

# The Impact of Institutional Investors on Corporate Governance: A View of Swiss Pension Funds in a Changing Financial Environment

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Theories on corporate governance have developed in line with the development of the financial markets and the increasing power of institutional investors. Indeed, the financial markets' power can be measured by the ability of shareholders, and of institutional investors in particular, to influence businesses and their managers. A number of reforms have been implemented in several countries, Switzerland included, in order to strengthen shareholders' powers. Making specific reference to Swiss case studies, this paper aims to create a better understanding of the role of institutional investors in corporate governance. Indeed, Switzerland is paradoxical in that it is generally considered Rhenish, with banks and families taking a leading role in controlling big business (David et al. 2004; Windolf & Nollert 2001), whilst developing a pension fund system which, since the mid-1980s, has attracted considerable funds and is still experiencing strong growth. How do these two approaches, traditionally at opposite ends of the spectrum as far as the subject's literature is concerned, reconcile themselves in the Swiss market?

**KEY WORDS** Corporate governance, Pension funds, Models of capitalism, Disintermediation, Reintermediation, Financial places

## Introduction

Theories on corporate governance have developed in line with the development of the financial markets and the increasing power of institutional investors. Indeed, the financial markets' power can be measured by the ability of shareholders, and of institutional investors in particular, to influence businesses and their managers. A number of reforms have been implemented in several countries, Switzerland included, in order to strengthen shareholders' powers.

These changes have reconfigured traditional models of capitalism, particularly in continental Europe. Let us not forget that the financial markets play a central role in the Anglo-Saxon model and institutional investors have a privileged place within it, with the

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businesses effectively being controlled externally and with the primary aim of creating wealth for the shareholders. In contrast, financial markets play traditionally a less influential role in Continental Europe. In the Rhenish model, banks are central to financial governance as much through their direct involvement in controlling businesses as through their financial service provision, whilst financial markets are still underdeveloped in comparison with Anglo-Saxon countries. Nevertheless, with financial globalisation and the strong development of market finance in most countries, the specificities of the financial structures developed up to now in the countries of mainland Europe seem to be becoming less marked. Therefore, and for some (e.g. Morin 2000), the traditional distinctions between Anglo-Saxon and other models are at the same time apparently becoming obsolete: the Anglo-Saxon model appears to be taking over as the standard framework model, imposing its 'structural forms' across the board, not just in terms of intermediation but also in terms of control. Others (e.g. Giraud 2001) observe that the Anglo-Saxon model is also undergoing transformation. Neither model is going to stop transforming and they are already converging towards 'something else'.

In all cases, alignment on the Anglo-Saxon model, with more or less resistance, or hybridisation of models, changes and reforms are today reconfiguring capitalism(s) and both institutional investors and pension funds are often said to play a key role in these changes. Highly active, they are in a position to impose new standards and regulations which favour the shareholder and ultimately put considerable pressure on company directors and business strategy (Lordon 2000; Morin 1998, 2000; Orléan 1999). Some see these investors as leading capitalism to a new stage of development (Clark & Hebb 2004). Others consider institutional investors to be taking a very passive role (Clearfield 2004), with few in a position to make their voices heard (Aglietta & Rebérioux 2004) and with little power to implement original policy (Engelen 2003).

Making specific reference to Swiss case studies, this paper aims to create a better understanding of the role of institutional investors in corporate governance. Indeed, Switzerland is paradoxical in that it is generally considered Rhenish, with banks and families taking a leading role in controlling big business (David et al. 2004; Windolf & Nollert 2001), whilst developing a pension fund system which, since the mid-1980s, has attracted considerable funds and is still experiencing strong growth. How do these two approaches, traditionally at opposite ends of the spectrum as far as the subject's literature is concerned, reconcile themselves in the Swiss market? Moreover, if Swiss pension funds manage an important and increasing amount of money and are consequently an emergent category of financial actors, are they to be considered as all-powerful and autonomous players and shareholders? Up to which point are they leading the move in Switzerland? Or are they just to be considered as a new but passive financial layer?

We posit that the financial market, which is concentrated around the Zurich area, and to a lesser extent around Geneva, has not abdicated control to the pension funds. The explanation which we propose for this draws on work by Martin and Minns (1995) and by Clark (2000, 2003), who follow the *course* taken by funds selected by pension funds, and show how the financial markets, precisely because they are based in London, retain power over the whole system. More specifically we will show how the financial system creates a number of *intermediaries* between the funds and the recipient companies and how the system makes investments *opaque* in the eyes of the eventual shareholders. It would seem that Swiss pension funds are subject to the disadvantages of both systems: of the Anglo-Saxon system in terms of risk bearing and of the Rhenish system in that they do not have the power to influence the way companies are managed.

In order to delineate the relationships between Swiss pension funds and the finance industry as well as the corporate engagement of pension funds, this paper draws on previous empirical research aimed at identifying the investment channels used by Swiss pension funds (Theurillat et al. 2006a). The first section looks at research into models of capitalism, the role and power of institutional investors as well as the organisation of the financial industry, its networks and its centres. The second section shows the unique way in which the Swiss system has developed within this context.

## **The Financial Markets, Forms of Intermediation and Control and Territory**

The primacy of the financial markets is one of the defining characteristics of our age. We will give a brief overview of contemporary views on financial systems and governance. Firstly, we will introduce the two stylised models of capitalism with distinct financial structures, i.e. the Rhenish model and the Anglo-Saxon model. If, until the 1980s, different types/models of capitalism seemed to coexist, the promotion and development of the financial markets seem to irrevocably affect all contemporary economies and challenge the Rhenish model. We also wish to examine some of the factors underlying these changes as well as the future of banking in this environment. Secondly, we will briefly return to the issue of corporate governance, as the boom in institutional investment is undoubtedly at the root of the resurgence in shareholder power. Finally, we shall attempt to define the spatial consequences of the previously described transformations.

### *Stylised Models of Capitalism, Intermediation and Forms of Control*

Within literature on the subject, traditionally two stylised models of capitalism<sup>1</sup> with distinct financial structures, and particularly those with different forms of intermediation and control, have tended to be placed in direct opposition to each other (Orléan 1999).

The first, the Rhenish model, epitomised by Germany, has a number of defining characteristics, such as a concentration of capital, giving the main shareholders internal control, particularly within large banks. Such banks play a key role as, given these companies are often major shareholders, they on the one hand provide them with credit, and on the other get involved in managing and overseeing them. If there is little transparency in this system, it nevertheless brings considerable organisational stability and encourages close, long-term relationships between the banks and industry. The banks attain their position through a power balance, which is built on plentiful and confidential information, as well as on regular, long-term bilateral relations. Ownership of capital is stabilised through retaining shares in one's own company and having reciprocal shareholdings. The financial markets are underdeveloped and *liquidity plays only a marginal role*. This is known as 'locked' capitalism and hostile takeover bids are infrequent. In short, in this model the banks are at the centre of financial governance.

The second, the Anglo-Saxon model, as epitomised by the United States and the United Kingdom, is configured differently: here, the financial markets are highly developed and liquid, with widely disseminated minority shareholders, making direct company control very difficult and, moreover, very costly. Shareholders are therefore unable to exercise direct, *ex-ante* control over management, but put pressure on the managers by threatening to withdraw their capital (defection). This is effectively 'distant', *ex post* control, as far as business results are concerned, but there is no direct involvement in company management

(Paillard & Amable 2000). In this second model, hostile takeovers are frequent and the financial markets play a vital role, both in terms of financing and control. In such cases, bank intermediation, and the banks themselves, play a minor role, as it is the markets that are at the heart of financial governance.

In a climate of financial globalisation and with the financial markets developing vigorously right around the globe, the individual character of the financial structures hitherto developed in continental Europe seem to be being weakened. Some see this heralding the end of alternative models as they are brought in line with the Anglo-Saxon model (e.g. Morin 2000). Others, such as Giraud (2001), see the Anglo-Saxon model itself evolving, with different models also undergoing constant change, already converging into ‘something else’. Thus, there may not simply be a one-sided convergence of the financial systems but rather reconstitutions, which give rise to hybrid, often original forms (Saïdane 2005) or new amalgams (Crouch 2005). We wish to contribute to this debate by tracing the specific trajectory of the Swiss model without necessarily delivering any definitive judgements upon it. At a very general level we can, however, see that on the one hand reforms made in many countries, including Switzerland, are directly inspired by the Anglo-Saxon model, and on the other hand the increasing power of institutional investors and some reforms favouring the free movement of capital have more or less successfully (depending on the country) transformed the economic landscape of continental Europe.

*Institutional investors and the move towards the free circulation of capital.* How can we explain the increase in the financial markets’ power in contemporary societies? There are two issues which we think are worth examining. Firstly, the increasing power of collective investment schemes and the concentration of them in the hands of institutional investors (Clark 2000, 2003; Montagne 2006) and, secondly, those political and institutional reforms aimed at promoting mobility/liquidity of capital (Corpataux & Crevoisier 2005a).

The increasing power of collective investment schemes and the concentration of these in the hands of institutional investors have played an important role in the transformations which are affecting the financial system. Indeed, even if there are increasing numbers of households investing either directly or indirectly in shares, it is primarily the *financial intermediaries* who manage these funds (banks, insurance firms and pension funds all fall under the rubric of *institutional investors*) and thus who seem to actually control them. In the US, since the late 1970s institutional investors appear to have become the key financial players and have come to manage the majority of financial assets (Giraud 2001; Orléan 2000). These investors are now mainly placing their fund investments in the financial markets. The development of these new actors pushed the financial industry to expand over the last years. As an emergent category of financial actors, clearly part of the contemporary financial system, institutional investors have been at the same time important vehicles for change in the financial markets. Of these, pension funds particularly stand out (Boubel & Pansard 2004; Giraud 2001; Plihon 2004).

Two types of institutional reforms have been introduced in most countries in order to create and support the development of the financial markets at both national and international level, i.e. internal and external liberalisation (Morin 2006). On the one hand, reforms aim to remove all regulatory obstacles to the free and absolute movement of capital. So, we have seen the UK’s removal of exchange controls in 1979, the partial opening up of Japan’s financial markets in 1983–84, the unimpeded movement of capital in Europe as dictated by the Single European Act (Bourguinat 2000); all of these measures are aimed at encouraging the spatial *omobility* of capital. On the other hand, there are reforms that aim

to improve the operational and informational efficiency of the financial markets, i.e. which aim to promote their *liquidity* and transparency as well as guaranteeing good quality public information. This is what we call the increase in capital mobility/liquidity (Corpataux & Crevoisier 2005a), since the liberalisation of the movement of capital goes hand-in-hand with the development of the financial markets and their liquidity.

According to writers (Aglietta 1998; Boyer 2000; Chesnais 2001; Lordon 2000; Orléan 1999) close to, or affiliated with the *Ecole de la Régulation*, an accumulation regime based on finance (defined as the ‘financialised accumulation regime’), apparently succeeds the techno-industrial regime based on mass production and consumption (the Fordist regime). In the Fordist regime, finance was subordinated to productive industrial capital and it took largely the form of bank credit. Finance was strongly ‘contained’ through different types of regulation. Competition between banks was not as centre stage as today. Economic policies were based on ‘cheap’ money, while banking institutions did not implement high profile policies of market segmentation between the various actors. In such a context, securing bank credit was relatively straightforward and available to most businesses. Finance is now increasingly acting as an autonomous force, imposing increasingly high financial profitability criteria (Morin 2006), whereas forms of finance are becoming more and more heterogeneous and are increasingly offered via the financial markets. The privatization wave in Europe of state-controlled companies in the 1990s allowed the listing of these companies on the stock markets and the growth of the latter. The finance industry expanded into new sectors of activity, such as property markets (Theurillat et al. 2006b) or urban infrastructures (Torrance 2006) too. Today, finance, the current dominant institutional form, can be seen as controlling the forms and the pace of accumulation. Thus, according to Orléan (1999: 214), ‘contemporary economies are mainly characterised by having taken financial power to previously unattained levels and having put this power at the very centre of their accumulation regime.’

This movement towards an economy which is governed by the financial markets raises a number of questions. Firstly, there is the crucial issue of the future of banking: the banks seem to have a less influential role in capitalist systems dominated by the financial markets. Indeed, where some pundits see the end of traditional banking intermediation, others believe that the role of banks is simply evolving or continuously in reinvention (Erturk & Solari 2007). In brief, if pension funds add a layer to the existing financial structure, some consider that the institutionalisation of savings has often led to the erosion of other institutions which provide financial intermediation services, not least of which are the banks. Others observe that one of the new roles of banks makes them ‘money managers’ for others and especially for pension funds when these last actors choose not to undertake all the management in-house.

*Institutional investors and changes to the financial circuits.* In common with Anglo-Saxon countries such as the UK, US and Canada, and with the Netherlands in continental Europe, Switzerland is an economy in which pension funds manage a considerable portion of household savings. They constitute a burgeoning group within finance. Up until the 1980s the collection and distribution of household savings was a service almost exclusively provided by the banks; pension funds are now making significant inroads into this area (Aglietta 2001). Banks collected savings locally and reinvested the greater part of it in their own region in the form of banking credit, mortgages, etc. Pension funds are now attracting a large proportion of these savings and are generally investing this money directly in the financial markets. By diverting these savings, the pension funds are competing with the banks on what used to be their own turf.

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The increasing importance of pension funds is pushing to the transformation and spatial reconfiguration of financial channels (Theurillat et al. 2007). When we consider the huge amount of household savings they attract, we should also examine how the big players divide up the financial intermediary services between them: are the banks being ousted (Boubel & Pansard 2004; Saïdane 2005)? Indeed, if some commentators herald this as the era of disintermediation, (i.e. the complete disappearance of financial intermediaries, leaving only the option of direct relations with those who supply and demand capital), others such as French and Leyshon (2004) insist that there is no such thing as disintermediation, but that we are simply seeing the emergence of new forms of intermediation, a process which they term reintermediation.

With this case in point, the banks are not necessarily disappearing, and are far from losing interest in the development of the financial markets. Their traditional intermediary role (collecting savings deposits, allocating credit) is simply being diminished and transformed. Indeed, some of them are increasingly abandoning their traditional role as credit providers to offer other financial services. They have even started to emphasise their activities on the financial markets by helping businesses and individuals to acquire securities (shares, bonds, negotiable debt instruments, etc.), or even by issuing shares on the money and financial markets. Morin (2006) has shown how, for example at international level, banks are not disappearing, quite the opposite in fact: those with the greatest power and presence are forming an oligopoly. In such a perspective banks have reinvented themselves so that they increasingly depend on new activities, generally indexed by the rise of fee income (Erturk & Solari 2007).

In this new context, what shareholder power do institutional investors, particularly pension funds, actually wield? Have they now become active, all-powerful shareholders?

### *Corporate Governance and Institutional Investors' Activism*

According to some, we are entering an age of shareholder capitalism. New relationships are springing up between shareholders and company managers. Reforms have been implemented to ensure a shareholder value model, in which the shareholders alone have control. In such set-ups, the investors apparently rule the roost: holding a substantial proportion of the shares, they can impose upon a business their own rules regarding management and profit margins, even whilst remaining minority shareholders.

*From managerial capitalism to shareholder capitalism?* In the US, Berle and Means (1932) observed that in the first half of the twentieth century, a growing number of firms fell under managerial control. At the time, business managers were dealing with a loose conglomeration of individual shareholders who were often isolated and scattered far and wide. Managers were therefore 'all-powerful' and their power rarely contested. In this context, this could be called managerial capitalism. Today, institutional investors hold a growing share of the capital of many businesses and seem to call managerial power into question. This concentration of capital and decision-making power in the hands of institutional investors – supposedly organised and professional fund managers – changes the set-up considerably (Boubel & Pansard 2004; Harmes 1998). Fund managers seem to be able to bring some power to bear upon company management, or at the very least, closely scrutinise the decisions that management make. Some have labelled this new configuration shareholder or 'patrimonial' capitalism (Orléan 2000; Plihon 2004).

Thus, if the financial markets are developing partly in response to the growth of institutional investor power, these same institutional investors are using the financial markets and their liquidity for their own ends. Their aim is perfectly straightforward: to increase shareholder wealth by pushing shares to their maximum price and increasing dividends (Orléan 1999). This is generally referred to as ‘creating shareholder value’. Adding shareholder value usually also involves instituting a new form of corporate governance. This aims simply to reduce asymmetric information between shareholders and managers and to bring the interests of the latter in line with those of the former (Lordon 2000). Of course, since Jensen and Meckling’s pioneering work (1976), a whole area of financial theory has been devoted to conceptualising possible relationships between managers and shareholders in terms of agency theory and in promoting the interests of shareholders. The latter provides the normative principles which favour shareholders and lead in particular to current corporate governance reforms. These principles specifically cover transparency of information to shareholders, the obligation for managers to be accountable to shareholders as well as to respect the rights of minority shareholders (Plihon 2004).

In the USA, institutional investor activism took root in the 1980s, when, for example, public pension funds and union funds started submitting shareholder proposals to companies (Gillan & Starks 2003). In France, for example, with the arrival of institutional investors in the capital, the traditional management and capital-holding model has undergone a radical transformation. Morin and Rigamonti (2002) have also shown that the shareholder structure has changed considerably over the last decade, while new management practices that favour shareholders have started to emerge. These are having an impact on companies’ operational management and strategic goals (Morin 1998). At the same time, these changes, in terms of shareholder structure and new management practices, are strongly related to the new importance of foreign investors – mainly Anglo-Saxon institutional investors – holding increasingly large quantities of share capital in French listed companies. Indeed, let’s observe that shareholders’ activism, even in foreign equity investments, seems to be an American phenomenon and mostly associated with a small number of large mutual funds such as Fidelity or public pension funds such as CalPERS (Golding 2003). Towards the end of the 1990s, Jeffers and Plihon (2002) estimated that this share in foreign hands had reached 50 per cent of all companies on the CAC 40 Index.

Germany, on the other hand, seems less affected: changes to its financial system and the relationships between the financial system and big business seem less profound, more superficial. The Rhenish model seems to endure and undergo mainly incremental transformations (Hackethal et al. 2005, 2006; O’Sullivan 2003). In Germany, from the point of view of the control of listed companies, integration has still not occurred at either a national or international level, at least had not by the late 1990s. Indeed, the German financial market remains highly regionalised. Geographic and organisational concentrations remain undiminished and the main shareholders are still largely from the same Land as the listed company (Wojcik 2002).

*Voice or exit?* In an environment which increasingly favours the shareholder, we should not lose sight of the fact that when shareholders are dissatisfied with their investment in a company, they have two choices: they either sell their shares (what Hirschman (1970) called the ‘exit strategy’), or they encourage the company to change its strategy, by exercising the voting rights which their shares confer (the voice strategy). The latter activity is called shareholder activism.

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Various writers have examined this issue and have come to different conclusions. According to Clark and Hebb (2004), institutional investors and pension funds, even as minority shareholders, re-aggregate hitherto disparate ownership rights to form a new power coalition with sufficient weight to influence company management. These parties, however, have little power in terms of exit strategy. Indeed, on the one hand, pension funds tend more and more towards index-tracking, passive fund management, which leaves them little room for manoeuvre. On the other hand, a mass exit could lead to the collapse of a company's stock market value, which is not in the funds' interests. Clark and Hebb maintain that this environment does not favour exit strategies and pension funds would rather utilise the voice strategy.

For Aglietta and Rebérioux (2004), however, such a system does little to encourage shareholder activism. If the development of the shareholder value principle increases the dissociation between the ownership and the control of a company, it pushes shareholders to adopt an exit rather than a voice strategy. According to these two authors, shareholders are now tending to abandon their right to control businesses in favour of the advantages of liquidity, i.e. the possibility of divesting oneself of one's shares on the stock market at any point.

The theories introduced so far are considered to be essential reading for anyone wanting to understand contemporary economic thinking, whether in a descriptive, prescriptive or even performative form (Callon 2007), as these theories do not simply describe the situation or provide working principles for some players (from a pre-existing immutable and objective reality), but are actually shaping and building this reality. Nevertheless, for the most part they remain based on nation-state boundaries and use a 'methodological nationalism' (Lévy 2007; Peck & Theodore 2007) where each nation-state is considered as a single point. National frontiers are therefore 'naturalized' (Lipietz 1977) without questioning their real relevance and any sub-national variations, differences or differentiations are neglected. Standard neoclassical theory looks for universal laws or theories that are valid at every time and everywhere and thus fails to place the players in their geographic context and do not take account of the networks of specific relationships in which they operate. More institutionalist views such as those developed by the French Regulation School or the Varieties of Capitalism stream are more sensitive to geographic or context-specific variations, even if they still remain mainly based on nation-state boundaries in most of their comparative works. In fact, the transformations that the financial system is currently undergoing have come from very specific spaces or sub-national places. In return, these same places are redrawing the geography of contemporary economies.

### *Reconfiguring the Financial Systems, Power and Regions*

There are few theories which link finance and regional development, and those that do were generally developed in the 1990s (see Corpataux & Crevoisier 2005a; or particularly Corpataux (2003) for a more complete review).

With the emergence of global cities, Sassen (1991) argues that as financial activities have developed they have started to cluster in certain areas. These 'global cities' should no longer be seen as straightforward regional capitals: they are becoming the 'command centres' of the world economy, from which multinational companies and international financial markets are run, and which are hothouses for financial innovation. This process of centralisation and spatial concentration of the financial system calls into question, at the

other end of the scale, the development and autonomy of local banking structures (Dow 1999) and, ultimately, the development of non-central regions, and specifically the SMEs (small and medium-sized enterprises) in these regions, who are largely dependent on the regional financial circuits and on bank credit. In point of fact, the absence or gradual disappearance of traditional financial circuits in these regions leads sooner or later to burgeoning SMEs being bought up by big businesses, often from outside the region. As a result, regional decision-making powers and consequently centres of accumulation are lost (Crevoisier 1997).

In short, financial power is being concentrated in these global cities, which work more as part of a network, and which at the same time are cutting themselves off from their hinterland. Furthermore, innovations in the financial sector (securitisation, the emergence of new financial products and practices, etc.), the free movement of capital at national and international level and the ability of financial centres to transform businesses' real assets into negotiable liquid securities on the stock markets have led to both a dissociation from the sites of investment and given the centre an ability/power of *spatial trade-off* (Leyshon & Thrift 1997) between the regional, national and international.

If the increasing power of institutional investors is now undeniable, to the extent that some writers are now talking about a fifth stage of capitalism to describe this new aggregated form of shareholder power (Clark & Hebb 2004), this new configuration can lead to a spatial concentration of financial power. Martin and Minns (1995) have shown for example that British pension funds are managed in a highly centralised way, by financial institutions based mainly in the south-east. Functional and spatial concentration often go hand-in-hand. Now, although a number of works are certainly taking the role of territory in corporate governance into account (Bouba-Olga 2006; Clark & Wojcik 2007), their primary focus is on shareholder profiles within (regional or international) listed companies. Such works are not looking at the 'structure' of the field within its context, i.e. the diversity of players within it, the ways and places in which they interact, and so on.<sup>2</sup> Our view is that these elements will now have a considerable bearing on the extent to which the shareholders can use their power.

### **Switzerland: A Paradoxal Model**

Since the late 1980s, Swiss capitalism, which used to resemble the Rhenish model, has undergone a number of significant transformations. Reforms such as decartelisation will encourage the restructuring of the financial system. Such financial activities are coalescing in the country's main financial centres, augmenting their decision-making powers and hastening the decline of regional financial channels. Yet the pension funds are somewhat implicated in these transformations. Throughout the 1990s their power increased, in an environment that was increasingly favourable for corporate governance. Has the way been paved for them to fall into this rather privileged position?

#### *Methodology*

The evidence used in this paper was collected during a previous research on the geographical and functional channels used by the assets of Swiss pension funds (Theurillat et al. 2006a). At that time, data were collected from both the (Swiss) Federal Statistics Office (OFS) between 1992 and 2004, and from privately collected information on Swiss institutional

investors (Lusenti et al.'s surveys between 1997 and 2005). In addition to this were some 20 semi-directive interviews, which were conducted with industry players in 2005. Furthermore, a panel of 13 experts gathered on two occasions: they met in December 2004 in order to validate the hypotheses and identify relevant sources of information and respondents; and in December 2005 to critically revisit the research results and to conclude the study.

This empirical research was not centred on corporate governance in Switzerland, but on the identification of the channels, the institutions and the strategies followed by the various players along the chain of investments of pension funds. At the end, it appeared that corporate governance issues were striking and paradoxical. Therefore, this paper is a derived but particularly relevant result of that empirical work. Consequently, on the base of this material, we can only bring partial conclusions and identify open research questions (see Conclusions).

#### *Defining Characteristics of the Helvetic Model and Recent Changes To It*

Up until the early 1990s, the Swiss model of holding and managing capital very much resembled the Rhenish model. According to David et al. (2004), there were three defining characteristics to the Swiss model: firstly, powers of control were highly concentrated and shared amongst only a few shareholders;<sup>3</sup> secondly, there were well-established, long-term relationships between banking and industry; and thirdly, measures were taken to protect big businesses from hostile and foreign takeovers. The Swiss model, following the Rhenish example, therefore seems 'locked' in comparison with its Anglo-Saxon counterpart. There, capital ownership is stabilised by an interplay of internal controls and cross-shareholdings, with the banks playing a key role here both in terms of control and credit provision. In short, the country has a more Rhenish 'macro-institutional' configuration, making it seem opaque and lacking in transparency to foreign investors, the Anglo-Saxons in particular.

Moreover, a financial market with international significance (specialising principally in international wealth management) peacefully co-existed with a banking system that is highly cartelised and very much focused on its domestic market. Banking conventions, particularly the existence of standard tariffs, suppressed competition and allowed a number of regional organisations to develop. Alongside an international financial market concentrated in three cities (Zurich, Geneva and Lugano) was an internal banking system made up of numerous cantonal and regional banks, as well as the big banks, which were still very much decentralised at the time.

In the early 1990s, various reforms, such as decartelisation<sup>4</sup> of the banking sector, led to centralisation. The larger banks are buying up failing regional banks, local stock exchanges have closed, financial operations coalesce towards Zurich and the country's main banks are becoming increasingly internationalised (Corpataux & Crevoisier 2005a, 2005b).

During the same period, when the second pillar came into force, an increase in the power of Swiss pension funds was observed. Indeed, Swiss pension funds have continued to grow from the mid-1980s into and beyond 2000. Since 1998 these savings have even outstripped national GDP. For example, in 2000 and 2004, the total assets managed by pension funds represented 118 and 108 per cent, respectively, of GDP (OFS). Throughout the 1990s, the pension funds' portfolio profile changed, and an ever-increasing proportion of the money that they manage now passes through the financial markets. In fact, the combined quantity of shares and bonds has regularly increased, going from 44 per cent of

overall wealth in 1992 (113bn) to 64 per cent in 2000 (314bn) and to 63 per cent in 2004 (307bn). This has been to the detriment of less liquid assets such as direct property holdings or investments with employers and mortgages.

From the year 2000 onward, important changes then affected the shareholding environment. These changes have strengthened the shareholders' position and make the Swiss model more transparent. Thus a whole series of both legal measures (e.g. Article 49 al 2 of the OPP2, requiring funds to specify whether or not they are exercising their shareholding rights (OFAS 2001b<sup>5</sup>)), and informal measures (the 'Swiss Codes of Best Practice for Corporate governance' for Economiesuisse as well as SWX Guidelines) have been made (Economiesuisse 2002). Nevertheless, and even at Economie Suisse, the umbrella organisation for the country's big businesses, a stand has been made against certain Anglo-Saxon principles. For example, the 'one share, one vote' principle is still not officially part of the code.

Quite simply, Switzerland is undergoing a transformation from a cartelised and regionally-based system of banking finance to a national/international financial system in which the financial markets are playing an increasingly influential role. The regional financial channels are in decline and are today simply making way for national and especially global channels. At the same time, decision-making powers are tending to be concentrated in the country's main financial centres whilst governance standards that favour shareholder capitalism seem to be being implemented. Yet in the mid-1990s, Guex and Pasquier-Dorthe (1996) believed that it was the banks, particularly the larger banks, which were leading the way in the financial markets and in innovations in Switzerland. Their study did not really include pension funds. If an increasingly significant number of pension funds are moving into the financial markets, what effects will this have on the country's banks and on the redistribution of shareholder power? To put it plainly, should we be considering funds as new financial players in their own right?

#### *Fund Passivity and the Structure of the Investment Industry*

Even if corporate governance reforms tend to favour minority shareholders, and therefore pension funds, are funds or indeed *can* funds really be active from a corporate governance point of view in Switzerland, fulfilling the minimal requirement, i.e. the exercise of voting rights or attendance of AGMs? Nevertheless, and despite recent reforms, funds do not seem to be any more active (Lusenti 2003; Swissca 2004).<sup>6</sup> A wide variety of reasons may explain the passivity of Swiss pension funds, not least of which is the absence of a shareholder culture in Switzerland (Oesch 2000; Wernli 2004). Yet, we would contend, the lack of any activism on the part of Swiss pension funds might be explained by the structure and the dynamic of the investment industry.

*Small funds managed by non-professionals.* For a start, the Swiss industry in particular has really taken off. Indeed, the second pillar system is made up of some 2445 funds registered in 2002, and, although they may be scattered across the territory as a whole, they are mainly coalescing around the country's main cities. Each one has its own investment policy. However, they are very often managed by representatives of the employees and employers who are not financial professionals. Their primary concern is ensuring that the return on their funds covers their present or future guaranteed annuities. These individuals not only determine the investment policy (the portfolio distribution of bonds, shares, real estate, etc.), they also determine what is managed internally and what is outsourced. In practice, almost all management is outsourced.

Indeed, besides *collective funds* (93 in 2002), which are entirely managed by insurance companies and banks,<sup>7</sup> only a few large independent funds<sup>8</sup> would have the means to employ internal managers and train them in-house. So, where the Novartis fund, for example, manages a large part of its securities in-house, Nestlé outsources. Nevertheless, interviews and meetings conducted with branch experts confirm that, in Switzerland, pension funds, even the large ones, generally look beyond their own company for the greater part of their securities portfolio management.

Again, the law now tends to institutionalise delegation to third parties, to outside experts. The revision of Article 50 of OPP2 allows for the ‘reformulation of the definition of security’, and essentially states that, in principle, pension fund investment activities are *their own responsibility* (OFAS 2000). Accordingly, the pension funds’ managing bodies (which are for the most part made up of ordinary citizens) have to turn to specialists, i.e. financial advisors and wealth managers, in order to meet their personal responsibilities. So what are these financial institutions that look after securities for pension funds, and where are they based?

The direct management of funds’ securities is therefore largely delegated to the financial institutions that are attached to the banks. The vast majority of funds turn to various investment bodies for management mandates as well as for collective investments (Lusenti 2003; Robeco 2002; SFO several years).<sup>9</sup>

Now, despite the increase in mandates or collective investments, only a small number of financial institutions covering this market exist. Indeed, in the case of management mandates, which made up 80 per cent of investments in 2002, the market is divided between private Swiss banks (30 per cent), the big banks (UBS and Crédit Suisse representing 28 per cent) and cantonal banks (17 per cent). Foreign banks and financial institutions have only a small share in the institutional management market (15 per cent) (Robeco 2002). When it comes to collective investments, the situation is exactly the same: the big investment companies and investment funds also belong to these players. All the wealth management departments of these businesses, as well as the majority of *investment companies*, are based in Zurich or Geneva.

Essentially, the country’s largest banks manage most of the assets. How does this financial sector invest its funds? On what management principles does it operate?

*The dispersal of shares and internationalisation.* Funds are now significant shareholders: their equity portfolios as a percentage of their total wealth jumped from 11 per cent (27.2bn) in 1992 to 27 per cent (131.3bn) in 2004. This increase in equity holdings is as much due to the increase in stock market rates as to new purchases. See Table 1.

TABLE 1  
Weight of pension funds on the Swiss Stock Exchange, 1992–2004 (in CHF millions)

	Swiss equity in funds	SPI market capitalisation	Weight of funds in the SPI (%)
1992	21'274	276'980	7.7
1994	29'809	372'586	8.0
1996	39'871	539'944	7.4
1998	63'828	946'615	6.7
2000	86'834	1'257'276	6.9
2002	51'214	737'999	6.9
2004	59'219	886'748	6.7

Sources: OFS (2000, 2002, 2003a, 2003b, 2004a, 2004b, 2006) and SWX.

However, this considerable move towards equity has not translated into an increase in the weight of pension funds on the Swiss Stock Exchange. In fact, their weight in the Swiss Performance Index (SPI) diminished between 1992 and 2004, from 7.7 to 6.7 per cent. This could be explained by the fact that investments are subject to an *internationalisation strategy*.

Indeed, if we focus exclusively on pension funds' equity portfolios, we can see that the proportion of Swiss equity (of the total equity portfolio), declined by over 30 points between 1992 and 2004, from 77 per cent (21.3bn) to 45 per cent (59.2bn), whilst shares in foreign equity rocketed from 23 per cent (6.4bn) in 1992 to 55 per cent (72.1bn) in 2004.

Taken globally, funds could be seen to have a certain influence. Nevertheless, taken individually, even large funds do not have much influence amongst the colossi of the stock market, which severely limits their powers of control and influence. For instance, if a fund with a fortune of 10bn (in 2002, only 15 funds managed over 5bn) decided to invest 25 per cent of its wealth in a single business such as Novartis, which was worth almost 143bn in 2002, it would still only have 1.7 per cent of voting rights. This is true for Switzerland's ten largest listed companies, as no fund held more than 5 per cent of their capital between 1998 and 2005 (SWX 2005). Can funds perhaps have more influence over small and midcaps companies? In research into *non-financial* organisations in the SPI, Wernli (2004) found that between 1998 and 2002, only 23 pension funds held a stake of over 5 per cent in secondary securities on the SPI.<sup>10</sup> Funds do not invest much in listed companies' capital, probably because most fund managers opt for a diversification strategy when structuring a large proportion of their investments. This diversification principle, which applies to management mandates as well as to securities, leads to multiple and highly disparate share purchases, the latter being, ultimately, very low.

In fact, four big businesses (Novartis, Nestlé, Roche and UBS) account for just under 60 per cent of the SPI (Table 2)! Even so, and backed by the responsible principle of diversification and the number of external mandates, it is highly probable that Swiss pension funds will ultimately find themselves shareholders of the same big businesses on the domestic market. Any players with a strategy of Swiss market index-tracking should expect to find that, of their equity investments in this market, at least 60 per cent of them are made up of shares in the big four. . .

Finally, it is worth noting the increase in collective investments. These do not tend to lead to fund activism ('voice'), as shareholders' rights generally fall to financial institutions

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TABLE 2  
The four largest listed companies on the Swiss stock market in 2004 (in CHF millions)

2004	Total stock market value	% shares in SPI
Novartis AG, Basel	152'999	17
Nestlé AG, Cham & Vevey	120'047	14
Roche Holding AG, Basel	115'965	13
UBS AG, Zurich	107'314	12
Total for 4 companies	496'326	56
SPI total	886'748	100

Source: SWX.

(funds, foundations and investment companies).<sup>11</sup> This is a crucial issue, given that, for both international and domestic investments, the trend is towards collective shareholding (7.8 per cent in 1992 and 23.4 per cent in 2004).

Swiss pension funds are unusually inactive due to a number of reasons, including the small size of the funds, a workforce of non-professionals, ordinary citizens who prefer to outsource, fragmentation of investments in company stock, etc. Moreover, we would also go on to argue that the very dynamic of the finance industry does not help funds to take a clear view of the situation. This also contributes to a further lack of activism on their part.

*The dynamics of the finance industry: a matter of transparency and . . . opacity.* Various, often contradictory, forces are at work within the Swiss finance industry, which render it *opaque* for certain players (Theurillat et al. 2007). Generally speaking, the finance industry needs to be transparent in order that different asset classes can be assessed and compared to determine relative risks and returns. Thus, using the information available, financiers can compare an investment in a Russian mining company and a Swiss chemicals firm, and an investment fund which has a mix of bonds and equity with a real estate fund, etc. Although there are some ambiguities around the definition of transparency, it is generally considered as being essential to the efficient operation of the markets and the development of their liquidity. All comparability in fact requires the permanent creation/construction of *transparency*, i.e. standardised and publicly available information. Yet, paradoxically, what we are seeing in the marketplace is a concomitant growth in *opacity*.

Let us recall, albeit briefly, three defining characteristics of the finance industry as it stands today (Theurillat et al. 2007). Firstly, the increase in capital mobility/liquidity and the principle of diversification both seem to conspire in favour of the *internationalisation of investments*. However, investors are less and less familiar with the new countries in which investments are made. Furthermore, with the emergence of *new sectors*, such as real estate (Theurillat et al. 2006b) or urban infrastructures (Torrance 2006), new skills are needed in relation to traditional industrial investments. Finally, in common with most other business sectors, the finance industry's products and services are simultaneously undergoing a process of both *standardisation* and *innovation/complexification*. However, new products (derivative products, composite products, etc.) are particularly complex and it is impossible to find the right exit point for any investment.

## Conclusions

In conclusion, what can we say about the respective roles of the pension funds and the banks within contemporary Swiss capitalism? Is real shareholder power emerging? How are the risks being distributed?

### *Funds are Rendered Inactive or Captive, Unable to Either Exercise an Exit or Voice a Strategy on the Domestic Market*

For the reasons given above (numerous funds managed by non-professionals with unsophisticated financial skills, multiplication and dispersal of investments in company stock, opacity), Swiss pension funds are particularly inactive. Thus, with the exception of a few large funds, i.e. generally those of big, listed companies and public, cantonal and federal funds, they are entirely dependent on the country's main banking and financial companies. They have neither the time nor the skills to know exactly which companies they hold shares

in, nor to acquire the relevant information to speak out at AGMs. If they remain passive, they can, *a contrario*, no longer exercise their right to exit. Indeed, exit promptly throws one back into the narrow confines of the Swiss market. This fundamentally affects the power which Aglietta and Rebérioux (2004) suggest that defection represents. On the Swiss market, we have not only the drawbacks of small shareholders but also the inability to really use their exit strategy and move freely in the market.

Moreover, in a financial environment which is essentially made up of the main banks managing the securities of the second pillar and of the country's biggest businesses, one should bear in mind that, in 2002, the country's 13 largest funds included five funds from the big listed or unlisted companies (i.e. from UBS, Crédit Suisse, Roche, Novartis and Migros). Yet these funds prefer not to interfere in the affairs of their parent companies nor of their competitors, as they are working in a very restricted marketplace. Interviews confirm that the large public funds have little contact with business management.

In summary, Swiss pension funds are not financial players but financialised players, in the sense that they clearly constitute a new financial layer but a passive and dependent one. From a shareholding perspective, they are not in a position to engage in either a voice or an exit strategy. In terms of their securities' management, they seem to be dependent upon the country's main financial players. In short, the main traditional financial actors remain in a position to impose their own views and practices.

#### *Banks Remain at the Heart of the System*

The industry is currently structured such that the vast majority of Swiss funds are shackled to the country's main banks and their asset management departments. The country's main banks have therefore not been bypassed by the implementation of market finance and the creation of the second pillar. Therefore, contrary to the idea of disintermediation (i.e. the disappearance of traditional financial intermediaries), we are rather witnessing an increase in functions, services, skills and, sometimes, players. Unlike the traditional banking system, this reintermediation above all strengthens the country's two main financial centres in which pension funds are managed.

The changes to banking revenues reflect this phenomenon. They increasingly derive from management fees and commissions for securities as well as financial operations (Schnyder et al. 2006). Securities' management costs vary between 0.25 and 0.5 per cent of the total pension funds' wealth and therefore yield between 1.25 and 2.5bn per annum (Lusenti 2003: 111–112; Robeco 2002: 125). Conversely, some figures show the extent to which banking credit is being withdrawn. In the six years between 1997 and 2003, lines of banking credit aimed at domestic business fell by around 60bn francs, to 302.1bn francs (Pedernana & Schacht 2004). This drop has particularly affected SMEs, which take up 86 per cent of the total volume of credit aimed at domestic businesses. It is worth noting that, although cantonal banks have slightly increased their credit services, the overall drop in credit can be explained by a marked withdrawal by the large banks.

Moreover, the diversion of savings through pension funds is detrimental to SMEs. According to Pühr's calculations (2003), in the year 2000, pension fund investments in SMEs only represented 1 per cent of second pillar wealth. Moreover the centralisation of pension fund management has led to a sectorial and spatial change to investments. These primarily profit the country's main industrial and financial players, which are based in the central regions (Theurillat et al. 2007). Investment abroad can be justified by the insufficient

absorption capacity of the national economy. Clearly, the strong growth of pension funds could not be fully absorbed by the Swiss economy without leading to inflation on capital goods (real estate, equity, etc.) . . . or at least on capital goods that were in one way or another reachable by the specific channels fuelled by the money of pension funds. Clearly, SMEs were not connected to the latter. Going through financial markets for investments is not a neutral process: certain spaces and businesses have been privileged whilst others have been excluded.

In summary, and purely in terms of the management of institutional assets, traditional players (the large private and public banks) remain centre stage, with the vast majority of pension funds looking to them for securities management services. Even when funds mix these players differently, the fieldwork shows that, paradoxically, the increase in the number of external mandates does not necessarily lead to a diversification of final investments. Indeed, the various external managers mostly adopt similar investment plans; this is even increasingly the case in the Swiss market, as it is highly concentrated, and only offers a few different possibilities. In brief, most Swiss pension funds are quite 'blind' and have no means and little power or competencies to implement original policy. Only a reform in the structure of the Swiss pension funds industry could be helpful. Reducing the high number of pension funds through mergers and the creation of a few large entities could favour some economies of scale as well as ensure the pooling of competencies. A second step could deal with the required and mixed competencies that these large entities would need: a few 'citizen-experts' that outsource to financial advisers or a 'representative' sample of citizens surrounded by in-house financial experts. . . Various combinations can be imagined.

If the funds do not exercise their rights as active shareholders, who influences decision making in Switzerland? Who benefits from the dispersal of investments in company stock and pension fund passivity? Are the banks that manage a significant proportion of pension funds actually active?

#### *Who is Exercising Shareholder Power in Switzerland?*

The great, unresolved issue is that of shareholder power. One might indeed conclude from this that power resides with a few banks, as there are only a small number of financial institutions covering the institutional fund management market. Yet it would seem that depository banks do not generally vote at AGMs (Hofstetter, 2002; Ledentu et al. 2003).

The fact that they specialise in offering services, and that they are also freeing themselves from internal control (Schnyder et al. 2006), leads one to believe that they do not necessarily want to invest in external control. Indeed, if *a priori*, they seem better equipped than the pension funds to exercise such control, it is only the cost of monitoring which seems to deter them (Hofstetter 2002).

It is nevertheless interesting to note that there is a market growing up around the exercise of shareholder votes, i.e. financial institutions (often the very same ones which manage wealth, such as the private bank Lombard Odier & Darier Hentsch), and often new, different players (e.g. Ethos), who are offering pension funds a service whereby they analyse the agendas of companies in which they hold shares and make voting recommendations. Nevertheless, their hold over and ability to influence big businesses remains, for the time being, minimal.

If changes in Swiss regulations are systematically tending towards strengthening shareholders' rights, 'shareholder capitalism' is far from being a reality! On the other hand, a major change in risk spreading has been noted.

### *New Risk Spreading and Industry Developments*

If the control and management of pension funds is concentrated in the country's two financial centres, risk does not follow the same 'law' of spatial concentration. Indeed, the final capital holders (subscribers) are spread throughout Switzerland. Disintermediation has allowed banks to divest themselves of risks, but reintermediation by financial players has not led to a new concentration of risks.

Rather like the emerging market in the exercise of shareholding rights, a consultancy market is springing up. Moreover, this is mainly composed of independent consultants, to the detriment of traditional consultants affiliated to banks and insurance companies. They provide a range of services from actuarial services to reporting on investment results, as well as selecting and assessing managers (Robeco 2002). In summary, the investment industry is becoming increasingly complex and the number and scope of skills are expanding as financial centres become more concentrated. We are dealing with experts in charge of controlling the experts to whom services are delegated. The finance industry is creating its own development dynamic! Much like any other industry, finance has seen an increase in the number of specialist agencies, either within existing organisations or with the creation of new businesses. The industry has therefore seen a noticeable increase in the number of players, the division of labour and outsourcing at all levels, and particularly in those areas where more specialised skills are developing (investment advisors; specific investment funds, such as hedge funds, emerging markets and international real estate; and fund management control, etc.). These specialised services are developing in the country's two financial centres. This echoes Sassen's (1991) view that one of the main functions of the *global city* is financial innovation.

Investors are becoming sufficiently professional and organised to make their voices heard, and yet, as the power of these institutional investors increases, are we witnessing the dawn of a truly democratic shareholding culture, or is this phenomenon, as Lordon (2000) suggests, simply a mirage? In Switzerland, if we are talking about pension funds, we would surely say this is a mirage. Looking at its spatial configuration, i.e. the development of a centralised financial environment which is capable of generating and interpreting data, providing services, breaking new ground, changing the rules to suit its own ends and of working across increasingly long distances, we can see all these factors are genuinely a testament to this apparent trend.

Financial industry governance is carried out to the detriment of funds, as they are widely dispersed, unprofessional, lack access to useful information, have no influence over the way the industry works, lack influential business contacts, etc. Given this situation, even a raft of measures designed to help shareholders could do little to change the situation.

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### **Notes**

- 1 There exist evidently more models of capitalism (see Crouch 2005 for an overview and a critical appraisal of the various authors or/and streams of thought using such theoretical

categorizations). Nevertheless, for questions of space and relevance, we will focus on two models. Firstly, the Rhenish model, especially considering that Switzerland is generally clearly allied with this model, even though there are some slight differences. On these similarities and differences with the Rhenish model, see the work of David et al. (2004). Secondly, the Anglo-Saxon model, especially considering that most of the reforms undertaken in Switzerland systematically took their inspiration from this last model.

- 2 One might make similar observations regarding standard financial theory as applied to corporate governance, as it is limited to ‘theorising’ an abstract relationship between two players, a principal (the shareholder) and an agent (the manager).
- 3 Comparing Switzerland, the Netherlands, Germany, France, the UK and the USA, Windolf and Nollert (2001) show that, at the beginning of the 1990s, the proportion of shareholders holding 50 per cent or more of share capital was still very high in Switzerland (31.1 per cent). Only Germany had a higher percentage (51 per cent). Moreover, a high proportion of Swiss multinationals were still in the hands of one person or a limited number of people. The proportion of large firms controlled by one individual, or a single family, was very high (31.1 per cent) and even higher than in Germany (18.9 per cent). In the UK, the situation was different because shareholdings were much more scattered: over 90 per cent of shareholders held less than 25 per cent of share capital, a percentage exceeded only by the USA, at 99.9 per cent. In Germany and Switzerland, shareholders holding less than 25 per cent of share capital were much less numerous – 53.3 and 35.1 per cent, respectively.
- 4 In Switzerland, the economic recession at the start of the 1990s brought about a series of institutional reforms called ‘decartelisation’, aimed at increasing competition and strengthening market mechanisms. These reforms also covered the domestic banking sector, highly cartelised until then (ASB 1999).
- 5 Further to the amendment in 2002, the Board of the Foundation has to decide whether the fund will exercise its right to vote or not. Should this be the case, it will then be required to issue guidelines which will allow it to define voting positions for each of the points on the AGM agenda for companies whose funds have shareholders (Robeco 2002:46).
- 6 The last poll by Lusenti (2003: 65) surveyed 192 respondents, and showed: only 31 per cent of funds exercise their voting rights in Switzerland; 13 per cent do not vote; 17 per cent vote at AGMs in Switzerland and abroad. Moreover, following the amendment in 2002 (Article 49, al. 2 OPP2), 45 per cent defined specific regulations, 27 per cent had no specific regulations, and 3 per cent specified ‘other’. According to a Swissca survey (2004), 40 per cent of respondents regularly attended AGMs, 32 per cent did not attend, and 27 per cent attended occasionally.
- 7 More specifically, this means that the administration as well as wealth management functions are generally *structurally delegated to an insurance company or, less usually, to a bank*.
- 8 In 2002, 62 funds managed over 1bn, and 15 of those over 5bn.
- 9 In the case of management mandates or direct investments, the funds invest directly in listed (public or private) companies’ securities (equity or bonds) and investments are managed individually. Nevertheless, unlike direct real estate investments, direct or individual property portfolio managers can, theoretically, be carried out either *internally* or *externally*, generally in the form of a management mandate. In the case of collective investments, the wealth from various investors is pooled in investment funds. Funds thus take up shares within *investment foundations*, *investment funds* or *investment companies*.
- 10 Only 23 funds held over a 5 per cent stake in a listed company: 21 have over 5 per cent in any single business; one in two, and one other in three (figures from SPI, 31 December 2001).
- 11 On one hand, no survey has been conducted into the specific issue of collective investments and the problems of shareholder rights; on the other hand, this situation is not covered by Swiss law (OFAS 2001a).

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