ACTING OUT INSTITUTIONAL CHANGE:

UNDERSTANDING THE RECENT TRANSFORMATION OF THE FRENCH FINANCIAL SYSTEM

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ABSTRACT

I analyse the causes and implications of the increasing role of financial markets in French capitalism based on an analysis of the actors that issued securities on the country's financial markets. I show that the government's role as an issuer, and the deficits that drove its need for external funds largely accounts for the development of these markets in the 1980s and early 1990s. In contrast, their dramatic growth from the late 1990s was largely attributable to the pursuit by French enterprises of external growth, especially cross-border mergers and acquisitions.

Keywords: institutional change; actor-centred; financial systems; varieties of capitalism

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In this article I analyse the causes and implications of the recent transformation of the French financial system with particular attention to the growth in the importance of the country's financial markets. I show that the regulatory reforms that took place in the 1980s did not automatically prompt this transformation. The behaviour of actors, especially firms, also needed to change and an analysis of their characteristics and strategies helps us to understand when and why this occurred.

Initially, leading French enterprises responded to regulatory reform by reducing their dependence on external funds. As a result, they did not take advantage of the new options for external financing that financial liberalization created in France. For most of the 1980s and the early 1990s it was the French government, rather than private enterprises, that drove the expansion of the financial markets. Its privatization programme was an important fillip to the expansion of the stock market, with the proceeds from privatisations largely earmarked for government coffers. The state was also the main issuer on the country's bond and commercial paper markets as it struggled to generate enough funds to finance ever-increasing deficits.

These patterns changed dramatically in the late 1990s when the pursuit by French enterprises of aggressive strategies of external growth, especially across borders, induced them to rely heavily on the financial markets for funding. Therefore, the participation by French companies in the globalization of product markets, and the process of consolidation that resulted, is a central part of the explanation for the growth of financial markets. The transmission mechanism for the impact of this type of globalization on the French financial system was managerial behaviour, notably the strategies for external growth that corporate managers designed and implemented. This explanation can be contrasted with the standard account of the role of globalization in prompting change in financial systems that focuses on the global integration of financial markets as the crucial development and locates the transmission mechanism in portfolio investors' financial strategies.

My analysis also sheds light on the implications of changes in the financial system for the French corporate economy. For some commentators, the developments that have taken place in the French financial system imply that French corporations are now subject to the dictates and demands of financial markets and the portfolio investors that constitute them. I argue that this claim is hard to sustain as a general proposition.

I identify financial and ownership conditions that are likely to precipitate a contest between insiders and outsiders for control of particular French corporations. While these conditions characterize certain companies, they are not typical of French corporations in general. I also show that, even when there has been a successful contestation of insider control, outsiders have not necessarily won these battles. In a number of important cases, the cohesion of the French elite has operated as an effective obstacle to outsiders' gaining control of French corporations. Today, the future of French capitalism largely depends on the willingness and capacity of the French elite to resist the pressures of financial markets on French companies.

In Section 1, I discuss the role of financial systems in comparative institutional analysis and highlight the growing emphasis on institutional change and the role of actors in mediating the relationship between institutions and behaviour. In Section 2 I analyse the changes that have taken place in the French financial system. I also identify the standard explanations of these changes and their implications as well as their limits for explaining what actually happened in France. In Section 3, I present an actor-centred analysis of financial change that focuses on the issuers that used the financial markets and analyse their reasons for doing so. In Sections 4 and 5 I use the evidence from this analysis as the basis for discussing the micro-foundations of institutional and for re-evaluationg the causes and the implications of that process. I conclude briefly in Section 6.

1. Financial Systems in Comparative Institutional Analysis

The academic literature on comparative institutions of capitalism has experienced a marked expansion in recent years with contributions from scholars working in various disciplines including political science, sociology, economics and history. Contemporary discussions of capitalist institutions have been largely preoccupied with variety and similarity in the institutions that influence economic activity in different countries and the implications of institutional patterns for economic and social outcomes. The concept of an "institution" is used in somewhat different ways by contributors to this literature, reflecting their diverse disciplinary origins. However, the following definition seems sufficiently expansive to capture what most scholars mean when they speak of institutions: "the laws, informal rules, and conventions that give a durable structure to social interactions among the members of a population" (Bowles, 2004, pp. 47-8).

Scholars who have contributed to this research stream have studied the characteristics and influence of a wide range of institutions. The institutionalized role of financial capital in economic activity features prominently in many of these analyses. This is hardly surprising given the importance of the financial system in capitalist economies; indeed, for some people, it defines the *differentia specifica* of capitalism.

When scholars talk about institutions in the context of financial systems, they tend to speak of banks and financial markets as institutions. What they are interested in, however, is not whether a country has a banking sector or a stock market, since most countries do, but whether banks and financial markets are engaged in important and durable interactions with economic actors; that is, whether they are an important aspect of institutionalized behaviour in the economy. Therefore, the role of financial systems is usually understood based on an analysis of structural characteristics that are intended to capture the most important interactions between the financial system and the rest of the economy.

Distinctions among financial systems based on institutionalized patterns of corporate finance and ownership are particularly common. With respect to the funding of corporate activity, it has become standard to draw lines between market-based, bank-based and government-based financial systems (Zysman, 1983, p. 55; Berglöf, 1990; Allen and Gale, 2000). As far as the ownership of corporate stock is concerned, the most common comparison is between dispersed and concentrated corporate ownership. Within the category of concentrated ownership further distinctions are often made based on the identity of large owners and specifically whether they are banks, families or governments (LaPorta, Lopez-de-Silanes, Shleifer, 1999; Becht and Mayer, 2001; Faccio and Lang, 2002).

Distinctions among financial systems have been used as elements in broader typologies of systems of capitalism that include institutions such as industrial relations and legal systems that are intended to capture the most important differences and similarities in the institutions of capitalism as well as the complementarities among them that make them cohere into systems of capitalism (Hall and Soskice, 2001; Lopez-de-Silanes, La Porta and Shleifer, 1998; Roe, 2003). These typologies have proven useful for addressing a variety of questions about the political economy of capitalism but, as their prevalence has increased, they have also drawn criticism. One concern that is commonly expressed is that the reliance on typologies for understanding capitalism has downplayed the importance of, and possibility even obscured, the process of change in capitalist economies. A second concern relates to the assumptions that underpin typologies of capitalism about the relationship between the characteristics of different institutions and economic behaviour.

1.1 Change in the Institutions of Capitalism

The project of constructing typologies as a basis for comparing financial systems, and capitalisms more generally, has led to an emphasis on the institutional characteristics of these systems when they are stable as well as the mechanisms that reproduce these institutional patterns over time. Until recently, institutional change has received much less attention in the literature and, when it was recognized, its significance for altering the systemic logic of institutions was often denied.

The structural approaches that dominate the analysis of financial and other institutions are certainly capable of *recognising* change over time. By comparing the structural characteristics of institutions at different times, such an approach can be used to identify similarity and difference over time just as it can across country. While, in principle at least, this “comparative static” approach allows us to pinpoint the extent to which change in institutions has occurred, it is less useful for *explaining* change; specifically, it tells us little about the causes and effects of that change. Given the traditional emphasis on the stability and coherence of institutions in the literature, it is particularly difficult to understand how the origins of change might be located in an extant system of capitalism. As a result, when institutional scholars contemplate the possibility of substantial institutional change, they have tended to characterize it as a response to exogenous shocks (Thelen, 2003, p. 209).

There is no question that exogenous shocks have historically played a role in prompting institutional change in different countries. As far as financial institutions are concerned, some scholars understand the global integration of financial markets as such a force, and argue that it is putting pressure on countries to deregulate their financial systems. However, this perspective is contested by scholars who have adduced evidence which suggests that, when financial deregulation and liberalization occur, the momentum for the change comes, to a substantial degree, from within the country undertaking the reforms (for a discussion, see Reiter, 2003).

Recently, the topic of institutional change has attracted a great deal of attention from institutionalists of various stripes. Much of their effort has been devoted to conceptualising the process of institutional change. So far, detailed analyses of how that process occurs are rather thin on the ground and the studies that have appeared focus primarily on changes in labour and welfare institutions. As yet, our knowledge of recent changes in financial institutions is limited despite the fact that they have undergone some of the most dramatic developments that have occurred in the institutional foundations of the global economy (for some exceptions, see Deeg, 2005; Reiter, 2003).

1.2 Institutions and Behaviour

During times of institutional change, it is difficult to know what will happen to behaviour. As a result, as they tried to explain the causes and implications of change, scholars began to pay greater attention to the way in which actors behaved. In doing so, they drew attention to another neglected area in the analysis of comparative institutions: the importance of the characteristics and strategies of actors in mediating the relationship between institutions and behaviour.

There are legitimate concerns about the robustness of the relationships that are posited between institutions and behaviour, in short, about the micro-foundations of institutional analysis. If we focus on typologies of financial systems, it is fair to say that they are analytically useful only insofar as they predict the essential features of capitalist economic activity. However, there is good reason to question the empirical robustness of some of the relationships that are posited to exist between financial institutions and corporate behaviour.

For some time, for example, there has been a debate about the relationship between characteristics of national financial systems and patterns of corporate finance. It was stimulated by the findings from a set of comparative studies that suggested that the standard typologies of financial systems were not reflected in patterns of corporate finance. As Mayer put it, these findings showed: "the insignificance of stock markets as sources of finance for industry, including countries such as the UK and US with large well developed stock markets (Mayer, 1988)." Moreover, as far as bank finance was concerned, these studies suggested that companies in Germany were no more reliant on bank finance than their British counterparts despite the fact that the former inhabited a bank-based financial system while the others operated in a market-based one (Mayer, 1988; Edwards and Fischer, 1994).

Although these findings were initially regarded as counter-intuitive, they soon became part of the conventional wisdom when they were replicated in other studies. For a time, they lived in an uneasy relationship with traditional characterizations of financial systems as market- or bank-based which were still widely used by institutionalists. More recently, there has been some tendency to move away from typologies of financial systems based on patterns of financing and to focus on comparative patterns in ownership structure for making distinctions among financial systems (Becht and Mayer, 2001).

However, recent empirical research has generated findings that help to explain the apparent contradiction between conventional classifications of financial systems and comparative studies of corporate finance. The heterogeneity of firms is the key issue. Specifically, the data which are the basis for these comparative studies measure net flows of funds between the financial system and the corporate sector and obscure the financing behaviour of companies raising funds by subtracting the retirements of stock and debt by companies with surplus funds. Recent studies which measure gross flows of funds provide evidence which is closer to the traditional designations of financial systems (Hackethal and Schmidt, 2000).

On the one hand, these findings go some way towards restoring the merits of distinctions among financial systems based on patterns of corporate finance. However, in highlighting the heterogeneity in the financing behaviour of enterprises that are subject to similar institutional possibilities and constraints, they raise new challenges for institutional analysis. It is no longer plausible to analyse the role of financial institutions in capitalist economies by looking only at the structural characteristics of these institutions. The conditions that lead some firms to rely on financial institutions for external funds, while other firms do not, must also be considered if the relationship between institutions and behaviour is to be understood.

What types of conditions might be important in this regard? In the literature on corporate finance, several characteristics of enterprises have been emphasized as important for determining their reliance on the financial system for external finance. The scale of internal resources that firms have at their disposal is likely to be an important factor. Firms also display differences in their demand for finance as a result of the strategies that they pursue. At a minimum, therefore, there is a need to understand what it is about firms that makes them more or less likely to turn to the financial system for funds.

To understand the relationship between institutions and behaviour, therefore, there is a need to take the characteristics and strategies of firms seriously in the analysis of institutions. This observation echoes a more general concern in institutional analysis that has led scholars to call for an increased emphasis on the role of actors in the analysis of institutions, that is, an "actor-centred" approach to the study of institutions (Scharpf, 1997; for an early focus on these issues, see North, 1990). Some scholars have emphasized the particular importance of firms as actors in these analyses (Hall and Soskice, 2001, p. 6; see also Aguilera and Jackson, 2003; Chandler, 1990; Guillen, 2001; Kogut, 1991; Lazonick, 1991; Murmann, 2003; Whitley, 1992; 1999) and firms seem especially important for understanding financial institutions given that our characterizations of these institutions are so heavily influenced by patterns of corporate finance and ownership.[1]

2. What Happened to France's Financial System?

Given the relatively early stage of theorizing on both institutional change and the relationship between institutions and behaviour, it is difficult to define clear theoretical alternatives that readily lend themselves to empirical testing. Therefore, at this stage, empirical research seems more useful for confirming the importance of certain theoretical directions and

[1] The importance of an increased attention to the complexity of firms and other actors is also apparent when it comes to studying the relationship between ownership structures and corporate behaviour. I will not explore this issue here but see Fligstein, 1990; Fligstein and Brantley, 1992; Freeland, 2001.

generating new ideas for further theoretical development. In this context, case studies are a particularly appropriate empirical methodology to employ (for a discussion of the possibilities of case-study analysis, see Rueschemeyer, 2003).

In this paper, I present a case study of the transformation of the French financial system over the last 25 years from a government-dominated system to one in which financial markets have grown to unprecedented proportions. The expansion in the French financial markets is especially notable given their small scale in the postwar period. In this regard, the development echoes what has happened in other parts of Europe. Therefore, focussing on the case of France should shed light on important questions about what Rajan and Zingales describe as the causes and implications of "the changing character of European finance" (Rajan and Zingales, 2003)."

The French financial system has changed in terms of patterns of both corporate ownership and financing. As far as ownership is concerned, the highlights of change are the decline in state ownership, the establishment of cross-shareholding networks in newly-privatised firms, their unwinding from the late 1990s and, finally, the incursion of foreign shareholders. These trends have already been well documented in the literature (Morin, 2000; Bloch and Kremp, 2001; Faccio and Lang, 2002).

In the discussion that follows, I focus on changes in the role of the French financial system in supplying funds to the economy. I begin by comparing the structural characteristics of the French financial system in the 1970s and 2001 to identify what has changed as well as the extent of change. I then discuss the standard explanations that scholars have provided for the causes and implications of these developments. Although they provide important insights into what has occurred, I raise concerns about their capacity to fully account for what has happened to the French financial system.

2.1 Characterising Institutional Change in French Finance

In the literature on comparative institutions of capitalism, the French financial system of the 1970s was regarded as highly distinctive (see, for example, Zysman, 1983).[2] In particular, the extensive involvement of the French state in the financing of economic activity is typically regarded as one of the defining features of French post-war capitalism. The government's control over the allocation of credit by financial institutions was one of the most important tools that it used to influence the evolution of the French economy.

On the face of it, as Table 1 suggests, the French financial system came closest to its German and Japanese counterparts at the time in terms of the economic importance of banks. However, and in contrast to Germany and Japan, the government dominated the allocation of bank credit in France through the framework or *encadrement* system that controlled the direction of credit allocation. It placed restrictions on the overall expansion of credit in the economy, thus limiting the lending autonomy of the banks. In cases where the government wanted to encourage particular activities it did so by making an exception to these credit restrictions for the relevant borrowers. In the early 1970s, unrestricted credit, monies allocated without government involvement, amounted to less than 20 per cent of total credit allocation. The state also established a number of public and semi-public agencies that could make subsidized loans to specific sectors and businesses to meet what were seen as their special needs; in the 1970s these agencies lent funds that amounted to approximately 60 per cent of the medium and long-term funds allocated by the banking sector to French firms (Loriaux, 1991, p. 49).

Table 1 Comparative Data on Financial Systems for Selected Countries

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[2] In his influential work on financial systems, John Zysman characterised the French system as an exemplar of a government-based financial system which he contrasted with the market-based systems of the US and the UK and Germany's bank-based system (Zysman, 1983).

In contrast to the scale of government lending, both through and beyond the banking system, France's financial markets were tiny in the mid-1970s. As Table 1 shows, the value of stocks and bonds as a share of gross domestic product was 27 per cent in 1975. That was much lower than the comparable figures of 102 per cent for the US and 84 per cent for Great Britain but France also ranked behind other major European economies in this regard.

The characteristics of the French financial system at the time were reflected in the patterns of financing by French corporate enterprises. These companies were major users of external funds and they depended heavily on debt finance -- supplied to them through the banking system as well as directly by the government -- for these monies. Among their counterparts in other advanced industrial countries, only Japanese enterprises came close to the French in terms of their reliance on bank debt for funding (Bertero, 1994).

By the late 20th century, the role of the French financial system in financing economic activity had been transformed along several crucial dimensions. First, there was a drastic contraction in the role of the state from a position of dominance over the allocation of funds to one of modest importance (Loriaux, 1991; Plihon, 1995). Second, the role of financial markets in the funding of economic activity experienced a marked expansion. As Table 1 shows, the French financial markets grew from 27 per cent of GDP in 1975 to 134 per cent by 2001. The expansion of the French stock market was especially dramatic; by the end of 2001 its market capitalisation was 79 per cent of GDP, up from a mere 11 per cent in 1975. The country's bond market also expanded over the period with its capitalisation growing from 16 per cent to 55 per cent of GDP. Although these changes began in the early 1980s, the growth in the importance of financial markets in France was neither steady nor smooth. By 1995, for example, stock market capitalisation was still quite small at only 33 per cent of GDP and a spurt of dramatic growth was required to bring it to its 2001 level.

Finally, the importance of the banking sector, relative to other sources of external funds, has declined. The intermediation ratio measures the importance of loans from French financial intermediaries in the total amount of financing obtained by non-financial agents in the French economy. It declined from 71 per cent in 1978 to 42 per cent in 2000. This trend represents a relative rather an absolute disintermediation. The overall volume of external funds raised by French companies increased relative to their economic activity. While markets have soaked up most of this expansion in corporations' use of external funds, banks have also participated in it to some degree. As a result, as Table 1 shows, the banking system's importance relative to the scale of economic activity has actually increased over the last twenty years underlining its continued importance for funding French economic activity.

The developments that have taken place in the French financial system over the last quarter of a century are reflected in patterns of corporate finance. As Figure 1 shows, there was an initial sharp decline in the mid-1980s in the high levels of dependence by French non-financial companies[3] on external finance which were largely from intermediated sources at the time. The importance of external finance rose again in the late 1980s, with market sources taking on a somewhat expanded role relative to bank debt, but another decline ensued coming into the 1990s. The final and most important phase in the importance of external finance for French companies began in the mid-1990s and accelerated sharply from the late 1990s. It was characterized by the clear dominance of market sources of finance – issues of stock, bonds and commercial paper -- although bank finance also enjoyed an expansion during this phase (Banque de France, 2002a).

Figure 1 Sources of Finance for the French Non-Financial Enterprise Sector

[3] Financial enterprises issue securities as part of the management of their ongoing businesses so that including their financing activities in discussions of patterns of corporate finance confuses the analysis.

As was the case for institutional characteristics, so changes in corporate finance reveal that the growing importance of market sources of finance was a lumpy rather than a smooth process. Stock issues, for example, grew from a very low level of less than 1 per cent of the value added of non-financial enterprises in the late 1970s and early 1980s to between 1 and 2 per cent from 1985 to 1996. However, the really dramatic increase in their importance as a source of finance occurred from the mid-1990s when they rose to 5.5 per cent of value added in 1997, then to 8 per cent in 1999 and as high as 14.5 per cent in 2000 before declining to 6.7 per cent in 2001, still a relatively high level (Banque de France, 2002a).

2.2 The Causes of Change in the French Financial System

Several explanations of the changes that occurred in the French financial system focus on the determinants of the dramatic liberalisation or deregulation of the financial system that occurred in France from the early 1980s. The need for financial deregulation had been discussed in France through the 1970s and several policy changes in that direction were undertaken at that time. However, a systematic process of financial liberalisation began only in 1984. It was initiated by a Socialist government and sustained thereafter by French governments of various political stripes.[4]

There has been considerable academic debate about the causes of these regulatory reforms. Explanations of these changes in terms of exogenous factors, notably developments in international financial markets, are favoured by some scholars. The specifics of these arguments differ but the basic contention is that France's financial liberalisation was a policy response to the growing integration of global financial markets. The process began with the abandonment in the early 1970s of the fixed exchange rate regime that governed international monetary relations

[4] Among the most important changes that were introduced were the removal of the postwar division of labour in the financial system as banks, insurance companies, and other financial companies were permitted to compete directly with each other by the 1984 Banking Act; the removal of subsidized credits in 1984 and the subsequent elimination of quantitative credit restrictions; as well as the reform and reorganization of the French stock exchanges (for detailed discussions, see Loriaux, 1991; and Bertero, 1994).

since Bretton Woods and gained momentum in the 1980s and 1990s. For France, moreover, as for all eurozone countries, the move to a single currency and the tighter integration of monetary policy and financial markets is also emphasised as an additional exogenous source of pressure for financial deregulation (Loriaux, 1991).

Other scholars have focussed to a greater extent on pressures for reform that were endogenous to the French economy and, indeed, the French financial system itself. They have emphasised that the interventionism of the French State, whatever its accomplishments in the 1950s and 1960s, ran into structural limits in the 1970s. Since a crucial aspect of that interventionism was the State's central role in the allocation of financial resources in the French economy, it was here that the pressure was felt most strongly. In particular, inflationary pressures built up as the banking system made more and more money available to the economy on terms that did not reflect its real economic cost (Hayward, 1986; Hall, 1986; Schmidt, 1996).

It is hard to imagine that one could tell the story of change in French's financial system without according a prominent role to these profound regulatory changes. However, a simple story that predicts institutional change from the transformation of the formal rules and regulations that governed the French financial system does not adequately account for the timing of the changes that took place in French financial institutions. Most of the expansion that has taken place in the financial markets was highly concentrated in the late 1990s and early 2000s. There were no major changes in the formal regulations that governed the French financial markets that could explain this concentrated expansion or the fact that it did not occur earlier.

In seeking better explanations, some scholars have focussed on global flows of one type of capital, portfolio capital, and emphasised the growing importance and influence of foreign institutional investors in France in the 1990s. Foreign ownership of French companies grew from 10 per cent of listed shares in 1985 to 25 per cent in 1994, largely as a result of the privatization process. It increased to 30 per cent by 1997, then jumped to nearly 35 per cent by 1999, to 40 per cent by 2000 and then to 42 per cent by 2002 (Banque de France, 2004). Foreign participation in the shareholding structures of the largest, listed French companies tended to be even higher than the average (Morin, 2000).

Michel Goyer emphasizes the growing influence of foreign investors, "composed primarily of Anglo-American mutual and pension funds" on the behaviour of French enterprises. He argues that "[o]n some critical indicators of corporate governance – related to the internal decision-making process and business strategy – French corporations have gone to great lengths to meet the preferences of Anglo-Saxon institutions investors (Goyer, 2001)." Of particular importance, he argues, is French companies' shift from conglomerate strategies to a focus on their core competences. In a similar vein, François Morin argues that France's leading companies are forced to obey the diktat of financial markets which makes the pursuit of "shareholder value" a necessity rather than a choice; they are, as he puts it: "subject to Anglo-Saxon management and return on capital norms (Morin, 2000)."

From this perspective, global financial markets penalize companies that do not conform to their demands. They also reward those that do comply by supplying them with capital at a relatively low cost. This argument therefore provides a possible explanation for the increased use of the financial markets by leading French enterprises in the late 1990s.

In this argument, the growing pressures for financial returns from institutional investors are seen as emanating from outside of the French economy.[5] However, this claim warrants further consideration when we consider how foreign investors managed to make such significant and rapid incursions into the shareholding structures of leading French companies. After all, until the mid-1990s, the French corporate economy was characterized by an extensive system of cross-shareholding that was designed to protect French enterprises from the unwanted attentions of foreign investors.

[5] In the US and UK economies, in contrast, these pressures have tended to come from within as domestic institutional investors have become powerful corporate shareholders on the strength of the large accumulations of pension assets that they manage. France does not have the large, homegrown accumulations of pension funds that could serve as an endogenous source of pressures for financial returns.

In fact, this system came undone in the late 1990s. The process was initiated in the wake of the merger, in early 1997, of Axa, the French insurance company, with its leading domestic competitor, UAP. The transaction created a veritable financial powerhouse with shareholding links to many of France's most important companies. Shortly after the merger, however, Claude Bébéar, the CEO of Axa who assumed the mantle of the newly-created company, announced that it would sell off its holdings in a number of important French corporations including Crédit National (12.4 percent), Schneider (7.1 percent), and Suez (6 percent). Only the holdings that Axa-UAP regarded as strategic to its core business, namely, BNP (12 percent) and Paribas (9.76 percent), were to be maintained. Shortly afterwards, other large French companies followed Axa's lead in unwinding their cross-shareholdings and, by the end of the 1990s, many of the ownership ties that had been put in place to protect French corporations from unwelcome scrutiny by outsiders had come undone (Morin, 1998).

This sequence of events has led some scholars to suggest a much greater emphasis on endogenous changes in interpreting the cause of recent developments in the French financial system. In a recent article, Pepper Culpepper (2005) attributes the transformation of French financial institutions to a mechanism called "joint belief shift" which is "the process by which actors use triggering events to coordinate their future expectations around the new rules of the games, that is, around new institutions (Culpepper, 2005, p. 176)." He interprets Bébéar's announcement as a triggering event that "sent a signal that a central member of the network no longer perceived a strategic value in holding shares of other companies in the hard-core network (Culpepper, 2005, p. 196)." This event prompted "a set of discussions among other managers in the hard-core networks about the effectiveness of cross-shareholdings (Culpepper, 2005, p. 195)" that led to a shift in their joint beliefs about the advantages of these mechanisms which ultimately induced a dismantling of cross-shareholding networks.

As Culpepper emphasizes, change came from the heart of the French enterprise sector not from its edges. As such, it seems more plausible to characterize that process as one that was generated by strong enterprises rather than forced on weak ones by external forces. As to why the Axa-UAO takeover proved to be the triggering event, Culpepper claims that "[w]hat caused UAP to shift its strategy was its takeover by Axa, not any shift in general material conditions" and he goes on to note that Axa was unusual among French companies in that Bébéar "had professed an unwillingness to engage in long-term strategic shareholding since at least 1993" (Culpepper, 2005, p. 195).

2.3 The Implications of Change in the French Financial System

There is debate among students of the French financial system not only about the causes of institutional change but also about the implications of that process. The idea that the French financial system in the early 21st century has undergone a systemic shift towards an outsider or market-oriented system is one that is often found in academic and popular discourse. Michel Goyer, for example, argues that "[t]he transformation of the French system of corporate governance is nothing short of impressive: in less than a decade, France shifted from an insider to an outsider model (Goyer, 2001)." Morin speaks of a revolution in French corporate governance: "[d]irectly inspired by the American 'shareholder value' model, the largest French groups are going through a managerial revolution (Morin, 2000)."

From this perspective, the control of state bureaucrats and corporate managers has been diluted and the dictates of financial markets, especially the demands of foreign institutional investors, now strongly influence the actions of French corporations. Therefore, it would seem, France has developed a financial system that is suitable to the ideal type of a liberal market economy. If this interpretation is correct, the question that naturally arises is whether the rest of French capitalism is in tune with this shift. Goyer, for example, raises serious concerns about the tensions inherent in what he sees as a mismatch between the country's newly transformed financial institutions and its long-standing social and political norms.

Vivien Schmidt, in contrast, rejects the notion that French capitalism has become systemically incoherent as a result of the transformation of its financial institutions. The title of a recent article, “French capitalism transformed, yet still a third variety of capitalism”, suggests the spirit of her argument: “[w]hile France’s state capitalism has been transformed through market-oriented reforms, it has become neither market capitalist nor managed capitalist. Rather it has moved from ‘state-led’ capitalism to a kind of ‘state-enhanced’ capitalism, in which the state plays an active albeit much reduced role (Schmidt, 2003, p. x).”

Disagreement between these authors turns not so much on what has happened in and to the financial system but on the role of the state. Goyer argues that “[t]he institutional apparatus that supported the dirigiste system has crumbled under both the pressures of globalization and the inability of state officials to credibly discipline poor performers (Goyer, 2003).” In contrast, Schmidt claims that “[i]n France, the state continues to intervene, albeit in a more limited, supply-side way, through laws and incentives intended not only to make the economy more competitive but also to ‘moralize’ business and labour relations (Schmidt, 2003, p. 547).”

3. An Actor-Centred Analysis of the Growth of French Financial Markets

In this section, I seek to shed more light on the causes and implications of change in the French financial system by focusing on the characteristics and strategies of the actors that turned to the country’s financial markets to raise funds. I analyse the companies that were the most important users of the French financial markets in terms of the volume of external funds that they raised and I study the purposes for which they used these funds. The most important finding of my analysis is that issues of stock and debt by French companies to finance acquisitions, especially foreign acquisitions, played a central role in the expansion of the French financial markets. Therefore, the timing of the most dramatic expansion of France’s financial markets coincides with the clustering of acquisitions by French companies from the late 1990s through 2001.

My analysis also focuses attention on actors other than firms that were important to the development of the financial markets. In particular, share issues undertaken in association with the French government's privatization programme were crucial to the development of the country's stock market. The government played an even more important role in the development of the bond market, dominating the market for issues until the mid-1990s and using the proceeds to fund its growing financial needs. Therefore, the evolution of government deficits was also important to the timing of the development of the country's financial markets.

3.1 The Self-Financing Capacity of French Enterprises

In seeking to explain the patterns in French enterprises' dependence on the financial system for funds that I described in Section x above, a good place to start is with a long-standing and widely-accepted proposition in corporate finance: that firms seek external funds only when they have exhausted their internal resources (Myers and Majluf, 1984). It suggests that firms' financing deficits and surpluses – the shortfall or excess of their internal funds or retentions with respect to their investments – will be the key determinant of their financial dependence or autonomy.

In Figure 2, I show the financing deficits generated by French non-financial enterprises from the late 1970s until the end of the 20th century. During the period from 1978 to 1985, these companies ran extremely large financing deficits of more than 30 per cent of their value added. High rates of fixed investment, at least until the early 1980s, contributed to these deficits but their main determinants were the limited retentions or savings of French enterprises which were in turn largely a result of the low rates of profitability that they generated at this time.

Figure 2 Financing Deficits, Retentions and Investments for the French Non-Financial Enterprise Sector

The financial autonomy of French non-financial enterprises reached a nadir in the early 1980s as their financing deficits rose to more than 50 per cent of their value added. From then on, their deficits fell as their investment rates declined and as improvements in their profitability drove up retention rates. By 1986, French enterprises were in a much stronger financial position; their financing deficits were down to just over 10 per cent of value added and, as retention rates continued to rise, they dropped even lower to 4 per cent of value added by the end of the 1980s.

These high levels of financial autonomy were not sustained for long by French non-financial enterprises. They experienced a sharp reversal of profitability which brought their retention rates down. In parallel, they increased their investment rates and, as a result, their financing deficits rose to nearly 20 per cent of their value added by the early 1990s.

As the 1990s evolved, however, French enterprises cut back on their investment rates to such an extent that, despite a decline in their retention rates, they actually generated an overall, albeit small, financial surplus by 1998. At the end of the decade, investment rates rose again while retentions continued to fall. As a result, there was an increase in French companies' financing deficits to between 3 and 4 per cent of value added in 2000 and 2001.

These trends in French companies' financing deficits and surpluses do not readily predict the patterns in their dependence on external finance that I have described above and that are shown in Figure 1. They suggest that French companies ought to have been most heavily reliant on external sources of funds during the period from 1978 to 1985. The strengthening of their self-financing capacity from then on should have made them relatively autonomous of the financial system for funds from then on. Only for the short periods from 1989 to 1992, and again in 2000 and 2001, when deficits were relatively high, would one expect to observe high levels of external financing. Of particular importance is the fact that the trends in French companies' self-financing capacity does not explain their unprecedented and sustained reliance on external sources of funds from the late 1990s through 2001 (Banque de France, 2002a).

3.2 Who Used the French Financial Markets and For What Purposes?

There are a range of plausible reasons why the relationship between French companies' internal sources of funds and their capital expenditures do not predict their patterns of external finance. One possibility is that the surpluses of French companies which did not need external finance obscure the deficits of those which were dependent on it. It is also conceivable that companies which raised external funds allocated them to uses other than the funding of real investment. And there are several other possibilities too. The most direct and systematic way to identify what happened is to focus on the issuers that raised external finance, especially market sources of finance, since it is here that the most dramatic changes occurred.

As I show, many of the security issues that took place on France's financial markets were used for purposes that are not measured as part of real investment or gross fixed capital formation by non-financial enterprises. For example, acquisitions, since they involve transfers of ownership over existing assets rather than the formation of new assets, are not included in economy-wide measures of gross fixed capital formation. In addition, the proceeds from privatisation transactions were largely channeled to fund government needs and, therefore, had no direct impact on the investment programmes of the corporations whose shares were sold. It is because of the importance of these types of transactions that we do not find evidence of any strong relationship between financial deficits and surpluses and the volume of external financing on the financial markets.

Issuers on the French Stock Market

The total cash proceeds raised by French listed companies through public share issues on these three markets during the period from 1978 to 2001 are plotted in Figure 3.[6] Based on these

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[6] My data on public share offerings were compiled from the yearbooks issued for each year from 1975 to 2000 by the Societé des Bourses Françaises (SBF), better known under its commercial name, Paris Bourse^{SBF} SA, which was responsible for the organization and operation of all three markets. In September 22, 2000, the SBF merged with the Amsterdam and Brussels Exchanges to form Euronext, a European

data, the French stock market reached an important turning point in 1985 with all subsequent years registering higher levels of public share issues than had been seen until then. However, the annual figures are volatile; only from 1996 to 2001 do we observe sustained high levels of stock issuance by listed companies, albeit rising from a low point in activity in the mid-1990s.

Figure 3 Proceeds from Public Share Offerings by French Listed Companies as a Percentage of GDP, 1978-2001

Public share offerings for cash by listed companies in France can be divided into a number of major types of issues: privatizations of state-owned companies; initial public offerings by privately-held companies; offerings by already-listed companies (seasoned offerings) of shares and share-like instruments (mostly convertible bonds); public sales of listed shares and a residual category described as "other" that includes shares issued as payment for dividends. In the discussion that follows, I focus on the three most important types of transactions in terms of the volume of financing -- privatizations, IPOs and issues of shares and convertible debt by already-listed companies -- to identify the most important issuers involved in the growing activity on the French stock market as well as the purposes of their issuance activity.

Privatisations

From the launch of France's privatisation programme in 1986, the sale of state-owned companies played an important role in driving the total proceeds from share issues on the stock market. As Figure 4 shows, the proceeds from privatization issues peaked in 1986 and 1987 as a percentage of GDP but, in total, more money was raised from these transactions in the 1990s than the 1980s. Overall, for the fifteen-year period from 1986 to

stock and derivatives market. Euronext operates three subsidiary holding companies in each of the three member countries but centralises certain functions.

2000, privatisations accounted for 18 per cent of the total proceeds of public share issues by French listed companies. They reached their highest level of importance in 1986 and 1987, when they represented nearly half of the total proceeds raised through public stock issues by domestic companies, as well as in 1993 and 1994 and from 1997 to 1999 when they represented more than 30 per cent of these proceeds.

Figure 4 Public Share Offerings related to, and excluding, Privatisations in France, 1978-2001

An analysis of the uses of the monies raised through the sale of enterprises by the State to the private sector makes it clear that the primary purpose of these privatization transactions was the shoring up of state finances. Of the €10.8 billion received from privatizations from 1986 to 1988, €7.0 billion (65 per cent) was used to pay off the State debt and €3.8 billion (35 per cent) was paid in subsidies to enterprises that remained in government ownership. Of the €16.6 billion raised from 1993 to 1995, €12.2 billion (74 per cent) was used to finance the current expenses of the State and €4.3 billion (26 per cent) was paid in subsidies to state-owned enterprises (Juvin, 1995). The receipts from privatizations conducted since 1996 were used primarily to finance equity loans, grants and contributions to public enterprises (Les Echos, February 11, 1999, p. 18).

In short, the vast majority of the money raised through privatization-related public share offerings in France was raised by and for the French government rather than for the enterprises that were privatised. Even when some money went to other enterprises, in the form of subsidies, it was directed to them by the government rather than the financial markets. As Hervé Juvin noted in his analysis of the financial repercussions of privatization in France:

> The most compelling reason for the privatisations was the State's budget deficit.
> In one way or another, every privatization resulted in a flow of capital from the

private sector into the coffers of the State. The primary motivation for the privatizations was financial -- the need to fund the current financial requirements of the government and to pay off the State debt -- rather than ideological (Juvin, 1995 translated from the original French by the author).

The money raised through the issue of corporate shares in privatization transactions flowed out of the enterprise sector to the government sector. As a result, the privatisation transactions left the liquidity positions of the corporations whose shares were sold largely unchanged. Therefore, we should not expect them to have had any direct impact on the investment behaviour of the privatized enterprises.

Stock Offerings other than Privatisations

As Figure 4 shows, at the beginning of the period the proceeds from stock offerings were very low at only 0.1 per cent of GDP in 1982. They were volatile for the decade or so that followed with alternating peaks and troughs in the scale of issuance activity. The deepest trough was recorded in 1995 when these stock issues collapsed to a mere 0.2 per cent of GDP. From then on, there was a steady rise in their importance to reach all-time highs for the period of 1.1 per cent of GDP in 1998, 1.2 per cent in 1999, 1.7 per cent in 2000 and 1.7 per cent in 2001. Stock offerings other than privatizations consist largely of seasoned offerings of stock and convertible debt and initial public offerings and these are discussed in greater detail below.

Seasoned Offerings of Shares and Convertible Debt

Until the mid-1980s, issues of shares and share-like instruments by already-listed companies dominated the limited capital-raising activity by French companies. They amounted to 95 per cent of all cash raised through share issues from 1976 to 1980 and 88 per cent from 1981 to 1985. As share issuance activity picked up their share declined to 62 per cent from 1986 to

1990 and about 40 per cent in the 1990s. Nevertheless, they still remained the most important category of public share issue in France.

In absolute terms, the proceeds from seasoned share offerings on the French stock market have increased substantially since the early 1980s but they have been very volatile. Only in the late 1990s was there a steady increase in the proceeds that they raised. Issues of convertible bonds also steadily increased from the mid-1990s albeit from the very low level that they attained in 1995. For the period from 1996 to 2001, French companies raised almost €60 billion from seasoned offerings of which €24 billion was raised through seasoned stock offerings and a further €36.2 billion through convertible debt issues. These totals compare with proceeds of €30.2 billion from IPOs over the same period and €19.5 billion from privatizations.

The vast majority of the proceeds of seasoned issues benefited large companies listed on the PM. Their seasoned offerings of stock and convertible debt amounted to more than 91 per cent of the proceeds of all such offerings from 1991 to 2000. In contrast, the SM accounted for about 6 per cent of the total and the NM for just over 2 per cent.[7]

An analysis of the uses of the proceeds of seasoned issues of shares and convertible debt shows that they served two major purposes: the reduction of debt and, especially in the late 1990s, the funding of acquisitions. Information on the stated uses of the proceeds of the largest fifteen seasoned issues of shares from 1991 to 2000 and the largest fifteen issues of convertible debt from 1993 to 2000 are shown in Table 2. These issues accounted for more than 50 per cent of all seasoned issues of stock and 48 per cent of all convertible issues for the periods in question. Particularly notable is the fact that acquisitions overwhelmingly dominated as an intended use of

[7] However, there are also important examples of companies of medium and small size that relied heavily on stock issues to fund their external growth. In this regard, the country's game software industry merits special mention. The industry was originally dominated by US and Japanese publishing companies which perform functions similar to music publishers in financing and marketing the development of games. However, in the 1990s, a number of medium-sized French companies, including Infogrames, Ubi Soft and Titus, propelled themselves into the top 20 global publishing companies in the industry based on aggressive strategies of external growth which they funded by issuing large quantities of stock and convertible debt (Larrue, Lazonick and O'Sullivan, 2003).

the proceeds of these issues from the mid-1990s on when seasoned issues reached particularly high levels. Moreover, to the extent that these issues in the second half of the 1990s were used to re-finance debt it tended to be acquisition-related debt.

Table 2 Largest Public Seasoned Share Offerings and Convertible Debt Offerings for Cash

These patterns beg the question of why French companies were raising cash to fund their acquisitions. In principle, companies can issue shares in exchange for the shares of other companies. In fact, French companies did this in the late 1990s as the extent of their merger and acquisition activity soared to unprecedented heights. However, the trend towards the use of shares as the preferred medium of exchange in acquisitions by French companies was stronger for domestic, than for foreign, transactions (based on an analysis of data from Acquisitions Monthly, Thomson Financial). These companies paid for many of their largest foreign acquisitions in cash, a fact that explains their appeal to the share or convertible debt markets to finance these purchases. The main reason for the lesser reliance on shares in foreign acquisitions seems to be the reluctance on the part of shareholders of foreign companies, and the inability of some US and British institutional investors, to accept shares of French companies as payment for M&A transactions.[8]

Initial Public Offerings

Although the initial public offering (IPO) is the capital-raising transaction most readily associated with the stock market, IPOs have never dominated the proceeds from French share

[8] Some French companies with listings on foreign exchanges, especially the US exchanges, were able to avoid this problem. Alcatel was perhaps the French company that made greatest use of its relative advantage in this regard to conclude share-for-share exchanges in acquisitions of North American companies (Carpenter, Lazonick and O'Sullivan, 2003).

issues. In the years prior to 1986, they accounted for at most 15 per cent of the total proceeds of public share issues. From 1986 to 1995 they were never higher than 5 per cent of overall proceeds and they usually amounted to less than that. From the mid-1990s, however, their relative importance increased and during the period from 1996 to 2000, they accounted for 15 per cent of the proceeds raised through public share offerings.

The growth in IPO activity from the middle of the 1990s was even more dramatic in absolute terms with the value of IPO proceeds reaching unprecedented levels in the last five years of the century. From 1996 to 2000, they amounted to an average annual total of €3.47 billion compared to an average of €385m for 1991 to 1995.[9] There was also a dramatic growth in the number of companies going public in the late 1990s. From 1996 to 2000, an average of 72 companies completed IPOs each year in France compared to an average of only 14 companies in the first half of the 1990s.[10]

When companies sell shares on the French stock market[11] they can issue them on any one of the country's three regulated stock markets: the Premier Marché (PM), the Second Marché (SM) and the Nouveau Marché (NM).[12] Most of the companies that went public in the late 1990s listed their shares on the SM and the NM, markets that the French stock exchange created in 1983 and 1996 respectively to facilitate listings by smaller, less-established companies. However, in terms of the amount of money raised in IPOs, large firms listing on the PM continued to dominate.

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[9] The comparable figures for 1986 to 1990, 1981 to 1985 and 1976 to 1980 were €378m, €208m and a mere €25m, respectively.
[10] The comparable figures for 1986 to 1990 and 1981 to 1985 were 40 and 20 respectively.
[11] French companies can also issue stock on foreign exchanges. Given my focus on the development of the French financial system, I do not deal with these issues herein.
[12] Companies quoted on the PM had to have a minimum market capitalisation of €750-800m and upon listing they were required to sell at least 25 per cent of their total equity to the public. Companies listing on the SM were required to have a minimum market capitalisation of only €12-15m and a public float of 10 per cent of their equity. Issuers on the NM could list if they had a minimum capital of €1.5 million and at least 20 per cent of that capital had to be held by the public on listing. Moreover, 100,000 shares of the capital, or shares with a total value of €4.5 million, had to be offered to the public when the company listed of which 50 per cent had to represent a capital increase.

For the entire period from 1974 to 2000 transactions on the PM accounted for 59 per cent of the total cash raised in IPOs compared with 27 per cent and 14 per cent for the SM and NM respectively. The dominance of the PM was actually greater in the late 1990s, the period of peak IPO activity, than earlier; IPOs on the PM accounted for 68 per cent of all IPO proceeds for the period from 1996 to 2000 compared with 14 per cent for the SM and 18 per cent for the NM.[13]

A list of all of the IPO transactions on the PM in which cash was raised[14] is provided in Table 3. Although they are few in number they account for 100 per cent of all cash raised in IPOs on the PM and 77 per cent of money raised in all IPOs on the French stock market (PM, SM, and NM) for the period from 1991 to 2000. An analysis of each of the transactions conducted during the 1990s shows that the raising of capital for the listing company was not the primary motivation for any of these transactions. In some cases, all of the proceeds of the IPO were paid, not to the company going public, but to the previous owners of the businesses. In other cases, such as Neopost and Business Objects, even when the listing company did raise capital for its own purposes, it represented only a minority of the proceeds of the public offering; once again the primary motivation for these IPOs was also to liquidate the stakes held by existing shareholders in the listing company.

Table 3 Domestic Initial Public Offerings (excluding privatisations) on the Premier Marché, 1991-2000

[13] If we analyse the relative importance of the three different markets in terms of the numbers of companies going public we get a different impression; for the entire period from 1974 to 2000, the PM accounted for only 7 per cent of the 758 French companies that went public during this time compared with 72 per cent for the SM and 21 per cent for the NM.

[14] The details above relate to new listings of private companies on the Premier Marché in which capital is raised. It should be noted that many companies that list for the first time on the PM do not raise capital. These companies can be split into two groups: those that have already been listed on the SM and transfer from that market to the PM and those formed from companies that were already listed on the PM.

There were signs of a change in the character of IPO activity in the year 2000. Even if some IPOs still served the purposes of liquidating shareholders, in most transactions that year a much higher proportion of the IPO proceeds went to the listing companies. However, closer inspection of the largest transaction that year, the IPO by Vivendi Environnement, shows that even these transactions could be designed to serve the financial needs of the parent rather than the subsidiary. Vivendi transferred a huge amount of the debts of the Vivendi group to Vivendi Environnement and the IPO did little to help the newly-listed company meet the enormous financial burden that it inherited.

The year 2001 saw the return of spin-offs undertaken for the direct benefit of the parent company rather than the newly-listed entity. The sale of shares in Orange by France Telecom dominated the year's activity, raising a massive but disappointing €6.9 billion for the beleaguered parent. Alcatel also spun off its cable business in the IPO of Nexans and absorbed all of the proceeds for its own purposes.

The identity of the companies using IPOs to spin off parts of their businesses suggests an important connection between transactions to retrench and extend corporate boundaries. Alcatel, France Telecom, Vivendi and Rhône-Poulenc (re-named Aventis subsequent to its merger with Hoechst) were all engaged in, or recovering from, major acquisition programmes at the time of their spin-offs. In some cases, there was an even more direct relationship between IPO and acquisition activity. JC Decaux went public in 2001 and retained most of the proceeds of the transaction to re-finance the debt it had assumed in pursuing an aggressive strategy of external growth and to fund future acquisitions. This relationship was even more marked for companies going public on the NM. For them, the use of the proceeds of their IPO to fund external growth was a common strategy.

Issuers on the French Debt Markets[15]

Turning now to the development of the French debt markets -- the bond and commercial paper markets -- I find that the government played an even more influential role in their expansion than it did for the stock market through its privatization activity. Indeed, until recently, the French state -- the central government as well as public and semi-public agencies -- dominated the growth of the bond market. The state's share of French bond issues rose from negligible levels in the mid-1970s to about 25 per cent in the mid-1980s and 40 per cent by the beginning of the 1990s. It then rose sharply to more than 70 per cent of total bond issues by 1993 and remained at levels of between 60 and 70 per cent through 1998.

The second most important category of issuers on the French bond markets were financial institutions, including banks and specialized financial institutions, which used bond issues primarily in the management of their businesses. They accounted for about 50 per cent of the market capitalization of the French bond market in the 1980s. Their share declined in the early 1990s but they still remained the second most important category of bond issuers.

Non-financial enterprises came third in importance as issuers on the French bond markets. They accounted for only 16 per cent of the capitalisation of the French bond markets in 1985 and their share declined to about 13 per cent by the mid-1990s. This category included large state-owned enterprises – the so-called grandes enterprises nationales (GENs) including La Poste – which accounted for 10 per cent of bond market capitalization in 1985 and between 8 and 9 per cent in the early 1990s. Therefore, the share of private non-financial enterprises in bond market capitalization was only about 5 per cent through 1995.

Similar patterns can also be observed in the French commercial paper market. It grew rapidly from its establishment in 1985 and, by the early 1990s, it was the largest domestic market for commercial paper in Europe. At that time, issuance was highly concentrated with State and

[15] The data underlying the following analysis were taken from the SBF Yearbooks unless otherwise stated.

financial institutions accounting for more that 90 per cent of total issues (Icard and Drumetz, 1994).

Given these characteristics of the French debt markets, it seemed reasonable to conclude in the mid-1990s, as Juvin did, that: "[t]he modernization and development of the French financial markets served the dual role of financing the public debt and facilitating the sale of public enterprises much more than the purpose of financing the private sector (Juvin, 1995 translated from the original French by the author). However, that changed in the second half of the 1990s as non-financial enterprises became more important to the development of the bond and commercial paper markets, a trend that once again was driven by their acquisition-related financing needs.

The state's share of French bond issues declined from 70 per cent in 1998 to 44 per cent in 1999 and 43 per cent in 2000 although it ticked up again to 59 per cent in 2001. The share of financial institutions also declined rather sharply in the 1990s and amounted to only 15 per cent by 2001. In parallel, the share of non-financial enterprises in total bond issues increased to reach 30 per cent by 2001. Issues by GENs accounted for about one third of these issues with private non-financial enterprises contributing the other two-thirds.

The growing volume of bond issues by the largest listed French companies and, more generally, their rising debt levels was strongly associated with their growing propensity to expand, especially internationally, through external growth. Based on firm-level data for the 98 non-financial companies in the SBF 120 index, Claude Picart showed that companies that internationalized most in the late 1990s were those that experienced the most rapid increase in indebtedness. Rising indebtedness was not confined to two or three large corporations; in fact, 39 of these 98 groups more than doubled their debt levels from the late 1990s (Picart, 2003).

Similar forces were at work in the market for commercial paper in the late 1990s. Between 1995 and 2000 there was an increase in commercial paper outstanding from €22 billion to €80 billion[16] with most of the increase occurring from mid-1998 on (Sahatdjian, 2001). The market remained highly concentrated – the top 21 issuers, each with more than €1 billion outstanding, accounted for 66 per cent of the total market – but by 2000, large corporations dominated the list of the major issuers (Sahatdjian, 2001).[17] The market for commercial paper proved to be a highly flexible source of short-term finance for the acquisitions of the leading French enterprises that were its major users (Rahmouni, 2000; Sahatdjian, 2001).

For the first time, therefore, French companies really took advantage of the debt markets. It was the largest companies in France, the listed companies included in the SBF 120 index, as well as state-owned enterprises, that did so. Only they experienced a major increase in overall debt levels in the late 1990s. In contrast, there was a gradual reduction in the indebtedness of other types of non-financial enterprises in the late 1990s. As a result, by 2000, SBF 120 companies and state-owned enterprises accounted for 52 per cent of the indebtedness of non-financial enterprises compared with only 30 per cent of their aggregate value added (Picart, 2003 p. 213).

Issues by medium and small listed companies accounted for a negligible share of total issues of bonds and commercial paper. For most French SMEs, the standard source of external finance remains the banking system. Their continued use of bank credit is an important factor in explaining the ongoing importance of the banking sector in the French economy. Although the rate of disintermediation, as measured by the importance of bank finance relative to other external sources of funds, increased throughout the French enterprise sector, it did so at a slower rate and to a lower level for SMEs than for larger companies.

[16] Compared with €26.9 billion for the UK, €18.5 billion for Sweden and €13.8 billion for Germany in September 2000 (Sahatdjian, 2001, p. 64).

[17] GE Capital Corporation was actually the largest issuer on the French commercial paper market in 2000 and other non-resident companies featured among the major issuers. Nevertheless, most of the largest issuers of commercial paper were large French corporations.

4. RE-EVALUATING THE CAUSES OF CHANGE IN FRENCH FINANCE

My analysis of the behaviour of the actors that used the French financial markets in recent decades fills out, qualifies and confronts some of the standard explanations that scholars have provided for the transformation of the French financial system and, in particular, for the growth in the importance of financial markets. As I noted earlier, several scholars have suggested that reforms in the formal rules and regulations that govern financial activity explain this development. However, this is, at best, an incomplete explanation and an analysis of the behaviour of French enterprises is necessary to fully understand the causes and effects of these regulatory changes.

As far as the causes of reform are concerned, the limited and declining capacity of French companies to fund their investment from internal sources, especially from the late 1970s into the early 1980s, was important in creating pressure for financial reform. The financing deficits of the non-financial enterprise sector were running at an average of 4.5 per cent of GDP from 1978 to 1982. As a result, they were more of a burden on the French financial system than government deficits which averaged 1.3 per cent of GDP during the same period (Loriaux, 1991, pp. 232-240).

With respect to the effects of regulatory changes, it turns out that reform in and of itself was not sufficient to bring about an expansion in the scale of financial markets. Financial reform certainly brought about important changes in the financing options available to French companies by eliminating the favourable credit terms to which they historically had access and making market-driven financing options more readily available. These developments did stimulate important changes in the financial behaviour of enterprises but not the ones that one might expect without taking explicit account of enterprise characteristics and strategies.

Leading French enterprises responded by increasing their internal funds, thus weaning themselves off external financing. Crucial to that effort was their success in raising their profitability, which they did in part by improving their competitive performance and also by reducing the returns paid to employees in the form of wages and salaries.[18] Both of these outcomes were achieved through a massive process of restructuring that was undertaken by these enterprises in the 1980s, in many cases with the direct assistance of the French State (Amable and Hancké, 2001). It was also facilitated by changes in government policy, notably the removal of wage indexation. In addition to raising their profits, these enterprises also increased their retention rate from a low point of 39 per cent of profits in 1981 to 58 per cent in 1988.

These changes made France's leading enterprises much less dependent on external funds than they had been before. Since these enterprises were the ones which, in principle, had the readiest access to financial markets, [19] it is not surprising that issuance activity by private enterprises was rather subdued for most of the 1980s through the mid-1990s. Although there was a substantial increase in stock issues in the mid-1980s, with levels of issuance thereafter attaining higher levels than had been witnessed until then, if we exclude the government's privatization programme stock issues remained relatively low, amounting to no more than 1 per cent of GDP and usually considerably less than that. A similar observation can also be made with respect to the country's bond markets although here French financial institutions were also significant users.

The growth in French financial markets that did occur, therefore, was largely in response to government demands for finance. The French public administration was the other major deficit-generating sector in the French economy from the late 1970s until 2001. Its deficits grew from 1.3 per cent of GDP in 1978 to 2.9 per cent in 1982 and then to 3.2 per cent in 1986. The government managed to bring them under control, to 2.5 per cent of GDP or less, from 1987 to

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[18] The compensation of employees represented 70.8 per cent of the value added of French non-financial enterprises in 1978 and increased from there to a peak of 72.5 per cent in 1982. It declined precipitously thereafter to reach 64.1 per cent by 1989 and hovered between 63 and 65 per cent from then until 2001 when it was 63.8 per cent (data from www.banque-france.fr).

[19] French banks responded to the transformation of their competitive environment by flooding enterprises with new money. Given the increased financial autonomy of leading French enterprises, the banking sector increasingly relied on making loans to poor credit risks and SMEs.

1991. However, in the early 1990s, they soared to unprecedented heights of 6 per cent in 1993 and remained high until 1997, before declining to less than 2 per cent in 1999, 2000 and 2001.

The State's growing financial deficits provide important context for understanding the growing commitment, across party lines, to privatization. They also explain the government's growing importance as an issuer on the country's debt markets. Government bond issues moved closely in line with the scale of its deficits reaching all-time highs, in absolute and relative terms, in the early to mid-1990s, but declining from the late 1990s as the State's financing deficits contracted.

There was a temporary change in this picture from 1989 to 1991 when a deterioration in the overall financial condition of the non-financial enterprise sector led to a corresponding increase in their demand for external finance. There was also an important but brief increase in external funding by large French enterprises, mostly from the financial markets, in connection with an upsurge in their acquisition activity at the time. A much more important and sustained change in French enterprises' reliance on the financial markets was induced by a subsequent, and more dramatic, wave of acquisitions.

The late 1990s and early 2000s was a period of unprecedented merger and acquisition activity involving French companies. Some of this merger and acquisition activity was domestic, involving French companies on both sides of the transaction, but foreign mergers and acquisitions became increasingly important over the course of the 1990s with French companies proving more likely to be acquirors than targets. As a result, the value of mergers and acquisitions of foreign firms by French companies increased from 0.6 per cent of Gross Domestic Product (GDP) in 1995 to 1.5 per cent in 1997 and 6.1 per cent in 1999 before reaching a peak of 12.9 per cent in 2000. It declined in 2001 and 2002 to 4.5 per cent and 2.4 per cent respectively but still remained well above the levels of the mid-1990s (UNCTAD, 2003).

The result was a major increase in the internationalization of the activities of French companies. In a recent article, Dervieux documented the trends in internationalization for the 32 non-financial companies in the CAC40. She presented evidence of a marked increase in the internationalization of these companies from 1997 to 2002. During this period, foreign sales increased from 56 per cent to 65 per cent of total sales for her sample of companies. Foreign employment increased from 50 per cent to 65 per cent of total employment and the foreign share of fixed tangible assets rose from 45 per cent to 68 per cent. The growing share of international operations in these companies' total activity reflects a dramatic expansion in their foreign operations compared to slow growth and even a decline in their levels of activity in France (Dervieux, 2003).

To finance their aggressive strategies for external growth, they needed access to copious amounts of funds. As the pace of acquisition activity became frenzied, French companies relied not only on the French stock and bond markets to underwrite their strategies; they also used the commercial paper market and took out bank loans as well. In short, the development of the French financial system in the late 1990s and early 2000s became inextricably tied to the merger and acquisition activity of French companies.

What is important about my explanation is that, in emphasizing the role of globalisation in inducing change in financial institutions, it focuses on the global integration of product markets as the crucial development. The transmission mechanism for the impact of this type of globalization on the French financial system was managerial behaviour, notably the strategies for external growth that corporate managers designed and implemented. This explanation can be contrasted with another standard account of the role of globalization in prompting change in financial systems which focuses on the global integration of financial markets as the crucial development and locates the transmission mechanism in foreign institutional investors' financial strategies.

There is no question that French companies' use of financial markets to fund their external growth has brought them into much closer contact with portfolio shareholders, especially foreign institutional shareholders, than was previously the case. It gave them an interest in courting financial markets to persuade them to underwrite their strategies of external growth. As a result, French corporate executives were often willing to countenance "investor-friendly" changes in corporate governance of the type that Goyer (2001) identifies. More generally, many leading French companies now had an interest in common with portfolio investors in rising stock valuations.

However, that is not the same as their being subject to the control of portfolio investors. During the period of the rapid expansion of the French financial markets, there is little evidence that outside shareholders gained such control. French managers were often able to manipulate the rhetoric of shareholder value for their own purposes claiming to deliver "what the shareholders want". For several years, Jean-Marie Messier, the former CEO of Vivendi, was highly effective at creating the space to pursue his own strategic actions by claiming to be responsive to his shareholders' interests. In companies like Vivendi this state of affairs was facilitated by the limited incentives and abilities of portfolio shareholders to monitor and sanction managerial behaviour that are characteristic of diffuse ownership structures. Only when things go really wrong, which they ultimately did at Vivendi, does this tend to change.

In fact, in contrast to Vivendi, some of France's most acquisitive companies did not have diffuse shareholding structures when they embarked on their aggressive strategies of external growth in the 1990s. France's most acquisitive companies represent a heterogeneous mix that includes widely-held companies like Alcatel and Danone as well as Vivendi but also state-owned enterprises such as France Telecom and closely-held corporations like LVMH and PPR. Most of the companies, such as Aventis, Axa, Cap Gemini, Carrefour, Suez and Valeo are somewhere in between with at least one shareholder holding more than 10 per cent, but less than 40 per cent, of the voting rights.

Not only does it seems implausible that pressures from portfolio investors were the crucial causal mechanism in the transformation of the French financial system, it appears that the growing role of these investors, including foreign institutions, in the ownership structures of

French corporations may have been an outcome of that transformation. French corporations' overseas acquisitions were recently pinpointed by the Banque de France as an important reason for the rise in the foreign ownership, especially by US and British institutional investors, of French companies (Banque de France, 2004).

The example of Cap Gemini shows how this process worked in practice. Until November 1997, Serge Kampf and Wendel Investissement together controlled 46 per cent of the voting rights of this company. By the end of 2002 their combined share of the voting rights of the company was 16.8 per cent. The dilution occurred primarily as a result of stock issues conducted by the company in 1998, 1999 and 2000 to raise cash for acquisitions and in exchange for the shares of other companies. As a result, portfolio investors -- outsiders with no relationship to the corporations in which they held shares -- became more prominent in the shareholding structures of these companies.[20]

My central claim is that insiders, corporate managers who were insulated from the pressure of financial markets by networks of cross-shareholdings, concentrated stakes and the passivity of portfolio shareholders precipitated the crucial changes that made financial markets more prominent in the French system of capitalism. The final step in re-evaluating the arguments that other scholars have made is to consider Culpepper's emphasis on the importance of a shift in joint beliefs in response to a triggering event in bringing about change in the French financial system. My argument joins forces with his in emphasizing the importance of actors at the heart of the French corporate economy in bringing about change. However, while my analysis is

[20] Not true for all companies though. In the case of Carrefour, share issues for cash and in exchange for shares led to some dilution but through one of its largest acquisitions, that of the French company Promodès, it also acquired some new family shareholders. Some closely-held companies, such as LVMH and PPR, managed to limit the dilution of their ownership structures without holding back their external growth. Moreover, large shareholders often protected their voting power even as the percentage of shares that they held declined. In the case of Valéo, for example, its major shareholder, Wendel Investissement, maintained its share of voting rights at 15.96 per cent in 2002 compared to 18.65 per cent in 1997, a decline of only 14 per cent compared to a much sharper drop of 53 per cent in the percentage of shares that it held. A similar phenomenon can also be observed at Axa, Carrefour and Suez although to a lesser extent.

preoccupied with these actors' strategies, Culpepper's argument focuses on their cognitive perspectives.

Ideally, these approaches should be complements rather than alternatives at least if we assume that there is a relationship between thought and action! The importance of external growth, especially international mergers and acquisitions, in the strategies of French companies provides important context for thinking about French executives' beliefs. Axa is an important example. Bebear took the helm of the company in 1982 when it was still a medium-sized enterprise. For the rest of the 1980s, he expanded the company's business in France largely through acquisition. In 1991, following a reorganization of its French insurance activities, the company embarked on a strategy to geographically expand and diversify its business. Axa made several large acquisitions in the US and Australasia in the first half of the 1990s. Its merger with UAP marked a continuation and acceleration of its global ambitions. In explaining the logic of the deal, Bebear said the two companies each had to make the same decision in the face of global competition: "Either find a niche or get big and fight" (International Herald Tribune, November 13, 1996).

To fund a strategy of getting big and fighting, Axa needed all the resources it could muster. In its 1996 annual report, it explained its investment and financing policy in the following terms: "[t]he Company plans to finance future acquisitions and strategic investments from funds retained from operations, from the issue of bonds and shares and from the sale of non-strategic assets." It was the imperative of its global expansion that explains why Axa was so eager to liquidate UAP's holdings in other French companies, especially as their stock prices rose in the late 1990s. Culpepper's alternative hypothesis, that Bébéar's distaste for "long-term strategic shareholding" was the key issue, seems much less plausible given that he was willing to live with Mutuelles Axa as Axa's principal shareholder throughout his tenure; in 2002, the mutual company still held more than 30 per cent of the voting rights in Axa.

The growing importance of external growth for other leading French companies from the mid-1990s also helps account for the second mechanism, the joint belief shift, that Culpepper highlights. Faced with similar incentives to those which confronted Axa, other large French companies followed suit in liquidating their holdings of shares in privatized enterprises to contribute to the funding of their mergers and acquisitions.

Therefore, if Culpepper is correct about the importance of these mechanisms in bringing about change, therefore, it would seem that what needs to be explored is why French corporate executives felt compelled to embark on aggressive global strategies from the 1990s. It seems likely that they were influenced by two factors: one is the growing trend towards global mergers and acquisitions in the world around them and a second is the fact that France's international position was weak relative to some of its major competitor countries. It must be said, however, that if further research supports these hypotheses, it will challenge Culpepper's notion that ideas were independent of material interests in the transformation of the French financial system.

5. Debating the Implications of Institutional Change

There remains the task of characterizing French financial institutions and their role as constituent elements in the French system of capitalism at the beginning of the 21st century. There clearly has been an important and clear-cut change in the distribution of corporate control in France as a result of the marked reduction in the capacity of the State to directly influence the French corporate sector. That change occurred in part as a result of the systemic change in the financing of French enterprises that led to a decline in the role of the State in the allocation of financial resources to business enterprises. It also resulted from the massive transfer of ownership of corporate enterprises from the public to the private sector through successive privatization programmes.

The intention behind this transformation was to replace the old system with a new, constrained system of market finance in which enterprises used markets to finance their activities but were protected from market or outsider control through the system of cross-shareholding. However, until the mid-1990s, it was the government rather than firms that benefited most from the expansion of the financial markets. French companies did turn to the financial markets in a major way from the late 1990s but, in parallel, the mechanisms that had been instituted to protect them from outside investors unraveled, largely as a result of corporate initiatives.

These days, as I noted earlier, the idea that French capitalism in the early 21st century has undergone a systemic shift towards outsider or market-oriented finance is one that is often heard in academic and popular discourse. From this perspective, the dictates of financial markets, especially the demands of foreign institutional investors, now strongly influence corporate actions. However, as a general proposition, this position is hard to sustain.

So far I have argued that insiders, corporate managers who were insulated from the pressure of financial markets by networks of cross-shareholdings, concentrated stakes and the passivity of portfolio shareholders precipitated the crucial changes that made financial investors more prominent in the French system of capitalism. However, that is not to say that these insiders could control what happened once they initiated these changes. In principle, it is possible that an unintended consequence of their actions will be a loss in their control in favour of outsiders.

In practice, however, the passivity of portfolio shareholders is a major barrier to shareholder control in France just as it is in countries like the US and the UK. Indeed, since foreign shareholders are even less likely than domestic shareholders to exercise their voting rights, French companies have tended to be even more insulated from the influence of portfolio shareholders than their US and UK counterparts. As I noted earlier, it is only under extreme circumstances that portfolio shareholders get actively involved in the direction of companies.

There are two conditions under which this can occur. First, to the extent that a company is subject to serious constraints in financing its operations, financial markets may be able to exert considerable influence in defining the terms and conditions on which new funds are made available. Second, pressures from financial markets may be exerted on companies through the market for ownership, rather than the market for finance, to the extent that their ownership structures make them vulnerable to hostile takeovers. Both conditions have recently operated in the cases of several leading companies in France.

A number of major French companies have found themselves in vulnerable financial positions as a result of their heavy reliance on aggressive strategies of external growth. Sustained losses and high debt levels have forced companies like Alcatel, EDF, France Telecom, Infogrames, Suez and Vivendi to turn to the financial markets when they are weak to get access to additional resources. They have typically undertaken extensive asset sales as part of major restructuring processes to increase profits and reduce their financial needs. In the process, some senior executives have lost their jobs to take responsibility for the strategic decisions that plunged these companies into financial crisis.

The other way in which outsiders could gain control over French companies is by bidding for their ownership in takeover battles. The greater diffusion of share ownership that has occurred for some of France's leading companies has certainly made them more vulnerable to takeover threats. In July 2003, the Canadian company, Alcan, launched a successful hostile bid to secure control of Péchiney, its French competitor in the aluminium industry (Financial Times, January 29, 2004, p. 21). Shortly afterwards, in January 2004, Sanofi-Synthélabo, the French pharmaceuticals company, announced a hostile bid to acquire Aventis, its much larger counterpart. The bidder was reportedly stimulated to action by fears of its own vulnerability to takeover given the decisions by its two main shareholders, Total and L'Oréal, not to renew their shareholding pact when it expired later in 2004. Jean-Francois Dehecq, Sanofi-Synthélabo's chairman, was a board member of Péchiney when it was acquired by Alcan and "[t]he lessons he apparently learnt were that these days you must grow not to be gobbled up and a hostile bid was possible even in France (Financial Times,[21] January 29, 2004, p. 21)."

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[21] Quoting Jerome Calvet, the head of European M&A at Societe Generale.

However, we cannot conclude from these and similar examples that French corporations are systematically vulnerable to the pressures of financial markets as a result of their financial and/ or ownership characteristics. If we analyse the financial condition of French listed companies, for example, there is little evidence of a general increase in their financial fragility. Although their internal resources have declined recently, non-financial enterprises continued to generate internal resources on a scale that was almost sufficient to fund their ongoing capital investments. As I have emphasised, in resorting to financial markets on a massive scale in the 1990s, French corporations did so largely to fund acquisitions. These large-ticket expenditures are a more discretionary form of investment than ongoing commitments to existing operations and, therefore, easier to defer in the face of financial constraints. Given the slowdown in global M&A activity, French companies' expenditures on acquisitions have dramatically declined across the board.

Similarly, although some leading French companies have diffuse shareholding structures today, and are therefore as vulnerable to takeover threats as Péchiney and Aventis were, in others the grip of large shareholders has been maintained and even strengthened, even as these companies pursued aggressive strategies of external growth. In the case of Carrefour, for example, share issues for cash and in exchange for shares led to some dilution but through one of its largest acquisitions, that of the French company Promodès, the company also acquired some new powerful family shareholders. Some closely-held companies, such as LVMH and PPR, managed to limit the dilution of their ownership structures because the major shareholders participated in equity issues to finance external growth in proportion to their shareholdings. Finally, large shareholders often protected their voting power even as the percentage of shares that they held declined. In the case of Valéo, for example, its major shareholder, Wendel Investissement, maintained its share of voting rights at 15.96 per cent in 2002 compared to 18.65 per cent in 1997, a decline of only 14 per cent compared to a much sharper drop of 53 per cent in the percentage of shares that it held.

There is also another reason to be skeptical of the claim that portfolio investors, foreign institutions or otherwise, can dictate to French corporations. When we look at the details of what happened even in the cases in which financial and/or ownership constraints have allowed outsiders to contest insider control, it is apparent that their assumption of control is not automatic. Vivendi is perhaps the most interesting example given the severity of its financial problems which reportedly brought the company to the brink of bankruptcy.

Jean-Marie Messier was pressured out of office in late 2000. The Bronfman family, the company's largest shareholder since its acquisition of Seagram, had tried to remove Messier earlier but it was unable to get the approval of the board to do so. The momentum to remove and replace Messier ultimately came from quintessential insiders to the French system who "persuaded" him to resign. Claude Bébéar, often described as the godfather of French capitalism, was a particularly important player even though he initially had no formal relationship to Vivendi Universal. He apparently recommended that Jean-René Fourtou, the former CEO of Rhône-Poulenc and a personal friend, replace Messier and then provided his assistance in securing the co-operation of the financial community in re-capitalising Vivendi (Le Figaro, September 27, 2002)."In short, the French elite closed ranks to ensure that Vivendi's restructuring was undertaken by one of their own. And there have been other, even more controversial, attempts by the French elite, politicians as well as executives, to protect French companies for the French.

Aventis initially reacted to Sanofi's bid by asking Novartis to act as a white knight. In response, the French Prime Minister, Jean-Pierre Raffarin, rebuked the Swiss company for getting involved in matters that affected France's national interest. Novartis initially announced that it would not make a bid for Aventis unless the French government remained neutral but, when the government hardened its position, Novartis opened formal merger talks with Aventis. However, the Swiss company quickly withdrew from negotiations claiming that its conditions for these talks had not been met. Shortly afterwards, Aventis agreed to merge with Sanofi to create a new, French pharmaceuticals giant.

The deal's successful conclusion is widely believed to have resulted from the intervention of Raffarin and Nicolas Sarkozy, the French Minister of Finance at the time. The apparent justification for their involvement was the risk of ceding control over technology sectors in which France is a player. The French government was widely-criticised for its actions. However, around the same time, the French government also acted as an obstacle to Siemens' reported interest in the French engineering company, Alstom, which was in serious financial trouble. Later that year the government supported the merger of Sagem, the French electrical equipment company, and Snecma, the state-owned aircraft engine maker, in a move widely criticized by investors. Sarkozy defended the deal, in a joint statement with the defense minister, arguing that "[t]he consolidation between these two French high-tech groups will pave the way for the creation of a major European industrial player (New York Times, October 30, 2004)."

Then, in December 2004, Electronic Arts, the US game software company took a 19.9 per cent stake in Ubisoft, one of France's leading game companies, in a move that was regarded as hostile. The French government was reportedly greatly concerned about what it saw as another foreign attack on another technology sector that it regards as strategic. Bruno Bonnell, the head of Infogrames, Ubisoft's leading French competitor, also expressed concern in a somewhat ironic statement from a man who headed up one of the most acquisitive companies in the industry: "[c]ompanies have chosen to live by the rules of the free market and must play by the rules of the free market. But there is a strong number of US competitors and healthy competition in Asia, so we need to keep European actors to prevent this becoming a mono-cultural industry, just as we do for cinema and music (Financial Times, January 6, 2005, p. 13)."

In light of these examples, is Schmidt (2003) correct in arguing that French capitalism is still distinctive for the role that the state plays? Certainly, there is new talk of old ideas such as "national champions" and "strategic sectors" by political and business elites in France. However, there is no denying that the formal mechanisms that the government has at its disposal to protect French corporations are much weaker than they were ten years ago. As Elie Cohen put it: "[t]he

French elite still speaks as if it is in charge of industrial affairs, but it no longer has the tools." In a similar vein, Robert Boyer, argues that "[y]ou have a desperate effort by senior civil servants to maintain some control, but they no longer have the power (New York Times, January 28, 2004, p. 1)."

Perhaps the only formal mechanism that the French State retains for influencing the corporate economy is the Caisse des Dépôts et Consignations which manages €220 billion in state pensions and is the largest institutional investor in the French stock market (Financial Times, January 29, 2004, p. 21). However, there is some ambiguity about the extent to which the government can influence the investment strategy of the CDC. On the one hand, the CDC facilitated the recent acquisition by Accor, the French hotel and leisure group, of a large stake in Club Med in a move interpreted as an attempt to protect the troubled tour operator from foreign takeover (La Vie Financière, June 18, 2004, p. 5). The CDC owns 6 per cent of Ubisoft and there have been suggestions that it should increase its stake to protect the French company from foreign takeover but as yet it has not done so. On the other hand, the chief executive of CDC is on record as saying that its role is not to perform "industrial meccano" (Les Echos, January 10, 2005, p. 23).

Arguably the most significant capacity to resist the pressures of financial markets on the French corporate economy force no longer resides in the organization or influence of the French State but in the cohesion and power of the French political and business elite. As the previous examples suggest, there does seem to be considerable agreement among members of this elite about the importance of protecting French ownership of companies in sectors that are seen as strategic for France. To the extent that these sectors are perceived to be under attack, the tight elite network in France may be the basis for the application of pressure for domestic consolidation to protect French companies from outside threats.

However, there are limits to this strategy. Not all sectors are perceived as strategic by French elites. Second, the cohesion of French elites may not endure. Finally, domestic options for consolidation do not necessarily exist. As far as the game software industry is concerned, for example, the financial difficulties of the other major French players in the industry mean that they are unlikely candidates for white knights and there is a further risk that they too will be taken over by foreign suitors. This may explain why the government reportedly told Ubisoft that its executives were on their own in seeking a solution because the State could not substitute for the market (Le Figaro Économie, January 10, 2005).

6. CONCLUSION

In this article, I have explored the causes and implications of the recent transformation of French financial institutions with particular attention to the enhanced role of financial markets in the economy. Based on an analysis of the actors that issued securities on the country's financial markets, I argued that the government's role as an issuer, and the deficits that drove it to rely heavily on stock, bond and commercial paper issues for funds, largely account for the development of the French financial markets in the 1980s and early 1990s.

However, from the middle of the 1990s, a new dynamic emerged. Leading French enterprises, in pursuit of aggressive strategies of external expansion, turned to the financial markets for funds to pay for their mergers and acquisitions and drove a major expansion in their role. From this perspective, it was the globalization of product markets that mattered to the development of French financial institutions at this time with the key transmission mechanism for change being the strategies that French corporate managers devised and executed. This contrasts with the standard account where the focus is on the impact of financial globalization refracted through the strategies of portfolio investors.

As far as the impact of recent changes is concerned, I challenge the notion that they have brought about a situation in which French corporate managers are subject to the control of the financial markets. Although there are identifiable conditions, related to the financing and ownership of particular corporations, where portfolio investors can contest the control of French corporations, these conditions are not generally characteristic of the French corporate economy.

Moreover, even when portfolio investors have been able to contest the control of French corporations, they have not always won because French business and political elites have been able to mount an effective defense.

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FIGURES & TABLES

Figure 1 Sources of Finance for French Non-Financial Enterprise Sector

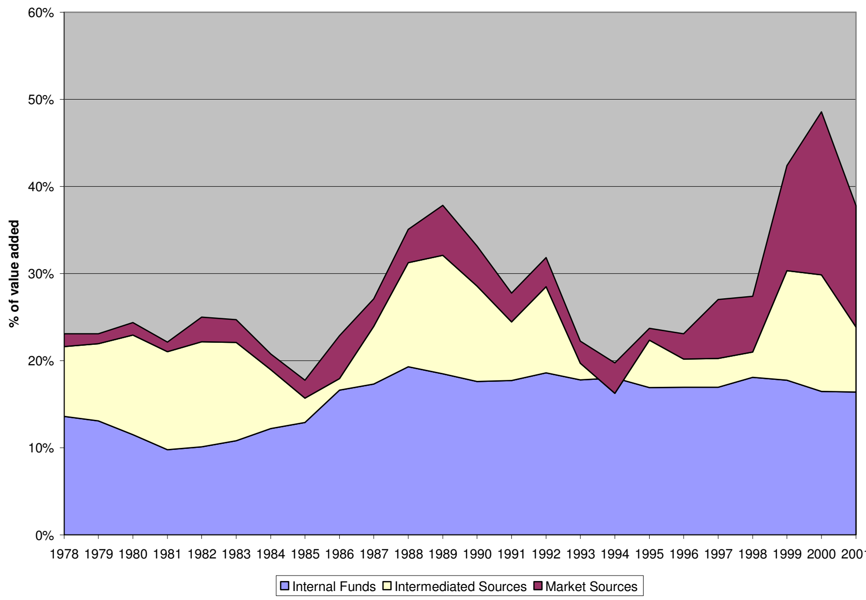

Figure 2 Financing Deficits, Retentions and Investments for the French Non-Financial Enterprise Sector

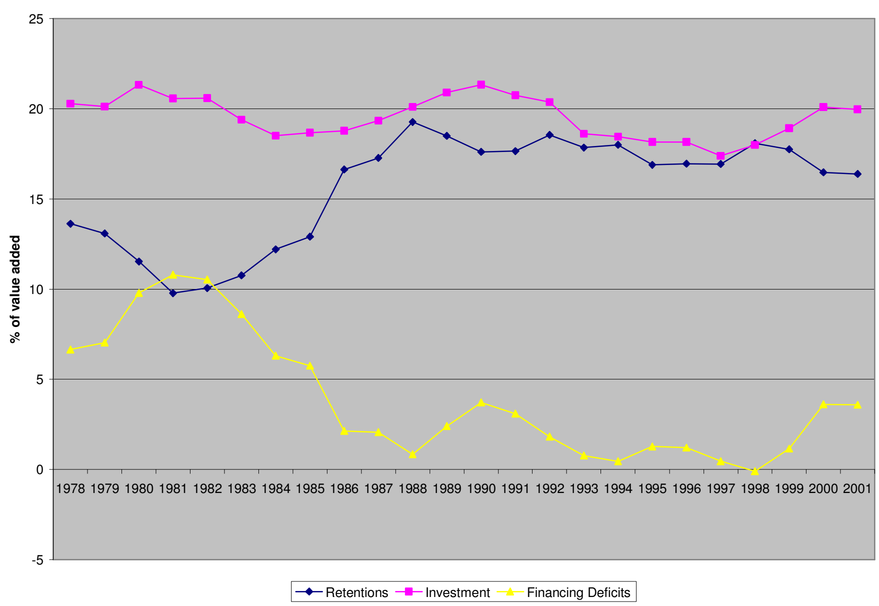

Figure 3 Proceeds from Public Share Offerings by French Listed Companies, 1974-2001

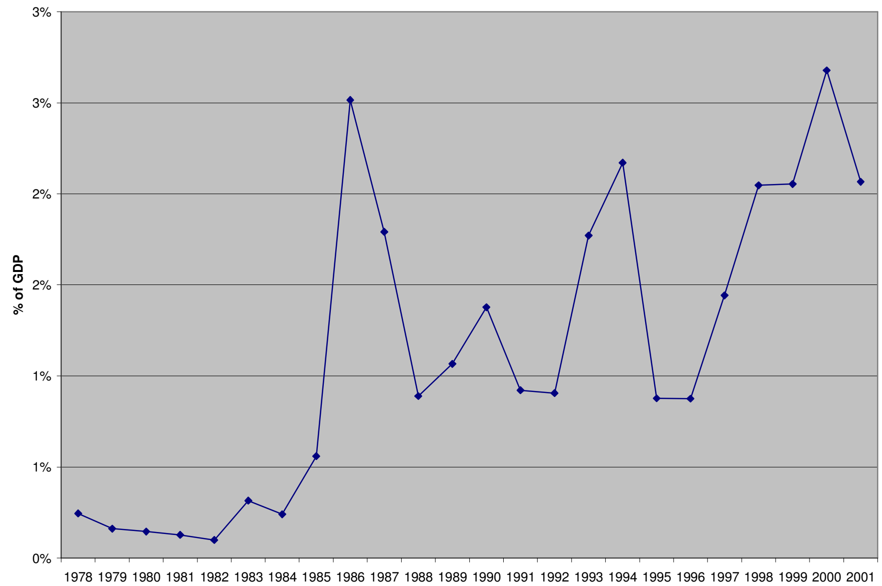

Figure 4 Public Share Offerings related to, and excluding, Privatisations in France, 1974-2001

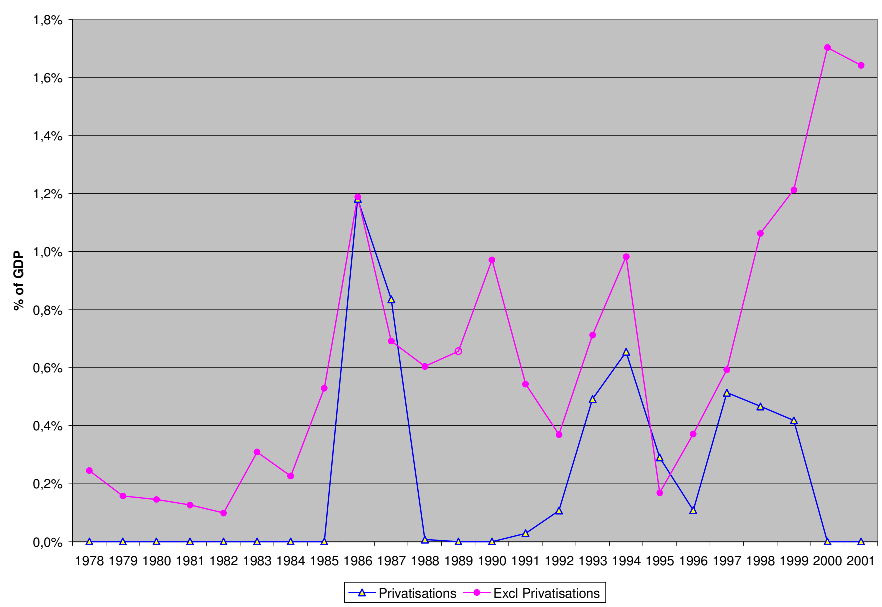

Table 1 Comparative Data on Financial Systems for Selected Countries

Country	**Bank Loans to Private Sector**		**Total Market Capitalisation**		**Stock Market Capitalisation**		**Bond Market Capitalisation**	
	1979	**2001**	**1975***	**2001**	**1975***	**2001**	**1975***	**2001**
France	72%	89%	27%	134%	11%	79%	16%	55%
Germany	83%	120%	43%	157%	13%	58%	30%	99%
Italy	59%	79%	72%	97%	7%	48%	65%	90%
Netherlands	62%	141%	44%	218%	24%	153%	20%	65%
Sweden	43%	44%	74%	172%	15%	108%	59%	64%
UK	27%	138%	84%	250%	41%	151%	43%	99%
USA	34%	42%	102%	323%	45%	138%	57%	185%
Japan	85%	111%	70%	108%	29%	54%	41%	54%

Source: Data on bank loans to private sector from International Financial Statistics, xxxx (see R&Z source); 1975 data for stock and bond market capitalization from Vittas, 1978, p. 30; 2001 data for stock and bond market capitalization from the International Federation of Stock Exchanges (www.fibv.com) except for France and Netherlands and the US bond market. Data for the Paris, Amsterdam and Brussels financial markets are reported only in aggregate terms by the FIBV since the merger of these exchanges to form Euronext. Disaggregated data on market capitalizations for these exchanges were compiled from Euronext's Annual Factbook for 2001 and divided by GDP as reported by the World Bank in its Global Development Indicators. The FIBV provides inexplicably small estimates of the size of US bond market. These figures were corrected using data on bond outstanding from the US Census Bureau, 2002, p. 731.

Table 2 Largest Public Seasoned Share Offerings and Convertible Debt Offerings for Cash

Fifteen Largest Public Seasoned Share Offerings for Cash, 1991-2000			
Year	**Issuer**	**Proceeds (€ millions)**	**Purpose**
2000	Axa	3,694.6	Acquisition
1999	Vivendi	2,730.3	Acquisition
1997	GAN	1,674.3	Recapitalisation
1990	UAP	1,600.7	Acquisition
2000	Bouygues	1,507.3	General investment including acquisitions
2000	Alcatel	1,402.5	Acquisitions
1993	Machines Bull	1,303.4	Recapitalisation
1994	Eurotunnel	1,111.0	Recapitalisation
1997	Rhône-Poulenc	1,067.1	Acquisition
1998	Valéo	1,036.7	Acquisition
1994	EuroDisney	907.1	Recapitalisation
1996	Axa	900.1	Purchase of its own shares
1992	Ciments-Français	761.3	Acquisition
1994	Paribas	631.6	Investment
1993	Générale des Eaux (Vivendi)	630.1	Acquisitions & debt re-financing
1998	Cap Gemini	572.2	Acquisitions
Fifteen Largest Public Seasoned Convertible Debt Offerings for Cash, 1993-2000			
Year	**Issuer**	**Proceeds (€ millions)**	**Purpose**
1999	Vivendi	2,850	Acquisition
1998	France Telecom	2,031	Acquisition
2000	Lafarge	1,727	Acquisition
1999	Vivendi	1,700	Debt re-financing (acquisition related)
1999	Axa	1,524	Acquisition
2000	ST Microelectronics	1,094	Investment including acquisitions
1999	PPR	1,000	Debt re-financing (acquisition related)
1999	ST Microelectronics	768	General Investment
1994	Alcatel	762	Debt re-financing
2000	Thomson Multimedia	800	Investment especially acquisitions
2000	Havas	700	Debt re-financing (acquisition related)
1996	Havas	644	Debt re-financing
1995	Sanofi	624	Investment especially acquisitions
1993	BSN	610	Acquisition
1994	Peugeot	604	Debt re-financing

Source: Année Boursière, 1991-1999; Autorité des Marchés Financiers, 2000; articles in Le Point, La Tribune, Les Echos, Financial Times.

Table 3 Domestic Initial Public Offerings (excl. privatisations) on the Premier Marché, 1991-2000

Year	Company	Money Raised EUR million	Description
1998	Alstom	3779.0	Spinoff
2000	Vivendi Environnement	2361.5	
2000	EADS n.v.	2308.5	
2000	Wanadoo	1710.0	
1998	Rhodia	1128.9	Spinoff
2000	Euler	479.5	
2000	Completel Europe n.v.	476.0	
2000	Liberty Surf	450.5	
2000	Trader.com n.v.	390.0	
2000	Elior	350.7	
1999	Neopost	233.1	
1997	ISIS	219.4	Spinoff
2000	Oberthur Card Systems SA	217.0	
2000	Coface	169.6	
1994	Coflexip	123.6	Spinoff
2000	Kaufman & Broad	118.0	
1994	Technip	64.5	Spinoff
1999	Business Objects	64.4	
1992	CBC (Compagnie Generale de Batiment et de Construction)	38.9	Spinoff

Source: author's analysis of data from Annee Boursiere, various years.