Università
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Dorsoduro 3246
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Master's Degree programme – Second Cycle
(*D.M. 270/2004*)
in Economia e gestione delle aziende
(International Management)

Final Thesis

Contemporary history of finance for companies in Italy, Germany, the United Kingdom and the United States of America

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Academic Year
2015 / 2016

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Acknowledgements

I wish to express my gratitude to Professor Giovanni Favero, my research supervisor, for his accurate guidelines and his useful critiques regarding this final project. It has been a pleasure to work under his supervision and to put into practice most of the economic and historic notions he taught me during my Masters degree.

I would like to thank Nada Sabbagh from The Economist, who patiently helped me with English grammar and structural corrections. Her advice has been of invaluable importance to me.

I would also like to extend my thanks to the librarians of Biblioteca Comunale di Cervignano del Friuli, Middlesex University Library of London and Lambeth Library of London for their help in providing me the papers and books needed for this research.

Finally, special thanks to my parents Alessandro and Elisabetta, my brother Francesco, my sister Irene and my girlfriend Daniela for their support and encouragement throughout my studies.

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Introduction

This dissertation is a comparative analysis of the causes that have led to different prevailing financing methods in four different countries: Italy, Germany, the UK and the USA. The period taken in consideration begins from the end of the Second World War [1945] to the end of the twentieth century, but in certain cases it has been necessary to describe episodes prior to the considered period of time. Contexts changed radically through political reforms, economic crisis and several turning points, thus it has been crucial to provide the reader the tools needed for a complete understanding of the core message.
The purpose of this dissertation is to describe the influences that politics and capital markets had on the financial support for companies and to compare them within the four states taken in consideration.

Each chapter is dedicated to one of the four countries researched, which are divided in four common paragraphs: *politics*, *economy*, *stock exchange* and a *final commentary*. An additional paragraph of each chapter will propose a study on the financing methods of national businesses, with each proposition closing on different ideas due to the intrinsic and unique features of the nation examined. The text aims to communicate notions regarding methods in finance, encouraging the reader to understand such differences and connect the dots as he/she continues reading.

In order to acquire the necessary background for a complete understanding of this dissertation, it seems reasonable to introduce the definitions of bank-based and market-based financing systems.
Following Levine, the 'bank-based [financing system] view highlights the role of banks in (i) acquiring information about firms and managers and thereby improving capital allocation and corporate governance, (ii) managing cross-sectional, inter-temporal, and liquidity risk and thereby enhancing investment efficiency and economic growth and (iii) mobilizing capital to exploit economies of scale.' (Levine 2002, 2).
On the other hand, the 'market-based [financing system] view highlights the growth enhancing role of well-functioning markets in (i) fostering greater incentives to research firms since it is easier to profit from this information by trading in big, liquid markets, (ii) enhancing corporate governance by easing takeovers and making it easier to tie managerial compensation to firm

performance, and (iii) facilitating risk management.' (Levine 2002, 3).

Examples of both the models today include the bank-based model which can be typically found in Germany and Japan. These have been the subject of many studies of researchers and academic for their brilliant economic development, mainly due to the important role played by universal banks (Levine 2002, 1). The market-based model, as its definition might suggest, has been implemented in the UK and the USA (Levine 2002, 1).

Italy, as it is described in Chapter 1, is an hybrid between the two models mixed with a prevailing role of the public sector due to the important role that the public sector had acquired in the management of large industrial firms since the Fascist regime (Barca 2010, 9).

CHAPTER 1

Italy

1.1 Politics

After the Second World War, the world was divided in two sides: the West and the East. This led to an ambiguous situation in Italy, where the *Partito Democristiano* [Christian Democratic Party] was positioned in the centre and ideologically closer to the Vatican and the Anglo-Americans (Duggan 2007, 468). The party's main objective was the reconstruction of the family as core value of the society, the personal progression before the progression of the market, to link the Church and the mass with modernity, and to combine these values within the concept of the free-market.

The coalition of many schools of thought of the Post-war era came both from the Right and the Left side. The DC was the main party, commanded by De Gasperi who was in clear opposition to the Communist party (Duggan 2007, 468-470). On the other hand, the *Partito Comunista Italiano* [Italian Communist Party] gathered the favours of the left-sided population who was looking at the Soviet Union in admiration (Duggan 2007, pp. 472-480).
The PCI was the largest Communist party in a Western country during the post-war period. Togliatti, the leader of the *Partitio Comunista Italiano*, was assigned the role of Justice Minister under De Gasperi government. He remained crucial for the recognition of the democratic state in Italy, and personally gave a substantial contribution to the Italian Constitution composition (Mueller 2008, 21). Even though Togliatti made many concessions to De Gasperi, he and his party were expelled from De Gasperi's government in 1947 (Mueller 2008, 21).

As in many other Western countries such as the US, West Germany, France and the UK, the Economic Miracle of the 1950s and early 1960s improved the position of the middle class who became the proactive part of the society that was able to work, thus boosting the consuming activity and saving money to invest in housing. The quick development and enlargement of the middle class inevitably carried problems to various levels of the society which exploded at the end of the 1960s (Mueller 2008, 23-24).
Mass worker militancy and student insurrections happened daily: mass workers

demanded for wage equality across skill levels, whilst students protested for the inequalities in the education system, claiming for the universal right to study and for more funds aimed to improve the education system (Mueller 2008, 24).
The FIAT factory in Turin had to shut down for three months in 1968 because of the workers' protests and factory line boycotts. FIAT's suppliers and many shops located near to the FIAT's district suffered from this situation. The end of the riots came only when FIAT and all the other main national industrial companies with the government mediation agreed to meet the workers' unions requests. The result was that the wages and retirement funds increased, then followed the introduction of a new regulation aimed at improving the work environment, safety and workers' rights (Mueller 2008, 26).

Many of the rebels were satisfied by what they accomplished, thanks to the political work of the workers' unions and the PCI, although part of them still aimed for a radical change of the entire economic system from capitalism to a new idea of communist state. Thus, the *Brigate Rosse* [Red Brigade] were spreading across the country, intending to implement terrorist attacks in order to catch the attention of the media. Their strategy seemed to work during the 1970s until Aldo Moro, the DC president and current Prime Minister, was captured and brutally murdered in 1978 (Duggan 2007, 530). However, in the 1980s the police successfully stopped the attacks and arrested all *Bigate Rosse*'s members putting an end to this dark chapter of the Italian history (Sundquist 2010, 61).

In the 1980s the economy accelerated at a faster pace and the "Italian lifestyle" caught the international attention of consumers and investors. On the other hand, domestic politics were not behaving as good as the economy. The political tensions influenced business activities which led to uncertainty and growing inflation. Left and Right leaning governments were only capable of easing money in the system and increasing public debt to try to support the unsustainable and slow public administrative system (Duggan 2007, 561-572). In 1983, DC lost the political election for the first time, but it remained powerful inside the parliament. Bettino Craxi, the PSI [Italian Socialist Party] leader, became Prime Minister from 1983 to 1987, but at the end of his political career he was accused of corruption and illicit financing for the Socialist Party, and this was just the beginning of the bigger picture (Duggan 2007, 598).

In 1992, Italy fell down in one of its worst episodes called *Inchiesta Mani Pulite*

[Clean Hands Investigation]. Mario Chiesa was director of a hospice in Milan and he was the first to be accused of bribery by the police among many other politicians and businessmen afterward. The Investigation officially ended in 1994, marking a clear end to the old party system and a new epoch for Italian politics (Biondani, 2015).

Silvio Berlusconi, president of the television company Mediaset, the publishing company Mondadori and many other large Italian firms, proposed himself as the centre-right political force in order to be the new face of the decrepit political panorama. In 1994, his party *Forza Italia* received positive feedback from those who did not want the Communists to gain political power. Prosecutions against Berlusconi's affairs started that same year and ruined his political campaign by addressing his past episodes of corruption (Duggan 2007, 610-613). During the 1990s Berlusconi headed the government for just one month, leaving the role to Lamberto Dini, a minister of his cabinet. Dini's cabinet lasted until 1995 and in 1996 was finally appointed a new centre-left government led by Romano Prodi (Duggan 2007, 618).

1.2 Economy

After the Second World War, the large majority of Italians were suffering the dramatic consequences that the war created on their wealth. In 1945 the average salary was half the peak reached in 1938-1939. The average factory workman would spend 95% of his wage on food. 48% of homes did not have a kitchen and 73% did not have a bathroom. In the countryside, average vehicles were carts and mules, while in the cities people would commute by bicycles and trams. In 1950 FIAT launched the cheapest car in the market at that time, the *Topolino*, which was worth twice the average yearly salary of factory workmen, meaning that it was almost impossible for the average Italian person to buy. It was only with the introduction of the *Vespa* scooter that Italians could afford to move in cities with a private-motor vehicle (Duggan 2007, 485-489).

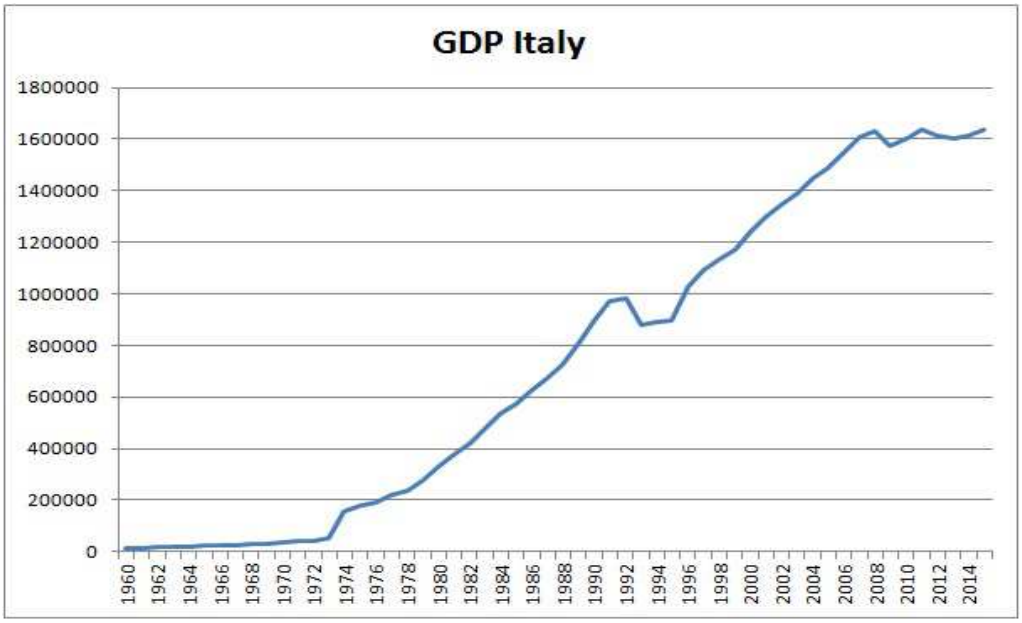

Figure 1: Italy GDP from 1960 to 2015 in € [EUR] (Country Economy, 2016)

From the mid-1950s to the mid-1960s, the country radically changed its economic morphology through the exponential growth of the manufacturing industry. The poor agriculture-based economy rapidly transformed to one of the most powerful economies of the world. The GDP fostered at an annual rate of 6% and the industrial production doubled in less than a decade (Duggan 2007, 492). The largest stake of the Italian industrial sector was located in the famous "industrial triangle" between Milan, Turin and Genoa, in the North-Western part of the country. It was mainly driven by FIAT and other smaller engineering companies which produced household appliances, fridges and televisions. In 1967, Italy was the third largest fridge-producer in the world and the European leading washing machine producer (Duggan 2007, 492-493).

The important factors that dramatically developed the economy and especially the industry were: (i) America lending $12 billion to the European continent through the Marshall Plan for the post-war reconstruction from 1948 to 1952; (ii) the Italian economy benefiting from the cleverness of some industrial leaders who gained valuable experience through the innovative environment of IRI [*Istituto per la Ricostruzione Industriale* – Industrial Reconstruction Institute]; (iii) Italy enjoying the lowest energy prices of the whole Western Europe due to the important gas reserves found in Valle Padana in the North of the country, and the agreement of cheap fuel imports; (iv) membership access to the newly born European Economic Community which, to this day, has allowed a freer movement of goods that Italian firms use to manufacture and export to the

community of member countries; (v) and one of the most important elements behind the “economic miracle”, the cheap labour force in the country, especially from Southern Italy. Many farmers were tempted to find a job in the cities of the industrial triangle, leaving the rural countryside where the salary was consistently lower (Duggan 2007, 494-499).

As long as the country developed, the government wanted to severely reduce the economic gap between the North and the South of the country. In 1950 the prime minister Alcide De Gasperi approved the *Cassa per il Mezzogiorno*, a governmental fund of 1403 billion lire which was to be directed to the Southern Italian industrial development in order to benefit from new infrastructures, industries, and housing (Istituto Luigi Sturzo, 2016). Unfortunately, corruption and the flux of emigration to Northern Italian cities resulted in missing the initial objectives and to the end of the funding in 1983 (Istituto Luigi Sturzo, 2016).

The waste of resources during the beginning of the 1970s and the consequent recession due to the high oil prices posed questions on the state of the general economy. However, the 1980s saw a return to growth: The northern industrial hubs restructured their operations to the changing environment and brought the general economy to new highs. Furthermore, the services industry grew at a faster pace than the industrial and agricultural ones, and in 1995 three fifth of the working population was employed in service-based work (Duggan 2007, 540).

The most relevant engine of the Italian growth was provided by the small and medium family-manufacturing firms located mainly in the North and Center of the country and concentrated in clusters: The Vigevano shoes, the ceramics in Sassuolo, knives in Lumezzane and Maniago, glasses in Belluno, furniture in Manzano and Poggibonsi, jewellery in Arezzo and apparel in Treviso. These clusters focused on craftworks, innovation, strong networks and hard work to fight the increasing competition from the Far East and preserve their strong position in Europe (Duggan 2007, 545). A relevant number of small and medium firms took advantage from the flexible fiscal policies of those years and did not pay taxes. The government did not put too much pressure on punishing tax evaders. The growing public debt and European threats of not including Italy in the future project of a united monetary union caused a switch of the governmental approach against tax avoidance (Duggan 2007, 573). Despite the Italian government taking measures to fight tax avoidance, the debt deficit doubled year by year between

1982 to 1990, and in 1992 the debt/GDP ratio overcame 100%. Though increased public debt was due to the challenging political climate, rising interest on public debt amounted to 10% of the GDP. (Duggan, 2007, 591).

The membership in the European Union and the constant boundaries posed by Bruxelles forced Andreotti's government to impose more taxes, to reduce public expense and to fight tax evaders more effectively.
Italy never reached the 60% debt/GDP ratio required by the European Union for the inclusion into the monetary union, but made a promise of long-term commitment to this objective. In 2002 Italy introduced with several other countries the Euro currency, replacing once and for all the weak Italian Lira (Duggan, 2007, 593).

1.3 The Italian Stock Exchange

The first stock exchange in Italy was born in 1807. Italy did not exist as a country when the North-Western part of actual Italy accommodated the French law regarding the financial capital market and its functions. During the nineteenth century, many cities of the Italian peninsula as Turin, Palermo and Venice created their own stock exchanges, but Milan soon rose as the most capitalized (Coltorti et al. 2011, 15).

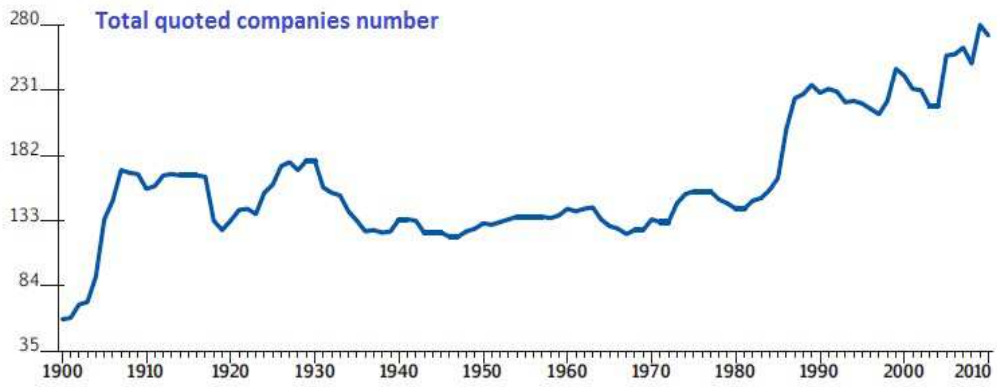

*Figure 2: Total quoted companies number in Italy from 1900 to 2010 (*Coltorti et al. 2011, 14*)*

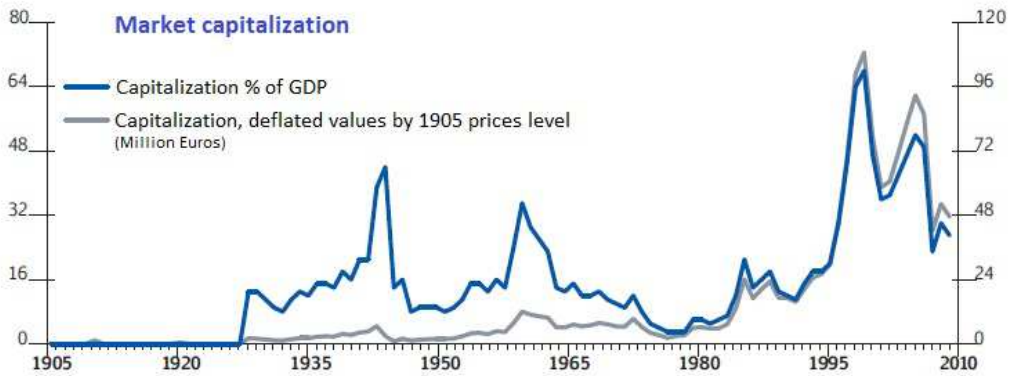

*Figure 3: Market capitalization in Italy from 1905 to 2010 in € [EUR] (*Coltorti et al. 2011, 14*)*

By the beginning of the twentieth century, the Italian banking and financial system were underdeveloped. It was a mixed system which combined together the Anglo-Saxon "market-oriented" formula and the German method of universal banking which undertook both commercial and industrial functions. The most important Italian universal banks by the beginning of 1900 were Comit [Banca Commerciale Italiana] and Credit [Credito Italiano], which were able to give a boost to economic and industrial development, providing long-term financing credit to firms and managing their stock quotation.

From 1900 to 1907, listed firms increased in number from 59 to 169. Universal banks not only favoured the quotation process, but also acquired large stakes of those companies (Coltorti et al. 2011, 15).

Universal banks had enormous interests in the majority of Italian quoted companies. Consequentially, universal banks exploited the lack of accurate legislation in the field and practiced one of the first episodes of insider trading in the world. The year 1907 is remembered as the first of many years called the "black phase" of the Italian stock exchange (Coltorti et al. 2011, 16).

The First World War had primed a chain reaction of cash withdrawals which affected banks but not the economy itself as much as many economists predicted. Indeed, due to public army expenses, the industrial sector grew by 15% from 1914 to 1918. The Italian stock exchange lost 59% of its capitalization during the same period, but trading never stopped working except for few days (Coltorti et al. 2011, 19).

The latest years of 1910s saw multiple bank takeover attempts as a consequence of their post-war unresolved weaknesses. The first one had been made by Ansaldo trying to acquire the majority of Comit, and the second one involved Snia

Viscosa trying to takeover Credit. Both operations failed. Consequently, the index lost again 25% capitalization until 1922 (Coltorti et al. 2011, 19).

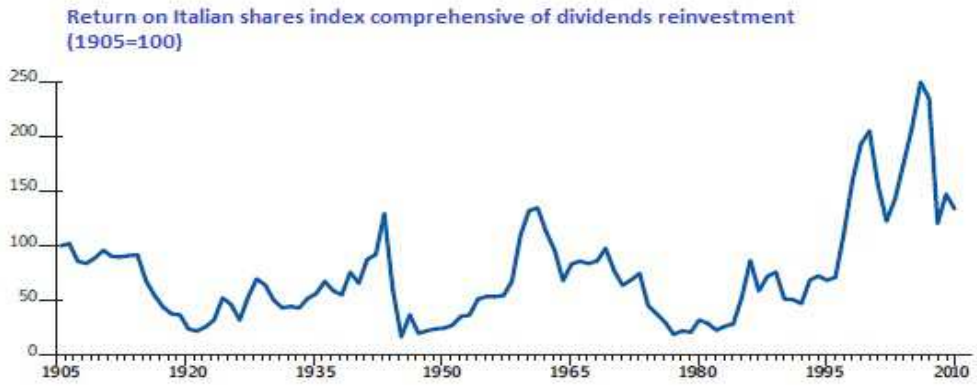

Figure 4: Return on Italian shares from 1905 to 2010 in € [EUR] (Coltorti et al. 2011, 16)

From 1923 to 1925, shares rose, reflecting the economic recovery and the solid growth of investments and industrial production but by the end of 1925 the market suddenly changed its direction and shares started to decline again. The three major universal banks joined forces and purchased additional shares from companies they already had in their portfolio but their move did not change the general index trend much. This worsened not only their own companies' capitalization but also their own equity (Colrtorti et al. 2011, 20).

In 1926 the Italian central bank implemented a deflationist monetary policy to strengthen the Italian Lira and shares sharpened their long time fall. In 1929, the American Federal Reserve decided to implement a restrictive policy because they were worried about increasing probabilities of a speculative bubble of American shares. Italy had already implemented the policy for three years, and the effects were tragic: 50% of general prices declined in a year (Coltorti et al. 2011, 20-21). Italian universal banks suffered more than ever because of their market exposition on industrial companies. Finally, State intervention rescued the three universal banks and the companies they controlled. The Fascist government created the IRI and IMI with the aim to regulate the economic activity and avoid the mistakes done by universal banks and financial markets (Coltorti et al. 2011, 21). Universal banks were lifted out from the stock exchange. Understandably, the market index was not able to grow again since IRI and IMI did not contribute to the purchase of shares in the stock exchange (Coltorti et al. 2011, 21).

The Second World War caused a new prices drop, but the following post-war reconstruction period and the Italian “economic miracle” gave trust to the investors who finally returned on Italian stocks purchases. Between 1947 and 1961 the real return on Italian shares was a 15% annual compounding interest (Coltorti et al. 2011, 23).
While the real economy was innovating and accelerating, Milan stock exchange did not evolve much. The number of listed companies remained more or less the same, and quoted companies did not entirely reflect the real economy because they were more traditionalist and less innovative than non-quoted companies (Coltorti et al. 2011, 24).

From 1962 to 1972 the Italian stock exchange has been characterized by a sharp decline, due especially to companies capital increases. Many companies wanted to raise more capital, but the capital market was not that large to sustain all the operations. Furthermore, the decline was also linked to the worsening economy and the protests of workers and students in 1968-1969 (Coltorti et al. 2011, 24-25).
The left-wing governments during that period had a sort of distrust regarding the stock exchange. They pushed for a more politically orientated planned economy, implemented by public controls on financial flows and the expansion of public participation on private companies. The Stock exchange was seen more as an obstacle than a useful platform for investments. Indeed, IRI acquired the entire quoted electric industry, leaving the Italian index without its main capitalised companies (Coltorti et al. 2011, 25-26).
From the point of view of the private shareholders, this episode had devastating consequences. Many of them were forced to sell their shares to the State in exchange of shares of other companies that were completely different than what they possessed before. This experience shed light on the tragic lack of regulation of the stock exchange and the protection of shareholders in cases of acquisitions and similar extraordinary operations (Coltorti et al. 2011, 27).

In 1973 the global oil crisis affected Italy and stocks as well. The central bank tried to stimulate the economy by depreciating the Italian Lira. The operation did not work as initially hoped and depreciation induced shocking rates of inflation [an average 20% between 1973 and 1983] (Coltorti et al. 2011, 28). As seen in Figure 3, in 1980 the stock exchange was back again on its post-war

period.

In the beginning of the 1980s the economy returned onto its positive track as due to many companies restructuring their profitability. GDP averaged 3% per year (Duggan 2007, 545).

From 1980 to 1997 the Italian Index had a positive trend, particularly due to the small private funds gathered by banks directed to invest in shares. People and institutions could increase their investments because of the massive legislative improvements adopted to regulate companies' reports and financial information, finally making it possible for the individual investor to be aware of the information concerning the company he/she was investing in (Coltorti et al. 2011, 33-34).

Furthermore, Consob, which is the Italian Securities and Exchange Commission, gained its position of independent authority responsible for the regulation of the Italian securities market.

Even though Italy was improving its moves against illegality, a weirdly high dose of opportunism and corruption has always been present in Italian capitalism. Speculation due to insider trading in both private and public listed firms spread the bad reputation of the Italian market to international investors. Nowadays, the Milan Stock Exchange includes 340 companies and a market capitalization of roughly $532 billion (Borsa Italiana, 2016).

It is also relevant to mention that in 2007 the company who managed the stock exchange operations, Borsa Italiana S.p.A., was acquired by London Stock Exchange. The change of direction enabled directors to quote for many new small/medium firms through a new market called AIM. It is specialized in market securities of small/medium firms to introduce them to new investors and gather capital necessary for their expansion.

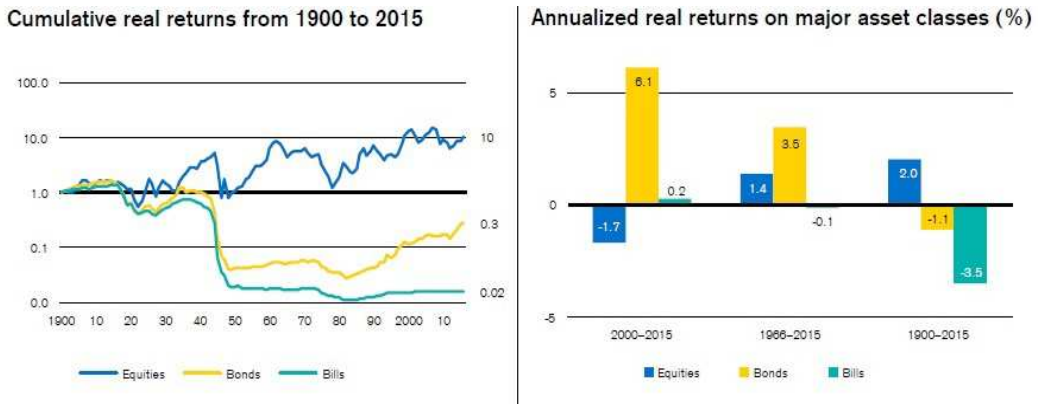

Figure 5: Cumulative real returns and Annualized real returns in Italy from 1900 to 2015 in $ [USD] (Dimson et al. 2016, 48)

1.4 The *Istituto per la Ricostruzione Industriale* (IRI)

Istituto per la Ricostruzione Industriale [Industrial Reconstruction Institute] was founded in 1933 by Alberto Beneduce beneath the Fascist regime. It was a public holding born to rescue Italian universal banks which were about to default. However, it later became a public fund with the objective to raise funds from the private investor to invest in new industrial companies. (Reference for Business, 2016)

Donato Menichella, Carlo Petrocchi, Meuccio Ruini, Bonaldo Stringher and most notably Francesco Saverio Nitti and Alberto Beneduce were convinced that Italy could aim to become a world economic power by moving private people's savings to entrepreneurs or managers who knew how to invest them effectively. This action required a public intervention for medium or long-term capital investments due to the mistrust of the Italian savers (De Cecco, Ferri 1998, 56-84). The interventions, they believed, could not be done through ordinary administrative institutions, but with new independent and flexible organizations created ad hoc basis (De Cecco, Ferri 1998, 56-84).

The consequences of the US Great Depression in 1929 affected the most powerful European economies including the United Kingdom, France, Germany and Italy. In 1933, under the instructions of the academic professor of statistics and demography Alberto Beneduce, the Fascist government of Benito Mussolini created the IRI to bail out the three largest banks of the country: Banco di Roma, Banca Commerciale and Credito Italiano which had substantial interests in the Italian industry (Reference for Business, 2016). Thus the IRI was born as a temporary organization. However, in 1937 Beneduce decided to officially give it a permanent legal structure. It later became the largest holding company in Italy and one of the biggest in the world.
It invested in industries such as cellulose, synthetic rubber and chemicals which were developed by the Fascist policies of self-sustainability and it soon expanded in sectors specifically devoted to the war production. By the end of the 1930s, the IRI had control over two thirds of the national telephone services, interests in iron and steel production, owned a quarter of electricity generation and distribution, and held a large stake in ship-building and engineering production (Reference for Business, 2016).

During the Second World War, many bomb attacks targeted the major Italian factories - aircraft manufacturing capacity was completely destroyed. Steel production was reduced from 80% to 99% and shipyard capacity up to 60% (Reference for Business, 2016). Consequently, the IRI was as devastated as the Italian economy. The resilience of the organization led to the creation of Finmeccanica in 1948, enabling the IRI to reorganize its engineering interests and to support the Italian economic miracle (Duggan 2007, 483). From that time, the "IRI formula" was internationally accredited as being an effective model of cooperation between private and state-owned businesses.

During the 1950s, IRI supported the introduction of the steel industry in Southern Italy, in order to reduce the gap with the North. It then engaged in activities related to the construction of the motorway Milan-Rome-Naples, which had been improving the national infrastructure including some of the most difficult terrains of the country. IRI separated Fincantieri, the shipyard holding IRI owned, to allow the construction of ships in different locations and their specialization. Finally, it owned a large majority of RAI's shares and took control of the national airline company Alitalia (Reference for Business, 2016).

IRI was a hybrid organization: it was a state-owned company which was able to have unique access to sectors such as steel and road-building that no one else wanted or could enter. On the other hand, given the experiences with the communist countries, the fear was that IRI could evolve into a bureaucratic, slow and non-efficient machine. Instead, it avoided these traps by creating distance with its holdings, encouraging managers to behave like entrepreneurs and to run their businesses as profit-seeking ones whilst IRI acted as an investor. Even if IRI was completely under the government control, its holdings were not. During the 1950s and 60s the Italian people found the courage to make private investments and take a share of the same companies IRI had already been supporting (Reference for Business, 2016).

Whilst organizations did expand, the first signs of problems emerged: the recession during the beginning of 1970s clearly made visible all the weaknesses of IRI, and costs were also too high. Though the general opinion was of the belief that economic prosperity could remain stable, with no more growth to support those costs, the IRI asked industrialists for more support since the private shareholders were selling their stocks. In this context, IRI became an enormous

organization with many sub-holdings showing losses (Reference for Business, 2016). The IRI would continue to invest in those companies in order to try to re-boost the Italian economy after the recession and promote the Southern Italian economy. IRI increased its employees to sustain national employment and acquired more debt to support its companies' operations. With losses that topped $2 billion in 1982, the consequences had become disastrous (Reference for Business, 2016).

The general belief was that privatisation could be the solution to this problem. Romano Prodi, an industrial organisation professor from the University of Bologna took on the role of making IRI profitable again, as well as dismantling it afterward. By 1987 IRI made profits for the first time in a decade. Prodi then started privatising some companies such as Mediobanca and Alfa Romeo, but he soon found obstacles during the process. Politicians were worried that these companies could be acquired by a group of few people, therefore opposing Romano Prodi's ideas (Reference for Business, 2016). Consequently, Prodi left his role in 1989 following pressures from the parliament and the government.

As a result, the IRI again showed some losses due to its holdings in too many companies that were still not profitable (Reference for Business, 2016). Due to pressures from the European Community to immediately solve the IRI's constant equity decrease and Italian economic issues, the republic president Carlo Azeglio Ciampi requested that Prodi conclude the privatisation process he had started years before. Prodi reluctantly accepted, and soon sold the equities of Banca Commerciale Italiana and Credito Italiano. IRI dissolved in 2000, leaving behind an important number of companies quoted in the Milan Stock Exchange (Reference for Business, 2016).

1.5 The *Istituto Mobiliare Italiano* (IMI)

The *Istituto Mobiliare Italiano* [Italian Securities Institute] was a public organisation born in 1931. Alberto Beneduce insisted on its constitution to rescue the three banks affected the most by the 1929 depression: Credito Italiano, Banca Commerciale Italiana and Banco di Roma. IMI also had another objective: to grant up to ten-years mortgages to Italian firms in exchange of real warranties, with the option of shares purchase (Franchini 2015, 2). IMI was able to raise

funds through governmental bond emissions.
Despite its most urgent objective, IMI did not rescue the three banks mentioned, because IMI's director Teodoro Mayer adopted a safer approach aimed at provide capital only to those companies which presented good financial fundamentals. As a consequence, Beneduce was forced to create another organisation: IRI (Franchini 2015, 4).

In 1936 two major changes occurred: Vincenzo Azzolini was elected as new President and the bank reform allowed IMI more room for action. They could now grant up to twenty-years mortgages to Italian firms.

The Second World War transformed IMI into a larger organisation able to sustain the mechanic industry (Franchini 2015, 4). Stefano Siglienti was elected as new President of IMI in 1946 where he then gave a new direction to the institute during the post-war period. IMI obtained the permission to manage the *Fondo per l'Industria Meccanica* [Mechanic Industry Fund] which converted the company from a war-goods supplier to civil usage industry (Franchini 2015, 6). Following the mechanic industry, the institute increased its lending to the electric industry and the shipping industry, boosting the Italian economy and becoming the largest single lender in Italy. The IMI became an important part of the Marshall Plan management over the Italian territory. It provided credit to Italian firms which specifically exported their products in foreign countries. Furthermore, it helped the development of the Southern economy, and improved the shipping armament whilst creating a strong international network with foreign organisations to increase FDIs to Italy (Intesa San Paolo, 2016).

By the end of the 60s, IMI was in charge of the Applied Research Fund to accelerate industrial development and advanced technologies. The long-term objective of the fund was the development of the Italian industry. IMI suffered an unfortunate period during the 1970s because of the global oil crisis. The structural chemical industry crisis in Italy started emerging which meant that IMI was largely exposed in the chemical industry as one of the major lenders and shareholders. After many governmental interventions, IMI had solved its issues and was able to focus on the Italian economy recovery (Franchini 2015, 9). IMI's newly elected President, Luigi Arcuti, adopted an approach aimed at strengthening the Institution's solidity by investing in companies with high growth yields in promising sectors. Also, it was possible to provide credit to firms as it

had always been traditionally done, and to acquire shares in the stock exchange as well (Franchini 2015, 10).

In the 1980s IMI's management transformed the group's activities from the industrial to the financial sector. By the end of the decade, IMI was a holding of many banks and financial companies such as Fideuram, which used to manage mutual funds, derivatives and warrants, Sige, which operated in business & finance, brokerage, real-estate and asset management of public and private portfolios and Banca Manusardi which specialised in stock intermediation both in Italy and in international markets (Franchini 2015, 10).

Following the Amato-Carli law of 1991, IMI became a public limited company. Private investors both in Italy and foreign countries acquired substantial stakes of the company, and it gained the role as the most important institute specialised in the public-to-private transition of governmental institutes (Franchini 2015, 10). Finally, in 1998 the merger with Banca San Paolo in Turin became known as San Paolo IMI. In 2006 the group merged again with Banca Intesa, resulting in becoming one of the largest banks in Italy: Intesa SanPaolo IMI (First Online, 2015).

1.6 Commentary on Italian Capitalism and its Financial System

Italy has always had a mixed system since the Fascist regime (Barca 2010, 9). As in the US, there was a net separation between banks and companies directed to guarantee the fundamental solidity of the first and to avoid extraordinary positions of control of the latter (Barca 2010, 10). But, as in Germany, banks remained the principal credit supplier of firms, while a modest and smaller role was given to the stock exchange market (Barca 2010, 10-11). Italy tried to implement both systems by merging them together in order to meet its own inner characteristics.

The USA used to have - and still have - one of the most capitalized markets in the world, while Italy has never been able to expand its stock exchange in the same way. Low liquidity means low market efficiency, and this is a constraint, especially for small household investors. Germany had an internal bank surveillance to protect shareholders and the bank itself (Fohlin 2005, 267). In Italy

there was no need for such a strict set of rules because IRI already satisfied the lack of internal regulations and guaranteed safety to shareholders. It was one of the first times when a public institution participated both to bank companies and industrial companies which were beneath those banks control (De Cecco, Ferri 1998, 56-84).

As previously mentioned, managers were told to behave as if they were entrepreneurs of companies they were directing. This new management style was merely an Italian invention which gained its influence from the Fascist way of governing. This had direct consequences on the relationships between those managers and the industrial lobbies (Barca 2010, 11). Public managers guaranteed a stable management, while industrialists gave them independence of action.

The "IRI model" was a successful achievement not only for the Fascist government which resulted in rescuing banks and give propulsion to the weak Italian industrial economy, but also a strategy constantly repeated by many following governments, especially the DC's ones.
Small and medium firms were able to obtain credit from banks under public control, which seemed to warranty them from possible future failures. Meanwhile, the same banks invested in large firms. IMI proved its reliability to markets in two ways: on the one hand, the large companies in which banks were investing in had a cushion from failures which could save them in times of crisis. As a result, private investors were more willing to invest in capital markets. Though the stock exchange was composed by less-innovating firms than the non listed ones, private investment did contribute to the upper trend of the Italian index in the post-war period. (Coltorti et al. 2011, 24).

Studies on Italian Capitalism outline different perspectives: some researchers state that it was the 'triumph of the super-liberalist vision', whilst others regard it as 'accentuated statalism' (Barca 2010, 11). However, as Barca mentions, the Italian model was a compromise between ideas and interests which has pros and cons: cons being the practical impossibility to set up a system of ordinary functioning of markets and public administration, and pros being the powerful range of actions that public institutions can deploy to rapidly solve problems that development create on the economy (Barca 2010, 11).

Unfortunately, this system is known to be typically “extraordinary”. Extraordinary means it can be used in case of emergency or when markets cannot work properly. Such a model had been implemented to take on an important role in the Italian capitalism.

Although IRI and IMI were born to move resources to those players who were capable to work efficiently for the industrial development, at the same time they were also a constraint both for public administration long-term vision and for efficient market functioning (De Cecco, Ferri 1998, 56-84).

Since Italy has historically had a reputation for corruption and opportunism, it is easy to see how opportunism and personal interests intertwined with public institutions such as IRI and IMI, induced the economy to be less flexible (De Cecco, Ferri 1998, 56-84).

Two others factors had been crucial for the Italian “economic miracle”: welfare benefit to small and medium firms and low wages growth.

During the 1960s, the State granted large benefits, especially to farmers, the craft sector, public employees and industrial small businesses. They were granted unconditional benefits for their activities and had very positive effects on Northern and Central businesses because of a more efficient public administration and a dense network of relationships between entrepreneurs who were able to exploit trust and completeness of assets. In Southern Italy they had not been able to do the same due to the different characteristics of the society (Barca 2010, 37). Instead, low wage growth, was not planned due to a natural consequence of the state of the economy. Firms decided in autonomy to increase current profits by reducing wages, which was also a macro economic effect of the high unemployment rate during the post-war period. As is has been mentioned before, economic development was advancing, but wages were not, and workers reacted in 1968 with protests and riots (Mueller 2008, 23-24).

CHAPTER 2
West Germany

2.1 Politics

After the end of the Second World War, the political panorama in what is today the unified Germany was composed by a few different parties from the left and right wings. On the left there were the Social Democratic Party and Communist Party which existed even before the war, whilst on the right wing there were just newly born parties such as the Christian Democratic Union which attracted centrist and Christians members, and the Free Democratic Party which mainly attracted liberals. In the Soviet zone Social Democratic Party and Communist Party merged together to the Socialist Unity Party, while in the Western administrations they remained two separate entities (TV Tropes, 2016).

The first election in West Germany was held in 1949 where Konrad Adenauer, the leader of the Christian Democratic Union, emerged as Chancellor. Adenauer would go on to implement the free market system and build its Western alliance. Adenauer opposed his political competitor Kurt Schumacher, a social democrat, who had wanted to be neutral and united with its Eastern side (Sailus, 2016).

Another crucial role during that same period of time had been that of Ludwig Erhard, a liberal who was elected as director of economics of the American and British administrations in 1948 (Sailus, 2016).
Adenauer appointed Erhard to continue with his economic and institutional reforms of West Germany. The introduction of the Deutsche Mark as new currency in West Germany had been one of his greatest macro-economic transformations and seemed to be one of the most important factors that helped the economic miracle of the 1950s. The completion of his plan was the creation of the German central bank [Deutsche Bundesbank] in 1957 (Sailus, 2016).

In 1953, Adenauer was re elected chancellor for the second time. He controlled a large part of the Parliament and even without the coalition he would have had the necessary majority to finalise his future plans. In 1955, Adenauer signed to join NATO, giving to West Germany a clear, international alliance with Western capitalistic countries (Sailus, 2016). In the same year, West Germany was again

given permission by the UN to have its own army, despite France strongly disagreed. To reassure France, Adenauer signed an agreement to guarantee cooperation not only to the French, but also with Belgium, Luxemburg, Italy and Netherlands: the first six countries to join what would have later become the European Union. Adenauer was one of the most influential politicians in the German post-war era. After the fourth time he was appointed as chancellor, he had to resign from his position due to public scandals among his collaborators (Sailus, 2016).

During the 1960s, West Germany started to worry about the economy and the new cabinet appointed Karl Schill as new Federal Ministry of Finance. Though West Germany transformed from a quasi-liberal country to a more social one and improved in its welfare system, it also increased public expenditures. In 1968 student riots reached Germany as well as France and Italy, but they were much less violent (TV Tropes, 2016).

During the 1970s the Social Democratic Party conquered the majority of Parliament, and its leader Willy Brandt became the first Social Democrat Chancellor since 1930. His work was especially relevant for international relations between West Germany and U.S.A to strengthen the entire European Community and to improve relations with Eastern European countries.

Around 1980, pacifists and anti-nuclear movements gave birth to the Greens (TV Tropes, 2016). They were able to gather politicians both from the right and left wing with their program which was based on social equality, feminism, environmental-friendly regulation. Above all, the movements' main objectives were to stop nuclear energy usage in West Germany. Although they gained some power, Greens had never obtained the majority that would have enabled them to govern the country. In the 1980s the right wing took charge, accelerated the services sector and exploiting the economic boom that all developed countries were experiencing (Sailus, 2016).
In 1989 the Berlin Wall was destroyed, and the West and East Germany reunified together again.

2.2 Economy

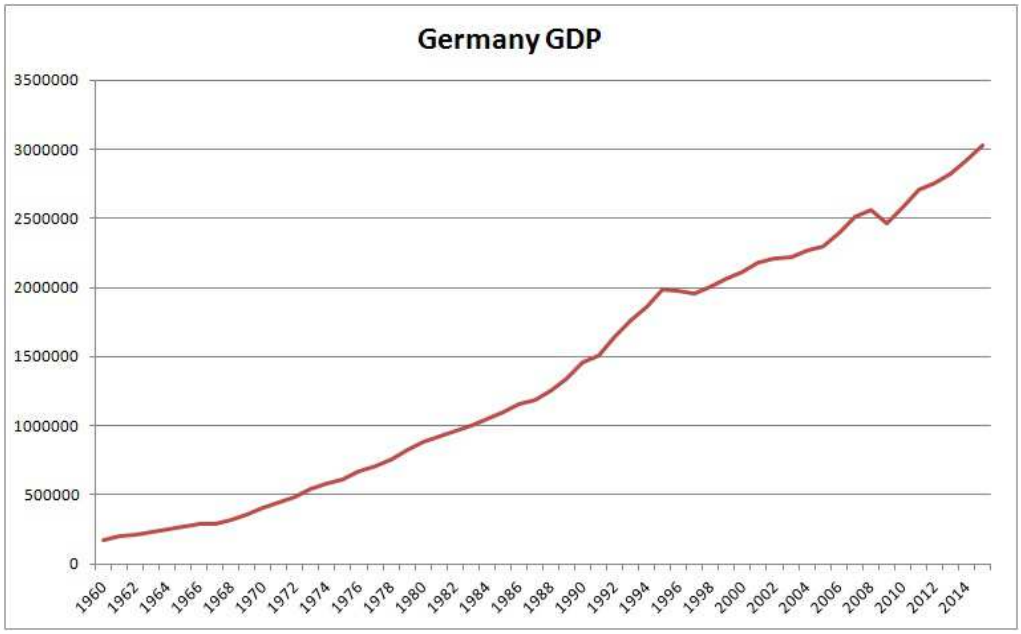

Figure 7: Germany GDP from 1960 to 2015 in € [EUR] (Country Economy, 2016)

After the Second World War, the four victorious allies - United Kingdom, USA, France and Soviet Union - divided Germany in four separated administrations beneath their government. France, the United Kingdom and the United States proposed the free-market model in their administrations, while the Soviet Union implemented the Communist system. This net division has marked German economy so deeply that consequences are visible still nowadays (Wikipedia, 2016).

In May 1945 Germany was in chaos and a large part of the country was completely devastated. Millions of people were homeless and trying to get to their own homes even if they were completely flattened (Knowles, 2014). However, housing was not even the main problem. Starvation was indeed the most urgent and diffused issue (Knowles, 2014). For example, rations in the British zone amounted to no more than 1000 calories per day per person, which was much less than half of the rations English people faced during the immediate post-war years when they were allowed to have up to 2800 calories per day (Knowles, 2014).

In terms of economic recovery plans, West Germany had different strategies than East Germany. In the West, governing countries employed ex-soldiers and most of the German civil population as a new labour force in agriculture and mines.

Understandably, since food was not sufficient, many of them could not be productive at all. During the years 1946-47, West Germany happened to be more a liability than an asset for its governing countries (Reichel 2002, 427-442).

In East Germany, the Soviet Union exploited the country by moving productive machinery and equipment to its own cities, depriving East Germany of the few resources it still possessed. The URSS soon announced a five-years plan to nationalise industries and agriculture output, however the flow of population escaping the country to go West caused large shortages of labour force in the East and increased disposal of low-cost labour force in West Germany where more was needed (Wikipedia, 2016).
Given these preconditions, in 1948 West Germany benefited from the full support of Western economies and the first introduction of the Marshall Plan given by the US. All these factors were crucial in reaching the highest rate of economic growth amongst all the European countries. Between 1949 to 1960, West Germany's Gross Domestic Product averaged on a rate of 6% per year.

As previously mentioned, the so-called *Wirtschaftswunder* [Economic Miracle] was also fuelled by the vital cheap labour force coming from East Germany. In 1961 the Soviet Union grappled with the long-term consequences of emigration to the West, and decided to close the border and build the Berlin Wall. (Wikipedia, 2016).

Chemicals, machinery tools, automotive and agriculture were the most important sectors during the German economic miracle. Unemployment slumped from 10.3% in 1950 to 1.2% in 1960, and the shortage of immigrants and emigration restrictions imposed by East Germany presented a problem for the insatiable need of workers in the industry. As a consequence, West Germany signed agreements with countries such as Italy, Spain, Greece and Turkey in order to ease the entry of their workers in the country (Reichel 2002, 427-442). However, even though supplementary workers had arrived from Southern Europe, the 1960s did not produce the dramatic growth rate of the 1950s.

It was time for a change of pace both in politics and the economy. The old government which was unable to manage a slowdown despite pushing for economic growth, was replaced by a different cabinet that included Karl Schilelr. Schilelr, the Federal Minister of Economic Affairs and a Keynesian, proposed a

new long term plan based on the conviction that the government had the power to shape the economy and give clear direction in times of stagnation. He introduced a fiscal policy that was expected to sustain public expenditure and social support. However, the economy did not improve as he had hoped, and the global oil crisis at the beginning of the 1970s worsened the situation: in 1975 West German GDP fell by 1.4%, which had become one of the worst years since the end of the war (Reichel 2002, 427-442).

From 1976 West Germany finally expanded again, but it did not last long. At the end of 1970s the economy was affected by another fall in production, in salaries and in higher levels of unemployment. Inflation was the only rate that grew, which was not a good thing since salaries did not increase. A new government decided to implement a more liberal policy by reducing taxes as well as public expenditures. Furthermore, they privatised many state-owned companies such as Lufthansa, Volkswagen and Salzgitter, reducing the public weight on the economy from 52% to 46% between 1982 and 1990 (Wikipedia, 2016). These actions seemed at first almost ineffective, because West Germany improved just a little compared to other more vital countries. Finally, just at the end of the decade West Germany experienced high rates of productivity, with a 3.7% increase in 1988 and 3.6% increase in 1989 (Wikipedia, 2016).

From 1990, Germany was reunified again into one single country. By then East Germany had serious problems with the economy which did not develop as much as expected, meaning that West Germany had to invest in its recovery to allow a consistent reunification of the two countries. Because of its past economic failures, East Germany still struggles with unemployment and lack of productivity (Wikipedia, 2016).

2.3 The German Stock Exchange

Following the First World War, the German stock exchange was hardly hit by the consequences of the war. Shares had been sold to liquidate positions and purchase bonds which were still considered safe. All foreign securities listings were not traded anymore and Frankfurt lost its appeal as the international financial trade centre (Deutsche Boerse, 2014). Inflation rose to new levels during the 1920s and Germany was badly affected by the international economic crisis

of 1929. As a result, stock prices dropped after the small increase experienced during the 1920s.
Though the economy started its recovery in 1932, this was around the time the Nazis gained power and took over the stock exchange supervision, reducing the number of quoted companies from 21 to 9 in few years (Deutsche Boerse, 2014).

In 1944 and 1945, trading stopped working many times due to the collapse of the exchange building hit by Americans and British attacks. Frankfurt stock exchange remained closed for six months in 1945 and then was re opened by the US military government. It was only with the monetary reform of 1948 that the stock exchange returned to its own levels of autonomy and proper functioning (Deutsche Boerse, 2014).
During the 1950s it was quickly regaining its old reputation as the international stock exchange: four currency exchanges were opened, including trading on the US Dollar, Canadian Dollar, Swiss Franc and other European currencies and international stocks that could finally be purchased after they had been de-listed by Nazis (Deutsche Boerse, 2014). Moreover, a person who invested in 1950 into the index could double his/her capital in less than 10 years. The market performance was nothing else than the true reflection of what was happening to the real economy: the German Economic Miracle.

The 1970s hit Frankfurt's stock exchange less than Milan's, the trend was almost flat, but technologic innovation was early introduced in the stock exchange functioning, allowing investors to trade with telecommunication systems. Germany had been the first European country together with UK to introduce this type of technologic advance in trading (Deutsche Boerse, 2014).

Despite the constant industrial growth and the expansion of the tertiary sector, the 1980s and the first half of 1990s saw the Frankfurt index staying flat, meaning that capital was actually eroding because of inflation and opportunity-cost to invest in other less risky and more remunerative assets. Even though Germany has now become the most important economy in terms of GDP among European countries, its stock exchange is composed just by 550 listed companies. If we compare it with the London Stock Exchange which lists more than 2000 companies, this number makes apparently no sense. This effect is mainly due to the inner nature of the corporate ownership system in Germany described in the next paragraph

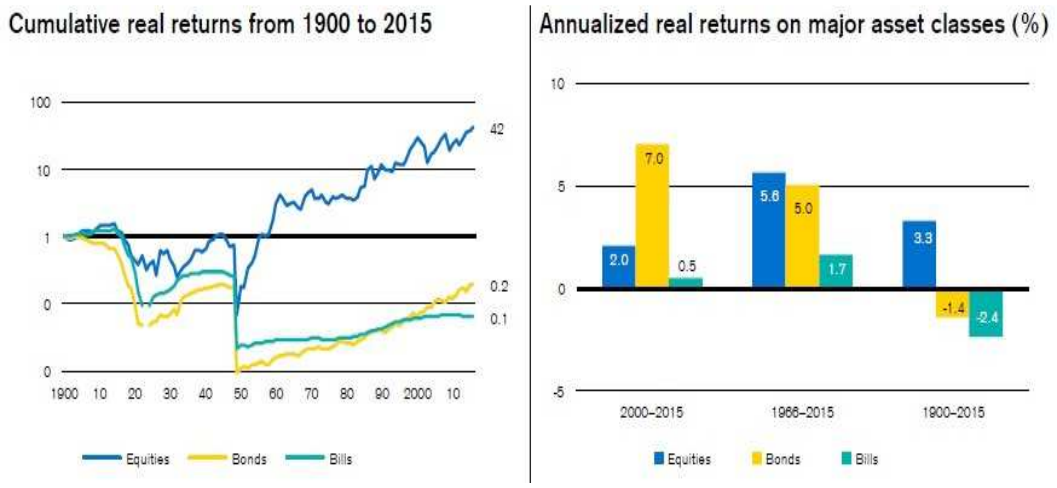

Figure 8: Annualized real returns in Germany from 1900 to 2015 in $ [USD] (Dimson et al. 2016, 46)

2.4 German Corporate Ownership, Control and Universal Banks

Listed public companies constantly diminished in number from 1975 to the beginning of 1990. Quoted companies reduced from 471 to 408, while other markets were expanding both in number of listed companies and capitalisation (World Bank, 2016). This was the direct consequence of a historical trend of acquisitions made by big corporate firms and universal banks. The table in the next page shows the shareholders' stakes in quoted companies distinguished by their status of companies, public, householders, banks.

It is remarkable that fifty years ago German families were more eager for investing their capitals than they nowadays do. By 2000, only 8% of the German population held shares. Similarly, the government also sold its stock holdings, due to the new privatisation policy adopted to transform the country in a free-market economy (Fohlin 2005, 233-234).

Share ownership in Germany, 1960–98 (%)

	West Germany, 1960–92					
Year	Banks	Insurers	Nonfinancial companies	Private households	Public	Foreign
1960	8.0	3.4	40.7	30.3	12.0	5.6
1965	7.5	3.7	39.3	30.6	10.0	8.9
1970	9.1	4.2	37.4	31.3	9.5	8.5
1975	9.7	4.2	42.1	25.1	8.9	9.9
1980	11.7	4.8	42.8	21.2	8.5	11.1
1985	11.0	5.8	38.8	22.5	7.5	14.4
1990	14.1	7.8	39.0	19.9	4.4	14.8
1992	14.9	9.0	41.4	17.6	3.9	13.2

	Unified Germany, 1990–98						
	Banks	Investment funds	Insurers	Nonfinancial companies	Private (including organizations)	Public	Foreign
1990	10.29	4.33	9.81	41.68	17.23	3.71	12.95
1991	10.27	4.84	10.32	41.36	16.65	3.67	12.89
1992	10.23	5.42	10.41	42.90	15.99	3.66	11.40
1993	9.78	7.27	12.22	38.72	16.66	3.17	12.18
1994	9.40	7.57	11.82	40.87	15.76	3.53	11.04
1995	10.12	7.45	10.93	41.46	15.35	4.39	10.30
1996	11.05	8.96	10.79	37.54	16.00	3.75	11.91
1997	10.93	11.28	14.50	30.46	16.61	2.86	13.35
1998	10.32	12.94	13.74	30.50	14.96	1.91	15.64

Figure 9: Share ownership in Germany from 1960 to 1998 (Fohlin 2005, 233)

While the government was following a precise long-term plan, private households were reacting to the new ongoing practice of the continued concentration of industrial power. The more families sold their shares, the more giant corporations were able to buy shares on the market and accumulate stakes of smaller corporations. This delisted many public firms and led to inefficiencies and illiquid stock exchange which prevented new investments form small private investors (Fohlin 2005, 234).

It is crucial to describe the historical roots of the important role that universal banks had in corporate ownership in Germany.

A universal bank is an organisation which engages in all forms of banking business: from every activity involved in commercial banking [holding deposit accounts, providing loans as well as extending overdrafts on current accounts and undertaking discount businesses], to all the different forms of investment banking [trading in securities, issuing shares, and floating loans for governments and municipalities] (Edwards 1996, 428).

The focus on this system can be traced back to the end of the nineteenth century, when a company had to fully pay up its own share capital to be listed in Frankfurt stock exchange. At that time the stock exchange was seen as the best way to raise capital quickly, but the full pay-up legal requirement could act as an enormous constraint to most companies.

Universal banks proved to be crucial in solving that issue, guaranteeing the capital pay-up by themselves in exchange of equity (Fohlin 2005, 252). As a consequence, universal banks effectively became shareholders of a new listed company, sometimes keeping even more shares than those placed to private investors. Furthermore, from 1870 business law regulation required that public companies have a supervisory board, whose main function was to monitor the board of managers. Due to their share holdings, universal banks were often represented in supervisory boards (Edwards, 1996).

Broadening the case to smaller unlisted firms, it can be noticed that banks had much less control given the non-historical reasons for this to happen (Fohlin 2005, 258). Small firms are typically not listed in German stock exchange (Deutsche Boerse, 2014).

During the twentieth century banks had changed their nature, but three universal banks still prevailed as the wealthiest: Deutsche Bank, Dresdner Bank and Commerzbank. From the 1960s these three banks actively pursued board seats to exert their control over corporate companies they were interested in. Furthermore, their aim was to gain power in the largest industrial corporations rather than in many small and medium ones (Fohlin 2005, 257).

Americans saw such a concentration in the hands of a few as a natural obstacle for shareholder democracy and stock exchange liquidity. They pushed West Germany to introduce reforms directed to restricting voting power of banks and outlawing all anonymous voting. In this regard, banks had to allow private shareholders to vote - even anonymously if they preferred - in the board. Moreover, they had to disclose to their clients how the bank intended to vote. The law also forced the government to sell its shares such as Volkswagen which was privatised in 1960 (Fohlin 2005, 266).

Even if the legislation was well structured, universal banks still continued to acquire positions in private corporations to extend their power. This practice lasted until the end of 1970s. With regard to the three main banks previously described, they held the vast majority of linkages in shareholders boarding, and

were willing to have long-term relations with the companies and keep on exerting the control they had for a long time.

By the beginning of the 1980s the trend changed: banks started to reduce their own participations in those companies. As an example, out of 100 of Germany's largest companies, banks exerted their control on 8.6% of their shares in 1978, while in 1996 their stake was reduced to 6.4% (Fohlin 2005, 253). The same trend could be viewed regarding board seats: among the 100 largest companies, two thirds of them had at least one bank employee being part of the management. In 1998 only 17% of them still had bankers sit on the board (Fohlin 2005, 253).
The reason why the situation changed was due to new governmental reforms. The reunification of West and East Germany opened a season of recession for the whole country as a consequence of the social, economic and political impact of this transformation. This raised again the problem of the banks' power, which was seen as inhibiting the economic progress and market efficiency. As a result, the government introduced three laws of transparency of financial statements: transparency prior and during board voting meetings and the law on registered shares and facilitation of voting rights for small private shareholders (Fohlin 2005, 267).

By tracing the history of universal banks in Germany it can now be adequately explained why universal banks have made such an important contribution to the German economy.
Asymmetry of information is the main problem investors face when they finance a company with their capitals (Edward 1996, 429). Savers have limited information regarding the company they want to invest in, since they are not managers nor have the right to attend supervisory boards. In fact, potential investors do not have any guarantee that once they give their capital to the firm, the manager will act exactly in accordance to their interests. Universal banks are the natural solution of such a problem: together with their representation on quoted companies' supervisory boards and their own interest in them, they are able to economise on costs of solving problems of asymmetric information (Edward 1996, 429).

2.5 Commentary on German Capitalism and its Financial System

Germany is usually taken as an example of a country where banks have a peculiar dominance in financing firms. This chapter outlined the historic roots of such a trend, which was born by the end of the nineteenth century because of a specific regulation that naturally eased large investments and financing made by universal banks. Germany has a long and great history of industrialisation, specifically in the Western and Southern areas of the country due to the past division between West and East. Universal banks seemed to have had the perfect role that industrial companies needed at the end of nineteenth century and again in the post-war period. Conversely, the German stock exchange could have benefited from more liquidity and a greater number of listed companies.

Scholars and researchers have found many similarities between Germany and Japan, comparing them with the USA or the UK which has totally different characteristics.
As Macey outlines in his article "Corporate Governance and Banking in Germany, Japan and the USA", German and Japanese universal banks take an active management role to mitigate and supervise the board of managers of companies they participated in without interfering or imposing much power (Macey 1997, 1). In particular, German universal banks had and still have 'the position, information, and power to effectively monitor the activity of management and, when necessary, to discipline management.' (Macey 1997, 1).

The German model is extremely different than the model implemented in the USA or in the UK, where much more power is left to the chief executive officer and the dimension of banks which has been historically limited by governmental regulation. Italy was, as previously mentioned, a hybrid system that took some aspects from both the German and the Ango-Saxon models, adding some more new ingredients that lead to the Economic Miracle in the post-war period.

CHAPTER 3
The United Kingdom

3.1 Politics

The United Kingdom won the Second World War together with its allies, but like other countries, Britain needed to radically reconstruct and reform its own system to face new difficulties after the war. The Labour government of 1945-1951 launched a new kind of consensus: a social democracy which was based on a mixed economy and a welfare state. It was the victory of the left-wing side of Parliament, which brought the nation to succeed economically (Morgan 2009, 467). The Attlee's cabinet also reformed the industrial system, with many industries and institutions undergoing public ownership such as coal, road, transport, gas, civil aviation, cable, electricity and even the Bank of England. Furthermore, the new welfare state adopted by the Attlee's government reached new goals by transforming National Health Service into a public institution, offered state-subsidised houses, introducing national insurance, increasing old age pensions, and raising the school-leaving age and child allowances (Morgan 2009, 472).
Although the welfare state had its limitations, it had been crucial for the after-war development of the country and it was generally accepted as a vital attribute of balancing society over the next twenty years. Moreover, the Labour government had a precise plan for the development of rural areas such as the Welsh valleys, Durham, Cumberland and the central part of Scotland, which benefited from the implementation of new industrial districts. However, unemployment increased and labour unions agreed to freeze wages to sustain profits (Morgan 2009, 474-475).

On the other hand, public debt hit new peaks and the war required a continuous use of resources to sustain military actions. Though the new social state was sustained by the incredible growth that the United Kingdom was experiencing, the system could not be preserved in the long-term. In those years there were moments of near-panic toward situations such as the devaluations of the pound against the dollar in 1949, difficulties on balance of payments in 1954 and continuous shortages of raw materials and food supplies which led to rationing for almost a decade (Morgan 2009, 482).

However, the post-war years were remembered by the working class as the most positive years they had experienced since the Victorian era. Wages increased to 30% over their 1938 level, unemployment was low, and there were higher living standards and more satisfying environmental and educational facilities. (Morgan 2009, 482).

The context in the British colonies was totally different: The UK faced many financial and administrative issues long before the Second World War, and those problems arose severely in 1947 when the United Kingdom finally decided begin the process of decolonization and grant self-government to India, Pakistan, Sri Lanka and Burma. (Darwin, 2011).

In its post-imperial phase, Britain became a more introspective power, and one whose role in the world affairs was uncertain. From 1949 the US and the UK were bound together strategically and geo-politically in NATO. The British politicians and businessmen generally tried to keep good relations with the Commonwealth countries due to the commonalities in culture and language (Morgan 2009, 518).

Instead, the relation with Europe was far from good. British people did not see any commonalities with Europeans and during the 1940s and 1950s the British governments were not interested in the European Economic Union. The first real attempt to join the European Common Market was made by McMillan's Conservative government but French President De Gaulle firmly opposed to their membership entry. Wilson's labour government tried again in 1967 and the European Community accepted their request (Morgan 2009, 537).

As in any other Western country, the United Kingdom grew at a pace never seen before, mostly during the 1950s. But also, as in other European countries such as France and Italy, British university students and the working-class instigated mass protests and revolts against the political climate in 1964. There were many different reasons that caused the riots in the country, but the common thread seemed to be a crisis of values. Consumerism and conformism was not appealing in a world whose ecology had been disturbed and whose very existence was threatened by weapons of unimaginable horror. Even Scotland and Wales joined the protests because they never really benefited from economic progress. All British post-war governments, in their opinion, neglected their growth to benefit England (Morgan 2009, 528).

The 1960s clearly made visible not only the social tensions that lied beneath many groups in the population but also deep economic and structure problems.
The economic pressures forced the Bank of England to devaluate the pound many times without achieving any real success. Britain was going to enter the longest recession of the post-war period and the consequences of this instigated other problems such as increasing unemployment and declining living standards brought for unions and their members. Due to this, strikes mounted up, which led to one of the largest strike movements: the case of coal mines (Morgan 2009, 539).

The oil crisis at the beginning of 1970s hit Britain's economy even more since they were already struggling with the economic decline of the previous decade. High oil prices soon led to inflation which increased unemployment and resulted in what is commonly known as "stagflation".
Keynesianism, the welfare state, the nationalised industry and a closer regulation of the economy had been the core values of the economic boost of Britain during the previous twenty years. In the 1970s these same values seemed to be the reason for the unsuccessful politics of the Labour government which could not find support even from the labour unions that sustained it during the 1950s and 1960s (Morgan 2009, 543).

Margaret Thatcher was elected in 1979 as the first female Prime Minister of the United Kingdom and leader of the Conservative party. She began her mandate by lowering taxes on income, increasing interest rates in order to slow inflation down and reducing expenditures on social services.
During the 1980s she focused on weakening the power of labour unions because, in her opinion, they were undermining parliamentary democracy and economic performance through strikes (Morgan 2009, 565). Labour unions tried to face the new governmental policies with new protests, but they slowly lost their power and in 1983 only 39% of union members voted the Labour party. Thatcher won the elections for the second time. The Conservative government saw the first signs of economic recovery, with higher employment level and a slowdown of inflation from the peak of 18% to 8.3%. Finally, the privatisation process was implemented with a higher velocity than the previous mandate: more than £29 billion were raised from the privatisation of many nationalised industries, and an additional £18 billion from the sale of council houses. The selling of council houses below their fair value was a strategy adopted by the Conservative

government to support people who could become landlords and enjoy their new assets increasing in value (Morgan 2009, 566-567).
Finally, to compensate the lack of economic propulsion due to the de-industrialisation, Thatcher helped businesses in the financial and service sectors by implementing a new policy that during the following years gave to the city of London the role of “European financial capital” (Morgan 2009, 568).

Although Margaret Thatcher governed for eleven straight years, in 1990 she was forced to resign because of decreasing support from her own party. John Major won the ballot against Thatcher and became Prime Minister from 1990 to 1997. The Conservative government led by Major had many conflicts with other European members because the British government did not accept the many new regulations that the EU imposed to the community members. Furthermore, the cabinet was accused of sex scandals and corruption episodes in line with what was happening in Italy and US during the same years (Denmar, 2016). The election of 1997 resulted in the victory of the Labour government after eighteen years of Conservative party supremacy, and Tony Blair was elected as Prime Minister until 2005 (Denmar, 2016).

3.2 Economy

Britain was officially the first world economic power in 1850. It had been the first country in the world to embrace industrialisation which usually lead to high growth rates, lower unemployment and radical cultural and social transformations (Quinault 2001, 32).

In 1950 the British government spent 6.6% of GDP in defence equipment which was higher than any other major country except Soviet Union. The United Kingdom could enjoy a position of absolute advantage than other major European countries and the USA, but environmental pollution was the price paid for the success. In 1950, British production output accounted for 25% of the entire world total output (Quinault 2001, 32).
Britain was the largest world producer of steel, coal, cars and textiles. There were growing science-based industries like technology and engineering, oil and chemical refining (Quinault 2001, 34).

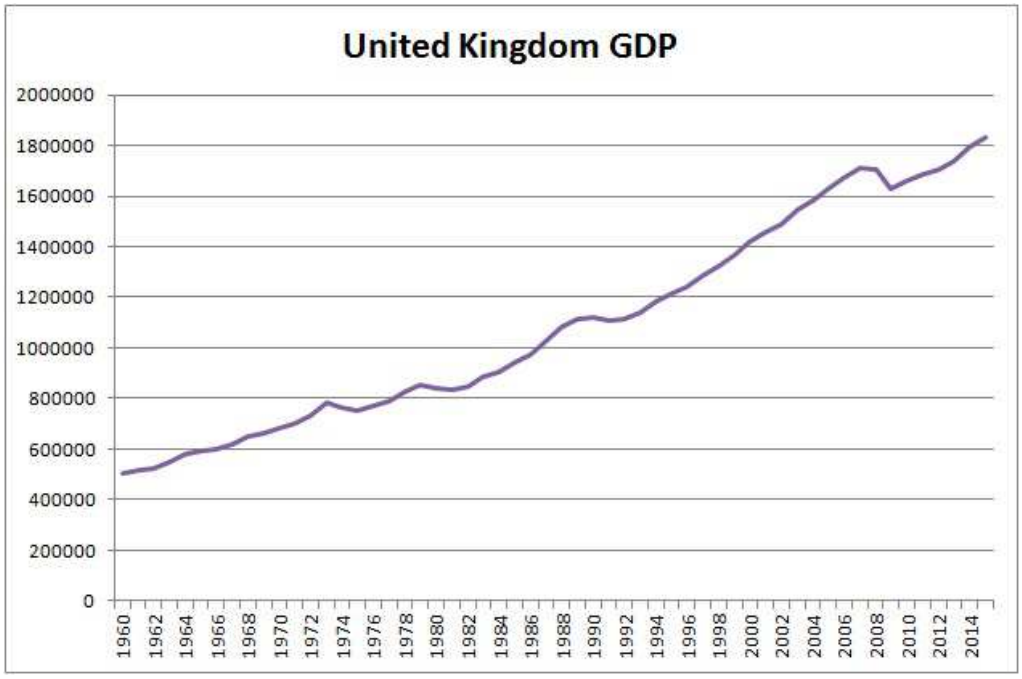

Figure 10: UK GDP from 1960 to 2015 in £ [GBP] (ONS, 2016)

As mentioned in the paragraph Politics, the Labour government nationalised many companies in the industrial sectors and also railways, electricity, gas and the Bank of England (Quinault 2001, 36).

But those were years of austerity too. Wars and political legacies left Britain with a very high level of state regulation and unprecedented taxation. Some basic food commodities such as tea, butter, and meat were rationed and, as a consequence, people produced their own food in-house. George Orwell's 1984 book depicted very well the bureaucracy of that period (Quinault 2001, 36).

While in the 1950s Western economies were generally booming, Britain was in relative recession compared to them. The UK was actually delivering wealthy rates of economic growth, but not as well those showed in other countries such as Germany, Italy and Japan (Kern 1997, 54).

The relative "closeness" of the country did not encourage economic growth. The UK preferred to keep to the same ways of doing things, which meant that a lack of capable management in companies could not promptly respond to the sudden changes that were transforming the Western world (Kern, 1997). Other important elements that brought the UK to be a non-performing player compared to other countries were: the increasingly damaging system of industrial relations, the decline of traditional vocational training and the weak competitive pulse (Crafts, 2002).

Economic policies during 1960s are sometimes considered a “stop-go”, a phrase that describes the actions of the Labour government to slow down or fuel the economy with monetary stimulus as a consequence of previous economic trends. The aim was to adjust figures in the balance of payments due to the tendency of English people to import more overseas goods when the pound was stronger and to freeze inflation when needed (London International, 2015).
The industry stayed relatively strong during the twenty years following the end of the war, and also house and commercial building sectors helped unemployment to stay low throughout the 1960s.
Strong labour unions and low competition continued to affect the industrial output which were still the real engine of British economy. At the beginning of 1970s the UK was hit more than other countries by the oil crisis which resulted in unemployment reaching to 12% in 1984. It was the time for a radical change in politics, since Labour governments were neither capable to increase wealth in the country nor to stand the threats of labour unions (Crafts, 2002).

The Thatcher Conservative cabinet was elected in 1979 and the implementation of its policies included improvement of competitiveness, privatisation, deregulation, downsizing of industrial policy, reform of industrial relations, restructuring of taxation, revision of public expenditure, radical revision of vocational training and expansion of higher education (Crafts, 2002). The 1980s started with a recession in the UK as in any other industrialised country, but by the end of the decade the British economy exploded. The service and financial sectors greatly compensated to the long decline of the industrial sector. As a result, the right timing of radical economic transformation induced the GDP to accelerate to over 4% per year (Kerk 1997, 56).
An emblematic example on how the relations between government and labour unions were profoundly changed were the days lost because of strikes per 1000 workers in 1992: 20 days in the UK compared to 110 days in the other OECD countries (Kerk 1997, 56).
During the Conservative government there was also a dramatic increase of entrepreneurship, with greatest rates of new business creation never seen before (Kerk 1997, 56).

Despite the other European economies suffered a deep recession, the UK kept

on growing until 1991. Then the recession had hit the British country for two years.
After 1993 the recovery brought the UK outside the spiral of recession and from 1993 to 1997 unemployment fell to 1.7 million people (Pettinger, 2007).

3.3 The British Stock Exchange

The birth of the British stock exchange can be traced back to 1689, when in John Castaing's Coffee House he started to issue market information of companies every Tuesday and Friday in a journal called "The Course of the Exchange and Other Things" (London Stock Exchange, 2016).
Since then, the stock exchange in London has been constantly developing, becoming the most important financial centre in Europe and one of the largest in the world.
The Second World War influenced the securities market as in every other country, but it worked as usual except for one week in 1939 at the beginning of the conflict. Shares prices fell drastically from the beginning of the war to 1944, when investors figured out the war was soon going to end with the victory of the USA and their allies. But the internal situation was neither clear nor good: public debt raised to record highs, reaching 200% GDP, industries were able to export only half of the output they were used to export in 1938 and government rationed food and clothing to meet the needs of the entire population (Blakey 2008, 18-19).

In 1945, Churchill and the Conservatives lost against Attlee and the Labourists. During the weeks after the election, the FT industrial index lost almost 25% of its value fearing that they would change the status quo.
Sales lasted for only a few months, leaving space to a bull market fuelled by new policies introduced in 1946. The Labour government believed it was time to cut on capital gains and dividend taxes and lower interest rates on money to help industrial firms to raise more money at cheaper interest rates. Consequentially, investors were both surprised and relieved, and the industrial index incremented to new highs (Blackey 2008, 27-29).
Meanwhile, the USA provided loans to the UK through the Marshall Plan, but investors feared that the USA would soon stop giving the benefits they hoped for due to the belief that they were unable to cope with the enormous public debt of

the UK.
By the end of 1950, due to many devaluations and political affairs, the FT30 Industrial Index was back at the same level of 1945 at 115 points (Blackey 2008, 34).

Even if taxes on capital gains and dividends had been reduced, other income and corporate taxes increased, and a new recession began at the start of the 1950s. One year later, the newly elected Labour government put into practice a sort of "Conservative programme" which involved maintaining full employment as well as the elimination of rationing and tax reductions. The FT30 started its recovery. (Blackey 2008, 36).

In 1953 the improving trend of the economy carried on, and the confidence of investors was reflected in the stock market. The first major post-war popular bull market was getting under way. It was popular because investors were common middle-class people who would buy stocks from companies they knew well because they were themselves customers of those ones (Blackey 2008, 39). For example, instead of buying exotic fast-growing companies they had never seen before, they could finally buy shares of firms like Marks & Spencer because they were content in knowing that by buying their shares as well as their merchandise, a capital gain and an ever increasing dividend would be assured. 1953 is commonly recognised as the foundation years for the cult of the equity and the share-owning democracy (Blackey 2008, 36-37).
In 1954 and 1955 the index repeatedly reached new heights, but this time it was recognised to be a sustainable bull trend since interest rates were not as low as in 1947 and profits looked good on average (Blackey 2008, 41).

Due to a rapid increase of the interest rate and a shortage of oil reserves, equities stayed flat and eventually declined to 160 points twice. This is marked by the end of the 1950s where the government liberalised trade between the UK and the USA, bank interests went down, the oil-reserves issue was solved and, as a result, industries could perform well again. The entire economy began to recover and so did the capital market, which reached 340 points in about a year setting the new all-time-high record and therefore following the same path of the American stock exchange (Blackey 2008, 50).

During the first five years of 1960s, the index fell to about 30%. Even if the

economy was still growing, the market overestimated its performance. The Central Bank lowered the interest rate to sustain asset prices, but the UK was paradoxically entering into a stagnation phase because many firms that used to have large revenues were not able to sustain their own success. Too much debt and a slight decline of foreign demand were detrimental for their activities (Blackey 2008, 53).

From 1965 to 1969, the Labour Government cut on public expenditures and posed limits on imports. Markets reacted badly, but the authority and professionalism of the government gave confidence to markets which once again established a bull market that reached new peaks at 520 points in 1969, topping the £1 billion capitalization for the first time ever (Blackey 2008, 80). Sentiment was helped by a sharply improving trend in the balance of payments in the final quarter of 1968, where a continuing merger boom evidenced the strong rise in industrial investment and consumption was paying off in terms of productivity gains and corporate profitability (Blackey 2008, 74).

In 1969 the prime minister announced an interest rate increase which induced the FT index to decline again. The decision was needed to avoid a market bubble since prices were growing too rapidly but unfortunately, as it had already happened in the past, a bear market usually followed an interest rate increase, and the index went from 520 to 452 points in few weeks, reaching a low of 360 in August and again in November (Blackey 2008, 82).

By the beginning of the 1970s trade unions were gaining more power against the Labourists by imposing wage increases along with strike threats. The London Stock Exchange did not react well, reaching new lows at 320. Due to worsening unemployment and data and industrial disruptions, the new elections resulted in a victory for the Conservatives, who would promise to battle against the salaries/inflation spiral, stagnant production and a cut of income taxes. Although the intentions of the new government were appreciated by capital market, when people realized their tax cuts were balanced with Special Deposits raised by 1% to 3.5% in order to curb bank advances, within a week the index dropped again, and investors feared a new rise in bank rate. After reaching a new low at 305 points, the FT index bottomed and ended a bear market that lasted for three years (Blackey 2008, 88).

From 1971 to 1973 the index returned to its highest levels of 500 points, until the Arabs cut 20% oil extraction. The oil crisis had serious consequences on the industry because energy costs were prohibitive and profits were negatively

affected by the crisis. It is remarkable that the index declined to 150 points, considering that such a level had never been seen since 1953. Shares were really cheap. There was no doubt that market was discounting almost every conceivable disaster (Blackey 2008, 98-114).

Bargain Basement
6th january 1975

Stock	Price (p.)	Div/Yld%	P/E	Mkt Cap (£m)
British Oxygen	17	19.5	3.3	35
BP	196	12.8	2.6	755
Grand Met	23.5	20.1	2.4	57
ICI	118	14.0	3.5	575
Lloyds Bank	96	10.1	2.1	125
Nat West	96	12.1	1.9	175
Trusthouse Forte	41.5	26.4	2.9	35

Figure 11: Example of astonishing low market valuations in 1975 (Blakey 2008, 140)

The recovery began in 1975 slowly and cautiously. London's advance gathered momentum and only during that year it topped 250 points for a 73% gain.
Over the following years it reached the 540 points level, but again the credit of this long increasing trend must be given to the ease of money during that period (Blackey 2008, 141).
Doubts centred on the likely difficulty of keeping the growth of money supply within the target range now that so much overseas money was pouring into the country, and fears that if this problem was countered by letting the pound to rise, then industrial competitiveness would suffer. The dilemma was partially solved by the announcement of tax concessions and reaffirming the lower public spending targets. The stock exchange stayed flat, which was exactly the intent of the governing bodies who knew the market could enter in a bubble if not stopped (Blackey 2008, 145).

Thatcher's governing decade reflected her vision for the radical transformation she wanted for the country through the markets (Blackey 2008, 147). The securities market slowly but constantly increased price levels. Markets reacted well because of her firm behaviour against labour unions: many tax and public expenditures cuts diminished public debt and helped private firms to slowly improve their profits. The change of the economy from an industrial to a service-based system was also reflected by the stock exchange composition. In 1984 the

FTSE 100 was first introduced to replace the old FT 30 that had been made up of the country's top 100 companies as market capitalization which were mostly involved in services, finance, banking and retailing (Blackey 2008, 150).

In the following years investors could benefit by higher share prices because the effects of Thatcher's political actions were visible to the population and business environment, bringing the index to 2400 points in 1987. This development severely affected shares in the UK with the index returning back to 1600 points, but it did not change direction for the real economy and Thatcher again won the national election for the third time in a row (Blackey 2008, 224).

The "Black Monday" correction in October 1987 happened because of a general vision of an upcoming world recession and financial collapsing. However, consumers continued to spend and profits kept on growing. The rate of growth in 1987 looked like exceeding the estimate in the budget, actually accelerating. The market returned to 2400 in 1989 but this time a recession was really going to stop the 1980s British economic miracle (Blackey 2008, 243).

The recession in the UK was unique in the sense that the traditional means of stimulating a recovery, namely devaluation and cutting interest rates, were strictly limited by reason of having joined the European Exchange Rate Mechanism, which set strict rules on monetary policies. The market discounted that fact that the recession had reached the bottom at 2400 points and also increased again during the following years.

During the 1990s the market returned to its highs and even beyond, going to 3000, then 4000, 5000 and finally 6000 points in 1998. It well reflected the economic situation in the UK which benefited from the transformation previously implemented by Thatcher's government (Blackey 2008, 320).

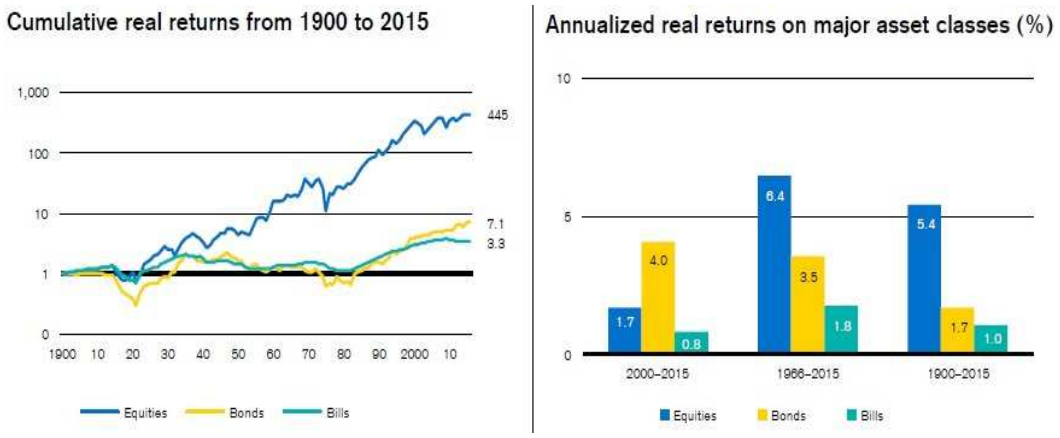

Figure 12: Annualized real returns in the UK from 1900 to 2015 in $ [USD] (Dimson et al. 2016, 59)

3.4 The Influence of Financial Markets in the Ownership and Control of British Companies

The examination of the chronological path that has determined the actual situation of dispersed ownership of British companies means that it is essential to begin this evaluation from the end of the nineteenth century. At that time the country had not developed a sophisticated corporate economy yet, and there were just sixty domestic commercial and industrial enterprises with shares listed in the London's Stock Exchange (Cheffins 2000, 12).
Then, during the beginning of the twentieth century, companies figured out the benefits of market listing and in 1907 more than 600 companies were quoted in the stock exchange. The number roughly doubled each decade, and the peak of 3500 quoted companies was reached in 1951. They accounted for more than 70% of the overall amount of profits created in the United Kingdom by corporate companies (Cheffins 2000, 13).

During the first half of the twentieth century, family dominance was the prevalent pattern treaded by British public companies. Their importance was not mainly due to their large-scale ownership in British companies, but to their hierarchical position in the organization and the board (Franks, Mayer, Rossi 2003, 9). Families often held disproportionate roles of power than the stakes they actually possessed (Franks, Mayer, Rossi 2003, 9). The reality was that their decreasing real ownership already started at the beginning of the century. Their decisions still mattered in practice and in total compliance with current shareholders

because of their loyalty in the old management. There were no contrasts from new main shareholders because they wanted to avoid conflicts and keep to the status quo (Franks, Mayer, Rossi 2003, 10).
This was possible only during the first half of the century because takeovers were usually made through external bid offers and agreements could be made privately (Franks, Mayer, Rossi 2003, 10).

The first documented case of complete takeover inside the capital market dates back to 1953, when the self-made millionaire Charles Clore launched a bid for the shoe shop chain-store J. Sears & Co.. Instead of following the conventional approach of negotiating with target management, he bought shares directly from current shareholders over the heads of management. The directors were astonished and as a counter-move they tripled dividends. It was not enough, at the end Clore acquired the majority of the company and held the new position of director (Franks, Mayer, Rossi 2003, 18).
Since families were unable to obtain protection from institutional takeovers and government did not support them, they erected their own barriers.
Companies started dual-class shares issuing, whereby one class guaranteed full rights to owners, while the latter restricted voting to outsiders. The incidence of anti-takeover measures increased further in the 1950s and 1960s (Franks, Mayer, Rossi 2003, 19).
The Institutions and the London Stock Exchange were worried about these measures because they believed that they could constraint the correct functioning of the capital market itself and withdraw their voting rights in favour of an unbalanced old hierarchical organisation structure. The London Stock Exchange took action and did not permit dual-class shares issuing anymore (Franks, Mayer, Rossi 2003, 19).

The intervention proved to be decisive for the transformation of the British corporate ownership and control system from the Continental to American model. It was during the second half of the twentieth century in particular that corporations experienced a widening gap between ownership and control. As said, this trend followed the US style of management which Alfred Chandler researched in detail (Cheffins 2000, 13). He studied both the American and British corporate environment and found a distinction between the two economies: in the first, companies hired well-trained salaried executives who made key decisions, whilst in the latter corporate companies continued to rely on

personal ways of management since families kept control over their firms (Cheffins 2000, 13-15). However, as mentioned before, the British corporate system evolved and transformed in US style managerial capitalism more than the European one.

Among the British firms which were not state-owned or wholly-owned subsidiaries, the ratio of companies which had a shareholder owning more than 10% of the equity slumped from nearly one out of two in 1976 to just over one out of three in 1988. This decrease was due to the decline of family control of UK companies (Cheffins 2000, 15).
The UK chose to follow this way because of its efficient and established capital market.

> ‘A country is only likely to develop a vibrant stock market and a widely dispersed pattern of share ownership if its legal regime provides sufficient protection to minority shareholders to allow them to feel “comfortable”’ (Cheffins, 2000).

In other words, the country should be capable of: honest and reliable legal system, regulating shareholder voting and pre-emptive rights, imposing a duty of loyalty on directors and constraining insider dealing and compelled disclosure by publicly quoted companies. The UK followed this exact model, however it should be noted that since the beginning of the twentieth century the healthy demand of equity encouraged a growing number of companies to go public.
Thus, the role of the state as direct regulator of market activity is not the direct cause, but the factor that contributed to a growing demand for shares. The number of listed companies which could rely on more capital in the securities market therefore increased (Cheffins 2000, 16).

	25	50	75	n
1	18	13	12	2
1	15	11	11	2
1	15	12	10	2
1	11	8	6	2
1	8	7	6	2
1	7	6	5	2
1	5	3	2	2
1	2	1	1	2
1	1	1	1	2
1	0	0	0	2
2	0	0	0	2

Figure 13: Number of companies where founding family shareholdings exceed 25%, 50%, and 75% of issued ordinary share capital for selected years, 1900 sample (Rossi 2003, 26)

	Largest shareholder is an	Block	n.
1	0	.	25
1	1	5.00	25
1	0	.	25
1	0	.	25
1	4	5.89	25
1	7	3.73	24
1	8	4.18	23
1	9	5.35	22
1	8	6.46	21
1	17	10.83	21
2	17	12.85	20

Figure 14: Number of companies where the largest shareholder is an institution and block size for selected years, 1900 sample (Rossi 2003, 27)

3.5 Commentary on British Capitalism and its Financial System

The United Kingdom appears to be more similar to the USA than European countries, however it has not always been like this. The shift was remarkable during the Thatcher's era, having transformed from decades of welfare state, state-owned firms and family control over corporate companies to the more

capitalistic system of liquid capital market, privatization and dispersed control over corporate companies.

The dual action of a favourable environment for a capital-based economic system and the Conservative party's politics were without a doubt decisive for such a radical transformation. Indeed, the 1980s revealed to be the perfect time for a change, since the British industrial economy was in decline and the requests of labour unions seemed uncontrollable from the point of view of long-term sustainability of wages and profits. The UK had to switch from being industrial-based to service-based before many other developed countries, Italy and Germany included.

Understandably, due to its inner characteristics and the long history of financial activity, London stayed at the top of the world financial centres, providing jobs and wealth to the entire country.
People trusted financial markets because they proved to be liquid, most of the times efficient and with a large range of firms coming not only from London but also from rural parts of the nation. The role of the stock exchange and the balanced regulation between "laissez-faire" and protection of shareholders' rights proved to encourage more and more people to invest in equity, activating a spiral of increasing firms looking for funds in this market.

The shift was not easy, and the British ownership and control model evolved slowly and with many obstacles on the way, which it still struggles with today. Managerial firms came out after many years of European influence of Britain, which mostly changed during the second half of the twentieth century to represent the American-model in Europe.

CHAPTER 4
The United States of America

4.1 Politics

European countries were in grave recession after the Second World War and the USA resulted to be the most powerful country in the world. Even if Pearl Harbour and other bombing attacks posed some infrastructural problems that affected the economy in the short-term, the USA had been able to develop more military and civil technologies than any other country (Suri, 2016). Due to the relatively favourable situation in the country, agriculture was exploding. Farmers were both capable of feeding the entire population whilst still possessing stock in excess which they sold to allies countries as the UK (Morgan 2009, 482).

However, the international panorama was not as optimistic. The Nazis defeat introduced the presence of a new enemy: the Communists. The Soviet Union soon became the national enemy of the USA and the government feared that the USSR could influence the Western European countries and create a Communist alliance against America. Hostilities became standard between Soviet Union and the USA, resulting in the “Cold War” (Suri, 2016). However, American media exacerbated the conflict, and propaganda against Communists spread at a velocity never seen before due to the mass diffusion of televisions and radios.

The Servicemen’s Readjustment Act - also known as the “GI Bill” - signed into law by President Roosevelt in 1944, became the main vehicle for federal aid to American war veterans (Suri, 2016). During Truman’s presidency from 1945 to 1953, the broad application of its benefits provided a foundation for remarkable American growth. Millions of veterans received education assistance and a vast majority attended universities paid directly by the government which spurred a societal transformation. The middle class expanded due to improved education which opened up better job placements and allowed them to earn higher wages. Higher salaries had a direct impact on the housing market and consumption. People read more, spent more, and saved more than their predecessors (Suri, 2016).

Truman was also quite concerned about the racial problems that America had faced for a long time, but they only became evident after the war. He was reluctant to move fast on social integration because he thought it was not socially healthy to rapidly change values and culture. However, he did take the first step in acknowledging these problems during the 1948 elections where he signed the "Executive Order 9881", which required 'equality of treatment and opportunity for all persons in the armed services without regard to race, colour, religion, or national origin.' (Suri, 2016). Truman's liberalism and his firm opposition against the communists set the foundation for a new American system. One such example is the National Security Act of 1947, which formally recognized military and foreign policy authority in the USA, giving more control to the president. The Act also created the Central Intelligence Agency [CIA] and the National Security Council (Suri, 2016).

In 1947 the national secretary George Marshall insisted on rebuilding the European countries that were torn by war. The USA provided $12 billion in four years to the European allied countries through the agreement of the Marshall Plan (Suri, 2016).
Truman not only improved relations with European countries, but also ensured America on their reliability because of the reconstruction aids.

President Eisenhower was elected after Truman in 1953 and he monopolised American politics during all the 1950s (Brinkley, 2016). He preferred a conflict-aversion approach in order to keep the American society in peace, to support capitalism, free enterprise and to maintain the economic boom. During his time in office the white middle class notably enlarged and improved its position in society (Brinkley, 2016), however minority groups such as black communities and women had little access to the same opportunities. It was in Montgomery in 1955 where African Americans established the Civil Rights Movement (Brinkley, 2016) which was followed by uprisings on February 1 1960 when four African American students protested against black segregation from all-white universities (Stikoff, 2016). During the following years protests spread in all the major cities of the USA, and in the spring of 1963, two years after president Kennedy election, Martin Luther King Jr. was determined to obtain a stronger civil rights legislation by organising a series of marches (Stikoff, 2016). In his famous speech 'I have a dream', he proclaimed for freedom and justice, but neither the marches nor his

speech stimulated the Congress to take action on the matter. It was only with the assassination of Kennedy in 1963 that the Right Act of 1964 was introduced, banning racial discrimination and segregation in most public accommodations and in employment (Stikoff, 2016). Following other protests, the Voting Rights Act was signed into law to eliminate barriers to vote registration.

In 1959 the USA declared war on Vietnam because of several communist takeovers of Southern territories. Eisenhower sent American troops to Vietnam, and by late 1963 Kennedy subsequently increased the number from a few hundred to more than sixteen thousand (Stikoff, 2016).
In 1966 the Johnson administration spent more on waging war than fighting poverty at home which spurred public concern over government spending over military aid (Stikoff, 2016). Despite this, North Vietnamese and Vietcong [South Vietnamese Communists] kept on fighting and launched massive offensives in 1968 against American bases throughout South Vietnam.
A shaken President Johnson declared he would stop bombing Vietnam to facilitate peace talks to end the war (Stikoff, 2016). In line with the protests in Europe, American university students also rallied against university rules, racism, the Vietnam war and, broadly speaking, against the middle-class consumerism (Stikoff, 2016).

In 1969 Nixon was elected as new president. He finally ended the conflict between America and North Vietnam. The war cost the US some 58,000 American deaths, 300,000 persons wounded, numerous soldiers with crippling and long-lasting psychological wounds, and the expenditure of at least $150 billion (Stikoff, 2016). Nixon would also put major efforts to end America's Cold War with the People's Republic of China and the Soviet Union. American foreign policy was aimed at empowering connections with Japan, with Western European countries encouraging imports from them.

In 1971, not surprisingly, the USA experienced negative trade balance for the first time since 1983 (Stein, 2016). Thus, in August 1971 Nixon ended the fixed monetary system that tied the dollar to the gold value. The Bretton Woods agreement ceased to exist. From that time on the currency would float and presumably decline in value. The US Dollar was cheaper in the short term, but the oil crisis of 1972-73 impacted the country in the worst economic crisis ever seen after the end of the war (Stein, 2016).

In 1972, a burglary occurred in the Watergate Office Complex which were where the headquarters of the Democratic National Committee was located. Shortly after Nixon's election as president, it was discovered that he had been involved in the spying operation and he then resigned to avoid impeachment (Stein, 2016).

The new president General Ford, was convinced the economic crisis could only finish if both inflation and oil prices decreased. On the other hand, the Democratic Congress believed the real problem was unemployment. After many compromises, Ford decided to cut tax. The consequence of this was a drop of inflation from 11% in 1974 to 5.8% in 1976, but unemployment stayed at 8% (Stein, 2016).

New elections resulted in the victory of Carter in 1977. He did not take relevant economic measures, and though unemployment did fall to 6.4% in 1978, rising imports continued to result in a negative trade balance (Stein, 2016). A remarkable measure taken by Carter was the tax cut on capital gains, which could encourage investment and jobs according to financier opinions. A new boost in oil prices in 1978 obliged the Federal Reserve to increase interest rates, but this move resulted in a raising of inflation and a new recession (Stein, 2016).

Reagan unseated Carter in 1980 and introduced "Reaganomics" a few months later his election. Reaganomics was the larger budget cut ever: it consisted of $35 billion in order to sustain personal income tax rate of roughly 25% (Troy, 2016). In 1981 Reagan was shot, and he took advantage from the media publicity to increase his own popularity. At the same time both unemployment and inflation increased. Just before new elections, the economy revived again. For eight years, the economic boom was consistent, yielding 20 million new jobs and a decline of inflation rates (Troy, 2016). Reagan was in his brightest position and conducted a more solid mandate than the first one. He visited East-Germany in 1987 and met Gorbachev where he famously posed in front of Berlin Wall and stated: 'Mr. Gorbachev, tear down this wall' (Troy, 2016). Two years later the Berlin Wall was knocked down, and in 1991 the Soviet Union dismantled.

The 1990s started in the best possible way for the USA. The Cold War was finally ended, the economy was still growing, and democracy and capitalism poised to spread across the world. The nation was also facing new issues due to the social

and technological change that globalisation brought to Americans. President Bush was elected in 1989 where he continued Reagan's revolution with a softer touch, however in 1991 the U.S.A and other Western countries were affected by a new economic recession (Troy, 2016).

Whilst Clinton conducted his electoral campaign, he asserted that Reagan only increased the gap between rich and poor in America in order to damage the middle class (Troy, 2016). Clinton won the elections in 1996. At around this time terrorist attacks from the Middle East began threatening the USA, which overshadowed the new Millennium with incumbent enemies ready to damage the American international role.

4.2 Economy

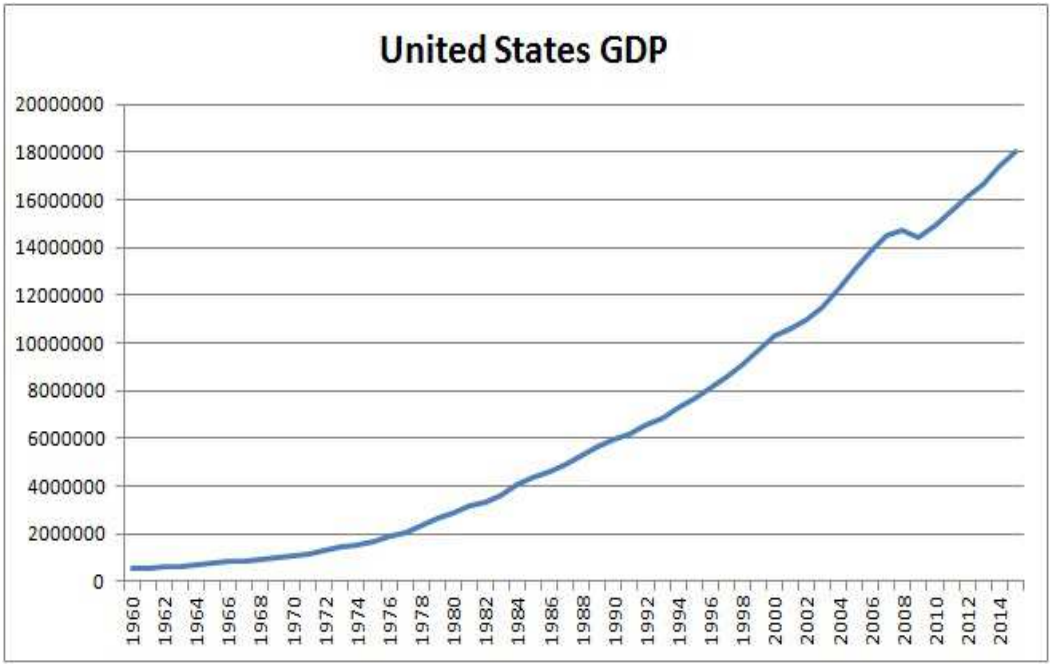

Figure 15: USA GDP from 1960 to 2015 in $ [USD] (Country Economy, 2016)

Before the end of the Second World War, many economists forecasted the worst scenarios for the US economy. Their idea was that after the end of the war, some ten million men would return home and join the labour force. There would be an unprecedented period of high unemployment rate and industrial dislocation (Suri, 2016), but nothing of the like actually happened after the Second World War.

In 1944, government spending accounted for 55% of American GDP to sustain the army, purchasing the necessary equipment from the military industry. But in 1947 public expenses accounted for just 16% of GDP (Suri, 2016).
The real turn-key factor was the conversion of the military industry in civil-goods. Factories that once used to produce bombs now manufactured toasters, and toaster sales were rising. Private consumption largely increased because more and more people were able to earn higher wages and spend more. Resources flowed from public to private use, and then followed with tax cuts and efficient private investments (Suri, 2016).

Despite warnings from economists, unemployment only rose from 1.9% to 3.9% until 1947 (Suri, 2016). As economist Robert Higgs points out:

> 'It was no miracle to herd 12 million men into the armed forces and attract millions of men and women to work in munitions plants during the war. The real miracle was to reallocate a third of the total labour force to serving private consumers and investors in just two years.' (Higgs 2006, 111).

During the American economic miracle, the GNP increased fourteen times faster than population and seven times faster than inflation between 1940 and 1965, and during the same twenty-five year period, the average American family income grew from $2200 to $8000 adjusted for inflation (Suri, 2016).
Despite the fact that the rich and poor classes were becoming wealthier, the gap between them remained almost unchanged (Suri, 2016).

As mentioned, the causes of the American dramatic growth were: the rapid conversion of factories from military-goods producers to civil-goods producers which initiated a spiral of higher wages, more consumers, higher profits, more investments, more production, and higher savings. Furthermore, investments in highways and home construction filled the gap the economy needed to be sustained in the long run.
Since veterans enjoyed the benefits provided by the GI Bill – namely, mortgage and education assistance – they were able to have a higher level of education, increase their personal income and purchase a house with an incentive on real-estate and ease to get the mortgage. Home ownership rose from 40% in 1945 to 60% in 1960 (Brinkley, 2016). The "post war baby boom" within the middle

classes saw an increase of the population of 76.4 million people from 1946 to 1964 which composed the 40% of the entire American population and helped to further boost consumption (History.com, 2016).
Nonetheless, the government did not stop to sponsor research in military and space, due to the severe competition of the Soviet Union and the Cold-War fears (Suri, 2016).

In his famous 1952 book titled 'American Capitalism', Harvard University economist John K. Galbraith agreed with the ideology of Capitalism, stating that 'It works!' and adding that:

> 'In the United States alone there need not lurk behind modern programs of social betterment that fundamental dilemma that everywhere paralyzes the will of every responsible man, the dilemma between economic progress and immediate increase of the real income of the masses.' (Galbraith 1952, 163).

His view was that Keynesianism effectively worked and that with monetary and fiscal policies it was possible to control the economy (Suri, 2016).

During the election campaign, Kennedy focused on the economic matter, promising a return of an average growth of 4-6% whilst also aiming to keep unemployment below 4% (Stikoff, 2016). After his election, he introduced a programme of twelve points among which the minimum wage increase from $1.00 to $1.25 per hour (Stikoff, 2016), an increase of social security benefits and further incentives for housing and education. Kennedy's conviction was that despite the economy recovering, stimulus packages would still be necessary. Several tax cuts on corporate taxes and personal income worked as forecasted and growth came to its pre-recession levels (Stikoff, 2016). Even though inflation concerned president Johnson, the situation was optimistic: the average Americans real income had increased 50% from ten years before, and median family income rose to $10,770 in 1969 (Stikoff, 2016).

The 1970s marked the real end of the 'American Golden Age'. The decade started with a new recession that was more problematic then the one experienced at the beginning of the 1960s (Stein, 2016). As previously mentioned, oil shortages would subsequently pump oil prices up, along with high

inflation. Combined with recession and growing unemployment, “stagflation” was the final result. The problem was a lack of leadership of the Federal Reserve which did not take sufficient measures to fight inflation. However, Nixon was not concerned about unemployment nor double-digit inflation (Stein, 2016). His only purpose was to avoid a new recession and boost growth. Nixon wanted low interest rates to increase investments and productivity and in 1971 he broke the last link on gold, turning the American dollar into a flat currency, consequently making it cheaper (Stein, 2016). Unfortunately, cheaper money and low interest rates increased inflation and kept it consistently high resulting in a 14% rise (Stein, 2016).

It would take the new Federal Reserve chairman, Paul A. Volcker, to accept the brutal crisis and impose a policy of tight money to return inflation to a single-digit rate (Troy, 2016). The short-term effect was indeed a new recession because loans and mortgages were harder to obtain and interest rates were high, however in the years coming, inflation returned to sustainable levels (Bresiger, 2016).

Together with Volcker, Reagan was elected as president of the United States at the beginning of the 1980s. His belief was that the private sector necessitated for freedom of action. He cut tax on individual income by 25% to promote greater consumer spending, savings. He also cut tax on businesses to promote major investments (Troy, 2016). The problems were not just due to the internal slowdown, but also because of a growing competition from Germany and Japan due to the openness of economies and globalisation (Troy, 2016). In 1984 the economic growth returned to the level that America experienced in the 1960s. Inflation went down because of the decreasing oil price and the monetary policies adopted by the Federal Reserve (Troy, 2016). Reagan’s correct - though late - forecasts on tax cuts successfully ensured him a second presidential mandate. GNP grew an annual rate of 4.2%, while the annual inflation rate ranged from 3% to 5% from 1983 to 1987. During this period of time, American firms created 13 million jobs (Troy, 2016).

However, it must be underlined that the gap between the richer and poorer classes remained constantly wide, and that public deficit drastically spiked as a consequence of less public revenues. Public deficit soared to $150 thousand million after a peak of $221 thousand million. In 1987 a one-day 26% decline in the stock market dramatized doubts about the stability of Reagan’s economic

measures but no serious consequences followed the isolated episode, otherwise known as “Black Monday”. The prosperity lasted until 1990.

The 1990s began with a one-year recession, and ended with a sudden recovery. It is argued that the economy was entering a phase of deep transformation (Harris, 2011). Competition from China and other emerging countries posed real issues to the industrial sector, leaving doubts on how it could innovate and lead the same growth rate of the past decades.

The USA, along with many other Western countries, renovated themselves by changing the basis of the growth: a new era of tertiary sector and Information Technology began. These new sectors would be the real engine of what initiated the expansion at the end of the decade. It was only the beginning of the new digital revolution that saw America as the undisputed global leader (Harris, 2011).

4.3 The American Stock Exchange

The history of the American stock exchange started during the nineteenth century in Philadelphia. The growing power of New York City overshadowed Philadelphia within a few decades, making it the largest financial centre both domestically and globally. (Geisst 1997, 10).

It can be seen how Wall Street well reflects the dynamics of the American economy and its prevailing sectors by the differentiation of its indexes. The Dow Jones Industrial is composed by industrial firms, the S&P 500 consists of big retailers and hardware technology manufacturers, and the NASDAQ instead is the younger index, composed by digital and IT stocks (Geisst 1997, 306).

The NYSE (New York Stock Exchange) began to change substantially in 1942. The Second World War was transforming the way the major industrial companies operated. The traditionally titled “wheelhorses”, stocks such as US Steel, Corn Products, Bethlehem Steel, Studebaker, and Anaconda Copper were losing their market share. The 12 wheelhorses which were present during the First and the Second World Wars accounted for 60% of total market volume in the WWI and only 18% during WWII. (Geisst 1997, 267).

During the course of the 1940s the small investor usually steered clear from stocks. People were more tempted to purchase a house which was seen as a more reliable asset and long-term durable investment.
After the end of the war in 1945, markets slowly increased both in volumes and prices. However, the margin requirements on stock market loans increased at the end of the 1940s from 50% to 70% before, and raised to 100% in late 1946 (Geisst 1997, 268). This meant that a person or institution had to pay the entire price in cash to obtain shares.
In 1951-1952 an antitrust case against 17 investment bankers hardly hit new shares issues and market trend (Time, 1951). When the judge dismissed the case, the modern era in finance began.

Wall Street had suffered during the 1929 crash, nonetheless it also suffered the New Dealers trials which was designed to weaken the enormous power that bankers had been acquired during the 1920s. Thus, a post-war boom developed in 1950s, but this boom was different than in the 1920s. The post-war boom was sustained by strong fundamentals and a new international economic environment which favoured business. The more Dow Jones industrial index increased, the more people wanted to invest their money (Geisst 1997, 273-274).

Industrial stocks had the best performance in terms of valuation, but also high technology, namely television and pharmaceuticals, outperformed the average stocks (Geisst 1997, 274).
Large volumes were also supported by the fact that New York was, at that time, the only major market open to foreign investors - even more than London because it was still regulated by severe restrictions on foreign trading.
Obviously, during the bull market that had lasted for fifteen years there were some corrections. In 1955 when president Eisenhower was stricken with a heart attack, the markets took it very badly and loss exceeded $14 billion, the largest drop until then. The sell-off was a sign of how markets were sensitive to bad news in the short-term (Geisst 1997, 278).

American consumerism accused a defeat in 1957 against the Russians. Despite different political and social practise to that of the United States, Russia had still been able to launch the first Sputnik into orbit. The country began to doubt its own prowess in science, wondering if the emphasis Americans put on

materialism could be helpful or just an obstacle to scientific and technologic progress (Geisst 1997, 279).
Eisenhower had immediately announced an increase on defence budget to allow for new research and development in weapons systems and the market reacted positively after his words. Companies that benefited the most from a surge in defence expenses in terms of market capitalisation were Raytheon and Texas Instruments, which joined the traditional favourites such as IBM and AT&T (Geisst 1997, 280).

In 1959 retail investors doubled in number compared to 1950, accounting for about 55%, while institutions accounted for 25%. The rest was mainly traded by floor members. Such a high percentage of small investors was not only possible thanks to the transparent regulation the NYSE reached following the 1929 crash, but also because many large brokerage firms used to produce investment research that they distributed to clients. It was a tremendous source of information for investors who did not possess a background in investing and finance (Geisst 1997, 280).
The prolonged bull market also had a profound effect upon Wall Street firms as well. Partnerships began to decline and many member firms started to incorporate other companies. The transformation to corporate status was accelerated by an increasing need to gather capital and limited liability (Geisst 1997, 281).
In the 1960s, under the Democrat government the stock market generally prospered well, even though there were some downs along the way. In 1962 a major sell-off occurred after investors acknowledged the administration's spending policies. Kennedy's policies were seen as negative for the American economy and the markets did not react well: on 28th May 1962 the Dow Jones dropped almost 6% calling for panic. However, the day after, the market recovered all the losses, meaning that short-term news was not affecting the future prospects of an even more flourished economy (Geisst 1997, 282).
Along with Johnson's presidency, market indices rose: The Dow Jones Industrial Index flirted with 1000 points in 1965, touching its historic high. The capital market was actually paralleling its trend with inflation at almost 3% per year. 1000 points were touched again in 1966 and 1968, retreating a year later and inflation increased at around 5% (Geisst 1997, 283).

The stock market dropped at the beginning of the 1970s after fourteen years of bull market in a row. Failures of NYSE member firms became common as well as did fraud and inefficiency. In the 1960s over 150 firms failed, an all-time record. In the previous twenty-five years only one NYSE member closed because of insolvency. Like a chain, when the market started its fall at the end of 1960s, many customers failed to meet margin calls and the firms at which they kept accounts fell short of cash (Geisst 1997, 302-303).

Since retail investors could not be insured by brokers' irregularities, Congress responded in 1971 by creating the Securities Investor Protection Corporation [SIPC]. Accounts at brokers were now insured against their frauds or mishandling. Regardless of what happened to the broker, the SIPC guaranteed that they were residing in a safe place.

Although the SIPC arrived on time to calm down the investors and give them more warranties, the Dow Jones sank to around 700 because inflation was seen as a growing problem (Geisst 1997, 302).

As the Bretton Woods agreement ceased to exist to re evaluate the dollar, the effect was the opposite and it lost ground against other currencies. Furthermore, a major crisis occurred when the Organization of Petroleum Exporting Countries [OPEC] announced a sharp rise in the price of oil in early 1973. The shock was immediate. People switched to risk-free bonds running out of equities. The combination was disastrous for Wall Street, which was already facing deep structural changes due to the frauds and failures suffered by the end of the 1960s (Geisst 1997, 304).

The impact was devastating on markets: the stock indices dove sharply in late 1973 and 1974. The oil crisis deeply impacted the American economy, as it did with other Western countries economies. Understandably, oil extractors and refineries were the only companies who benefited from the OPEC's decision. As an example, Exxon's income rose 90% in 1973, increasing its dividend from $0.95 to $1.10 per share, while many other companies in NYSE were lowering or cutting dividends (Geisst 1997, 305).

While the bear market was dominating, in 1975 NYSE introduced for the first time financial futures and options on currencies, stocks and commodities. They quickly became known as derivatives, and volatility became the norm on financial instruments. Moreover, in the same year all the stock markets introduced tape to report tickers shortly after orders were executed. This was the first step to the

automation of prices in stock exchanges, and New York proved to be technologically advanced in this regard (Geisst 1997, 308-309).
The recession of 1974-1975 deeply damaged companies' earnings, and oil prices did not stop to rise. But after the recession, 1975 saw the broke of 1000 points in the Dow Jones Industrial Index. Merrill Lynch, for example, disclosed a profit of $100 million, a 30% increase than the last good year, 1971 (Geisst 1997, 315).

As mentioned before, the 1970s were mostly negative for the American economy. Following the brief recovery in 1975, the structural problems the USA had previously been affected by returned and brought with it a serious recession where inflation expanded even more and the bear market largely corrected equity valuations (Geisst 1997, 317).
It was only when president Carter appointed Paul Volcker as chairman of Federal Reserve that investors applauded the government, due to Volcker's reputation as a capable and firm man. Carter needed the support of Wall Street having been conscious that the American economy was largely dependent from the financial community. In 1979, Volcker raised interest rates and implemented other special measures to rein in the supply of money and stop inflation, which was considered the most urgent problem. Wall Street responded negatively as expected because the ease of money may have been stopped anytime due to the clear message which the Federal Reserve was serving to private banks. The change in the Fed policy marked the beginning of the slide into the deepest stage of the bear market (Geisst 1997, 318).

Carter lost the next election and Reagan became the new president. He agreed to follow the similar path Thatcher was already treading in the UK and he proceeded with tax cuts and measures to favour entrepreneurship, while Volcker increased and decreased interest rates as a consequence of the radical different states of the economy. Wall Street welcomed Reagan's doctrine (Geisst 1997, 324).

In 1981 inflation continued to rise, investment stopped because firms were waiting for better times and low economic growth produced "stagflation". The Fed interest rate rose to 21.5% at its peak, provoking a chain effect on markets. They initially reacted badly because high interest rates meant higher costs for debt, less investment and more savings. However, the dollar began a major rally and foreign investors became convinced that Volcker's fight against inflation was

succeeding and the dollar could be a good buy opportunity (Geisst 1997, 325). Within the next four years the dollar recovered nearly 40%, mainly due to foreign investors, while Americans feared high inflation and interest rates. The situation evolved in a positive way, with foreign investors buying bonds initially attracted by the high interest rates and then by securities. In 1982 the stock market began a prolonged rally that would reach the 2000 points on the Dow Jones. At this point, Volcker could finally ease monetary supply and the stock market prolonged its positive trend (Geisst 1997, 328).

But raising capital was still not an easy task for companies. Regulation was still strict on the matter, and the issuing of new shares was considered a complex procedure. Thus in March 1982, the Security Exchange Commission allowed companies to preregister their financing needs. When companies wanted new capital, they could quickly get their investment bankers to organize the new share issue anytime within two years. This process was called “shelf registration” (Geisst 1997, 332). By the mid-1980s, even General Motors was using new investment bankers that were able to quickly underwrite its new issues instead of relying on Morgan Stanley which was traditionally its investment bank. “Shelf registration” proved to be an effective way to cut bureaucratic practices in Wall Street, but many other situations actually needed more regulations so as to not damage the economy (Geisst 1997, 332).

The 1980s are usually remembered not only for a long time bull-market but also as the decade of junk bond takeovers, insider trading scandals, general financial excess and enormous merger deals. The “Black Monday” in October 1987 proved that the financial system necessitated a dramatic change of its regulation to meet the new challenges that corporations and personal interests were posing (Geisst 1997, 328).

The task-force that was set up on purpose to discuss the market break of October 1987 recognized that the real problem was the too large range of different financial products – namely derivatives – that were separate but often spilled over into each other’s territory. Circumstances proved that problems in one product could easily be amplified by the others (Geisst 1997, 348-349). The Security Exchange Commission soon adopted a system called “circuit breaker”, that would eventually stop trading if prices fell too fast. However, the regulation was not radical enough to set limits to derivative bad functioning and commercial banks financial games (Geisst 1997, 352-353).

The 1990s were as volatile as the preceding years: the financial markets declined between 1990 and 1992 and the first recession after eight years of economic boom finally forced the Fed to decrease interest rates.
It soon became apparent that low interest rates were not good for bond-owners, and the derivatives linked to them performed worse. The climactic point was when the municipal government of Orange County, California, announced they were suffering huge losses on a derivatives portfolio sold by Merrill Lynch.
Consequentially, the entire country felt reverberations after this episode (Geisst 1997, 363).
The larger paradox in the 1990s was that the derivatives were seen as the major problem in the financial sector, but everyone kept on using them to earn higher interest rates in a depressed market.

Profitability was also down in the mid-1990s, and to show better quality financial statements, corporate companies literally “bought growth” by acquiring smaller firms, even those which were not in the same sector. This is an accounting technique that is designed to yield more profits in the short term, but can have devastating effects in the long-term if costs are not kept down or profitability does not improve, which can be hard if the corporation becomes too big too soon. The market rallied during mid-1990s and the stock market seemed to boom, but not the state of the real economy (Geisst 1997, 377).

NASDAQ presented itself as the market of the future. Not only were the shares that composed its list all part of the new technologies and IT sectors, but also its own system was technologically advanced for trading online, enabling it to execute quicker transactions with lower commissions. Not surprisingly, by the end of the 1990s it powered over the major bull market more than other American indexes, becoming first in fair valuations based on fundamentals, than speculations and finally to the “tech-bubble” that exploded in 2001 with serious damages to both the financial and economic states (Geisst 1997, 393). Instead, the derivatives continued to be sold, until the 2007 financial crisis inevitably showed all their gaps.

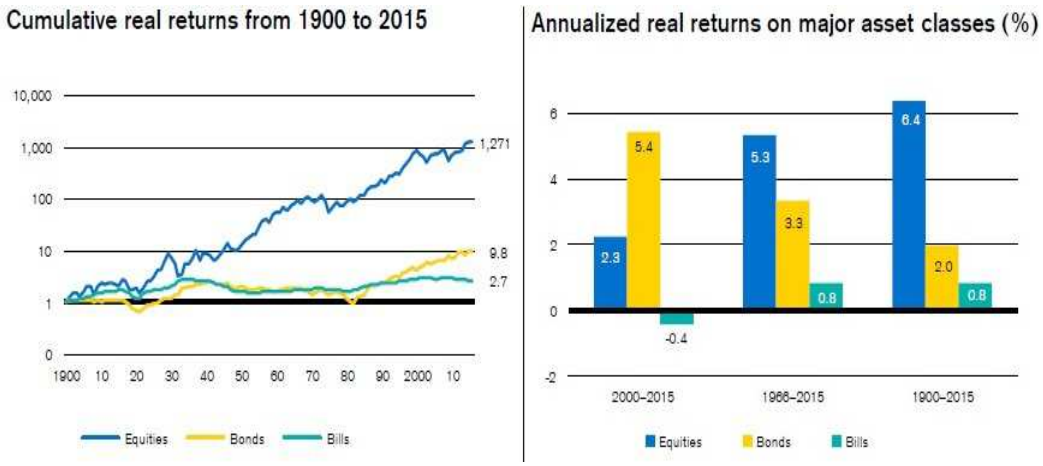

Figure 16: Annualized real returns in the USA from 1900 to 2015 in $ [USD] (Dimson et al. 2016, 60)

4.4 American Market-Based Financial System: the Importance of the Stock Exchange

The market-based financial system supports firms through well-functioning and liquid markets. Investors are attracted by the large variety of listed companies and financial products, the market efficiency and a reliable regulation and surveillance (Levine 2002, 3).

Proponents of the market-based system support this view believing that it can solve the problem of inefficiencies associated with banks and that it can fuel economic growth sharing risks between shareholders.

With the US now housing the largest financial market in the world sizing roughly $30 trillion if NYSE and NASDAQ are summed together (Desjardins, 2016) it is easy to see why it attracts new investors.

Another factor that naturally leads to major investments is the separation between corporate ownership and control. This model was first introduced in America when people with little or no stake in the company would be included in the board of directors.

Chandler deeply researched and studied the epochal switch from single-entrepreneur owner of personal firms to the multi-unitary managerial firm from 1850, following the technological and infrastructural improvements that the USA were experiencing at that time (Chandler 1973, 4-5). The example of AT&T is very remarkable due to the company's fame: between 1905 and 1907 the financier Clarence Mackay purchased about 5% of AT&T outstanding shares,

giving him the majority of the stake in the company. Such a stake, as he argued, would have entitled him a representation on the company's board of directors. However, the president Frederick P. Fish insisted to leave the board unchanged, even though the directors did not possess substantial participation in the company to justify their role as Mackay argued. The directors – he wrote in his reply letter to Mackay – "had an obligation to serve each and all of the stockholders, and it was unwise to have any stock interest specifically represented on the Board" (Lipartito, Morii 2010, 1025).

Conglomerates are a further aspect that deserves explanation. Because of the high share prices of the 1950s, corporations found themselves in the position to capitalise their own powerful positions. Some of them had price/earnings ratios [a financial measure of valuation] of 40 to 50, enabling them to raise new stock easily. These companies actively searched for bargains outside their own industries to mitigate risks of their own main industry.
The history of conglomerates was lucky until profits decreased. Thus, by the end of the 1960s, conglomerates showed all the weaknesses that the booming economy had been able to hide: their organizations were too large, costs increased and became unsustainable and too many assets were unprofitable (Geisst 1997, 294)

The 1970s saw a different transformation of the American financial market with the entry of a new player: the institutional investor. In the last quarter of the twentieth century they radically changed the way in which the stock market behaved. In so doing, the stock market changed its own fundamentals.
These funds increasingly gathered liquidity from middle-class people who looked for a protection against high inflation rates (Becker 2002, 17).
Fund managers were more interested in short-term results in stock price and in maximum dividends than in long-term appreciation of the stock price. As Benjamin Graham would define them, they were more "speculators" than "investors" (Graham 1949, 18).

Mutual and pension funds purchased stocks in large quantity. In 1965, block trading represented only the 3.1% of the market total activity. In 1985, block trading reached the 51.7% (Becker 2002, 17-18).
In 1981, institutional investors owned more than 50% property of 101 companies on the S&P index composed by a total of 500 companies. Some companies were

owned by more than 60%. Volatility has increased since then, due to their frequent buying and selling operations that can change the direction of the market even in relatively quite periods with no remarkable economic or business-related news (Becker 2002, 19-20).

Thanks to this dynamic financial environment, large, medium and even small firms often opted to raise capital issuing shares instead of borrowing money from banks. The reason for this trend is simple: when a company obtains credit from banks it needs to repay it with interests in a limited amount of time. Instead, by issuing shares, companies are able to raise capital without the need to repay it. Furthermore, risks and property are shared, but control remains in the hand of the managers who could - as they could not - be investors in the company itself. Instead of having a board of directors with different interests that can be in conflict with the long-term profitability of the company, this system sees a consistent guidance made by expert managers who take neutral positions and act as entrepreneurs to enhance the value of the company.

The short-term view of the institutional investors can be detrimental for the companies, because managers can forget to focus on long-term planning for the sake of boosting short-term profits. However, the presence of institutional investors has with no doubt improved market efficiency, helping the American middle-class to invest money and radically changing the way they look at the stock market. Consequentially, firms are more capable of raising capitals if they can rely on a market with a high liquidity, fair regulation and with many investors.

4.5 Commentary on American Capitalism and its Financial System

The US has followed a path similar to the UK to some extent, but the influence of financial markets is much more visible in the American economy.
While both countries are without a doubt market-based, the American version created managerial firms long before British firms. It is important to highlight this concept because even if it is not directly linked to the financing of business' operations and investments, it is crucial for the development of a model that sets clear differences on who owns and who controls the company. As a consequence, the financial sector could develop in a way where large institutions can concentrate more on gathering funds and investing them instead of

participating with the boards of directors within the firms they are involved in. At the same time, other type of investors can trust the management because it is neutral, objective, professional and generally focused on fostering the value of the company in the hands of its shareholders, whoever they are. Conflicts of interest are avoided, and everyone can participate in the business profits/losses.

The power and breadth of the American Banking System means that small/medium businesses rely largely on bank loans to sustain their operations and investments (Wikipedia, 2016).

Although it was and is a uniquely dynamic system, it suffered an epochal transformation by the end of the 1920s with the Great Depression. In 1929, bank runs happened very often because deposits were not insured and banks were not obligated to keep a fraction of deposits in reserve. The bank crisis was solved by Roosevelt's New Deal and his Emergency Banking Act, which incorporated small banks in single-large organisations able to face crisis as disastrous as the Great Depression (Wikipedia, 2016).

Conclusions

Italy, Germany, the UK and the USA have a profound different history. Many variables in each one of these countries led to different scenarios that are still embedded in the all four states today.

Since the Fascist regime, the Italian public sector has had a certain influence on major companies. Italy was a compromise of two models that were incorporated in one new hybrid model. Like the American system, the separation between banks and companies was needed to guarantee a fundamental solidity of the first and avoid too much control on the latter (Barca 2010, 10-11). Like Germany, banks remained the main source of credit for firms, while a modest and smaller role was given to the stock exchange market (Barca 2010, 10-11). The mixing of the two models was helped by the constitution of IRI and IMI, which gave support to the growth of industrial companies. They were a sort of bridge between private investors who did not trust the financial system and companies who needed capitals in a period when the economic boom brought incredible opportunities for the real development of a country which used to be relatively poor. In a country where the need for public sector was so strong, the presence of corruption and opportunism at all levels of public administration showed all the weaknesses of the hybrid Italian model.

Germany started with public regulation which - consciously or not – influenced the future development of universal banks in a way that, together with Japan, it is now taken as the academic example of bank-based financing system in the world.
Universal banks in Germany functioned as a connection between investors and companies in need for capitals. The stock exchange was surely larger than in Italy, but there was a clear shift from private household investors who were active buyers until 1950 and commercial banks stock purchases lately in the 1970s and 1980s. People preferred to leave their savings in the bank deposits, which banks could reinvest in companies and directly participate on the control of the same companies. This model forced many governments to deeply regulate the management and control of listed companies due to the increasing power of universal banks.

The UK and the USA shared a similar history of separation between ownership and control and subsequent development of their capital markets.
The USA could enjoy this process long before Britain. While at the beginning of the twentieth century it was already clear that American businesses were administrated by professional business individuals hired to manage the firm and enhance its value, British companies were still under the control of single entrepreneurs or families. Only by the 1950s did the trend change in favour of the American-style of management.

Again, this is of primary importance in discussing the evolution of capital markets. It allowed each type of investor [banks, insurers, non-financial companies, private households, public and foreign ones] to invest their capitals in businesses without worrying about conflict of interest between shareholders.
Certainly, there were cases of corruption even with this form of management, but the model works in theory and, most of the times, in practice.

A clear and effective regulation of the stock exchanges was also fundamentally important for the correct functioning of the market-based financing model.
When all these variables were implemented, the financial sector saw an increase of institutional companies such as asset managers, hedge funds, pension funds and insurers who took advantage of the middle-class's need to invest savings and hedge against inflation.
Both in the UK, but especially in the USA, capital markets increased in size due to the introduction of these new fresh capitals and more liquidity which meant major efficiency. The other side of the coin was that more liquidity also meant more volatility, thus more risk.

Each country implements its financial, social, economic and political practices in accordance with its own conditions. Such models are unique to both the inner characteristics of a nation and how it deals with the external environment that has affected the history of the country itself.
The fact that the four countries taken in consideration are somehow linked with each other is relevant. Italy and Germany have industrial economies with frequent exchanges of goods and services in and outgoing. The USA provided help in the post-war period to the reconstruction of Italy and Germany, while it kept strong connections with the UK before, during and after the Second World War.

The USA and the UK shared similar evolution patterns in their economies, which is regarded as strange if one is to think about their geographical distance. The UK should logically resemble the structures of some European countries such as Italy and Germany. The answer is history: the roots for such a trend stretches back to the old imperialist epoch, when the British empire invaded North America and established one of its colonies there. Culture, the share of the same language and the Common Wealth have all been important to the long-term connection of these two countries.

It cannot be said whether one system is more effective then another. Different variables and characteristics require the introduction of different models that change in time, which is a thing that needs to be taken in consideration. For example, it would be difficult for Italy to implement a market-based system in a short period of time because of the limits the stock exchange presents. Additionally, the combination of small financial institutions around capital markets, the lack of trust the middle-class has in the financial system, inefficiencies and illiquidity are all detrimental factors for the market-based system. Only a common program introduced by the Italian government which sets long-term guidelines can bring the financial system in this direction. It can work in a country as Italy that consistently needs to cope with corruption problems and that is too reliant on banks and public administration. However it would be resource-consuming, nonetheless hard to implement due to the cultural distrust of the stock exchange.

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