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DEPARTMENT OF POLITICAL AND SOCIAL SCIENCES

The State Strikes Back

Industrial Policy, State Power and the Emergence of Competitive Multinational Enterprises in Italy and Spain

Fabio Bulfone

Thesis submitted for assessment with a view to obtaining the degree of Doctor of Political and Social Sciences of the European University Institute

Florence, 17 November 2017.

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Examining Board

Professor Pepper D. Culpepper, formerly EUI/University of Oxford (Supervisor)
Professor Dorothee Bohle, European University Institute
Professor Richard Deeg, Temple University
Professor Mark Thatcher, London School of Economics

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Department of Political and Social Sciences - Doctoral Programme

I Fabio Bulfone certify that I am the author of the work 'The State Strikes Back: Industrial Policy, State Power and the Emergence of Competitive Multinational Enterprises in Italy and Spain' I have presented for examination for the Ph.D. at the European University Institute. I also certify that this is solely my own original work, other than where I have clearly indicated, in this declaration and in the thesis, that it is the work of others.

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San Domenico di Fiesole, 30 October 2017

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ABSTRACT

This thesis compares the industrial policy strategy implemented by the Italian and Spanish governments to favour the internationalisation of domestic firms in the high value-added sectors of banking, electricity and telecommunications. The trajectory of six firms that successfully completed the transition from inward-looking monopolist to European champion (the banks Unicredit, Intesa-Sanpaolo, BBVA and Santander, the Italian electricity utility ENEL and the Spanish telecommunications firm Telefonica) is compared with that of two firms that failed to become European champions and are currently controlled by foreign competitors (the Spanish electricity utility Endesa and the Italian telecommunications incumbent Telecom Italia). The comparison of successes and failures makes clear the factors that led some Italian and Spanish firms to become European champions and others to be taken over.

Through in-depth qualitative case studies of the trajectory of the eight firms between the late 1980s and the mid-2000s this thesis shows how the successful internationalisation of the Italian and Spanish European champions is the result of an activist industrial policy implemented by the Italian and Spanish governments. This industrial policy strategy centred on four main pillars: 1) the promotion of a process of sheltered consolidation among domestic firms aimed at favouring the emergence of domestic champions with sufficient size to compete in the European market; 2) direct intervention by the government during the privatisation of banks and utilities to select the main private investors and the methods for the sell-offs; 3) implementation of a series of delaying tactics aimed at slowing down the pace of liberalisation of the Italian and Spanish market (thus protecting the dominant position of national champions) and; 4) the use of the diplomatic channel to favour the internationalisation of banks and utilities.

To explain why, in the cases of Telecom Italia and Endesa, a similarly activist industrial policy strategy by the Italian and Spanish governments led to a failure this work focuses on the balance of power between the state and private business actors. It shows how the successful outcome of the process of industrial restructuring is conditional on the availability of three power resources the state can use to influence the behaviour of business actors: ownership power, regulatory power, and partisan proximity power.

The theoretical framework this study develops – based on state ownership power, regulatory power, and partisan proximity power – as well as its findings contribute to the study of three often debated issues within the comparative political economy debate. These are the analysis of the role of the state in fostering economic development through new forms of

industrial policy, the study of hybrid, and problematic, models of capitalism like that of Italy and Spain, and the study of state–business power relations and – particularly – sources of state power over business.

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Introduction

The idea for this thesis came from the ambition to explain the puzzling success of a handful of Italian and Spanish multinationals active in banking and network industries. Among the largest and most efficient EU firms in their sector of activity, Telefonica, Santander, BBVA, ENEL, Intesa-Sanpaolo, and Unicredit are global brands that most European consumers are familiar with. Their logos can be spotted in advertisements during Champions League football games, on Ferrari's Formula One cars, at Moto GP races, during the Giro d'Italia bike race, and at the fancy tennis courts of Indian Wells. What makes the success of these banks, electricity utilities and telecommunications firms puzzling in the eyes of a comparative political economist is that they come from Italy and Spain, two countries that are not generally considered particularly successful forms of capitalism. In the case of Spain, two decades of buoyant economic growth turned for the worse after 2009 due to the bursting of the housing bubble, the consequent severe economic recession and the massive rise in unemployment (Cioffi and Dubin 2016; Royo 2009a, 2009b). For Italy, the two decades of anaemic growth experienced from the early 1990s prompted scholars to talk about a 'dysfunctional' (De Cecco 2007; Della Sala 2004) or 'failed' (Schmidt 2002) model of capitalism well before the beginning of the Eurozone crisis. Hence, this thesis initially sought an answer to a straightforward, yet challenging, research question: How did world-leading multinationals emerge in two countries characterised by a dysfunctional model of capitalism and in sectors in which Italy and Spain lack a comparative advantage?

The trajectory of the six successful Italian and Spanish banks and utilities ought to be understood in connection with the process of EU-led market integration of their sectors of activity: banking, electricity and telecommunications. The gradual opening of all European markets to competition created many investment opportunities for the most active European banks and utilities. Telefonica, Santander, BBVA, ENEL, Unicredit and Intesa-Sanpaolo seized these opportunities to expand abroad taking over foreign competitors and becoming European champions in their sector of activity. However, by analysing the EU-led liberalisation of banking, telecommunications, and electricity, I discovered that the success of the six firms I analyse is mirrored by the failure of other Italian and Spanish firms like the telecommunications incumbent Telecom Italia and the Spanish electricity incumbent Endesa.

Both Endesa and Telecom Italia failed to take advantage of the process of EU-led market integration and are currently controlled by a foreign competitor. Their underperformance made them prey rather than predators during the wave of cross-border consolidation that followed the integration of the European market. Although their unsuccessful trajectory is less puzzling, the study of Telecom Italia and Endesa is nevertheless important as it clarifies the factors that led some Italian and Spanish firms to successfully take advantage of the process of market integration and others to fail. The inclusion of Telecom Italia and Endesa was required to broaden my initial research question to ask about factors that led some Italian and Spanish banking, electricity and telecommunications firms to successfully expand abroad becoming European champions and others to fail.

The main argument of this thesis is that the Italian and Spanish states played a decisive role in favouring the foreign expansion of domestic banks and utilities. Hence, this is a thesis about industrial policy, a long-overlooked theme within the comparative political economy debate that was recently brought back to scholar's attention by a series of influential contributions (Mazzucato 2015; Clift and Woll 2012). It will be argued that the Italian and Spanish states implemented an activist industrial policy strategy to turn domestic banks and utilities into European champions that centred on four main pillars: 1) the promotion of a process of sheltered consolidation among domestic firms; 2) the implementation of a series of delaying tactics aimed at slowing down the pace of liberalisation of the domestic market; 3) an active role of the state during the privatisation process to choose the methods for the sell-off of strategic firms and the main private shareholders, and; 4) the use of the diplomatic channel to favour the internationalisation of domestic firms.

By pointing at the role of the state as the key factor in explaining the success of Italian and Spanish banks and utilities this work follows in the line of recent studies on the internationalisation of EU banks and utilities (Clifton et al. 2010; Colli et al. 2014; Chari 2015). However, the Italian and Spanish states implemented an activist industrial policy strategy also in the cases of Telecom Italia and Endesa. Yet, unlike in the case of the six European champions, this strategy resulted in failure. Therefore, a more nuanced explanation is required to account for the fact that a similarly activist industrial policy by the Italian and Spanish states led to opposite outcomes in different sectors. The thesis explains this divergent outcome by looking at the balance of power between the state and private business actors in Italy and Spain. It argues that the success of the Italian and Spanish states in transforming domestic firms into European champions is conditional on the availability of three crucial power resources the state can use to influence the behaviour of business actors: *regulatory power, ownership power* and *partisan proximity powe*r.

The state exerts ownership power over domestic firms when it owns a controlling stake in them or has golden share powers over them. Regulatory power is conditional on the regulatory dependence of domestic firms upon their home government. When the lion's share of the revenue of a firm depends on the regulatory decisions of its domestic government, the state has regulatory power over that firm (Culpepper and Reinke 2014). Partisan proximity power refers to the political proximity to the government of the managers and shareholders of a firm. When these three power resources were available at crucial stages during the restructuring process and the state strategically used them to influence the behaviour of private business actors industrial restructuring was successfully completed as in the case of Unicredit, Intesa-Sanpaolo, Telefonica, ENEL, Santander and BBVA. Instead, when at key junctures the state lacked the necessary ownership, regulatory and partisan proximity power resources, or chose not to activate them, it lost control of the process of industrial restructuring, leading to a failure as in the case of Endesa and Telecom Italia.

Why should the study of eight Italian and Spanish banks and utilities be of any interest to an audience wider than that formed by specialists of Italian and Spanish capitalism or of the three sectors analysed? There are at least two reasons. First, this is not only a story about industrial policy in Italy and Spain. This is a story about industrial policy in the age of regulation, an era in which the EU institutions imposed to member states the model of a regulatory state that should focus on ensuring fair competition in the domestic market retreating from the direct ownership of domestic firms, abstaining from implementing activist industrial policy strategies and leaving former national champions to their fate (Thatcher 2013). The shift towards the regulatory state is a European (if not global) trend that did not affect only Italy and Spain.

Hence, the findings concerning the Italian and Spanish case tell us something about new forms of industrial policy the state can implement to resist to the EU-inspired 'supranational neo-liberalization' (Thatcher 2013, p. 177) of the European market. In this regard, the main message of this thesis is that industrial policy might have changed in its form and objectives, but did not disappear. After all, the very shift towards the regulatory state since the early 1980s can be seen as an industrial policy strategy by some governments that felt their domestic firms had an advantage in the high value-added sectors that were liberalised. Future research should focus on the industrial policy strategy implemented to help domestic firms in other countries, those larger than Italy and Spain that hosted more efficient firms like France and Germany, and those that because of the limited size of their domestic market, the lack of efficiency of their domestic incumbents or exogenous factors had even less room of manoeuvre than Italy and Spain, i.e. Belgium, Portugal and the Central and Eastern European Countries (CEEC).

Second, by focusing on Italian and Spanish capitalism this work deals with two problematic cases within the comparative political economy debate for which many labels were coined including ‘hybrid’ (Hall and Soskice 2001), ‘mixed-market’ (Molina and Rhodes 2007), ‘southern European’ (Amable 2003), and ‘state-led’ (Schmidt 2002) economies none of which is fully satisfying, to say the least. By investigating the patterns of state–firm interaction in three strategic sectors this work provides a detailed analysis of the mechanisms of adjustment to exogenous pressure in these problematic models of capitalism (Jackson and Deeg 2012). These insights can lay the foundations for a new analysis of Italy, Spain and other problematic models of capitalism, that instead of focusing on the alleged similarities or (growing) differences between the two countries tries to identify the cross-class coalitions that led them to choose different models of growth (Amable 2003; Baccaro and Pontusson 2016).

The rest of the thesis is organised as follows. Chapter one presents the main building blocks of the present analysis setting-up the initial puzzle concerning the success of Italian and Spanish firms, reviewing the existing political economy analyses of Italian and Spanish capitalism and of the process of EU-led market integration of banking, electricity and telecommunications and showing how they fail to account for the success of the Italian and Spanish firms here analysed. The chapter continues by describing the theoretical framework here adopted based on state power over business actors and confronting its predictions with those made following two influential strands of the literature: partisan studies and state-capture studies. The chapter closes with a methodological section focusing in particular on the rationale for the selection of the countries, sectors and firms here analysed.

Chapter two and three give the reader some background knowledge necessary to deal with the firms here analysed. Chapter two focuses on the process of EU-led integration of electricity, telecommunications and banking, while chapter three analyses the identity and preferences of the state and business actors involved in the process of industrial restructuring in Italy and Spain. Chapters four to six form the core of the thesis, i.e. the three sector-based case studies in which the trajectories of the Italian and Spanish national champions are compared. Chapter four deals with the banking sector describing the emergence in Italy and Spain of the four European champions Unicredit, Intesa-Sanpaolo, BBVA and Santander. Chapter five focuses on the divergent trajectory of the Italian and Spanish telecommunications incumbents explaining why Telefonica succeeded in upgrading into a European champion while Telecom Italia failed. Chapter six compares the electricity incumbents ENEL from Italy and Endesa from Spain explaining why the former succeeded in becoming a European champion while the latter failed. The conclusion summarizes the main findings of the thesis and develops the avenues for future research touched upon in this introduction.

Chapter 1. Puzzle, literature review, and research design

1.1 Introduction and main puzzle

Since the early 1980s the European Commission has made the liberalisation of high-value-added services a central political priority. While by the late 1970s the Treaty of Rome and successive rulings from the European Court of Justice had removed most barriers to the free circulation of goods (Stone Sweet 2004), the EU services market was still fragmented. In network industries like telecommunications and electricity, segmented domestic markets were typically dominated by a state-owned monopolist. Banking fragmentation prevailed with hundreds of small banks active in each member state. Legal barriers to the entry of foreign firms limited competition, preventing cross-border consolidation among European firms. Consequently, the largest EU banks and utilities were small compared to their American and Japanese counterparts. Worried by the lack of size of EU firms, the Commission adopted the Single European Act (SEA) and other sector-specific Directives aimed at transforming the heavily regulated and segmented services markets of each member state into an integrated European market. The Commission wished to trigger a wave of cross-border mergers and acquisitions allowing for the emergence of 'European champions' with sufficient size to compete with the US and Japanese giants (Thatcher 2013; 2014a).

However, by liberalising strategic sectors with important security-related implications like banking, electricity, and telecommunications, the Commission touched a vital interest of EU member states. In fact, with the integration of the European market, member states faced the concrete prospect of seeing their domestic banks and utilities taken over by foreign competitors. For this reason, EU-led market integration of banking and network industries exhibits a clear tension between the European industrial policy of the Commission and the domestic industrial policy of each member state. The only way for member states to prevent the foreign colonisation of strategic sectors like banking, electricity and telecommunications has been to make sure their 'national champions' were strong enough to play an active role during the wave of cross-border mergers and acquisitions that would follow European market integration. To achieve this goal member states needed to launch a process of industrial restructuring aimed at improving the performance of their inward-looking 'national champions' turning them into internationally competitive 'European champions'.

The strongest players at the beginning of this consolidation frenzy were the banks, electricity utilities, and telecommunications firms from France, Germany, the Netherlands and the United Kingdom. Favoured by the size of their domestic market and their efficiency, giants like Deutsche Bank, BNP, Paribas, ABN Amro, Deutsche Telekom, British Telecom and Electricité de France were likely candidates to become European champions, winning the takeover battle with banks and utilities from smaller member states. For the study of this struggle for survival among European firms, Italy and Spain provide a particularly interesting angle. In fact, although their domestic market was larger than the European average, their national champions were considerably less efficient than their British, French, and German counterparts. Thus, although the Italian and Spanish governments still enjoyed some room of manoeuvre to help the internationalisation of their domestic firms – unlike smaller states like Austria, Belgium and Portugal whose firms were swiftly taken over by larger competitors – they were in a position of clear weakness when compared with France, Germany, the UK and the Netherlands. In spite of their comparative disadvantage, however, Italy and Spain still succeeded in promoting the emergence of successful European champions.

Because of a state-led process of industrial restructuring, thirty years after the start of the EU-led liberalisation of services, Italy and Spain each host three European leaders in the sectors of banking, electricity, and telecommunications: in Italy the banks Unicredit, Intesa-Sanpaolo, and the electricity utility ENEL; in Spain the banks BBVA and Santander, and the telecommunication giant Telefonica. The success of these six multinational enterprises is undoubtedly remarkable if one compares their performance with those of the largest Italian and Spanish banks and utilities prior to the launch of EU-led liberalisation. In the 1980s Italian and Spanish banks were among the least efficient in Europe, hampered by their small size and the pervasive nature of domestic banking regulation (Garcia Calvo 2013; Deeg 2012). In the late 1980s the Spanish telecommunications incumbent Telefonica was a backward firm that relied on the technological input of the US giant ITT (Clifton et al. 2011). For its part, in the early 2000s the Italian ENEL was still an inward-looking firm that had failed to successfully penetrate foreign markets, and was considered a likely target in the upcoming wave of cross-border consolidation among European electricity utilities (Bergami et al. 2013).

The first aim of this dissertation is to explain the puzzling turnaround of these banks and utilities. However, not all Italian and Spanish national champions succeeded in becoming

European leaders in their sector of activity, as the success of the six firms mentioned above has been mirrored by the failure of the Spanish electricity utility Endesa and the Italian telecommunications incumbent Telecom Italia (TI). In 2007 Endesa was taken over by the Italian ENEL ceasing to exist as an independent firm, for its part TI is currently controlled by the French media group Vivendi. This negative outcome was by no means inevitable as in the 1990s both Endesa and TI had the potential to become European champions. In 1997 TI was the first telecommunications utility in Europe by number of lines per employee, fifth in the world for connections, sixth for international traffic and seventh for turnover (Florio 2007), and rivalled with Telefonica for the leadership in the Latin American market. For its part in the late 1990s Endesa was the main electricity utility in Latin America and was present as well in France, Germany and Italy. Hence, at the onset of EU-led market integration Endesa and TI had as many chances of becoming European champions as ENEL and Telefonica. However, they failed to do so. The aim of this study is to understand why in similar conditions some Italian and Spanish firms succeeded in upgrading into European champions, while others failed. Studying unsuccessful trajectories like those of Endesa and TI is crucial to get a full understanding of the factors that led the other six Italian and Spanish firms to succeed.

1.1.1 The argument in brief

To explain the puzzling success of some Italian and Spanish firms, and the failure of others, this work focuses on the role played by the state in helping the transformation of domestic banks and utilities into European champions. By focusing on role of the state in helping domestic firms this work contributes to the recent literature on industrial policy and the role of the government in fostering economic development (Clift and Woll 2012; Thatcher 2014b; Mazzucato 2015). Banking, electricity and telecommunications provide an interesting angle for the study of industrial policy because they are heavily regulated sectors still shaped to a large extent by ad hoc regulations by the state and public agencies (Colli et al. 2014).

The crucial importance of industrial policy in explaining the pattern of internationalisation of European banks and utilities is confirmed by the existing literature dealing with EU-led liberalisation of the three sectors (Thatcher 2007; Clifton et al. 2010; Colli et al. 2014; Chari 2015). These studies all mention the active role of the state as a crucial factor behind the success of those bank and utilities that became European champions. This is true both for countries sharing a long-standing tradition of state intervention in the economy like

France, Italy and Spain, and for those where the state has traditionally played a less central role like the Netherlands and Germany (Chari 2015; Colli et al. 2014). The strong correlation between the direct involvement of the state and the success of banks and utilities is confirmed as well by the fact that where, like in the UK, the state adopted a more passive stance withdrawing from direct ownership and prioritising competition over the protection of domestic firms, 'national champions' struggled in the integrated European market and were often taken over by foreign competitors (Clifton et al. 2011; Chari 2015).

If the direct involvement of the Italian and Spanish states was decisive in helping the upgrade of domestic firms into European champions, it remains to be understood under which conditions industrial policy led to a success, and under which others it led to a failure. This work explains these opposite outcomes by looking at the balance of power between the state and business actors (Lindblom 1977; Block 1977; Katzenstein 1978; Evans et al. 1985). It is argued that the capacity of the Italian and Spanish states to turn domestic banks and utilities into European champions is conditional on the availability of three types of power resources the state could use to influence the behaviour of business actors: *ownership power, regulatory power* and *partisan proximity power*. When these power resources were available, and the state used them strategically it could influence the behaviour of business actors – e.g. the managers of the banks and utilities it wished to upgrade into European champions, or other investors involved in the restructuring - and successfully complete the process of industrial restructuring, as in the case of Unicredit, Intesa–Sanpaolo, BBVA, Santander, ENEL and Telefonica. Instead, when at key junctures the state lacked these power resources, or chose not to activate them, it lost control of the industrial restructuring process failing to turn domestic firms into European champions, like in the case of TI and Endesa.

The state can exert ownership power over domestic firms through two mechanisms:

- The direct ownership of a controlling stake in the potential European champions.
- The availability of golden share rights through which the government can influence the managerial choices of potential European champion even after privatisation.

The state has regulatory power over domestic firms when they depend upon regulatory protection from the state in their sector of activity (Culpepper and Reinke 2014). This regulatory dependence is in turn conditional on two factors: the geographical distribution of the revenue of a firm, and the level of supranational market integration of a sector. Concerning the geographical distribution of revenue, state regulatory power will be stronger when a firm makes most of its revenue in the domestic market, while worldwide successful multinationals will be less tied to the domestic market and thus less dependent upon regulatory protection from the state. Concerning the degree of supranational market integration of a sector, firms depend less upon regulatory protection of the state when their main sector of activity has already been liberalised at the supranational (i.e. EU) level thus leaving less scope for state's regulation. Partisan proximity power relates to the political proximity to the ruling government of managers and owners of a firm.

The model here presented is non-deterministic in the sense that the availability of the three power resources alone is not a guarantee of successful industrial restructuring. Instead there is scope for both agency and timing to influence the outcome of industrial restructuring. Agency is important because in order to be effective the ownership, regulatory and partisan proximity power resources need to be strategically deployed by the state. Consequently, the emergence of European champions is conditional on a state's willingness to activate the available power resources. Concerning timing, the power resources should not be seen as constant and invariable, instead they are subject to variation over time, and this variation has a decisive influence on the outcome of the process of industrial restructuring.

1.2 Literature review

This literature review is organised in three sections. The first section reviews the main comparative political economy contributions to the study of Italian and Spanish capitalism. The second focuses on the literature on state capacity and the role of the state in fostering economic development. The third covers the literature dealing with EU-led liberalisation of banking, electricity and telecommunications.

1.2.1 Italy and Spain in the comparative political economy debate

This first section reviews the existing comparative political economy analyses of Italian and Spanish capitalism. By focusing pre-eminently on the institutional dysfunctionalities of the two models, it shows how the existing literature fails to provide a satisfying explanation for the emergence of successful banks and utilities. Despite this shortcoming, however, the studies reviewed here have the merit of highlighting some similarities and differences between the Italian and Spanish model of capitalism that will have a crucial importance for the present analysis.

The categorisation of Italian and Spanish capitalism within the comparative political economy debate has always been difficult. In their seminal contribution *Varieties of Capitalism* (2001) Hall and Soskice put Italy and Spain along with France in the 'hybrid' category, as they share institutional features of both the Liberal Market (LME) and the Coordinated model (CME). This institutional heterogeneity, Hall and Soskice argue, condemns hybrid models of capitalism to worse economic performance than pure LMEs or CMEs. In a later contribution, Molina and Rhodes (2007) put Italy and Spain in the 'mixed-market economies' category. According to Molina and Rhodes, in mixed-market economies the extreme fragmentation of employers and labour makes institutional coordination more difficult to achieve than in CMEs. However, employers and unions are sufficiently powerful to act as veto players, thus making the implementation of reforms more difficult than in LMEs. According to Molina and Rhodes, to address this fragmentation and facilitate coordination among domestic actors the Italian and Spanish states has to directly intervene in the economy more than in CMEs and LMEs.

The recognition of the pivotal role of the state in Italian and Spanish capitalism follows in the line of the work by Vivien Schmidt (2002). According to Schmidt the role of the state in the economy of countries like France, Italy, and Spain is so fundamental that they should be labelled 'State-led market economies'. However, Schmidt considers Italy and Spain less efficient forms of 'State-led market economies' compared to France. This is due to the fact, Schmidt argues, that often the direct intervention of the Italian and Spanish states in the economy hinders rather than favours economic development. Such a view is shared as well by later contributions focusing on the Italian case, like those from Della Sala (2004) and De Cecco (2007) who label Italy a form of 'dysfunctional state capitalism'. The CPE works reviewed so far all agree in considering the Italian and Spanish model of capitalism institutionally dysfunctional and thus condemned to sub-optimal economic performance. Although this is undoubtedly a pertinent observation, an approach that focuses solely on the institutional deficiencies of Italian and Spanish capitalism is of little use when trying to explain the emergence in these two countries of world-leading banks and utilities.

More focused contributions deal with an institutional domain of Italian and Spanish capitalism that is particularly important for the present study: corporate governance. Political economy analyses of Italian and Spanish corporate governance highlight the many similarities historically characterising the two countries. Until recently, both countries were considered archetypal examples of Continental corporate governance characterised by low stock market capitalisation, widespread state ownership, a bank-dominated credit system, a fragmented banking sector, and a very concentrated ownership structure with few blockholders controlling most domestic firms (Barca 1997; Aguilera 2004). However, the identity and sector of activity of these blockholders is different. In Italy, they are families active in the manufacturing sector (Barca 1997; Deeg 2005; Culpepper 2007; McCann 2007), while in Spain they are a cartel of large domestic banks (Aguilera 2004; Aguilera and Garcia-Castro 2012). This difference in the identity and preferences of Italian and Spanish blockholders has a decisive influence on the outcome of the process of industrial restructuring, as in both countries blockholders are directly involved in the privatisation of telecommunications and electricity utilities.

Despite pointing to an important difference between Italy and Spain, corporate governance studies also fall short in providing a satisfying explanation for the success of the firms here analysed. In fact, they mostly look at country-wide corporate indicators like the level of stock market capitalisation or the level of ownership concentration among listed firms. Although such a systemic approach allows meaningful observations about the trajectory of change of Italian and Spanish corporate governance, it fails to account for firm-level changes like the emergence of the six successful banks and utilities.

Despite their failure to provide a satisfying explanation for the emergence of successful banks and utilities in Italy and Spain, the studies reviewed so far allow identifying two institutional features of Italian and Spanish capitalism that will prove decisive in explaining the outcome of industrial restructuring:

- The activist role traditionally played by the state in the political economy of both countries.
- The dominant position of a restricted group of blockholders and their different identity: banks in Spain and manufacturing families in Italy.

1.2.2 The literature on the role of the state in fostering economic development

This section covers the main contributions to the study of state capacity to foster economic development. The works here reviewed are part of an effort to ‘bring the state back in’ as the key actor in comparative political economy against the society-centred paradigms of Neo-Marxist and Pluralist studies (Skocpol 1985).

The collection of essays *Between Power and Plenty* edited in 1978 by Peter Katzenstein is the first attempt to systematically analyse the role of the state in shaping the foreign economic policy of industrialised countries. The essays compare the foreign economic policy of the United States, the United Kingdom, Japan, France, Italy and Germany. Katzenstein's edited volume provides a number of interesting insights for the present analysis. First, going against then-prevalent neo-Marxist and Pluralist traditions Katzenstein adopts a 'statist' view focusing on the role of elected governments in developing the foreign economic policy of advanced economies. Second, Katzenstein argues that the capacity to elaborate a successful strategy of foreign economic policy is conditional on state power, which is stronger in some countries and weaker in others. According to Katzenstein state power derives from different sources including the degree of cohesiveness of state bureaucracy, the capacity to resist to pressure coming from societal groups and the capacity of state officials to elicit cooperation from private actors. Also this study considers the capacity of the state to get private actors involved in joint projects a key factor. Third, Katzenstein and the other contributors in the volume identify different policy instruments the state can use to implement its strategy of foreign economic policy. These include: sectoral policies aimed at increasing industrial concentration in strategic sectors, regulatory barriers to protect domestic producers, and measures aimed at boosting exports to foreign markets.

Between Power and Plenty provides as well an in-depth assessment of the strength of the Italian state. According to Katzenstein the Italian state (along with its German counterpart) is in an intermediate position between the strong states of Japan and France, and the weak ones of the United Kingdom and the United States. In his essay focusing specifically on Italy, Posner argues that this intermediate strength results from the co-existence of extremely weak governments and inefficient bureaucratic bodies controlled by the Christian Democracy, and of very efficient actors like large state-owned firms and the Bank of Italy. According to Posner these state-owned firms have become highly competitive at home and abroad thanks to the development of strong technical know-how and the guidance of dynamic company leaders, while the Bank of Italy exerts a decisive influence over economic policy thanks to the great prestige of its personnel.

Katzenstein's edited volume gives many valuable insights including the idea to focus on the state and state-society relations, the identification of different policy instruments elected governments can use to implement an activist foreign economic policy strategy, and the analysis of the pivotal role played by large state-owned firms and the Central Bank in Italy.

However, *Between Power and Plenty* was written four decades ago to analyse an international political economy completely different from that of nowadays. For this reason it could not account for the deepening of the process of EU market integration, which has led to the progressive erosion of many of the instruments of foreign economic policy Katzenstein describes. As a consequence, a more updated framework is needed to identify new strategies of industrial policy and sources of state power available to EU member states.

Building on Katzenstein's work, the volume *Bringing the State Back In* edited by Evans, Skocpol and Rueschemeyer calls for a more systematic analysis of the way in which state policies affect political and social processes (Skocpol 1985, p. 3). In the introduction to the volume Skocpol argues that state-centred analyses should focus in particular on the degree of autonomy of the state from other societal actors and the capacity of the state to realize its policy goals. Like in Katzenstein's analysis state capacity is not seen as constant but changes across time, countries and industrial sectors.

According to Skocpol state capacity is conditional on the availability of skilled and loyal officials, ample financial resources, and the capacity to channel credit flows to restructure specific industries or firms and to insulate state officials from the pressure coming from other societal groups. State capacity is also conditional on the availability of power resources the state can use to alter the behaviour of domestic business actors.

Skocpol rightly observes that it would be simplistic to argue that state officials act solely in pursue of an overreaching social interest. Instead state officials seek to favour certain actors and implement reforms that allow them to strengthen their position in power. According to Skocpol and the other contributors state-centred analyses should consider the state as more than the government, taking into account the fact that different state agencies might pursue divergent and often conflicting goals. Although this work does not question this assumption, it will be argued that the specific features of the sector here analysed justify the choice to equate state preference with that of elected governments.

In their contribution to the volume Rueschemeyer and Evans deal with the relationship between the decentralisation of state administrative tasks and state capacity. They argue that, while a certain degree of decentralisation is necessary to implement coherent policies, decentralisation might also hamper the coherence of state action as different sub-units might pursue divergent goals. This observation is important for the Spanish case, as the rivalry between the central government of Spain and the regional government of Catalonia played a decisive role in the failed restructuring of Endesa.

Evans has further developed his reflections on the role of the state in fostering economic development in his classic *Embedded Autonomy* (1995) in which he compares the strategy implemented by state to promote industrial growth in the IT sector during the 1970s and 1980s. In his analysis Evans chooses to focus on three 'newly industrializing countries' (NIC): Brazil, Korea and India because they occupy an intermediate position in global production being less thoroughly constrained than peripheral raw material exporters but more desperate to upgrade domestic production than fully industrialised countries.

According to Evans only those states that can count on an efficient and highly selective bureaucracy capable of developing close ties with private business groups will have the 'embedded autonomy' necessary to foster domestic industrial growth. While Korea possesses both features, India and Brazil lack one of the decisive dimensions of 'embedded autonomy' being thus less capable of bringing about industrial development. Brazil has very close ties between the state and business actors but lacks an efficient bureaucracy, the highly selective Indian civil service lacks stable connections with private business actors.

Like *Embedded Autonomy,* this work focuses on two countries that have to build a comparative advantage in high value-added sectors in which they face competition from large and more efficient states. In this sense the relationship of Italy and Spain vis-à-vis core member states resembles that of the NICs described by Evans vis-à-vis developed economies. This work is equally indebted to Evans' idea to focus on in-depth case studies of selected industrial sectors. Like Evans et al. (1985) Evans points as well at the decisive importance of state capacity to get private actors involved in joint projects, a key factor in explaining the outcome of the process of industrial restructuring described in this thesis.

Despite these many points of contact, Evans' work focuses on the effort by the state to help the emergence of new firms in sectors in which they previously did not exist. Instead, Italy and Spain had to deal with the internationalisation of firms that were already strong on the domestic market. Furthermore, while the NICs analysed by Evans welcomed the creation of joint ventures between domestic firms and foreign MNEs, Italy and Spain considered the protection of the domestic ownership of strategic national champions a key priority. Also the concept of state capacity is not fully suitable for the present study. In fact, it can be argued that unlike most of the NICs Evans analyses, both the Italian and Spanish states had the capacity to develop competitive firms in the sectors of analysis as they could rely on strong managerial and technical know-how and close state-firm ties. This is true even in the case of a rather ‘weak’ state like that of Italy, as the sectors here analysed constitute islands of efficiency within an otherwise inefficient state bureaucracy (Katzenstein 1978; Oddo and Pons 2006; Bergami et al. 2013). Hence a more nuanced explanation is required to understand why the industrial policy effort led to a failure in cases in which Italy and Spain arguably had the capacity to foster Evans’ ‘embedded autonomy’.

The present work differs from *Embedded Autonomy* also in the choice of the sector of analysis. In fact, Evans focuses on a sector, IT, in which the state does not play a central role as most of the productive activity is carried out by private investors. For this reason, Evans argues that the state should not be directly involved in productive activities, focusing instead on supporting private firms (Evans 1995, p. 97). Another key feature of the IT sector is the fact that, in Evans’ view, production should not be concentrated in the hands of a single ‘national champion’, instead the state should try to create a competitive environment between a handful of cutting-edge domestic firms (Evans 1995, p. 100). These features make IT structurally different from the sectors here analysed. In fact, due to their strategic importance electricity, telecommunications and banking have historically been characterised by heavy state involvement in production, and nowadays many of the largest European firms active in these sectors are still state-owned. Furthermore, the high level of investment required to operate in these sectors make scale crucially important. For this reason both Italy and Spain followed a ‘national champion’ policy aimed at creating one or two large domestic firms with sufficient size to compete in the European market.

1.2.3 The literature on EU-led liberalisation of services

This section reviews the literature dealing with the impact of EU-led liberalisation of banking, electricity and telecommunications on the domestic political economy of member states. This theme has drawn the attention of scholars from different fields, in their analyses they focused particularly on the factors that led some ‘national champions’ to succeed in upgrading into European champions and others to fail.

In his path-breaking contribution Mark Thatcher (2007) studied the impact of market internationalisation on the domestic economic institutions of France, Germany, Italy and the United Kingdom by focusing on five strategic sectors: securities trading, telecommunications, electricity, airlines and postal services. Thatcher’s comparison of the long-term evolution of the domestic institutions of the five largest European economies provides three important insights for the present study. First, Thatcher shows how the EU-led integration of service and network industries had a particularly profound impact on the domestic institutions of France, Germany and Italy. This study draws on this insight by focusing on the impact of EU-led liberalisation on Italy and Spain.

Second, and relatedly, Thatcher finds that most institutional change in the domestic institutions of the five countries has occurred between 1990 and 2005 while in previous decades institutional resilience and inertia prevailed. For this reason, the present analysis will focus primarily on the industrial policy strategy implemented by the Italian and Spanish governments between the early 1990s and the mid-2000s. This is the period between the launch of the process of EU-led market integration and its completion. It is possible to describe the integration of the European market as the gradual opening of a door that started in the late 1980s, and finished in the mid-2000s. Until the late 1980s the door remained shut and member states could freely regulate their domestic markets. After the mid-2000s the door was fully open and member states were left with little room of manoeuvre to help their national champions. If by then their 'national champions' did not match the size and efficiency of their main European competitors, member states could do little to shelter them from foreign takeovers. Between these two extremes member states could still implement an industrial policy strategy aimed at turning their domestic firms into European champions. The present analysis is interested precisely in finding under which conditions this industrial policy strategy led to a successful outcome and in others it led to failure.

Third, Thatcher observes that domestic actors had ample room of manoeuvre in mediating the impact of market integration on domestic institutions, and were thus the 'carriers of internationalisation' (p. 3). Consequently, even though EU-led market integration had a profound impact on the domestic institutions of France, Italy, Germany and the United Kingdom, 'change took place through nationally specific routes' (p.3). This is an important observation as this study will also look at how domestic actors, especially state and private blockholders, have mediated the impact of EU-led liberalisation on Italian and Spanish banks and utilities. Despite these invaluable insights, Thatcher is more interested in assessing the impact of market internationalisation on domestic formal institutions. Consequently, to measure institutional change Thatcher looks at variation in the ownership structure of the domestic incumbents and in the allocation of formal regulatory power at the domestic level. Although these indicators will also be taken into account in the present analysis, their comparison is not sufficient to identify the factors that led some Italian and Spanish firms to succeed and others to fail.

In a more recent contribution Raj Chari (2015) compares the post-privatisation performance of formerly state-owned automobile, electricity and air transport firms from France, Germany, Italy, Spain and the United Kingdom. Chari's work has the important merit of comparing firms that succeeded in becoming European leaders ('alphas') with those that failed to do so ('betas'). To distinguish alphas from betas, Chari develops two empirical tests based on the size of a firm and its ownership structure. A firm that passes both tests can be considered a European leader in its sector of activity (i.e., an alpha), otherwise it's a beta. Chari's 'alpha test' provides a rigorous way to distinguish firms that succeed from those that fail to become European champions. Later in this chapter, a revised version of Chari's test will be performed to assess which Italian and Spanish banks and utilities succeeded in becoming European champions and which others failed.

In his work Chari also identifies a series of endogenous and exogenous factors that allowed alpha firms to become European leaders in their sector of activity. Among them Chari mentions the role of the state in helping the internationalisation of domestic firms. In this regard Chari highlights the strategic importance of maintaining direct state ownership in a firm to prevent foreign takeovers. Chari enumerates as well other measures the state can implement to have an influence over privatised firms, like the appointment in the board of privatised firms of politicians closely linked to the executive. The direct ownership of a controlling stake and the appointment of politically close managers at the head of a firm are among the power resources identified in the present analysis. Despite its many merits, however, Chari's work has an important limit because the factors that he identifies as decisive in helping the emergence of alpha firms are often a consequence of, rather than the reason for, their success.

For instance, Chari argues that a crucial factor behind the success of alpha firms is the presence of Anglo–American institutional owner-investors. However, it can be easily argued that this is rather a consequence of their success as Anglo–American funds might have decided to invest in these firms precisely because of their good performance. The lack of clarity in identifying the factors behind the success of alphas leads to an equally unsatisfying treatment of betas (i.e., those firms that failed to become European champions). This becomes evident when Chari tries to explain the lack of success of the Spanish electricity utility Endesa that failed to become a European champion being taken over by ENEL. In his case study Chari first describes in great detail the successful internationalisation that by the mid-2000s had turned

Endesa into one of the largest electricity utilities in the world, then moves to the analysis of the takeover battle between E.ON, Gas Natural and ENEL that ultimately led to the takeover of Endesa. What is left without explanation is how in the brief stint of a couple of years a world leader in the electricity sector found itself as the target of three takeover bids. By comparing the trajectory of Endesa with that of the European champion Telefonica, this thesis will shed better light on the reasons behind Endesa's failure.

Colli, Mariotti and Piscitelli (2014) compare the post-privatisation performance of telecommunications and electricity utilities from France, Germany, Italy, Spain and the UK. They claim that the successful internationalisation of all French and German–and some Italian and Spanish – utilities was decisively helped by the close interaction between the government and large domestic firms. Instead, the *laissez-faire* approach of the British government that chose to open the domestic market to foreign investors led UK utilities to underperform compared to their European peers. Moving to the analysis of Italy and Spain, Colli et al. (2014) compare the successful internationalisation of Telefonica and ENEL with the failure of TI and Endesa. Even though their case study selection is like the present study's, their analysis of the trajectory of the four firms overlooks crucial details, also because of a lack of space. In particular, Colli et al. ascribe TI's and Endesa's failure to become European champions to a generic 'government misdirection'. This work will show how this argument is overly simplistic, as the failure and success of Italian and Spanish firms is better understood by looking at the changing balance of power between the government and domestic investors.

While many studies have compared the post-privatisation performance of electricity and telecommunications utilities, very few have compared these two sectors with banking. This is because when the EU launched the liberalisation of banking the sector had a very different economic structure than electricity and telecommunications. In fact, while in most European countries the electricity and telecommunications market was organised as a monopoly, or oligopoly, dominated by a state-owned incumbent, in banking many credit institutions competed in each domestic market. Consequently, industrial restructuring in the banking sector involved a process of domestic consolidation aimed at creating banking groups with sufficient size to become European champions. Instead, in telecommunications and electricity a domestic incumbent already existed and the state had to decide how to privatise it and help its internationalisation. In other words, while in telecommunications and electricity a national champion with potential to become European champion already existed, in banking the state had to 'build' it. Despite this difference it will be shown how banking can be fruitfully compared with electricity and telecommunications as the state pursued the same goal in all sectors: the upgrade of domestic firms into European champions.

Among the few studies comparing banking with telecommunications and/or electricity those by Angela Garcia Calvo (2013) and Sebastian Etchemendy (2004) deserve a mention. In her comparative study of the emergence of Spanish multinationals in the sectors of banking, telecommunications and professional electronics Garcia Calvo (2013) claims that the success of firms like BBVA, Santander, and Telefonica is the result of close ‘peer coordination’ between the state and the management of these firms. Interestingly, Garcia Calvo claims that this close coordination was due to fact that the state and the firms were tied by a relationship of mutual dependence. On the one hand, the Spanish state could not promote successful upgrading acting independently because of the lack of an efficient state bureaucracy. On the other hand, to become European champions Spanish banks and telecommunications utilities dependent upon regulatory protection of their home government in the domestic market. This idea of a relationship of mutual dependence between the Spanish state and domestic firms due to the need for Spanish banks and utilities to get a favourable regulatory environment in their home market will also feature as a decisive element in the present analysis. For his part, Etchemendy (2004) shows how the Spanish state decisively helped the growth of domestic banks and utilities by protecting them from foreign takeovers and helping their internationalisation.

Moving to single-sector analyses Sofia Perez (1997) studies the evolving relationship between the Spanish government and large domestic banks between the 1930s and the 1980s. Perez shows how the liberalizing financial reforms implemented in Spain since the 1970s were the result of a reciprocal accommodation between a group of state technocrats close to the Bank of Spain and the main domestic banks. According to Perez, the Bank of Spain technocrats shaped financial liberalisation around the preferences of the main domestic banks, abstaining from implementing any measure that could go against their interest. In exchange the banking cartel gave its support to a series of reforms aimed at strengthening the institutional power of the Central Bank. Since Spanish access to the European Community and the advent to power of the Socialist Party (PSOE) the protection of the banking cartel has become part of a bipartisan effort to defend the ‘national’ character of strategic firms (Perez 1997, p. 137). Two elements of Perez’s analysis are salient for the present study: the idea of a two-way relationship of reciprocal accommodation between the state and private banks, and of the close ties between the PSOE government and the Bank of Spain technocrats.

Focusing like Perez on the banking sector, Guillen and Tschoegl (2008) and McCann (2007) provide very detailed analyses of the process of banking consolidation in Spain and Italy. In a more recent contribution Deeg (2012) provides what is so far the only comparative analysis of the emergence of European banking champions in Italy and Spain. In it Deeg highlights how Italian and Spanish governments helped the internationalisation of their domestic banks by following a 'liberal economic nationalist' strategy, that combined the protection from foreign takeovers with measures aimed at improving the efficiency of domestic banks and put them in condition to compete in the European market.

1.3 Theoretical framework and main argument

1.3.1 The structural and instrumental power of business

To explain which factors led some Italian and Spanish firms to succeed in becoming European champions and others to fail this work looks at the balance of power between state and business actors readapting the concepts of instrumental and structural power to the study of industrial policy.

The debate on the structural power of business was heavily influenced by the work of Block (1977) and Lindblom (1977). In his classic *Politics and Markets*, Lindblom argues that in market systems business occupy a 'uniquely' privileged position. This is because governments depend on the attainment of growth, employment and prosperity for their re-election. Growth, employment and prosperity in turn depend on the independent investment decisions of the owners of capital. Consequently, if governments anticipate that a reform will generate disinvestment and affect negatively the aggregate production, they will refrain from implementing it. In other words, the need to achieve economic growth forces governments to 'anticipate and defer' (Lindblom 1977, p. 325) to the preferences of the owners of capital. The automatic nature of structural power distinguishes it from the instrumental power resources also available to business like financial means and lobbying capacity because, unlike structural power, these latter need to be activated through a collective action. The main instrumental power resources available to business include financial means, lobbying capacity, a close relationship with policy-makers, expertise on technical issues, and the capacity to coordinate action among peers (Culpepper 2015; Fairfield 2015; Bulfone 2017b). Although instrumental power resources are also an important mean of influence for the business community, they can be mobilised as well by other pressure groups like trade unions and religious organisations. Instead, the structural power deriving from the disinvestment threat is available only to the business community.

While few would question the claim that business occupies a structurally prominent position in capitalist societies, since the 1980s the concept of structural power progressively went out of academic fashions. This academic neglect was due first and foremost to three limits in the classic rendition of structural power. These limits can be summarised with three arguments (Paster 2015): *no agency, no variation,* and *black box*.

The *no variation* argument focuses on the fact that Lindblom sees the structurally privileged position of business as intrinsic to capitalism and thus constant (Paster 2015). Hence, business will always be structurally powerful. The lack of variation in Lindblom's view of structural power drew early criticism from the pluralist camp, with Vogel (1987) highlighting how the ability of business to influence the government by threatening to withhold making new investment is not constant, changing according to the business cycle. Secondly, the *no agency* argument (Paster 2015) concerns the fact that according to Lindblom structural power does not need activation. In other words, because of the disinvestment threat structural power constrains policy-makers 'independently and automatically' (Hacker and Person 2002, p. 277). Taken together, the lack of agency and lack of variation in the classic version of structural power severely limit its scope of operationalisation, thus making empirical investigation impossible (Bell and Hindmoor 2014; Paster 2015). Thirdly, the *black box* argument is based on the lack of clarity in terms of the unit of analysis of Lindblom's work (Vogel 1987). In fact, Lindblom sees both business and the government as monolithic actors. Thus, structural power is seen as an advantage the entire business class has over other interest groups and the government. However, early critics as well as more recent works have shown how the business community is often divided on issues like trade policy and taxation (Vogel 1987; Hacker and Pierson 2002), and the state is far from being the coherent and cohesive institution Lindblom portrays (Marsh 1983).

Taken together these three limits reduced the analytical appeal of structural power. Another factor contributing to the neglect of business structural – and instrumental – power has been the growing attention comparative political economists devoted to the study of business *preferences* (Culpepper 2015). Inspired by the *Varieties of Capitalism* (VoC) theoretical framework (Hall and Sokice 2001), the CPE debate increasingly focused on the determinants of business preferences and their impact on the domestic institutions of market economies. The rich literature inspired by the VoC framework – part of which was included in the previous literature review – greatly advanced the study of institutional variation among capitalist economies. However, this came at the cost of pushing to the background the study of business power. The lack of academic interest in the instrumental and structural power of business is even more remarkable as it occurred during the neo-liberal era, a time when business influence reached its zenith (Reinke and Culpepper 2014).

After decades of academic neglect, the global financial crisis has recently revived scholarly interest in business power. This reappraisal has happened for two reasons. First, the Lehman Brothers bankruptcy made the public aware of the problems of coping with banks that, owing to their structural position in the economy, have become 'too big to fail'. Second, during the crisis the American government scored some high-profile successes in disputes with large domestic and international banks over issues like the banking bailouts and banking secrecy (Culpepper 2015; Emmenegger 2015). To facilitate the operationalisation of the concept of structural power, post-crisis contributions tried to overcome the three limits in the traditional rendition of structural power.

To counter the *no variation* argument, scholars focused on identifying the background conditions leading to fluctuations in the structural power of business. Among these background conditions, many authors focus on the *state of the economy*. Some argue that business' structural power peaks during economic recessions because the government will make any effort to restore economic growth. Others contend that structural power decreases during economic crises, as additional disinvestment is likely to have a marginal impact on the economy (for an overview of the different positions Paster 2015, Fairfield 2015). Hacker and Pierson (2002) find that a decisive background condition affecting the structural power of business is the change in *political institutions*. They claim that business power will be lower in a federal system than in a confederation because the centralisation of policy-making reduces capital volatility. For his part, Culpepper (2010) argues that business structural power is likely to decrease when the *salience* of an issue increases. As Fairfield pertinently observes (2015) this list of background conditions is by no means exhaustive as a myriad of other factors might lead to fluctuations in business structural power. In the following section, it will be argued that EU-led liberalisation of services represents an important change in background conditions affecting the balance of power between the state and business actors.

Attention has also been given to the other major limitation in the original conception of structural power, the lack of agency. Culpepper and Reinke (2014) for instance show how both instrumental and structural power can be mobilised not only automatically – i.e., with no action on the part of business – but also strategically (i.e., through a deliberate choice). Similarly, Bell and Hindmoor (2015) focus on *state strategy* showing how state officials can have agency in shaping, mediating and structuring their structural power relationship with business. This focus on state agency and the strategic reshaping of structural power relationships is particularly important as it allows adaptation of the concept of instrumental and structural power to the study of industrial policy.

Apart from coping with the limits in the classic rendition of structural power, the recent literature also broadened the analytical scope of its applicability. In fact, in its original version structural power was seen as the one-way dependence of a weak actor, the state, upon a strong actor, business. However, the recent success of the US government in imposing tough regulatory sanctions to powerful banks, i.e. the most structurally powerful among business actors, runs counter the idea of a structurally weak state (Emmenegger 2015; Culpepper and Reinke 2014). On crucial issues for credit institutions like the design of banking bailouts and the regulation of banking secrecy the US government managed to impose its will over domestic banking giants like JP Morgan and Wells Fargo (Culpepper and Reinke 2014), as well as foreign banks like Credit Swiss (Emmenegger 2015). These puzzling successes are the clear sign that, in virtue of their central position in the international economy or of the size of their domestic market, some states can exert structural power over business.

Culpepper and Reinke (2014) notably focus on the reasons that led US healthy banks to accept a tough recapitalisation plan designed by the government, while UK healthy banks refused to do so. They argue that the success of the US government in imposing its will over domestic banks derives from the fact that US banks make most of their revenue in the domestic market. This makes US banks considerably more tied to their domestic market than UK banks. Consequently, regulatory sanctions from the domestic authority have a potentially more negative impact on the revenue of US banks than on that of their British counterparts. In other words, the need to maintain a good relationship with domestic regulators made US banks structurally weak vis-à-vis their government forcing them to participate in a recapitalisation plan they would have otherwise avoided. This observation prompted a redefinition of the concept of structural power seen not simply as a one-way structural dependence of the state upon the owners of capital but rather as an inter-subjective relationship of mutual dependence between the state and business (Bell and Hindmoor 2014; Culpepper 2015).

This view of structural power as a mutual dependence between the state and the owners of capital re-echoes early criticisms of the concept of structural power. Scholars focusing on state capacity and state-society interactions argue that the relative power of the state vis-à-vis other societal actors should be the object of careful analysis (Katzenstein 1978; Skocpol et al. 1985, Evans 1995). Similarly, Vogel (1987) observes that political scientists should focus not only on the way in which the state is dependent upon the owners of capitals, but also on how the owners of capital are dependent upon the government to secure their property rights and a regulatory environment favourable to their investment. For this reason, Vogel claims, the power resources of state and business are always relative and should be studied in their interaction and variation over time. Hence, business is dependent upon the government as much as the government is dependent upon business, and the balance of power between the two is the locus of a constant political struggle (Culpepper 2015).

To get a full understanding of the state–business relationship scholars should focus on the identification of the sources of this mutual dependence, and in particular on the sources of instrumental and structural power the state has at its disposal to influence business behaviour.

When exploring the mutual relationship between the state and business recent contributions tried as well to overcome the *black box* limit of the classic version of structural power by providing a sharper definition of what 'business' and the 'state/government' are (Marsh et al. 2015). This requires understanding which specific industrial sectors, or firms, are more active on certain issues (Paster 2015), as well as distinguishing between the power of governments, governmental agencies, and other state bodies (Marsh et al. 2015).

Recent contributions focused as well on business' instrumental power. This led to the identification of the many sources of instrumental power available to business leaders including a close relationship with policy-makers, the internal cohesiveness of the business community, the availability of large financial means and an unparalleled lobbying capacity (Culpepper 2010; Fairfield 2010; 2015). Instrumental power was also studied in its relationship with structural power exploring the possible interactions between the two. Recent studies focused either on the analysis of the way in which structural and instrumental power work together mutually enforcing each other (Fairfield 2010 and 2015), or on trying to insulate the impact of one of the two dimensions when the other is weak (Culpepper and Reinke 2014).

1.3.2 Industrial policy, ownership power, regulatory power and partisan proximity power

This thesis contributes to the analysis of state–business power relations, and especially the study of state power over business, by readapting the concepts of instrumental and structural power to the study of industrial policy. Like Katzenstein (1978) and Evans et al. (1985) thirty years ago, by identifying the sources of state power to shape business this work fills a gap in the recent literature as so far most scholarship focused on the sources of business power over the state..

The comparative analysis of the industrial policy strategy implemented by the Italian and Spanish governments to favour the emergence of European champions provides a particularly interesting angle for the study of the sources of state power over business. In fact, to turn domestic firms into European champions the state had to supersede to activities like the privatisation of state-owned electricity and telecommunications incumbents and the consolidation among domestic banks. Both these activities required a constant interaction between the state and business actors – either owners of capital or managers. In fact, to successfully complete the transition from national monopolist to European champion, the Italian and Spanish states needed to convince these business actors to participate in the industrial restructuring, either committing large financial resources or managing the potential European champions.

The capacity to convince business actors was in turn conditional on the availability of different power resources of the state over business. When the Italian and Spanish states had these power resources they could use them to force private actors to participate to the industrial restructuring and thus lead to a successful outcome. When these power resources were not available, as in the case of Endesa and TI, the state lost control of the restructuring process and the firms failed to become European champions. In this sense, the process of industrial restructuring of domestic banks and utilities can be seen as a power struggle between two mutually dependent actors, the state and business (Culpepper 2015). This relationship of mutual dependence tied together the Italian and Spanish states and domestic business groups between the late 1980s, when EU-led liberalisation was launched, and the mid-2000s, when the process of market integration had reached an advanced stage leaving very little scope for the industrial policy strategy of member states.

Even though the recent debate on the instrumental and structural power of the state over business was a decisive source of inspiration for the present study, the analytical categories of instrumental and structural power are not suitable for the study of industrial policy. For this reason, this study provides three alternative definitions of the state power resources that prove decisive in influencing the outcome of industrial restructuring: *ownership power, regulatory power* and *partisan proximity power.* It is argued that the capacity of the Italian and Spanish states to successfully complete the process of industrial restructuring has been conditional on the availability at crucial moments of the restructuring process of one or more of these power resources. When these power resources have been available the state has been able to use them to influence the behaviour of business actors – either managers or owners of the banks and utilities – and bring the process of industrial restructuring to completion. When they have not been available, the state has lost control of the restructuring process leading to industrial failure.

The first power resource the state has been able to use to influence the behaviour of business actors is *ownership power.* Two main mechanisms grant the state ownership power over domestic firms:

- The direct ownership of a controlling stake in the banks and utilities to restructure.
- The availability of golden share rights over the banks and utilities.

Golden shares are legal agreements giving the state veto power over mergers and takeovers involving a firm, even when the state does not directly own shares in it. The state typically establishes a golden share to have a say over the management of strategic firms after their privatisation.

To define the second power resource of the state, *regulatory power*, this work draws on Culpepper and Reinke's (2014) analysis of the sources of state regulatory power over domestic firms. Culpepper and Reinke argue that the state succeeds in imposing its will over private firms when the latter depend upon regulatory protection from the former. In turn, this regulatory dependence is conditional on two factors. First, following Culpepper and Reinke, firms are dependent upon regulatory protection from the state when they make most of their revenue in the domestic market. Instead, business groups that make most of their revenue abroad will be less interested in securing a friendly regulatory environment in their home market. Second, the regulatory power of the state is conditional on the degree of supranational (i.e. EU) regulation of the sector of activity of a domestic firm. The process of European integration spread unevenly in different economic sectors. In some of them – including most manufacturing sectors – a series of rulings from the ECJ, e.g. Cassis de Dijon, removed most barriers to the circulation of goods thus bringing the process of market integration to completion as early as in the late 1970s (Stone Sweet 2004). Consequently, member states were left with very little room of manoeuvre in regulating the activity of domestic firms. Instead in sectors like banking member states maintained – until very recently (and to some extent still maintain) – a certain degree of independence in regulating their domestic market. Consequently, the state has more regulatory power over firms that operate in less integrated sectors like banking, than in more integrated sectors like manufacturing.

This sectoral difference in the regulatory power of the state will play a decisive role in influencing the outcome of the process of industrial restructuring in telecommunications, explaining why the Spanish state succeeded in convincing the main domestic banks to invest as passive blockholders in Telefonica, buying a large stake in the firm but allowing the state to act as de facto blockholder. Spanish banks accepted this seemingly disadvantageous deal because when Telefonica was privatised the Spanish state retained ample regulatory power over the Spanish banking sector (see chapter 4). This in turn made Spanish banks dependent upon regulatory protection of their home government. Instead, when the Italian state privatised TI the only domestic investors with sufficient financial resources to buy a large stake in the telecommunications incumbent were family blockholders active in the manufacturing sectors. The firms owned by these blockholders were internationally competitive MNEs less tied to the domestic market than the Spanish banks.

In addition, these manufacturing MNEs were active in liberalised sectors in which member states' regulation played a marginal role as the process of EU-led market integration had already reached an advanced stage (Stone Sweet 2004). The combination of a minor reliance on the domestic market, and a more integrated sector of activity made Italian manufacturing families less dependent upon regulatory protection from their home government than Spanish banks. For this reason, Italian manufacturing blockholders could easily resist calls from the government to invest in TI as passive blockholders. The consequent instability of TI's ownership structure would ultimately lead to its failure in becoming a European champion (see chapter 5).

The third source of state power over business here identified is *partisan proximity power* and is related to the political proximity to the government of business actors involved in the restructuring of the firms.

Following in the line of recent contributions to the study of state–business power relations (Hacker and Pierson 2002; Culpepper 2010; Paster 2015, Fairfield 2015) this work does not treat ownership power, regulatory power and partisan proximity power as immutable, dealing instead with their variation over time. It will be shown how the availability of the three sources of state power over business is conditional on many intervening variables. For instance, in the late 1990s the urgent need to reduce public debt and deficit to qualify for the EMU membership forced the Italian and Spanish governments to partially or fully privatise state-owned banks and utilities thus renouncing to a key source of ownership power (Thatcher 2014b). Similarly, in the mid-2000s a ruling from the European Court of Justice forced the Spanish government to renounce to the golden share powers it still held over firms like Endesa and Telefonica, thus depriving it of a second source of ownership power. Similarly, the progressive integration of the EU banking market described in chapter two led to a gradual erosion of the regulatory power of the Italian and Spanish governments over domestic banks. For its part partisan proximity power is often, but not always, related to partisan cycles as changes in the ruling coalition often lead to the removal of managers hostile to the new government.

In general, the deepening of the process of EU market integration led to a gradual erosion of the sources of ownership, regulatory and partisan proximity power of the state over domestic firms. In this sense, the liberalisation of banking, telecommunications, and electricity can be compared to the gradual opening of a door. Prior to liberalisation, when the door was shut, state's power over domestic firms was at its peak as state-owned monopolists operating under the direct control of the government dominated segmented domestic markets (Thatcher 2014b; Fairfield 2015). By increasing capital volatility, facilitating foreign takeovers, delegating to the Commission the regulation of cross-border mergers, making monopolies illegal, and imposing stricter budgetary rules that led to a wave of privatisations (Thatcher 2013; 2014b), the deepening of EU market integration led to a gradual erosion of state's ownership power, regulatory power and partisan proximity power over business.

Nevertheless, this erosion should not be seen as a sudden and complete process. In fact, the EU required member states to open their domestic market to competition very gradually. It is in this sense that EU-led liberalisation resembles the slow and gradual opening of a door that led to the progressive erosion of the sources of ownership, regulatory and partisan proximity power available to the Italian and Spanish states. This process lasted between the mid-1980s when the liberalisation of banking, electricity, and telecommunications was launched and the mid-2000s when, with the Second Electricity Directive, market integration was finally achieved also in the electricity sector. Until the door was fully open the Italian and Spanish states had still some room of manoeuvre to implement an industrial policy strategy aimed at strengthening domestic banks and utilities. In other words, the main aim of this work is to understand how the Italian and Spanish states succeeded (or failed) in exploiting this closing window of opportunity to strategically deploy their eroding power resources to turn domestic banks and utilities into European champions.

The importance given in the present analysis to the strategic use of ownership power, regulatory power and partisan proximity power resources by the Italian and Spanish states matters. This is because it avoids replicating the excessively structuralist nature of the classic conception of structural power (Bell and Hindmoor 2015). Instead, this study shows how, in order to be effective, the three power resources need to be activated by the state. If the state lacks the willingness to activate them, industrial restructuring leads to a failure in spite of the availability of the necessary power resources.

Along with the variation in ownership, regulatory, and partisan proximity power this study deals as well with the mutually enforcing relationship between these three power resources. For instance, it will be shown how the state can leverage its regulatory power over the private owners of banks and utilities to influence their behaviour. This way the state can act as de facto blockholder even without directly owning shares in the banks and utilities. In other words, the availability of regulatory power over the controlling shareholders of banks and utilities allows the state to have de facto ownership power over them.

To address the *black box* argument made against classic studies of state–business power interactions this work refrains from treating business and the state as monolithic actors, identifying instead which state and business actors are decisive at each stage of the restructuring process. In particular, this work focuses on the interaction between elected governments and large domestic blockholders. The choice to equate the preferences of the state with that of elected governments, contra Evans et al. (1985) and Evans (1995), is motivated by some specific features of the sectors here analysed. In fact, banking, electricity and telecommunications are sectors in which the state has historically played a decisive role through regulation and direct ownership (Thatcher 2007; Colli et al. 2014). Furthermore, due to the strategic importance of these sectors key figures of the executive of Italy and Spain were directly involved in decisions concerning the privatisation, merger or acquisition of domestic firms. For these reasons it is the governments of Italy and Spain, rather than other administrative, regulatory or bureaucratic bodies, that could decisively influence the process of industrial restructuring (Clifton et al. 2010; Colli et al. 2014; Chari 2015). Moving to the analysis of business actors, this study deals only with domestic blockholders because when, due to pressing budgetary needs, the Italian and Spanish governments had to privatise state-owned banks and utilities they were the only domestic investors with sufficient financial resources to buy large stakes. A detailed analysis of the rationale behind the selection of the different state and business actors included in the present analysis is provided in chapter 3.

To sum up this work makes four contributions to the debate on state–business power relations:

- It uses, for the first time, industrial policy as a focus for the analysis of state–business power relations. This is an important contribution per se as industrial policy involves a constant interaction between the state and private business actors, thus providing a particularly interesting angle for the study of the mutual power relationship between the two.
- It identifies three power resources of the state that has been decisive in influencing the outcome of the process of industrial restructuring: regulatory power, ownership power and partisan proximity power. It thus 'brings the state back in' (Skocpol et al. 1985), contributing to the still scarce recent literature on the sources of state power over business.
- It traces the impact of an important change in the background conditions, EU-led integration of service and network industries, on the balance of power between the state and business actors. In particular, it looks at the way in which the state tried to strategically deploy its eroding power resources to favour the upgrade of domestic firms into European champions.
- It identifies in a rigorous and detailed way which specific state and business actors were involved at every stage of the restructuring process.

1.4 Alternative hypotheses: Partisan theory and state-capture theory

Throughout this thesis the findings derived from the framework based on state ownership, regulatory, and partisan proximity power will be compared with predictions concerning the successful completion of the process of industrial restructuring derived from two influential strands of the literature: partisan theory and state-capture theory.

1.4.1 Partisan theory

Partisan theorists argue that the partisan affiliation of elected governments has a decisive influence over the institutional features of domestic capitalism (Boix 1998; Roe 2003; Cioffi and Hoepner 2006). According to Boix (1998) left-wing and right-wing governments try to achieve economic growth, and thus win re-elections, by following radically different strategies. On the one hand, left-wing governments achieve growth by fostering labour and capital productivity through direct state interventions aimed, among other things, at strengthening selected national champions. On the other hand, right-wing governments reject state-led programs of capital formation, relying instead on private individuals to maximize their rate of return, and for extension the rate of return of the economy. Instead of investing in state-owned firms conservative governments promote fast and radical privatisation campaigns aimed at diffusing share ownership among the population.

Partisan theories focusing in particular on corporate governance also find that partisan coalitions have a crucial impact on corporate indicators, and in particular on the degree of ownership concentration among listed firms (Roe 2003; Cioffi and Hoepner 2006). However, they have divergent views on the corporate preferences of left-wing and right-wing coalitions. According to Roe (2003) left-wing governments tend to promote stakeholders' corporate models in which the interests of workers and consumers prime over those of shareholders. In such models, ownership is concentrated in the hands of few blockholders thus favouring long-term growth strategies over the pursuit of short-term profit. Instead, Roe argues that right-wing governments tend to favour corporate liberalisation, ownership diffusion and a shift towards shareholder capitalism. Comparing the liberalising corporate reforms implemented since the 1990s in France, Italy, Germany and the United States, Cioffi and Hoepner (2006) contend that, in their quest for centrist voters, left-wing coalitions have implemented ambitious liberalising measures including privatisations, banking liberalisation and reforms of the corporate legislation aimed at strengthening minority shareholders' rights. Instead, according to Cioffi and Hoepner, conservative governments are more likely to slow the pace of corporate liberalisation as they tend to side with established corporate insiders like managers and large blockholders.

Before elaborating testable predictions based on partisan theories it is worth highlighting how, to successfully complete the process of industrial restructuring, the Italian and Spanish governments needed to combine measures aimed at improving the performance of their national champions making them internationally competitive (i.e. stick), and measures aimed at protecting the dominant position of national champions in the domestic market and shelter them from foreign takeovers (i.e. carrot) (Deeg 2012; Clift and Woll 2012). Only by finding the right balance between stick and carrot the Italian and Spanish states could turn domestic firms into European champions. Partisan theories expect left-wing governments to be better than right-wing governments at finding this balance as they combine the genuine liberalizing zeal necessary to improve the efficiency of national champions (Cioffi and Hoepner 2006; Deeg 2005) with the readiness to directly intervene in the economy to protect and nurture potential European champions (Boix 1998). Instead, partisan theorists argue, right-wing governments are likely to be either too protectionist, focusing solely on the defence of inefficient lame ducks (Cioffi and Hoepner 2006), or too enthusiastic in their liberalising zeal and thus unable to shelter national champions from foreign takeovers (Boix 1998).

Partisan analyses of Italian and Spanish capitalism largely conform to these general predictions. The Italian Centre-Left and the Spanish Socialist Party (PSOE) are generally portrayed as ‘pragmatic’ liberalising coalitions capable of combining partial privatisations and targeted liberalisations, with measures aimed at strengthening strategic national champions like the set up of favourable tariff regimes or the awarding of monetary compensations for the costs of transition to competition (Deeg 2005; 2012; McCann 2007; Boix 1998; Murphy 1998; Etchemendy 2004).

Instead, partisan theories posit, the Italian Centre-Right and the Spanish Popular Party (PP) are similarly unlikely to promote the emergence of successful European champions, although for opposite reasons. On one hand, the Italian Centre-Right is portrayed in the literature as a protectionist conservative coalition only interested in defending established corporate insiders. Hence, according to partisan theories, the Centre-Right protects national champions, even when they are lame ducks, but falls short of implementing the liberalising reforms necessary to improve their performance and turn them into European champions (Cioffi and Hoepner 2006; Deeg 2005; Culpepper 2007; McCann 2007; Barta 2011). On the other hand, the Spanish PP is often portrayed as a neo-liberal conservative coalition that, similar to the British Conservatives under Margaret Thatcher (Boix 1998; Colli et al. 2014), exceeds in its liberalising zeal thus being incapable (and uninterested) of defending its national champions from foreign takeovers. As proof of this neo-liberal attitude the literature highlights how the PP earned its first electoral victory in 1996 by promising to launch a radical privatisation campaign aimed at bringing to an end direct state ownership similar to that implemented by the Thatcher government in the 1980s (Murphy 1998; Mota 1998; Cabrera and Del Rey 2007). To sum up, partisan theorists expect the Italian Centre-Left and the Spanish PSOE to have played a key role in the successful upgrade of those Italian and Spanish firms that became European champions. Instead, due to their incapacity to find the right balance between stick and carrot the Centre-Right and the PP are expected to have decisively contributed the failure of Endesa and TI.

Partisan Theory	State-power Theory

Premises
 	
• Left-wing governments can combine targeted liberalising measures (*stick*) and measures aimed at protecting the dominant position of domestic incumbents (*carrot*).
 	
• Right-wing governments are either excessively *protectionist* i.e. they protect national champions without improving their performance (Cioffi and Hoepner 2006).
 	
• Or *Neo-liberals* i.e. they prioritise domestic liberalisation over the protection of national champions (Boix 1998)
 	
Main Hypothesis
• Left-wing governments are better than right-wing governments at helping the emergence of European champions
	Premises
	
	• Left-wing governments and right-wing governments try to achieve the same objectives when dealing with industrial restructuring: promote the emergence of strong European champions, and favour the rise of politically close managers and shareholders.
	
	• Left-wing and right-wing governments implement a similar industrial policy strategy centring on:
	  • Active role of the state during privatisation
	  • Promotion of domestic consolidation
	  • Implementation of delaying tactics to slowdown domestic liberalisation
	  • Use of the diplomatic channel to favour internationalisation
	
	Main Hypothesis
	• The partisan orientation of governments does not affect their capacity to favour the emergence of European champions, which is instead conditional on the availability of ownership, regulatory and partisan proximity power resources.

Table 1.1 Partisan and state-power hypotheses

However, the evidence presented in the following chapters disconfirms the predictions derived from partisan theories showing how Left-wing and Right-wing governments experienced similar results in their efforts to create European champions. At times, they both successfully helped the process of industrial restructuring, while in other occasions they slowed it down leading to industrial failures. If left-wing and right-wing governments experienced similar results, it derives that their partisan orientation is not a key factor in determining their capacity to favour a successful process of industrial restructuring. This is because of, irrespective of their partisan orientation, when they dealt with the restructuring of strategic national champions Italian and Spanish governments implemented a similar industrial policy strategy trying to achieve the same objectives: creating strong European champions, and favouring the rise of politically close managers and shareholders at the head of them.

This is a sign that the progressive opening of the Italian and Spanish economies to foreign investment has led economic patriotism to primacy over the ideological affiliation of elected governments (Helleiner 2002; Clift and Woll 2012; Morgan 2012; Naczyk 2014; Colli et al. 2014; Laffey et al. 2016). The appeal of 'economic nationalism' is particularly strong in the case of EU member states due to the pervasiveness of the process of market integration (Deeg 2012; Morgan 2012). Faced with the concrete prospect of the foreign colonisation of strategic sectors, EU governments of both stripes have frequently implemented 'nationalist' industrial policy strategies aimed at protecting the domestic ownership of firms (Colli et al. 2014; Deeg 2012), regain control of their shareholding in case they had been taken over (Naczyk 2014) or favour their internationalisation (Clift and Woll 2012; Morgan 2012; Laffey et al. 2016). In the case of Italy and Spain this 'nationalist' industrial policy strategy centres on four pillars:

- The active involvement of the state during the privatisation of domestic national champions to determine the methods of the sell-offs and select the main private shareholders.
- The promotion, when needed, of a process of sheltered consolidation among domestic firms aimed at favouring the emergence of banks and utilities with sufficient size to compete in the European market.
- The implementation of delaying tactics aimed at slowing down the pace of EU-led integration of the domestic market, coupled with the implementation of a series of reforms aimed at improving the efficiency of domestic European champions.

- The use of diplomatic channels to favour the foreign expansion of domestic banks and utilities.

The successful outcome of this industrial policy strategy was conditional on the availability of ownership, regulatory, and partisan proximity power resources at crucial moments during the restructuring process, and on the willingness of the Italian and Spanish governments to strategically deploy these power resources. When the power resources were available, and the Italian and Spanish states deployed them strategically, the industrial restructuring led to a successful outcome and the government managed to favour the rise of politically close managers and shareholders, when they were not available it led to a failure.

1.4.2 State-capture theory

The state-capture theory posits that the emergence of the successful banks and utilities here analysed is the result of the Italian and Spanish states having been captured by the management of the European champions (Cabrera and Del Rey 2007; Jordana et al. 2006; Silva 2004). The state capture hypothesis builds on the negative assessments about Italian and Spanish capitalism within the comparative political economy debate (Katzenstein 1978; Schmidt 2002; Della Sala 2004; Molina and Rhodes 2007; Amable 2003). Schmidt (2002) argues that Italy constitutes an instance of 'failed state capitalism' in which the state is often captured by particularistic interests and fails to provide an efficient guidance to the economy on the model of France. On a similar vein, Della Sala (2004) and De Cecco (2007) highlight the 'dysfunctional' nature of state's intervention in the Italian economy. According to these analyses the inherent weakness of the Italian state makes it incapable of challenging the power of established business actors (Deeg 2005; Culpepper 2007; Rangone and Solari 2012). Although the Spanish state is generally deemed more efficient than its Italian counterpart (Schmidt and Gualmini 2013), the fact that also in Spain, like in Italy, the state solves coordination problems among domestic actors by directly intervening in the economy opens the scope for the development of clientelistic networks favouring powerful domestic business interests (Molina and Rhodes 2007). According to Molina and Rhodes (2007) the risk for the state to be captured by powerful domestic business actors is even more concrete in Spain than in Italy because large Spanish firms, in particular banks and utilities, have unparalleled lobbying power over the government (p. 240).

Given the historically powerful position occupied by large banks and utilities in the Italian and Spanish economy, and the tendency for the Italian and Spanish states to be prone to capture by established domestic firms, state-capture theories hypothesize that the successful upgrade of Italian and Spanish banks and utilities was the result of a process of capture of the state by the managers of the European champions. If this were true, the Italian and Spanish states always acted in the interest of domestic banks and utilities, accommodating their preferences without having any direct means of influence over their managers and owners.

Due to the overwhelmingly powerful position occupied by banks and utilities during the Franco dictatorship (1936–75) and in later years, many scholars found evidence of state capture in the case of Spain (Aguilera 1998; Cabrera and Del Rey 2007; Sancho 2000). Cabrera and Del Rey (2007) find evidence of state capture by domestic banks during the transition to democracy and under the PSOE and PP governments of the 1980s and 1990s (Cabrera and Del Rey 2007). On a similar vein, Lancaster (1989) argues that due to their pivotal position in the Spanish economy private banks dictate the main regulatory reforms to the government both in the banking sector and in electricity, a sector of interest for the banks as they are among the main shareholders of private electricity groups. Focusing specifically on the electricity sector Arocena et al. (2002) find evidence of a clear pro-industry bias in the pricing policies followed by the Spanish government, arguing that this is due to the strong lobbying power of the main electricity producers. Similarly, Jordana et al. (2006) argue that the slow pace of liberalisation in the Spanish electricity sector is due to the strong influence the main electricity groups have over the government. In their analysis of the Spanish telecommunications sector Sancho (2000) and Jordana and Sancho (2005) find clear evidence of state capture showing how, due to its unparalleled technical expertise, Telefonica was allowed by Spanish governments of both colours to act as a self-regulated monopolist until well into the 1990s, and even afterwards retained a decisive influence over the regulation of the Spanish telecommunications sector.

Focusing on the Italian case Posner finds that the managers of the large state-owned conglomerates Istituto di Ricostruzione Industriale (IRI) and ENI decisively influenced the foreign economic policy of the weak Christian Democratic governments of the 1960s and 1970s (Katzenstein 1978). Concerning the banking sector clear evidence of state capture was found in the case of the Milan-based investment bank Mediobanca, whose undisputed leader Enrico Cuccia exerted a strong influence over the government until his death in the early 2000s (McCann 2000a; Deeg 2005; Oddo and Pons 2006). Moving to the electricity sector Silva argues that the incomplete liberalisation of the Italian electricity market is due to the lobbying power exerted by the former monopolist ENEL over Italian governments of both colours (Silva 2004). Rangoni (2011) finds clear evidence of this pro-ENEL bias in the awarding by the government of generous monetary compensations to ENEL for the costs of transition to competition, and in the progressive marginalisation of the electricity regulator AEEG. Concerning the telecommunications sector Negrier (1997) finds that, similar to the case of Telefonica, due to its limited technical expertise until the late 1990s the Italian government left ample room of manoeuvre to the management of TI’s forerunner Stet in shaping the regulation of the telecommunications sectors.

State-capture theory	**State-power theory**

Premises
 	
• The Italian and Spanish states is prone to capture by powerful domestic business groups (Schmidt 2002; Molina and Rhodes 2007).
• Banks and utilities are among the most powerful business groups in Italian and Spanish capitalism (Perez 1997; Jordana and Sancho 2003; Negrier 1997; Silva 2004).
 	
Main Hypotheses
 	
• The emergence of the European champions is the result of state capture by the management of the banks and utilities.
 	
• The state exerts very little influence over the banks and utilities, passively abiding by their requests.
	Premise
	
	• The Italian and Spanish states can exert influence over domestic banks and utilities leveraging three power resources:
	    • Ownership Power
	    • Regulatory Power
	    • Partisan Proximity Power
	
	Main Hypotheses
	
	• The emergence of the European champions is the result of an industrial policy process led by the Italian and Spanish states.
	
	• Leveraging its ownership, regulatory, and partisan proximity power resources the Italian and Spanish states could force managerial and ownership shake-ups in the banks and utilities.

Table 1.2 State-capture and state-power hypotheses

To sum up, state-capture theorists argue that the emergence of European champions is the result of the self-regulation of the management of the banks and utilities. In this framework banks and utilities exerted commanding power over the capture-prone governments of Italy and Spain defining in full autonomy the domestic regulation of their sector of activity. If this were true we would expect the Italian and Spanish governments to have had very little influence over the management of the banks and utilities, passively abiding by their demands. However, the case studies will show how on several occasions the Italian and Spanish governments succeeded in bringing about changes of ownership or managerial shake-ups in the banks and utilities when the goals of the managers or owners started diverging with those of the government. The capacity of the Italian and Spanish governments to force these managerial and ownership changes is inconsistent with the view of a weak state captured by strong business actors, and was conditional on the availability of ownership, regulatory, and partisan proximity power resources. When these power resources were available the state succeeded in imposing its will over the managers and owners of domestic banks and utilities, when they were not available it failed losing control of the process of industrial restructuring.

1.5 Definition of industrial success and failure

This study starts from the assumption that four Italian and Spanish banks (Intesa–Sanpaolo, Unicredit, BBVA and Santander) and two utilities (Telefonica and ENEL) succeeded in becoming European champions, while two other utilities (TI and Endesa) failed to do so. However, failure and success are vague concepts that require a more accurate definition. To assess in a rigorous and quantitative way which Italian and Spanish banks and utilities succeeded in becoming European champions and which others failed, this study draws on Chari's analysis of the post-privatisation performance of European firms (Chari 2015). In his work Chari develops two empirical tests to distinguish between the firms that are among the European and global leaders in their sector of activity and retain their independence (alphas) and those that are not European leaders and/or were taken over by larger competitors (betas). According to Chari to be considered an Alpha a firm must pass two empirical tests:

1) **Global Movers Test**. To be considered an alpha a firm must appear in the Forbes 2000 list and be among the top one per cent of EU-27 firms in its sector of activity in terms of operating turnover, total assets, shareholder funds and number of employees.

2) **Independence Test**. An alpha should exist as an independent firm not having been taken over by a competitor, and not having a competitor directly or indirectly controlling 25 per cent or more of its shares.

Chari's double test has the important merit of providing a quantitative, objective and easily replicable way to assess if a firm failed or succeeded in becoming a European champion. Although the present study will replicate most elements of Chari's test, it will adapt it to the structure of the industrial sectors here analysed. In addition, it adds a third dimension to the test by assessing the economic performance of the relevant firms.

For the present analysis to be considered a European champion a firm should pass three tests concerning its size, performance, and ownership structure:

1) **Size**. It is safe to say that a European champion should rank among the largest EU firms in its sector of activity. However, the number of European champions active in each business sector is conditional on the level of industrial concentration. Since industrial concentration is higher in electricity and telecommunications than in banking, there will be fewer European champions in the former sectors than in the latter. Consequently, to be considered European champions, electricity and telecommunication utilities should rank among the five largest EU firms in their sector of activity, while banks should rank in the top 20.

2) **Performance**. A European champion should have satisfying economic performance, being at least at par with its sectoral peers and showing no potential of becoming a takeover target in the near future. To assess the performance of banks and utilities this study looks among other things at the level of outstanding debt, the rating of a firm, as well as its capacity to successfully penetrate foreign markets.

3) **Ownership structure**. A European champion should not have a competitor as its de facto controlling shareholder. Since banks and utilities tend to have a very diffused ownership, a 20 per cent stake is sufficient to exert de facto control over them. Consequently, to be considered European champions banks and utilities should not have a competitor as the largest shareholder with 20 per cent or more of the shares.

The following sections will apply the size, ownership and performance tests to the eight Italian and Spanish banks and utilities, assessing which succeeded in becoming European champions and which others failed to do so.

This work follows the literature on the internationalisation of banks and utilities in considering the size and level of foreign expansion of a firm key dimensions of economic success (Clifton et al. 2010; Colli et al. 2014; Chari 2015). These two factors are decisive because with the integration of the European market banks and utilities faced an 'eat or be eaten' situation in which they either gained size by expanding abroad or they risked being taken over by foreign competitors. For reasons of parsimony, other performance indicators like cost-to-income ratio, return on asset, operating expenses to income, network coverage and installed capacity are not included in the analysis as they arguably are less decisive in determining the success of a European champion.

Related to the above is a point about case study selection. Since the aim of this analysis is to determine the conditions that led to the emergence of successful European champions, and not to explore all the possible dimensions of the success of a firm, this work does not deal with Italian and Spanish banks and utilities that, despite being successful, lack the size necessary to be considered European champions. This is the case for instance of those Italian cooperative banks (*banche di credito cooperativo* and *popolari*) that play a decisive role in financing SMEs in Northern Italy, or of the Spanish electricity utility Iberdrola that is among the Continental leaders in the production of green energy.

1.5.1 ENEL

Table 1.3 Largest electricity utilities in the EU (2014)

Company	Revenue (US$ Million)	Country
E.ON	157,057	Germany
Engie	126,076	France
ENEL	**110,560**	**Italy**
Electricité de France	90,806	France
RWE	68,345	Germany
SSE Electric Utility	50,610	UK
Iberdrola	44,005	Spain
Centrica	36,860	UK
Vattenfall	27,890	Sweden
EnBW	27,890	Germany
National Grid	22,067	UK

Source: Fortune Global 500

With operating revenue of US$110 billion, in 2014 ENEL was the third largest electricity utility in the EU after Germany's E.ON and France's Engie (Fortune Global 500 2014). In 2012 ENEL ranked in the top five also in terms of total assets (fourth), shareholders' funds (second) and number of employees (fourth) (Chari 2015). Its size places ENEL squarely among the five largest electricity utilities in the EU, the other four being Engie, E.ON, EDF and RWE (Thomas 2009). ENEL combines a strong position in the domestic market (where is the largest electricity utility and the second largest gas distributor), with an important international presence. Because of its successful penetration of foreign markets ENEL is nowadays the main electricity utility in the Iberian Peninsula and in Latin America, and has important investments in many CEEC countries and Russia (Bergami et al. 2013). Although the acquisition of Spanish Endesa meant the outstanding debt of the group peaked above €55 billion in 2009, market operators always perceived the company as solid (Bergami et al. 2013). Furthermore, because of the cession of non-core assets by 2015 the debt of the group was brought below €37.5 billion. ENEL's largest shareholder is the Italian state with a 23.6 per cent stake that makes it the de facto controlling shareholder. Other large shareholders include institutional investors like

Blackrock, the Bank of China and the Norwegian Sovereign Fund. No direct competitor owns a large stake in ENEL.

These indicators clearly show how ENEL possesses the characteristics of a European champion in terms of size, economic performance and ownership. This view is shared as well by scholars and market operators that highlight ENEL's remarkable turnaround from inward-looking domestic incumbent to successful multinational (Bergami et al. 2013; Castronovo and Paoloni 2013; Nardozzi and Carbone 2011).

1.5.2 Telefonica

Table 1.4 Largest telecommunications utilities in the EU (2014)

Company	Revenue (US$ Million)	Country
Telefonica	**87,372**	**Spain**
Deutsche Telekom	81,554	Germany
Vodafone	74,051	UK
Orange	62,955	France
Telecom Italia	42,070	Italy
BT Group	30,734	UK

Source: Fortune Global 500

In 2014 Telefonica was the largest telecommunications utility in the EU ahead of Deutsche Telekom and Vodafone with revenue of over US$87 billion. Telefonica is the leading telecommunications provider in Spain, Brazil, Argentina and Chile and has important investments across most other Latin American countries (Clifton et al. 2011). Telefonica expanded as well in the EU where is active in Slovakia, the Czech Republic, the UK (where it bought the mobile operator O2) and Germany (where in 2014 it completed the takeover of E-Plus). These acquisitions made Telefonica a global leader and the fastest growing telecommunications firm in the EU (Colli et al. 2014). This result is even more remarkable when compared with the situation of the mid-1980s when Telefonica was still an inward-looking inefficient national champion, dependent upon the technological input of the US group ITT (Clifton et al. 2011). The main shareholders of Telefonica are the Spanish banking groups

BBVA and La Caixa with a 6 and 5 per cent share respectively. All other shareholders are below the two per cent threshold. Similar to ENEL, Telefonica's size, successful international expansion and ownership structure make it a European champion.

1.5.3 The four banks: Unicredit, Intesa-Sanpaolo, Santander and BBVA

The four Italian and Spanish banks rank among the twenty largest banks in the EU both in terms of assets and market capitalisation. Banco Santander is the sixth largest for assets and second for market capitalisation, Unicredit is eleventh and fourteenth, BBVA is fourteenth and fifth and Intesa-Sanpaolo is fifteenth and ninth (Accuity 2016; Banksdaily 2016). The four banks reached this remarkable size by combining a strong presence in the domestic market, with successful expansion in foreign markets. When investing abroad, Spanish banks mainly targeted the Latin American market (where Santander has achieved a dominant position in Brazil and Argentina, and BBVA in Mexico), while their Italian counterparts expanded in Central and Eastern Europe and in the Balkans (Unicredit is the main Western bank in the CEEC region while Intesa-Sanpaolo has an important presence in Serbia, Croatia, Slovakia and Albania). BBVA, Unicredit, and Santander invested as well in Western Europe. Both Spanish banks expanded in Portugal, with Santander venturing as well in the British market with the acquisition of Abbey National in 2005. For its part Unicredit entered the German market taking over Hypovereinsbank (HVB) (Deeg 2012). Among the four banks Intesa-Sanpaolo remains the most domestic oriented group, although in 2009 a fifth of its revenue came from abroad (Deeg 2012, p. 39).

All four banks fared comparatively well during the first phase of the Eurozone crisis owing to their retail focus and their marginal exposure to subprime products (Howarth 2013). As a result, none of them required financial assistance from their home government. To the contrary, they contributed to restoring market confidence in Italy and Spain by purchasing a large amount of sovereign bonds (Deeg 2012; Quaglia and Royo 2015). However, the four banks have recently experienced some difficulties because of the prolonged recession of the Italian and Spanish economies. The sluggish economic performance of Italy and Spain loaded the balance sheet of the four large banks with non-performing loans. The situation is particularly serious for Italian banks as in 2015 the amount of non-performing loans held by Italian banks reached an estimated €360 billion – nearly doubling since 2010 (Romei and Murphy 2016). However, the share of bad loans as percentage of total loans held by Unicredit and Intesa-Sanpaolo is considerably lower than that of other smaller Italian banks like the financially distressed Monte dei Paschi (Romei and Murphy 2016). In addition, both the Italian banks and their Spanish counterparts passed the 2016 stress tests performed by the European Banking Authority. Only Unicredit finished low in the ranking with the sixth worst fully loaded CET1 ratio among the 51 European banks monitored, Santander and BBVA were respectively thirty-fifth and thirty-sixth, while Intesa–Sanpaolo had a very strong performance finishing sixteenth with a CET1 ratio of 10.21 (beaten only by Credit Agricole and Sweden's Nordea among the twenty largest European banks) (Noonan et al. 2016). Unicredit's difficulties, due among other things to the delayed completion of the process of banking consolidation in Italy (see chapter 4), are not posing a threat to the survival of the group, and the recently appointed CEO Jean-Pierre Mustier is already regaining market confidence by selling non-core assets. All banks have a very diffused ownership structure with Anglo–American institutional investors among their largest shareholders. In the case of the Italian banks also local banking foundations occupy a prominent position in the ownership structure.

All in all, the four Italian and Spanish banks meet the required standards in terms of size, performance and ownership structure to be considered European champions.

1.5.4 Telecom Italia

With revenue of US$26 billion in 2016 TI was the sixth largest telecommunications group in the EU (down from the fifth place in 2014) after Deutsche Telekom, Vodafone, Telefonica, Orange and BT. Hence, TI ranks outside the top five of EU telecommunication companies thus failing to qualify as a European champion in terms of size. In addition, the recent economic performance of TI was far from impressive. In fact, after a process of de-internationalisation nowadays the group is active only in the domestic market, Brazil, and Argentina. TI's limited presence in foreign markets is in stark contrast with the situation of the early 2000s when TI rivalled with Telefonica for the leadership in Latin America operating as well in Austria, Greece, Serbia and Spain. Another indicator of TI's weak performance is the size of the debt burden on the group that in 2015 stood at €31 billion (considerably higher than the market capitalisation of €23 billion). Also in terms of the ownership structure TI lacks the independence of a European champion. In fact, TI's largest shareholder is the French telecommunications and media group Vivendi with a 24.9 per cent stake. This stake allows Vivendi to act as de facto blockholder.

Proof of this is the fact that between 2015 and 2016 the French group managed to secure the election of four board members and more crucially the ousting of the CEO Marco Patuano, who disagreed with the investment strategy of Vivendi's owner Vincent Bolloré (Sanderson and Thomas 2016). While the reasons motivating Vivendi's investment in TI are still unclear, most market observers agree in considering TI a likely target in the upcoming process of consolidation among European telecommunications firms. According to these views TI could either become part of the Vivendi group (Thomson 2016; Sanderson and Thomas 2016) or Vivendi could use TI as a bargaining chip in a larger deal with the French telecommunications group Orange (Thomas and Sanderson 2016; Whitfield 2016; Williams 2016).

All in all, TI fails to meet the required standards in terms of size, performance and ownership structure to be considered a European champion in its sector of activity. This assessment is shared as well by scholars and market operators that dealt with the recent trajectory of the firm (Sanderson and Thomas 2016; Thomas and Sanderson 2016; Thomas et al. 2015; Williams 2016; Florio 2007).

1.5.5 Endesa

The categorisation of Endesa as a firm that failed to become a European champion is very straightforward, as in 2007 the Spanish electricity utility was taken over by the Italian competitor ENEL than now owns a 92 per cent majority stake. This happened even though in the late 1990s Endesa was one of the largest electricity utilities in Europe, main player in the Latin American market, and with a strong presence in core EU member states like France, Germany, and Italy. The sector-based case studies will analyse the factors behind this failure.

1.6 Methodology and case study selection

This thesis identifies the factors that led some Italian and Spanish firms to succeed in becoming European champions and others to fail by combining small-N cross-case comparative analysis with within-case process tracing (Beach and Pedersen 2016). While within-case process tracing is vital for unpacking the causal mechanism that occurs in-between a cause and its effect (Trampusch and Pallier 2016; Falleti 2016), cross-case comparisons allow refining and testing causal claims across the entire population of relevant cases (Beach and Pedersen 2016). The categories of regulatory power, ownership power and partisan proximity power are developed through an inductive theory-building approach (George and Bennett 2005; Trahmpusch and Pallier 2016; Falleti 2016). The empirical material produced drawing on primary and secondary sources as well as newspaper articles is used to build plausible hypotheses about the causal relationship between the power resources and the outcome of the process of industrial restructuring (Beach and Pedersen 2016).

This thesis claims that the availability of ownership power, regulatory power or partisan proximity power is a *necessary but not sufficient* condition for the successful outcome of the process of industrial restructuring (Mahoney 2008). These power resources are necessary but not sufficient because in order to be effective they need to be activated by the state. When at least one of the power resources is combined with state willingness to strategically deploy it, it becomes *necessary and sufficient* condition for successful industrial restructuring. The argument can be summarized as follows:

$$Y = A \mathbin{\&} (OP \vee RP \vee PP)$$

Where Y = successful restructuring; A = state's willingness to deploy power resources; OP = ownership power; RP = regulatory power; PP = partisan proximity power.

To create a European champion the state does not need to have the power resources at its disposal at every stage of the restructuring process. Power resources are necessary in particular at 'critical junctures' (Mahoney 2015; Beach and Pedersen 2016), i.e. decisive moments in which by strategically deploying them the state can determine the outcome of industrial restructuring. For the purpose of this analysis critical junctures are moments in which there is the concrete possibility of a change of ownership (through privatisation, merger or takeover) or a managerial shake-up in the firms analysed. If at a critical juncture the state does not have the necessary power resources, or decides not to activate them, it does not necessarily mean that the process of industrial restructuring will lead to a failure. However, in a path-dependent logic, the consequent weakening of the potential European champion lowers the chances of having a successful outcome.

1.6.1 The sectors: Banking, electricity and telecommunications

The sectors of banking, electricity and telecommunications were chosen as case studies because they have three characteristics in common: large size, strategic importance and the fact of having undergone a process of EU-led liberalisation between the mid-1980s and the mid-2000s. First, banking, electricity and telecommunications are major sectors that occupy a prominent position in the European economy. According to the Fortune Global 500, in 2014 17 of the 100 largest EU firms were banks, eight electricity utilities and six telecommunications utilities. This means that taken together the three sectors account for one-third of the largest EU firms. These sectors are even more prominent when considering the Italian and Spanish economies as in 2014 six out of nine Italian firms and five out of eight Spanish firms included in the Fortune Global 500 were banks, electricity utilities or telecommunications utilities.

Second, banking, electricity, and telecommunications are sectors of national interest whose importance goes beyond purely economic considerations (Thatcher 2007). Electricity, and telecommunications are closely associated to the provision of public goods by the state, and to the defence of the national interest more in general (Colli et al. 2014). For their part, banks are strategic because they serve a unique and critical function for the economic development of a country: 'banks control capital that is essential for economic growth and employment; banks finance government debt; states can use banks to influence the allocation of capital in the economy; and banks are often used for public and social purposes' (Deeg 2012, p.2).

Third, all sectors underwent a similar process of EU-led liberalisation from the mid-1980s to the mid-2000s. Although the timing of the legislative reforms in the three sectors differed to some extent, as market integration was completed earlier in telecommunications than in banking and electricity, the impact on cross-border competition in the three sectors was similar (Thatcher 2007; Jordana et al. 2006). Proof of this is the fact that market integration triggered a similar wave of cross-border M&A in the three sectors. Between 1990 and 2007, the Commission assessed 581 cross-border merger plans involving banking, energy (i.e. electricity and oil & gas), and telecommunications firms under the EC Merger Regulation (ECMR) framework. This represents a substantial proportion of the 4,280 merger plans assessed by the Commission (around 13 per cent) (Thatcher 2014a, p. 451–452). The 581 merger plans were distributed squarely within the sectors: 198 in telecommunications, 196 in energy (electricity plus oil & gas) and 187 in banking (Thatcher 2014a, p. 452).

The fact that banking, electricity, and telecommunications combine economic prominence, strategic importance and EU-led liberalisation explains why they were chosen *en lieu* of other potentially interesting case studies like air transport and oil & gas. In the case of air transport, the sector also underwent a process of EU-led liberalisation between the 1990s and the 2000s, and Italy and Spain each host a flag carrier that could have become a European champion – Alitalia and Iberia. However, the economic weight of the sector is considerably lower than that of banking, electricity and telecommunications. In 2014 only two airlines ranked among the 100 largest EU firms – Lufthansa and Air France–KLM – and neither was in the top five.

Economic prominence and strategic importance are undoubtedly characteristics of the oil & gas sector. Four oil & gas firms rank among the ten largest EU companies – including the top three – and the safe provision of oil & gas ranks high among the priorities of all government. Furthermore, Italy and Spain each host a large domestic firm in the sector, respectively ENI and Repsol. However, the oil & gas sector was not integrated because of a process of EU-led liberalisation, being instead a global market driven more by commodity prices than policy integration. In addition, the Italian oil & gas firm ENI is a global leader since the 1950s, so the leading position it currently occupies in the European and global market – respectively fourth and eleventh – is less puzzling.

1.6.2 The countries: Italy and Spain

Italy and Spain share similarities in multiple areas: their societal and cultural profile, with relatively recent authoritarian experiences and a strong Catholic background (Etchemendy 2011; Natili 2016); labour market and welfare state institutions, with sharply dualised labour markets, fragmented welfare states and confrontational industrial relations (Ferrera 1996; Picot and Tassinari 2017); productive structure, with late industrialisation, prevalence of small and medium enterprises and the self-employed, a relatively low contribution of services to the GDP and specialisation in medium value-added manufacturing goods (Molina and Rhodes 2007; Karamessini 2008); and corporate governance structures, with a bank-dominated credit system, low stock market capitalisation and widespread state ownership among listed firms (Deeg 2005; Culpepper 2007; Aguilera 1998). Because of these common traits Italy and Spain are routinely treated as most similar models of capitalism within the comparative political economy debate, a debate that is acute here as there is as yet no consensus on how these states should be classified (Schmidt 2002; Molina and Rhodes 2007).

At the onset of the process of EU-led market integration Italy and Spain shared also many similarities in the organisation of banking, electricity and telecommunications. Until the early 1990s both countries were characterised by a very fragmented and highly inefficient banking sector, telecommunications in both countries was dominated by a partially state-owned monopolist, while in electricity the largest domestic producer and supplier was the state-owned incumbent. Because of these common features it seems plausible to threat Italy and Spain as most-similar cases thus holding constant systemic country effects while maximizing the variance of the power resources considered relevant to explain the outcome of the process of industrial restructuring (Lijphart 1971).

Italy and Spain provide a particularly interesting angle for the study of the sectors of interest because they allow for variation in the outcome of the process of industrial restructuring. In fact, in both countries the state-led effort of industrial restructuring led to mixed results with some firms succeeding in upgrading into European champions and others failing to do so (Colli et al. 2014). This draws the Italian and Spanish trajectory apart both from that of core member states like France and Germany, and of smaller states like Austria, Belgium, Portugal and the CEEC countries. In fact, on one hand, studying France and Germany would preclude coverage of industrial failures as both countries succeeded producing at least one European champion in the sectors of banking, electricity, and telecommunications.

On the other hand, very few firms from smaller member states had sufficient size to survive in the integrated European market. Consequently, most Austrian, Belgian, Portuguese and CEEC banks and utilities were taken over by foreign competitors failing to become European champions. In other words, Italy and Spain are interesting because they were the underdogs in a game only the largest European economies could play. The UK is not included in the analysis because, even though British banks and utilities had the potential to become big players in the European market, the government decided to follow a *laissez-faire* strategy opening the domestic market to competition and refraining from actively supporting domestic firms. This approach led to the comparative underperformance of British telecommunications and electricity utilities, confining them to a marginal role in the European market (Colli et al. 2014; Clifton et al. 2011). In addition, the lack of engagement of the British state would not allow for a meaningful study of the mutual power relationship between state and business.

1.6.3 Firms

The eight firms covered in this study are the largest Italian and Spanish banks, and telecommunications and electricity utilities. However, the identification of the relevant firms in each sector followed a different logic due to the structural difference between banking on the one hand, and electricity and telecommunications on the other. On the one hand, when EU-led liberalisation was launched the electricity and telecommunications utilities Telefonica, TI, Endesa, and ENEL were already the dominant actor in their domestic market. On the other, in the early 1990s the Italian and Spanish banking sector was very fragmented and three out of the four banks here analysed did not yet exist (and the only one that was already active, Santander, was a small regional bank very different from the banking giant that is nowadays). Hence, in the case of banking this study covers the process of domestic consolidation that led to the emergence of these four banks. Instead, in the case of telecommunications and electricity it studies the privatisation and internationalisation of four state-owned incumbents that already existed.

The choice to focus on Telefonica, TI and ENEL is quite straightforward. When EU-led liberalisation was launched – or shortly afterwards – these state-owned incumbents had a quasi-monopoly in the domestic market with shares ranging between 70 and 90 per cent. The situation of the electricity sector in Spain requires more careful analysis. In fact, at the onset of EU-led market integration the Spanish electricity sector was an oligopoly dominated by two firms of a similar size: Endesa and Iberdrola that combined accounted for 80 per cent of production and distribution (Arocena et al. 1999, p, 389). Hence, also Iberdrola would have made an interesting case study. However, two reasons motivate the choice to focus instead on Endesa. First, in the late 1990s Endesa was the largest Spanish electricity utility, with 50 per cent of the generation and 43 per cent of distribution compared to 38 and 41 for Iberdrola (Arocena et al. 1999, p. 389). Second, Iberdrola has always been a private company, while Endesa originated as a state-owned firm. Hence, the Spanish state had scope to exert a more direct influence over Endesa than over Iberdrola. This makes Endesa a more relevant case than Iberdrola for the study of the interaction between the state and business actors.

1.7 Plan of the dissertation

The rest of the dissertation is organised as follows. Chapter two provides a detailed comparison of the process of EU-led market integration of banking, electricity and telecommunications. Particular attention is devoted to the different timing of market integration in the three sectors. This analysis is important because it provides a description of the change in the background conditions, i.e. EU-led market integration, which altered the state-business power relationship by progressively eroding the sources of state power over domestic banks and utilities. Chapter three describes the identity and preferences of the Italian and Spanish business and state actors involved in the restructuring of the firms here analysed. Chapters four to six are devoted to the sector-based case studies. They show how the outcome of industrial restructuring in the three sectors of analysis was decisively influenced by the availability and strategic use of ownership power, regulatory power and partisan proximity power at decisive moments of the restructuring process.

Chapter 2. The Changing Background: EU-led Liberalisation of Banking, Electricity and Telecommunications

2.1 Introduction

This chapter compares EU-led liberalisation of banking, electricity, and telecommunications giving an overview of the change in the background conditions triggered by the progressive integration of the European market. The sector based case studies will then provide a detailed analysis of the way in which this change in the background conditions altered the ownership, regulatory and partisan proximity power relationship between the state and business actors in Italy and Spain.

The comparison of the process of EU-led liberalisation highlights how, in all three sectors, market integration was not sudden being instead a gradual process that left member states considerable room of manoeuvre in regulating their domestic sector. Apart from detailing the main legal reforms in each sector, this chapter also provides a brief analysis of the position of Italy and Spain during the intergovernmental negotiations that led to the integration of banking, electricity, and telecommunications. It is shown how in no sector the two countries were among those pushing for liberalisation, oscillating instead between open hostility towards market integration and passive acceptance of liberalisation.

Along with the many similarities characterising the process of EU-led liberalisation in the three sectors the present analysis identifies also a crucial difference in timing, as market integration was completed earlier in telecommunications than in banking and electricity. This in turn led cross-border consolidation among EU firms to take place earlier in telecommunications than in electricity (and banking). The sector-based case studies (chapter 5 and 6) will show how this difference in timing will have a decisive impact on the trajectory of the Spanish electricity and telecommunications incumbents Endesa and Telefonica. In fact, although the Spanish government implemented a similar restructuring strategy in the sectors of electricity and telecommunications, this led to opposite outcomes because cross-border consolidation in electricity took place when the Spanish state had already lost its main sources of ownership, regulatory and partisan proximity power.

2.2 EU-led Liberalisation of Retail Banking

Until the early 1990s the European market for retail banking was segmented at the domestic level (Ibanez and Molyneux 2006). Regulatory barriers like interest rates regulations, capital controls, and branching restrictions limited cross-border competition (Romero De Avila 2003). By the late 1980s only the United Kingdom and the Netherlands had liberalised their domestic market, while in all other member states banking remained 'repressed' by heavy-handed state regulation (Dermine 2002). Italy and Spain, as well as France and Portugal, stood out for their particularly protectionist legislation (Perez 1997; Ibanez and Molyneux 2002). In these countries, state regulation allowed domestic banks to pile up large oligopolistic rents (Romero De Avila 2003).

Since the late 1970s a series of technological and regulatory changes broke the status quo opening the scope for the integration of the banking market. Important advances in information technology and risk management techniques, coupled with the deregulation of the British and American financial sectors progressively favoured a shift towards shareholder value (Vives 1999; Jabko 2006). The European Commission exploited the changing international environment to implement a series of measures aimed at integrating the European financial market including the 1977 First Banking Directive (FBD) that established the principle of home banking control (Jabko 2006). According to the home banking control principle the supervision of a credit institution operating in two or more member states ought to be gradually shifted from the host to the home country of the credit institution (Dermine 2002). However, the FBD lacked specific measures on how to implement the home banking control principle. Consequently, the FBD did little to increase cross-border competition and the retail-banking sector remained fragmented (Dermine 2002).

Only in the 1980s did the Commission succeed in passing two key measures that effectively initiated the integration of the retail banking segment: the 1985 White Paper *Completing the Internal Market* and the Single European Act. The White Paper and the SEA set the goal of creating a more integrated and efficient banking market by favouring cross-border competition among EU credit institutions (Romero De Avila 2003). Inspired by the SEA, the Directive 88/361 lifted capital controls establishing that all member states ensure free capital circulation by 1990 (although Spain and other member states with a less developed financial sector were given a two-year extension) (Romero De Avila 2003).

However, the most decisive piece of legislation for the liberalisation of banking was the Second Banking Directive (SBD) adopted in 1989. With the SBD, all credit institutions authorised in a EU country were allowed to establish branches or supply financial services in all other EU countries without further authorisation (Dermine 2006). The SBD was essentially based on two principles: the universal banking model, under which all credit institutions can undertake investment banking activities, and home control of solvency (Dermine 2006). The home control principle, also known as the 'Single Banking Licence' principle, took away from host countries the power to supervise foreign banks, thus making it more difficult for member states to veto the entry of foreign banks in the domestic market (Romero De Avila 2003). Under the SBD the 'host state', i.e. the state in which a foreign bank is located, retains regulatory power over foreign banks only in case their activity poses a threat to the public interest (Dermine 2006). By adopting the universal banking model, the single banking licence, and the control of home country principle the SBD effectively opened the scope for cross-border competition among EU banks (Vives 1999). The SBD called as well for the harmonisation of prudential regulation in terms of capital adequacy standards and large exposure rules (Dermine 2006). The implementation of the EMU gave further impetus to cross-border banking penetration by eliminating the exchange rate risk and the competitive advantage domestic banks enjoyed because of their expertise on the national monetary policy of a country (Ekkayokkaya et al. 2009).

Even though the SBD and the EMU gave an important impetus to the process of banking integration, the removal of some barriers to cross-border competition did not mean that member states had relinquished all means of influence over their domestic banking sector. In this regard, the Maastricht Treaty established that the supervision of the domestic banking sector remained a task of each member state's Central Bank. By allowing Central Banks to have the final say over mergers and acquisitions involving domestic banks, the Maastricht Treaty gave member states an important mean to continue influencing their domestic banking sector (Deeg 2012). In addition, although the SBD established the home-regulator principle as a general rule, the possibility to appeal to the defence of 'public interest' allowed domestic regulators significant leeway in restricting the activity of foreign banks (Grossman and Leblond 2011). Consequently, despite the integration of the European market the relationship between banks, states and industry still followed distinct logics in each member state (Garcia Calvo 2013).

Member states exploited the room of manoeuvre allowed by European regulations to try to prevent the foreign colonisation of their domestic banking sector. This protectionist effort focused in particular on the retail banking segment because retail banks play a key role in the provision of credit to the domestic economy (Darmine 2006). Consequently, member states considered retail banks ‘domestic flagships’ to be sheltered from foreign takeover (Boot 1999). Protectionist measures put in place by member states to avoid the colonisation of their banking sector ranged from the delaying or denying of foreign acquisitions of domestic banks, to the promotion of a process of consolidation among domestic banks. This process of ‘sheltered’ consolidation aimed at favouring the emergence of domestic banks with sufficient size to become European champions (Berger 2007). Member states typically implemented these protectionist tactics in close coordination with their Central Banks.

The frequent recourse to protectionist measures delayed cross-border consolidation in the retail-banking segment. As a result, while by the early 2000s the wholesale market was fully integrated, the retail-banking segment remained fragmented (Dermine 2006). Proof of this is the fact that, although between 1985 and 2003 the number of credit institutions active in the EU fell from 12,256 to 7,444, cross-border transactions accounted for less than 25 per cent of the total value of banking acquisitions (Dermine 2006, p. 66). Hence, because of the protectionist attitude of member states, the integration of the European market did not trigger the expected wave of cross-border consolidation among EU banks. The few cross-border deals that took place before the mid-2000s involved the acquisition of UK merchant banks by continental credit institutions, the foreign expansion of the Netherlands’ ABN Amro in Belgium and Germany, and the consolidation among Scandinavian banks (Dermine 2006).

Central and Eastern European Countries (CEEC) constitute a notable exception to this lack of cross-border transactions, as since the late 1990s they undertook major reforms of their banking sector including privatisations and deregulations (Dermine 2006). These reforms in turn opened the CEEC banking sector to the colonisation from credit institutions of core member states. Consequently, by the mid-2000s foreign banks controlled 50 per cent or more of the banking sector of most CEEC countries – with the share rising to 83, 96 and 67 per cent respectively in Hungary, the Czech Republic and Poland (Dermine 2006, p. 79). This was in stark contrast with the situation encountered in the largest Continental economies – France, Germany, Italy and Spain – where the average share of foreign penetration was less than 10 per cent (Berger 2007, p. 1956). Because of the widespread recourse to protectionist measures, until the mid-2000s there was no major cross-border transaction involving two retail banks from large member states. For this reason, the period between the early 1990s and the mid-2000s was a phase of transition in the process of market integration during which EU-led liberalisation of banking had been launched, but was yet to be completed. Member states exploited this window of opportunity to stimulate a process of consolidation among domestic banks. This way they hoped domestic banks could reach a size that would allow them to play an active role during the future process of cross-border consolidation.

The protectionist attitude of member states was also favoured by the fact that in retail-banking internationalisation mainly occurs through the acquisition of foreign subsidiaries rather than the opening of branches (Dermine 2006). The tendency for banks to internationalise through the acquisition of subsidiaries is because the increase in the number of financial products offered by credit institutions made investment in networks and information technology increasingly important (Vives 1999). Consequently, banking has become a knowledge-based activity in which scale and size have a crucial importance. The prominent role of internationalisation through M&A is confirmed by the fact that while the number of credit institutions active in the EU nearly halved between 1990 and 2004 the number of banking branches remained constant (Ekkayokkaya et al. 2009, p. 452). This makes the pattern of internationalisation in the banking sector increasingly like that of electricity and telecommunications, sectors in which the high operational costs and the need to operate in networks make acquisitions the preferred form of internationalisation. The tendency for banks to internationalise through the acquisition of foreign subsidiaries makes the penetration of foreign markets conditional on the prior approval from the Central Bank of the host country, thus opening further scope for protectionist policies.

Aware of the still incomplete degree of integration of the European financial market, in 1999 the Commission launched the Financial Service Action Plan (FSAP), which was endorsed by the Council the following year (Romero De Avila 2003). The FSAP consists of 42 initiatives aimed at achieving by 2005 the full integration of the market for wholesale financial services and retail banking (Dermine 2006). The implementation of the FSAP brought to completion the process of integration of the EU banking market started with the 1977 FBD. Over the years many barriers to the foreign expansion of EU banks were removed including the exchange rate controls, capital controls, branch restrictions and restrictions to the entry of foreign banks. Although even after the implementation of the FSAP member states continued enjoying some room of manoeuvre in regulating their domestic banking sector, the liberalising effort led to the emergence of a level playing field and ended the 'repression' of banking (Dermine 2006). The achievement of a satisfying level of market integration is confirmed by the fact that since the mid-2000s there was a growth of cross-border integration among European banks. Between 2003 and 2007 the average level of cross-border banking penetration in the EU rose from 15 to 20 per cent (Schoenmaker 2011, p. 2). Focusing on the retail segment in 2003 Britain's Barclays acquired the Spanish Banco Zaragozano, while in 2004 the acquisition of Britain's Abbey National by Banco Santander was the first major cross-border operation involving banks of two large EU member states. The following year Unicredit acquired Germany's HVB confirming the trend towards growing cross-border penetration (Goddard et al. 2007, p. 1919). Hence, Italian and Spanish banks were at the forefront in the process of cross-border integration. The banking case study will show that this successful foreign expansion was the result of an activist industrial policy by the Italian and Spanish states.

The Commission also played a decisive role in favouring cross-border consolidation. In fact, under the European Commission Merger Regulation (ECMR) framework cross-border mergers and acquisitions involving EU firms are conditional on the prior approval from the Commission. Under the ECMR framework the Commission can veto a merger if it is deemed harmful for competition. This happened very rarely in banking as between 1990 and 2007 the Commission gave immediate approval to 186 out of the 187 mergers plans that were notified under the ECMR scheme (Thatcher 2014a, p. 452). This signals the fact that the Commission prioritised the strengthening of pan-European banking champions to the defence of competition (Thatcher 2013; 2014a).

On the issue of banking liberalisation member states were divided in two coalitions: the 'market-making' coalition and the 'market-shaping' coalition (Quaglia 2012). The market making coalition was led by the United Kingdom and included also Ireland and the Scandinavian country. The 'market-shaping' coalition coalesced around France and included Italy, Spain, and the other Mediterranean countries. Although shifting between the two positions, Germany tended to side with the 'market-shaping' front. The 'market-making' coalition favoured market integration and emphasised the objectives of competition and market efficiency, the 'market-shaping' coalition favoured a heavy-handed regulation of the financial sector with a strong steering action from public authorities. Hence, their support to the market-shaping coalition meant that Italy and Spain favoured a more cautious approach towards market integration. This was because of at the launch of EU-led liberalisation both countries had a heavily regulated banking sector in which state's legislation played a pivotal role (Deeg 2012).

2.3 EU-led liberalisation of telecommunications

Like banking, until the 1980s the European telecommunications market remained fragmented at the domestic level. Member states could freely regulate their home market, which was typically dominated by a state-owned monopolist the PTO (public telecommunications operator) (Sandholtz 1998; Thatcher 2007). PTOs had legal monopoly over the operation of the network and the provision of telecommunication services (Thatcher 2007). In most European countries, the PTO was considered a branch of the state, housed within the Ministry of Posts and Telecommunications (Sandholtz 1998). That was the case in Spain where a partially state-owned monopolist, Telefonica, dominated the market. Although different telecommunication providers were active in Italy, they were all closely connected to the government (Bartle 2005). Competition was not a concern for European governments that instead focused on universal coverage and on the national security implications of the telecommunications network. In many member states, including Italy and Spain, the close relationship between the government and the telecommunications monopolist created strong resistance to change from the executive and the management of the PTOs (Thatcher 2007). Consequently, prior to the mid-1980s the EU did not take any relevant liberalising initiative, and the only international institutions were intergovernmental cooperative organisations with limited tasks (Bartle 2005).

Throughout the 1970s and 1980s key technological upgrades altered the status quo changing the face of the telecommunications sector. The most important among them was the marriage of telecommunications with microelectronics that dramatically lowered the costs associated with the provision of telecommunications services (Thatcher 2007). Other key technological upgrades like the use of satellites and fibre-optic cables also contributed to lowering the cost of service provision (Sandhooltz 1998). Some countries reacted to these technological changes by swiftly opening their domestic market to competition. The most prominent among these early liberalisers were the US, with the divestiture of American Telephone and Telegraph, and the UK with the privatisation of Cable and Wireless and British Telecom (Jordana et al. 2006).

Like in banking, the Commission tried to take advantage of the technological and institutional changes to push forward a liberalising agenda aimed at integrating the EU telecommunications market. To this aim, between 1979 and 1984 the Commission issued different statements that called for the creation of a Europe-wide telecommunications market (Sandholtz 1998). However, most member states defended the status quo voicing their opposition to market integration (Thatcher 2007).

In 1987 the Commission scored an important success with the adoption of the first Green Paper on telecommunications. The Green Paper set up the agenda for EU-led liberalisation of telecommunications by fixing two main goals: the abolition of monopolies to allow market access to new entrants, and the establishment of common regulatory standards to favour cross-border competition (Sandholtz 1998). The Green Paper contained several policy recommendations to achieve these goals including: the liberalisation of terminals and advanced services markets; the possibility to extend competition to voice telephony; the establishment of European standards to achieve interoperability, and; the applicability of EC competition rules to prevent abuses of dominant position by incumbents (Sandholtz 1998; Thatcher 2007). In its liberalising effort, the Commission found a strong ally in the European Court of Justice (ECJ) that with the 1985 *British Telecom* ruling established that the provision of telecommunications services was subject to the EC general rules on competitions (Schmidt 1998). Bolstered by the support from the ECJ the Commission used Article 90.3 of the Treaty to speed up the process of market integration winning the resistance of the most protectionist member states. Under Article 90 the Commission can unilaterally adopt Directives without waiting for the approval from the Council (Schmidt 1998). Between 1988 and 1998 the Commission used Article 90 to pass a series of liberalising Directives that advanced the integration of the telecommunications market (Schmidt 1998).

The first Article 90 Directive was issued in 1988 and covered the liberalisation of terminal equipment. Some member states including France and Italy questioned the legal basis for the initiative of the Commission. Despite this legal conflict the Commission issued another Article 90 Directive to liberalise telecoms services. The decision was again challenged by a group of member states this time guided by Spain and including France and Italy. However, the ECJ backed the initiative from the Commission (Schmidt 1998). The liberalising measures passed in this period mainly aimed at opening the market to new entrants by making monopolies illegal (Thatcher 2007). Bolstered by the support from the ECJ in the early 1990s the Commission passed a series of Article 90 Directives that extended the scope of application of liberalising measures to include satellite services, mobile telecommunications, voice telephony and infrastructure (Thatcher 2007). In this initiative, the Commission was also supported by private actors and key member states like the UK and Germany (and later France) (Sandholtz 1998). Such widespread support allowed the Commission to overcome the resistance of more recalcitrant member states like Italy and Spain, achieving the full liberalisation of the telecommunications market by January 1998 (Schmidt 1998). This meant that by January 1998 the PTOs monopoly on networks came to an end and the telecommunications market was opened to cable television operators, utility companies, mobile networks and satellite systems (Sandholtz 1998).

However, the completion of the process of EU-led liberalisation did not mean that member states were left without any room of manoeuvre in regulating their domestic market. For instance, the liberalising measures did not impose the privatisation of state-owned incumbents, and allowed for the establishment of golden shares through which governments could keep influencing managerial decisions even after the privatisation of state-owned utilities. In addition, EU legislation did not mandate the independence of domestic regulatory authorities from their home government (Thatcher 2007). This room of manoeuvre meant that, similar to banking, member states could implement an industrial policy strategy aimed at helping the internationalisation of domestic telecommunications incumbents (Jordana et al. 2006).

Except for the United Kingdom, all large member states actively engaged in such an effort (Colli et al. 2014). Like in banking, this strategy was decisively favoured by the Commission, which had launched the liberalisation precisely in view of reducing the gap in size between European telecommunications firms and their US and Japanese competitors (Bartle 2005). Like in banking, the Commission pursued an activist strategy of industrial policy supporting cross-border consolidation among European firms. Proof of this is that between 1990 and 2009 the Commission approved 184 out of the 198 merger plans involving telecommunications firms notified under the ECMR framework (Thatcher 2014a, p. 452).

The full liberalisation of telecommunications in 1998, and the supportive attitude of the Commission triggered a wave of cross-border M&A among EU telecommunications operators. The pace of cross-border consolidation accelerated between 1999 and 2000 with operations like the acquisition of France's Orange by Germany's Mannesmann (1999), that of France's E-Plus by the Netherlands' KPN (1999), and above all the US$190 billion takeover of Mannesmann by Britain's Vodafone (2000). The Mannesmann–Vodafone deal triggered the acquisition of Orange by France Telecom (Trillas 2002, p. 275). A second wave of smaller proportions took place between 2005 and 2006 with Spain's Telefonica leading the way with the acquisition of Britain's O2 and the Czech operator Cesky Telecom. It should be highlighted that these large cross-border deals occurred well before than in banking and electricity (Cambini and Rondi 2006). This difference in timing will prove decisive in explaining the divergent outcome of the process of industrial restructuring in the Spanish electricity and telecommunications sectors, highlighting the importance of temporal variation in the availability of ownership, regulatory and partisan proximity power resources.

Like banking, in telecommunications Italy and Spain were also among the countries that opposed, or at least tried to slow, market integration (Clifton et al. 2011). While Bartle identifies a more openly protectionist stance by the Spanish government compared to its Italian counterpart, none of the two countries is listed among those pushing for market integration (Bartle 2005). In fact, both countries initially questioned the use of Article 90 by the Commission, they were both criticised for their slow implementation of the Article 90 Directives (in particular Spain), and at different stages they both engaged in open confrontations with the Commission (for a detailed analysis see Bartle 2005, p. 90–1 and 137–140).

2.4 EU-led liberalisation of electricity

Until the early 1990s the electricity sector had many features in common with telecommunications. Both were network industries with very high costs and limited international connections, both were considered natural monopolies, and governments deemed them both 'public services' of strategic importance (Bartle 2005). As in telecommunications, domestic markets were sometimes dominated by state-owned monopolies. That was the case for instance in France and Italy. However, more often than in telecommunications, domestic markets could also be organised as oligopolies with different state-owned and private firms sharing the market. Prominent examples of such a market organisation were Germany and Spain.

The more diverse structure of electricity markets in the EU was also because the electricity industry is itself divided in three different functions: generation (which involves the production of energy), transmission, and distribution (Bartle 2005). Distribution was later separated from the supply of energy to end consumers. While in Italy the state-owned monopolist ENEL oversaw all activities, in Spain energy was produced by a small number of private companies and the state-owned Endesa, transmission was controlled by a state-owned company, and distribution was dominated by the same large companies that controlled production (Bartle 2005). The state-owned Endesa was the largest player both in the production and distribution segment. Between the 1960s and 1990s all attempts at having a supranational coordination in the electricity sector failed, as member states were keen to maintain close control over a strategic sector (Eberlein 2008).

Although some factors delaying market integration like the strategic importance of the electricity sector were also common to telecommunications, some specific features of electricity contributed to making market integration even less likely than in telecommunications. First, technological upgrades had a more marginal impact on electricity than on telecommunications. For instance, while alternatives to copper wires are available in telecommunications this is not the case in electricity (Jordana et al. 2006). In addition, technology offers opportunities for using electricity grids to transmit telecommunications data, but telecommunications networks cannot be used to transmit electricity. Consequently, electricity utilities become potential competitors of telecommunications firms but telecommunications firms cannot enter the electricity market (Jordana et al. 2006). Also, the IT revolution had a marginal impact on the electricity sector (Bartle 2005). Overall, technological changes like those that led to the globalisation of telecommunications were virtually absent in electricity (Eising 2002). Second, the Commission could not rely on the support from the ECJ to speed up the integration of the electricity market (Schmidt 1998). In fact, since the 1990s the ECJ had reversed its pro-competition attitude, stressing instead the public service obligations related to energy supply and criticising the Commission for its strategic use of infringement procedures to favour the integration of the electricity market (Eberlein 2008). Third, at least initially the Commission encountered even more resistance from member states, and from the main electricity incumbents, than in the case of telecommunications (Schmidt 1998).

Even though the Directorate General for energy had been part of the Commission since 1968 the many obstacles to market integration ruled out the possibility to adopt any liberalising measure until the early 1990s, (Jordana et al. 2006). Furthermore, the opposition from most member states made it impossible to revert to Qualified Majority Voting to insulate recalcitrant governments (Padgett 2003). Consequently, the Commission had to seek for unanimous support from the Council.

Like in telecommunications, the implementation of early liberalising measures in the US, the UK and Scandinavia gave decisive impulse to the integration of the European market (Green 2006). In particular, the three main principles that inspired the liberalisation of Britain's electricity market will have a decisive influence on the integrationist agenda of the Commission (Padgett 2003). These principles were:

- Non-discriminatory access to the transmission and distribution networks for all market participants at a tariff set by an independent authority (Bartle 2005).
- Operational independence of the network operator from both generation and electricity supply as a necessary condition for non-discriminatory access. This is the so-called unbundling, i.e. the separation of monopoly and competitive segments of the market (Green 2006).
- Mandatory establishment of an independent regulatory authority to guarantee fair competition.

For those member states whose market was dominated by a state-owned monopolist the UK principles mandated both vertical unbundling (i.e. the separation of transmission and distribution from generation and electricity supply to ensure the non-discriminatory access to the network for all market participants) and horizontal unbundling (i.e. the reduction of the market share of the incumbent in generation and energy supply below a certain threshold to create market space for new entrants in the competitive segment) (Jamasb and Pollitt 2005). The mismatch with the UK principles was particularly acute in countries like France and Italy, where a vertically integrated state-owned monopolist dominated generation, distribution, transmission and supply (Thatcher 2007).

Lacking strong economic and technological arguments in favour of the integration of the electricity market, the Commission tried to legitimise its liberalising agenda drawing on the SEA and the Single Market Project. The liberalising effort of the Commission resulted in a Draft Directive submitted to the Council in 1992 that aimed at abolishing the exclusive rights over distribution and generation (Goyer and Valdivielso del Real 2012). This ambitious proposal, heavily inspired by the UK liberalisation plan, would have led to a complete overhaul of the EU electricity market (Padgett 2003).[1] The proposal drew heavy criticism from all

[1] In more detail, the draft directive aimed at: allowing large users to contract delivers with distributors different from their 'area suppliers', abolishing all exclusive rights for the construction of power lines and power stations, and mandating the 'unbundling' of vertically integrated utilities (Eising 2002).

member states, apart from the UK and Ireland, and later Finland and Sweden. France, Italy and Spain took a particularly critical stance (Eising 2002). The lack of support forced the Commission to present an amended and more limited proposal in 1993 (Schmidt 1998).

During the following four years the proposal of the Commission was object of intense negotiations among member state. The deadlock was finally broken at a Franco-German bilateral summit and in 1996 the First Electricity Directive (FED) was finally adopted (Schmidt 1998). The FED obliged member states to allow competition in generation, it mandated that at least 25–33 per cent of the distribution for large users be liberalised by 2003, it provided a certain level of third-party access to the monopoly grid for all suppliers, it imposed vertically integrated utilities to allow access to the grid to other competitors and it ended the monopoly rights for the construction of power lines and power stations (Eising and Jabko 2001; Thatcher 2007). The FED constituted a first decisive step in the process of market integration.

However, the need to mediate between the divergent interests of member states meant that the FED deviated from the UK model in many important respects. First, the regulated Third-party access came together with the less liberal 'Single Buyer' model sponsored by France. Second, the provisions mandating unbundling had been decisively weakened. Third, the Directive failed to set a deadline for full market opening. Fourth and crucially, national authorities had still ample room of manoeuvre in discouraging market entry through the imposition of onerous public service obligations (Padgett 2003). Hence, the 1996 Directive fell short of achieving the integration of the EU electricity market (Padgett 2003; Thatcher 2007).

The Second Electricity Directive (SED) adopted in 2003 was a more decisive step in the direction of market opening. The SED mandated the full liberalisation of the electricity market for all users by 2007, removed the Single Buyer option imposing regulated third-party access to the grid, stressed the need to have regulatory authorities independent from suppliers at the domestic level, and put in place stricter rules concerning the legal unbundling of transmission system operators from vertically integrated utilities (Thatcher 2007; Bartle 2005).

By raising the standards for competition and leading to regulatory convergence among member states the SED brought market integration in electricity to a level close to that of telecommunications (Jordana et al. 2006). Owing to the SED, by the mid-2000s all EU member states had converged to an institutional framework characterised by partially or fully private electricity incumbents, markets open to competition and independent sectoral regulatory authorities (Thatcher 2007). However, like banking and telecommunications EU-led market integration left member states a certain degree of autonomy in the regulation of their domestic market. For instance, the SED does not regulate issues concerning the ownership structure of electricity utilities, allowing member states to maintain direct state ownership of domestic incumbents (Valdivielso del Real and Goyer 2012). In addition, the Directive mandates that Regulatory Authorities be independent from domestic electricity suppliers, but not necessarily from the government, thus leaving scope for state interference in their activity (Valdivielso del Real and Goyer 2012). Moreover, not all member states implemented the Directive in an efficient and comprehensive manner (Domanico 2012).

Consequently, also in electricity member states could exploit the room of manoeuvre allowed by the EU Directives to implement an industrial policy strategy aimed at helping the internationalisation of domestic incumbents (Jordana et al. 2006). Despite the similar outcome of the process of liberalisation in telecommunications and electricity, an important difference concerning the *timing* of liberalisation in the two sectors deserves to be highlighted. In fact, the full integration of the electricity market was achieved only in 2007, a decade later than in telecommunications (1998). Consequently, cross-border consolidation in electricity took place nearly a decade later than in telecommunications (Bartle 2005).

In fact, until the mid-2000s electricity markets remained segmented at the national level with very few cross-border mergers involving EU electricity utilities (Green 2006).[2] Although the years 2000–2 saw an increase in the number of M&A among EU electricity firms, consolidation mainly occurred at the domestic level (Codognet et al. 2003). Domestic consolidation took place in those member states, in particularly Germany, characterised by the presence of a multitude of regional electricity providers (Thomas 2003). Like in banking, this wave of domestic consolidation aimed at creating ‘national champions’ with sufficient size to compete in the European market. The only difference with banking is that in electricity this process took place only in some member states, while in others (like Italy) a vertically integrated monopolist with sufficient size to become a European champion already existed. In these latter cases monopolists were sometimes forced by their home government to shed part of their productive capacity (Leveque and Monturus 2008). Because of the enduring segmentation of the electricity market, the only large cross-border merger that took place before 2005 was the

[2] The only exception was Electricité de France (EDF), which since the late 1990s had engaged in a campaign of foreign acquisitions in the UK, Scandinavia, Germany, and Italy.

2003 acquisition of the Belgian incumbent Electrabel by France's Suez (Leveque and Monturus 2008).

It was only with the adoption of the SED in 2003 that cross-border consolidation took off, accelerating as the 2007 deadline for the complete opening of the electricity market drew closer. In 2005 France's EDF in association with a group of Italian investors took over the second largest Italian producer Edison. However, it was in 2007 that the largest cross-border deals took place: the defensive merger between the French groups Gaz de France and Suez (aimed at preventing a takeover of Suez by ENEL), the takeover of the Spanish electricity incumbent Endesa by ENEL (in association with the Spanish construction group Acciona), and the takeover of the UK's Scottish Power by the second largest Spanish electricity producer Iberdrola. These three deals, worth on aggregate more than €80 billion, changed the face of the EU electricity sector (Leveque and Monturus 2008, p. 325).

Like in banking and telecommunications, cross-border integration was openly supported by the Commission (Bartle 2005). Proof of this pro-integrationist attitude by the Commission is the fact that between 1990 and 2009 the Commission authorised 187 out of 196 merger plans involving energy utilities that had been notified under the ECMR framework (Thatcher 2014a, p. 453). The wave of cross-border mergers that took place in 2007 reminds that occurring between 1999 and 2000 in telecommunications. However, the different timing of cross-border consolidation in the two sectors will have a decisive impact on the trajectory of Endesa and Telefonica.

Like in banking and telecommunications, Italy and Spain were not among the main supporters of EU-led liberalisation of electricity. According to Bartle (2005), Italy had a more openly protectionist attitude, while Spain kept a lower profile. Studies focusing solely on the Italian case, instead, contend that in 1996 the Italian government made efforts to speed up the implementation of the First Electricity Directive (Luciani and Mazzanti 2006). For their part Jordana et al. (2006) see a more protectionist attitude of the Spanish government in the electricity sector than in telecommunications, justifying it with the great proximity between the government and domestic electricity producers. Anyway, there is consensus on the fact that none of the two countries was among the liberalisation enthusiasts pushing for more market integration (Bartle 2005).

2.5 Cross-sector and cross-country comparisons

The comparison of the process of EU-led market integration in the sectors of banking, electricity, and telecommunications identifies many similarities as well as an important difference. Four common features of the liberalisation process in the three sectors deserve to be highlighted. First, liberalisation led to a similar outcome with the removal of most barriers to cross-border competition among EU firms. However, the integration of the European market did not mean that member states lost all means of influence over domestic firms. In fact, liberalising measures did not contain prescriptions on the ownership structure of banks and utilities, thus allowing member states to maintain an important ownership power resource to influence domestic firms. In addition, member states continued enjoying some room of manoeuvre in the regulation of the domestic market.

In banking, the Maastricht Treaty confirmed the decentralisation of banking supervision. Consequently, the Central Bank of each member state was allowed to veto or delay the foreign acquisition of a domestic bank. In telecommunications and electricity, the EU did not impose the independence of domestic regulators from the government, thus leaving ample scope for political interference. The scope for member states' influence was further increased by the slow pace of the liberalisation process. Second, and related, most member states exploited the room of manoeuvre allowed by the EU legislation to implement industrial policy strategies aimed at helping the internationalisation of domestic banks and utilities. These industrial policy strategies centred on the protection of domestic firms from foreign takeovers, the supervision of a process of industrial restructuring aimed at improving the performance of domestic incumbents, and, when needed, the promotion of a process of 'sheltered' consolidation among domestic firms to favour the emergence of banks and utilities with sufficient size to become European champions. Third, the structure of banking, electricity, and telecommunications makes the acquisition of foreign firms the preferred form of internationalisation. Fourth, in all sectors the Commission actively favoured cross-border consolidation by constantly authorising cross-border mergers and acquisitions among European banks and utilities.

These important similarities make the comparison of banking, electricity, and telecommunications particularly salient. In fact, in all sectors liberalisation led to a gradual opening of the market that in turn triggered a process of industrial restructuring aimed at favouring the emergence of European champions. This process took place in the decisive interval between the launch of the process of market integration, and its completion. Only by successfully exploiting this window of opportunity to engineer a successful process of industrial restructuring could member states turn domestic firms into European champions. The sector-based case studies will show how the outcome of this process of industrial restructuring was conditional on the direct involvement of domestic business actors. State's capacity to convince business actors to participate in the restructuring process was in turn conditional on the availability of ownership, regulatory and partisan proximity power resources. When these resources were available the state managed to get private actors involved leading to the emergence of successful European champions, when these resources were not available the state lost control of the restructuring process leading to industrial failures.

Sector	Beginning of Market Integration	Completion of Market Integration	First Cross-Border Deal	Peak of Cross-Border Mergers
Banking	1977 First Banking Directive	1999–2005 Financial Service Action Plan	2004 Santander–Abbey National	2004–5
Telecommunications	1988 First Green Paper	1998 Implementation Last Green Paper	1999 Orange–Mannesmann	1999–2000
Electricity	1996 First Electricity Directive	2007 Implementation Second Electricity Directive	2005 EdF–Edison	2007

Table 2.1 Timing of the Process Market Integration in Banking, Telecommunications and Electricity.

Despite the many similarities characterising the three sectors, a key difference concerning the timing of market integration should be highlighted. In fact, while the full integration of the telecommunications market was achieved already in 1998, in banking and electricity this happened only in the mid-2000s. Consequently, the process of cross-border consolidation among EU firms started earlier in telecommunications than in electricity and banking. The first major cross-border operation involving European telecommunications utilities, the takeover of Orange by Mannesmann, took place already in 1999, and was followed between 1999 and 2000 by a wave of large cross-border deals. Instead, in banking and electricity the first cross-border deal of a relevant size occurred respectively in 2004 with Santander taking over Abbey National, and 2005 with the acquisition of Edison by EDF. The different timing of the process of cross-border consolidation is particularly important when comparing electricity with telecommunications, as it will explain the opposite outcome of the industrial policy strategy implemented by the Spanish government in the two sectors. In fact, by the time cross-border integration in electricity finally occurred, the Spanish government had lost the ownership, regulatory and partisan proximity power resources that had previously allowed the successful completion of industrial restructuring in telecommunications.

Chapter 3. State and Business Actors in Italy and Spain

3.1 Introduction

This chapter describes the identity and preferences of the state and business actors involved in the restructuring of the banks and utilities. The identification of the specific business and state actors that participated to the process of industrial restructuring provides an answer to the black box criticism levelled against traditional studies of state–business power relations (Lindblom 1977).

Unlike Katzenstein (1978) and Evans et al. (1985), this work follows the literature on the EU-led liberalisation banking, electricity and telecommunications in equating state preferences with those of elected governments (Clifton et al. 2011; Colli et al. 2014; Chari 2015). The state actors relevant to this study are the parties and coalitions that ruled Italy and Spain during the process of industrial restructuring that led to the emergence of the successful banks and utilities. In both countries, this period essentially spanned the early 1990s and the mid-2000s, except for the banking sector in Spain in which industrial restructuring started already in the late 1980s. During this time span Italy and Spain were both ruled by two types of partisan governments – in Spain the leftist PSOE and the right-wing PP, in Italy the Centre-Left and the Centre-Right. The chapter shows how all these partisan governments deemed the restructuring of domestic banks, and electricity and telecommunications utilities a key political priority. Consequently, members of the core executive including the Prime Minister and the Minister of Finance were directly involved in the implementation of the process of industrial restructuring having the final word on issues like privatisations, mergers and acquisitions of domestic firms and the establishment of golden share powers. Instead, domestic regulators and other administrative bodies were generally confined to a marginal role, except for the Bank of Italy and Bank of Spain during the restructuring of the banking sector.

When restructuring domestic national champions, the Spanish PSOE and PP and the Italian Centre-Left and Centre-Right wished to achieve the same objectives: promoting the emergence of internationally competitive banks and utilities, and favouring the rise of politically close managers and blockholders at the head of them. To do so all four partisan governments implemented a similar industrial policy strategy centring on: an activist role of the state during the privatisation process, the promotion of a process of sheltered consolidation among domestic firms, the support to politically close managers and shareholders, the establishment at home of a regulatory environment favourable to domestic incumbents, and the use of the diplomatic channel to help the internationalisation of banks and utilities. If Italian and Spanish governments of both colours implemented a similarly activist industrial policy trying to achieve similar objectives, it derives that the cross-sectoral and cross-country variation in the outcome of the process of industrial restructuring cannot be explained by looking at the different partisan orientation of the government (Boix 1998; Cioffi and Hoepner 2006). Instead, this work argues, the outcome of the process of industrial restructuring is conditional on the availability or lack of ownership, regulatory and partisan proximity power resources used by the state to influence the behaviour of business actors.

Moving to the analysis of the private sphere, the business actors relevant to this study are only those domestic investors that had sufficient financial resources to buy large stakes in the privatised telecommunications and electricity utilities. In Spain, these actors were the main private banks. In Italy, they were a restricted number of family blockholders active in the manufacturing sector. The chapter provides a careful analysis of the preferences of these business actors and of their regulatory power relationship vis-à-vis the state. It highlights how, while in Spain the state had strong regulatory power over domestic banks, in Italy the state lacked regulatory power over manufacturing blockholders. This difference in the regulatory power relationship between the state and domestic investors will have a decisive influence on the restructuring of the Italian and Spanish telecommunications incumbents Telefonica and TI (chapter 5).

The rest of the chapter is organised as follows. The second section deals with Spanish state actors showing the continuity between industrial policy strategy of the PSOE and the PP. The third section describes the preferences and regulatory power relationship vis-à-vis the state of Spanish private banks. In this section banks are analysed not as potential European champions but in their role as blockholders in the privatised utilities. The fourth section shows how, despite the overall discontinuity in their economic policies, the Italian Centre-Right and Centre-Left implemented a similar industrial policy strategy when dealing with the restructuring of domestic banks and utilities. The fifth section covers the preferences and regulatory power relationship vis-à-vis the state of Italian manufacturing blockholders, the only domestic investors with sufficient resources to buy large stakes in the privatised utilities. The sixth section concludes with a brief cross-country comparison.

3.2 Spanish state actors: The PSOE and the PP

3.2.1 The PSOE under Felipe Gonzalez (1982–96)

When the Spanish Socialist Party (PSOE) won the 1982 elections by a landslide the Spanish economy was in a dire state. The manufacturing sector had never recovered from the 1979 oil shock, while the first democratically elected Prime Minister Adolfo Suarez had done little to modernise the Spanish economy, having instead focused on strengthening the nascent Spanish democracy (Tayfur 2003). To address the industrial crisis triggered by the oil shock without causing social disruption the Suarez government took over most of the ailing manufacturing firms. Consequently, when taking office, the PSOE inherited a large and inefficient state-owned sector (Valdivielso del Real 2001).

Key to explaining the electoral success of the PSOE was the choice of its leader Felipe Gonzalez to break with the Marxist tradition of the Party. Under Gonzalez's leadership the PSOE reinvented itself as a centrist, pro-European catch-all party (Kennedy 2013). This strategy paid high electoral dividends as the PSOE won four consecutive elections remaining in power for fourteen consecutive years (1982–96). In 1982 Gonzalez won his first election on the promise to modernise the Spanish economy and society. Membership in the European Community, achieved in 1986, was the overreaching goal of this modernising agenda (Tayfur 2003). To turn around the Spanish economy in an environment of growing capital mobility the PSOE opted to embrace the free-market implementing supply-side economic reforms, market liberalisation, orthodox monetary policy and tight fiscal policy (Etchemendy 2004).

This neo-liberal turn was inspired by the *renovadores*, the pro-market wing of the PSOE. Often sharing a technocratic background, the *renovadores* were the main architects of the PSOE economic agenda. Proof of this is the fact that between 1982 and 1996 the key post of Minister of Finance was always occupied by a member of the *renovadores* wing: Miguel Boyer (1982–5), Carlos Solchaga (1986–93) and Pedro Solbes (1993–6). These pro-market technocrats had close ties both with the Bank of Spain and with the main domestic banks (Chari 1998). The Bank of Spain in particular became a close ally of the PSOE in its plan for economic modernisation, playing a decisive role in the reform of the Spanish banking sector (Garcia Calvo 2016).

Despite its orthodox economic policy, however, the PSOE did not wholeheartedly embrace free market principles, as supply-side economic reforms came along with a series of interventionist measures aimed at restructuring strategic sectors (Etchemendy 2004). These measures mainly aimed at turning a handful of domestic banks and utilities into a new generation of internationally competitive Spanish MNEs (Valdivielso del Real 2001; Tayfur 2003; Arocena 2004). To achieve this goal the PSOE did not shy away from implementing a set of illiberal and protectionist measures. These included: promotion of a process of sheltered consolidation among domestic firms; the 'managed' privatisation of state-owned firms; establishment of a protective regulatory environment for domestic banks and utilities to the detriment of competition, and; active engagement of the executive to help the internationalisation of national champions (Etchemendy 2004).

The PSOE superseded to a process of sheltered consolidation among domestic firms both in banking and electricity, while in telecommunications consolidation was not needed as Telefonica already occupied a dominant position in the Spanish market. In electricity, the PSOE succeeded in bringing the process of domestic consolidation to completion. As a result, by 1996 the three largest electricity utilities controlled 95 per cent of the market (Kutlay 2010, p. 78–79). In banking since the late 1980s the PSOE and the Bank of Spain encouraged a wave of mergers and acquisitions among the seven largest domestic banks, while at the same time restricting foreign investment in the Spanish market (Perez 1997). To increase banking concentration, the PSOE also merged all the state-owned banks into Argentaria (Arocena 2004). Apart from favouring the emergence of Spanish banks with sufficient size to compete in the European market, the PSOE took advantage of the process of banking consolidation to favour the strengthening of politically close banking managers (Gomez Escorial 2004).

The second pillar of the industrial policy of the PSOE was the partial privatisation of state-owned banking, electricity and telecommunications firms. This wave of privatisations was mainly motivated by budgetary needs, as in the early 1990s Spain was under pressure to reduce its public debt and deficit to meet the Maastricht criteria and qualify for the EMU membership (Arocena 2004). To meet this ambitious goal the PSOE had little choice but to privatise the highly profitable state-owned banks and utilities. However, while doing so the PSOE did not want to lose control of strategic national champions. For this reason, when privatising Endesa, Telefonica, and the state-owned bank Argentaria the PSOE established a series of power resources that allowed maintaining the firms under state control (Valdivielso del Real 2001).

The first of these power resources was the direct ownership of a controlling stake in the banks and utilities. In fact, the PSOE chose to *partially* privatise Endesa, Telefonica, and Argentaria listing them on the stock exchange, reducing state-ownership but at the same time keeping a controlling stake in the firms (Comin 2008). Hence, the PSOE did not give up the main source of ownership power over domestic firms. In addition, in 1995 the PSOE set up a second ownership power resource over strategic firms by establishing golden share powers over Argentaria, Endesa and Telefonica (Arocena 2004). The golden shares allowed the Spanish government to veto eventual takeovers or mergers of companies of 'public interest' (Etchemendy 2004). Third, the PSOE sold large stakes of the privatised utilities Endesa and Telefonica to hard cores of domestic investors. The hard cores set up by the PSOE centred on the four largest domestic banks: Santander, BBV, BCH and the state-owned Argentaria. Each bank owned stakes between two and five per cent in the privatised utilities. The hard cores allowed the PSOE to give ownership stability to the privatised firms and protect their 'Spanishness' (Toral 2008). Furthermore, since the PSOE had regulatory power over domestic banks, as they depended upon the protection of their home government in their main sector of activity (see following section), the banks agreed to invest as passive shareholders leaving the main managerial decisions to the state (Etchemendy 2004).

Consequently, even after privatisation the PSOE could still appoint politically close managers at the head of the main domestic banks and utilities (Salmon 2000). The government combined the cession of large stakes to the banks with a series of Public Offerings aimed at diffusing share ownership among the Spanish population (Etchemendy 2004). To increase their international visibility and favour their foreign expansion Telefonica and Endesa were also listed on the New York stock exchange (Bel and Costas 2001). From this analysis it clearly emerges how the PSOE designed a partial privatisation strategy that allowed maintaining two sources of ownership power over domestic banks and utilities: the direct ownership of a controlling stake and golden share powers. In addition, the PSOE kept privatised utilities under even closer scrutiny by leveraging its regulatory power over the banks part of the hard cores.

The international listing of Telefonica and Endesa is closely linked with the third pillar of the 'national champions' policy of the PSOE: the use of the diplomatic channel to help the foreign expansion of banks and utilities. Between the late 1980s and the early 1990s this effort focused mainly on Latin America and to a minor extent Portugal (Salmon 2000). The PSOE engaged in bilateral talks with Latin American leaders, and signed bilateral agreements for the protection of the Spanish investment in the region (Toral 2008). Like with the consolidation among domestic firms, the PSOE saw the penetration of foreign markets as a way to increase the size of domestic banks and utilities, thus reducing the scope for takeovers from larger European competitors.

The fourth and last pillar of the industrial policy of the PSOE was the establishment of a protective regulatory environment for banks and utilities in the domestic market. For instance, the Spanish government delayed the opening to competition of the electricity and telecommunications market, resisting calls for an earlier liberalisation coming from the European Commission (Toral 2008). Later, when the domestic market was finally liberalised, the PSOE awarded generous monetary compensations to the domestic electricity and telecommunications incumbents to reimburse the costs of transition to competition (Toral 2011a). Endesa and Telefonica then used these cash handouts to finance their Latin American expansion (Toral 2008). In a similar vein, in 1985 the PSOE agreed with Brussels the possibility to limit foreign investment in the banking sector until 1992 (Perez 1997).

3.2.2 The Years of the Partido Popular (1996–2004)

Although during its time in office the PSOE had scored important successes like the achievement of the EC membership, by the early 1990s widespread corruption among party officials and a grave economic recession had irremediably tarnished the reputation of the Socialists. In 1996 the weakening of the PSOE paved the way for the electoral victory of the right-wing Partido Popular (PP) led by José Maria Aznar. Like Gonzalez a decade earlier, Aznar won the elections by turning the PP into a centrist, catch-all and pro-European party. In doing so Aznar broke with the Francoist nostalgia that had characterised the PP throughout the 1980s (Tayfur 2003). Loyal to its pro-European identity, the PP made clear that the main goal of the executive was to secure Spain's accession in the EMU as a founding member (Murphy 1998). This required pursuing in the line of fiscal moderation of the previous PSOE executive. In fact, although promising an economic revolution when in office the PP followed the exact same economic agenda of the PSOE championing tight fiscal and monetary policy, labour market deregulation at the margins, targeted liberalisations and privatisations (Murphy 1998; Royo 2009a). Continuity between the economic policy of the PSOE and the PP was also assured by the fact that the Ministry of Finance was again led by a technocratic figure, Rodrigo Rato (Royo 2009b). Like his predecessors, Rato defined the government's economic policy acting in close coordination with the Bank of Spain (Garcia Calvo 2013).

Thanks to the Spanish electoral system the PP could form strong executives, in particular after winning the absolute majority of the seats in the 2000 elections. This meant that the PP could plan a long-term economic policy strategy. And like with the PSOE, the creation of Spanish 'European champions' in banking, electricity, and telecommunications was one of the main pillars of that strategy (Toral 2008). Similar to with the PSOE, the 'national champions' policy of the PP centred on the direct intervention of the state in the privatisation process, the superseding of a process of consolidation among domestic firms, the establishment of a protective regulatory environment at home and the use of the diplomatic channel to favour the foreign expansion of domestic banks and utilities (Salmon 2000; Tayfur 2003).

The first pillar of the 'national champions' strategy of the PP was the privatisation of state-owned banks and utilities. This was one of the few areas of discontinuity between the PP and the previous PSOE cabinets. In fact, while the PSOE pursued privatisation quite reluctantly, and kept a controlling stake in the main banks and utilities, the PP was ideologically committed to total privatisation (Arocena 2004). For this reason, in June 1996 the PP presented a plan forecasting the full privatisation of all state-owned firms, including the main banks and utilities, by 2001 (Ubillos 2005). The announce was followed by a massive wave of sell-offs that saw direct state ownership among Spanish listed firms brought down to a negligible level by the early 2000s (Ubillos 2005). By selling off the controlling stake the state held in Telefonica, Endesa and Argentaria the PP gave up on a crucial ownership power resource over these firms.

However, its ideological commitment to privatisation did not mean that the PP was willing to renounce to all sources of influence over strategic firms, as partisan theories would expect (Boix 1998). Proof of this is the fact that the PP confirmed and extended the golden share powers established by the PSOE, thus maintaining an ownership power resource over Argentaria, Telefonica and Endesa (Murphy 1998). In addition, the PP carried out the privatisation of the state-owned utilities Endesa and Telefonica combining POs to small investors with private auctions in which large stakes were offered to the main domestic banks (Etchemendy 2004). By selling large stakes of the privatised utilities to the main domestic banks the PP strengthened the hard cores previously set up by the PSOE. The two largest domestic banks Santander and BBVA played a prominent role in these hard cores, often joined by savings banks like La Caixa and Caja Madrid (Clifton et al. 2007).

The strengthening of the hard cores placed a very restricted and cohesive elite formed by the state, the banks and the utilities at the very core of Spanish capitalism (Jimenez 2001; Etchemendy 2004). Since domestic banks depended upon regulatory protection of the state in their main sector of activity, they allowed the PP to act as de facto blockholder even after the full privatisation of Telefonica and Endesa (Salmon 2000). For instance, in 2000 leveraging the support of the main banking blockholders the Aznar government could dictate the replacement of Telefonica’s Chairman Juan Villalonga with Cesar Alierta (Bel and Trillas 2005). This is an instance in which regulatory power over the private blockholders of Telefonica gave the PP indirect ownership power over the firm.

From this analysis, it clearly emerges how in their privatisation strategy both the PSOE and the PP combined a strong commitment to the strengthening of the banks and utilities, with the establishment of regulatory and ownership power resources that allowed the state to have an influence over strategic firms even after privatisation (Arocena 2004). Always in view of strengthening the selected ‘national champions’, and not in line with the behaviour partisan theorists would expect from a neo-liberal conservative coalition (Boix 1998), the PP did not accompany the process of privatisation with the liberalisation of the domestic market, turning instead state-owned monopolies into private monopolies (Arocena 2004). The potential for market liberalisation was further reduced by the fact that the Tribunal for the Defence of competition as well as the other domestic regulators could only issue non-binding recommendations (Galloway 2007).

The PP also favoured the completion of the process of domestic consolidation in the banking sector. In 1999 the Aznar government superseded to the two last mergers involving large domestic banks, that between Banco Santander and Banco Central Hispano and that between BBV and the state-owned Argentaria. The mergers, actively supported by the Bank of Spain, gave Spain two banks with sufficient size to compete in the European market (Garcia Calvo 2013). Like the previous government, the PP combined the goal of creating large banking groups with that of favouring the rise of politically close managers (Cabrera and Del Rey 2007). To this end the government appointed Francisco Gonzalez, a manager very close to Aznar, at the head of the state-owned Argentaria before privatising the bank, forced a merger between BBV and Argentaria, and helped Gonzalez’s rise at the head of BBVA (see details in chapter 4) (Garcia Calvo 2013).

Like the PSOE, the PP actively supported the foreign expansion of domestic banks and utilities. To this end, Prime Minister Aznar directly engaged in bilateral talks with its foreign counterparts (Kutlay 2012). For instance, between 1999 and 2000 the PP backed the operation Veronica, a series of share purchases with which Telefonica acquired the absolute majority of shares in most of its Latin America subsidiaries.

3.2.3 The return to power of the PSOE (2004–11)

José Luis Zapatero guided the PSOE to an unexpected electoral victory in the 2004 elections. However, as with the previous PP administration, the change in power did not bring about a change in economic policy (Royo 2009b). In fact, similar to the Aznar and Gonzalez executives, Zapatero followed an economic policy centring on fiscal moderation and liberalisations (Royo 2009a). Continuity in economic policy-making was ensured as well by the fact that Zapatero appointed as Minister of Finance Pedro Solbes, who had already served in that position in the previous Gonzalez cabinet. Hence, economic policy continued to be the responsibility of a technocratic figure closely linked with the Bank of Spain (Royo 2009a).

Like his predecessors, Zapatero also implemented an interventionist industrial policy aimed at favouring the strengthening of strategic national champions (Kutlay 2010). In particular, the Zapatero executive played an active role in helping internationalise Spanish banks and utilities. It was during the Zapatero era that, after having successfully penetrated the Latin American market, Spanish banks and utilities started expanding in core EU member states. For instance, between 2004 and 2005 Santander and Telefonica took over Britain's Abbey National and O2.

However, the progressive erosion of the ownership, regulatory and partisan proximity power resources established by the previous administrations to maintain state's control over privatised firms limited the effectiveness of the industrial policy of the PSOE. For instance, amid strong pressure from the European Commission in 2005 the PSOE agreed to give up the golden share powers over privatised utilities (Cabeza Garcia and Gomez Anson 2007). In chapter 6 it will be shown how the loss of key ownership, partisan proximity, and regulatory power resources decisively weakened the position of the PSOE government during the takeover battle involving the electricity incumbent Endesa.

3.3 Spanish business actors: Large domestic banks

The most prominent feature of Spanish capitalism has always been the overwhelming power of a restricted cartel of privately owned commercial banks, the Big Seven (Perez 1997). Already among the economic powerhouses prior to the Civil War (1936–9), the Big Seven further increased their wealth and power during the Franco dictatorship (1939–75). The dictatorship sheltered the Big Seven from foreign competition allowing them to operate as a state-sanctioned cartel (Perez 1997). In exchange, the Big Seven generously financed the autarkic economic policy of the Franco dictatorship (Aguilera 1998). Hence, while banks did not have a dominant position vis-à-vis the Franco dictatorship, it was rather a balanced power relationship characterised by mutual exchanges in which banks had often to meet the demands of the regime (Perez 1997; Binda 2013).

From the 1950s banks started investing the oligopolistic rents acquired thanks to the close relationship with the Franco dictatorship to buy controlling stakes in the main domestic manufacturing groups. As a result, by the 1970s the main domestic banks controlled between 40 and 50 per cent of the manufacturing sector (Tayfur 2003, p. 150). However, banks saw their industrial holdings as financial investments that could be sold at good profit. Consequently, unlike German banks, Spanish banks did not ensure a stable ownership to the main manufacturing groups (Deeg and Perez 2000). Manufacturing groups were further weakened by the very high interest rates applied by the Big Seven, being thus confined to a marginal position in Spanish capitalism (Perez 1997; Etchemendy 2004). The only exception to the weakness of the industrial sector was represented by the main electricity and telecommunications utilities that had close ties both with the banks and with the Franco regime (Aguilera 1998).

The three main features of Spanish capitalism during the Franco era – the close relationship between the state and the main domestic banks, the privileged position of domestic utilities and the weakness of manufacturing groups – were not called into question with the democratic transition and the advent to power of the PSOE in 1982 (Lancaster 1989). On the contrary, the PSOE immediately established very close ties with the Big Seven, making them the cornerstone of its ‘national champions’ policy (Chari 1998; Etchemendy 2004). On one hand, banks were considered among the few Spanish firms with the potential to become ‘European champions’, being thus sheltered from foreign takeovers (Etchemendy 2004). On the other, both the PSOE and the PP chose large domestic banks as the reference shareholders when privatising state-owned utilities (Perez 1997).

This work carefully analyses both these roles. In the banking chapter banks will be studied as potential ‘national champions’. In the electricity and telecommunications case studies Spanish banks will be studied in their role as blockholders of the privatised utilities.

While the analysis of banks as national champions deals only with the trajectory of the Big Seven and their successors BBVA and Santander (chapter 4), when dealing with the role of banks as blockholders in the privatised utilities this work covers all banks that held a relevant stake in Endesa and Telefonica (chapters 5–6). These include BBVA and Santander but also large savings banks like La Caixa and Caja Madrid.

The rest of this section focuses in particular on the role of banks as blockholders in the privatised utilities. Two main reasons motivated the choice of the PSOE to offer large stakes of strategic firms like Endesa and Telefonica to the main domestic banks. First, given the weakness of the Spanish manufacturing groups (Binda 2013), banks were the only domestic investors with sufficient resources to buy large stakes in the privatised utilities (Valdivielso del Real 2001). Second, large banks accepted the role of passive blockholders, acquiring a large stake in the privatised utilities but allowing the state to act as the de facto blockholder (Etchemendy 2004). Large domestic banks accepted this seemingly disadvantageous deal because the Spanish state had regulatory power over them.

This regulatory power stemmed from two factors. First between 1993 and 1996, when the main utilities were privatised the process of EU-led market integration of banking was still at an early stage. Consequently, the Spanish government and the Bank of Spain retained ample powers in regulating the Spanish banking sector. Second, in the 1990s banks like BBVA and Santander still made most of their revenue in the domestic market being thus interested in maintaining a good relationship with the domestic regulator (Garcia Calvo 2013). Consequently, Spanish banks were keen to invest in the privatised utilities as passive blockholders if this meant they could get regulatory protection from the government in their main sector of activity in exchange (Etchemendy 2004). The fact that by leveraging its regulatory power vis-à-vis domestic banks the Spanish state could constrain their behaviour militates against the idea of the state being captured by large domestic banks (Lancaster 1989; Cabrera and Del Rey 2007). The changing regulatory power relationship between the Spanish government and domestic banks will have a decisive influence on the outcome of the industrial restructuring of Endesa and Telefonica.

3.4 Italian state actors: The Centre-Left and Centre-Right

3.4.1 The Centre-Left (1992–2001 and 2006–8)

Between 1992 and 2001, and again between 2006 and 2008, Italy was ruled by governments supported by the centre-left coalition.[3] The Centre-Left came into office after the dissolution of the Christian Democrats (DC), the party that had ruled Italy without interruption between 1947 and 1992. Although it had decisively helped the economic miracle of the 1950s and 1960s, later the DC became increasingly enmeshed in a wave of clientelistic networks (Barta 2011). Their unveiling by Milan public prosecutors in the early 1990s and the consequent electoral meltdown of the DC left a political void filled by a group of reform-minded technocrats from the Bank of Italy and the Treasury. Between 1992 and 1996 the technocrats guided a series of non-partisan governments that received the Parliamentary support of the Centre-Left (McCann 2000a).

The political proximity between the technocrats and the Centre-Left was motivated by the fact that they both shared the desire to qualify Italy for the EMU as a founding member. To achieve such an ambitious goal, between 1992 and 1996 the technocrats launched a far-reaching plan of reforms centring on fiscal consolidation, privatisations, labour market liberalisation and welfare state reforms (Barta 2011). The Centre-Left won the 1996 elections on the promise to complete the technocrat's economic agenda qualifying Italy for the EMU as a founding member (Barta 2011; Deeg 2005). Proof of the continuity between the Centre-Left and the technocrats is the fact that the three technocratic Prime Ministers who governed Italy between 1992 and 1996 (Giuliano Amato, Lamberto Dini and Carlo Azeglio Ciampi) occupied key Ministries in the centre-left executive that took office after the 1996 elections. Romano Prodi, Prime Minister of the Centre-Left between 1996 and 1998, had himself a technocratic background being an economist who had twice guided the state-owned industrial conglomerate IRI (*Istituto di Ricostruzione Industriale*) between the 1980s and 1990s (McCann 2000b).

The alliance with the liberalising technocrats was part of a strategy of the Italian Left to break away from the communist ideology reinventing itself as a centrist catch-all political force (Deeg 2012). Like the Spanish PSOE ten years before, to appeal centrist voters the Italian left

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[3] The only exception was the short-lived Berlusconi I executive lasting less than nine months between 1994 and 1995

crafted a new political message based on ideas like ‘Europeanisation’, ‘modernisation’, ‘liberalism’ and ‘new left’ (Deeg 2005, p. 532). Proof of this changed attitude is the fact that during the 1996 electoral campaign the *Partito dei Democratici di Sinistra* (PDS), the main political party of the left, made explicit reference to the need to privatise state-owned firms, reform the welfare state and continue in the effort of fiscal consolidation initiated by the technocrats to qualify Italy for the EMU membership (Hopkin and Ignazi 2008; Barta 2011). The ambitious reformist agenda of the Centre-Left and the technocrats went well beyond fiscal consolidation as they wanted to overhaul Italian capitalism liberalising corporate and labour relations, stimulating the stock market and diffusing share ownership (Amatori and Colli 2000). This reformist agenda created tensions between the Centre-Left and the family blockholders that had traditionally dominated Italian capitalism, as they strenuously opposed corporate liberalisation (see following sections) (McCann 2000a; Deeg 2005).

Although less explicit in the definition of a ‘national champions’ policy than the Spanish PSOE (and PP), the Italian Centre-Left nevertheless implemented a series of measures aimed at favouring the emergence of European champions in the sectors of banking, electricity and telecommunications (Colli et al. 2014; Deeg 2012). These included: an activist role of the state during the privatisation process to select the private reference shareholders of strategic firms, the promotion of a wave of sheltered consolidation among domestic banks, the establishment at home of a regulatory environment favourable to domestic incumbents, and the use of the diplomatic channel to favour the internationalisation of domestic incumbents.

The enormous size of Italy’s public sector made the privatisation of state-owned firms a key pillar of the industrial policy of the Centre-Left. Until the early 1990s the Italian state controlled many large manufacturing companies and most of the banking sector (Deeg and Perez 2000). State ownership spanned very diverse sectors from banking, to textile, from food production to steel. As a result, in the 1980s state-owned firms made over 50 per cent of Italy’s GDP (Della Sala 2004, p. 1046), and in 1991 state-owned banks collected 80 per cent of domestic deposits and gave 90 per cent of all loans (McCann 2007, p. 108). The state also held a controlling stake in the electricity and telecommunications incumbents ENEL and TI.

The main driver of the Italian economy until the 1960s, the state-owned sector has since the 1980s experienced a progressive deterioration in performance (Della Sala 2004). As a result, by 1992 the non-financial firms’ part of the state-owned conglomerate IRI had piled up a debt worth more than five per cent of GDP, and the losses of the industrial conglomerate EFIM doubled its net sales (Goldstein 2003, p. 5). This profound crisis was due to a combination of weak oversight over public managers, lack of budgetary constraints, inefficient productive technologies and constant political interference from the main parties (Aganin and Volpin 2005; Onida 2014).

Because of the firm opposition of the Christian Democrats and the Socialists, the restructuring of the state-owned sector was delayed until the early 1990s. It was only in 1992, after the Tangentopoli scandal had caused the dissolution of the DC and Italy had been ejected from the ERM, that the technocratic government guided by Giuliano Amato could finally trigger the privatisation process (Goldstein 2003). The economic and political turmoil hit Italy when the country was struggling to meet the Maastricht criteria and qualify for the EMU membership (Deeg 2005). For this reason, the Amato government saw the sell-off of state-owned firms first and foremost as a way to shore-up public finances. In 1992 the Amato government issued a document forecasting the full privatisation of all state-owned firms (Macchiati 1999). Like Spanish governments of both colours, the Centre-Left played an active role during the privatisation process shaping the ownership structure of privatised firms and favouring the rise of politically close managers and shareholders (Colli et al. 2014). In doing so the Centre-Left wished to favour the emergence of a new group of politically close industrial groups capable of challenging the power of traditional family blockholders (Goldstein 2003).

Analysing in more detail the methods chosen by the Centre-Left to privatise state-owned firms it is possible to identify three phases. During a first phase lasting between 1992 and 1994 the government opted for the full privatisation of domestic firms through POs aimed at favouring the emergence of public companies with diffuse ownership (Goldstein 2000). Most notably, this privatisation strategy was chosen by the Ciampi technocratic cabinet when privatising the two large state-owned banks, Comit and Credit (McCann 2000b). Ownership diffusion was meant to prevent Comit and Credit from falling in the hands of the family blockholders and their allied the merchant bank Mediobanca. However, shortly after privatisation Mediobanca succeeded nevertheless in gaining control of both banks by buying shares from small investors (McCann 2000b).

Scorned by the failure of the 'public company' strategy in 1994 the Ciampi technocratic government passed a framework law on privatisations (Law 474) that mentioned the possibility for the Treasury to privatise strategic firms by selling large stakes to select domestic investors (Goldstein 2003). The Law 474 inaugurated a second phase in the privatisation process (1994–9), during which the technocratic – and later Centre-Left – executives privatised domestic firms by forming hard cores of private investors (Barucci and Pierobon 2007). Most notably, this strategy was chosen in 1997 for the privatisation of the telecommunications incumbent TI. The Centre-Left privatised TI combining a public offering and a private auction in which large share blocks were offered to select domestic investors (Florio 2007). However, as will be shown in chapter 5 the Italian government lacked the regulatory power necessary to convince family blockholders, the only domestic investors with sufficient resources to enter the hard core, to buy large stakes in TI (Amatori and Colli 2000). The consequent ownership instability of TI would have a decisive influence on the future trajectory of the firm.

Attempts to form stable hard cores in other non-financial firms proved equally unsuccessful (Barucci and Pierobon 2007). The failure of the hardcore strategy left the Centre-Left with little choice but to opt for the partial privatisation of the remaining strategic firms, thus keeping a crucial ownership power resource over them. By keeping a controlling stake, the state could give ownership stability to the privatised firms, influencing managerial appointments and key strategic decisions. The Centre-Left chose to partially privatise the electricity incumbent ENEL, but also other strategic firms not included in the present study like the oil & gas conglomerate ENI and the defence MNE Finmeccanica.

Even though the approach to privatisation of the Centre-Left involved less long-term planning than that of the Spanish PSOE and PP, being more the result of trials and errors (Binda 2013), there are important similarities between the governments of the two countries. In fact, like in Spain privatisations did not come along with a process of liberalisation of the domestic market (Macchiati 1999). Like in Spain, electricity and telecommunications incumbents were not broken up, allowing them to retain a dominant position in the market (Goldstein 2003). The potential for market liberalisation was further reduced by the fact that the domestic regulators for energy (AEEG) and telecommunications (AGCOM) could only issue non-binding pronouncements and faced constant political interference in their activities (Rangoni 2011; Onida 2014).

Like in Spain, the industrial policy of the Centre-Left involved as well direct interventions of the government to prevent foreign takeovers of domestic firms. For instance, in 1999 Prime Minister Massimo D'Alema threatened to use its golden share powers to veto the merger between TI and Deutsche Telekom (Woods 1999). The Centre-Left also made efforts to help the rise of politically close managers and shareholders. Again, the trajectory of TI provides two clear examples in this regard. First, in 1999 the centre-left government openly favoured the hostile takeover of TI by Olivetti, an IT firm guided by a manager with leftist sympathies, Roberto Colaninno (Amatori and Colli 2000; Oddo and Pons 2006). Second, shortly after coming back to power in 2006 the Centre-Left favoured the ousting of Marco Tronchetti Provera, who had become manager and main shareholder of TI in the early 2000s and was said to be close to the Centre-Right (Florio 2007).

The Centre-Left launched as well a process of sheltered consolidation among domestic firms aimed at favouring the emergence of 'national champions' with sufficient size to compete in the European market. This occurred in particular in the banking sector, characterised until the early 1990s by a high degree of fragmentation. Acting in close coordination with the Bank of Italy, the Centre-Left engineered a twin process of privatisation and consolidation among domestic banks aimed at favouring the emergence of large banking groups guided by politically close bankers (McCann 2007; Deeg 2012). The Centre-Left initiated the process of banking consolidation in the late 1990s, bringing it to completion after 2006.

Apart from helping the emergence of large domestic firms, and establishing a favourable regulatory environment at home, the Centre-Left also took measures aimed at favouring the international expansion of Italian banks and utilities. For instance, in the mid-2000s key figures of the Centre-Left government engaged in bilateral talks with the Russian government to favour ENEL's investments in Eastern Europe (Bergami et al. 2013). Similarly, in 2007 Prime Minister Prodi supported ENEL's takeover of Endesa during a bilateral meeting with his Spanish counterpart Zapatero (Chari 2015).

3.4.2 The Centre-Right (1994–5 and 2001–6)

The trajectory of the Centre-Right coalition is closely linked to that of its undisputed leader, the media tycoon Silvio Berlusconi. In the run up to the 1994 elections, Berlusconi, who lacked previous experience in politics, created a brand new 'personal party' *Forza Italia* (FI) (McDonnell 2013). Against all odds, Berlusconi guided FI to an electoral triumph forming an alliance with the post-fascist far right and the secessionist Northern League. The Centre-Right won by appealing to those socio-economic groups that had suffered the most for the fiscal retrenchment imposed by the technocratic governments of the early 1990s. These were small and medium enterprises from the northeast, shopkeepers, and citizens located in the south who depended upon the state for their support (Amable et al. 2011). Another element that brought together, and gave an identity, to the Centre-Right was the widespread anti-communist feeling among its voters (Diamanti and Lello 2005).

While the Centre-Left supported fiscal moderation and the reduction Italy's enormous public debt, the need to redistribute resources among socio-economic groups with highly heterogeneous preferences meant that the Centre-Right struggled to keep a balanced budget (Barta 2011).[4] As a result, between 2001 and 2006 the Centre-Right eroded the primary surplus of 5.5 per cent of the GDP inherited from the previous centre-left administration (Barta 2011, p. 120). In addition, the incompatibility between the economic preferences of its constituencies made it difficult for the Centre-Right to elaborate a coherent economic policy that could go beyond deficit spending (Diamanti and Lello 2005; Amable et al. 2011).

While the Centre-Left was strongly pro-European, the stance of the Centre-Right oscillated between the soft Euroscepticism of Berlusconi's FI and the hard Euroscepticism of the Northern League (Quaglia 2011). Rather than uncritically supporting the European project, Berlusconi followed a neo-national policy, defending what he perceived as the national interest of Italy even when this caused open confrontations with Brussels or other member states (Donovan 2003; Quaglia 2011).

While the Centre-Left aimed at moving Italian capitalism closer to the Anglo–American corporate model, promoting popular capitalism and challenging the power of the dominant blockholding families, the Centre-Right explicitly sided with family blockholders (Deeg 2005; Cioffi and Hoepner 2006; McCann 2007). Proof of this is the fact that the Centre-Right passed blockholder-friendly legislative reforms like the decriminalisation of false accounting (Deeg 2005). From this brief description, it clearly emerges how the economic platform of the Centre-Right was at odds with that of the Centre-Left. Furthermore, its Euroscepticism, fiscal profligacy, and protectionist attitude make the Centre-Right an outlier even when compared with the Spanish PSOE and PP. The fundamental incompatibility between the economic agenda of the Centre-Left and the Centre-Right meant that when in office both coalitions regularly dismantled the policies of their predecessors (Barta 2011).

According to partisan theories, due to its protectionist economic agenda the Centre-Right solely focuses on protecting inward-looking national champions, being thus incapable of triggering the process of industrial restructuring necessary to turn domestic incumbents into European champions (Cioffi and Hoepner 2006). However, contrary to the expectations of

[4] In fact, generous public spending was the only way to reconcile the neo-liberal anti-tax feeling prevalent among SMEs and the self-employed with the economic assistance demanded by the dependants of the state from the south (Amable et al. 2011).

partisan theories, the following case studies will show how, when dealing with the restructuring of domestic banks and utilities, the Centre-Right implemented an industrial policy similar in its content to that of the Centre-Left, aiming at achieving the same objectives. In fact, like the Centre-Left the Centre-Right wished to favour the emergence of strong domestic banks and utilities, capable of competing in the European market, helping at the same time the rise of politically close managers. To achieve these goals, like the Centre-Left, the Centre-Right implemented an industrial policy strategy centring on: an activist role of the state in the privatisation of strategic companies, the promotion of a process of sheltered consolidation among domestic firms, the establishment of a protective regulatory environment for banks and utilities in the domestic market, and the use of the diplomatic channel to help the internationalisation of 'national champions'. The following chapters will show how the success or failure of this strategy was not conditional on the partisan orientation of the government, but on the availability of state's ownership power, regulatory power and partisan proximity power at crucial stages of the restructuring process.

Scholars dealing with the periodisation of the Italian privatisation process observe how the pace of the sell-offs slowed-down after the electoral victory of the Centre-Right in 2001 (Goldstein 2003). However, despite this difference, there is substantial continuity between the privatisation strategy of the Centre-Left and Centre-Right. In fact, when dealing with strategic firms like ENEL also the Centre-Right chose the line of partial privatisation, reducing state ownership but keeping a controlling stake in the firms. Substantial continuity between the two coalitions is confirmed by the fact that, when back in power in 2006, also the Centre-Left maintained the controlling stakes in strategic firms inherited from the Centre-Right. Like the Centre-Left, the Centre-Right used the controlling stake in ENEL to give ownership stability to the firm, influence the main investment strategies, and appoint leading managerial figures. However, the fact that ENEL was a public company, closely scrutinised by market operators, meant that the Centre-Right was forced to appoint managerial figures in virtue of their professional background rather than their political affiliation (Bergami et al. 2013).

The Centre-Right attempted as well to complete the process of banking consolidation, albeit with less success than the centre-left governments of the 1990s. When in 2001 the Centre-Right won the elections most of the largest domestic banks were guided by managers close to the Centre-Left. The Centre-Right tried to rebalance this situation by promoting the rise of a politically close mid-sized bank, the *Banca Popolare di Lodi* (BPL). In particular, the Centre-Right executive and the Bank of Italy actively supported BPL's takeover of the larger domestic bank, Antonveneta, against a rival bid from the Netherlands' ABN Amro (McCann 2007). However, this strategy ended up in a fiasco as the Governor of the Bank of Italy Antonio Fazio was forced to resign amid allegations that his protection of mid-sized Italian banks breached domestic and European legislation.

The management of BPL was convicted, Antonveneta was taken over by a foreign bank, and once back in power in 2006 the Centre-Left completed the process of banking consolidation favouring the rise of politically close managers at the head of the two largest domestic banks, Intesa–Sanpaolo and Unicredit (Messori 2005; Quaglia 2005; Deeg 2012). However, chapter 4 will show that the failure of the Centre-Right was not due to a different attitude towards banking consolidation than the Centre-Left, as partisan theories would argue (Cioffi and Hoepner 2006). In fact, like the Centre-Left, the Centre-Right wished to favour the rise of politically close banking groups. Instead, the Centre-Right failed because at crucial moments during the process of banking consolidation it lacked the ownership power resources necessary to achieve its objectives.

Efforts by the Centre-Right to favour the rise of politically close managers and owners were not limited to the banking sector. In fact, shortly after taking office in 2001 the Centre-Right backed the takeover of the privatised TI by an alliance of family blockholders including the Pirelli and Benetton families (Florio 2007). The support to the Pirelli/Benetton takeover is a further sign of the proximity between the Centre-Right and family blockholders.

The industrial policy strategy of the Centre-Right also involved the protection of the dominant position of banks and utilities in the domestic market at the detriment of competition. This was particularly evident in the case of ENEL as Minister of Finance Giulio Tremonti engaged in an open confrontation with the domestic energy regulator to defend the high tariffs ENEL charged to produce electricity (Silva 2004).

Lastly, like the Centre-Left, the Centre-Right often used diplomatic channels to favour the foreign expansion of domestic firms. For instance, Berlusconi leveraged his close relationship with Vladimir Putin to favour ENEL's investment in Russia (Renda and Ricciuti 2011). And in 2006 the Centre-Right actively supported ENEL's failed takeover of France's Suez (Bergami et al. 2013).

3.5 Italian business actors: Manufacturing Family Blockholders

A restricted alliance of family blockholders active in the manufacturing sector has historically occupied a dominant position in Italian capitalism (Barca 1997; Amatori and Colli 2000). Already strong in the interwar period, since the 1970s family blockholders have further increased their wealth and power thanks to the frequent recourse to control-enhancing mechanisms like cross-shareholding, pyramidal groups and shareholder alliances (Colli and Vasta 2015). The Milan-based merchant bank Mediobanca has played a decisive role in orchestrating this complex web of ownership alliances (Amatori and Colli 2000). Faced with the dominant power of the blockholding families and Mediobanca, state-owned banks were confined to a marginal role in Italian capitalism (Melis 2000).

Until the early 1990s, family blockholders relied on the support of the Christian Democrats to protect their financial rents (Deeg 2005; Cioffi and Hoepner 2006). However, the advent to power of the technocrats and the Centre-Left deprived family blockholders of their political connections (Cioffi and Hoepner 2006; Bulfone 2015). In fact, one of the main goals of the Centre-Left and the technocrats has been to end the domination of family blockholders bringing Italian capitalism closer to the Anglo–American corporate model (Deeg 2005). Already weakened by the electoral collapse of the Christian Democrats, throughout the 1990s manufacturing families as well suffered an erosion of the profit margins in their main sector of activity due to growing competition from developing countries (De Cecco 2009). Consequently, even prominent family groups like the Agnelli and Pirelli came close to bankruptcy (Aganin and Volpin 2005; De Cecco 2007).

Paradoxically, it was be one of the reforms implemented by the Centre-Left to challenge the power of family blockholders – the privatisation of state-owned firms – that would help them in overcoming their industrial crisis (De Cecco 2007). As seen in the previous sections, between 1994 and 1999 the Centre-Left privatised state-owned firms by forming hard cores of domestic investors. However, until the emergence of the two large banks Unicredit and Intesa–Sanpaolo in the mid-2000s, Italy lacked credit institutions with sufficient financial resources to invest in the hard cores of privatised firms (Macchiati 1999). This left family blockholders as the only domestic investors with enough resources to buy large stakes in large firms like TI. Like in Spain, by entering the hard core of privatised firms, family blockholders had to accept being passive investors, leaving the main decisions to the state (which retained its golden share powers), and to state-appointed managers.

However, unlike in the Spanish case the Italian government lacked the regulatory power resources necessary to convince manufacturing families to invest as passive shareholders. The state's lack of regulatory power over manufacturing families was due to two factors. First, when they were asked to enter the hard core of privatised utilities, families like the Pirellis, the Benetton family and the Agnellis already owned successful multinationals making most of their revenue outside the Italian market. They were thus less dependent upon regulatory protection by their home government (Binda 2013). Second, family blockholders were active in manufacturing sectors that had already been liberalised by the EU in the 1970s (Stone Sweet 2004), leaving little regulatory scope for the Italian government. Consequently, family blockholders could easily resist calls from the government to invest as passive shareholders in the privatised firms. The lack of state regulatory power over domestic blockholders would prove decisive in explaining the failed attempt to form a strong hard core in TI (see chapter 5).

Instead of investing as passive blockholders, manufacturing families wished to gain full control of privatised firms active in sheltered sectors like TI to use them as cash cows to compensate for the losses they made in their core manufacturing businesses (De Cecco 2007; Colli and Vasta 2015). However, such an approach was not compatible with the Centre-Left's desire to create 'European champions'. Family blockholders were not interested in investing to improve the performance and favour the foreign expansion of privatised firms (Florio 2007). The conflicting goals between the Centre-Left government and family blockholders made Italian privatisations a complex game between the state and private investors for the control of financial rents (Florio 2007).

This game in turn shows how standard accounts of state-capture theorists look at the issue of industrial restructuring from the wrong angle. In fact, state-capture scholars try to assess whether the government was captured by the management of large banks and utilities (Negrier 1997; Silva 2004). However, since at the time of privatisation banks and utilities occupied a privileged position in the domestic market and operated in protected sectors, they were themselves prone to capture by private investors interested in gaining oligopolistic rents. This idea of the capture of the formerly state-owned utilities by private investors, rather than capture of the state by the privatised utilities, is decisive in explaining the outcome of the restructuring of TI (chapter 5).

3.6 Cross-country comparison

The comparative analysis of the identity and preferences of state and business actors allowed identifying many similarities as well as some crucial differences between Italy and Spain. An important similarity between the two countries concerns the governmental attitude towards 'national champions'. In fact, Italian and Spanish governments of both colours considered the creation of strong 'national champions' in banking, electricity and telecommunications a key political priority. Consequently, the core executive, typically in the figures of the Prime Minister and the Minister of Finance, was directly involved in the design of the 'national champions' policy. While industrial policy in Spain was often the result of long-term planning by the executive, in Italy it was more the result of trials and errors and emergency measures.

Despite this difference, however, in both countries the executive implemented similar measures aimed at strengthening 'national champions' including: direct intervention of the state to influence the privatisation process; set up of a protective regulatory environment in the domestic market; promotion of a process of sheltered consolidation among domestic firms; support to politically close managers or shareholders; and use of diplomatic channels to help the internationalisation of domestic banks and utilities. In implementing these measures governments of both countries aimed at achieving two objectives: strengthening domestic banks and utilities making them capable of competing in the European market, and favouring the emergence of politically close managers and shareholders.

If, irrespective of the country of provenance and the ideological affiliation, all governments implemented a similar industrial policy strategy in pursuit of the same goals, partisan theories are of little use to explain the outcome of the process of industrial restructuring (Boix 1998; Cioffi and Hoepner 2006). Instead, the following chapters will show how to explain the outcome of the process of industrial restructuring it is necessary to focus first and foremost on the balance of power between the state and business actors, and in particular on the availability of state's ownership, regulatory and partisan proximity power resources at crucial moments during the restructuring process.

The sections on Italian and Spanish private actors dealt with the domestic investors owning sufficient financial resources to buy large stakes in the privatised utilities. In Spain, they were large private banks, in Italy family blockholders active in the manufacturing sector. The comparison of their identities and preferences allowed identification of a crucial difference in their regulatory power relationship vis-à-vis the state. On the one hand, because of their eminently domestic focus and the heavily regulated nature of their sector of activity, Spanish banks depend upon regulatory protection of their home government. The dependence of Spanish banks upon regulatory protection of their home government contradicts the views of state-capture theorists (Lancaster 1989; Cabrera and Del Rey 2007) and will have a decisive influence on the pattern of restructuring of Spanish utilities, as banks will accept to invest in the privatised utilities as passive blockholders in exchange for state regulatory protection in their main sector of activity. On the other hand, the Italian state lacks regulatory power over domestic family blockholders as they own highly internationalised MNEs less tied to the domestic market that operate in liberalised manufacturing sectors in which state's regulation plays a minor role. Consequently, manufacturing families could easily resist calls from the Italian government to invest in the hard core of TI as passive blockholders. The following chapters will show how this difference in the regulatory power of the government vis-à-vis domestic investors had a decisive impact on the trajectory of Italian and Spanish telecommunications and electricity incumbents.

Chapter 4. Banking and the Emergence of BBVA, Santander, and Unicredit

4.1 Introduction

This chapter provides a comparative analysis of the process of industrial restructuring that led to the emergence in Italy and Spain of four of the largest banks in the Eurozone (BBVA and Santander in Spain; Intesa-Sanpaolo and Unicredit in Italy). It will be shown how in both countries the emergence of successful banks was the result of a process of sheltered consolidation among domestic credit institutions superseded by the government and the Central Bank. The chapter will highlight that even though both countries succeeded in creating two banking champions, Spain completed the process of banking consolidation seven years ahead of Italy. While the last relevant merger among Spanish banks occurred in 1999, banking consolidation in Italy was completed only in 2007. This time difference has had a decisive impact on the performance of Italian and Spanish banks, explaining why nowadays Spanish banks outperform their Italian counterparts in terms of size and efficiency. In fact, the recent difficulties experienced by Italian banks (especially Unicredit) are because they made the last relevant acquisitions of domestic and foreign banks between 2006 and 2007. Consequently, they had very little time to reorganise their internal structure before the start of the Eurozone crisis. Instead, having completed the process of domestic consolidation in 1999, BBVA and Santander had seven years to reorganise and focus on their foreign expansion before the crisis hit.

The chapter highlights the delay in consolidation in Italy due to the lack of mergers involving the three largest domestic banking groups in 2001–6. The fact that this five-year absence coincided with the advent to power of the Centre-Right coalition seems to corroborate the findings of partisan analyses of Italian corporate governance (Deeg 2005; 2012; Cioffi and Hoepner 2006). According to partisan theorists, while the Italian Centre-Left has had a modernising economic agenda and wished to favour the emergence of large and competitive banking groups, the Centre-Right has been an inward-looking coalition that has focused exclusively on the protection of established rents, being thus uninterested in promoting the emergence of dynamic banks with the potential to become European champions. However, the chapter will show that this difference did not play a role in the banking sector. In fact, when dealing with banking consolidation the Centre-Left and the Centre-Right (as well as the Spanish PP and PSOE) aimed at achieving the same objectives: favouring the emergence of domestic banks with sufficient size to compete in the European market, and helping the rise of politically close banking managers.

To achieve these goals Italian and Spanish governments of both stripes engineered a process of sheltered consolidation acting in close coordination with the Central Bank. If governments of both colours had overlapping goals, partisan theories fail to explain why banking consolidation slowed under Centre-Right rule. Instead, the chapter argues that to account for the different timing of banking consolidation in Italy and Spain it is necessary to look at the balance of power between the state and business actors, and in particular at the availability or lack of two key ownership power resources of the state over business: the direct ownership of a controlling stake in a large domestic bank, and the availability of golden share rights over the same bank.

The rest of the chapter is organised as follows: the second section describes the process of banking consolidation in Spain. Particular attention is devoted to the description of the way in which the PP leveraged the availability of a controlling stake in a large domestic bank, and golden share rights over the same bank, to bring the process of banking consolidation to completion by the late 1990s, also favouring the rise of a politically close manager at the head of BBVA. The third section focuses on Italy and shows that in the absence of the necessary ownership power resources, the Centre-Right failed to complete the process of banking consolidation. Consequently, the last round of mergers among Italian banks had to wait until the Centre-Left regained power in 2006. The chapter concludes with a cross-country comparison.

4.2 Spain

4.2.1 The pre-reform status quo

Spanish capitalism has historically been dominated by a restricted group of private banks, the Big Seven (Banesto, Bilbao, Central, Vizcaya, Hispano Americano, Popular and Santander), owned by business families in their respective regions of origin (Cabrera and del Rey 2007).

Already strong before the Civil War (1936–9), the Big Seven further increased their wealth and power during the Franco dictatorship (Perez 1997; Aguilera 1998). The Francoist regime designed a biased regulatory framework that allowed the Big Seven to operate as a self-regulated, state-sanctioned cartel (Aguilera 1998; Valles Codina 2014). Main pillar of this protective regime was the 1946 'Status Quo' banking law that banned foreign banks from the Spanish market, and placed important restrictions on the establishment of new domestic credit institutions. A state-directed circuit of credit allocation, geographic branching restrictions and the segmentation between commercial and savings banks (*cajas de ahorro*) further reduced the scope for competition (Deeg 2012). In exchange for regulatory protection they received, the Big Seven generously financed the autarkic economic policy of the Francoist regime (Aguilera 1998), and tolerated frequent political interferences in their activity (Binda 2013). Consequently, the Franco dictatorship and the Big Seven were tied together by a relationship of mutual dependence, sustained reciprocity and reciprocal accommodation (Perez 1997; Valles Codina 2014).

This mutually beneficial relationship came at the expense of the main domestic manufacturing groups. Even though Spain had a bank-dominated credit system, manufacturing groups could not benefit from the provision of 'patient capital' as in the German model (Deeg and Perez 2000). In fact, although throughout the 1960s and 1970s the Big Seven had acquired a significant industrial portfolio (Tayfur 2003), they treated their industrial holdings as financial investments that could be easily sold at good profit. Manufacturing groups were further weakened by the fact that banks provided credit only on a short-term basis (Garcia Calvo 2013), charging very high interest rates (Perez 1997). Only state-owned monopolists, like Telefonica, could benefit from favourable credit conditions and a more stable ownership structure owing to their close ties with the banks and the Franco regime (Tayfur 2003; Garcia Calvo 2013).

Protected by the dictatorship, by the early 1970s the Big Seven had come to occupy a dominant position in the commercial banking segment, controlling 70 per cent of total assets and granting 60 per cent of all loans (Tayfur 2003, p. 150). Despite their strength in the domestic market, however, the Big Seven were small in international comparison (Garcia Calvo 2013). In addition, despite their large profit margins, the Big Seven were among the least efficient banks in Europe (Perez 1997; Cabrera and Del Rey 2007), as the lack of competition allowed them to impose wide interest spreads to their customers without needing to reduce their operational costs (Guillen and Tschoegl 2008).

4.2.2 Liberalisation and the first wave of consolidation under the PSOE

In 1982 the PSOE won elections on the promise to modernise the economy and steer Spain into the European Community, a goal achieved in 1986. Although the PSOE considered EC membership a decisive catalyst for Spain's economic development, the executive nevertheless feared that with the integration of the Spanish economy in the European market, domestic banks might be taken over by more efficient competitors from core member states. This concern stemmed from the fact that in the late 1980s Spanish banks lagged their main European competitors in terms of size and efficiency. Even though in 1990 Spanish banks had the highest interest margin in Europe (4.21 per cent), they also had very high operational costs (Perez 1997, p. 21). In addition, the fact that seven large banks competed in a relatively small market meant that the Big Seven were small by international standards. In 1985 the largest Spanish bank Central barely made it in the top 100 worldwide and was just the forty-sixth largest bank in Europe (Tortella et al., p. 153). According to Minister of Finance Carlos Solchaga the lack of size and efficiency of Spanish banks made them likely targets of foreign takeovers (Guillen and Tschoegl 2008). A similar concern was voiced in 1987 by the Governor of the Bank of Spain Mariano Rubio who observed that Spanish banks were too small and lacked a foreign presence comparable to the size of the Spanish economy (El Pais 20/11/1987).

Worried by the weakness of the Big Seven the PSOE passed a series of liberalising reforms aimed at improving the efficiency of the Spanish financial sector (Deeg 2012). These included the removal of exchange rate ceilings, the deregulation of savings banks, the removal of geographical branching restrictions, and the liberalisation of cross-border capital flows (Guillen and Tschoegl 2008). With these liberalising measures the PSOE hoped to trigger a wave of consolidation among the Big Seven allowing for the emergence of Spanish banks with sufficient size to compete in the European market (Perez 1997; Cabrera and Del Rey 2008).

Banking consolidation was recommended as well by an influential report written in 1987 by the Welsh economist Jack Revell. According to the Revell Report, to be internationally competitive the Big Seven needed to merge with each other, as seven large banks were too many for the size of the Spanish market. The Revell Report divided the Big Seven in two groups, one formed by the larger but less efficient Banesto, Central and Hispano Americano, the other formed by the remaining four banks that were smaller but had better performance (Bilbao, Vizcaya, Santander and Popular). As a guiding principle for banking consolidation the

Revell Report recommended that a bank from the latter group should take over one from the former (Cabrera and Del Rey 2008). The Bank of Spain and the PSOE officially endorsed the conclusions of the Revell report calling for a wave of consolidation among the Big Seven (El Pais 6/12/1987; 8/12/1987; 11/12/1987).

In 1987 the Governor of the Bank of Spain Rubio said that he saw with favour a ‘coordinated and rapid’ process of consolidation among the main domestic banks (El Pais 20/11/1987). The following year Rubio added that banking consolidation would ‘allow maintaining the core of our credit system in Spanish hands, preventing Spanish banks from becoming subsidiaries of foreign banking groups’ (El Pais 1/6/1988). For its part, the PSOE government championed banking consolidation for two reasons: first, to create a group of internationally competitive banks; second, to favour the emergence of a new generation of banking managers politically close to the executive (Gomez Escorial 2004).

To prevent foreign banks from taking advantage of the process of banking consolidation to acquire the Big Seven, in 1985 the PSOE agreed with the European Commission to establish an interim period of seven years during which the Bank of Spain could limit the entry of foreign banks in the Spanish market (Perez 1997). During this interim period, any individual or institution willing to purchase five per cent or more of the shares of a bank had to inform the Bank of Spain, while the acquisition of stakes above fifteen per cent was conditional on a prior administrative authorisation (El Pais 11/12/1987; Garcia Calvo 2013). Because of these protectionist measures some scholars argued that the PSOE used the process of banking consolidation to promote a form of ‘financial nationalism’ (Aguilera 1998, p. 328). According to these views, rather than fostering competition in the banking sector, the PSOE protected the oligopolistic privileges of the Big Seven allowing them to reach a size comparable to that of their main European competitors (Perez 1997).

The process of banking consolidation started in 1987 when the most efficient and dynamic Spanish bank Bilbao, located in the Basque country, announced its intention to merge with Banesto, one of the large and inefficient banks from Madrid. The negative reaction from the board of Banesto turned the friendly bid into a hostile takeover that failed because of the opposition from all the other members of the banking cartel (Gomez Escorial 2004). Minister of Finance Solchaga did not hide his disappointment at the collapse of the deal, reiterating his support for banking consolidation (El Pais 8/12/1987). The failed takeover by Bilbao led to a managerial shake up inside Banesto with the appointment of Mario Conde as President. A very ambitious manager lacking previous banking experience Conde did not hide his political proximity with the main opposition party the PP, and his hostility towards the PSOE executive (Gomez Escorial 2004; Cabreras and Del Rey 2008).

Bilbao did not give up on the plan to find a partner, and in 1988 it finalised a merger with the other Basque bank Vizcaya leading to the creation of BBV. By far the largest domestic bank and third in the European ranking, BBV controlled 20 per cent of the Spanish market (El Pais 23/01/1988). Even though a merger between two small and dynamic banks departed from the logic of the Revell Report, both the Bank of Spain and the PSOE applauded the operation (Cabrera and Del Rey 2008). The executive was particularly supportive of the merger since the management of both banks had close ties with the PSOE (Guillen and Tschoegl 2008). This prompted many observers to label BBV the PSOE's 'bank of choice' (Perez 1997, p. 161; El Pais 12/12/1987).

The merger between Bilbao and Vizcaya triggered a defensive move from two of the large and less efficient banks from Madrid – Hispano Americano and Central – which merged in 1991 to form *Banco Central Hispano* (BCH). Although a deal between two inefficient banks was at odds with the logic of the Revell Report, the PSOE nevertheless supported the merger and granted BCH the maximum possible level of tax exemptions (Tortella et al. 2013). The merger between Hispano Americano and Central came only weeks after the PSOE government had merged all state-owned credit institutions to create the fifth largest domestic bank: Argentaria (Tekinbas 2009, p. 77). Between 1993 and 1994 the PSOE partially privatised Argentaria, although keeping a controlling stake in the bank (Tekinbas 2009). In 1995 to further strengthen its control over Argentaria the PSOE established a golden share over the bank (Etchemendy 2004).

Three of the big seven had remained at the margins of the consolidation process: Banesto, Popular and Santander. While Popular will not change this attitude, defending its independence and focusing on improving its efficiency (Cabrera and Del Rey 2008), since the early 1990s Banesto and Santander played a more active role. Under the leadership of Emilio Botin, heir of the Botin family that had controlled the bank for generations, Santander initially focused on reducing its operational costs and gaining market shares through the offer of a high-interest credit account, the *Supercuenta* (Cabreras and Del Rey 2008).

Banesto for its part was facing increasing troubles due to the mismanagement of President Mario Conde, who had also developed a very tense relationship with the PSOE due to his political proximity with the PP (Gomez Escorial 2004; Cabrera and Del Rey 2008). When in the early 1990s Banesto's financial situation further deteriorated, the Bank of Spain – supported by the PSOE government – decided to intervene in the bank ousting Conde and all his managerial team (Cabrera and Del Rey 2008). Although Conde's mismanagement had decisively weakened the bank, some observers, including Conde himself, argued that the intervention of the Bank of Spain was motivated by the PSOE's desire to remove a politically hostile banker (Cabrera and Del Rey 2008, p. 158; Gomez Escorial 2004, p. 68; El Pais 12/01/1994). In 1994 the Bank of Spain organised a domestic auction for the acquisition of Banesto in which Santander outbid BBV and Argentaria. The acquisition of Banesto made Santander the largest bank in Spain and was the last operation finalised under PSOE rule (Gomez Escorial 2004, p. 7).

To favour the emergence of domestic banks with sufficient size to compete in the European market the PSOE had superseded to a transformation of the Spanish banking sector. This process involved a wave of sheltered consolidation among private banks that brought the Big Seven down to four (BBV, Santander, BCH and Popular), the establishment of a protectionist regulatory framework to shelter domestic banks from foreign takeovers, and the merger of all state-owned banks to create a new big player, Argentaria. This process of banking restructuring, carried out by the PSOE acting in close coordination with the Bank of Spain, led to the emergence of three dynamic and modern banks with the potential to become European champions: Santander, BBV and Argentaria (while BCH was far less efficient and Popular was smaller). The PSOE took advantage of the process of banking restructuring to favour the emergence of a new banking elite formed by politically close managers. As a result, when the PSOE left office both BBV and Argentaria were guided by managers with open leftist sympathies (Perez 1997; Gomez Escorial 2004), and the Botin family of Santander was not hostile to the government (Financial Times 25/01/2013). Despite these successes, however, BBV, Santander and Argentaria were too small to be considered European champions. Consequently, when the PSOE lost the elections to the PP in 1996 there was still room for a further round of mergers involving the largest domestic banks (Guillen and Tschoegl 2008).

4.2.3 The second wave of banking mergers under the PP

When the PP took office in 1996 the banking sector was dominated by managers close to the PSOE. The proximity between the PSOE and the main domestic banks was seen with great suspicion by Prime Minister José Maria Aznar and Minister of Finance Rodrigo Rato (Cabrera and Del Rey 2007). The PP was particularly hostile towards the management of BBV as the bank was among the owners of a TV channel openly hostile towards the PP government (Guillen and Tschoegl 2008). In contrast, the PP had no outstanding issues with Santander as the management of the bank had always maintained a low profile on political matters (Guillen and Tschoegl 2008; Cinco Dias 18/01/1999). Consequently, the PP wished to take advantage of the second wave of M&A among domestic banks to remove the 'bankers of the PSOE' that guided BBV replacing them with politically close managers (Guillen and Tshcoegl 2008).

The first relevant operation under PP rule occurred in 1999 when Santander announced its intention to merge with BCH forming Santander-BCH. Although formally a merger among equals, after three years the Botin family reasserted full control over the new bank, later renamed Banco Santander (Guillen and Tschoegl 2008). Both Aznar and Minister of Finance Rato followed every step of the negotiations expressing their support to the merger (El Pais 16/01/1999; Cinco Dias 18/01/1999). Thanks to the merger with BCH, by 1999 Santander had achieved a dominant position in the domestic market, and could shift its focus on an aggressive campaign of foreign expansion in Latin America and Europe.

The Santander–BCH merger was a success for the PP as it allowed for the emergence of a potential European champion guided by managers that were not hostile to the executive. However, the PP government knew the process of banking consolidation was yet to be completed, as there was scope for another big merger. In addition, the PP wished to replace the left-leaning management of BBV and Argentaria. This was quite easy in the case of Argentaria, as when the PP took office the bank was still state owned. Consequently, shortly after winning the 1996 elections the PP could remove the president appointed by the PSOE, replacing him with Francisco Gonzalez, a broker with very close ties to Prime Minister Aznar (El Pais 20/10/1999; 21/03/2004; 29/01/2010; Gomez Escorial 2004). Gonzalez immediately embarked in a process of internal restructuring of Argentaria cutting the operational costs and increasing its efficiency (Gomez Escorial 2004). In 1998 the PP fully privatised Argentaria, although keeping golden share ownership powers over the firm. The PP considered the internal restructuring and privatisation of Argentaria the necessary premises for a future merger with BBV (Gomez Escorial 2004).

Additionally, the management of BBV saw a consolidation with Argentaria positively, deeming it necessary to match the size of Santander-BCH (El Pais 24/10/1999). However, BBV did not want to merge with Argentaria, it wanted to *acquire it* and remove Francisco Gonzalez, seen as a threat to the independence of BBV due to his close ties with the PP government

(Gomez Escorial 2004; El Pais 19/5/2002). BBV's ambition to acquire Argentaria rather than accept a merger among equals was grounded on the fact that BBV's profits of 139 billion pesetas (€835 million) more than doubled those of Argentaria (Cabreras and Del Rey 2008, p. 167). However, in October 1999 amid strong pressure from the government BBV finally accepted a merger of equals with Argentaria that led to the creation of BBVA (Cabrera and Del Rey 2008; El Pais 21/10/1999; 7/4/2002). It was agreed that the president of BBV Emilio Ybarra would be appointed president of BBVA until 2002, when he was to be replaced by Francisco Gonzalez (Gomez Escorial 2004). Key figures of the PP government including Aznar and Rato were directly involved in the merger negotiations and could decisively influence the operation in virtue of the golden share powers over Argentaria (El Pais 21/10/1999; 24/10/1999; Cinco Dias 15/03/1999; 2/2/1999; 23/9/1999).

In 2002, three years after the merger, the delicate managerial balance inside BBVA was altered by the discovery of a series illegal off shore accounts that had been used by BBV managers since the 1980s (Gomez Escorial 2004). The consequent scandal led to the removal of BBVA's President Ybarra and of other former members of the BBV managerial team, leaving the PP protégé Francisco Gonzalez as the undisputed leader of BBVA (Gomez Escorial 2004). Since the off-shore accounts dated back to the 1980s it is highly unlikely that either the management of BBVA, the Bank of Spain or the government were unaware of their existence. This prompted many observers to claim that the PP government simply used the off-shore scandal as a pretext to force Ybarra's removal (Garcia Calvo 2013; The Independent 19/04/1999; Cinco Dias 11/04/2002). This is a view shared as well by the economic spokesperson of the PSOE opposition Jordi Sevilla who affirmed that the off-shore case was 'a scandal affecting all Spanish people' because 'the (PP) Government took advantage of the off-shore accounts to gain control of BBVA'. Sevilla also questioned the strange nature of the BBV–Argentaria merger because the 'small fish ended up eating the big fish' (El Pais 13/04/2002).

In less than three years after it took office the PP had scored two important successes, giving Spain two banks with the potential to become European champions, and placing a politically close manager at the head of one of them (Guillen and Tschoegl 2008; El Pais 24/10/1999; 21/03/2004). The PP successfully completed the process of banking consolidation by strategically deploying two key ownership power resources: the direct ownership of a controlling stake in a large bank, Argentaria, and the establishment of golden share rights over the same. Thanks to these two ownership power resources the PP could use Argentaria as a

Trojan horse to ‘conquer’ BBV. In fact, the direct ownership of a controlling stake allowed the PP to place a politically close manager, Francisco Gonzalez, at the head of Argentaria, at that time the fourth largest domestic bank. Then, after Argentaria was fully privatised, the PP used its golden share powers to play an active role during the negotiations leading to the merger with BBV (El Pais 21/10/1999; Cinco Dias 12/13/1999; 23/09/1999). The political pressure exerted by the PP forced the management of BBV to accept a merger among equals with the smaller Argentaria, and to grant the PP protégé Francisco Gonzalez a key managerial position in BBVA (Cabrera and Del Rey 2008; El Pais 24/10/1999; 21/03/2004). Once Gonzalez had secured the appointment as co-president of BBVA, the PP could easily find an excuse, the off-shore scandal, to force the resignation of leading BBV managers and leave Gonzalez as the undisputed leader of BBVA.

With the emergence of BBVA and Banco Santander Hispano (later Banco Santander) the process of banking consolidation was brought to completion. As a result, in 2002 BBVA and Santander accounted for more than 50 per cent of the Spanish commercial banking sector (Aguilera 2004, p. 204), a figure that rose to 70 per cent by 2005 (Parada et al. 2009, p. 658). The fact that banking consolidation in Spain was completed already in the late 1990s, nearly a decade prior than in other EU countries like Italy, meant that since the early 2000s Spanish banks could focus their efforts on the penetration of foreign markets. Both the PSOE and the PP made frequent use of the diplomatic channel to help this process of foreign expansion (Toral 2008; Tekinbas 2009). For their internationalisation campaign, initially BBVA and Santander targeted Latin America, completing the first large acquisitions in the region between 1995 and 1996 (Gomez Escorial 2004, p. 18). Both banks saw their Latin American expansion as a defensive move to prevent foreign takeovers (Guillen and Tschoegl 2008). Because of their activism, by the early 2000s Santander and BBVA were the first and second largest banks, respectively, in the region (Guillen and Tschoegl 2008, p. 110). While Santander achieved a strong position in Brazil, Argentina, Chile and Mexico, BBVA focused in particular on the Mexican market becoming by far the dominant player (Deeg 2012). Later BBVA and Santander expanded as well in the European market, gaining an important presence in Portugal and trying to do the same in Italy (Guillen and Tschoegl 2008). However, the rest of the chapter will show that the protectionist attitude of Italian authorities forced BBVA and Santander to give up on their Italian strategy.

When in 2004 the PP was defeated by the PSOE and José Luis Zapatero replaced Aznar, the process of banking consolidation had already been completed. Furthermore, the PSOE lacked the ownership power resources necessary to influence the behaviour of BBVA and Banco Santander. Without directly owning a controlling stake in any of the banks, or at least golden share rights over them, the Zapatero executive could not remove the PP protégé Francisco Gonzalez from the Presidency of BBVA (El Mundo 7/04/2005; Daly Deal 21/01/2005). However, the Zapatero governed could still play a role in helping the internationalisation of Spanish banks. A decisive step in this regard occurred in 2004 when Santander took over the UK bank Abbey National in an operation worth €13 billion – at the time the largest ever cross-border banking acquisition in Europe (Parada et al. 2009, p. 669). Although both BBVA and Santander are European champions, the acquisition of Abbey National represented the quantum leap that turned Santander into a global leader (Guillen and Tschoegl 2008). As a result, by 2016 Santander was the second largest bank in the Eurozone by market capitalisation and fourth by assets, while BBVA was fifth and fourteenth (Accuity 2016; Banksdaily 2016).

4.3 Italy

4.3.1 The pre-reform status quo

Until the early 1990s Italy had a heavily regulated and highly fragmented banking sector. Unlike in Spain, most domestic banks were state-owned. Widespread state ownership dated back to the Great Depression of 1929 when the three largest investment banks went bankrupt and were taken over by the state (Aganin and Volpin 2005). The Fascist dictatorship placed the three banks under the umbrella of the industrial conglomerate *Istituto di Ricostruzione Industriale* (IRI) and created a fourth state-owned bank the *Istituto Mobiliare Italiano* (IMI) to extend medium and long-term loans to industry (Ferrarini 2005). Initially meant as a short-term emergency measure, state ownership became a permanent solution. As a result, in 1991 state-owned banks accounted for 80 per cent of the credits and gave 90 per cent of the loans (McCann 2007, p. 108). In 1992 the state directly or indirectly controlled 75 per cent of the banking sector compared to 62 per cent in Germany and 36 in France (Inzerillo and Messori 2000, p. 129). Widespread state-ownership meant that banks were often captured by political parties. Local and national politicians dominated the board and dictated credit decisions, and banking was seen more as a function of public service rather than a for profit commercial activity (Deeg 2005).

Along with widespread state ownership, the second hallmark of the Italian banking sector was its heavily regulated nature. Under the 1936 Banking Law credit institutions were not allowed to own shares in non-financial firms, and only special credit institutions could engage in medium and long-term lending (Deeg 2005). Legal segmentation prevented competition between commercial, savings and cooperative banks (Quaglia 2014), and banks faced rigid regional branching restrictions (McCann 2007). This intrusive regulation weakened the bank-firm relationship preventing banks from having a say over the management of industrial companies. Lack of oversight over their industrial borrowers, in turn, confined Italian banks to a marginal role in domestic capitalism (Melis 2000). As a result, while in Spain the bank-industry relation was unbalanced in favour of large private banks, in Italy manufacturing families had the upper hand over their banking creditors. The only exception to the weakness of Italian banks was the Milan-based investment bank Mediobanca that was exempted from most legal restrictions (McCann 2000a). This allowed Mediobanca and its undisputed leader Enrico Cuccia to occupy a pivotal position in Italian capitalism, becoming the key allied of family blockholders.

Restrictive regulations and constant political interference in their activity hampered the efficiency of Italian banks. Consequently, even though they charged comparatively high interest rates, Italian banks were nevertheless among the least profitable in the EU. In 1994 their Return on Equity (ROE) was 0.8, compared to 3.4 in France, 5.1 in Germany and 11.3 in Spain (Ibanez and Molyneaux 2002, p. 46). Low efficiency was the result of uncontrolled branching proliferation and high operational costs (Inzerillo and Messori 2000). In addition, the banking sector was characterised by a very low level of concentration. In 1990 the five largest Italian banks accounted for 19 per cent of the sector, compared to 35 in Spain and 43 in France, making Italy the country with the lowest level of banking concentration in the EU after Germany (Inzerillo and Messori 2000, p. 137).

Although the government and the Bank of Italy were acutely aware of the lack of efficiency of Italian banks, reforms were delayed until the early 1990s. This was because of the Christian Democrats and the other ruling parties feared that by liberalising the credit system they could lose control of the main domestic banks (McCann 2007; Quaglia 2014).

4.3.2 The Centre-Left in power: Banking liberalisation and privatisation

Banking liberalisation had to wait until the early 1990s when the Christian Democrats were replaced by a group of technocrats from the Bank of Italy and the Treasury (Deeg 2005). The reform-minded technocrats were well aware of the fact that Italian banks lacked the size and efficiency to compete in the European market (Quaglia 2014). To address this issue, since the early 1990s they implemented a series of measures including the liberalisation of banking activity, the privatisation of state-owned banking groups, and the promotion of a process of sheltered consolidation among domestic credit institutions (Deeg 2005).

The first relevant piece of legislation passed by the technocrats was the 1990 Amato Law that transformed local savings banks into joint stock options paving the way for their privatisation and consolidation (Deeg 2005). The Amato law gave the control of local savings banks to not-for-profit banking foundations formally engaged in charitable activities (Messori 2002). The largest among these banking foundations progressively came to occupy a prominent position in the ownership of many of the main domestic banks (McCann 2007). If on the one hand this could create a problem for the management of privatised banks, as foundations were often controlled by local politicians and lacked transparent governance rules (Inzerillo and Messori 2000),[5] on the other hand foundations gave ownership stability to the privatised savings banks, and their cross-shareholding networks contributed to speeding-up the process of banking consolidation (Inzerillo and Messori 2000). Since banking foundations were often indirectly controlled by the state or local governments it can be argued that this privatisation strategy bears resemblance with the partial privatisation of other large state-owned firms like ENEL described in chapter 6. In fact, through the banking foundations the state could maintain a certain degree of control over local savings banks even after their privatisation.

The Amato law was followed in 1993 by a new Banking Law that brought the Italian legislation in line with the EU Directives (Quaglia 2014). The 1993 Banking Law introduced universal banking by allowing banks to own shares in non-financial firms and eliminating the distinction between different types of credit institutions. In addition, the law introduced in Italy the EU ‘Single Passport’ principle thus formally opening the Italian market to foreign banks

[5] The most striking example of this risk is the mismanagement of the Siena-based bank Monte dei Paschi by the controlling banking foundation.

(Deeg 2005). Nevertheless, the Italian government and the Bank of Italy retained ample room of manoeuvre in sheltering domestic banks from foreign takeovers.[6]

Along with the liberalisation of banking, the technocrats and the Centre-Left superseded as well to the privatisation of state-owned banks. The sell offs most notably involved the seven largest domestic banks that in the early 1990s were still directly or indirectly controlled by the state (Messori 2002, p. 189). When privatising the main domestic banks, the technocrats initially followed a different strategy than with local savings banks opting for public offerings aimed at attracting small investors. This way they aimed at diffusing share ownership to create true public companies. This strategy was chosen in 1993 for the privatisation of two of the largest domestic banks: Comit and Credit (McCann 2000b). However, the public company strategy ended up in a fiasco as shortly after privatisation the investment bank Mediobanca, ally of the manufacturing blockholders, succeeded in getting control of both banks by repurchasing shares from small shareholders. The failure of the privatisation of Comit and Credit convinced the technocratic governments, and the centre-left executive that took power in 1996, to conduct the remaining banking privatisations through private auctions aimed at forming hard cores of selected investors (Inzerillo and Messori 2000). These selected investors often included the foundations that controlled local savings banks. Consequently, a restricted number of banking foundations came to occupy a key position in the ownership of the largest domestic banks (Inzerillo and Messori 2000). Along with banking foundations, also foreign banks like France's Credit Agricole, the Netherlands' ABN Amro and the Spanish BBVA and Santander acquired relevant stakes in the privatised banks. However, the Bank of Italy and the government prevented foreign credit groups from acquiring controlling stakes in the privatised banks, relegating them to the role of passive investors (Guillen and Tschoegl 2008).

Because of the wave of privatisations by 2001 state ownership in the banking sector had become negligible (0.12 of the sector). It had been 70 per cent in 1992 (Messori 2002, p. 184). It is important to highlight that, while in the early 1990s state ownership in the banking sector was widespread in Italy and absent in Spain, by the end of the decade a complete reversal had occurred as the Italian state had given up its ownership power over domestic banks, while the Spanish state owned a controlling stake and had golden share powers over Argentaria,

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[6] The last relevant piece of legislation implemented by the Centre-Left was the 1998 Ciampi Law that forced foundations to reduce their stakes in banks below 50 per cent (Quaglia 2014). However, this provision did not call into question the key role of foundations in the ownership of banks as in firms with diffused ownership it is possible to have a decisive influence even owning a stake considerably lower than the absolute majority.

the fourth largest domestic bank. The following sections will show that this difference had a decisive influence on the timing of the process of banking restructuring in Italy and Spain.

4.3.3 The first wave of consolidation under the Centre-Left

Despite the important liberalising reforms implemented by the centre-left and technocratic governments, and the wave of privatisations that took place throughout the 1990s, Italian banks were still too small and inefficient to compete in the European market. In 1997 the five largest Italian banks accounted for less than 25 per cent of the sector, making Italy the country with the second lowest level of banking concentration in the EU (Messori and Inzerillo 2000, p. 136). That same year Italian banks had a lower ROE than their counterparts from France, Germany, Spain and the UK, and were second only to French banks in the ratio of operating costs to income (Messori 2002, p.198). Furthermore, while many foreign banks had acquired large stakes in Italian banks, the foreign presence of Italian banks was limited to some minor acquisitions in Eastern Europe (Messori 2002). Consequently, Italy faced the concrete risk of being a passive witness in the process of cross-border banking consolidation and of failing to produce European champions in the sector leading to banks being taken over by foreign competitors.

The weakness of Italian banks was a cause of concern for the centre-left government that since 1996 started pushing for a wave of sheltered consolidation among domestic banks (McCann 2007). When launching the process of sheltered consolidation, the Centre-Left found a crucial ally in the Bank of Italy under the leadership of Governor Antonio Fazio. Throughout the 1990s, in his speeches Fazio made constant references to the need for domestic banks to increase their size to avoid being taken over by foreign competitors (Banca D'Italia 1998, p. 35; 1999, p. 18; Montanaro and Tonveronachi 2006). The Bank of Italy could decisively influence the process of banking consolidation because, like Spain, it retained ample room of manoeuvre in regulating the banking sector. Despite the EU-led process of market integration, banking supervision remained a task of each member state's Central Bank (Garcia Calvo 2013). The Bank of Italy was even more powerful than its Spanish counterpart. In fact, under Italian legislation no individual could acquire a stake greater than five per cent in a bank without prior approval from the Central Bank (McCann 2007, p. 112), while the approval from the Bank of Spain was required only to acquire stakes greater than 15 per cent. Since the mid-1990s the Centre-Left and the Bank of Italy exploited their ample discretionary powers to favour a process of sheltered consolidation similar to that overseen by the Spanish PSOE in the late 1980s. Similar to the PSOE, the Centre-Left took advantage of the wave of mergers to favour the emergence of politically close bankers (Deeg 2012).

The first relevant operation was agreed in 1997 when two banks from northern Italy, Cariplo and the Banco Ambrosiano Veneto, merged to create Banca Intesa. The banking foundations controlling Cariplo and Banco Ambrosiano Veneto played a key role in favouring the merger, and retained a pivotal position in the ownership structure of Intesa, with a combined stake of 25 per cent, like that of the French bank Credit Agricole. The operation was strongly supported both by the Centre-Left and by the Bank of Italy (Corriere Della Sera 20/5/1997). The Centre-Left backed the deal also because the president of Intesa Giovanni Bazoli had leftist sympathies and very close ties with Prime Minister Romano Prodi (Corriere Della Sera 20/5/1997; 21/4/2000; Il Foglio 25/05/2008). The proximity between Bazoli and the Centre-Left is confirmed by the fact that he was asked to be the leader of the centre-left coalition at the 2001 general elections (Corriere Della Sera 9/6/2000). In the early 2000s Bazoli appointed Corrado Passera, another left-leaning manager, as CEO of Intesa.

The creation of Intesa was followed in 1998 by the merger between San Paolo and IMI. The bank resulting from the merger, San Paolo-IMI, had three banking foundations as its main shareholders with an aggregate share of 25 per cent, followed by Spain's Santander (Corriere Della Sera 27/4/1998). The centre-left government applauded the operation with Deputy Prime Minister Walter Veltroni declaring that 'Italian banks have a problem of size when compared to their international competitors, consequently it is normal to have mergers and aggregations' (Corriere Della Sera 12/2/1998).

Always in 1998 Credit merged with a consortium of savings banks to form Unicredito Italiano, a large bank mainly located in northern Italy ranked fifth in the European rankings (Corriere Della Sera 16/04/1998). The move was praised by both the Bank of Italy and the Centre-Left (Corriere Della Sera 17/04/1988). Led by CEO Alessandro Profumo, another manager close to the Centre-Left, Unicredito Italiano quickly emerged as the most dynamic Italian bank (Corriere Della Sera 3/07/2005; 4/08/2007). After having cut Unicredito's operational costs Profumo engaged in an aggressive campaign of foreign expansion in Central and Eastern Europe (Oddo and Pons 2005).

The last relevant operation that took place under centre-left rule was the takeover of Comit by Intesa completed in 1999. After this acquisition three banking groups dominated the

Italian market: Intesa, San Paolo-IMI and Unicredit.[7] Like the PSOE in Spain it was the Centre-Left in Italy that oversaw the first wave of consolidation among domestic banks. Moreover, and again like the PSOE, it completed the process while favouring the rise of banking groups guided by left-leaning managers. The CEOs of Intesa and Unicredit were vocal supporters of the Centre-Left and regularly voted at the leftist primaries (Corriere Della Sera 15/10/2007; Barbacetto 2005), while the president of the banking foundation that controlled San Paolo-IMI was close to the PDS, the successor to Italy's communist party (Corriere Della Sera 22/5/1997). The wave of mergers led to a sizeable increase in the level of banking concentration as in 1999 the five largest banking groups controlled 50 per cent of the domestic market (up to 29 per cent in 1991) a share close to the EU average of 57 per cent (Messori 2002, p. 186). Increased concentration came with improved banking efficiency due to a remarkable reduction in operational and staff costs and an increase in the ROE (Messori 2002, p. 197).

Despite these improvements, however, Italian banks were still too small to compete in the European market, and their foreign presence was still limited (except for Unicredit in Eastern Europe). In 2000 Italy's largest bank was outside the top fifteen in Europe and the top thirty worldwide (Messori 2002, p. 204). In addition, despite the veto on foreign takeovers by the Bank of Italy, foreign credit groups like Credit Agricole, ABN Amro, Santander and BBVA had acquired relevant stakes in the largest Italian banks (Inzerillo and Messori 2000). Consequently, when in 2001 the Centre-Left lost the elections to Berlusconi's Centre-Right right scope for further consolidation remained.

4.3.4 The slowdown in banking consolidation under the Centre-Right

When the Centre-Right won the 2001 elections it found itself in a situation like that of the Spanish PP in 1996. Always in opposition[8] like the PP, the Centre-Right had witnessed the 'colonisation' of the banking sector by managers with leftist sympathies. Intesa and Unicredit were routinely labelled 'banks of the centre-left' by the press (Oddo and Pons 2005, p. 67). The banking foundation controlling San Paolo-IMI was also close to the leftist coalition. Prime

[7] The acquisition of Comit by Intesa sanctioned the decline of Mediobanca's influence over the banking sector, as Credit and Comit had both become part of larger banking groups.

[8] Except for the Berlusconi executive of 1994–5, which lasted less than a year.

Minister Silvio Berlusconi and Minister of Finance Giulio Tremonti did not hide their frustration for the proximity between the Centre-Left and the main domestic bankers (Corriere Della Sera 19/10/2005; La Repubblica 8/03/2003; Turani 2005, p. 10). For instance, in 2003 a weekly paper owned by Berlusconi claimed that Unicredit and Intesa were sponsoring a 'judicial coup' to replace Berlusconi with Prodi (La Repubblica 14/03/2003). And in 2005, commenting on the fact that most leading banking managers had voted at the leftist primaries, Berlusconi stated: 'The left controls all the main domestic banks, and this should be a matter of concern for Italian voters' (La Repubblica 19/10/2005).

This brief description clearly shows how on the issue of banking consolidation the Centre-Right had similar goals to the Spanish PP: regaining control of a banking sector dominated by politically hostile managers, while at the same bringing the process of banking consolidation to completion giving Italy banks with sufficient size to become European champions. The Spanish case study has shown how Aznar indeed succeeded in putting a protégé of the PP, Francisco Gonzalez at the head of BBVA. This successful outcome was conditional on the availability of two decisive ownership power resources: the direct ownership of a controlling stake in a large domestic bank (Argentaria) and the establishment of a golden share over the same bank. These two ownership power resources allowed the PP to use Argentaria as a Trojan horse.

However, this strategy was not available to the Centre-Right. Following the wave of privatisations of the 1990s the state did not own controlling stakes or have golden share powers over any large domestic bank (Messori 2002). Lacking ownership power resources, the Centre-Right had to find alternative strategies to favour the emergence of a politically close bank. In 2001 the Centre-Right tried to increase its influence over the three large banks close to the Centre-Left by passing a law that expanded the role of local and regional politicians in the governance of banking foundations (Corriere Della Sera 14/07/2000; Il Foglio 25/05/2008; McCann 2007). This way the Centre-Right, which controlled most of the local governments in northern Italy, hoped to increase its partisan proximity power over the banking foundations that owned large stakes in Unicredit, Intesa and San Paolo-IMI. However, in 2003 the reform of banking foundations was repealed by the Constitutional Court (Oddo and Pons 2005).

Lacking the means to influence the governance of the three largest banks, the Centre-Right had no option but to favour the growth of a politically close, mid-sized credit institution (Oddo and Pons 2005; Turani 2005). This effort to create a Centre-Right aligned banking champion was supported especially by the Northern League, a regional party allied to

Berlusconi with a strong electoral base in northern Italy (Turani 2005; La Repubblica 23/12/2005), and by the Governor of the Bank of Italy, Antonio Fazio. In fact, although Fazio had favoured the first wave of mergers among large domestic banks, from the late 1990s he progressively changed his stance towards banking consolidation (Banca d'Italia 2002, p. 29-30; Corriere Della Sera 10/10/2000). In 2000 he argued that because the five largest banks accounted for 50 per cent of the sector there was no room for further consolidation (Corriere Della Sera 20/10/2000). True to his words, after the acquisition of Comit by Intesa in 1999 Fazio blocked all merger plans involving the three largest domestic banks (Intesa, San Paolo-IMI and Unicredit) (Financial Times 30/11/2004). In 2000 he vetoed a merger between Intesa and San Paolo-IMI (Corriere Della Sera 24/8/2000), while the following year he judged negatively a merger between Intesa and Unicredit that would have led to the acquisition of a mid-sized bank by San Paolo-IMI (Corriere Della Sera 4/2/2001). Furthermore, in 1999 Fazio expressed his concern over the attempted merger between Uncredit and Spain's BBVA, ultimately leading to its failure (Corriere Della Sera 16/10/1999).

The veto of the Bank of Italy against any merger involving the three largest domestic banks was in line with the goals of the Centre-Right, as it prevented banking groups guided by leftist managers from further strengthening their position in the domestic market. For this reason, Berlusconi and other Centre-Right politicians publicly expressed their support for Fazio's approach to banking consolidation (La Repubblica 15/01/2005; Financial Times 17/01/2005). Frustrated by Fazio's vetoes of their merger plans, the most dynamic Italian banks started working on cross-border deals. In 2005 Unicredit acquired Germany's HVB in an operation worth €19 billion that was at the time the largest cross-border banking acquisition in the EU (Corriere Della Sera 13/6/2005). HVB was a major player in the German market with a strong position in Bavaria, Austria and Eastern Europe. Also, San Paolo-IMI entered talks for a merger with the Franco–Belgian Dexia, although the deal derailed amid resistance from Dexia's shareholders.

The Centre-Right also supported the second pillar of Fazio's approach to banking consolidation: protection of mid-sized banks from foreign takeovers (Corriere Della Sera 6/07/1998; Financial Times 12/04/2005; Messori 2005). In fact, since the early 2000s foreign banks had started targeting Italian mid-sized credit institutions. Wishing to protect the 'Italianness' of the credit system, Fazio shut the door to foreign investors, favouring at the same time a process of sheltered consolidation among mid-sized banks with the intent to see new banking groups with a size similar to that of Unicredit, Intesa, and San Paolo-IMI emerge

(Banca d'Italia 2000, p. 15; Messori 2005). Fazio's plan to merge mid-sized banks was in line with the Centre-Right's desire to challenge the domination of the 'leftist bankers' through a fourth large bank aligned with the Centre-Right (Turani 2005). The Centre-Right and the Bank of Italy also protected mid-sized banks because they feared that the entry of foreign banks would break Italy's close relationship between local banks and the small and medium enterprises of the northeast (McCann 2007).

The takeover battle for control of the mid-sized Banca Antonveneta (BAV) gave the Centre-Right and the Bank of Italy an occasion to put their plan to create a new banking giant politically close to the Centre-Right into practice. The battle started in early 2005 when the Netherlands' ABN Amro announced its intention to acquire BAV. The threat of a foreign takeover led to a rival bid from *Banca Popolare di Lodi* (BPL), a mid-sized bank with a capitalisation of less than 50 per cent of BAV's (Messori 2005, p. 152). The CEO of BPL, Gianpiero Fiorani, had strong personal ties with Governor Fazio, and was politically close to the Centre-Right, especially the Northern League (Financial Times 28/07/2005; 29/07/2005; La Repubblica 20/12/2005; Turani 2005; Malaguti and Onado 2005). During a meeting with Fiorani, Berlusconi gave his full support to the takeover (La Repubblica 22/03/2013), as he saw the strengthening of BPL as a way to counterbalance the dominance of the large 'leftist' banks (Barbacetto 2005).

However, in late 2005 the attempt to create a Centre-Right aligned banking champion failed as Italian public prosecutors suspended Fiorani from BPL and arrested him on charges of insider trading (Quaglia 2005). Fiorani's arrest led to the immediate withdrawal of BPL's bid for BAV. Because of his intimacy with Fiorani, Fazio was also put under judicial investigation for insider trading and abuse of office (McCann 2007). Meanwhile his protectionist manoeuvres had come under scrutiny of the European Commission on grounds that they could jeopardise cross-border competition in banking (Quaglia 2005). Initially the Centre-Right defended Fazio with Berlusconi stating in August 2005 that 'No one in the government has ever had, has or will have the intention of putting someone on trial, least of all the Bank of Italy governor' (Financial Times 2/8/2005). However, as growing evidence of Fazio's wrongdoings made his position indefensible, the Centre-Right had to back down and ask him to resign (Messori 2005). He finally did so in December 2005. Shortly afterwards the centre-right government was defeated by the Centre-Left which returned to power after five years in opposition.

While banking consolidation under centre-left rule was a success, the failure of BPL's takeover of BAV points to the failure of the Centre-Right's plan to create a new, politically close banking champion. In addition, the Bank of Italy's veto against mergers between the three largest banks meant that the level of banking concentration in 2006 was like that of 2001. The Centre-Right's failure was not due to a different attitude towards banking consolidation than its opponents, as partisan theorists would argue (Cioffi and Hoepner 2006), but instead to the lack of key ownership power resources at crucial moments during the process of domestic consolidation.

A comparison between the Centre-Right and Spain's PP is particularly telling in this regard. As seen in the previous section in the brief stint of three years the PP successfully completed the process of banking consolidation putting a politically close manager at the head of BBVA in the process. The success of the PP was conditional on the availability of two key ownership power resources: the direct ownership of a controlling stake in a large domestic bank, and the availability of golden share rights over the same bank. Lacking these two power resources, the Centre-Right had to opt for an alternative strategy to favour the emergence of politically close bankers. This involved on the one hand the support to the Bank of Italy's veto against mergers between 'leftist' bankers, and on the other hand efforts to turn a politically close, mid-sized bank into a new 'banking champion'. However, this strategy did not yield the expected results and when the Centre-Left returned to power banking consolidation had not yet been completed.

4.3.5 The return to power of the Centre-Left and the second wave of consolidation

Shortly before leaving office the Centre-Right had passed a reform of the Bank of Italy's statute that strengthened the Executive Board vis-à-vis the Governor, and introduced a fixed-term mandate for the Governor (Quaglia 2005). In late 2005 Mario Draghi, a Goldman Sachs banker and former Director General of the Treasury, replaced Fazio as Governor of the Bank of Italy. During his years at the Treasury in the 1990s, Draghi had been among the main architects of the liberalising reforms implemented by the Centre-Left (Deeg 2005). Although not fully liberal, as he shared the goal of promoting the emergence of Italian banking champions capable of competing in the European market, Draghi was less openly protectionist than Fazio (Deeg 2012). The appointment of Draghi was followed by the victory of Romano Prodi's Centre-Left in the 2006 general elections.

Due to the slowdown of banking consolidation under the Centre-Right, in 2006 the four largest domestic banks controlled 44 per cent of the market, a share similar to that of the late 1990s (Financial Times 12/04/2005). As a result, Italy had the lowest level of banking concentration in the EU after Germany (Quaglia 2005). Low concentration made Italian banks potential targets of foreign takeovers, which was as recognised as well by the CEO of Intesa Corrado Passera (Financial Times 12/04/2005). Consequently, there was scope for a further round of consolidation among the four main domestic credit groups: Unicredit, San Paolo-IMI, Intesa and the large but inefficient, Rome-based Capitalia.

In 2006 Draghi expressively referred to the need for further consolidation arguing that: 'It is desirable that the process of consolidation in the banking sector should start up again as there is still ample room for mergers'. Directly addressing the main domestic bankers Draghi added: 'You, the chairmen and chief executives, have the responsibility to create European operators able to exploit the opportunities not just of the national market – or to leave these opportunities to be taken up by foreign investors' (Financial Times 12/06/2006). Draghi's approach to banking consolidation was at odds with Fazio's, as he pushed for a process of sheltered consolidation among the four largest banks while at the same time allowing foreign acquisitions of mid-sized banks (Financial Times 19/10/2006; Il Sole 24 Ore 29/05/2011; Quaglia 2005). Proof of this changed attitude is the fact that shortly after Draghi took office the Netherlands' ABN Amro completed the takeover of BAV, while France's Credit Agricole acquired the *Banca Nazionale del Lavoro*, another mid-sized bank involved in takeover disputes during Fazio's governorship.

The centre-left government was equally supportive of mergers that would allow the emergence of domestic banks with the potential to become European champions. In 2006 Minister of Finance Tommaso Padoa-Schioppa declared: 'We want to see a strong Italian banking system… which knows how to expand in the great European market and in the global one' adding that 'patriotism is a virtue' but 'It must be practiced according to the rules, which these days are European, and with the right manual, which is not a protectionist manual' (Financial Times 12/06/2006; Corriere Della Sera 19/05/2007). The Centre-Left supported big mergers also because they would inevitably strengthen the three largest banking groups, Intesa, Unicredit and San Paolo-IMI, all guided by politically close managers, thus increasing their partisan proximity power over the banking sector.

The changing attitude of the government and the Bank of Italy immediately bore some fruit as in 2006 Intesa and San Paolo-IMI announced their intention to merge forming Intesa–

Sanpaolo a banking giant that alone accounted for 20 per cent of the Italian market (Financial Times 19/10/2006). The Prime Minister Romano Prodi followed closely the negotiations in virtue of his personal ties with the management of both banks (Corriere Della Sera 24/8/2006), and when the deal was nearly sealed he affirmed: 'I hope this operation goes ahead, because it's a good thing, a really good thing for the Italian banking system (as) this will provide Italy with two groups of international size – Unicredit and the entity born out of this operation'. (Financial Times 24/8/2006).

The merger between Intesa and Sanpaolo-IMI triggered a defensive move by the third large Italian bank, Unicredit, that acquired the large but inefficient Capitalia. The acquisition made Unicredit the second largest bank in the EU and the largest bank in the Eurozone with market capitalisation of €100 billion (Financial Times 20/5/2007). The Prime Minister Prodi applauded 'the strengthening of Italian credit institutions' while Minister of Finance Padoa-Schioppa labelled the new bank 'A European if not global champion' (Corriere Della Sera 19/5/2007). For his part, the CEO of Unicredit and supporter of the Center-Left, Alessandro Profumo, highlighted the crucial role played by the Bank of Italy in facilitating the operation (Corriere Della Sera 21/5/2007). The activist role played by the Bank of Italy in favouring Unicredit's acquisition of Capitalia shows that, although less protectionist than Fazio, Draghi also prioritised the strengthening of domestic banks over competition (Deeg 2012). In fact, Draghi, resisted calls from Capitalia's management to allow foreign banks to present a competitive bid giving instead immediate green light to Unicredit (Financial Times 21/5/2007).

With the two mergers of 2006 and 2007 the process of banking consolidation was completed as Intesa-Sanpaolo and Unicredit together accounted for more than 40 per cent of the domestic market. The two big banks had also reached a size that allowed them to be considered European champions, having climbed from the seventh and eighteenth place to the third and eleventh place, respectively, in the EU rankings (Banca d'Italia 2007, p. 16-7). In addition, the mergers diluted the stakes held by foreign banks in Intesa-Sanpaolo and Unicredit, thus ruling out the possibility of foreign takeovers. This was the result of Draghi's 'pragmatic' policy of favouring mergers among the largest domestic banks, while allowing non-systemic banks to be taken over by foreign investors. The retreat of foreign investors led to a relative strengthening of banking foundations that occupied, and still occupy, a prominent position in the ownership of Intesa–Sanpaolo and Unicredit (Deeg 2012).

In its brief stint of two years the Centre-Left had succeeded in creating two European champions guided by politically close managers. In fact, the CEOs of Intesa–Sanpaolo and

Unicredit voted at the 2007 Centre-Left primaries and routinely expressed their support to the executive (Corriere Della Sera 15/10/2007). This caused frustration within the ranks of the Centre-Right with the MP Giorgio Jannone stating that 'Through his interventionism and patronage Romano Prodi has managed to put his men at the top of the Italian banking system' (Corriere Della Sera 1/6/2007), for his part during the 2008 electoral campaign Berlusconi remarked that 'We are friends with the people, the left is friends with the bankers' (Barbacetto 2005). The success of the Centre-Left was down to the fact that three largest domestic banks were still guided by politically close managers when it returned to power. Having this key partisan proximity power resource at its disposal, the Centre-Left simply needed to favour a process of consolidation among the three largest banks to produce politically aligned banking giants. Instead, the Centre-Right had to create its own banking giant by strengthening smaller banks, an objective that proved impossible to achieve without the key ownership power resources available to Spain's PP.[9]

After completing the process of banking consolidation, both Unicredit and Intesa-Sanpaolo focused on foreign expansion, although choosing different strategies. Unicredit opted for an aggressive internationalisation campaign initially targeting Central and Eastern Europe, where it became the largest banking group. It later moved into core EU markets like Germany and Austria, where it became a key player with the acquisition of HVB (Deeg 2012). Intesa–Sanpaolo on the other hand, while having a non-negligible presence in the Balkans, the CEEC, and Turkey, focused mainly on strengthening its position in the domestic market and improving its efficiency (Deeg 2012). The efficiency gains realised by the management saw the bank produce strong results in the 2016 stress tests performed by the ECB (Noonan et al. 2016).

4.4 Cross-country comparison

The chapter has analysed the process of industrial restructuring that led to the emergence of four European banking champions in Italy and Spain. It was shown how the emergence of Intesa–Sanpaolo and Unicredit in Italy and BBVA and Santander in Spain was the result of a process of sheltered consolidation among domestic banks overseen by the government and the Central Bank. Even though the process of industrial restructuring led to a similar outcome in

[9] It should be noted that since the late 2000s the Centre-Right has managed to exert a greater influence over Unicredit and Intesa-Sanpaolo. This came after the ousting of Alessandro Profumo from Unicredit and the distancing of the CEO of Intesa-Sanpaolo Corrado Passera from the Centre-Left. However, this process did not affect the pace of banking consolidation, as it occurred after the two European champions had already been created.

the two countries an important difference in terms of timing needs highlighting. Spain completed the process of banking consolidation seven years ahead of Italy. While the last relevant operation among Spanish banks occurred in 1999 (merger BBV-Argentaria), in Italy it was finalised only in 2007 (acquisition of Capitalia by Unicredit).

This difference is crucial as it explains why, even though all four Southern European banks can be considered European champions, Spanish banks outperform their Italian rivals in terms of size and efficiency. In fact, Spain succeeded in developing by far the largest bank, Santander, and nowadays Santander and BBVA have better performance than Unicredit. For instance, while BBVA and Santander (but also Intesa–Sanpaolo) fared well in the 2016 ECB stress tests, Unicredit barely passed the test with the sixth worst ratio among the 51 banks monitored. This difference in performance is because of, having completed the process of domestic consolidation as early as in 1999, BBVA and Santander had seven years to 'digest' the banks they had acquired, optimise their internal structure and focus on their foreign expansion. Instead, Italian banks and in particular Unicredit made their last relevant acquisitions right before the crisis. This meant that Unicredit acquired overvalued banks like Capitalia and some of the banks acquired in Eastern Europe, and was hit by the crisis when it was in the midst of a process of internal restructuring. This in turn weakened Unicredit opening a period of difficulties that was overcome only recently with the appointment of the new CEO Jean Pierre Mustier. Even though also Intesa–Sanpaolo was created shortly before the crisis, in that case the reorganisation proved less difficult as the bank resulted from the merger between two fairly efficient credit groups.

The direct relationship between the delayed acquisition of Capitalia and the difficulties recently experienced by Unicredit is confirmed by the fact that most of the €17.7 billion of bad loans Unicredit sold to Pimco and Fortress in 2017 dated back to the acquisition of Capitalia (Financial Times 17/07/2017; La Repubblica 14/12/2016). Apart from the bad loans inherited by Unicredit as a consequence of the acquisition, Capitalia was itself hugely overvalued[10]. Suffice to say in this regard that Unicredit in 2007 paid €15 billion for Capitalia, a figure close to what in 2011 was the market capitalisation of the entire group (La Repubblica 14/11/2011).

[10] It is worth noting that the financial press and market observers considered the acquisition of Capitalia a risky move already back in 2007, i.e. before the triggering of the subprime crisis, due the inefficient lending practices of the Rome-based bank (La Repubblica 15/05/2007; La Repubblica 16/06/2008). This negative assessment led Unicredit shares to lose 50 per cent of their value between 2007 and 2008, underperforming compared to most European and Italian banks (La Repubblica 30/09/2008). A further drop meant that between 2007 and 2016 Unicredit lost 87 per cent of its market value (Financial Times 12/01/2016).

Profumo himself later recognised that the Capitalia acquisition has been a decisive mistake motivated by the idea that ‘at the time all the world looked rosy’ (La Repubblica 7/10/2008).

Government	Years	Ownership Power	Regulatory Power	Partisan Proximity Power	Industrial Restructuring Outcome
Centre-Left	1996–2001	1996–9: *Weakening* due to privatisation 1999–2001: *Absent*	*Strong* Due to the limited size of domestic banks could favour the rise of politically close managers	*Strong* Three largest domestic banks guided by politically close managers	*Success* Wave of domestic M&A Emergence of three large banks Guided by politically close managers
Centre-Right	2001–6	*Absent* No direct ownership in any large bank No golden share powers over any large bank	*Weakening* Could not force managerial changes in three largest banks	*Absent* Three largest banks guided by politically hostile managers	*Failure* Slowdown of domestic consolidation Failure of the plan to upgrade mid-size banks No banking giant close to the CR
Centre-Left	2006–8	*Absent* No direct ownership in any large bank No golden share powers over any large bank	*Weakening*	*Strong* Three largest domestic banks guided by politically close managers	*Success* Completion of domestic consolidation Emergence of two European champions

Table 4.1 Ownership, Regulatory, Partisan Proximity Power and Industrial Outcomes in the Italian Banking Sector

Government	Years	Ownership Power	Regulatory Power	Partisan Proximity Power	Industrial Restructuring Outcome
PSOE	1982–96	1982–95: *Weak* Ownership of small domestic banks 1995–6: *Strong* State-owned banks merged to create Argentaria (fourth largest) Golden share powers over Argentaria	*Strong* Due to the limited size of domestic banks could favour the rise of politically close managers	*Strong* Argentaria and BBV guided by politically close managers Santander neutral	*Success* Wave of domestic M&A Emergence of three large and efficient banks Guided by politically close managers
PP	1996–2004	1996–9: *Strong* Direct ownership of controlling stake in Argentaria Golden share powers over Argentaria	*Strong* Forced managerial shake up in BBVA through the off-shore accounts scandal.	*Strengthening* 1996 Managerial shake up in Argentaria 1999 Manager close to the PP (Gonzalez) at the head of BBVA 2002 Gonzalez undisputed leader of BBVA	*Success* Emergence of two European champions Guided by politically close managers
PSOE	2004–12	*Absent*	*Weak*	*Weak* BBVA guided by politically hostile manager Santander neutral	*Limited impact* Could not force managerial shake ups Helped internationalisation

Table 4.2 Ownership, Regulatory, Partisan Proximity Power and Industrial Outcomes in the Spanish Banking Sector

The delayed completion of the process of banking consolidation in Italy occurred because no relevant operation between the three largest domestic banks was agreed between 2001 and 2006. This was even though between 1999 and 2001 Unicredit, Intesa and San Paolo-IMI had presented three mergers plans that would have allowed to bring the process of domestic consolidation to completion. Accordingly, even though Italian banks had started the process of consolidation a decade later than their Spanish counterparts (1997 vs. 1987), they were nevertheless ready to complete it as early as 1999. It was the veto of the Bank of Italy (with the support of the Centre-Right) that delayed banking consolidation.

The fact that the slowdown of banking consolidation coincided with the advent of the Centre-Right to power seems to corroborate the findings of partisan theorists (Deeg 2005; Cioffi and Hoepner 2006). However, this chapter has shown how the lack of mergers and acquisitions under the Centre-Right was not due to a difference in the attitude towards banking consolidation between the two camps. In fact, Italian governments of both colours (like their Spanish counterparts) were motivated by the same goals when approaching banking consolidation: promoting the emergence of large and internationally competitive domestic banks, and placing politically close managers at the head of them. In the context of this partisan struggle for the control of the banking sector, being in office at the onset of the process of banking consolidation was an important advantage. In fact, as all domestic banks were relatively small it was easy for the coalition in power to favour the rise of those that were politically closer. Both in Italy and in Spain it was leftist coalitions that had this advantage. And the Centre-Left and the PSOE were able to exploit it, as when they left office all the most dynamic Italian and Spanish banks were guided by 'leftist' managers. Hence, when they came to power Spain's PP and the Italian Centre-Right were faced with the daunting task of rebalancing a situation inherited from their predecessors, replacing the leftist managers that headed the largest domestic banks, or creating new, politically close banks. While Spain's PP succeeded in placing a politically close manager at the head of the second largest domestic bank, bringing banking consolidation to completion in the process, the Italian Centre-Right failed on both accounts as during its five years in power there was a slowdown of banking consolidation, and all the main domestic banks remained close to the Centre-Left.

The chapter has demonstrated that explaining this requires looking at the balance of power between the state and domestic banks. The availability, or lack thereof, of two key ownership power resources the state can use to influence the outcome of banking consolidation is crucial. These are direct ownership of a controlling stake in a large domestic bank, and existence of golden share rights over the same bank. Leveraging these two power resources in the brief stint of two years the PP managed to put a politically close manager at the head of the state-owned Argentaria, force a merger among equals between Argentaria and the much larger BBV, and then use an expedient to remove the management of BBV, leaving the manager close to the PP as the undisputed leader of the bank resulting from the merger.

This strategy was not available to the Italian Centre-Right as when it came to power in 2001 the state did not own stakes or had golden share powers in any of the largest domestic banks. Lacking ownership power resources over domestic banks, the Centre-Right had no options but to try to merge two politically close mid-sized banks to create a new bank that could match the size of those close to the Centre-Left. However, this strategy did not yield the expected results as no large bank close to the Centre-Right emerged. At the same time, the Centre-Right backed the vetoes of the Bank of Italy against any merger involving the three largest domestic banks, thus decisively slowing down the process of banking consolidation. Banking consolidation was only completed between 2006 and 2007 when the Centre-Left was back in power, and only months before the beginning of the sub-prime crisis, which then triggered the Eurozone crisis. This represented a problem in particular for Unicredit that in 2007 had acquired the large but inefficient Capitalia. In fact, the management of Unicredit had to deal at the same time with the internal reorganisation necessary after the takeover and with the impact of the crisis. Had the Centre-Right had the ownership power resources leveraged by the PP at its disposal, it could have completed the process of banking consolidation much earlier, thus giving Italian banks more time to improve their efficiency before the crisis.

Chapter 5. Telecommunications: The divergent trajectories of Telefonica and Telecom Italia

5.1 Introduction

This chapter compares the opposite trajectories of the Italian and Spanish telecommunications incumbents Telecom Italia (TI) and Telefonica. Telefonica has become one of the largest and most successful telecommunications firms in Europe, and can legitimately be considered a European champion in its sector of activity. In contrast, TI remains small by European standards, controlled by the French media group Vivendi (with a 24.9 per cent stake), and is a likely target in the upcoming process of consolidation among European telecommunications firms. This opposite outcome was by no means inevitable. When it was privatised in 1997, TI had the potential to become a European champion (Florio 2007), and still in 1999 it was larger in terms of revenue (€29 billion annually) than Telefonica (€24 billion) (Clifton et al. 2010, p. 994). However, while Telefonica succeeded in the transition from inward-looking monopolist to successful multinational, TI failed.

This divergence occurred even though both the Italian and Spanish governments implemented an activist industrial policy strategy aimed at turning their domestic incumbents into European champions. To this end the two governments focused especially on improving the performance and increasing the size of Telefonica and TI. A key moment in the process of industrial restructuring was the privatisation of the two state-owned incumbents, a particularly delicate issue for Italy and Spain. In fact, in the mid-1990s both countries needed to reduce their public debt and deficit to meet the Maastricht criteria. The success of this effort of fiscal consolidation, in turn, was conditional on the privatisation of profitable state-owned firms like Telefonica and TI. Consequently, both the Italian and Spanish governments had to renounce to a key ownership power resource over them; namely, the direct ownership of a controlling stake in the firms. Their urgent budgetary needs saw the trajectory of Italy and Spain draw apart from that of countries like France, Germany and the Netherlands where the state could keep a controlling stake in the telecommunications incumbent for a longer period.

When privatising TI and Telefonica, both governments opted for the creation of a hard core of stable investors owning around 15 per cent of the shares. In the intentions of the

Spanish and Italian government the hard core was meant to give ownership and managerial stability to TI and Telefonica, sheltering them from hostile takeovers and helping the transition from inward looking monopolist to public company operating in a competitive market. It was precisely on the issue of the hard core of domestic investors that the trajectory of TI and Telefonica started diverging. In fact, while Spain's PSOE succeeded in forming a strong hard core centring on the main domestic banks (BBV, Argentaria and the savings bank La Caixa), the Italian Centre-Left failed to convince manufacturing family blockholders, the only domestic actors with sufficient financial resources to buy a large stake in TI, to invest in the hard core. The different strength of Telefonica's and TI's hard cores had a decisive influence on the future trajectory of the two firms, explaining why the former succeeded in becoming a European champion while the latter failed.

This chapter argues that the failure of the Italian Centre-Left and the success of Spain's PSOE (and later PP) in convincing domestic business actors to invest in the hard core of TI and Telefonica is due to the different regulatory power relationship between the state and business actors in the two countries. In fact, by entering TI's and Telefonica's hard cores, Italian and Spanish private investors accepted sinking important financial resources in firms in which the key managerial figures had been appointed before privatisation by the state, which also retained golden share rights. In other words, Spanish banks and Italian family blockholders had to accept they would be passive investors, leaving the main managerial decisions to the state and state-appointed managers.

To make domestic investors accept this seemingly disadvantageous deal the Italian and Spanish states needed a bargaining chip to offer them: regulatory protection in their main sector of activity. Spanish banks agreed to enter the hard core of Telefonica because, unlike Italian manufacturing blockholders, they depended upon regulatory protection from the state in their main sector of activity. This regulatory dependence stemmed from two factors. First, following Culpepper and Reinke (2014), Spanish banks were interested in maintaining a close relationship with their domestic government because they made most of their revenue in the domestic market. Instead, Italian family blockholders owned worldwide successful MNEs that made most of their revenue outside Italy. Consequently, they did not depend upon regulatory protection from their home government. Second, in the late 1990s the EU-led process of market integration of banking was still at an early stage (see chapter 2). Consequently, the Spanish state and the Bank of Spain had ample regulatory power over domestic banks. Instead, the Italian state lacked regulatory power over manufacturing family blockholders as they owned firms that operated in fully liberalised manufacturing sectors like clothing in which state regulation is minimal (Stone Sweet 2004).

The trajectory of TI also highlights the importance of agency in determining the outcome of industrial restructuring showing how the available power resources need to be strategically activated by the state in order to be effective. In fact, in 1999 the Centre-Left government allowed the takeover of TI by the IT firm Olivetti despite having the regulatory and ownership power to block the deal. The takeover in turn led to a huge increase of TI outstanding debt and the ousting of a competent managerial team, thus decisively weakening the Italian telecommunications incumbent champion.

The rest of the chapter is organised as follows. Section two describes the trajectory of TI showing how the lack of regulatory power over domestic blockholders led to the failure to form a strong hard core in TI. The resulting weakness of TI's ownership structure would ultimately lead to its failure to upgrade into a European champion. Section three describes the industrial restructuring process that turned Telefonica into a European champion, highlighting the importance of state ownership, regulatory and partisan proximity power in determining this successful outcome. The chapter closes with a cross-country comparison.

5.2 Italy

5.2.1 The pre-reform status quo

In 1923 the dictator Benito Mussolini awarded five licences to private companies to provide telecommunications services throughout Italy (Florio 2007). After the Second World War, the first democratically elected government of Italy rejected the idea of an alliance between the five concession holders and America's ITT, opting instead for the gradual nationalisation of all telecommunications operators (Negrier 1997). The telecommunications sector was characterised by high fragmentation with different independent corporations responsible for the various market segments – e.g. domestic telephone services, intercontinental services, equipment and manufacturing (Goldstein 2000). Lack of coordination between the different corporations led to inefficiencies, duplication of tasks and wasteful human resource practices (Kornelakis 2015). Consequently, since the late 1970s Italy witnessed a rapid deterioration in the quality of its telecommunications service (Kornelakis 2015). Furthermore, domestic fragmentation meant that Italy lacked a telecommunications firm of equal size to its main European rivals, France Telecom, Deutsche Telekom and BT (Oddo and Pons 2006).

Throughout the 1980s various initiatives were taken to reorganise the telecommunications sector and improve the efficiency of domestic operators (Thatcher 2007). However, these efforts produced few results. The ruling parties were keen to defend the status quo as they used the different telecommunications companies to award jobs and financial support to political clients (Thatcher 2007).

Like in banking, the stalemate was finally broken in the early 1990s when the Tangentopoli investigation led to the dissolution of the main traditional parties and their replacement with a group of reform-minded technocrats from the Bank of Italy and the Treasury. The contemporary launch of the Single European Market made policy-makers aware of the fact that there was no room to further delay the reorganisation of the telecommunications sector. The process of domestic reform began in 1994 when the Ciampi technocratic government merged all the state-owned concession holders to create Telecom Italia (TI) (Florio 2007). In the intentions of the technocrats the merger served two purposes: facilitating the future privatisation of the state-owned incumbent, and giving Italy a firm with sufficient size to compete with its European peers (Thatcher 2007). When it was created TI had clear potential to become a European champion being the first telecommunications firm in Europe in number of lines per employee, fifth in the world for connections, sixth in international traffic, and seventh in turnover (Florio 2007, p. 3).

Furthermore, since the 1980s TI had also successfully expanded abroad achieving a relevant presence in Latin America (Argentina, Bolivia, Cuba and Chile) but also in some European markets like Greece (Oddo and Pons 2006). Despite these important assets, however, the delayed reorganisation of the telecommunications sector represented an important weakness, as TI had to cope with its privatisation and the liberalisation of the domestic market when it was still in the midst of a process of internal restructuring (Oddo and Pons 2006). In fact, in 1995 in compliance with the EU Directives the Italian government opened the mobile phone segment to competition awarding the second licence to the domestic IT firm Olivetti (Kornelakis 2015). This meant that TI started suffering competition in the most profitable segment of its activity only one year after its creation.

5.2.2 The Centre-Left and the privatisation of Telecom Italia

The merger of all telecommunications firms into TI was the necessary premise for the privatisation of the state-owned telecommunications incumbent, an operation carried out by the centre-left government that took office in 1996. The Centre-Left had won the elections promising to qualify Italy for the EMU as a founding member. However, this required an important effort of fiscal consolidation that was conditional on the privatisation of profitable state-owned firms like TI (Macchiati 1999).[11] For this reason, the Centre-Left opted for a one-off privatisation of TI, thus ceding a crucial ownership power resource over the firm (Kornelakis 2015). The need to fulfil urgent budgetary needs, coupled with the desire to create a strong national champion, led the Centre-Left to privatise TI before the liberalisation of the domestic market (La Stampa 17/09/2006). In fact, the regulatory authority for telecommunications (AGCOM) was created only in 1998, and was a very weak regulator that lacked independence from the government (Goldstein 2000). Although the domestic competition authority (AGCM) had more powers than the AGCOM, it was created only in 1997 and started fully operating when TI was already in private hands (Kornelakis 2015).

The Centre-Left planned to privatise TI partly through a public offering aimed at attracting small investors, and partly through a private auction aimed at forming a hard core of mostly domestic, stable investors controlling between 15 and 20 per cent of the shares (President of the Italian Council 8/8/1997; La Repubblica 9/8/1997; 22/09/1997; Florio 2007; Cambini and Giannaccari 2007). In the intentions of the Centre-Left, the hard core of domestic investors should help TI's transition from inward-looking monopolist to European champion, giving ownership stability to the firm and protecting the management for at least three years (President of the Italian Council 8/8/1997; Oddo and Pons 2006). After the three years the hardcore investors could either keep their shares, or sell them transforming TI into a public company (Oddo and Pons 2006). To prevent TI from falling in the hands of a single private investor, no member of the hard core was allowed to buy a stake larger than 3 per cent. In addition, the Centre-Left had established golden share powers over TI that allowed the government to have a say over key decisions like the entry of new shareholders, the sell-off of the firm or its merger with other entities (Florio 2007).

The privatisation was a key test for the Centre-Left because TI was the third largest industrial group in the country with sales of about €21 billion (Amatori and Colli 2000, p. 45), and along with the electricity incumbent ENEL and the oil & gas conglomerate ENI was one of

[11] The sell-off of TI was made even more urgent by a 1993 agreement between Minister of Treasury Beniamino Andreatta and Commissioner for Competition Karel Van Miert. According to the Andreatta–Van Miert agreement Italy had to bring the debt of the state-owned industrial conglomerate IRI to a sustainable level by 1997 (Oddo and Pons 2006). Since TI was by far the most profitable firm part of IRI the fulfilment of the Andreatta–Van Miert pact required its privatisation (Thatcher 2007).

the few Italian firms with the potential to become European champion (La Repubblica 22/02/1998; 01/10/1999; Il Sole 24 Ore 10/10/2002; Florio 2007; Onado 2013; Oddo and Pons 2006). In the intentions of the government TI's hard core of domestic investors was to serve as a model for the future privatisation of ENEL and ENI (Oddo and Pons 2006). Before completing the privatisation, the Centre-Left appointed Guido Rossi as president and Tommaso Tommasi di Vignano as CEO asking them to guide TI through the transition toward the public company. Tommasi and Rossi combined a solid professional background and political proximity with the Centre-Left (Oddo and Pons 2006).

In October 1997, the government sold little more than 35 per cent of its 44 per cent stake in TI gaining over twenty-six thousand billion lira (around €13.5 billion) (Florio 2007, p. 3). While small investors responded very well to the PO, with an estimated 1.5 million Italians buying shares in the company (Fransman 2003, p. 1), the private auction to form the hard core was far less successful. In fact, the hardcore investors bought only 6.62 of TI's shares, less than half of the 15 per cent stake forecasted by the centre-left government (Florio 2007, p. 3). The hard core was essentially formed by a group of domestic banks, banking foundations and insurance groups with stakes ranging between 0.8 and 0.3 per cent, along with the Swiss bank Credit Suisse. Among the family blockholders traditionally dominating Italian capitalism only the Agnellis bought in (with a 0.6 per cent stake) (Oddo and Pons 2006, p. 38; Giacalone 2004, p. 23). In fact, the weakness of the hard core was precisely because of the Centre-Left had failed to convince other family blockholders to invest in TI (La Repubblica 23/09/1997; La Stampa 25/09/1997).

Manufacturing families were not keen to invest relevant financial resources – one per cent of TI was worth approximately €300 million (La Repubblica 22/9/1997) – for three years in a company over which the state had golden share powers, and had recently appointed a new Chairman and CEO (Amatori and Colli 2000). For this reason, families like the Benetton and the Del Vecchio (owner of the glass-maker Luxottica) that were approached by the government and by TI's management decided to opt out from the hard core (La Repubblica 09/08/1997, 19/09/1997; 22/9/1997). The case of the Benetton family is particularly relevant to understand the nature of the regulatory power relationship between the state and family blockholders. In fact, in those same years the Benetton were investing huge financial resources in many privatised firms[12] (Amatori and Colli 2000). This means that the Benetton family, whose main business in 1995 had revenue of €4.6 billion (La Repubblica 26/10/1998), did not lack the resources necessary to invest in TI. However, in an interview the patriarch Gilberto Benetton made clear that the family decided not to enter TI's hard core, despite pressure from the government to do so, because the Benetton invested only in firms where they could be the controlling shareholders. That was not the case of TI, where the government asked the Benetton family to be 'passive' blockholders immobilising huge financial resources for three years without having relevant means of influence over the management (La Repubblica 2/10/1997; La Stampa 17/09/1997; 25/09/1997; Cisnetto 2000).

The comparison with the Spanish case clearly shows how the failure to form a strong hard core in TI was because the Italian state lacked regulatory power over manufacturing family blockholders. As Culpepper and Reinke (2014) argue, the regulatory power of the state vis-à-vis domestic firms is conditional on the revenue they make on the domestic market. When a firm makes most of its revenue in the domestic market, the managers will be more interested in maintaining a good relationship with domestic regulators. In other words, the government will succeed in imposing its will on domestic firms because it has a bargaining chip to offer them: future regulatory protection in their sector of activity. However, in the early 1990s family groups like the Benetton and Luxottica already made most of their profit abroad. In 1996 the Benetton group had 7,000 clothing shops worldwide, of which 2,800 were located outside Europe (The Globe and Mail 1/10/1996), selling its products in 120 countries (Benetton Group 1998, p. 13), and making 66 per cent of its revenue outside the domestic market (Benetton Group 1998, p.49). According to the magazine *Financial World*, in 1995 Benetton was the second most valuable Italian brand worldwide, after Pirelli (La Repubblica 16/7/1995). For its part Luxottica controlled 20 per cent of the glasses frames market worldwide, and had its main market in the US where it made 44 per cent of its revenue, having also an important presence in the Far East and in Europe (New York Times 1/4/1995).

Consequently, the hard core was formed only by the Agnelli family and some domestic credit institutions.[13] Even though the Agnelli family was also not tied to the domestic market,

[12] For instance, in late 1997 less than a month after the privatisation of TI, the Benetton family acquired a controlling stake in the motorway concession holder Autostrade for €170 million, investing as well in the company managing the Rome airport.

[13] The Italian government had approached also the US company AT&T and the European telecoms alliance Unisource. However, they both decided not to invest in TI (Goldstein 2000).

as its main business (the carmaker FIAT) was active worldwide, they nevertheless decided to invest in TI for two reasons. First, in 1996 FIAT had revenue of €45 billion, so a €200 million investment to buy a 0.6 stake in TI was not so relevant. Second, since the 1960s FIAT had received constant financial support from Christian Democratic governments, enjoying a very favourable regulatory environment at home (Germano 2012). By participating in TI's hard core the Agnelli family hoped to build a similarly strong relationship with the technocratic governments and the Centre-Left.

The participation of Italian banks in the hard core of TI identifies another important source of regulatory power of the state vis-à-vis domestic investors. In fact, five domestic banks, three insurance groups and two banking foundations participated in the hard core.[14] Corroborating Culpepper and Reinke's claim (2014) the credit groups that accepted to enter the hard core were mainly active in the domestic market. In addition, banks and insurance groups operated in sectors in which the EU-led process of market integration was still at an early stage. Consequently, the Italian government and the Bank of Italy retained ample regulatory power over the domestic market. This was particularly true for banks as when TI was privatised the process of banking consolidation was still underway, and the previous chapter has shown the extent to the Italian government could influence its outcome. Hence, it comes as no surprise that managers of banks like Credit, IMI and San Paolo that were directly involved in the merger frenzy saw the participation in the hard core as a way to strengthen their ties with the centre-left government and protect their core business (Oddo and Pons 2006, p. 63; La Repubblica 25/9/1997; Corriere Della Sera 6/10/1997). The participation of Italian banks to the hard core identifies another crucial difference with the Spanish case. In fact, the process of banking consolidation occurred later in Italy than in Spain. Consequently, when TI was privatised Italian banks were smaller than their Spanish counterparts and lacked the resources to form a strong hard core alone (Macchiati 1999; Goldstein 2000).

The Centre-Left's failure to form a strong hard core will have a decisive influence on the following trajectory of TI, ultimately leading to its failure in becoming a European champion (Oddo and Pons 2006; Onado 2013). In fact, the weakness of the hard core led to a period of managerial and ownership instability in TI. The Chairman Guido Rossi resigned immediately after the privatisation claiming that the weakness of the hard core made it

[14] The banks were IMI, Credito Italiano, Comit, Mps and Rolo Banca. The insurance groups were Generali, INA and Alleanza and the banking foundations were Cariplo and Compagnia San Paolo. All these financial groups had stakes of between 0.8 and 0.3 per cent.

impossible to transform TI into a public company (Giacalone 2004). Guido Rossi was replaced by Gian Marco Rossignolo, a manager close to the Agnelli family. Rossignolo immediately developed a tense relationship with the CEO Tommasi, previously appointed by the government. Since the hard core was too weak to intervene in the clash between the Chairman and the CEO, TI was left without a strong managerial guide at a very delicate moment of its trajectory (Woods 1999).

The lack of strong managerial guidance had a negative impact on TI's stock value. As a result, in October 1998 TI's shares hit a record low at €4.33 (Oddo and Pons 2006, p. 72), 19 per cent below the price paid by the hardcore investors (Fransman 2003, p. 1). However, this stock underperformance did not prevent TI from successfully expanding abroad, acquiring licences in Serbia, Austria, Spain (where it participated to the joint venture to create the second mobile phone operator Retevision) and Brazil where it became the second largest player after Telefonica (Oddo and Pons 2006).

In late 1998 the hardcore investors and the government agreed to remove Tommasi and Rossignolo appointing Franco Bernabé as CEO. Bernabé had gained a solid reputation among market operators for having restructured the oil & gas conglomerate ENI turning it into one of the main global players in its sector of activity (La Stampa 17/09/2006; The Globe and Mail 22/02/1999; Amatori and Colli 2000; Florio 2007). Market operators reacted positively to Bernabé's appointment and in one month TI's shares nearly doubled their value reaching €7 per share (Oddo and Pons 2006, p. 158). However, the previous stock market underperformance of TI, and the weakness of its ownership structure had made the firm a likely target of a hostile takeover. For this reason, since late 1998 Roberto Colaninno had been working on a plan to takeover TI. Colaninno was the CEO and controlling shareholder of Olivetti, a domestic IT group active also in the telecommunications sector (Woods 1999). Colaninno headed a group of small investors located in northern Italy attracted by the possibility of acquiring TI at a cheap price (Oddo and Pons 2006). Hence, even though Olivetti had experience in the telecommunications sector, the takeover of TI was a primarily financial operation, aimed at gaining control of a firm that made large profits and had a dominant position in the domestic market (Woods 1999; Onado 2013).

Colaninno was a 'new man' with no relationship with the traditional family blockholders (Florio 2007). He was close to the Centre-Left, especially the post-communist PDS, the largest party of the coalition (La Repubblica 19/4/1999; Giacalone 2004; Oddo and Pons 2006; Florio 2007). In October 1998, the main leader of the PDS, Massimo D'Alema, replaced Romano Prodi as Prime Minister after an internal shake-up within the centre-left coalition. Like his predecessor Prodi, D'Alema saw the great influence historically exercised by traditional family blockholders negatively (Florio 2007). However, while Prodi wished to promote popular capitalism, moving Italy closer to the Anglo–American corporate model, D'Alema instead wanted to replace the existing blockholding families with new politically close managers and blockholders (La Repubblica 19/2/1999; Giacalone 2004; Barbacetto 2005). In D'Alema's view, by acquiring TI, Colaninno could become the leader of this new group of entrepreneurs close to the Centre-Left (La Repubblica 19/4/1999; Florio 2007).

In late 1998 Colaninno met D'Alema who granted his support for the Olivetti takeover of TI (Giacalone 2004). Bolstered by the support from D'Alema the following day Olivetti launched a takeover bid for TI offering €10 per share. Since the CEO of TI Bernabé and its board rejected the offer, the bid turned hostile. The centre-left government immediately showed its support for the deal, with Prime Minister D'Alema making pressure on the market regulator Consob to clear the Olivetti offer despite some formal irregularities (Amatori and Colli 2000).

Bernabé reacted by calling a shareholders' meeting for April 1999 during which he sought to convince TI's shareholder to reject the Olivetti bid by presenting a new industrial plan. According to TI's statute, for a shareholder meeting to take place at least 30 per cent of the shares need to be present and vote (Florio 2007). Since usually the turnout in such meetings is quite low, the government could play a decisive role, as the Treasury was still the largest shareholder in TI with a 5.5 per cent stake. According to the Director General of the Treasury, Mario Draghi, the best way to show the neutrality of the government was for the Treasury to participate to the shareholders' meeting, allowing it to happen, and then abstain during the vote on Bernabé's plan (La Repubblica 19/04/1999; Oddo and Pons 2006). Instead, D'Alema who had the last word as Prime Minister asked the Treasury not to participate to the meeting.[15] When the news that the Treasury was not attending the shareholder meeting was made public, other institutional and small investors decided not to attend. Consequently, only 22.3 per cent of the shares were present and the meeting failed to meet the 30 per cent quorum (Giacalone 2004, p. 58). Even though all the hardcore investors supported Bernabé and attended the meeting, with a 6.6 per cent stake they were too weak to defend the manager. Had the hard core

[15] The clash between the Prime Minister and the Treasury was so profound that Draghi asked for a formal letter stating the Prime Minister had requested the Treasury participate to avoid any future responsibility (Giacalone 2004).

owned a 15 per cent stake as in Prodi's plan it would have allowed the shareholder meeting to happen, and probably the takeover would have failed.

In the last effort to derail the hostile takeover, Bernabé proposed a strategic merger between TI and Deutsche Telekom (DT) that would have led to the creation of the largest telecommunications company in Europe with a market capitalisation of €200 billion (Woods 1999, p. 157). Although formally a merger among equals, DT's shareholders would have owned between 55 and 60 per cent of the entity and the headquarters would have moved to Germany (Goldstein 2000, p. 213). The prospect of a loss of independence of TI triggered a very negative reaction from both the centre-left government and the centre-right opposition, confirming the claim that both coalitions saw very negatively the foreign takeover of a national champion (Corriere Della Sera 14/041999; La Repubblica 2/06/1999; La Stampa 15/04/1999). Similar to the Spanish case, the centre-left government questioned the idea that a privatised company like TI would merge with a firm in which the German state with its 72 per cent stake was still the majority shareholder (Kornelakis 2015, p. 895; La Repubblica 2/6/1999). For this reason, Prime Minister D'Alema threatened to use the golden share power to block the deal (La Repubblica 19/4/1999)[16].

Having understood that he could do little against a bid strongly supported by the government, in April 1999 Bernabé stepped down sanctioning the success of the Olivetti takeover. In the meantime, Colaninno had increased Olivetti's bid from €10 to €11.5 per share (Oddo and Pons 2006, p. 162), an offer that gained around 51 per cent of TI's shares in a deal worth over €34 billion (Fransman 2003, p. 2). Because of the takeover, Olivetti (with market capitalisation of €9.4 billion), acquired a firm valued at €60 billion (Kruse 2007, p. 134). The fact that the Centre-Left succeeded in forcing a change of ownership in TI despite opposition from the main private shareholders and the management runs counter the idea of the Italian state being captured by TI (Negrier 1997). The takeover was a leveraged buyout meaning that of the €34 billion only 4 billion was directly invested by Olivetti,[17] while the rest was financed by debt (Meoli et al. 2006, p. 3). To takeover TI, Colaninno set up the pyramidal structure presented in figure 5.1.

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[16] For his part, the leader of the centre-right opposition, Silvio Berlusconi, affirmed that a merger between TI and DT 'would be contrary to the national interest (of Italy) and to the interest of TI's shareholders' as it would be equal to a takeover of an Italian firm by a German competitor (La Repubblica 25/4/1999).

[17] Money mostly coming from the cession of Omnitel and Infostrada, the two telecommunications operators owned by Olivetti, to Germany's Mannesmann.

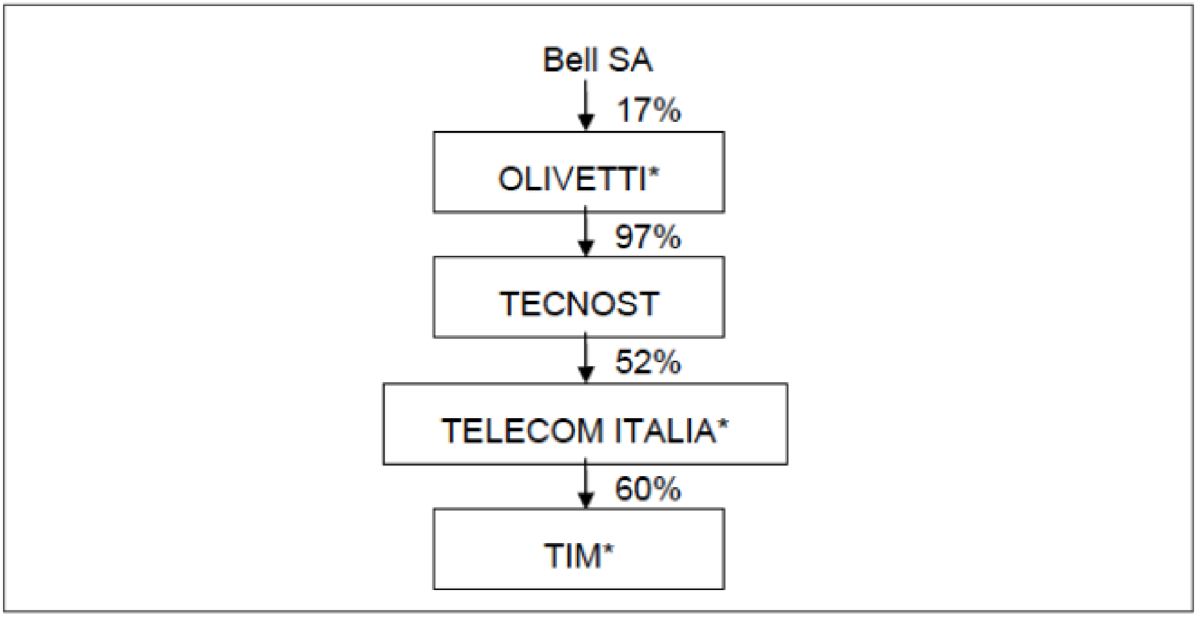

Figure 5.1 TI's ownership structure after the Olivetti takeover (from Meoli et al. 2006).

Although the Anglo–Saxon financial press hailed the Olivetti takeover as a path-breaking event in Italian corporate governance (Amatori and Colli 2000), it was more the result of the failure of the privatisation strategy of the Centre-Left (La Stampa 07/05/1999; La Repubblica 02/06/1999; Il Sole 24 Ore 04/01/2000; Goldstein 2000; Onado 2013; Woods 1999; Oddo and Pons 2006). Specifically, it was the result of the weakness of the hard core of domestic investors that according to the privatisation plan was meant to help the transition from state-owned monopolist to public company. In turn, the weakness of the hard core was because of the Italian state lacked the regulatory power necessary to convince the main family blockholders to invest in TI.

Because of Colaninno's takeover, TI became the only telecommunications incumbent in Europe owned by a single private investor. In fact, all the other large players were controlled by a hard core (Telefonica until the early 2000s), by the state (France Telecom and Deutsche Telekom) or had diffused ownership (BT and Telefonica from the mid-2000s) (Fransman 2003; Onado 2013). The derailment of the privatisation plan centring on the hard core of domestic investors and the Olivetti takeover will prove decisive in explaining TI's failed upgrade into European champions.

5.2.3 Olivetti, Pirelli, and the de-internationalisation of Telecom Italia

The ownership pyramid set up by Olivetti to acquire TI had two main weaknesses. First, Colaninno and his allies controlled Olivetti with a 17 per cent stake, which was below the 30 per cent threshold that made it mandatory to launch a hostile takeover according to the Italian corporate legislation (Deeg 2005). This meant that it was possible to gain control of Olivetti by buying a stake larger than 17 per cent, and in turn acquire TI, without the need to launch a takeover for the entire Olivetti (and in turn for TI). Second, the takeover of TI was a leveraged buyout mainly financed through debt. However, most of the €16 billion debt did not weight on TI, a profitable firm that paid high dividends, but on the financial holding Tecnost, which had no productive activity (Fransman 2003). In other words, while most of the debt was at the top of the pyramid, the cash flow necessary to reduce it was at the lower level of the pyramid. In such a situation, the owner of the pyramidal structure must find a solution to mobilise the cash flow at the top of the pyramid without triggering a negative reaction from minority shareholders (Fransman 2003).

The problem of the debt will have a decisive impact on TI because both under Olivetti and the following owners reducing the debt of the group, and finding a way to channel TI's cash flow into the financial holding Tecnost, became the main concern of the management (Oddo and Pons 2006). This is coherent with the eminently financial nature of Olivetti's leveraged buyout of TI (Woods 1999). However, it is at odds with the idea of creating a strong firm with the potential to become a European champion (Giacalone 2004).

In September 1999 Colaninno made the first attempt to channel TI's cash flow up the pyramid by proposing a merger between the financial holding Tecnost and TIM, TI's mobile phone subsidiary and one of the most profitable firms of the group (Florio 2007). This way TIM's cash flow would be used to reduce Tecnost's debt. However, the proposal was met with harsh criticism both in the financial press and among minority shareholders (Fransman 2003). After TI's shares lost 8.2 per cent of their value in two days Colaninno had to withdraw the plan (Kruse 2007, p. 137). Later Colaninno merged Olivetti and Tecnost, in a move that simplified TI's ownership pyramid but did not address the issue of the debt, as after the cession of its telecommunications activities Olivetti was also a financial holding with no productive activity. Then in February 2001 Colaninno proposed another plan to reduce the debt that now weighted on Olivetti. TI's shareholders were offered to buy more expensive voting shares. The plan would have reduced Olivetti's stake in TI to around 40 per cent allowing at the same time a cut in the debt of about a third (Fransman 2003, p. 7). However, as with the previous plan minority shareholders and institutional investors deemed the conditions of the offer disproportionately advantageous for Olivetti's shareholders at the detriment of TI (Kruse 2007). The share reconversion plan irremediably tarnished Colaninno's relationship with market operators, and all the shares of the TI group posted large losses (Oddo and Pons 2006).

The issue of the debt did not halt TI's foreign expansion as the group strengthened its position in Latin America and Europe (Telecom Italia 2000). As a result, in 2001 TI was active in Argentina, Bolivia, Brazil, Chile, Cuba, Peru and Venezuela, Austria, France, the Netherlands, Spain (where it co-owned the second licenced operator Retevision), the Czech Republic, Serbia, Greece and Turkey (Kornelakis 2015). However, the acquisitions made by Colaninno were often overpriced, thus further increasing TI's debt burden, and lacked a coherent long-term plan (Giacalone 2004; Oddo and Pons 2006). The lack of a coherent plan of internationalisation was mainly because of the main concern of the managerial team was to find a way to channel TI's cash flow towards Tecnost.

After the attempted plan of share reconversion Colaninno lost the confidence of market operators and TI's shares sank again. Between 1996 and 2001 TI's shares lost 42 per cent of their value, compared to 28 per cent for Deutsche Telekom, 13 per cent for France Telecom and 6 per cent for British Telecom (Fransman 2003, p. 8). The bad performance of TI's shares led market operators to focus on the second weakness of TI's ownership structure: the fact that the financial holding Bell controlled Olivetti with a stake lower than 30 per cent. Consequently, by negotiating with Colaninno and his allied it was possible to takeover Bell, and in turn gain control of TI, without the need to launch a takeover bid for the entire TI. Exploiting this weakness one of the wealthiest families of Italian capitalism, the Pirelli, in alliance with the Benetton offered a large premium to Colaninno and his allied to buy their controlling stake of Bell (Florio 2007). Pirelli and Benetton paid €4.175 for the Olivetti shares owned by Bell, when they were quoted at €2.25 (Oddo and Pons 2006, p. 296). This way, by investing little more €7 billion Pirelli and Benetton acquired TI, a company that at the time had a capitalisation of €55 billion (Fransman 2003, p. 1). Minority shareholders were not involved in the deal and could not benefit from the large premium (Fransman 2003). The CEO of Pirelli and main architect of the operation Marco Tronchetti Provera recognised himself that it would not have been possible to launch a takeover for the entire TI as his group did not have sufficient financial resources (La Repubblica 8/9/2001). Like Olivetti, for Pirelli and Benetton the takeover of TI was basically a financial operation that allowed them to diversify in a more profitable, and still sheltered, sector (La Repubblica 31/07/2001; De Cecco 2007). After the acquisition of the Olivetti stake, Pirelli and Benetton created a new pyramidal structure like that set up by Colaninno, the only difference being that weak spots were protected by poison pills (Florio 2007). Tronchetti Provera became the CEO and president of TI.

The main business of the Pirelli family was the company of the same name, founded in 1872. Pirelli was a world-leading multinational specialised in the production of wires and cables. As a producer of optical and fibre cables Pirelli was one of TI's main suppliers (Oddo and Pons 2006). In 2001 Pirelli sold its fibre optic business to the US company Corning for US$6 billion obtaining the financial resources necessary to finance the takeover of TI (Fransman 2003, p. 10). This was not the first time Pirelli had tried to acquire TI. In 1993 it offered to form a hard core of investors including Mediobanca to control TI's forerunner Stet (Goldstein 2000). However, the Ciampi technocratic government advised by Prodi, then president of IRI, rejected the offer because it was considered harmful for competition for Stet to be taken over by one of its main suppliers (La Repubblica 26/7/1994**).** For the same reason Pirelli was not allowed to enter the hard core during TI's privatisation, when Prodi was Prime Minister and Ciampi Minister of Finance (Oddo and Pons 2006). However, in 2001 there was a change of government as the Centre-Left lost the elections to Berlusconi's Centre-Right. The Centre-Right saw a change of ownership in TI positively, as Colaninno was considered a 'man of the centre-left' (La Repubblica 29/7/2001b). In addition, the Centre-Right was in favour of an operation that maintained TI in domestic hands**.** Although the Centre-Right formally maintained a line of neutrality on the deal, Tronchetti Provera had regular meetings with representatives of the government (La Repubblica 29/7/2001a; The Guardian 31/07/2001; New York Times 30/07/2001). Shortly after the Pirelli/Benetton acquisition the Treasury sold its remaining stake in TI, although keeping golden share rights over the firm.

The analysis of the Benetton's family choice not to enter TI's hard core in 1997 but to support the Pirelli acquisition in 2001 helps to shed better light on the preferences of family blockholders and on their regulatory power relationship vis-à-vis the state. To acquire TI in 2001 the Benetton family financed 40 per cent of an operation worth €7 billion. For this reason, it is highly likely that in 1997 they already had sufficient financial resources to enter TI's hard core. However, they refused to do so because the centre-left government had asked them to invest for three years as passive blockholders in a firm over which they would have had little influence. Instead, in 2001 they invested in an operation that allowed them to gain control of TI.

The attitude of the Benetton confirms the claim that family blockholders saw the privatisation of state-owned firms as a way to gain financial rents by diversifying in sheltered public service sectors (De Cecco 2007; Florio 2007; Oddo and Pons 2006; La Repubblica 31/7/2001). Such an opportunity was particularly interesting for Pirelli and Benetton as in those years they were suffering an erosion of their profits in their main sector of activity (Fransman 2003).

Hence, in 1997 the Benetton family did not invest in the hard core because they were not interested in acting as ‘passive’ blockholders in a firm in which the state still had golden share powers and had appointed leading managerial figures, but invested in 2001 because that gave them the occasion to be, along with the Pirelli, TI’s controlling shareholders. In turn, the Benetton’s capacity to resist government’s calls to enter the hard core in 1997 was because the government lacked regulatory power over them, as they operated in a liberalised sector and made most of their revenue outside Italy.

From TI’s perspective, the problem of the Pirelli/Benetton takeover was that it was an eminently financial operation. Consequently, the new owners lacked a long-term industrial plan to turn TI into a European champion (Onado 2013). Like Colaninno, their main concern was to reduce the debt of the group and use TI’s cash flow to pay back the debt of the acquirers (Telecom Italia 2003, p. 3; La Repubblica 21/09/2006; Florio 2007). To achieve these goals, Tronchetti merged Olivetti with TI and then TI with its mobile phone subsidiary TIM. Although these two mergers shortened TI’s ownership pyramid they also led to a huge increase in TI’s outstanding debt, which reached €46 billion in 2005 (Oddo and Pons 2006, p. xix). To reduce the debt Tronchetti launched a campaign of de-internationalisation selling many of TI’s foreign holdings (Telecom Italia 2002; 2003). As a result, by 2003 the group had already sold €10 billion of assets (Telecom Italia 2004, p. 3). Although these sell-offs were partially justified by the need to redress the disorganised internationalisation of the Olivetti era, the overreaching goal of reducing the debt burden meant that TI left profitable markets like Austria and Chile (Giacalone 2004).

From this brief description, it clearly emerges how Tronchetti’s managerial strategy was at odds with the goal of creating a strong European champion. In fact, the main concern of the management was to reduce TI’s debt and pay generous dividends to transfer value to the top of the pyramid (Florio 2007). This came at the cost of a low level of investment and a progressive retreat from international markets (Onado 2013). As a result, by 2006 TI was active only in Argentina, Brazil and in the domestic market. That same year the Centre-Left won the elections and had an open clash with Tronchetti who then decided to step down from his position (Florio

2007). In 2007 Pirelli sold its stake in the financial holding that controlled TI to a group of Italian banks allied with the Spanish telecommunications incumbent Telefonica. In the following years growing competition in the domestic market led to a progressive erosion of TI's profit margins. As a result, in 2011 the company posted losses of €4 billion (Onado 2013, p, 3). Since 2015 Vivendi has been the de facto controlling shareholder of TI with a 24.9 share, while Telefonica sold its stake. TI is currently considered a likely target in the upcoming process of consolidation among European telecommunications firms, and is undoubtedly a firm that failed to upgrade into a European champion (Onado 2013).

5.3 Spain

5.3.1 The pre-reform status quo

In 1924 the dictator Primo De Rivera merged all the private telecommunications firms operating in Spain to create Telefonica (*Compania Nacional Telefonica de Espana*). Telefonica was established as a private firm owned by domestic investors along with the US firm ITT (Sancho 2000). The fact that Telefonica originated as a private firm with foreign ownership sets the Spanish trajectory apart from that of most other European countries where the telecommunications service was provided by a state-owned incumbent (Clifton et al. 2011). In 1946 the dictator Franco nationalised Telefonica acquiring most of the stake owned by ITT. Although the state became the largest shareholder in Telefonica (with a 50 per cent stake), the firm was never fully nationalised (Bel and Trillas 2005, p. 28). An agreement between the Franco dictatorship and Telefonica established that the firm was a state-controlled monopoly, meaning that the state appointed key managerial figures and could influence the day-to-day operation of the firm (Bel and Trillas 2005). However, the Franco dictatorship lacked the interest and the technical expertise to effectively regulate the telecommunications sector. Consequently, Telefonica operated as a self-regulated monopolist (Sancho 2000). Telefonica's self-management continued under the first democratically elected government of Adolfo Suarez, which focused most of its efforts on strengthening the nascent Spanish democracy (Sancho 2000).

5.3.2 Telefonica under the PSOE: Internationalisation and partial privatisation

In 1982 the PSOE won the elections promising to modernise the Spanish economy. A key pillar of this modernising agenda was the creation of a group of internationally competitive Spanish multinationals in the sectors of banking, energy and telecommunications (El Pais 29/04/1995; Etchemendy 2004; Serrano Robles 2013). In the intention of the PSOE, Telefonica as the largest domestic firm by revenue was to lead this group of Spanish multinationals (Etchemendy 2004, p. 636). However, even though Telefonica had a very strong position in the domestic market, it lagged its main European competitors in terms of network development, quality of service, revenue, technological capacity and profitability (Garcia Calvo 2013). In 1989 Telefonica operated only in the domestic market and had less than 12 million fixed lines (Toral 2011a, p. 66). The weakness of Telefonica compared to its European peers worried the PSOE as in the 1980s the EU was launching the liberalisation of the telecommunications sector. The integration of the European market meant that, without improving its performance, Telefonica risked being taken over by larger competitors. For this reason, the PSOE steered a process of industrial restructuring aimed at preparing Telefonica for the integration of the European market. In particular, the PSOE promoted a campaign of foreign investment, mainly targeted at Latin America, aimed at increasing the size of Telefonica, thus reducing the scope for hostile takeovers (Rozas Balbontin 2003). At the same time, the PSOE protected Telefonica's position in the domestic market delaying the implementation of the EU liberalising directives (Jordana and Sancho 2007).

To finance Telefonica's foreign expansion, in 1985 the PSOE floated the firm on the New York stock exchange selling a six per cent stake through a public offering. The state reduced its stake to 32 per cent, raising over €280 million (Bel and Trillas 2005, p. 28). Apart from making additional capital resources available, the floating on the NY stock exchange increased market scrutiny on Telefonica, disciplining its management and stimulating improvement in its performance (Clifton et al. 2011).

In 1987 the PSOE passed the Law on Telecommunications (LoT), the first telecommunications act in 70 years. The LoT provided a clearer legal distinction between the state and the operator, established the Telecommunications Advisory Council, and introduced some timid liberalising measures (Jordana et al. 2006). That same year the Commission passed the first Green Paper on telecommunications opening to the future integration of the European market (Sancho 2000). Although the LoT was adopted before the Green Paper, the European debate had an influence on the content of the law (Jordana et al. 2006).

The concrete prospect of a future integration of the EU telecommunications market accelerated the pace of Telefonica's internationalisation. In 1988 Telefonica started its expansion in the Latin American market acquiring a 40 per cent stake in the Argentinian operator Entel. The PSOE played a decisive role in favouring the deal with Prime Minister Felipe Gonzalez engaging in bilateral talks with the Peronist leader Carlos Menem (El Pais 30/10/1988). The following year the PSOE appointed Candido Velazquez as Chairman of Telefonica. Under Velazquez's leadership the process of internationalisation further accelerated. Between 1990 and 1996 Telefonica expanded in Brazil, Chile, Venezuela, Puerto Rico and Peru (Toral 2011a). Telefonica's expansion was decisively favoured by the Latin American debt crisis and the consequent wave of privatisations of state-owned utilities in the region (Rozas Balbontin 2003). Telefonica was a very aggressive investor, often paying high premiums for the firms it acquired or electing to invest in unstable countries like Peru (Yanez 2000; El Pais 10/11/1990). This rush into the Latin American market can be better understood in the context of the process of EU-led liberalisation. In fact, the PSOE hoped that by gaining size through foreign acquisitions Telefonica could prevent a hostile takeover from a larger European competitor (Yanez 2000; Toral 2011a).

It should be noted that Telefonica's internationalisation started when the firm was still a state-owned monopolist operating in a protected market (Clifton et al. 2011; Yanez 2000). In fact, while favouring Telefonica's foreign expansion, the PSOE fought hard to delay the opening of the Spanish market to competition (Jordana and Sancho 2007). For instance, like TI in Italy, Telefonica was allowed to operate as a monopolist in the mobile phone segment until 1995 (Garcia Calvo 2013). Furthermore, when in 1995 the PSOE government finally awarded the second licence, the winning group Airtel had to pay 85 billion pesetas (€510 million) for it, while the first licence had been previously awarded to Telefonica for free (Sancho 2000). This openly protectionist measure led the Commissioner for Competition Van Miert to open an infringement procedure against Spain.

Like in the Italian case, the choice to delay the liberalisation of the domestic market was also due to the PSOE's desire to maximize the proceeds from Telefonica's privatisation (Arocena 2004). For that same reason, Telefonica enjoyed a very favourable regulatory environment in the domestic market, which resulted in Spain having the highest average price for phone calls in the EU (El Pais 16/4/1991). In June 1993, the EU Council approved a resolution mandating the total opening of the telecommunications market by January 1998. However, to protect Telefonica the PSOE claimed that Spain needed more time to liberalise the domestic market due to the underdevelopment of its telecommunications network (Garcia Calvo 2013). In 1994 the PSOE decided to give up on the transition period, but only after Telefonica had reassured the government that it could sustain competition (Sancho 2000).

Apart from protecting Telefonica in the domestic market and favouring its internationalisation, the PSOE oversaw as well the partial privatisation of the firm. Like in Italy, the PSOE's decision to privatise Telefonica stemmed from the need to reduce public debt and deficits to qualify for EMU membership (Arocena 2004). For this reason, in 1995 the PSOE sold a 11 per cent stake reducing state ownership in Telefonica to 21 per cent (Bel and Trillas 2005, p. 19). Part of the shares was sold through a public offering aimed at attracting small investors, and part through a private auction aimed at forming a hard core of domestic banks (El Pais 24/3/1995). Like with the Italian Centre-Left, in the intentions of the PSOE the hard core of domestic investors was to help Telefonica in the transition from state-owned monopolist to public company, giving ownership stability to the firm and sheltering it from foreign takeovers (El Pais 3/2/1995; 30/03/1995; Etchemendy 2004). The PSOE chose to form the hard core around large domestic banks because in a country with an underdeveloped stock market they were the only investors with sufficient financial resources to buy a large stake in Telefonica (Mota 1998).

The Minister of Finance, Pedro Solbes, and the management of Telefonica had various meetings with the management of the large domestic banks BBV and Argentaria and the savings bank La Caixa to convince them to enter Telefonica's hard core (El Pais 3/2/1995; 19/04/1995). The presidents of the three banks agreed to purchase a 2.5 per cent stake in Telefonica forming a hard core of domestic investors controlling 7.5 per cent of the shares (El Pais 3/2/1995; 24/3/1995). By April 1995 the hard core of domestic banks controlled a little less than nine per cent of Telefonica (El Pais 22/4/1995).[18] At the time of this second round of privatisation a one per cent stake in Telefonica was worth approximately €90 million (15 billion pesetas) (El Pais 29/4/1995), meaning that each bank invested more than €200 million to participate in the hard core. Hence, Spanish banks agreed to invest important sums in a firm over which they could have little influence, as the state was still the controlling shareholder with a 21 per cent stake (Etchemendy 2004).

[18] BBV owned a 3.31 per cent stake. La Caixa's was 3.09 per cent and Argentaria's 2.42 per cent.

Spanish banks accepted this seemingly disadvantageous deal because the Spanish state had regulatory power over them. This regulatory power derived from two factors. First, when they were asked to enter Telefonica's hard core the three banks BBV, Argentaria and La Caixa were active eminently on the domestic market. Even though it is now a global bank, BBV completed its first relevant foreign acquisitions only later that year taking over Peru's Banco Continental (Gomez Escorial 2004), while Argentaria and La Caixa were active only in the Spanish market.

Second, the comparison with the Italian case shows that the regulatory power of the state over domestic firms is conditional on the degree of supranational integration of their sector of activity. In fact, the Italian state failed to convince family blockholders like Del Vecchio and Benetton to invest in TI's hard core because they operated in clothing and eye-wear, manufacturing sectors in which the process of EU-led market integration had already reached and advanced stage and state's legislation played a limited role (Stone Sweet 2004). Instead, Spanish banks operated in less integrated sectors that between the late 1980s and early 1990s were undergoing a process of domestic consolidation whose outcome could be decisively influenced by the Spanish government and the Bank of Spain, as shown in the previous chapter. Consequently, they were heavily dependent upon regulatory protection by the PSOE and the Bank of Spain.

Hence, Spanish banks agreed to invest in Telefonica, leaving the main managerial decisions to the government because the government had an important bargaining chip to offer them: regulatory protection in their main sector of activity (Mota 1998; Etchemendy 2004). A further power resource the PSOE deployed to convince Spanish banks to invest in Telefonica's hard core was the partisan proximity with the managers of BBV, Argentaria and La Caixa. The state-owned Argentaria was guided by the PSOE nominee Francisco Luzon, BBV was deemed the 'government's bank of choice' due to the strong support of the PSOE for its managers. The PSOE also had partisan proximity power over La Caixa because since 1993 it was ruling in coalition with the Catalan Nationalist Party, which was very close to the bank (for the relationship between La Caixa and the local government of Catalonia, see chapter 6) (Mota 1998).

Before losing the elections to the PP, the PSOE set up another important ownership power resource to influence the future trajectory of Telefonica: a ten-year golden share over the firm that allowed the government to veto any purchase of more than ten per cent of the shares

(Garcia Calvo 2013). Hence, like the Italian case with TI, any future takeover of Telefonica was conditional on the government's approval (Arocena 2004).

5.3.3 Telefonica under the PP: Total privatisation and elevation to global player status

The electoral victory of the PP in 1996 led to a change of attitude concerning Telefonica's privatisation. In fact, while the PSOE had opted for a gradual and partial sell-off, the PP chose the line of fast and full privatisation (Mota 1998). Despite this difference, however, there was substantial continuity between the PSOE and the PP in their attitude towards Telefonica. In fact, like the PSOE, the PP also aimed at making Telefonica the leader of a new group of Spanish multinationals (Sancho 2000). To do so, the PP supported Telefonica's internationalisation while protecting its dominant position in the domestic market (Jordana and Sancho 2007).

Shortly after taking office, and before Telefonica's privatisation, the PP replaced the PSOE nominee Candido Velazquez with Juan Villalonga. Villalonga, an investment banker with no previous experience in the telecommunications sector, had very close ties with the PP and in particular with Prime Minister José Maria Aznar (El Pais 24/05/1996; 17/06/1997; Clifton et al. 2011). Along with Villalonga, the PP government appointed as well more than half of Telefonica's board members. The last measure passed by the PP to make sure the state could maintain a certain degree of control over Telefonica after privatisation was the confirmation of the 10-year golden share established by the PSOE (Trillas 2002).

In February 1997, the PP sold the entire 21 per cent stake held by the state in Telefonica. The sale was conducted through a public offering and revenue amounted to €3.9 billion (Bel and Trillas 2005, p. 29). As with the previous sell-off under Socialist rule the PP offered discounts to attract small investors (Trillas 2002). Like the PSOE, the PP chose an 'interventionist' approach aimed at influencing the future ownership structure of Telefonica (Etchemendy 2004). This is particularly evident in the decision of the PP to strengthen the hard core of domestic investors previously set up by the PSOE (El Pais 23/7/1996). As a result, by 1997 the hard core raised its stake in Telefonica to 15 per cent with BBV, Argentaria, and La Caixa each owning approximately 5 per cent of the shares (Bel and Trillas 2005, p. 29). The hard core created by the PSOE and strengthened by the PP allowed to give ownership stability to Telefonica, and had a size similar to that the Centre-Left had sought for TI. Shortly after privatisation, the Chairman Villalonga invited the three banks to further increase their stakes up to 25 per cent (El Pais 18/12/1996; 08/01/1997).

Like under the PSOE, Spanish banks agreed to invest in a firm to which the PP government had previously appointed key managerial figures, a large part of the board of directors, and had golden share powers because the state had regulatory power over them. In fact, Spanish banks still made most of their profits on the domestic market, as the only large international acquisition made by BBV did not change its domestic focus. In addition, the process of banking consolidation was still underway as in 1997 there was still room for at least two mergers involving the four main domestic banks: BBV, Argentaria, Santander and Central-Hispano (see chapter 4). Since the government and the Bank of Spain had veto power over any merger involving domestic banks, the PP had still plenty of regulatory power to force the banks to participate in the hard core (Mota 1998).

Owing to their regulatory weakness vis-à-vis the Spanish state, the banks agreed to invest as passive blockholders, allowing the state to act as de facto blockholder even after privatisation (Cinco Dias 08/12/2000; Mota 1998; Bel and Trillas 2005). A further power resource the PP could use to influence the banks part of the hard core was the partisan proximity of the managers at the head of the banks. In fact, at the time of Telefonica's privatisation the PP had placed the politically close Francisco Gonzalez at the head of the state-owned bank Argentaria, while La Caixa supported the government because, like the PSOE three years before, the PP had formed a minority government with the support of the Catalan Nationalist Party (El Pais 15/4/1996). In 1999 with the merger between BBV and Argentaria the PP gained further partisan proximity power over the banks part of the hard core. In fact, Francisco Gonzalez came to occupy a prominent position in BBVA, Telefonica's largest shareholder with a 9 per cent stake (Rozas Balbontin 2003, p. 26). Apart from giving ownership stability to Telefonica the hard core also ensured state control over the board of directors, as both the government and the banks were overrepresented (Toral 2011b).

Few months after privatisation, with the support of the PP, Villalonga modified Telefonica's corporate rules to further strengthen his position. Because of the reform a candidate for the Board of Directors had to be a Telefonica shareholder for at least three years prior to his appointment, to become Chairman a candidate must have sat in the Board of Directors for at least three years, and independently from his holdings no shareholder was allowed to issue votes for more than 10 per cent of the total votes (Trillas 2002, p. 279–280).

These norms cemented Villalonga's position at the head of Telefonica by limiting the number of potential candidates that could replace him, and made a hostile takeover very difficult[19].

Contrary to the expectations of partisan theorists (Boix 1998), the PP followed in the PSOE's footsteps also when dealing with the protection of Telefonica's dominant position in the Spanish market implementing a series of delaying measures aimed at slowing down domestic liberalisation (Jordana and Sancho 2007). For instance, the PP government allowed Telefonica to maintain a comparatively high level of tariffs, leading to the second highest average telecommunications prices in the EU (El Pais 13/2/1999). Furthermore, the PP did not award a third mobile phone licence until 1998 (Sancho 2000). In addition, as in Italy, the domestic telecommunications regulator (CMT), created in 1996, was placed under governmental authority, thus limiting its capacity to stimulate competition (Jordana et al. 2006). This protectionist attitude led to frequent confrontations between Spain and the Commissioner for Competition Karel Van Miert (El Pais 28/3/1998).

The PP gave as well generous monetary compensations to Telefonica, most notably in 1997 the firm was awarded US$1 billion for the costs incurred to adapt to competition (Toral 2008). Villalonga reinvested these monetary compensations to finance Telefonica's expansion in Latin America. In 1998 Telefonica acquired various Brazilian mobile and fixed telephony concession holders becoming the main player in the Brazilian market (El Pais 30/7/1998). However, the quantum leap for Telefonica's ambitions in Latin America was the 2000 Operation Veronica, a series of takeovers of Telefonica's Latin American subsidiaries.[20] The operation, worth US$21 billion made Telefonica the main player on the Latin American market (Garcia Calvo 2013, p. 98). Apart from strengthening the ownership ties with its Latin American subsidiaries, the Operation Veronica allowed Telefonica to gain size thus reducing the scope for hostile takeovers (El Pais 11/5/2000; 07/05/2000).

Under Villalonga's leadership Telefonica had successfully completed the transition from inward-looking monopolist to global player in the telecommunications market (Trillas 2002; Giacalone 2004). To further strengthen Telefonica's position in the Spanish market in 2000 Villalonga signed a partnership with BBVA, the second largest domestic bank and first

[19] Because of the pervasiveness of these defensive measures Telefonica was not listed among the companies fulfilling the code of good conduct by the Spanish stock exchange regulator (Trillas 2002).

[20] In detail with Operation Veronica Telefonica increased its stake in Telefonica de Argentina (from 28 to 98 per cent), the Brasilian Telesp (18 to 87) and Telesudeste (17 to 76) and Telefonica de Peru (40 to 93).

shareholder of Telefonica, also guided by a manager close to the PP, Francisco Gonzalez (Rozas Balbontin 2003)[21].

Although Villalonga's position at the head of Telefonica seemed stronger than ever after the agreement with BBVA, shortly afterwards the Chairman fell out of favour with the PP government. The relationship between the PP and Villalonga started deteriorating when a plan to reward the top executives of Telefonica with generous stock options was made public during the 2000 electoral campaign (Trillas 2002). Since Villalonga was considered a 'man of the PP' the PSOE used the stock option plan to attack Aznar (Bel and Trillas 2005). Even though the PP ultimately won the elections, the stock options plan caused embarrassment to the incumbent government. However, what cost Villalonga his job was his attempt to merge Telefonica with the Dutch telecommunications incumbent KPN.

In April 2000 Villalonga and the CEO of KPN, Paul Smits, announced their intention to merge. Although formally a merger among equals, Telefonica's shareholders would have controlled 62 per cent of the shares in the entity resulting from the merger, and Villalonga would be appointed Chairman and managerial leader (El Pais 6/5/2000). The merger would have led to the creation of one of the ten largest telecommunications firms worldwide, sheltering Telefonica and KPN from any future hostile takeover attempt. However, the PP immediately expressed its discontent threatening to use its golden share ownership power to block the deal (Sunday Business 07/05/2000; New York Times 27/07/2000). Like its Italian counterpart in the case of the TI-DT merger attempt, the Spanish government opposed the deal because the Dutch government, still the controlling shareholder of KPN, would have become the largest shareholder of the firm resulting from the merger with a 17 per cent stake. According to Prime Minister Aznar this was unacceptable, as it would have reversed the effect of Telefonica's privatisation (El Pais 2/7/2000). For this reason, Minister of Finance Rodrigo Rato labelled the deal 'very difficult' and 'harmful for competition' (El Pais 2/7/2000). Even when the Dutch government took the official engagement to sell its stake within the next 18 months, Rato reiterated his negative opinion demanding a more rapid sell-off (El Pais 5/5/2000).

When Villalonga presented the plan to merge with KPN to Telefonica's board the banks part of the hard core, BBVA and La Caixa, showed their loyalty to the government voting

[21] The partnership between two of the largest domestic firms guided by PP nominees prompted a bitter reaction from the PSOE opposition with the spokesperson Juan Manuel Eguiagaray stating: '(Prime Minister) Aznar raises them, (Minister of Finance) Rato blesses them and they get together' (El Pais 12/2/2000).

against the merger (El Pais 6/5/2000; Cinco Dias 13/05/2000). Officially, the banks opposed the deal because they saw negatively the dilution of their stake in Telefonica (BBVA would have gone from 9 to 6, La Caixa from 5 to 3) **(**El Pais 6/5/2000). Shortly after the merger the PP government put pressure on the market watchdog (CNMV) to investigate Villalonga for insider trading related to a minor stock options operation of 1998 (Bel and Trillas 2005). Having understood that he had lost the support of the government, and the banks part of the hard core, in July 2000 Villalonga stepped down to be replaced by Cesar Alierta, another manager close to the PP, and former head of the tobacco monopolist Tabacalera (Mota 1998). Shortly after Villalonga had stepped down the CNMV closed the investigation for insider trading without any charge.

The decision of BBVA and La Caixa to distance themselves from Villalonga, decisively weakening his position, shows how in 2000 the government was still able to impose its will on the main domestic banks. In fact, despite their official criticism both banks saw positively the merger between Telefonica and KPN, having given a preliminary approval at a board meeting in April (El Pais 14/05/2000b), but were unwilling to trigger an open confrontation with the executive (El Pais 7/5/2000; Cinco Dias 08/12/2000). BBVA and La Caixa's passivity was in turn because the Spanish state had still regulatory power over them. Being active only in the domestic market, La Caixa was willing to maintain a good relationship with domestic regulators (Culpepper and Reinke 2014). Similarly, although it was expanding fast in Latin America, BBVA still retained a strong domestic focus. In addition, BBVA had a manager close to the PP, Francisco Gonzalez, as co-president. The Spanish government leveraged its regulatory and partisan proximity power over domestic banks to act as Telefonica's de facto blockholder, forcing the removal of a manager that had previously appointed after his goals had started conflicting with those of the executive (El Pais 14/05/2000a; 27/07/2000b; Cinco Dias 27/07/2000; Trillas 2002). In particular, the PP's decision to remove Villalonga was because of his plan to merge with KPN risked threatening Telefonica's existence as an independent firm.

This confirms the tendency of Spanish governments of both colours to defend the independence of their 'national champions'. The important role played by the government and the banks part of the hard core in Villalonga's removal was confirmed by the CEO of KPN Paul Smits who affirmed 'Despite his impressive management of the company, Villalonga started conflicting with many figures, including his long-time friend (Aznar) and the main banks' (El Pais 3/8/2000). Similarly, the Anglo–American financial press remarked how Villalonga's removal was a move inspired by the government with the support of the hard core banks (Bel and Trillas 2005). The fact that Villalonga was replaced by Cesar Alierta, another manager close to the PP (Mota 1998), signalled that the government was still willing to influence Telefonica's trajectory. The partisan proximity between Alierta and the government prompted the PSOE economic spokesperson Jordi Sevilla to affirm: 'The government replaced a friend of Aznar with a friend of Rato' (El Pais 27/7/2000a).

By 2001 under Villalonga's leadership Telefonica had become the main player in the Spanish- and Portuguese-speaking market, and the second largest telecommunications group in the EU for market capitalisation (Telefonica 1998; New York Times 27/07/2000; El Pais 28/06/2000; Rozas Balbontin 2003, p. 35). That same year Telefonica was the most internationalised among EU telecommunications incumbents making 51 per cent of its revenue abroad, compared to 38 per cent of DT and 20 per cent of TI (Clifton et al. 2011, p. 766). Telefonica was an integrated group operating in the fixed and mobile phone segment, that also provided television, online and audio-visual services (Toral 2011a). The managerial stability enjoyed by Telefonica in the crucial years after its privatisation is a key factor behind its success. In fact, while after privatisation TI changed four managerial teams and was twice taken over in less than four years, the strength of its hard core meant that until Villalonga's removal Telefonica was always guided by the same manager and had the same reference shareholders.

Since by the early 2000s Telefonica's size made a hostile takeover impossible, the hard core had fulfilled its goal to help the transition from state-owned monopolist to public company. Consequently, shortly after Alierta's appointment the agreement establishing Telefonica's hard core expired (Rozas Balbontin 2003), and the firm became a public company with diffused shareholding (Cambini and Giannaccari 2007).[22] Always in the early 2000s the European Court of Justice opened an investigation against Spain deeming that the golden share established by the Spanish government in Telefonica and other privatised firms constituted an illegal restriction to the free movement of capital (El Pais 1/7/2000).

When in 2004 the PSOE won the elections and José Luis Zapatero replaced Aznar, Alierta remained at the head of Telefonica even though he was a PP nominee. This is a sign of the fact that the state had progressively lost the regulatory and ownership power over Telefonica and its shareholders. The hard core had been dissolved, and by the mid-2000s

[22] Despite the end of the hardcore agreement BBVA and La Caixa remain Telefonica's main shareholders with stakes of six and five per cent, respectively.

BBVA made a large part of its revenue outside the Spanish market, being thus less dependent upon regulatory protection from the state (Guillen and Tschoegl 2008). The Zapatero government could not use the golden share ownership power either, as Spain was still under investigation from the European Court of Justice. However, Alierta's long tenure at the head of Telefonica is also explained by the good performance of the firm.

Under Alierta's leadership Telefonica focused on the European market concluding important acquisitions like Britain's O2 in 2006, and the Czech incumbent, Cesky Telekom, while at the same time retaining its dominant position in Latin America (Clifton et al. 2011). In 2014 Telefonica was the first telecommunications firm in Europe by revenue, and when Alierta stepped down in 2016 Telefonica had 322 million clients in 20 countries (El Pais 29/3/2016) making 74 per cent of its revenue outside the Spanish market (El Pais 30/3/2016). As seen in chapter one, these results make Telefonica a European champion in its sector of activity. Although the large number of acquisitions completed during Alierta's tenure had increased the debt burden on the group, the new Chairman José Maria Alvarez-Pallete is now engaging in a campaign of divesting non-core assets that will help Telefonica to retain its position among the largest telecommunications companies in Europe.

5.4 Cross-country comparison

This chapter described the divergent path taken since the mid-1990s by the Italian and Spanish telecommunications incumbents TI and Telefonica. While Telefonica has grown to become the largest telecommunications firm in the EU by revenue and market capitalisation, TI failed to become a European champion and is now a small firm active only in the domestic market, Brazil and Argentina. This divergence occurred even though until the late 1990s TI was larger than Telefonica, and had the potential to become a European champion (Oddo and Pons 2006), and even though both the Italian and Spanish governments engaged in an active effort of industrial policy aimed at favouring the foreign expansion of their telecommunications incumbents. The key moment in this process of industrial restructuring was the privatisation of TI and Telefonica. In fact, for budgetary reasons both the Italian and Spanish governments had to fully privatise their telecommunications incumbents renouncing to a key ownership power resource over them.

To give ownership stability to TI and Telefonica after privatisation and prevent foreign takeovers, both the Italian and Spanish governments established golden share powers over the firms, and tried to form a hard core of domestic investors. In the intentions of both governments the hard cores were meant to help TI's and Telefonica's transition from state-owned monopolist to public company operating in a liberalised market. Both the Italian and Spanish governments deemed that the fulfilment of this crucial task required the creation of a strong hard core owning at least a 15 per cent stake. Spain's PSOE, and later the PP, succeeded in creating a strong hard core, with the three banks – BBV, Argentaria and La Caixa – each owning a five per cent stake in Telefonica. In contrast, the Italian Centre-Left failed to convince enough domestic investors to enter TI's hard core. As a result, TI was left with a weak hard core owning a mere 6.6 per cent stake.

The weakness of TI's hard core would have a decisive influence on the future trajectory of the firm. In fact, the hardcore investors were not sufficiently powerful to defend a strong manager like Franco Bernabé from the Olivetti takeover. Had the hardcore investors owned at least 15 per cent of TI's shares they would have allowed the shareholders' meeting of April 1999 to happen, leading to the failure of the Olivetti takeover. In other words, the Olivetti takeover was a direct consequence of the weakness of TI's hard core. In turn, the Olivetti leveraged buyout and the consequent increase of TI's debt burden explain TI's failure to become a European champion. In fact, still in the late 1990s TI was a group with a strong international presence that rivalled Telefonica for leadership in the Latin American market.

However, since then the trajectory of TI and Telefonica has diverged. While in 2000 Telefonica further strengthened its foreign presence becoming the key player in Latin America with Operation Veronica, after the takeover by Pirelli and Benetton TI started a campaign of de-internationalisation aimed at reducing the debt burden of the group. The reduction of TI's foreign presence continued throughout the 2000s, while under Alierta's leadership Telefonica was further expanding in the European market. Because of these divergent managerial strategies, by 2014 Telefonica had become the largest European telecommunications firm by revenue (Fortune Global 500 2014), while TI is now a marginal player in the European market controlled by the French media group Vivendi.

The chapter has shown how the failure of the Italian government, and the success of its Spanish counterpart, to form a strong hard core is due to the different regulatory power relationship between the state and domestic investors in the two countries. It should be noted that, in the perspective of domestic investors, entering the hard core meant immobilising huge financial resources in a firm over which the state had golden share powers, and that was guided by managers appointed by the state prior to privatisation. In other words, Italian and Spanish investors that entered the hard core accepted to be passive shareholders, investing important financial resources in firms in which the state could still act as a de facto blockholder.

To make domestic investors accept this seemingly disadvantageous agreement, the Italian and Spanish states needed a bargaining chip to offer them: regulatory protection in their main sector of activity. Only when the state had regulatory power over domestic firms (Culpepper and Reinke 2014), did they agree to invest as passive blockholders. While this was the case in Spain, in Italy domestic investors could resist the calls to enter TI's hard core as the state lacked regulatory power over them. This difference in the state–business regulatory power relationship is due to a long-standing difference between Italian and Spanish capitalism. While the dominant actors in Spanish capitalism have historically been domestic banks, in Italy the bulk of the economic power was in the hands of family blockholders active in the manufacturing sector. Consequently, Spanish banks and Italian manufacturing families were the only domestic investors with sufficient financial resources to buy large stakes in Telefonica and TI.

The Spanish government succeeded in convincing domestic banks to enter the hard core of Telefonica because it had regulatory power over them. This power stemmed from two factors. First, as Culpepper and Reinke (2014) argue domestic firms are more dependent upon regulatory protection from their domestic regulator when they make most of their revenue on the domestic market. The Spanish trajectory confirms this claim as when Telefonica was privatised the banks BBV, La Caixa, and Argentaria were active only on the domestic market. Instead, the Italian manufacturing families that refused to enter the hard core of TI owned internationally competitive firms less tied to the Italian market.

Second, the regulatory power of the government vis-à-vis domestic investors is conditional on the degree of supranational market integration of their sector of activity. Firms active in less integrated sectors in which state's regulation still plays a decisive role, like banking in the late 1990s, will be more dependent upon regulatory protection from the state than those active in sectors in which the completion of the process of EU-led market integration left little scope for state legislation, like manufacturing (Stone Sweet 2004). This factor played a decisive role in the decision of the main Spanish banks to enter Telefonica's hard core. In fact, when Telefonica was privatised the Spanish banking sector was undergoing a process of domestic consolidation that could be decisively influenced by the Spanish government (see chapter 4). Consequently, Spanish banks were eager to invest in Telefonica if this allowed them to maintain a good relationship with domestic regulators. Instead, manufacturing families like the Benetton and Del Vecchio families operated in clothing and eye wear, two fully integrated sectors in which state regulation is limited. Consequently, the Italian state lacked regulatory power over domestic blockholders and they could easily turn down the offer to enter TI's hard core.

The Spanish banks' decision to side with the PP government in the confrontation with the Chairman Villalonga, which would ultimately lead to him being replaced by Cesar Alierta, is the clearest example of the enduring regulatory dependence of Spanish banks upon the PP government. Further proof of the regulatory dependence of inward-looking banks upon their domestic regulator is the fact that Italian banks and insurance groups occupied a prominent position in TI's hard core. However, when TI was privatised the process of banking consolidation in Italy had yet to start. Consequently, Italian banks were too small to buy large stakes in TI. Along with the availability of regulatory power over domestic banks, the Spanish PSOE and PP were helped as well by the partisan proximity with the main domestic banking managers (see chapter 4).

Government	Years	Ownership Power	Regulatory Power	Partisan Proximity Power	Industrial Restructuring Outcome
Centre-Left	1996–2001	*Weakening* 1997 Privatisation of TI the state keeps small share Golden share powers over TI	*Absent* Could not force family blockholders to invest in the hard core	1996–9: *Weak* Managers with weak political affiliation in TI Owners not close to the Centre-Left 1999–2001 *Strengthening* With the Olivetti takeover. owners close to the CL	*Failure* Failure of the privatisation strategy leads to ownership instability Frequent managerial turnovers The Olivetti takeover increases the debt burden over TI
Centre-Right	2001–6	*Weak* Full privatisation Golden share powers (never directly used)	*Absent* No regulatory power over TI's shareholders	*Strengthening* 2001 takeover by Pirelli and Benetton families (close to the CR)	*Failure* Ownership instability Managerial instability Further increase of debt burden De-internationalisation
Centre-Left	2006–8	*Weak* Golden share powers	*Absent* No regulatory power over TI's shareholders	*Weak* Change of ownership with foreign blockholders (Telefonica)	*Failure* De-internationalisation and further increase of the debt TI is marginal actor in EU telecommunications

Table 5.1 Ownership, Regulatory, Partisan Proximity Power and Industrial Outcomes in the Italian Telecommunications Sector

Government	Years	Ownership Power	Regulatory Power	Partisan Proximity Power	Industrial Restructuring Outcome
PSOE	1982–1996	*Strong* 1995 Partial privatisation of Telefonica but keeping controlling stake Golden share powers over Telefonica	*Strong* Strong regulatory power over banking shareholders part of the hard core (Inward looking banks, weakly integrated sector)	*Strong* Two managers close to the PSOE appointed at the head of Telefonica Banks part of the hard core guided by managers close to the PSOE	*Success* International listing of Telefonica Foreign expansion in Latin America Improved efficiency
PP	1996–2004	*Weakening* Full privatisation of Telefonica Golden share powers over Telefonica	*Strong* Strong regulatory power over banking shareholders part of the hard core (inward looking banks, weakly integrated sector)	*Strong* Two managers close to the PP appointed at the head of Telefonica Banks part of the hard core loyal to the PP	*Success* Telefonica becomes global champion with Operation Veronica Forces managerial shake-up when Villalonga's goals conflict with those of the executive
PSOE	2004–12	*Absent* 2005 Ruling of the ECJ forces Spain to give up golden share	*Weakening* Banks in the hard core are more internationalised and the sector is more integrated at EU level	*Weak* Telefonica guided by manager close to the PP Main banking shareholder (BBVA) guided by manager close to the PP	*Limited impact* Cannot force managerial shake-up Supports Telefonica's expansion in Europe

Table 5.2 Ownership, Regulatory, Partisan Proximity Power and Industrial Outcomes in the Spanish Telecommunications Sector

The chapter has shown as well how the Italian Centre-Left bears direct responsibility for TI's failed elevation into a European champion. In fact, TI's poor performance was due to the failure of the Centre-Left's privatisation plan centring on the hard core of domestic investors and to the decision of the Centre-Left to back the takeover of TI by Olivetti. The support to the Olivetti takeover involved controversial decisions like the choice of the government not to attend the April 1999 shareholders' meeting in which Bernabé wanted to present his defence against the takeover. The role of the Centre-Left in the Olivetti takeover highlights the importance of state agency in determining the outcome of industrial restructuring. In fact, the executive had the regulatory and ownership power to block the deal and protect Bernabé and his team. However, the government decided not to activate the available power resources, thus giving implicit green light to the leveraged buyout by Olivetti, which in turn led to a huge increase in the level of outstanding debt of TI. This attitude shows how, in order to achieve successful industrial restructuring, the ownership, regulatory and partisan proximity power resources need to be combined with state willingness to activate them.

Chapter 6. Electricity: The Divergent Trajectories of ENEL and Endesa

6.1 Introduction

This chapter compares the opposite performance of the Italian and Spanish electricity incumbents ENEL and Endesa. While ENEL successfully completed the transition from inward-looking monopolist to successful multinational, becoming the third largest electricity company in the EU by revenue, Endesa was taken over by ENEL ceasing to exist as an independent firm. The chapter shows how key in explaining ENEL's success was the decision of Italian governments of both colours to keep a controlling stake in the firm. The direct ownership of a controlling stake in ENEL was a crucial ownership power resource that allowed the state to act as reference shareholder giving ownership and managerial stability to the firm. In particular, the state could protect the three managerial teams that between 1996 and 2014 turned ENEL into a European champion. The chapter shows how the decision of Italian governments of both stripes to keep a controlling stake in ENEL is closely related to the failure of TI's privatisation described in the previous chapter. In fact, the post-privatisation trajectory of TI had made clear that the lack of state regulatory power over manufacturing family blockholders ruled out the possibility to form strong hard cores of domestic investors. Lacking the regulatory power necessary to give ENEL a strong hard core, the Italian government kept instead a key ownership power resource over the firm: the direct ownership of a controlling stake.

In the Spanish case, instead, the PP government decided to fully privatise Endesa forming a hard core of domestic banks, similar to that created in Telefonica. However, since the early 2000s different factors led to a progressive erosion of the ownership, regulatory and partisan proximity power resources that had allowed the Spanish state to successfully complete the process of industrial restructuring in telecommunications: the regulatory dependence of Spanish banks upon their domestic government, the golden share powers over privatised firms, and the partisan proximity of the banking managers part of the hard core of privatised utilities. Lacking these power resources in 2006 the PSOE government guided by José Luis Zapatero failed to bring about a merger between Endesa and the Catalan Gas Natural that would have allowed for the creation of a diversified Spanish energy champion. Instead, in 2007 the PSOE had to accept the takeover of Endesa by ENEL and the construction group Acciona. When two years later Acciona sold its stake, ENEL became the sole owner of Endesa, sanctioning the failure of the PSOE's plan to form a Spanish 'national champion' in electricity.

Like TI, the Endesa case study highlights how partisan proximity and regulatory power resources are not automatic and, to be effective, they need to be strategically activated. If the state lacks the willingness to do so, it will fail to get the preferred outcome despite a powerful position vis-à-vis domestic business actor. State's agency explains the failure of the 2001 merger between Endesa and its main domestic competitor Iberdrola, supported by the PP government. The Iberdrola-Endesa merger failed even though the PP government had the regulatory power to determine its outcome, and despite the fact Endesa was guided by a manager politically close to the executive. This was because when authorising the deal, the PP government imposed remedies that were judged too restrictive by Endesa and Iberdrola, forcing the management of the two firms to call off the merger plan. The derailment of the Endesa-Iberdrola merger shows that, even when they have regulatory and partisan proximity power over domestic firms, governments might still not get their preferred outcome because they fail to deploy their power resources effectively.

The rest of the chapter is organised as follows: section two analyses ENEL's transformation into a European champion highlighting the crucial importance for the firm of the direct ownership of a controlling stake by the state. Section three describes Endesa's trajectory from privatisation to the takeover by ENEL showing how the failure to upgrade into a European champion was due to the progressive erosion of the state's ownership, regulatory and partisan proximity power resources over Endesa's shareholders and managers. The chapter closes with a cross-country comparison.

6.2 Italy

6.2.1 ENEL's origins

The *Ente nazionale per l'energia elettrica* (ENEL) was created in 1962 following the decision of the government to nationalise the Italian power system by taking over and merging the main domestic electricity firms. ENEL was created to produce, transform and distribute energy for the entire country, a task crucial for Italy's transition from an agricultural to a manufacturing economy (Bergami et al. 2013). Two decisive events marked the first three decades of ENEL's history. First, the 1973 oil shock convinced the government and ENEL's management of the need to invest in energy sources alternative to oil, and in particular on nuclear power (Bergami et al. 2013). Second, the 1987 referendum in which, owing to the profound impact the Chernobyl disaster had on public opinion, a large majority of the population voted in favour of abandoning the nuclear option (Castronovo and Paoloni 2013). The decision to abandon nuclear energy made power production particularly expensive resulting in energy prices well above the European average (Di Porto and Silva 2005).

Owing to its monopolistic position in the domestic market, by 1986 ENEL had grown to become the second largest electricity utility in the world (Brunetti 2012, p. 64). However, because of lack of competition in the domestic market ENEL was inefficient and overstaffed, plagued by high operational costs (Bergami et al. 2013; Testa 2003). Consequently, a radical process of internal reorganisation was needed to prepare ENEL for competition in a liberalised European market (Bergami et al. 2013).

6.2.2 The Centre-Left and ENEL's partial privatisation

Until the early 1990s the EU played no role in electricity supply and the market remained segmented at the national level (Thatcher 2007). Competition was virtually absent in all member states, especially those like Italy and France where a vertically integrated state-owned monopolist dominated all the three activities constituting the supply of electricity: generation, transmission, and distribution (Thatcher 2007). In the early 1990s a plan to allow free competition for all consumers and provide free access to transmission grids met the opposition of all member states other than Britain and Ireland (Thatcher 2007).

The opposition of the large majority of member states convinced the Commission to opt for a more gradual approach that ultimately led to the adoption of the First Electricity Directive (FED) (96/92/EC). The FED made important steps in the direction of market integration forcing member states to: allow competition in generation and supply to large final users; provide access to the transmission grid for all suppliers thereby allowing competition in generation and distribution, and; create independent dispute settlement authorities to solve conflicts over the access to the electricity network (Thatcher 2007). However, to win the resistance of the French government the FED left considerable room of manoeuvre for member states in the regulation of the domestic electricity market, most notably by not mandating structural 'unbundling' – i.e., the break-up of vertically integrated companies into different companies to separate production, distribution, and transmission (Thatcher 2007).

When the FED was adopted in 1996 Italy was ruled by the centre-left coalition. Although the Italian government decisively contributed to the adoption of the FED when it took over the rotating presidency of the European Council (Luciani and Mazzanti 2006), the Centre-Left was nevertheless aware of the fact that to compete in a liberalised market ENEL needed radical restructuring. To favour this process of internal reorganisation, in 1992 the Amato technocratic executive transformed ENEL into a joint-stock company. Although ENEL remained a state-owned firm the flotation on the stock exchange was the necessary premise for its restructuring and future privatisation (Castronovo and Paoloni 2013).

Always in view of favouring ENEL's industrial restructuring in 1996, the Prodi centre-left government appointed a new managerial team led by Chicco Testa (Chairman) and Franco Tatò (CEO). Although they were both politically close to the centre-left government (La Repubblica 2/11/1998), Tatò and Testa were chosen in virtue of their professional background. Tatò's long experience in the private sector (Il Sole 24 Ore 29/08/1996)[23] made him the ideal candidate to guide ENEL through the difficult transition from inward-looking monopolist to international firm operating in a liberalised market (Bergami et al. 2013). Apart from improving ENEL's performance, Tatò and Testa were also given the task of maximizing its stock value in view of the upcoming privatisation (Testa 2003).

The centre-Left was split on the approach to follow regarding the liberalisation of the domestic electricity market and the privatisation of ENEL. On one hand, the most pro-market

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[23] In firms like Fininvest and Olivetti.

wing of the executive favoured a fast and radical liberalisation of the domestic market (Di Porto and Silva 2005). Proponents of this view wanted radical market integration, full deregulation of the domestic market, mandatory unbundling of ENEL's activities, and the forced separation of ENEL's productive capacity in many different companies to foster competition (Il Sole 24 Ore 02/01/1997; La Repubblica 10/02/1997). The main supporter of this liberalising agenda was the Minister of Industry, Pierluigi Bersani, backed by the newly created independent energy regulator AEEG (Prontera 2010). On the other hand, another fraction of the centre-Left opposed the radical liberalisation of the electricity market for two reasons. First, the Treasury opposed unbundling because it risked depressing ENEL's market value, thus reducing the future proceeds from its privatisation (Di Porto and Silva 2005). This was deemed unacceptable at a moment when Italy was struggling to meet the Maastricht convergence criteria (Di Porto and Silva 2005).

Second, and relatedly, political figures of the centre-left government, including Prime Minister Romano Prodi and his successor D'Alema (La Repubblica 14/8/1997**;** 14/10/1999), and the centre-right opposition deemed it vital for Italy to have a strong 'national champion' in a strategic sector with important security related implications like electricity (La Repubblica 08/02/1999; Silva 2004; Giulietti and Sicca 1999). According to this view, a strong ENEL controlling a large share of the domestic market would be in better position to expand abroad taking advantage of the opening of the European market, while at the same time ensuring the safe provision of energy to Italy (Chari 2015). In addition, many centre-left leaders thought that an internationally competitive ENEL could, along with the large banks emerging from the process of banking consolidation, form a new group of corporate actors capable of challenging the domination of family blockholders (Il Sole 24 Ore 10/10/2002; 02/03/1997; La Repubblica 1/10/1999). The Bersani Decree, a 1999 law transposing the FED, was a compromise between these two opposing views (Silva 2004). The main elements of the reform were:

- The forced unbundling of ENEL's generation, transmission, and distribution activities.
- The prescription that no operator would be allowed to produce more than 50 per cent of the electricity generated and imported in Italy, thus obliging ENEL to sell 15 GW of its generating production by 2003.
- The transfer of ownership of the electricity grid from ENEL to a newly established company, Terna, to be fully privatised by 2005.

The obligation to sell 15 GW of production, not prescribed by the FED, was particularly challenging for ENEL as it forced the firm to divest a significant part of its productive capacity (Financial Times 08/02/2005; Bergami et al. 2013). Overall, liberalisation in Italy exceeded the requirements of the FED, and was more radical than in other large continental economies like France and Germany (Luciani and Mazzanti 2006). Other than Italy, only the UK forced its incumbent to shed some of its productive capacity (Bergami et al. 2013). Nevertheless, Italy did not choose the line of full liberalisation as the Bersani decree allowed ENEL to maintain a dominant position in the domestic market with 50 per cent of production and generation (Silva 2004; Asquer 2010). In addition, while the Bersani decree theoretically mandated a substantial opening of the Italian market, in the following years the liberalising zeal of the Italian government progressively waned. As a result, since the early 2000s in the electricity sector (as in banking and telecommunications) Italian governments of both colours have prioritised the strengthening of their national champion over the liberalisation of the domestic market (La Repubblica 8/2/1999). Proof of this changed attitude are the slow and patchy implementation of the Bersani decree, the progressive capture of the energy regulator AEEG by the government, and the implementation of measures aimed at protecting ENEL's position in the domestic market (La Repubblica 02/11/1998; Silva 2004; Rangoni 2011).

The transformation of ENEL into a joint-stock company, the creation of an energy regulator and the implementation of the Bersani decree were necessary premises for ENEL's privatisation. In this regard, the technocratic executives of the early 1990s all agreed on the idea to fully privatise ENEL, selling the entire stake the Treasury held in the firm. In 1993 the Ciampi technocratic executive presented a plan to fully privatise ENEL by the end of 1994 through a public offering, establishing at the same time golden share powers over the firm (Il Sole 24 Ore 17/01/1997; La Repubblica 21/10/1993**;** 8/7/1994). Also, the short-lived centre-right government that took power in 1994 championed the line of full privatisation, even though the coalition was divided on the future ownership structure of ENEL. While the Northern League supported diffused ownership, Berlusconi's FI favoured the creation of a hard core of domestic investors (La Repubblica 31/3/1994).

The technocratic government of Lamberto Dini that took power in 1995 reiterated the intention to fully privatise ENEL by 1997 part through a public offering and part through a private auction aimed at forming a hard core of domestic investors (La Repubblica 25/11/1995). The Treasury Minister Rainer Maseras even engaged in informal talks with potential hardcore investors like the Agnelli and Falck families and the second domestic electricity group Edison

(Il Sole 24 Ore 25/2/1995). Initially, also the centre-left government that won the 1996 elections favoured the full privatisation of ENEL. In fact, Prime Minister Prodi saw the total privatisation of the telecommunications incumbent TI as a model for the future cession of other potential 'European champions' like ENEL and the oil & gas conglomerate ENI (Oddo and Pons 2006). Following the TI model, the Centre-Left wanted to fully privatise ENEL forming a strong hard core of domestic investors that would grant ownership stability to the firm, protect the managers appointed by the executive prior to privatisation, and help the transition from the public to the private sector. After some years, the hardcore investors would have the possibility to sell their stakes transforming ENEL into a public company (Oddo and Pons 2006; Il Sole 24 Ore 4/1/2000).

However, the post-privatisation trajectory of TI changed the Centre-Left's attitude towards ENEL's privatisation. In fact, as seen in the previous chapter, the Centre-Left had failed to convince enough domestic investors to enter TI's hard core. The consequent ownership instability of TI, which ultimately led to the Olivetti takeover, made the Centre-Left aware of the fact that a privatisation strategy based on a hard core of domestic investors was not applicable in Italy, as explicitly recognised both by Minister of Industry Bersani and Minister of Finance Vincenzo Visco (La Repubblica 23/2/1998**,** La Repubblica 31/10/1999). The Centre-Left's failure to form strong hard cores was due to the Italian state's lack of regulatory power over family blockholders, the only domestic investors with sufficient resources to buy a large stake in firms like ENEL and TI. In fact, family manufacturing groups like the Benetton and the Del Vecchio made large part of their revenue outside the domestic market, and operated in liberalised sectors. Consequently, manufacturing family blockholders depended less upon regulatory protection from their home government, the Centre-Left lacked a bargaining chip to convince them to invest as passive blockholders in firms like TI and ENEL.

Given the impossibility of forming a strong hard core of domestic investors, since the late 1990s the Centre-Left has progressively abandoned the plan to fully privatise ENEL, choosing instead the line of partial privatisation. In 1998 the Treasury Minister, Carlo Azeglio Ciampi, explicitly mentioned the government's intention to keep a controlling stake in ENEL (La Repubblica 21/1/1998), while the following year Massimo D'Alema, who had replaced Prodi as Prime Minister, affirmed that the government had no plan to privatise ENEL and anyway the eventual sell-off would be a 'very gradual' process (Il Sole 24 Ore 13/01/1999; La Repubblica 3/11/1999).

By keeping a controlling stake in ENEL, the state could act as reference shareholder giving ownership and managerial stability to the firm (La Repubblica 25/5/1998). Such stability has been lacking in the case of TI, leading to three changes of the managerial team in less than two years between 1997 and 1999 (Oddo and Pons 2006). In other words, lacking the regulatory power to convince private investors to participate in ENEL's hard core, the Italian state retained a key ownership power resource to help ENEL's transition from state-owned monopolist to successful multinational: the direct ownership of a controlling stake. However, the partial privatisation strategy of the Centre-Left nevertheless involved ENEL's flotation and the reduction of the stake directly owned by the state.

This happened for two main reasons. First, ENEL's privatisation was an important source of revenue necessary to reduce Italy's public debt and deficit. Second, by floating ENEL's shares the Centre-Left increased market scrutiny over the firm thus reducing the scope for political interference in its management (Lorrain and Defeuilley 2005). This way governments of both colours were forced to choose ENEL's managers in virtue of their expertise and professional background rather than their political affiliation. The managers, in turn, had to focus exclusively on the maximisation of shareholders' value, as in every listed firm, and not on the satisfaction of clientelistic demands coming from the political sphere (Il Sole 24 Ore 10/10/2002**;** Bergami et al. 2013). The partial privatisation of ENEL was officially launched in November 1999 when the Treasury sold a 32 per cent stake through the largest public offering in Italian history (Bergami et al. 2013), which generated US$17 billion (Chari 2015, p. 180).

After the partial privatisation of ENEL, the centre-left executive confirmed Franco Tatò and Chicco Testa at the head of the firm. Since their appointment in 1996 the two managers had embarked on a process of profound restructuring aimed at preparing ENEL for the liberalisation of the European electricity market. Apart from renewing ENEL's internal structure Tatò and Testa focused on improving the efficiency of the firm and reducing the number of employees (Bergami et al. 2013). The provisions of the Bersani Decree that forced ENEL to shed a relevant part of its productive capacity made this process of internal restructuring even more challenging.

With the support of the centre-left government, Tatò and Testa reacted to the forced reduction of ENEL's market share in the core electricity business by diversifying in other service sectors like gas, telecommunications, water, IT technology and real estate (ENEL 2001; Il Sole 24 Ore 16/06/2001; La Repubblica 11/10/1999; Bergami et al. 2013). The Centre-Left supported this diversification strategy, as it was a way for ENEL to gain size, reducing the scope for hostile takeovers, and increase its stock value (Giulietti and Sicca 1999). Tatò and Testa made their most relevant investment in telecommunications, with ENEL forming a joint venture with France Télécom and Deutsche Telekom to create Wind, the third mobile phone operator in Italy. By 1998 Wind had already gained an important share of the domestic market with 3.5 million customers (Castronovo and Paoloni 2013, p. 104).

While the managerial team focused most efforts on the diversification of ENEL's domestic activity, less attention was paid to the penetration of foreign markets (Lorenzoni 2003). In fact, while electricity groups like France's EDF and Germany's E.ON were already expanding abroad taking advantage of the early liberalisation of Britain's market, and Endesa was gaining a strong position in Latin America, ENEL waited until 2002 to conclude its first (minor) foreign acquisition, the takeover of Spain's Electrica de Viesgo (Chari 2015).

6.2.3 The Centre-Right in power: Refocusing, foreign expansion and further (partial) privatisation

Although Tatò and Testa had decisively contributed to ENEL's restructuring, from the late 1990s their multiutility strategy started attracting negative remarks both from the centre-right opposition and the press. Criticisms focused mainly on the poor financial results of ENEL's investments in sectors unrelated to its core electricity business (Il Sole 24 Ore 21/02/2004). For instance, Forza Italia MP Beppe Pisanu stated that if the Centre-Right won the general elections in 2001 one of the first measures would be to remove Tatò and dismantle the 'useless colossus' he had created by investing in sectors unrelated to ENEL's core business (La Repubblica 12/10/2000). For its part, in 2002 the rating agency Moody's judged that the continuation of the multiutility strategy risked further deteriorating ENEL's financial profile (Lorrain and Defeuilley 2005, p. 109). In addition, because of the limited penetration of foreign markets ENEL was losing ground vis-à-vis its main European competitors (La Repubblica 8/2/1999**;** La Repubblica 11/10/1999).

For these reasons, after winning the 2001 elections the centre-right executive removed Testa and Tatò, replacing them with Paolo Scaroni as CEO and Piero Gnudi as Chairman. Even though Tatò and Testa's leftist sympathies also played a role in the Centre-Right's decision to remove them, their replacements Scaroni and Gnudi were both selected first and foremost in virtue of their strong professional background (La Repubblica 9/5/2002). Scaroni had earned unanimous praise from market operators as CEO of the UK glass manufacturing company Pilkington, while Gnudi had extensive experience in the state-owned industrial conglomerate IRI (The Independent 15/05/2002; The Daily Telegraph 15/05/2002; La Repubblica 15/05/2002; Bergami et al. 2013). The process that led to Scaroni and Gnudi's appointments shows the importance of partially privatising ENEL. In fact, the scrutiny from market operators forced Prime Minister Berlusconi and his Minister of Finance Giulio Tremonti to choose high profile managers, resisting calls for more political appointments coming from the National Alliance, junior allied of the Centre-Right (La Repubblica 29/4/2002). The high profile of Scaroni and Gnudi is confirmed by the fact that both the centre-left opposition and market operators reacted positively to their appointment (La Repubblica 15/5/2002).

Like the previous centre-left government, the Centre-Right also prioritised the protection of ENEL's dominant position in the domestic market over competition for two reasons. First, the Centre-Right considered ENEL a strategic 'national champion', and wanted to favour its elevation to an internationally successful European champion (Silva 2004; Il Sole 24 Ore 22/12/2001). Second, the Centre-Right wished to maximise the proceeds from ENEL's partial privatisation (Silva 2004). This pro-ENEL bias caused frequent tensions between the centre-right government and the electricity regulator AEEG (La Repubblica 21/11/2001; Verda 2014). For instance, in 2002 AEEG criticised the government for imposing a high level of tariffs to defend ENEL's margins at the detriment of consumers (La Repubblica 31/7/2002).

Concerning ENEL's privatisation, the Centre-Right followed in the line of partial privatisation of the previous centre-left government. In fact, although the Centre-Right progressively reduced the 68 per cent stake the state held in ENEL, it never went below the 30 per cent threshold deemed necessary to maintain the firm under state control (Il Sole 24 Ore 18/7/2004; Financial Times 24/02/2005).[24] Hence, also the Centre-Right considered the direct ownership of a controlling stake in ENEL a key ownership power resource to help the firm's transition from inward looking monopolist to European champion. The Minister of Economic Development, Antonio Marzano, justified the choice to maintain a controlling stake in ENEL by making direct reference to the fact that countries like Germany and France also owned a large stake in their electricity incumbent (La Repubblica 3/1/2002).

[24] Between 2003 and 2005 the Centre-Right government reduced the Treasury's stake in ENEL from 68 to 32 per cent (Nardozzi and Carbone 2011, p, 183), earning US$17 billion (Chari 2015, p. 180).

Despite keeping a controlling stake in ENEL, bringing state ownership below the absolute majority of the shares, increased market scrutiny over ENEL, thus creating the conditions for the appointment of competent managers like Scaroni and Gnudi. A similar scheme was adopted for other state-owned firms active in strategic sectors like the oil and gas conglomerate ENI and the defence multinational Finmeccanica in which the state retained, and still retains, a 25–30 per cent controlling stake.

In 2003, shortly after Scaroni and Gnudi's appointment, the EU adopted the Second Electricity Directive that opened the market to competition for all users (Thatcher 2007). The liberalising push of the Commission came as a further challenge for firms like ENEL, which had already lost ground vis-à-vis its main competitors in the domestic market. In fact, between 1992 and 2005 ENEL's share of energy production in the domestic market had dropped from 73 to 40 per cent. As a result, between 1996 and 2000 ENEL fell from second to fifth among EU electricity utilities in terms of production, closely followed by Spain's Endesa in sixth place (Testa 2003, p. 119). ENEL's drop in the Continental ranking was also a consequence of the international activism of its main competitors. For instance France's EDF had expanded in Belgium, Austria, Eastern Europe and Italy (with the acquisition of Edison), Germany's E.ON had acquired the UK Powergen, and Endesa had become the dominant player in the Latin American market (Bergami et al. 2013).

To relaunch ENEL's ambitions Scaroni and Gnudi elaborated a new strategy based on two pillars: the refocus on the core energy business – electricity and gas – and a push towards internationalisation (ENEL 2002, p. 4; La Repubblica 02/11/2002; Bergami et al. 2013). The shift from the 'multiutility' to the 'multienergy' strategy meant that ENEL gradually left all sectors unrelated to the core energy business (Castronovo and Paoloni 2013). The managerial team elaborated this new strategy acting in close coordination with the centre-right executive (Silva 2004). Showing his support for the 'multienergy' strategy in 2002 the Minister for Economic Development, Antonio Marzano, declared that ENEL's main objective should be to 'strengthen the core energy business which ENEL had developed much less than its main European competitors' (La Repubblica 16/5/2002). The refocus on the energy business was also aimed at winning back market operators' confidence, as Scaroni himself recognised that the only way to defend ENEL as a 'national champion' was to bring efficiency and value for its shareholders (Il Sole 24 Ore 15/5/2002).

The second pillar of Scaroni's plan was the penetration of foreign markets. Since the early 2000s ENEL started expanding in Latin America – with investments in Brazil and El

Salvador – and in Eastern Europe entering Bulgaria, Rumania and most crucially Russia, where ENEL was a prime mover among European electricity utilities (Bergami et al. 2013; Castronovo and Paoloni 2013).

In 2005 the Centre-Right replaced Paolo Scaroni, named CEO of the oil & gas group ENI, with Fulvio Conti. Conti had worked in ENEL since 1999 and his appointment, along with Gnudi's confirmation, meant that the government favoured the continuation of ENEL's strategy to refocus on the core energy business and expand abroad (La Repubblica 15/5/2005). Like the previous appointments, Conti was chosen in virtue of his expertise rather than for his political proximity with the executive (Bergami et al. 2013). Again, the Ministry of Finance had to resist calls for a more political appointment coming from the centre-right coalition in order not to hurt ENEL's stock performance (La Repubblica 13/5/2005). For its part, the centre-left opposition supported both Conti's appointment and his confirmation in 2009 (La Repubblica 30/5/2008). Conti's first move at the head of ENEL was the cession of the telecommunications firm Wind for €3 billion (Castronovo and Paoloni 2013, p. 117). The financial resources acquired from the sale were channelled to an aggressive campaign of foreign expansion.

In Conti's view ENEL needed to gain size to keep up with its main European peers (ENEL 2006, p. 8; Financial Times 08/09/2006). For this reason, between 2005 and 2006 ENEL completed the acquisition of the Slovakian group Slovenské Elektràrne, the second largest power producer in Central and Eastern Europe, and further expanded in Latin America (Bergami et al. 2013). However, to match the dimension of the European leaders E.ON and Edf, ENEL needed to take over a large European competitor, a 'big fish' in Conti's words (Bergami et al. 2013, p. 125; Corriere Della Sera 03/03/2014). In fact, Conti was well aware of the fact that only four or five 'European champions' would survive the wave of M&A triggered by the Second Electricity Directive, and both he and the government wanted ENEL to be among them (La Repubblica 19/3/2007; Il Sole 24 Ore 02/11/1998).

In its quest for a big acquisition, ENEL first targeted the French electricity and water group Suez. In early 2006 ENEL made public the intention to takeover Suez forming a joint venture with the French water and electricity group Veolia. However, ENEL's attempt led to a defensive move by the French government that engineered a merger between Suez and the state-owned group Gaz de France (GdF) to prevent the foreign takeover of a strategic firm (Bergami et al. 2013). In backing the defensive merger between the two French energy firms, Prime Minister Dominique de Villepin explicitly referred to the need for 'true economic patriotism' to protect strategic firms from foreign takeovers (Financial Times 21/3/2006). The centre-right government had actively supported ENEL's bid and reacted harshly to the protectionist attitude of its French counterpart, with Minister of Finance Tremonti comparing the French nationalist rhetoric to that heard in Europe in August 1914 (Financial Times 04/07/2005; 21/3/2006; Il Sole 24 Ore 23/02/2006). Also, the centre-left opposition expressed its frustration for the protectionist attitude of the French government, signalling strong bipartisan support for ENEL's internationalisation (La Repubblica 14/6/2006; La Stampa 24/02/2006).

6.2.4 The Centre-Left back in power: The takeover of Endesa

The electoral victory of the Centre-Left in 2006 did not change the government's attitude towards ENEL, both concerning the support for Conti's internationalisation plan and the approach to ENEL's privatisation (La Stampa 24/02/2006; Il Sole 24 Ore 12/03/2006). On this second issue, the Centre-Left reiterated the intention to maintain a controlling stake in ENEL with Minister of Finance Tommaso Padoa-Schioppa, explicitly declaring that: 'There is no room to further reduce the state's participation in ENEL' below the 30 per cent stake the Centre-Left inherited from the previous government' (La Repubblica 21/7/2006). Hence, Italian governments of both colours considered the controlling stake the state held in ENEL a crucial power resource to provide ownership and managerial stability to the firm, protecting it from foreign takeovers and helping the transition from domestic monopolist to European champion. Further proof that the Centre-Left saw positively the direct ownership of a controlling stake in strategic firms is the fact that in 2006 the government briefly considered the idea of buying back from Pirelli a controlling stake in TI (Financial Times 18/9/2006). Although the plan was not implemented this is the clear sign that the government perceived TI's full privatisation as a mistake.

While ENEL was unsuccessfully attempting to acquire Suez, another prolonged takeover battle was underway, involving Gas Natural and Endesa of Spain and Germany's E.ON. In late 2005 the Spanish energy group Gas Natural attempted to take Endesa over but was later outbid by E.ON with a cash offer worth €29 billion, later raised to €41 billion (Thomas 2009). Although Endesa's shareholders were satisfied with E.ON's offer, the Spanish Minister of Finance, Pedro Solbes, blocked the deal stating that a foreign takeover of Endesa represented a threat for the 'the national energy future of Spain' and he would rather opt for a ‘deal in Spain’s national interest in a strategic sector as energy’ (Chari 2015, p. 221). ENEL seized the opportunity created by the stalemate to form a joint venture with the Spanish construction group Acciona and launch a rival bid for Endesa. Learning from the failure of the Suez deal, ENEL’s management tried to build a cooperative relationship with the PSOE government, helped in this by the diplomatic effort of the Centre-Left. In February 2007, Prime Minister Prodi personally engaged in a bilateral meeting with his Spanish counterpart Zapatero in Ibiza where he managed to secure the Spanish government’s approval for ENEL’s bid, promising in exchange to allow Telefonica’s acquisition of a stake in TI (La Stampa 28/09/2006; La Repubblica 19/03/2007; Chari 2015). The deal shows that, similar to the Centre-Right, the Centre-Left made direct efforts to help the internationalisation of its national champions. To favour the deal, Prodi exploited his close ties with Minister of Finance Solbes, who had served in the Prodi Commission (Chari 2015). Having obtained the backing from the PSOE government, in October 2007 Acciona and ENEL completed Endesa’s takeover for €43 billion. ENEL and Acciona acquired 92 per cent of Endesa’s shares, with ENEL directly owning a 66 per cent stake.

The Endesa takeover was the quantum leap ENEL’s management was aiming for. As a result of the deal ENEL became the main player both in Spain and in the Latin American market and more than doubled its revenue going from €21 to 52 billion (Brunetti 2012, p. 30). More crucially, with the Endesa takeover ENEL has become a European champion in its sector of activity, entering the Big Five of EU electricity utilities that more than double the revenue of their nearest rival - the other four being GDF Suez, E.ON, EDF and RWE (Thomas 2009). After having completed the takeover, to avoid retaliations from the German government, ENEL agreed to cede €11 billion worth of Endesa’s assets to E.ON (Chari 2015).

It is worth highlighting that ENEL’s elevation to a European champion was by no means an inevitable outcome, in particular after the failed attempt to takeover Suez. In an interview, a senior ENEL executive recognised that ENEL took over Endesa but the opposite could easily have been the case (Bergami et al. 2013, p. 128). In fact, still in 2000 Endesa was rivalling with ENEL for the fifth place among EU electricity utilities (Testa 2003). Furthermore, while by the early 2000s Endesa had already successfully internationalised becoming the main player in Latin America, in 2006 ENEL was seen as a fading national champion increasingly exposed to competition in the domestic market and with a negligible foreign presence (Financial Times 19/6/2007).

However, Conti's managerial skills and the decisive diplomatic support from the centre-left government allowed ENEL to emerge victorious from the Endesa takeover battle (Financial Times 04/04/2007). ENEL's success was decisively helped as well by the controlling stake owned by the state. In fact, state ownership gave managerial stability to the firm, allowing the different managerial teams to develop long-term strategies, and at the same time sheltering ENEL from the threat of hostile takeovers. This was recognised as well by the Italian press that after the Endesa takeover compared ENEL's success to the difficulties experienced by the fully privatised TI (Bergami et al. 2013). Commentators mentioned the direct ownership of a controlling stake by the state, and the diplomatic effort of the Centre-Left as the two key factors behind ENEL's success (La Repubblica 17/12/2007; 19/03/2007; La Stampa 04/04/2007).

After the acquisition of Endesa, ENEL scored another important success in Russia where it expanded in the upstream gas sector by acquiring the power group OGK-5. Also in this case the centre-left government used the diplomatic channel to support ENEL's expansion with Minister for Economic Development Bersani engaging in bilateral talks with Vladimir Putin and declaring that a 'teamwork' between the government and the main Italian firms was crucial to help their internationalisation (La Repubblica 30/11/2006). These declarations show how, by the mid-2000s also Bersani, the main figure of the pro-liberalising wing in the late 1990s, now prioritised the strengthening of ENEL as a 'national champion' over the liberalisation of the domestic market. In 2009 needing financial resources to reduce its debt Acciona sold ENEL its stake in Endesa for €9.6 billion (Chari 2015, p. 223). As a result, ENEL raised its ownership in Endesa to 92 per cent. Although the Endesa deal was a decisive step in ENEL's upgrade into a European champion, it also led to a five-fold increase of the debt of the group that in 2007 reached €57 billion (Corriere Della Sera 03/03/2014; Bergami et al. 2013, p. 83).

Thanks to its successful penetration of foreign markets, culminated with the Endesa takeover, ENEL has become the third largest electricity utility in Europe after E.ON and GDF-Suez both in terms of revenue (€86 billion) and total assets (€171 billion) (Chari 2015, p. 187). ENEL has over 60 million customers in 40 countries and is the leading electricity utility in Italy (where is also the second largest gas distributor), the Iberian Peninsula, and the Latin American market, with important investments as well in Eastern Europe and in particular in Russia (Thomas 2009). The international orientation of the group is confirmed by the fact that in 2010 more than 50 per cent of its installed capacity was located outside Italy (Bergami et al. 2013, p. 60).

As seen in the first chapter, its strong performance and global reach make ENEL a European champion in its sector of activity. Even though the Endesa takeover brought ENEL's debt above €55 billion, market operators have always perceived the company as solid. Furthermore, owing to the divestiture of non-core assets by 2015 the outstanding debt of the group was brought down to €37 billion (La Repubblica 22/2/2017). In 2014 the Renzi centre-left government replaced Fulvio Conti with Francesco Starace. Much like his predecessors, Starace was chosen in virtue of his professional background and long experience in ENEL, and his appointment was praised by market operators (Financial Times 15/4/2014). So far, Starace has been able to combine very strong financial results with a renewed effort to strengthen ENEL's leadership in the production of renewable energy (La Repubblica 12/5/2014).

6.3 Spain

6.3.1 Endesa's origins

The first Spanish electricity firms formed in the 1870s. Thirty years later more than 800 local producers of small dimensions were active in the Spanish market (Toral 2011a). In the following decades, a process of consolidation reduced the number of domestic producers. In 1944 the largest surviving companies created the umbrella organisation, UNESA. It immediately emerged as one of the most powerful domestic lobbying groups developing a close relationship with the Franco dictatorship and the main domestic banks (Arocena et al. 1999). Also in 1944, the Franco regime established Endesa as a state-owned electricity company tasked with the construction of new power stations. Initially, Endesa was a small actor involved only in the generation segment that did not challenge the domination of the private firms within UNESA (Valdivielso del Real and Goyer 2012).

Throughout the 1950s and 1960s the Franco regime allowed UNESA to operate as a self-regulated cartel, designing all aspects of the regulation of the electricity sector (Jordana et al. 2006). It was only in 1969 that the administration took a more active role, passing an Energy Plan that forced electricity producers to engage in the building of nuclear plants (Toral 2011a). This onerous endeavour led to a sizeable increase of the debt burden of the main electricity utilities.

6.3.2 Endesa under the PSOE (1982–1996): Partial privatisation and foreign expansion

The transition to democracy and the advent to power of the PSOE in 1982 did not alter the Francoist tradition of behind closed doors negotiations between the government and the main electricity utilities (Arocena et al. 1999). The first PSOE government agreed with UNESA the implementation of a comprehensive set of measures aimed at relieving the heavily indebted electricity companies including the nationalisation of the high-voltage transmission network; a moratorium on the construction of new nuclear plants; and, more crucially, a system of tariffs to subsidise electricity firms for the costs they incurred to produce energy (Arocena et al. 1999). To address the financial difficulties experienced by most electricity utilities, the PSOE superseded as well to a wave of domestic consolidation. As a result, by the mid-1980s ten vertically integrated regional producers had achieved a dominant position in the domestic market (Arocena et al. 2002). Along with these private firms, the PSOE strengthened Endesa, which then acquired all the other state-owned electricity utilities and took over the nuclear plan. As a result, by the mid-1980s Endesa had gone from being a small electricity producer to a diversified and vertically integrated group with interests in oil, coal, nuclear and hydroelectric energy (Toral 2011b).

Notwithstanding the generous subsidy system put in place by the PSOE, the financial situation of the main private utilities remained dire. Consequently, between the late 1980s and the early 1990s the PSOE oversaw a second wave of consolidation among domestic electricity firms (Goyer and Valdivielso 2012). Endesa played a leading role during this second wave of consolidation, taking over many private competitors to emerge as the main electricity utility in Spain (Marcos 2012). The second protagonist of the process of domestic consolidation was Iberdrola, a private firm created in 1992 because of the merger between Iberdruero and Hidrola. The second wave of mergers and acquisitions changed the face of the Spanish electricity sector leaving only four firms in the market: Endesa, Iberdrola, Union Fenosa, and Hidrocantabrico. Among them, Endesa and Iberdrola had a commanding position with a combined 80 per cent share of both the generation and distribution segments (Endesa led the way with 50 per cent of the generation and 43 per cent of the distribution closely followed by Iberdrola) (Arocena et al. 1999, p. 389).

Hence, like in Italy by the late 1980s the state-owned incumbent was the largest player in the domestic market. However, an important difference between Italy and Spain deserves to be highlighted. In fact, after taking over the main private electricity utilities in the 1960s ENEL had become a monopolist accounting for more than 80 per cent of the market both in production and distribution. Instead, in the early 1990s the Spanish electricity market was organised as an oligopoly with Endesa closely followed by Iberdrola, and two other firms with shares between 5 and 10 per cent of the market.

The PSOE strengthened Endesa's position in the domestic market because the electricity incumbent was considered one of the few Spanish firms with the potential to become a successful multinational (El Pais 2/11/1995; 24/10/2000; Financial Times 25/01/1996; Etchemendy 2004). Always seeking to give Endesa sufficient size to be internationally competitive, the PSOE supported its expansion in Latin America. In 1992 Endesa made its first relevant acquisition in Argentina, later investing in Peru, Brazil and the Dominican Republic (Toral 2011a). Like Telefonica, the PSOE considered Endesa's foreign expansion as a way to gain size thus reducing the scope for hostile takeovers by larger EU competitors (Yanez 2003). Proof of this is the fact the pace of Endesa's Latin American acquisitions accelerated after 1992, when the EU started discussing the first project for the integration of the electricity market (Jordana et al. 2006).

Like with Telefonica, the PSOE also supported Endesa's foreign expansion because it was a way to increase its stock value in view of the upcoming privatisation. Endesa's sell off started in 1988 when the PSOE floated a 20 per cent stake on the New York stock exchange. A second 9 per cent tranche was sold in 1994, although the state maintained a 66 per cent controlling stake (Marcos 2012, p. 5). State's revenue from these sell-offs totalled more than US$2.1 billion (Chari 2015, p. 183). As in the case of Telefonica, by gradually privatising Endesa the PSOE could continue influencing the firm's strategy and appoint key managerial figures. As with Telefonica and Argentaria, the PSOE established golden share powers that allowed the government to have a say over key managerial decisions and veto eventual takeovers even after having completed the privatisation process (Arocena 2004).

Like Telefonica, Endesa was privatised in part through a public offering aimed at attracting small investors, and in part through a private auction to form a hard core of domestic investors (Etchemendy 2004; El Pais 2/11/1995). As in the case of Telefonica, the hard core of domestic banks had the crucial task of giving ownership stability to Endesa and protecting the management from hostile takeovers (El Pais 21/04/1996; Valdivielso del Real and Goyer 2012). Leveraging its regulatory power over domestic banks by 1996 the PSOE had managed to create a hard core that controlled 8 per cent of Endesa, formed by: Banco Santander (3 per cent), Banco Central Hispano (3) and the still state-owned Argentaria (1.8) (El Pais 17/9/1996; El Pais 19/4/1996).

While the PSOE superseded to a radical restructuring of the electricity sector with the consolidation among the main domestic producers and the partial privatisation of Endesa, it did little to change the regulatory framework inherited from the Franco dictatorship, maintaining a high level of tariffs and regulatory barriers to entry (Arocena et al. 1999).

6.3.3 Endesa under the PP: Full privatisation and failed merger with Iberdrola

The coming to power of the PP in 1996 was contemporaneous to the adoption of the First Electricity Directive (FED). The FED mandated open access to the transmission and distribution networks, but left member states considerable room of manoeuvre in defining the degree of openness of the distribution segment and did not make unbundling mandatory (Jordana et al. 2006).

The implementation of the FED was an occasion for the PP to reform the regulatory framework inherited from the PSOE. However, in doing so the PP did not break with the tradition of bilateral consultations between the executive and the main electricity firms dating bank to the Franco era (Arocena et al. 1999). In fact, the main aspects of the new Electricity Law (54/1997) were agreed in a Protocol signed in December 1996 by the executive and the main electricity utilities. The Electricity Law ended the tariff system and opened the domestic market for generation to competition, introduced a competitive wholesale market and paved the way for the gradual liberalisation of the supply segment. Like in Italy, and other European countries, the law divided the network operator REE into two institutions, the Market Operator and the Network Operator (Toral 2011b). The electricity authority was strengthened, and was renamed the National Energy Commission (NEC), although it remained an advisory body placed under the authority of the executive (Jordana et al. 2006).

Although the Electricity Law made the Spanish market more competitive, the PP did not choose the line of full liberalisation. For instance, the PP allowed the main domestic electricity incumbents to postpone the legal separation of their generation and distribution activities until 2001 (Régibeau 1999). In addition, the PP generously compensated Endesa and the other domestic utilities for the costs of transition to competition, the so-called ‘stranded costs’. Overall the four electricity utilities received more than US$13 billion from the government, financial resources that were then re-invested to expand in Latin America (Toral 2011a, p. 100). Even more crucially, the PP decided not to split Endesa in different companies and privatise them separately to stimulate competition. Instead, like in Italy, the PP chose to keep Endesa united for two reasons: first, to maximise the proceeds from its future privatisation (Arocena et al. 1999), second to make sure Endesa had a size comparable to that of its main European competitors. In fact, like the PSOE, the PP wanted to make Endesa one the leaders of a new generation of Spanish multinationals (Etchemendy 2004; Toral 2011b; El Pais 14/10/2002; 24/10/2000).

Unlike ENEL, Endesa was not forced to shed part of its productive capacity. Although this might signal the fact that the Italian government was more open to liberalisation than its Spanish counterpart, it is also because of ENEL was a monopolist that in 1999 accounted for 80 per cent of domestic production and 84 per cent of distribution, shares considerably higher than the 40 per cent controlled by Endesa (Asquer 2010, p. 104). Instead, Spain chose a more radical approach than Italy when dealing with the sell-off of the electricity incumbent, opting for the full privatisation of Endesa. As a result, between 1997 and 1998 the PP executive sold 58 per cent of the stake it held in Endesa through two POs, keeping only a tiny 3 per cent share (Trillas 2001, p.27). The Spanish state gained approximately US$11 billion from the sales (Chari 2015, p. 183). In contrast, the failure of TI's full privatisation convinced Italian executives of both colours to maintain direct ownership power over ENEL. Similar to Telefonica, prior to privatisation to strengthen its partisan proximity power over Endesa the PP appointed a new Chairman, the former MP Rodolfo Martin Villa, along with a majority of the board members (Trillas 2001). The new board members loyal to the PP included Manuel Pizarro, economic advisor of Aznar, and the president of Argentaria, Francisco Gonzalez (Mota 1998).

When dealing with the full privatisation of Endesa, the PP followed in the footsteps of the previous PSOE executive, choosing a twin-track privatisation strategy that targeted small investors to disperse the ownership on the on hand, and offered larger stakes to the main domestic banks on the other (El Pais 22/6/1996; 07/02/1998). Both Aznar and Minister of Finance Rodrigo Rato publicly asked the main domestic banks to invest in the privatisation of large state-owned utilities like Endesa and Telefonica (El Pais 23/7/1996: 27/06/1996). Responding to the calls from the government, Banco Santander and BCH maintained their three per cent stake in Endesa, while the state-owned Argentaria raised its stake to three per cent (El Pais 25/07/1996; Mota 1998, p. 224).

The participation of Argentaria ensured the hard core's loyalty to the government, as the bank was still state-owned and guided by PP nominee Francisco Gonzalez. For their part, Santander and BCH were also willing to maintain a good relationship with the executive, as the PP had strong regulatory power over them (see chapter 4). To further increase its control over the privatised Endesa, in 1998 the PP confirmed the golden share established by the PSOE for the duration of ten years (Law 5/1995; Valdivielso del Real and Goyer 2012). In addition, as with Telefonica, prior to privatisation the board of Endesa had passed a series of defensive measures including voting ceilings that limited shareholders' votes to ten per cent irrespective of the stake they held (Mota 1998).

Under Martin Villa's leadership Endesa diversified its activity in sectors like gas distribution, water management, waste management and telecommunications (Toral 2011a). This strategy resembles that chosen by ENEL to gain size under the leadership of Tatò and Testa. Like ENEL, Endesa made its most relevant investment in telecommunications forming a joint venture with the other electricity utility Union Fenosa and the Italian telecommunications incumbent TI to acquire Retevision, the second licenced telecommunications firm in Spain after Telefonica.

With the support of the PP executive, Martin Villa also accelerated the pace of Endesa's expansion in Latin America. Similar to the PSOE, the PP considered Endesa's foreign expansion as a crucial defensive measure to gain size in the context of the liberalisation of the EU electricity market (Yanez 2003; El Pais 12/5/2002). Martin Villa himself recognised that in an integrated 'European market Endesa had to gain size… as its 44 per cent share of the Spanish market was only the 2.5 per cent of the European market' (El Pais 20/12/1999). The acquisition of Chile's Enersis, completed between 1997 and 1999, represented the quantum leap for Endesa's ambitions in the region. In fact, at the time of Endesa's takeover Enersis was the largest private electricity group in Latin America active in the domestic market, Argentina, Brazil, Peru and Colombia (Toral 2011a). The acquisition of Enersis and later operations in Brazil and Argentina made Endesa the leading private electricity multinational in Latin America. Between 1997 and 1999 Endesa invested little less than US$6.5 billion in the region (Chislett 2003, p.55). Endesa's early foreign push was like that of Telefonica, while the Italian ENEL delayed its internationalisation until the mid-2000s (Clifton et al. 2010). However, the excessive exposure to the Latin American market will later prove a crucial weakness for Endesa.

Although Latin America remained by far the most important focus of Endesa's foreign expansion, the firm invested as well in recently liberalised European markets like France and Italy. In 2001 Endesa gained an important foothold in the Italian market acquiring Elettrogen, one of the firms ENEL was forced to sell to reduce its market share in compliance with the Bersani Decree (Chari 2015). In France Endesa acquired a controlling stake of the electricity utility SNEF. As a result of this expansion in 2006 Endesa ranked among the largest electricity utilities in the world (Chari 2015).

Between the late 1990s and the early 2000s some changes occurred in the composition of Endesa's hard core. In fact, after their merger in 1999 Santander and BCH had to reduce their 6 per cent stake in Endesa in compliance with a corporate law passed by the PP. Adopted in 2000 the new legislation limited cross-shareholding and forbade multiple board representation in firms active in the same sector for competitiveness reasons (El Pais 18/10/2000). Owning a large stake in the electricity firm Union Fenosa, in the early 2000s Santander-BCH opted to exit from Endesa's hard core. For similar reasons, after the merger with BBV Argentaria reduced to 2.5 per cent its stake in Endesa and Francisco Gonzalez left Endesa's board (Valdivielso del Real and Goyer 2012, p. 88).

The consequent weakening of Endesa's hard core worried the Chairman Martin Villa, who asked La Caixa and Caja Madrid, the two largest Spanish savings banks ('cajas de ahorro'), to invest in Endesa (El Pais 20/12/1999). Spanish savings banks are local credit institutions that, until recently, were closely tied to the local government of their region of origin. Local governments could appoint up to half of the executive board, and had a decisive influence over the main managerial decisions. The statute of savings banks, and their eminently regional focus, made them dependent upon regulatory protection of their local government, similarly to the way in which large national banks are dependent upon the national regulator. Both La Caixa and Caja Madrid responded to Martin Villa's call each acquiring a five per cent stake in Endesa (Valdivielso del Real and Goyer 2012, p. 88). Consequently, in 2000 the two savings banks became Endesa hard core's largest investors. Since the Madrid local government is an electoral stronghold of the PP, the strengthening of Caja Madrid allowed the PP to exert an even closer control over Endesa. For its part, the savings bank La Caixa had close ties with the Catalan regional government that was controlled by the Catalan Nationalist Party (CiU), ally of the PP between 1996 and 2000 (Marcos 2012). It is worth again highlighting that savings banks depend more upon regulatory protection of their *regional* government than on that of the *central* government, as this will decisively influence Endesa's trajectory.

Although its successful expansion in Latin America and Europe had made Endesa one of the largest electricity utilities in the EU, since the early 2000s the firm started suffering some seatbacks (Chari 2015). These difficulties mainly originated from Endesa's failed attempt to merge with its main domestic competitor Iberdrola. In September 2000, the management of Endesa and Iberdrola communicated the intention to merge the two companies. The company resulting from the merger would have controlled 80 per cent of both the generation and distribution segments in Spain, becoming the undisputed leader as well in the Latin American market (Escobar Perez and Gonzalez Gonzalez 2005). Crucially, the merger would have allowed Endesa and Iberdrola to gain sufficient size thus preventing hostile takeovers from larger EU competitors (Yanez 2003).

Aware that the Spanish government, in compliance with the EU Directives, could not allow a firm to achieve such a dominant position in the domestic market Endesa and Iberdrola proposed a plan to divest part of their holdings to reach a share of 45 for cent of distribution and 60 of generation. This reduction was not judged sufficient by the independent National Energy Commission (NEC) and the Competition Court that in their non-binding opinions asked the two firms to reduce their shares to a level close to 40 per cent both in distribution and generation (Escobar Perez and Gonzalez Gonzalez 2005, p. 12). The PP executive found itself in a particularly delicate situation. In fact, it was generally understood that the PP, and in particular Prime Minister Aznar, favoured the deal (El Pais 21/1/2001; 16/01/1999; Sunday Business 22/10/2000; Cinco Dias 11/11/2000). However, the government could not allow Iberdrola and Endesa to grow too much in the domestic market as one year before the PP had vetoed a merger attempt between the smaller Hidrocantabrico and Union Fenosa on grounds that it could hamper competition (El Pais 24/10/2000; Cinco Dias 03/02/2001; Yanez 2003).

Consequently, in February 2001 the PP tried to opt for the middle ground sweetening the conditions imposed by the Competition Court by asking Endesa and Iberdrola to reduce their domestic share to 42 per cent in generation and 50 per cent in distribution (El Pais 03/02/2001; 04/02/2001; Escobar Perez and Gonzalez Gonzalez 2005, p. 12). However, the management of Iberdrola and Endesa caught the PP government by surprise judging the conditions excessively restrictive and calling off the merger plan (Cinco Dias 03/02/2001; 07/02/2001; El Pais 6/2/2001). The failure of the Endesa-Iberdrola merger clearly shows how regulatory and partisan proximity power resources are not automatic, and there is ample room for state's agency. In fact, even though the PP had regulatory power over the merger, was politically close to Endesa's Chairman Martin Villa, and tried to please Endesa and Iberdrola as much as possible (El Pais 11/2/2001), it failed to meet the demands of the two electricity companies.

The failed merger had multiple important repercussions on Endesa. First, in 2003 the bank BBVA that favoured an alternative bid for Iberdrola from the Catalan group Gas Natural, sold its stake in Endesa (Valdivielso del Real and Goyer 2012, p. 88). This left the two savings banks Caja Madrid and La Caixa as the only members of Endesa's hard core. Second, and more crucially, the failed merger left both Endesa and Iberdrola as potential targets of foreign takeovers (Sunday Business 11/02/2001; El Pais 07/02/2001; Yanez 2003). Endesa was further weakened by the economic crisis hitting Latin America in the early 2000s, and in particular by the Argentinian Great Depression of 1998-2002. The impact of the crisis on Endesa was quite severe as in 2002 the group made more than 35 per cent of its operating income in Latin America (Chislett 2003).

The large devaluation of the Argentinian peso was particularly painful for Endesa leading to huge losses in a key market that represented 7 per cent of the group's global revenues (New York Times 8/1/2002). Crucially, the devaluation of Endesa's subsidiaries in Latin America led to a sizeable increase of the group's outstanding debt, already high as a result of the acquisitions of the late 1990s. In 2001 Endesa had a debt of €25 billion (up from €7 billion in 1996), considerably higher than its revenue of €16 billion (El Pais 10/5/2002). As a result, between January and September 2002 Endesa's shares lost 45 per cent of their market value (El Pais 22/9/2002). Due to the high indebtedness of the group in February 2003 the rating agency Moody's downgraded Endesa's long-term outlook from A3 to Baa1 (El Pais 28/2/2003).

In 2002 Martin Villa was replaced by Manuel Pizarro, another manager close to the PP and economic advisor of Aznar and Rato (Mota 1998). Although Endesa was now a fully private company, the PP government could still have a say over the appointment of Pizarro as the board was still dominated by directors named by the executive prior to privatisation, and the PP-led local government of Madrid had regulatory power over Endesa's largest shareholder Caja Madrid (El Pais 22/1/2002). Pizarro focused on reducing Endesa's outstanding debt part through a capital increase and a syndicated loan worth US$4.5 billion, and part through a plan of divestment of non-core assets for US$1 billion (Toral 2011a, p. 115). When choosing which assets to sell-off Pizarro focused in particular on the holdings in sectors unrelated to the core energy business like telecommunications. Because of Pizarro's efforts by 2005 Endesa had brought its outstanding debt down to US$16.5 billion (El Pais 6/2/2005). However, the urgent need to reduce its debt meant that Endesa had to reduce its level of investment, thus being overtaken by Iberdrola as the largest electricity producer in Spain (38 versus 36 per cent of the market) (Lasheras 2005, p. 66). In virtue of its lower level of outstanding debt and lower exposure to the Latin American market in 2002 Iberdrola overtook Endesa also in terms of market capitalisation (Chislett 2003).

6.3.4 The return to power of the PSOE and the takeover battle for Endesa

After winning the 2004 elections the PSOE tried to replace Pizarro with a politically close manager (El Pais 5/6/2005). To weaken Pizarro's position at the head of Endesa the PSOE passed a review of the stranded cost system set up by the PP that led Endesa to lose €2.5 billion in missed compensation payments (The Business 10/10/2004). However, the review of the stranded costs was not enough to challenge Pizarro's position as the PSOE lacked further regulatory and ownership power resources over Endesa. In fact, Pizarro had the support of Endesa's board, dominated by directors politically close to the PP, and of Endesa's largest shareholder, the savings bank Caja Madrid (El Pais 5/6/2005). The PP's control over Endesa was further strengthened in 2005 when Caja Madrid raised its stake in Endesa to nine per cent (Valdivielso del Real and Goyer 2012, p. 88).

The negative impact of the Latin America crisis meant that Endesa found itself in a difficult financial situation at a delicate juncture for the EU electricity market. In fact, by mandating full market liberalisation by 2007, the Second Electricity Directive had opened the scope for a wave of cross-border mergers and acquisitions among electricity incumbents (Jordana et al. 2006). As a result, between August and September 2005 France's Suez completed the takeover of the Belgian incumbent Electrabel, while Germany's E.ON unsuccessfully bid for the UK's Scottish Power. Due to its low market capitalisation and relatively small size, Endesa was considered a prey rather than a predator in the upcoming process of cross-border consolidation among EU electricity utilities. Even though also Telefonica like Endesa had suffered from the Latin American crisis, by the mid-2000s the Spanish telecommunications incumbent had achieved a size that sheltered it from any hostile takeover attempt. With revenue of more than €66 billion in 2006 Telefonica was the second largest telecommunications incumbent in the EU after Deutsche Telekom and had twice the size of its nearest competitors. Instead, with revenue of €21 billion Endesa was fifth in the EU rankings and had less than a third of the size of E.ON and half the size of EDF, RWE, and ENEL (Clifton et al. 2010, p. 994–995).

Endesa's low stock value attracted the attention of the Catalan based energy group Gas Natural. Gas Natural was a relatively small firm operating in the gas supply segment that had half of Endesa's market capitalisation. Endesa's acquisition by Gas Natural would have allowed the creation of a diversified 'national champion' active both in electricity and oil & gas (Marcos 2012). Backed by the local government of Catalonia, in 2001 and 2003 Gas Natural had twice tried to takeover Iberdrola. However, the effort failed because of the opposition from the PP executive. In September 2005 Gas Natural officially launched a tender offer for all the shares of Endesa worth €22.5 billion (€21.3 per share). The offer was part in cash and part in Gas Natural shares (Marcos 2012). Gas Natural's bid for Endesa divided the Spanish political and economic elite between two opposing fronts.

On the one hand, the PSOE executive immediately showed its support for the deal. In particular, Prime Minister José Luis Zapatero saw the emergence of a Spanish 'energy champion' positively (Daily Deal 26/9/2005; El Pais 05/09/2006; El Mundo 04/05/2008). Furthermore, by backing the Catalan-based Gas Natural Zapatero hoped to strengthen his relationship with the Catalan Nationalist Party, junior allied of the PSOE government and main political sponsor of the deal (Chari 2015). The bid was supported as well by the Catalan-based savings bank La Caixa, Gas Natural's controlling shareholder. Previously, La Caixa had also been part of the hard core of Endesa but it had decided to sell its five per cent stake in early 2005 after failing to get representation in the board (El Pais 4/6/2003). Despite its support to the deal, however, the PSOE lacked the ownership, regulatory and partisan proximity power resources to influence Endesa's management.

On the other hand, Endesa's Chairman Manuel Pizarro opposed the deal, considering Gas Natural's offer 'grossly inadequate' and not reflecting Endesa's market value (Cabral 2009, p.2). Endesa's board unanimously supported Pizarro rejecting the bid outright and turning Gas Natural's offer into a hostile takeover attempt. Although Pizarro motivated his opposition to the Gas Natural takeover with the desire to maximize shareholders' value, the deal had a clear partisan dimension as well. In fact, Pizarro had been appointed by the previous PP government, the PP controlled Endesa's board and, through the local government of Madrid, had regulatory power over Endesa's largest shareholder Caja Madrid. The PP immediately expressed its support to Pizarro with key political figures voicing their concerns about the deal. The former Prime Minister Aznar labelled the eventual merger 'a serious mistake' accusing the PSOE of ‘politically promoting an attack against competition and free enterprise’ (Daily Deal 26/9/2005). On a similar vein, the economic spokesperson of the PP, Arias Canete, affirmed that Gas Natural’s offer was a political move to favour Pizarro’s ousting (El Pais 6/9/2005). For his part, the president of Caja Madrid Miguel Blesa openly backed Pizarro saying that the price offered by Gas Natural was too low (El Pais 24/1/2006). A similar view was shared as well by the foreign investment funds that owned shares in Endesa (Cabral 2009). Bolstered by the support from its board and main shareholders, Pizarro engaged in a legal battle to delay the Gas Natural bid, questioning its validity on different grounds (El Pais 10/09/2005; Marcos 2012).

In November 2005, the European Commission ruled that, since Endesa and Gas Natural made more than two thirds of their revenue at home, the takeover lacked a EU dimension and was hence subject to the Spanish merger regulation (Marcos 2012). According to the Spanish legislation the Tribunal for the Defence of Competition (TDC) is the body charged with investigating the impact on competition of a planned merger (Galloway 2007). However, the TDC can only issue non-binding recommendations with the government having a final say over the merger (Valdivielso del Real and Goyer 2012). In January 2006, the TDC issued a statement recommending the executive to veto Gas Natural’s takeover of Endesa due to its anticompetitive impact on the Spanish energy market (partisan cleavages again played a role as the majority of the members of the TDC had been named by the previous PP government and they all voted in favour of the statement while the PSOE nominees voted against) (Marcos 2012). However, this was a non-binding recommendation and in February 2006 the Zapatero executive overturned it, clearing the Gas Natural bid.

In the meantime, from late 2005 the management of Endesa was looking for a foreign firm interested in intervening in the takeover battle as a White Knight (Cinco Dias 03/02/2007). The quest proved successful as in late February 2006 Germany’s electricity incumbent E.ON presented a rival bid for Endesa. E.ON offered better conditions than Gas Natural as Endesa was valued more than €29 billion, against 22.5, and the offer was cash only (Marcos 2012). The offer by Germany’s E.ON led to a reversal of the two camps with Endesa’s board, the PP and Caja Madrid in favour of the bid, and the PSOE government against (Cinco Dias 03/02/2007; BBC 19/04/2006; Financial Times 27/03/2007). In particular, Endesa’s board judged the offer ‘non-hostile’ showing a more positive attitude than in the case of the Gas Natural bid (Marcos 2012). Pizarro himself labelled the offer ‘bittersweet’ as, although a takeover by E.ON would mean that he had to leave his job, the new offer was more in line with Endesa’s market value (El Pais 26/2/2006).

For its part, the PSOE government immediately expressed its opposition to the deal. Although E.ON offered better conditions than Gas Natural, the PSOE refused to see a strategic firm like Endesa falling in the hands of a foreign competitor (The Guardian 21/11/2008; Cinco Dias 04/05/2008; 03/02/2007; Marcos 2012). A spokesperson of the government affirmed that the PSOE wanted to 'do everything in our power to ensure that Spanish energy companies remain Spanish' (Galloway 2007). Zapatero himself stated that 'Markets are very important but for this government the citizens are more important… I understand that Germany wants to have a strong global energy company but so does Spain' (Cabral 2009, p. 4–5).

The attitude of the PSOE government reminds that of the Italian Centre-Left in 1997 when TI planned a merger with Germany's Deutsche Telekom, and that of the Spanish PP in 2000 when Villalonga tried to merge Telefonica with the Netherlands' KPN. In both cases, the Italian and Spanish governments opposed a merger that would have led to the loss of independence of a domestic 'national champion'. The Italian Centre-Left and Spanish PP ultimately succeeded in derailing the TI–DT and Telefonica–KPN mergers by threatening to use its golden share powers. However, this ownership power resource was not available to the PSOE executive in occasion of the E.ON bid for Endesa. In fact, in 2005, in compliance with a 2003 ruling from the European Court of Justice, the Zapatero government had agreed to give up the golden share powers over Endesa before their expiration in 2007 (El Pais 25/11/2005). Hence, although the government still formally held golden share ownership powers over Endesa it was deemed politically unfeasible to exercise them when the PSOE had already agreed their abolition (Cabral 2009).[25] Similarly, the PSOE could not rely on strong regulatory and partisan proximity power over the banks part of Endesa's hard core, as the PP had done to prevent the Telefonica–KPN merger and oust Villalonga. In fact, the only bank that held a relevant stake in Endesa was the savings bank Caja Madrid, dominated by the PP local government of Madrid, which favoured the E.ON deal.

Pressure on the Spanish government to act increased when the Spanish TDC cleared the E.ON bid not seeing any threat for competition (Marcos 2012). The Spanish government reacted passing a decree that increased the supervisory power of the domestic energy regulator (NEC) in case of acquisitions of a ten per cent stake in a domestic firm operating in a regulated sector (Marcos 2012). Concretely, the norm imposed an additional preliminary control over the

[25] When in February 2006 Zapatero mentioned the possibility of using the golden share to block the E.ON deal he came under heavy criticism from the Commission. The Commission reminded the PSOE of the previous ruling from the ECJ and the decision of the Spanish government to renounce to its golden share powers.

E.ON bid, being thus labelled ‘anti-E.ON decree’ (Cinco Dias 12/04/2006). However, the Commission immediately opened a procedure against Spain judging that the decree might infringe the EU legislation (The Guardian 08/09/2006; Marcos 2012). At the same time, the Commission reminded the PSOE that, since E.ON made less than two thirds of its revenue in the Spanish territory, the deal had a EU dimension. Consequently, under Article 21 of the EC Merger Regulation the Commission had exclusive competence to assess the merger (Soares 2008). While in April the Commission approved the E.ON deal without conditions, in July the Spanish NEC imposed 19 conditions concerning among other things the obligation to keep the structure of the Endesa group unchanged for a period of time (Marcos 2012). However, the Commission deemed the NEC conditions unlawful, asking the PSOE government to withdraw them and opening another infringement procedure against Spain (Soares 2008).

The confrontation between the Commission and the Spanish government clearly shows how the PSOE had lost the ownership, regulatory and partisan proximity power resources that had allowed the previous Spanish and Italian governments to veto unwanted takeovers of their national champions. However, these delaying tactics served the PSOE to find a third group willing to bid for Endesa. In fact, in September 2006 Acciona, a Spanish diversified group mainly active in construction, notified to the domestic market regulator the purchase of a ten per cent stake in Endesa. Acciona immediately appeared as a Trojan horse of the PSOE executive (Cabral 2009; Chari 2015; Financial Times 28/09/2006; The Times 30/09/2006; La Repubblica 19/03/2007). In fact, Acciona made large part of its profits from the participation in large-scale public procurements and for this reason had developed very close ties with the PSOE government, as well as with the previous PP administration (Chari 2015). The close relationship with the Spanish executive was also because of in 2007 Acciona’s construction division made 82 per cent of its revenue at home (Acciona 2008, p. 35). The fact that Acciona depended upon government procurement for its revenue coupled with its eminently domestic focus meant that the PSOE had strong regulatory power over Acciona. Consequently, the PSOE could easily force Acciona to invest in Endesa. Acciona’s stake made it more difficult for E.ON to acquire the 50 per cent stake necessary to change Endesa’s statute removing the voting ceiling that limited at 10 per cent the voting rights of any shareholder irrespective of the share (Valdivielso and Goyer 2012). To counter Acciona’s defensive move, in February 2007 E.ON increased its bid for Endesa to €38.75 per share (€4.25 per share more than the initial offer) (Marcos 2012, p. 25).

Despite having decisively slowed down the E.ON takeover, Acciona lacked sufficient financial resources to takeover Endesa alone. The Italian electricity utility ENEL seized the opportunity stepping in and forming an alliance with Acciona. By March 2007 ENEL had bought a 25 per cent stake in Endesa while Acciona had rose its stake to 21 per cent. With a combined stake of 46 per cent the two firms were in a privileged position to take Endesa over. Aware of the possible resistance coming from the Spanish government, ENEL made sure to get the PSOE's approval for the deal. This happened in 2007 when Zapatero and his Italian counterpart Prodi discussed the issue during a bilateral meeting in Ibiza. Zapatero agreed to back ENEL's takeover in return for Prodi's approval of Telefonica's acquisition of a large stake in TI[26] (Financial Times 01/03/2007; 02/03/2007; Chari 2015). Facing a competing offer from a group that had already gathered 46 per cent of the shares and had the approval of the Spanish government E.ON decided to withdraw its bid. Later, when the takeover was completed, and to avoid retaliation from the German government, Acciona and ENEL ceded to E.ON €11 billion worth of Endesa's assets in France, Italy and other European countries, as well as the Spanish subsidiary of ENEL (Chari 2015).

In July 2007, the Spanish competition authority cleared the ENEL/Acciona takeover and by October 92 per cent of the share capital had accepted the offer. Although controlling 66 per cent of the shares, ENEL accepted to sign an agreement with which it granted Acciona 50.01 per cent of the voting rights in the holding company controlling Endesa (Marcos 2012). Like in the case of the E.ON deal, the domestic energy authority NEC approved the acquisition attaching several conditions to safeguard Endesa's independence from ENEL, and again the Commission deemed the conditions unlawful unconditionally approving the deal (Cabral 2009).

The PSOE government was keen to present the deal as a Spanish solution, with Zapatero remarking that Endesa had not been taken over by a foreign competitor, but was instead co-owned by the Spanish Acciona (El Pais 7/3/2008). Initially the deal looked like a success for the PSOE as Acciona had the majority of the votes and could appoint the president of the group. However, in 2009 Acciona's financial struggles forced the Spanish group to sell its stake to ENEL that as a result became Endesa's sole owner with a 92 per cent stake (Marcos 2012). The 2009 operation sanctioned the failure of the PSOE's plan to maintain Endesa in Spanish hands, as the firm became a subsidiary of ENEL.

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[26] Telefonica would later sell its stake in TI after having failed to gain control of the firm, or in alternative to force TI's exit from the Argentinian and Brazilian market where both firms had a leading position.

6.4 Cross-country comparison

The chapter has analysed the opposite outcome of the process of industrial restructuring of ENEL and Endesa. While ENEL has become a European leader in its sector of activity, Endesa was taken over in 2009 ceasing to exist as an independent firm. The successful transition from inward looking monopolist to European champion of ENEL was decisively helped by the direct ownership of a controlling stake by the state. This key ownership power resource allowed the state to protect the three managerial teams that between 1996 and 2014 completed ENEL's transition from inward-looking inefficient monopolist to successful multinational (Bergami et al. 2013; Castronovo and Paoloni 2013; Nardozzi and Carbone 2011). Between 1996 and 2000 Testa and Tatò radically changed ENEL's organisation preparing the firm for competition in the free market. In particular, they embarked in an important process of cost cutting and rationalisation of the labour force (Bergami et al. 2013). The two following CEOs, Scaroni and Conti, had the merit to refocus on the core energy business and engineer ENEL's successful internationalisation.

The importance of having competent managerial teams and the possibility for them to work in a stable environment helps shed light on a key difference between ENEL's trajectory and that of the Italian telecommunications incumbent TI. In fact, the weakness of TI's hard core and the consequent lack of ownership stability led to frequent managerial turnovers, two takeovers in less than two years, the uncontrolled increase of TI's debt burden, and the ousting of a competent manager like Franco Bernabé. The failure of TI's privatisation made Italian executives of both colours aware of the fact that the lack of regulatory power over domestic family blockholders ruled out the possibility to form strong hard cores of private investors. To compensate for its regulatory weakness vis-à-vis domestic investors, the Italian state retained a key ownership power resource that allowed influencing ENEL's trajectory, the direct ownership of a controlling stake. The crucial importance of the direct ownership of a controlling stake in ENEL was recently confirmed by the centre-left Prime Minister, Renzi, who in 2016 affirmed that the government had no intention to further reduce the state's 24 per cent stake in the firm (La Repubblica 23/06/2016). However, it should also be highlighted that the choice to keep a controlling stake was combined with the equally important decision to transform ENEL into a joint-stock company and reduce state's ownership below 50 per cent of the shares. In fact, this increased market scrutiny over the firm forcing governments of both colours to appoint managers in virtue of their professional background rather than their political affiliation.

Along with the state's direct ownership of a controlling stake, the successful internationalisation of ENEL was also helped by the diplomatic efforts made by Italian governments of both stripes. Both the Centre-Right and the Centre-Left actively supported the failed takeover of Suez, the successful acquisition of Endesa, as well as ENEL's investments in Eastern Europe. The active contribution to ENEL's internationalisation by the Centre-Right and the Centre-Left shows how Italian governments of both colours had a similar approach when dealing with the restructuring of the electricity incumbent, protecting its independence and passing measures aimed at stimulating its upgrade into European champion. This goes against partisan theorists' claim that, due to its eminently protectionist attitude, the Centre-Right is incapable of implementing the measures necessary to improve the efficiency of domestic national champions turning them into competitive European champions (Cioffi and Hoepner 2006).

Governments of both persuasions also played a decisive role in assuring a favourable regulatory environment for ENEL in the domestic market, this happened in particular since the early 2000s when the liberalising push of the 1990s left space to a bipartisan effort to strengthen ENEL as a 'European champion'. The drawback of such a strategy is that the liberalisation of the Italian market remained incomplete, and ENEL retains a dominant position in an oligopolistic market (Silva 2004; Rangoni 2011). However, this does not mean that ENEL's success was the result of state capture by the management of ENEL. Both the Centre-Left and the Centre-Right implemented targeted liberalising measures, like the forced sell-off of part of ENEL's productive capacity, which went against the short-term interest of ENEL's management.

Government	Years	Ownership Power	Regulatory Power	Partisan Proximity Power	Industrial Restructuring Outcome
Centre-Left	1996–2001	*Very strong* Partial privatisation keeping direct state ownership above 50 per cent	*Strong* Limited EU integration with FED	*Strong* Two managers with Left-wing sympathies at the head of ENEL	*Partial Success* Internal restructuring of ENEL Multiutility strategy Improvement of performance Limited foreign expansion
Centre-Right	2001–6	*Strong* Partial privatisation reducing state ownership below 50 per cent	*Weakening* Deeper EU integration with SED	*Low* Managers appointed in virtue of their technical background	*Success* Refocus on core energy business Improvement of performance Foreign expansion in Latin America and Eastern Europe
Centre-Left	2006–9	*Strong* Maintains stake inherited by the Centre-Right	*Weakening* Full implementation of SED	*Low* Managers appointed in virtue of their technical background	*Success* Takeover of Endesa Expansion in Russia ENEL becomes European champion

Table 6.1 Ownership, Regulatory, Partisan Proximity Power and Industrial Outcomes in the Italian Electricity Sector

Government	Years	Ownership Power	Regulatory Power	Partisan Proximity Power	Industrial Restructuring Outcome
PSOE	1982–1996	*Very strong* Partial privatisation but keeping stake above 50 per cent in Endesa Golden share powers	*Strong* Strong regulatory power over banks part of the hard core (inward-looking and low supranational integration)	*Strong* Managers close to the PSOE appointed at the head of Endesa	*Success* Internal restructuring of Endesa Endesa becomes main player in Latin America
PP	1996–2004	*Weakening* 1997–8 Full privatisation of Endesa Golden share powers maintained	1996–2000 *Strong* Strong regulatory power over BCH, Santander and Argentaria 2000–4 *Very strong* Caja Madrid close to the PP government of Madrid becomes main shareholder second shareholder La Caixa close to the PP because of coalition government with Catalans	*Strong* Two managers close to the PP appointed at the head of Endesa	*Mixed* Further expansion in the Latin American market Expansion in Europe Latin American crisis and increase of the debt burden Failed merger with Iberdrola

Table 6.2 Ownership, Regulatory, Partisan Proximity Power and Industrial Outcomes in the Spanish Electricity Sector

Government	Years	Ownership Power	Regulatory Power	Partisan Proximity Power	Industrial Restructuring Outcome
PSOE	1996–2004	*Absent* 2005 Zapatero government agrees with ECJ to give up golden share powers over Endesa	*Absent* Endesa's largest shareholder is the politically hostile Caja Madrid close to the PP government of Madrid	*Absent* Endesa guided by manager close to PP Board members loyal to PP Management of Endesa's largest shareholder close to PP	*Failure* Failed attempt to merge Endesa and Gas Natural Endesa taken over by ENEL ceasing to exist as independent firm

Table 6.2 Ownership, Regulatory, Partisan Proximity Power and Industrial Outcomes in the Spanish Electricity Sector

While ENEL's successful transition from domestic monopolist to European champion was helped by the state's direct ownership of a controlling stake, the failure of Endesa's transition is due to the progressive erosion of the ownership, partisan proximity and regulatory power resources that had allowed the successful upgrade of the other Spanish champions Telefonica, BBVA and Santander. The comparison between Endesa and Telefonica is particularly telling in this regard. In fact, the PP government adopted a similar strategy when dealing with the privatisation of the two domestic incumbents, fully privatising Endesa and Telefonica, forming a hard core of domestic banks, and extending the golden share powers established by the previous PSOE government. Similar to in the case of Telefonica, Spanish governments of both stripes relied on three power resources to successfully complete the process of industrial restructuring: the regulatory power of the state over domestic banks that allowed to form a strong and loyal hard core, the availability of golden share ownership powers allowing the government to veto any unwanted takeover of Endesa, and the partisan proximity with the managers of Endesa and of the banks part of the hard core.

However, since the early 2000s different factors contributed to the progressive erosion of these power resources. On the one hand, local savings banks replaced large national banks in the hard core of Endesa. This changed the regulatory power relationship between the Spanish central government and the banking shareholders of Endesa. In fact, because of their statute savings banks depend upon regulatory protection from the government of their region of origin more than upon that of the central government of Spain. The regulatory dependence of savings banks vis-à-vis the local government of their region of origin in turn creates a potential source of tension between savings banks and the central government when the banks are in regions ruled by the party in opposition at the national level.

This occurred in 2004 when the PSOE won the general elections while Endesa's largest shareholder was the savings bank Caja Madrid, controlled by the PP-led local government of Madrid. The regulatory dependence of Caja Madrid vis-à-vis the PP local government of Madrid, coupled with the fact that when the PSOE came to power Endesa's board was still controlled by directors that had strong partisan ties with the PP, meant that the PSOE government lacked the regulatory and partisan proximity power resources necessary to impose its will over the president of Endesa, Manuel Pizarro, himself a PP nominee. On the other hand, under pressure from the European Commission, in 2005 the PSOE government was forced to give up the golden share power it held over Endesa. The progressive loss of the ownership, regulatory and partisan proximity power resources that in the early 2000s had allowed the PP to veto the merger between Telefonica and the Netherlands' KPN and oust the rebellious manager Juan Villalonga, meant that the PSOE could not do the same when the chairman of Endesa Pizarro proposed a merger with Germany's E.ON.

The lack of power resources to influence Endesa's managers and shareholders also led to the failure of the merger between Gas Natural and Endesa, that would have allowed for the emergence of a Spanish diversified 'energy champion'. Had the PSOE owned a controlling stake in Endesa, it could have forced the removal of Pizarro and the merger with Gas Natural. However, the PSOE did not have that ownership power resource as the previous PP administration had fully privatised Endesa. The crucial importance of the direct ownership of a controlling stake in a firm involved in a takeover battle is confirmed by the comparison between the Endesa-Gas Natural unsuccessful merger attempt and the successful defensive merger between the two French energy firms Suez and GdF. In fact, when in 2006 ENEL targeted Suez the French government could easily force a merger between Suez and GdF as it owned a relevant stake in both firms. Instead, lacking a controlling stake in Endesa, golden share powers over the same firm, or regulatory power over Caja Madrid, the PSOE had to give up on the plan to merge Endesa and Gas Natural.

The failure of the PSOE highlights the importance of timing in explaining the outcome of industrial restructuring. In fact, when dealing with the privatisation of Endesa Spanish governments of both colours implemented the same strategy they had chosen for Telefonica. However, as seen in chapter 2, market integration was completed later in electricity than in telecommunications. Consequently, while cross-border consolidation in telecommunications started in the late 1990s, in electricity the first relevant cross-border mergers occurred only in 2005, when the Spanish state had already lost all power resources over Endesa. The fact that the PSOE failed to turn Endesa into a European champion contradicts the views of partisan theorists who claim that Left-wing governments are better than Right-wing governments at combining the liberalising and protectionist measures necessary to turn domestic firms into European champions (Boix 1998). Instead, the case study has shown that the successful outcome of the process of industrial restructuring is not conditional on the partisan affiliation of the government, but on the availability or lack of key state's power resources over business actors.

The trajectory of Endesa confirms the importance of state agency. In fact, state power is not automatic. Instead, in order for there to be a successful process of industrial restructuring the available power resources need to be strategically activated by the state. When the state lacks the willingness to do so it might not be able to get the preferred outcome despite having partisan proximity and regulatory power over domestic firms. This occurred to the PP government in occasion of the attempted merger between Endesa and its main domestic competitor Iberdrola. In fact, even though the PP government favoured the merger, had regulatory power to authorise it and could count on the partisan proximity with Endesa's Chairman Martin Villa, it nevertheless imposed conditions that were deemed excessively restrictive by the managers of both firms. Consequently, Iberdrola and Endesa called off their merger plan. The derailment of the merger with Iberdrola had a decisive influence on Endesa's trajectory as it left both Spanish firms as potential targets of foreign takeovers. While by taking over the UK Scottish Power Iberdrola gained sufficient size to prevent foreign takeovers, but not to be considered a European champion, Endesa was ultimately taken over by ENEL.

7. Conclusion

This thesis has compared the trajectory of eight Italian and Spanish banks and utilities, six of which successfully completed the transition from inward-looking monopolist to European champion, while the other two failed, being taken over by larger European competitors. The sector-based case studies showed how both partisan theories (Boix 1998; Cioffi and Hoepner 2006) and state-capture theories (Cabrera and Del Rey 2007; Jordana et al. 2006; Silva 2004; Negrier 1997) fall short in providing a satisfying explanation for the opposite trajectories of the firms here analysed. Instead, to explain the outcome of the process of industrial restructuring it is necessary to look at the balance of power between the state and domestic business actors and in particular at the availability of three key sources of state power over business: *ownership power*, *regulatory power* and *partisan proximity power*. When these power resources were available and the state decided to strategically deploy them, industrial restructuring was successfully completed, as in the case of BBVA, Santander, Intesa-Sanpaolo, Unicredit, ENEL and Telefonica, when at key junctures the state lacked these power resources, or chose not to activate them, the process of industrial restructuring led to a failure, as in the case of Telecom Italia and Endesa.

This conclusion is divided into seven sections. The first two sections summarize the findings of this study and define the theoretical framework here developed based on state power over business. Sections three and four provide cross-sector evidence to disconfirm the predictions based on the partisan and state-capture hypotheses. Section five presents the main contributions the present study makes to the debate on state power over business. Sections six and seven present two avenues for future research that draw on the findings.

7.1 It’s industrial policy, stupid!

The first finding of this thesis is that, despite the EU-inspired move towards a neo-liberal regulatory state (Thatcher 2013), the Italian and Spanish governments still found ways to implement an activist industrial policy strategy to help the internationalisation of domestic banks, electricity firms and telecommunications utilities. By highlighting the key role played by the state in favouring the industrial restructuring of domestic banks and utilities this work follows in the line of recent contributions on the role of the government in bringing about economic development (Mazzucato 2015; Clift and Woll 2012; Thatcher 2014b), and of more focused studies on the role of the state in helping the internationalisation of domestic electricity and telecommunications incumbents (Clifton et al. 2012; Colli et al. 2014; Chari 2015). The sector-based case studies have shown how Italian and Spanish governments of both persuasions considered the building of strong European champions a key political priority. Consequently, they implemented an activist industrial policy strategy aimed at improving the efficiency of domestic banks and utilities. This way they hoped their national champions could play an active during the wave of cross-border consolidation that followed the integration of the European market. The industrial policy strategy implemented by the Italian and Spanish governments centred on four pillars:

- An activist role of the state during the privatisation of strategic firms to define the methods for the sell-offs and select the main private shareholders.
- The promotion of a process of sheltered consolidation among domestic firms to create banks and utilities with sufficient size to compete in the European market (e.g. in the banking sector in both countries and in the electricity sector in Spain).
- The combination of a series of protectionist measures aimed at delaying the opening to competition of the domestic market with targeted liberalising measures aimed at increasing market scrutiny over domestic incumbents thus improving their performance.
- The use of the diplomatic channel to help the foreign expansion of domestic incumbents.

When implementing this industrial policy strategy Italian and Spanish aimed at achieving the same objectives:

- Promoting the emergence of strong European champions in the sectors of banking, electricity and telecommunications.
- Favouring the rise of politically close managers and owners at the head of the European champions.

At times, these two objectives proved incompatible, and the Italian and Spanish states ended up slowing the process of domestic consolidation instead of favouring it.

7.2 State regulatory power, ownership power and partisan proximity power

The sector-based case studies have shown how the Italian and Spanish states implemented a similarly activist industrial policy strategy in the cases that led to a successful restructuring, and in those that ended up in a failure. In other words, the failure of Endesa and Telecom Italia is not the result of the Italian and Spanish states having prioritised competition over the protection of domestic firms and the creation of European champions (Colli et al. 2014). To explain the divergent outcome of a similar industrial policy effort this thesis looked at the balance of power between the state and private business actors (Linblom 1977; Block 1977) and in particular at the availability at of three power resources the state could use to influence the behaviour of business actors:

- **Ownership power.** This is available when the state owns a controlling stake in a firm or has golden share powers over the same firm.
- **Regulatory power.** This is available when a firm depends upon regulatory protection of the state in its main sector of activity. This regulatory dependence is in turn conditional on two factors: the geographical distribution of the revenue of a firm and the degree of supranational integration of its main sector of activity. Firms that make most of their revenue in the domestic market and operate in sectors in which there is a low degree of supranational integration will be more dependent upon state's protection than those that sell their products worldwide and operate in sectors in which there is a high degree of supranational integration.
- **Partisan proximity power.** This relates to the political proximity of the government to managers or owners of strategic firms or firms involved in the restructuring of strategic firms.

The case studies have shown how the outcome of the process of industrial restructuring was conditional on the availability of these three power resources at critical junctures during the restructuring process, and on state willingness to strategically deploy them. When these power resources were available and the Italian and Spanish states deployed them strategically the industrial restructuring process led to a success, when as in the case of Endesa and Telecom Italia, they were not available, or the state decided not to activate them, it led to a failure.

7.3 Alternative explanations: Why this is not about the partisan affiliation of the government

The thesis has provided ample cross-sector evidence to disconfirm the hypotheses derived from two influential strands of the literature: partisan theories and state-capture theories. The main assumption of partisan theories is that the partisan affiliation of elected governments has a decisive impact on the institutional features of domestic capitalism (Boix 1998; Roe 2003; Cioffi and Hoepner 2006). Concerning the outcome of the process of industrial restructuring partisan theories expect that, due to their capacity to combine targeted liberalising measures and protectionist measures left-wing governments should be better than right-wing governments at implementing the activist industrial policy strategy necessary to turn domestic firms into European champions (Boix 1998; Cioffi and Hoepner 2006). Instead, partisan theories expect right-wing governments to be incapable of promoting a successful process of industrial restructuring as they are either too protectionist and thus uninterested in improving the performance of domestic incumbents (Cioffi and Hoepner 2006), or solely focused on domestic liberalisation and privatisations and thus uninterested in nurturing and protecting national champions (Boix 1998).

However, the case studies have shown how the partisan affiliation of Italian and Spanish governments was not a decisive factor in determining the outcome of the process of industrial restructuring. In fact, right-wing and left-wing governments in Italy and Spain obtained similar results when dealing with the industrial restructuring of domestic firms. Sometimes they succeeded in turning domestic firms into European champions while in other occasions they failed.

In particular, left-wing governments proved less successful in helping the emergence of domestic national champions than what partisan theorists would expect. For instance, the failure of TI was the result of the Italian Centre-Left's incapacity to form a strong hard core of private investors and of the Centre-Left's support to the Olivetti takeover. Similarly, Spain's PSOE was directly involved in the failed attempt to merge Endesa with Gas Natural, which ultimately led to the takeover of the Spanish electricity incumbent. Instead, right-wing governments were more successful than what partisan theorists would expect, playing at times a decisive role in favouring the process of industrial restructuring of domestic firms. For instance, Spain's PP successfully completed the process of banking consolidation leading to the emergence of two domestic European champions, BBVA and Santander, while the Italian

Centre-Right appointed the two managerial teams that turned ENEL into a European leader in its sector of activity. If left-wing and right-wing governments obtained similarly mixed results in their effort to create European champions, it derives that the outcome of the industrial restructuring process was not conditional on their partisan affiliation but on the availability and the strategic use of ownership, regulatory and partisan proximity power resources of the state.

7.4 Alternative explanations: Why this is not about state capture

State-capture theorists claim that the success of the European champions is the result of the Italian and Spanish governments having been captured by the management of domestic banks and utilities (Lancaster 1989; Jordana et al. 2006; Silva 2004; Negrier 1997). If this were true we would expect the Italian and Spanish states to have always passively abided by the requests of the management of the European champions, shaping domestic regulation around their needs without having any means of influence over the firms. However, the case studies have shown how the state-capture hypothesis does not hold, as often the Italian and Spanish governments succeeded in forcing managerial and ownership shake-ups inside domestic banks and utilities against the will of their managers and reference shareholders.

For instance, Spain's PP forced a merger between the two domestic banks BBV and Argentaria against the will of BBV's managers, while earlier the PSOE had removed the politically hostile Mario Conde from the large domestic bank Banesto. In the telecommunications sector the support of the Italian government was decisive in occasion of two changes of ownership in TI (the Centre-Left favoured the Olivetti takeover against the will of the incumbent manager Franco Bernabé and of the main private shareholders of TI, while the Centre-Right backed the Pirelli-Benetton takeover that marginalised Olivetti). In the electricity sector both the Italian and the Spanish government implemented liberalising measures that went against the short-term interest of the management of ENEL and Endesa and run counter the idea of a captured state (the Italian Centre-Left exceeded the requirements of the First Electricity Directive forcing ENEL to shed part of its productive capacity, while the Spanish PSOE passed a review of the stranded costs system that led to a huge financial loss for Endesa). All these examples show how, contrary to what state-capture theorists would expect, the Italian and Spanish states succeeded in exerting a decisive influence over the management of domestic banks and utilities. The capacity to exert this influence was in turn conditional on the availability of ownership, regulatory and partisan proximity power resources the state could use to constrain the behaviour of private business actors.

7.5 Contributions to the debate on state–business power relations

The theoretical framework based on state's ownership, regulatory, and partisan proximity power draws on the literature on structural and instrumental power (Lindblom 1977; Block 1977), and in particular on the recent contributions exploring the sources of state's power over business actors (Culpepper 2015; Emmenegger 2015; Culpepper and Reinke 2014). The thesis has made four important contributions to the literature on state's power over business actors:

- It has used industrial policy as a focus to study state–business power relations. This has produced important advances in identifying state power resources over business actors. In fact, the industrial policy strategy implemented by the Italian and Spanish governments to restructure domestic banks and utilities involved a series of measures that have depended for their success on the constant involvement of private business actors (i.e. privatisations and banking mergers). The capacity of the Italian and Spanish states to get business actors involved has in turn been conditional on the availability of state power resources over business.
- It has provided an innovative definition of three important sources of state power over business actors: ownership power, regulatory power, and partisan proximity power. These categories can be applied to assess the effectiveness of state's reforms in other institutional domains like the labour market, the welfare state and corporate governance. State ownership power, regulatory power, and partisan proximity power should also be studied in relation to the sources of business power over the state recently identified by studies focusing on tax legislation (Fairfield 2010) or corporate governance (Culpepper 2010; Bulfone 2017b).
- It has explored the mutual relationship between ownership, regulatory and partisan proximity power, showing how they can reinforce or substitute each other. In particular, it has shown how the most stable power resource the state can use to influence the restructuring of national champions is the direct ownership of a controlling stake in a firm. In fact by directly owning a controlling stake the state can secure the ownership and managerial stability necessary to turn a domestic firm into European champion, as in the case of ENEL. Since banks and utilities typically have a very diffuse ownership structure,

the direct ownership of a 25-30 per cent stake is sufficient for the state to be controlling shareholder. This stake can be even lower in presence of blockholder-friendly legislative measures like loyalty shares. The trajectory of Telefonica has shown that, when the state decides, or when it is forced by budgetary needs to privatise a potential European champion, regulatory power over the new private blockholders becomes necessary in order to have successful industrial restructuring. The chances of a successful outcome further increase when regulatory power is combined with residual ownership power through a golden share. The main drawback of a restructuring process based on a combination of regulatory power vis-à-vis private blockholders and golden share powers is that both power resources are subject to progressive erosion, as shown by the divergent trajectory of Telefonica and Endesa. Instead, the direct ownership of a controlling stake is not subject to erosion, unless the government decides or is forced to privatise a potential European champion. Although the availability, or lack thereof, of partisan proximity power over the managers and owners of national champions has proved decisive in influencing the process of industrial restructuring, the findings presented here do not allow us to understand whether partisan proximity power alone is sufficient to have a successful outcome. Further investigation is needed to have a more systemic and accurate analysis of the mutual relationship between power resources.

- It has studied the impact that the gradual process of EU-led market integration of electricity, banking and telecommunications have had on the sources of state ownership, regulatory and partisan proximity power over business actors. Further reflections concerning this contribution are included in the following section.
- It has identified the specific state and business actors involved in the restructuring of the banks and utilities, thus responding to the criticism concerning the lack of clarity in terms of the unit of analysis in earlier studies of state–business power relations (Vogel 1977). It has been shown how the state actors involved in the industrial restructuring of strategic firms were key members of the core executive of Italy and Spain including the Prime Minister and the Minister of Finance. Concerning business actors, this work has covered both the managers of the banks and utilities and their main private shareholders.

7.6 Pathways for future research: Industrial policy in the EU

This work has focused on two most-similar country cases, Italy and Spain, comparing their effort to favour the internationalisation of domestic banks and utilities. This task was made all the more challenging by the progressive erosion of state ownership, regulatory, and partisan proximity power resources caused by the deepening of the EU-led process of market integration. By deepening the process of market integration, the Commission has sought to replace industrial policy with a regulatory state focusing on ensuring free competition member states' domestic markets (Thatcher 2013).

In other words, Italy and Spain have had to engineer an industrial policy strategy in an environment that since the early 1990s progressively reduced the scope for 'old' industrial policy measures like the direct ownership of national champions and the awarding of subsides to selected domestic firms (Thatcher 2014b). To do so they have had to implement 'new' measures aimed at restructuring their inward-looking national champions to turn them into internationally competitive firms (Thatcher 2014b; Clift and Woll 2012). The problem of having to craft new forms of industrial policy in the age of regulation is not one just the Italian and Spanish governments have had to cope with. In fact, the shift towards a regulatory state is a trend affecting the entire European Union (Thatcher 2013). Consequently, an interesting avenue for future research would be to study the industrial policy strategy implemented by other EU countries with a different profile than Spain and Italy. Such comparative analysis should divide EU member states into four groups characterised by the different size of their domestic market and the different size and efficiency of their national champions:

- **Big Guns**: France and Germany. At the beginning of the process of market integration these two countries were in a position of clear advantage compared to other EU member states due to the size of their domestic market and the capacity of the state to coordinate its action with private actors, thus favouring the implementation of a successful industrial policy strategy. As a result, both France and Germany now host at least one European champion in banking, electricity and telecoms.
- **Underdogs**: Italy and Spain. The situation of these countries was analysed in detail in the thesis. At the launch of the process of EU-led market integration they were in a position of clear weakness compared to France and Germany. Yet, they had more room of manoeuvre to implement an activist industrial policy than smaller member states due to larger size of their domestic market.

- **Small Fish**: Belgium and Portugal. The small size of their domestic market and, Consequently, of their domestic incumbents represented a crucial weakness for these countries. In addition, they shared the disadvantage of having a large neighbour country with which they had strong economic and cultural ties and could thus easily takeover their domestic incumbents. Even though, consequently, the national champions from these countries were often taken over by larger competitors, the study of the few firms that managed to become European champions (e.g. Energias de Portugal) is nevertheless interesting in comparative terms.
- **The Colonised Periphery**: This category comprehends most Central and Eastern European Countries (CEEC) that, as part of the conditions for achieving the EU membership, had to open their banking, electricity, and telecommunications markets to foreign investors. Two factors make the study of these countries particularly salient. First, the possibility to trace the impact of foreign investors on the pattern of interaction between the state and local business actors. Second, the possibility to cover the recent re-nationalisation campaigns launched by many populist governments of the region (e.g. Hungary).

Such a study would advance understanding of state–business power relations, as well as of the goals different governments pursue when dealing with the industrial restructuring of potential European champions (it might be that in countries like Germany and France a more forward-looking state has always been willing to strategically deploy the available power resources, while in the case of the CEEC foreign investors might have played a key role in influencing the goals of the governments).

7.7 Pathways for future research: The quest for a distinct 'Southern European' variety of capitalism

The categorisation of Italy and Spain within the comparative political economy debate has always been difficult. In their seminal contribution *Varieties of Capitalism* (VoC), Hall and Soskice (2001) put Italy and Spain (along with France) in the hybrid category. The co-existence in these hybrid models of features of both liberal-market and coordinated-market economies, Hall and Soskice argue, condemns them to worse economic performance. While agreeing on the fact that Italy and Spain underperform compared to CMEs and LMEs, Molina and Rhodes (2007) contend that this is due to the fragmentation of domestic employers and labour organisations in the two countries. In a similar vein, Bruno Amable (2003) observes that due to fragmented labour relations, low social protection, low competition in the product market and concentrated ownership among listed firms, southern European economies succeed in being internationally competitive only in low value-added sectors.

Despite their merits, throughout the last three decades these contributions have been disconfirmed by the economic performance of Italy and Spain. In fact, at different times, both countries have outperformed most CMEs and LMEs in terms of growth. Contrary to what Amable expects, this thesis has shown that this solid growth performance has not been solely based on low value-added goods. Italy and Spain have succeeded in promoting the emergence of world-leading multinationals in high value-added services like banking, telecommunications and energy. In addition, while comparative political economists were still struggling to make sense of Italian and Spanish capitalism, the Eurozone crisis led to profound changes in the institutional organisation of both countries.

Quite puzzlingly, the common liberalising pressure felt by Italy and Spain during the crisis led to increasing heterogeneity in the labour market and corporate governance institutions of the two countries, thus calling into question the very idea of pairing them together as examples of the same model of capitalism (Bulfone 2017a). The detailed analysis of the pattern of state–business interaction in three strategic sectors provided in this thesis, and the other research projects I followed during my PhD focusing on corporate governance (Bulfone 2017b) and the labour market (Bulfone and Afonso 2017) in Italy and Spain might lay the foundations for a new approach to the study of the mechanisms of institutional change in two problematic models of capitalism (Jackson and Deeg 2012). Further work is needed to trace the cross-class interactions among Italian and Spanish socio-economic groups that led to the emergence in the two countries of different 'social blocs' supporting the development of different growth models (Amable and Palombarini 2009; Amable et al. 2011; Baccaro and Pontusson 2016).

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