors with private equity investors to drive this market segment forward. The ill-fated *Neuer Markt* was also established in 1997 to support this development, though closed in 2002 after the bursting of the global DOT.COM bubble. The late 1990s saw a flurry of new equity issues in Germany, but equity financing in Germany largely dried up after the bubble collapsed. Yet, as we will see below, new equity issuance has moved to other global markets with greater liquidity. Private equity and venture capital still remains small in comparison to the United Kingdom and the United States, yet the sector continues to develop.

While the changes in securities and corporate governance regulations are significant, it is important to recognize that such changes are mainly applicable to large or mid-sized publically listed firms. As a result, there is still contestation that convergence toward Anglo-American financial systems and corporate governance traditions is occurring (see e.g. Engelen, Konings and Fernandez 2010). It is important to remember that the German economy is characterized by its large number of private small- to medium-sized enterprises, also known as the *Mittelstand*. As a result, there has been some suggestion that the German political economy is bifurcated, whereby large German firms follow global trends in corporate financial practice, whereas the *Mittelstand* continues to rely on the traditions of the coordinated market economy, and thus the bank-based financial system. It has been argued also that the bank-based financial system is further sustained given the larger size of the manufacturing sector in Germany compared with Anglo-American countries (see e.g. Deeg 2009). Yet, while divergence may persist to a certain degree, trends indicate that SMEs are changing as well. We can see such trends by comparing aggregate balance sheet data of German firms from national accounts data with their counterparts in the United States, the so-called quintessential LME.

### 3.2 Expanding the financing mix

As table 1 indicates, presenting balance sheet ratios of all German firms between 1997-2008, we can see that debt-to-equity ratios have decreased since 1997 as equity capital has increased from 16.3 percent to 25.5 percent. Although capitalization of German firms is lower in comparison to firms in Anglo-American economies, as table 2 suggests below for the US manufacturing sector, there is a clear deleveraging trend. This

trend coincides with a diminished reliance on external debt financing, with a considerable decrease in both short-term and long-term bank lending. Moreover, other forms of debt financing appear to have grown at the expense of bank lending.

**Table 1:** *Balance sheet ratios for German firms - Total, 1997-2008*

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008e
Equity Capital	16,3	17,5	18,4	18,6	19,5	21,1	21,6	22,8	23,8	24,3	24,9	25,5
Total short-term liabilities	47,2	45,9	45,3	46,3	46,1	45,1	44,6	43,8	43,6	43,5	44,3	43,5
<i>Short-term bank liabilities</i>	10,2	10,0	9,5	9,4	9,4	8,7	8,2	7,5	6,7	6,3	6,5	6,7
Total long-term liabilities	17,3	17,5	17,2	16,1	15,4	14,5	14,4	13,5	12,7	12,4	11,8	12,5
<i>Long-term bank liabilities</i>	11,3	11,5	11,5	10,7	10,4	9,3	8,8	8,0	7,6	7,3	7,2	7,3
Provisions	19,0	18,7	18,7	18,7	18,6	18,9	19,1	19,4	19,5	19,3	18,6	18,5

Source: Deutsche Bundesbank, Extrapolated results from financial statements of German enterprises from 1997 to 2008

**Table 2:** *Balance sheet ratios for US firms - Manufacturing, 1997-2008*

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Equity Capital	39,4	37,5	37,8	39,3	38,6	36,7	39,2	41,8	42,3	43,6	44,1	40,3
Total short-term liabilities	26,6	25,9	25,8	26,2	25,7	25,1	24,4	23,8	24,6	23,5	22,8	22,9
<i>Short-term bank liabilities</i>	1,6	1,7	1,7	1,5	1,5	1,1	0,9	0,9	0,8	1,1	0,9	1,0
Total long-term liabilities	20,0	21,8	21,9	20,7	21,5	21,7	21,1	18,8	17,6	17,9	18,2	21,0
<i>Long-term bank liabilities</i>	6,3	7,6	7,6	7,1	6,6	5,9	5,5	4,8	4,6	4,9	4,9	5,9
Provisions	15,0	14,9	14,5	13,7	14,2	16,5	15,3	15,6	15,5	15,0	14,9	15,8

Source: US Census Bureau, Quarterly Financial Report - Manufacturing, Mining, and Trade Corporations

While equity capital has increased it is important to consider the role of provisions and what they mean in the balance sheet. According to International Accounting Standards<sup>4</sup>, provisions are considered contingent liabilities, which may have an uncertain cost and fall at an uncertain period in time. Provisions can be seen as a form of self-financing that sits in between equity and debt. Provisions are actually any part of shareholders' equity except for basic share capital. So, while provisions cannot be conceived explicitly as equity, until such funds actually leave the firm they are essentially a form of equity. In effect, if such contingent liabilities fail to manifest or manifest below the assumed level, then the remaining account returns to shareholders' equity. Traditionally, these contingent liabilities have been associated with pension obligations, particularly at large firms. However, more recently, book reserve pensions have been transferred into pension trust funds (Contractual Trust Arrangements) separate from the firm in question, as a way of clarifying and ringfencing contingent liabilities (Clark 2003; Dixon 2009).

We see comparable trends, as presented in table 3, for the German manufacturing sector. Manufacturing firms have decreased debt-to-equity ratios, while decreasing their reliance on bank lending. When contrasted with the balance sheets of US manufacturing firms presented in table 2, we see interesting similarities. US manufacturing firms are more capitalized than their German counterparts; yet, while equity in US manufacturing firms shows no discernable upward or downward trend, a clear upward trend exists for German manufacturing firms. Interestingly, US manufacturing firms show a greater preference for long-term debt financing in comparison, while long-term bank lending for both seems to have converged to a similar level. German manufacturing firms have diminished their reliance on short-term bank lending, but still maintain a higher reliance on

<sup>4</sup>/. IAS 37 Provisions, *Contingent Liabilities and Contingent Assets*

short-term financing. This difference between short-term and long-term debt financing is particularly striking coupled with the convergence of long-term bank lending, as it suggests that German manufacturing firms are no more likely to possess 'patient capital' in contrast to US manufacturing firms.

**Table 3:** *Balance sheet ratios for German firms - Manufacturing, 1997-2007*

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Equity Capital	22,8	23,9	25,1	24,3	25,1	26,6	26,6	27,1	27,4	27,5	28,3
Total short-term liabilities	37,8	37,4	36,9	38,9	39,1	38,0	38,2	37,9	38,3	38,9	39,3
<i>Short-term bank liabilities</i>	6,5	6,3	6,2	6,0	6,2	5,4	5,1	4,8	4,2	4,0	4,1
Total long-term liabilities	13,5	13,6	13,2	12,6	12,0	12,0	11,9	11,4	10,7	10,4	9,9
<i>Long-term bank liabilities</i>	7,7	8,0	7,9	7,4	7,3	6,6	6,1	5,6	5,4	5,0	5,1
Provisions	25,7	24,8	24,5	23,9	23,6	23,2	23,1	23,4	23,3	22,9	22,3

Source: Deutsche Bundesbank, Extrapolated results from financial statements of German enterprises from 1997 to 2008

When we disaggregate for SMEs in Germany in table 4, compared with US SME manufacturing firms in table 5, again we see interesting similarities. While this is not a perfect comparison, as it considers all German SMEs, it still provides interesting caveats concerning the financial situation of smaller German firms. For German SMEs over the ten-year period of 1997-2007 debt-to-equity levels decreased substantially, in line with the rest of firms in the economy.<sup>5</sup> Interestingly, the capitalization of small US manufacturing firms decreased slightly during the period. Bank lending remains a significant source of external finance for German SMEs; yet again, there is a clear downward trend in this area. More importantly, no significant differences exist between German SMEs and small US manufacturers in terms of overall reliance on bank lending. However, whereas overall bank-lending levels have remained relatively flat for US firms, they have decreased for German firms. Where a difference does exist is in relation to short-term vs. long-term bank lending. Small US manufacturing firms maintain a larger reliance on long-term bank lending than do German SMEs. Again, it does not appear that German firms are any more capable of attracting and maintaining long-term 'patient capital'.

**Table 4:** *Balance sheet ratios for German firms - Small and Medium Sized Firms, 1997-2007*

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Equity Capital	13,3	14,4	15,5	16,5	17,2	19,4	21,0	23,1	24,6	25,0	25,2
Total short-term liabilities	56,0	54,7	53,9	53,5	53,1	52,0	50,7	49,2	47,6	47,0	47,6
<i>Short-term bank liabilities</i>	13,6	13,6	12,8	12,7	12,8	21,3	11,4	10,6	9,5	9,0	9,0
Total long-term liabilities	18,1	18,3	18,0	17,3	16,8	15,0	14,3	13,3	13,3	13,2	12,8
<i>Long-term bank liabilities</i>	11,6	11,7	11,6	11,2	10,9	9,7	9,1	8,0	8,1	7,7	7,9
Provisions	12,2	12,2	12,2	12,3	12,5	13,1	13,5	13,9	13,9	14,3	13,5

Source: Deutsche Bundesbank, Extrapolated results from financial statements of German enterprises from 1997 to 2008

<sup>5</sup>/. It is questionable whether the characteristically low book value of equity is an accurate portrayal of enterprise value of German SMEs, given the relatively conservative accounting standards in the German Commercial Code (HGB). The accounting principles in the HGB characteristically understate the value of assets while overstating the value of liabilities, as a means of limiting a firm's tax liabilities. They also allow managers considerable scope to accumulate hidden reserves. As the latter are value relevant, equity is likely to be understated. In effect, the capital structure may appear to be more leveraged than it actually is. Another partial explanation behind the increase in equity could have been an increase in firms adopting International Accounting Standards, which result in a higher book value for equity capital (Hung and Subramanyam 2007)

**Table 5: Balance sheet ratios for US firms - Manufacturing, Assets less than \$25 million, 1997-2008**

	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Equity Capital	48,1	44,4	43,2	42,9	44,6	43,8	42,4	39,4	42,8	45,9	46,6	44,8
Total short-term liabilities	31,7	32,8	32,4	31,9	31,0	31,7	33,4	36,3	34,0	33,0	32,3	32,8
<i>Short-term bank liabilities</i>	4,7	4,5	4,7	4,8	5,4	5,5	5,2	5,7	5,6	5,6	5,1	4,0
Total long-term liabilities	18,0	20,2	22,2	23,1	22,3	21,8	21,9	21,5	21,0	19,1	19,4	20,3
<i>Long-term bank liabilities</i>	10,3	11,1	12,6	12,3	12,3	11,9	12,1	11,9	11,1	10,7	10,0	11,6
Provisions	2,2	2,6	2,1	2,1	2,1	2,6	2,2	2,8	2,2	2,0	1,7	2,0

Source: US Census Bureau, Quarterly Financial Report - Manufacturing, Mining, and Trade Corporations

### 3.3 Sourcing capital from abroad

While we can see convergence trends across German firms toward balance-sheet structures similar to their US counterparts, it is more interesting to see where German firms are raising capital. As table 6 demonstrates, until the end of the century, non-financial German firms received most of their external financing from within the German financial system, with short-term and long-term bank lending from German banks dominating the mix. Over the last decade this continuity has changed substantially. Foreign banks have encroached significantly on the long-term lending business of German banks, yet short-term lending is still dominated by German banks. The more substantial trend is that firms are increasingly obtaining both short-term and long-term funds from non-bank lenders, which are often foreign institutions (e.g. GE Capital). Non-bank lending has become an important feature of most capitalist economies, as profits in traditional banking decreased due to lower interest rates, and as institutional investors seek new sources of diversification.

**Table 6: Non-financial corporations' financing ratios to total asset formation**

	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
<b>External Financing Ratios</b>																		
Short-term lending Germany	10,6	1,4	-3,2	1,4	6,6	4,7	1,9	5,7	-1,4	3,4	1,9	-9,0	-10,3	-10,9	-4,1	-1,4	3,0	3,9
<i>Short-term lending foreign</i>	2,5	-0,6	-1,1	-1,1	1,0	0,5	1,1	0,2	4,0	-1,0	-1,3	-1,3	-0,2	-2,3	-0,4	1,5	-0,6	0,5
Short-term non-bank lending Germany	-0,5	-0,2	0,5	0,2	-0,6	-0,3	-0,2	-0,4	0,2	0,3	-0,1	1,9	3,1	1,0	1,5	1,1	-0,7	-0,3
<i>Short-term non-bank lending foreign</i>	2,8	0,7	0,3	3,4	2,4	5,4	4,9	2,1	10,2	14,7	1,8	-6,9	5,2	-0,8	9,0	10,8	6,6	2,0
Long-term lending Germany	21,3	19,6	18,4	6,3	15,8	14,2	14,3	14,0	13,8	5,7	5,5	1,2	-5,6	-1,2	0,6	2,1	6,5	1,3
<i>Long-term lending foreign</i>	0,1	0,5	0,9	0,5	-0,1	-0,1	0,2	0,5	0,7	0,3	3,3	0,8	-0,9	0,9	3,5	5,1	4,5	6,5
Longer-term non-bank lending Germany	0,2	3,1	2,6	8,5	-3,2	-0,9	0,3	-1,5	3,9	-1,2	0,8	3,6	-0,7	-1,2	-4,1	-5,2	0,9	-1,0
<i>Longer-term non-bank lending foreign</i>	1,6	2,1	1,4	0,7	2,1	0,7	1,6	6,4	7,1	13,5	13,1	16,3	0,6	-16,1	3,0	4,8	-3,7	5,3
Equity financing Germany	5,5	6,8	6,4	6,6	5,6	9,5	5,0	17,2	14,7	14,4	14,4	0,1	-4,1	0,7	-0,8	3,5	2,6	0,8
<i>Equity financing foreign</i>	0,9	-1,7	-0,7	0,9	1,0	-0,3	1,6	0,8	4,8	19,6	3,5	10,7	18,2	14,5	4,5	7,0	6,7	3,9
Securities Market	1,5	9,0	19,1	18,0	-1,3	-1,7	-1,2	-1,1	0,3	1,7	2,7	2,2	11,3	1,0	1,1	3,7	2,0	2,7
Internal Financing Ratio	48,7	56,2	55,6	53,1	68,8	66,5	69,0	53,5	37,7	27,5	51,0	82,4	76,9	105,4	76,9	61,2	63,0	67,2

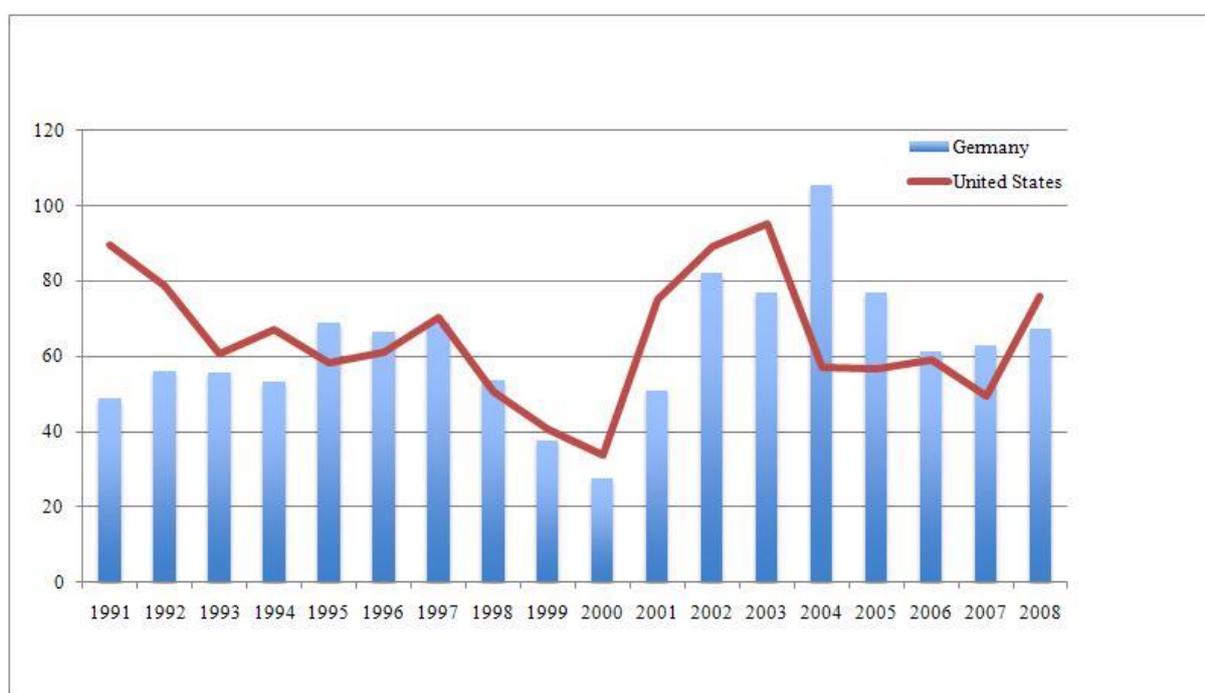
Source: Deutsche Bundesbank

Equity financing in Germany saw a burst of activity during the DOT.COM bubble of the late 1990s, as mentioned above, but has failed to gain traction ever since. This does not, however, suggest that German firms are reticent towards equity financing. Instead of raising equity in Germany, the data suggest that German firms prefer to raise capital on foreign markets, such as New York and London, which are more liquid markets. In-

deed, while equity issues tailed off substantially in Germany after 2001, foreign equity issues remained high until recession gripped the global economy in 2008.

While we see convergence trends and/or similarities between firms in the United States and Germany in terms of external financing, it is important to analyze internal financing ratios. Indeed, firms often finance activities through retained earnings and depreciation. When analyzed at aggregate level, non-financial corporations in Germany and the US show similar patterns of internal financing. Figure 1, which shows internal financing ratios<sup>6</sup> calculated from the national accounts of Germany and the United States, shows that during the 1990s both German and US non-financial firms increased their use of external financing, as conditions for doing so were in their favor. After the DOT.COM bubble, internal financing increased for both, only to decline again as economic growth picked up after 2003/04. Internal financing then picked up again as economic growth waned and financial markets tightened.

**Figure 1:** *Non-financial Corporations Internal Financing Ratio*



Source: Deutsche Bundesbank; US Beareau of Economic Analysis

As the above data suggest, how German and US firms finance their activities does not appear to diverge to a significant degree, at least to a degree sufficient enough to make theoretical inferences vis-à-vis capitalist diversity. Bank lending does appear to remain important in Germany in aggregate and for manufacturing firms and SMEs in particular. Yet, bank lending is also significant for US manufacturing firms, both small and large. Whereas financing patterns for US firms do not appear to have changed significantly since the late 1990s, German firms appear to be converging toward similar patterns at an increasing rate. More significantly, foreign

<sup>6</sup>/. Internal financing ratio is calculated as internal financing as a percentage of total asset formation. Internal financing is net retained income less consumption of fixed assets (depreciation). Total asset formation is gross capital formation plus acquisitions less disposals of non-financial non-produced assets plus net acquisition of financial assets.

sources of capital have grown for German firms. Such internationalization is important moreover, as it limits the explanatory power of a territorially defined financial system, particularly as European financial integration facilitates opportunities for German firms – small and large – to seek financing abroad and facilitates the opportunities for foreign financial institutions to provide financing in Germany.

## 4 Restructuring the German Banking System

While the last section provided a glimpse into changes in corporate financing, which indicates increasing convergence towards balance-sheet structures similar to supposedly more liberal political economies and to financial intermediation through multiple channels, we can come at the issue from a different angle through an analysis of changes in Germany's banking institutions, particularly public sector banks.

### 4.1 Banks, or financial services providers?

The German banking system is characterized as having a multi-tiered banking system (Hackethal 2004). The first pillar consists of the large private banks, which includes Deutsche Bank, Commerzbank, Deutsche Postbank and HypoVereinsbank<sup>7</sup>, as well as smaller commercial banks and the branches of foreign banks. The first pillar operates across Germany and internationally. The second pillar consists of the public sector banks, the regional savings banks (Sparkassen) and the Landesbanken, the latter of which can be viewed as the head institutions of the former in their respective region. The mandate of the second pillar has been historically to foster regional development, with profit maximization being a cursory concern. But, as we will see below, this function has changed. The third pillar consists of the cooperative sector. This sector consists of a two-tiered framework as in the public sector, yet the head office is not broken-up by regions. The sector has two cooperative central banks (DZ Bank and WGZ Bank), which conducts wholesale activities for the sector and provides other supervisory roles. Cooperatives are the main competitors to the Sparkassen, particularly in small towns and rural areas. While banks in this sector have traditionally maintained a regional focus or a focus on certain customer groups, this characteristic has changed as the sector has become more consolidated. An additional pillar exists in the form of specialist banks, such as state-owned Kreditanstalt für Wiederaufbau (KfW), SME lender IKB Deutsche Industriebank and real estate banks.

A primary reason Germany is often considered to be a bank-based financial system is due to the sheer number of banking institutions within Germany and the large proportion of banking assets to GDP. While Germany does possess a significant banking market, it is important to examine what we mean by bank. If a simple definition of a bank is a financial institution that accepts deposits and channels those deposits into lending, such a definition only captures a part of what banks do in Germany. Yet, it is this type of financial activity that is presupposed to distinguish the CME with a bank-based financial system vis-à-vis the LME with more market-based forms of financial intermediation. However, Germany's characteristic universal banking system does not lend itself to such a parsimonious status. As a universal banking system, banks in Germany historically have been able to offer a broad range of financial services to their clients, such as deposit taking, consumer and commercial lending, securities underwriting and trading, and investment management (Grunson and Schneider 1995).

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<sup>7</sup>/. HypoVereinsbank is a subsidiary of Italy-based pan-European UniCredit Group. UniCredit acquired the bank in 2005. Cross-border M&A in the financial sector is another source of convergence, limiting the explanatory power of territorially defined financial systems following specific *national* logics.

As German banks – specifically the large private banks, the Landesbanken, the central banks of the cooperative sector and the specialist banks – are active in a variety of areas from market-based to lending-based financial intermediation, it is therefore difficult to simplify the German financial system into either a bank-based or a market-based system. This is particularly relevant given the data presented in the last section on corporate finance. Furthermore, as the activities of German banks have not been constrained as in other political economies, such as the United States before the repeal of the Glass-Steagall Act in 1999, the large public and private German banks have been able to realign easily their business focus away from simple lending operations at the same time as expanding their geographic scope, given new opportunities provided by economic and political globalization (Grunson and Schneider 1995).

While such internationalization is easily recognized in the for-profit private commercial banking sector, it is not sufficiently recognized that the public sector Landesbanken have been very internationally oriented for decades despite their regional mandates. If the ‘globalization’ of the private sector banks coincided with abandonment of the insider relations necessary to sustain the logic of the coordinated market economy, it is therefore more difficult to assume that other financial institutions within the German political economy are and will continue to conform to tradition and the supposed logic of the coordinated market economy, instead of measuring clients on their business prospects determined in comparison to other potential clients from within and without the German political economy. We can infer from changes in the public sector Landesbanken that such continued commitment to such logics is tenuous at best, and seems unlikely to rematerialize.

## 4.2 From regional development to global opportunity

As noted above, Landesbanken are state owned banks. Historically, Landesbanken were characterized by their public function and public law status, acting as development banks for their home region, for which they received statutory liability guarantees. They also fulfill a central banking role for the savings banks of their region, mediating their broader capital market needs. This public mandate meant, in theory, that development of the regional economy superseded any profit maximizing objectives. Yet in practice, Landesbanken have not been *stricto sensu* institutions solely in pursuit of the public good. Landesbanken provide universal banking services to domestic and international customers, governments, corporations and individuals; they are both commercial and investment banks. Moreover, their activities have not remained confined to the home region. Branches of Landesbanken in major financial centers such as New York and London have existed for several decades, offering banking and capital market services to German subsidiaries as well as foreign companies. Landesbanken also have been engaged in derivatives-type activities such as interest-rate and currency swaps for decades (Grunson and Schneider 1995).

In the late 1990s European private banks began to challenge the system of state guarantees provided to Landesbanken by regional governments, which are known as *Anstaltslast* (deficiency guarantee) and *Gewährträgerhaftung* (maintenance guarantee), arguing that the guarantees provided for favorable long-term credit ratings for the public institutions. The private bank sector argued that this put them at a competitive disadvantage vis-à-vis the Landesbanken, which were competing in the same markets and operating, arguably, beyond the original intent of their regional mandates, thus contravening European competition law in respect of state aid. While the issue of privatization had surfaced from time to time, particularly as privatization of government-owned businesses more generally became popular across affluent democracies in the last few decades of the twentieth century, the principles of competition set forth by European Union legislation brought the issue to the fore (Grossman 2006).

In December 1999 the European Banking Federation filed a complaint with the Directorate General of Competition of the European Commission. Following an enquiry, on July 18, 2001 the Commission and the German

authorities reached an agreement to abolish Gewährträgerhaftung and to curtail Anstaltslast; liabilities made until that point would be grandfathered in and guaranteed until July 18, 2005, after which the guarantees would cease. In effect, by July 2005 the protective umbrella of state guarantees would no longer cover the Landesbanken, leveling the playing field among financial institutions and further eroding the distinctiveness of different categories of banks in Germany.

Such distinctiveness has been further eroded as several regional banks, specifically HSH Nordbank AG (which resulted from the merger between Hamburg LB and LB Schleswig-Holstein), Landesbank Berlin AG and WestLB AG (North Rhine-Westphalia), were converted into joint stock companies (Aktiengesellschaft) operating under private law. Ownership in some of these cases (Landesbank Berlin and West LB) is still completely held by Länder governments and other public entities, yet in the case of HSH Nordbank the change in legal status involved new outside capital. As of March 2010, US-based private equity firm J.C. Flowers owns 26.6 percent of HSH Nordbank. Whereas some Landesbanken were privatized, other Länder governments simply revised legislation removing the guarantees, while maintaining the public law status of the Landesbank.

Removal of guarantees naturally set forth a realignment of business operations in Landesbanken with the view of creating more independent banks, and in some cases more specialization. This was necessary, as the removal of guarantees would likely result in deteriorated credit ratings. This, in turn, would raise the cost of capital for the Landesbanken on their debt securities, which on average comprised about 30 percent of their balance sheets, thus decreasing their profit margins on loan activity (Brunner *et al.* 2004). From a strategic perspective Landesbanken had to follow a more market-oriented approach, which suggests a potentially greater impetus for profit generation. As a result, some Landesbanken began to expand operations and to diversify income streams, particularly into structured finance. Yet given that Landesbanken had been already increasingly active in multiple business areas such as derivatives, both domestically and internationally, it is difficult to make a causal claim that the changed legal environment resulted in a major paradigmatic shift in the sector's practices and strategies anymore than was already underway. Momentum for expansion and business realignment across the financial sector had already taken hold in the 1990s, as the aforementioned reforms discussed in section three suggest. Like German industry, German financial institutions, public and private, would not eschew the opportunities provided by economic and political globalization. For instance, many Landesbanken had securitization operations with special-purpose conduits before the removal of guarantees; they were riding the global securitization boom just like everyone else. HSH Nordbank LB, for example, set up its Asset Backed Finance Group in 2000 in New York, which conducts its business through a special-purpose vehicle Hannover Funding.<sup>8</sup> For some Landesbanken, however, the move into securitization proved fatal if not very painful.

### 4.3 The crisis and its consequences

The recent financial crisis significantly affected the German financial services industry, particularly public sector institutions. As a result, the German government created a EUR 480 billion fund, the *Sonderfonds Finanzmarktstabilisierung*. Although the ultimate consequences of the financial crisis remain to be seen, the crisis has revealed further the significant underlying changes that have been occurring in the practices and geographic scope of German banks as noted above. While some may think the crisis will involve a return to past practice and traditions typical of a stylized CME bank-based financial system, the transnationalization and internationalization of German financial services is too engrained and likely to remain significant. A brief examination of the failures of Sachsen LB and IKB Deutsche Industriebank, the two initial German casualties

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<sup>8</sup>/. See [www.hsh-nordbank.com](http://www.hsh-nordbank.com); accessed March 2010.

of the subprime crisis, is apposite for highlighting such change in the face of the crisis and the emerging consequences.

Sachsen LB, the Landesbank of the Free State of Saxony founded in 1992 as a result of the unification of East and West Germany<sup>9</sup>, was one of the first casualties of the 2007 subprime crisis. Like other Landesbanken, Sachsen LB's guarantees were eliminated in 2001, becoming effective in 2005. A realignment of the business ensued. In 2003 and 2004 the bank set up two special purpose investment conduits, Georges Quay and Ormond Quay respectively, through its wholly-owned subsidiary Sachsen LB Europe plc located in Dublin, Ireland, which had a relatively lax regulatory environment. These off balance sheet investment vehicles borrowed in the short-term commercial paper market and invested in longer-term structured credit instruments, the latter of which had significant exposure to US subprime mortgages, which at the time were highly rated. At the end of 2003 the volume of funds in the conduits stood at circa EUR 4 billion. By June 30, 2007, there was circa EUR 26 billion invested. The Dublin operations easily became the most profitable business of Sachsen LB, with a return on equity exceeding 30 percent by 2005.<sup>10</sup> Not surprisingly another fund was started, Sachsen Funding, in the spring of 2007 just as crisis tremors emerged.<sup>11</sup>

This run in high finance quickly came to an end, as the asset-backed securities market began to tumble in the spring of 2007. By August 2007 Sachsen LB's conduits were unable to cover their liabilities in the short-term paper market. A banking pool of other Landesbanken and the Sparkassen-Finanzgruppe, the German association of savings banks, provided EUR 17.1 billion to the Ormond Quay conduit to cover its liabilities. As further investment losses eroded Sachsen LB's equity capital to below regulatory standards, the bank's owner, the Free State of Saxony and the Sachsen Finanzgruppe (a state-owned holding company) had to find a suitable solution for the bank. On 26 August 2007 the owners concluded an agreement to sell Sachsen LB to Landesbank Baden-Württemberg (LBBW), but not before the regional parliament had changed the legal status of the bank into a joint stock company.<sup>12</sup>

As a result of the sale, Sachsen LB was reorganized and renamed Sachsen Bank. The new bank's operations were brought back from the global level and reoriented as LBBW's regional presence for central Germany and adjacent Eastern European regions, particularly Poland and the Czech Republic, responsible for high net-worth customers and SMEs. The global ambitions of Sachsen LB may have been tamed by the crisis, suggesting a reassertion of regional circuits of capital, but its new owner is a globally operative universal bank active in multiple lines of business, from corporate financing and asset management, to private equity and structured finance. No fundamental structural change has emerged. While LBBW may have strong German roots and a professed commitment to German firms, it has become a global bank competing across different political economies in the pursuit of profit and market share.<sup>13</sup> In effect, given this broad geographical and operational scope, it is difficult to place the bank within a particular national institutional sphere. Moreover, it is problematical to assume that the bank can maintain significantly divergent practices and expectations of operational performance across geographies.

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<sup>9</sup>/. Sachsen was the only former GDR Länder to establish a new Landesbank; other GDR Länder delegated tasks to existing Landesbanken in West Germany.

<sup>10</sup>/. Annual Report Sachsen LB 2005

<sup>11</sup>/. Annual Report Sachsen LB 2007

<sup>12</sup>/. Gesetz zur Umwandlung der Landesbank Sachsen Girozentrale in eine Aktiengesellschaft of 4 July 2007. Available at [www.recht.sachsen.de](http://www.recht.sachsen.de)

<sup>13</sup>/. Annual Report LBBW 2008

While not a Landesbank, IKB Deutsche Industriebank has fulfilled an important development role for German SMEs, providing loans to more than 20,000 firms with annual sales of EUR 7.5 million to EUR 1 billion, maintaining a market-leading share of just over 12 percent in the long-term lending to SMEs. The Düsseldorf-based bank was founded in 1974 with the merger of *Bank für deutsche Industrieobligationen* (1924) and *Deutsche Industriebank*. Prior to the crisis the bank had total assets of EUR 52 billion, a return on equity of 20.6 percent, strong long-term ratings (Moody's Aa3), and a market capitalization of EUR 2.63 billion. Ownership spread was among KfW Bankengruppe (38%), Stiftung Industrieforschung (12%), and institutional and private shareholders (50%). While not exclusively a state-owned institution, the controlling shareholding of the state-owned KfW blurred the distinction between public and private.

Beginning in the mid 1990s, IKB embarked on a strategy of securitizing loan risks and diversifying its portfolio via investments in international loan portfolios. By the end of 2006 IKB had securitized EUR 17 billion in 8 CLO (collateralized loan obligations) transactions. Direct investments of EUR 6.9 billion in international loan portfolios, and EUR 12 billion in investments via conduits (Rhineland and Rhinebridge). Approximately 75% of these investments had AAA or AA ratings. Such operations, which freed up capital, allowed IKB to significantly improve profitability and return on equity; the latter increased from 15% in 2001 to just over 20% by 2006. Tier 1 capital ratio remained around 7.0%, despite growth in loan volume.<sup>14</sup> It has been suggested that by moving into these more profitable areas IKB could keep ailing small businesses afloat.<sup>15</sup>

In July 2007, as the US subprime mortgage market began to sour, IKB's investment conduits (Rhineland and Rhinebridge), like those of Sachsen LB, could no longer meet their asset-backed commercial paper refinancing commitments. Although these conduits were off-balance sheet, IKB had committed credit facilities, thus exposing IKB to the subprime risk. IKB's direct portfolio investments were also in trouble – write-downs would eventually exceed 15 billion dollars. As IKB itself could no longer obtain sufficient sources of liquidity on the capital markets, a roughly EUR 10 billion rescue was launched by KfW in conjunction with BaFin, the Bundesbank and three associations of the German banking industry (BdB, BVR and DSGV)<sup>16</sup> – KfW's ownership stake increased to 90.8% by August 2008. On August 21, 2008, KfW agreed to sell all its shares to Dallas Texas-based private equity firm Lone Star, as KfW would not have been able to retain ownership under European regulations concerning state aid.<sup>17</sup>

The sale of a significant mid-sized German bank focused on the *Mittelstand* has clear implications, which need little exposition, for the continuance of the so-called coordinated market economy. Ultimately, the sale to a US-based private equity specialized in buying distressed assets is further verification that the German political economy and its financial system forms part of a much larger economic and financial sphere that cuts across institutional domains. That particular institutional practices and modes of coordination can be maintained seems uncertain.

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<sup>14</sup>/. Annual Report 2006/2007 IKB Deutsche Bank (28 June 2007 version)

<sup>15</sup>/. See Beat Balzli and Wolfgang Reuter, 'Small Businesses Worried Will Lone Star Stampede Germany's IKB?' *Spiegel Online International*, 2 September 2008.

<sup>16</sup>/. Annual Report IKB Deutsche Industriebank 2007/2008

<sup>17</sup>/. Annual Report IKB Deutsche Industriebank 2008/2009

## 5 Implications and Conclusions

This paper provides an empirical challenge to the theoretical notion of territorially defined models of capitalism, particularly as political and economic globalization changes the opportunities for firms and financial institutions. Analyzing the case of Germany, this paper demonstrates that German firms are adopting balance sheet structures similar to their US counterparts and are expanding their range of corporate financing away from German banks and traditional lending. Moreover, it does not appear that German firms are significantly more likely to attract and maintain long-term 'patient' capital, as compared to US firms. German firms appear to be appreciably different only if US firms and financial intermediation in the United States are overly essentialized as being oriented exclusively on the short term and operating at arm's length. However, as the data suggest, US firms of different sizes rely on relationship-based financing almost as much as their German counterparts do. If German firms are expanding their range of financing options beyond Germany and to different types of financial intermediaries, as the opportunities of European and global financial integration present themselves, it is difficult to maintain that strong institutional coherence between different national spheres of the so-called coordinated market economy exists and will necessarily persist.

While German firms are looking outward, so too are German financial institutions. The contention that German financial institutions across the sector are particularly committed to exclusively national or regional concerns over the pursuit of profitability does not stand up to empirical rigor. Germany's unique financial system has changed significantly, both from a legal standpoint but more importantly from the standpoint of financial practices and geographic scope. The financial crisis has only served to expose this outward expansion and change, which has been on the march for several decades along with global expansion of German firms. German financial institutions are in a competitive struggle with other financial institutions both within Germany and without. That a significant number of these institutions can or are willing to abide by the 'rules of the game' of the coordinated market need not be presumed. Just as they themselves are under competitive constraints and are judged by balance sheet criteria and potential profitability, it seems improbable that they will employ alternative forms of judgment for local firms and their financial prospects – at least over the long term.

Although this paper has argued that the German political economy has undergone important changes – just as others have made the case (e.g. Clark and Wójcik 2007; Hassel 1999; Streeck 2009) – we should be careful in calling the end of a unique German model. Indeed, while some institutional domains appear to be converging toward global trends, often along regional lines, much of this convergence remains contingent. Indeed, while this paper shows convergence, such convergence is nevertheless incomplete. This suggests that local factors continue to constrain forces of convergence, suggesting the development of hybrid characteristics. This implies that great care needs to be taken when evaluating the German model.

Ultimately, however, understanding contemporary capitalism in general and the world of finance in particular requires modes of analysis and theorizing that do not necessarily overemphasize the national level at the expense of other scales. While diversity will always exist in capitalism, as capitalist development is inherently uneven, it is important not to overvalue such diversity at the expense of understanding similarity and homogeneity, or to assume that change is always path dependent. Too often scholars are concerned with difference so much so that what is the same, which is ultimately what may matter the most for understanding political economy and economic geography, is ignored. This reticence to see the bigger picture may be arguably a function of nostalgia for past political-economic forms and a preference for denying the scope and extent of contemporary political and economic globalization. Capitalism may be variegated, but it is capitalism nonetheless. As global opportunities abound for firms and financial institutions, getting back to capitalism in the singular will naturally return to the scholarly lexicon.

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