Institutional Change After the Global Financial Crisis: Why a Whimper, Not a Bang?

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**Abstract**

The 2008 global financial crisis has shown the inadequacy of existing models of institutional change. Given the severity and scale of the crisis, significant reforms of financial market regulation, if not the economic system as a whole, were generally expected. Yet, early evidence suggests that very little substantial change has materialized, with change best characterized as incremental. This shows that severe shock events do not necessarily have to lead to radical change—at least not in the short term. Hence, the assumption often made in the literature—that the type of crisis determines the type of change—forestalls a deeper understanding of how crises and change are connected without seeing one as a precondition of the other. This paper provides an explanation of the continued incremental mode of change after the 2008 financial crisis. Unlike most models of institutional change, which focus on top-down methods of change based on policymaking, the explanation given here draws on the actor-centered approach to concentrate on the role of corporations. I argue that mechanisms of bottom-up change are potentially more powerful in times of crisis, when companies are more likely to engage in mimetic isomorphism as a means of reducing the uncertainty caused by the crisis situation. Copying perceived best practice from peers and opinion-leaders, new practices spread among firms and, when reaching critical mass, become institutionalized on the firm level. Four methods of bottom-up change, and how their potency may be enhanced by the crisis, are discussed. With policymakers’ attention and resources tied up with enacting emergency legislation aimed at saving the economy, leaving little to no concern with more fine-grained areas of law directly relevant to corporations, bottom-up processes become the driver of incremental change. I argue that this may even explain the absence of radical change in specific policy areas, but not in macro-economic policy terms, where more radical change could also have been expected.
Introduction

The global financial crisis of 2008 and ensuing period of economic recession has given increased currency to the view that periods of crisis occur cyclically and perhaps inevitably, signifying a wake-up call from the triumphant declarations of the ‘end of history’ made only a few years prior. Unsurprisingly, this realization has led to renewed interest in the economic and political processes that produce, construct and resolve situations of systemic crisis in capitalist systems. A takeaway from this line of enquiry is that crises have common features and antecedents, but that their political nature makes it impossible to predict outcomes in terms of the type and degree of change that may result from them (cf Gamble 2009; Reinhart & Rogoff 2009). While this may seem a rather unsurprising insight, it is exactly what some important models of institutional change fall prey to. Traditional ‘punctuated equilibrium’-based models of change rely on periods of severe crisis to explain radical institutional change, seen to stand in stark contrast to periods of stability. More recent scholars of institutional change have come to embrace the idea of gradual, yet over time transformative change that turns into radical change at ‘critical junctures’ or when reaching a ‘tipping point’ (cf. Streeck & Thelen 2005a). In other words, both older and newer conceptions of institutional change tend to associate (often external) shock events with radical change as well as endogenous triggers with incremental modes of change, thereby drawing a connection between the magnitude and source of a crisis event on one hand and mode of change on the other.

The recent crisis, however, highlights that such a connection may not necessarily exist. Given the severity and the global scale of the financial crisis, it was certainly a reasonable expectation that consequential reforms of financial market regulation, if not the economic system as a whole, would ensue—at least if we are to believe Polanyi’s (1944) argument that the ‘pendulum’ will swing back the other way once an economic system breaks down. Against these expectations, however, very little substantial regulatory change has materialized. Empirical evidence of changes in financial market regulation after the crisis suggests that governments enacted ‘fire fighting’ legislation as expected to stave off a deepening of the crisis, but produced few substantial reforms towards long-term change and reigning in of financial markets (Mayntz 2012). As is evident from the developments after this recent crisis, severe shock events do not necessarily have to lead to radical change—at least not in the short term. Hence, the assumption often made in the literature—that the type of crisis determines the type of change—forestalls a deeper understanding of how crises and change are connected without seeing one as a precondition of the other.

The continuation of incremental change rather than radical institutional upheaval after the 2008 financial crisis illustrates the limitations of existing models of institutional change, which often try to explain outcomes post hoc. Early theories of institutional change based on the concept of the ‘punctuated equilibrium’ (Krasner 1984) run out of steam rather quickly in trying to explain the absence of radical
change. Their conception of institutional change hinges entirely on shock events that unsettle an existing equilibrium, leading to a sharp distinction between long periods of stability, where no change occurs, and rare instances of upheaval, where radical institutional change takes place. Hence, these models can neither explain the absence of radical change after the financial crisis, nor the incremental mode of change observed. More recent incrementalist approaches (Streeck & Thelen 2005a) fare somewhat better, but also face limitations. These approaches have shown that times of stability do not equate institutional stasis, but rather a series of incremental changes that may amount to transformative changes over time. Despite this important contribution, incrementalist approaches are still based on the dichotomy between ‘normal’ times and times of upheaval. Hence, they are also hard-pressed to explain why the financial crisis does not constitute a ‘critical juncture’ that should lead to radical change.

Some authors have pointed to the role of corporations as both drivers and obstructing forces of institutional change. Culpepper’s (2011) model of institutional change sees businesses as powerful actors in the change process, but their power vis-à-vis politicians is based on an issue’s political salience. When an issue is of little interest to the public, the media, and politicians, the latter are more likely to give firms a powerful role in shaping regulation that mainly affects them. Conversely, when an issue such as corporate governance that usually slumbers in obscurity far from public interest is catapulted into the spotlight by a financial crisis, businesses are said to lose power vis-à-vis policymakers. While an important step towards contextualizing change processes, this still leaves us searching for an explanation of the absence of radical change after the financial crisis, as the reduced power of business interests should have allowed policymakers to implement radical change.

The immediate goal of this paper is to provide an explanation of the continued incremental mode of change after the 2008 financial crisis. Unlike most models of institutional change, which focus on top-down methods of change based on policymaking, the explanation given here draws on the actor-centered approach to concentrate on the role of corporations. I argue that mechanisms of bottom-up change are potentially more powerful in times of crisis, when companies are more likely to engage in mimetic isomorphism as a means of reducing uncertainty. Institutions are often understood to be uncertainty-reducing devices, giving firms an interest in maintaining the status quo in order to keep taking advantage of institutional arrangements. In times of severe crisis, however, some institutions that are seen as instrumental in causing the crisis may lose the power to reduce uncertainty and instead become a cause of uncertainty. If this is indeed the case, firms may resort to imitating the behavior of other corporations they see as role models or best-practice leaders. Such mimetic isomorphism has an uncertainty-reducing function, making it an appropriate and likely reaction in times of crisis. Hence, firms could be more likely to resist the coercive and normative pressures associated with the institutions called in question by the crisis, instead following
best-practice examples of 'what works' in the present circumstances from other leading firms—even from abroad. As a result, they import practices that may diverge significantly from national norms, thus introducing radically different catalysts of change into bottom-up channels of change. Such practices may run afoul of the law, giving courts and important signaling role to other corporations. It is likely though that courts are more lenient and siding with the interests of managers in times of severe crisis, for instance to prevent job losses in already precarious economic circumstances. When the practices spread among firms and reach critical mass, they may ultimately become institutionalized as new legitimate forms of compliance. In other words, bottom-up methods of change may become more potent in times of crisis, enhancing the power of firms to effect institutional change through their practices rather than through direct engagement with legislatures. It is this argument that I advance in this paper as an explanation for the continuation of incremental change throughout and after the financial crisis.

With corporations adapting their practices according to best practice, they can make a credible case to lawmakers that no deep reforms are needed. Policymakers, whose agendas are dominated by macro-economic concerns rather than the specifics of, say, corporate governance legislation in times of crisis, can then point to those corporations as examples of effective self-regulation, freeing them of the effort to legislate more heavily. I argue that this may explain the absence of radical change in specific policy areas, but not in macro-economic policy terms, where more radical change could also have been expected. Other authors, however, have taken up the challenge to provide answers to this question (Crouch 2011; Schmidt & Thatcher 2013).

The paper proceeds as follows: first, the literature is discussed in terms of how the most important models of institutional change are able to account for situations of crisis in general and how they can explain the mode of change in the aftermath of the 2008 global financial crisis in particular. Here, the advances that have been made towards contextualizing institutional change will be pointed out, as well as the areas where further research is necessary. Second, I will develop the argument that bottom-up mechanisms of institutional change are more potent in times of crisis, as corporations mimic each other’s behavior to reduce uncertainty. To conclude, I will position the argument as part of a larger effort to create a contextualized model of institutional change that considers how the dynamics of change—the balance of power between different agents, the mechanisms and the origins of change—vary based on macro-economic circumstances. In the concluding section, a path for future research will be outlined.
Literature Review

Theories of institutional change are necessarily closely related to how one conceives of institutions and their relationship to economic and political actors. New institutionalism (or neo-institutionalism) seeks to explain socio-economic outcomes, which it contends are a result of the choices made by a variety of actors—the state, organizations and individuals—within the constraints imposed by their institutional environment. Actors’ choices are therefore the proximate cause of outcomes, while institutions are a remote cause. Institutions are generally seen as formal and informal rules and rule-like norms and expectations, which structure behavior and thereby reduce uncertainty and risk in interactions between actors.

While neo-institutionalism was traditionally more concerned with explaining the status quo of institutional arrangements than how systems change, the three major strands of new institutionalism—rational-choice institutionalism (RCI), historical institutionalism (HI) and sociological institutionalism (SI)—each have their own conception of what enables and constrains change, thus creating different starting points for the debate on institutional change. The central claims of these approaches—the assumption of rational, utility maximizing actors with fixed preferences in RCI, the role of history in constraining today’s choices in HI, or the normative influence of societal rules or expectations in SI—are still subject to debate, with current approaches seeking to draw from and reconcile them.

Despite broad similarities, there are distinct differences between RCI, HI and SCI in terms of their conception of institutions—on what level they constrain actors and why actors comply—as well as their conception of actors—what their interests are and whether they are rule-makers or rule-takers. For the purposes of this paper, it is sufficient to keep these different roots in mind, as they explain why theories of institutional change differ the way they do.

The modern conception of capitalist crises is that they are socially constructed and, “above all, political events; they arise politically, they are constructed politically and they are resolved politically” (Gamble 2009, p.10). The political economy of crisis can thus be seen as the determinant of the outcome of a crisis, i.e. the kind and degree of change in the capitalist system it produces. As a matter of definition, Gamble (2009) differentiates between the narrower meaning of “crisis as a political emergency, a critical event demanding an immediate response,” and the wider meaning referring to a “deep-seated impasse in an organization, a society, or a state. Here crisis is used to refer not just to the turning point of a particular historical process but also to a set of historical events, which may take place over quite long time-spans” (Gamble 2009, pp.39-40). Applying this logic to this financial crisis, we can think of several crisis events in the narrow sense, such as the sub-prime mortgage crisis in the US, the collapse of Lehman Brothers in 2008, the bailouts and nationalizations of banks across a number of countries, with these events being part of a larger crisis in the wider sense, the ‘Great Recession’ that started in 2008 and
developed into a prolonged period of economic and political uncertainty and volatility.

The crisis can be argued to have once again exposed the dependence of the markets on the state, as “in a crisis only the state has the resources and capacity to intervene and save the market from itself” (Gamble 2009, p.97). Governments answered this call for action during the recent crisis in a number of ways, following a variety of ideological stances. The US’ approach of stimulus spending combined with quantitative easing followed a two-pronged fiscal and monetary approach, while the British government pursued a more monetarist approach. Such immediate emergency measures need to be conceptually separated, however, from permanent regulatory changes, intended to fix the perceived underlying issues that caused the crisis and place the economy on a steady footing in the long-term. The former are well documented at this late stage of the crisis, but form a necessary precursor to the latter.

Against expectations, considering the magnitude of the crisis, very little substantial regulatory change has materialized, however. Empirical evidence of changes in financial market regulation after the crisis suggests that governments enacted, as expected, ‘fire fighting’ legislation to stave off a deepening of the crisis, but produced few substantial reforms towards long-term change and reigning in of financial markets (Mayntz 2012). Mayntz (2012, pp.13-14) explains this lack of reforms through the atypical interest group formation during this crisis: “the pre-crisis mixture of regulation and deregulation that appeared to support economic growth had prevented the development of two opposed social blocs, one challenging and one defending the status quo. [...] There were experts and regulators who would have preferred stricter regulation, but they remained voices crying in the wilderness. It was the crisis that led to a wave of criticism and the demand for radical reforms, but the critics scarcely formed a single social bloc.” This lack of coherent support for tighter regulation might be a result of the largely unopposed rise of finance capitalism and the neo-liberal narrative in the 1990s, which was paradoxically fueled by center-left parties (cf. Cioffi & Höpner 2006; Schnyder 2011). That way, many countries wound up with two pro finance capitalism, pro business parties—the new guardians of minority shareholder rights on the left-of-center, and the traditional defendants of organized capitalism and managerialism on the right-of-center. As long as everyone seemed to profit from finance capitalism in one way or the other, there was little reason for an organized opposition, arguing for tighter regulation and/or an alternative model, to emerge. Such political accounts aimed at explaining the surprising resilience of neo-liberalism (cf. Schmidt & Thatcher 2013; Crouch 2011) are important, of course, but are limited by applying primarily to the specific circumstances of the recent ‘Great Recession.’ So, how can theories of institutional change explain the absence of radical change and the continued incremental adjustments?
Punctuated Equilibrium

One of the early ‘milestones’ of theorizing institutional change, the ‘punctuated equilibrium’ concept borrows a term from evolutionary theory (Krasner 1984) to describe a model of change associated with historical institutionalism. The causal factors that explain the origin and development of institutional structures are seen to be distinct from the causal factors that explain institutional stability over time. Hence, the model distinguishes between clearly demarked times of institutional change and of institutional stasis. “New structures originate during periods of crisis. They may be imposed through conquest or be implanted by a particular fragment of the existing social structure. But once institutions are in place they can assume a life of their own, extracting societal resources, socializing individuals, and even altering the basic nature of civil society itself” (Krasner 1984, p.240).

Long periods of institutional stability are hinged on the notion of path dependence, whereby past choices determine the options available today. “It is not possible in human affairs to start de novo with every change in wants, needs, and power capabilities. Past choices preclude certain strategies or make them very costly” (Krasner 1984, p.240). North (2005, p.51), who quips that the term ‘path dependence’ has been “used, misused, and abused,” proposes a more comprehensive definition of the term, in which “the institutions that have accumulated give rise to organizations whose survival depends on the perpetuation of those institutions and which hence will devote resources to preventing any alteration that threatens their survival.” In other words, North places a great deal of power on organizations, presumably both private and public, to which significant deviations from ‘the path’ would be risky and costly. Their vested interest lies in exploiting institutional arrangements, making them the guardians of the status quo.

While this may be a plausible scenario for some instances of stability, it is not fully convincing. For instance, why would a firm be opposed to liberalization that gives businesses more leeway in pursuing strategies of their choice, or allows them to opt-out of collective bargaining arrangements or union representation entirely? It has, of course, been sufficiently documented elsewhere that these ‘constraining’ institutions have benefits of their own, which firms may or may not be aware of, but some forms of change are surely more appealing and less risky for firms than others, casting doubt on the assertion that firms are the main drivers of path dependence and road blocks to change. Indeed, there is evidence to both ends—of firms recognizing the value of institutions even when they may be constraining (Culpepper 2011), and of organizations (trade unions) pursuing a course of reform in some regards (financialization) which counteracts their efforts to hold on to established institutions (industrial relations) in others (Callaghan & Höpner 2012). This indicates that we cannot jump to conclusions regarding whether firms are aware of institutional benefits, their interests or whether their actions necessarily make rational sense. Firms may thus support or inhibit change in unpredictable ways—a phenomenon that may be exacerbated in times of crisis, when uncertainty, time
pressure and unclear preferences introduce even more volatility into actors’ decision-making.

With these strong forces towards stability, institutional change is seen to arise from external shock events, as only events of great magnitude are able to break path dependency. By stressing institutional structures to the point of breaking, shock events trigger institutional reevaluation and replacement.

Despite its merit as laying the groundwork for many conceptions of institutional change, the punctuated equilibrium model has a number of severe limitations that manifest themselves in the inability to explain the aftermath of the global financial crisis. First, its black-and-white view of times of change versus times stasis cannot account for incremental change (North 2005, pp.2-3). While this is true generally, it is fails to even consider the possibility within moments of upheaval, i.e. in times of crisis. The lock-in due to path dependence and vested interests means that change is either inhibited or, if a powerful exogenous shock event occurs, of the radical kind.

Second, the focus on exogenous shocks downplays the power of endogenous agents of change. The global financial crisis originated in the United States, where it would certainly be an endogenous shock event, but then spread like a wildfire across the majority of advanced capitalist economies. The crisis can be construed as an exogenous shock event in those nations, but it was the exposedness and weaknesses in the national financial systems that enabled the systemic spread. An endogenous element is thus hard to deny even outside the US. A crucial contribution to addressing this issue comes from Baumgartner and Jones (1993), who develop a model that, while still dichotomous between periods of stability and change, consider endogenous sources of change. Drawing on the agenda-setting model of the political process, Baumgartner and Jones argue that groundbreaking new ideas can destabilize policy monopolies, the source of stability in their model, over time. “As disadvantaged policy entrepreneurs are successful in convincing others that their view of an issue is more accurate than the views of their opponents, they may achieve rapid success in altering public policy arrangements, even if these arrangements have been in place for decades” (Baumgartner & Jones 1993, p.4). Baumgartner and Jones’ model hence takes endogenous sources of change into account, which can trigger radical change once a ‘tipping point’ is reached.

Third, the punctuated equilibrium perspective has been criticized for being deterministic. Blyth (2002) argues that punctuated equilibrium models fall flat as they follow a post hoc, ergo propter hoc logic. Punctuated equilibrium models see the type of institutional change resulting from shock events as determined by the exogenous event, as if there was only one possible outcome. “Theoretically, no exogenous factor can in and of itself explain the specific forms that institutional change takes. While the destabilization of existing institutions can be exogenously driven, moving from such a position to a new stable institutional order must be seen as an endogenous process. Specifically, how agents redesign and rebuild institutional
orders, and the conditions under which these activities take place, need to be analyzed” (Blyth 2002, p.8). In other words, an exogenous shock is neither a guarantee for radical institutional change, nor can it predict the outcomes of the institutional rebuilding process it triggers. This is precisely where punctuated equilibrium models fail to explain the aftermath of the global financial crisis. While the crisis should have led to radical change according to the model, its absence highlights the fallacy of seeing such change as the only possible outcome.

**Incrementalist approaches**

The move away from a purely punctuated equilibrium-based perspective opens up the possibility of endogenous forces gradually changing institutions. An important contribution to reconciling radical with incremental change comes from Streeck and Thelen (2005b, p.8), who warn against “being caught in a conceptual schema that provides only for either incremental change supporting institutional continuity through reproductive adaptation, or disruptive change causing institutional breakdown and innovation and thereby resulting in discontinuity.” Their model distinguishes between the process and outcome of institutional change, which allows them to take incremental and sudden, as well as reproductive and transformative change into account. The default direction and mode of institutional change in Streeck and Thelen’s (2005b) model has, since the post-war period, been incremental liberalization, uninterrupted by major shock events. “In fact, an essential and defining characteristic of the ongoing worldwide liberalization of advanced political economies is that it evolves in the form of gradual change that takes place within, and is conditioned and constrained by, the very same postwar institutions that it is reforming or even dissolving” (Streeck & Thelen 2005b, p.4). This path dependence is, whereby choices in the present are confined by past choices, is a key feature of the historical institutionalist approach as well as the punctuated equilibrium view, which has been incorporated therein. However, this also means that the same fundamental criticism regarding the circular logic of change applies: if institutions themselves inform and constrain institutional change, how can change ever deviate from the historic trajectory?

The most important contribution of the incremental approach has been to show that times of stability do not equal institutional stasis, but rather a series of small adjustments that may amount to substantial change over time. In Streeck and Thelen’s (2005b) influential model, these changes are not solely created in the political arena, but result from the social interaction between rule makers and rule takers. They are in constant dialectic adjustment, “during which ever new interpretations of the rule will be discovered, invented, suggested, rejected, or for the time being, adopted” (Streeck & Thelen 2005b, p.16). Their model is not only of great import for identifying specific mechanisms of change, but also for moving beyond a purely rule-maker-driven understanding of how change is created. Yet, some of the
mechanisms apply mainly to the policymaking-level, conceiving of firms’ influence largely as accepting or rejecting an institution, rather than allowing for more proactive influence or the normative influence of their practices. Firms are afforded a more active role in Mahoney and Thelen’s (2010) model of gradual institutional change resulting from inherent agents of change. They employ a power-distributional approach to change, supplemented with a compliance-dimension. Rule interpretation and enforcement uncertainties are seen to open up possibilities for internal change as actors apply rules in new ways.

Despite the numerous important advances over previous conceptions of institutional change, the incremental approach carries over a severe limitation from punctuated equilibrium models. It still sticks to a dichotomy between times of relative stability and times of upheaval triggered by ‘critical junctures,’ and hence still predicts radical change in reaction to severe shock events. The incrementalist approach is therefore hard-pressed to explain why the financial crisis does not constitute a ‘critical juncture’ that should lead to radical change. It could be argued that what constitutes a ‘critical juncture’ only becomes apparent after the fact, but that amounts to a circular argument.

With the focus on political processes, the approach offers an explanation of incremental change generally, but it cannot explain why the incremental mode of change continued throughout and after the crisis. The mode of change is said to shift from incremental to radical during times of upheaval, as old institutions break down and are replaced by new ones. Equally, the political processes that are usually the drivers of incremental change are also said to shift into a different gear, as policymakers seek to implement far-reaching reforms in reaction to public demand for swift and decisive action. If this did indeed not happen, as early accounts suggest (Mayntz 2012), another factor (or other agents) must be at play.

**Reflexive approaches**

The incrementalist view of institutional change has brought with it the realization that change does not only have to result from external shock events, but that endogenous forces may also transform institutions through gradual adjustments. However, this raises the question what exactly those endogenous forces are that can effect institutional change. While there is little doubt that policymakers are formally endowed with the power to create, change and abolish formal institutions in the form of law, regulations and policies, there is less consensus on what other actors influence the policymaking process and where policymakers derive their ‘inspiration’ for changes from.

One line of thought, which can be termed the ‘top-down’ view, holds that party politics and interest group alliances, e.g. between investors and managers, are the main impetus for change. Hereby, policymakers are seen to produce formal
institutional changes, which are then implemented in practice on the firm level. In other words, formal change precedes informal change. Cioffi (2010), for instance, conceives of corporate governance reforms as a political game between political parties and interest groups. While not discounting the influence of managerial interests outright, their influence is said to have waned with rising political salience of corporate governance over the past decade as a result of a series of corporate scandals. Because firms squandered their influence over policymaking, they are only seen as background noise in Cioffi’s politics-centered model. “The primacy of politics in corporate governance reform should come as no surprise. The corporation, by definition, is a creation of the law; law, in turn, is a product of politics” (Cioffi 2010, p.7).

Others, taking a ‘bottom-up’ perspective, contend that the ones most affected by an institution, e.g. firms, hold a considerable degree of power that goes beyond accepting or rejecting policymaker-decreed change. Firms change their practices first, which become institutionalized and legitimated by lawmakers to reflect corporate practice—informal change therefore preceding formal change. One way in which firms contribute to change is by ‘defection,’ i.e. giving way to policy initiatives and allowing old institutions to erode, as observed in the case of the transformation of the French financial system (Culpepper et al. 2006; O’Sullivan 2007). Another, more active way is through engaging in “deviant’ behaviour, with a view to bringing formal rules or legal regimes back into alignment with behaviour” (Hall & Thelen 2009, p.17). This strategy, called ‘reinterpretation,’ can be based on firms exploiting judicial decisions, or on pushing at the boundaries of established forms of compliance: “In some cases, this occurs when the courts reinterpret a legal or regulatory regime. In others, it involves the gradual acceptance of practices that would not formerly have been seen as congruent with the formal institution” (Hall & Thelen 2009, p.19).

Seeking to integrate insights from both top-down and bottom-up perspectives of change, the literature has come to embrace a reflexive approach, whereby change is a result of the interaction between a variety of actors (policymakers, political parties, firms, labor unions, etc), who are in constant dialectic adjustment with their institutional environment. Recognizing that both rule-makers and rule-takers can be powerful drivers (or inhibitors) of change raises the question how the power between the two is balanced. The perhaps most prevalent line of thought argues that the balance of power shifts depending on the issue in question and whether said issue is ‘politically salient.’ This idea is based on the assumption that policymakers ultimately have the power to enact whatever policies they wish, but that they neither have the resources nor inclination to do so in every case. Instead, when an issue is of low importance to the public at large and thus has low political salience (Schattschneider 1960), policymakers tend to follow the wishes of those most affected by a policy—in case of finance, corporate governance, and labor relations issues often those of corporations. When saliency is high though, it can act as a “stimulus for action by key
players, driving the search for solutions to problems, though not determining outcomes” (Gospel & Edwards 2012).

Taking this concept into account, Culpepper (2011) argues that power shifts between party politics and interest groups on the one hand, and managerial interests on the other, depending on an issue’s political salience. Culpepper argues that party politics and interest group coalition-driven perspectives of legal change are flawed as they “treat corporate control like any other high-profile battle in democracies, where public opinion and legislative votes are the most valuable currencies” (Culpepper 2011, p.3). With low political salience of the issue, though, pressure for change is unlikely to come through these avenues. In areas of low political salience, such as regulation on corporate control, firms heavily influence policy due to “their superior lobbying capacity and the deference of legislators” (Culpepper 2011). Conversely, the more salient an issue, the more politicians start paying attention to public opinion and business interests lose power.

Lending this approach particular importance is the dynamic nature of political salience. An issue that might normally be of little interest to the public can become salient through a corporate or economic crisis, or mobilization through a political entrepreneur. As the media starts to pick up and discuss the issue, the public becomes aware of it and forms an opinion, leaving politicians little room for maneuver if they want to be reelected (Culpepper 2011). Closely related to political salience is issue complexity—the more complex an issue (e.g. corporate governance technicalities such as takeover defenses), the harder it is for the media and the public to engage with and understand it, thus giving managers the role of undisputed experts on the matter. Culpepper calls low salience and high complexity an “ideal combination of circumstances for managerial groups, which both understand the issues of corporate control and care about them a great deal, to wield disproportionate political influence” (Culpepper 2011, p.8). However, when salience flares up, for example during a hostile takeover attempt being reported in the news, high complexity is only a shield for managerial interests as long as salience is fleeting, so media and politicians have no incentive to become thoroughly informed on the issue, and is not a result of perceived managerial incompetence, as in the case of the Enron debacle or the financial crisis (Culpepper 2011). By relying on political salience and issue complexity, Culpepper’s model can be seen as an important first step towards contextualizing theories of institutional change.

So, how capable is his model of explaining the absence of radical change and continuation of incremental change after the global financial crisis? To stay in the policy area of corporate governance, there is little doubt that a significant share of the blame for the crisis was laid upon corporate governance failures (Adams 2009; Kirkpatrick 2009; D. Walker 2009). The debate concerned weak governance generally, but also specific issues like board independence and executive compensation. The latter became a particularly thorny issue in the public debate, as excessive pay fuelled public outrage at a time of economic crisis and rising
unemployment. Hence, there can be little doubt that the political salience of corporate governance rose dramatically during the crisis, with some issues still being regular topic of headlines some five years after the crash. So if the crisis indeed catapulted corporate governance from relative obscurity into the public spotlight, it should have tipped the balance of power in favor of policymakers, who should be eager to legislate to satisfy public demand for tougher regulation. While some corporate governance reforms were implemented in the UK’s Corporate Governance Code following the Walker review (2009), they can hardly be called radical or revolutionary. Culpepper’s (2011) model thus cannot provide a satisfactory explanation for this incremental outcome.

Why a Whimper, Not a Bang?

None of the existing models of institutional change are fully capable of explaining the type of change observed in the immediate aftermath of the global financial crisis. While ultimately also unable to provide a convincing explanation, the recent work of Culpepper (2011) is most promising, as it points to the role of businesses in the institutional change process. Indeed, the call to focus more heavily on corporate actors is not particularly new, but still has not been fully heeded.

Actor-centered institutionalism, first formulated almost 20 years ago (Mayntz & Scharpf 1995; Scharpf 1997), marked an important first step towards considering the role of corporations more fully, as it emphasizes all actors that are relevant to a certain field of regulation or policy. Rather than only looking at state actors, it takes both state and economic actors (corporations) into account. Rooted in the political sciences, actor-centered institutionalism focuses on processes rather than outcomes and recognizes structure (political system) as well as rules (institutions). The rule-making process is shaped not only by political structures, but also dominant interests of actors, which are in turn shaped by their institutional context. Thus, the approach regards institutions both as explanatory variables and as something to be explained; they do not determine outcomes, but are a constraining and enabling context (Mayntz & Scharpf 1995, p.43). While it did not theorize specific methods of influence and remained constrained in a number of ways, actor-centered institutionalism clearly made a case for taking firms seriously as actors shaping their institutional environment.

This call for intensifying the focus on the firm level is also reinforced by several other authors. Hall and Soskice’s (2001) influential “Varieties of Capitalism” framework, while not mainly concerned with institutional change, shows that, in order to understand a nation’s institutional set-up, we need to focus on the firm-level and how various actors coordinate their activities. Jackson (2010) argues that to move beyond broad typologies of institutions, we should examine the identity and constellation of actors in a contextualized way. Actor-centered approaches do just that and therefore represent a promising path forward in the quest to “see
institutionalization as dynamic and actor-centered social process, recognizing the
duality of structure and agency, as well as the material and cognitive aspects of
institutions” (Jackson 2010, p.66). Thelen’s recent work has similarly emphasized the
importance of corporate actors in change processes (Mahoney & Thelen 2010; Hall &
Thelen 2009; Streeck & Thelen 2005a).

All of these authors have advanced the field in significant ways by exploring
further the role of corporations relative to their institutional environment or how
they influence institutional change processes. In an important way, however, they
have not: there is still an overwhelming emphasis on institutional change as a
politically driven process. In this top-down view, the power of firms is either seen as
reactionary or based on the deference of policymakers. If we want to take firms and
their role in institutional change seriously, however, we need to subject them to the
same scrutiny as the policymaking level. That means moving beyond conceiving
reform processes as either purely political battles or as struggles between
policymakers and firms, to also consider the struggles and processes that occur
between firms. Shedding more light on the firm level could help us understand better
how firm practices change and spread, which is the first step towards a better
understanding of bottom-up processes of change, i.e. how firms can affect their
institutional environment through their practices rather than engaging with
policymakers directly.

Empirical evidence for bottom-up change is fairly new and sometimes limited to
specific cases, but nonetheless convincing and deserving of close attention. Schnyder
(2010) points to evidence of cases where firm practices change before legal changes
were made to reflect them (Coffee 2001; Cheffins 2000), as well as firm practices
defying legal changes (Culpepper 2005; Culpepper 2007). Reinforcing Culpepper’s
(2007) criticism that the interaction of firm-level changes of practice and legal
changes are ill-understood, Schnyder (2010) makes an important contribution to
filling this gap by studying corporate governance reform in Switzerland. He finds that
“as an increasing number of companies introduced more investor-friendly corporate
governance practices, their opposition to the legal reform became meaningless and
reform became possible” (Schnyder 2010, p.592). Switzerland’s consensual polity was
thus found to impact the directionality of change (firm practice change preceding
legal change), as large coalitions are necessary to implement reforms, requiring the
support, or at least non-resistance, of business elites. While these findings need
further testing in other consensual polities, such as Germany, as well as majoritarian
systems, it is important evidence for bottom-up institutional change. Given this
evidence, the role of corporate practices is emphasized in this explanation of
institutional change after the global financial crisis.

A focus on firm practices necessitates an understanding of the behavior of
corporate actors in times of crisis. Studying their behavior in detail surely needs to be
subject of a larger empirical enquiry, but the literature offers a useful point of
departure: the uncertainty caused by situations of crises and how actors aim to
reduce it. Institutions are often understood to be devices reducing uncertainty in economic exchanges by limiting actors’ leeway for opportunistic behavior, thereby reducing transaction costs (North 1984; North 1990; Williamson 1981). Under normal circumstances, firms thus have an incentive to work towards maintaining those institutional arrangements, both to continually reduce the chances of opportunistic behavior of others, but also because they benefit from exploiting the status quo of the institutional set-up for their own gains. In times of severe crisis, however, different factors come into play. For one, institutions that are seen as instrumental in causing the crisis may lose support from the public, policymakers, or even the firms affected. With mounting normative pressure to reevaluate and change the institutions, actors may start to defect from them, turning the institutions from uncertainty reducing into uncertainty-causing devices.

More generally, times of severe crisis can be understood as situations of Knightian uncertainty, i.e. “situations regarded by contemporary agents as unique events where the agents are unsure as to what their interests actually are, let alone how to realize them” (Blyth 2002, p.9). Hence, crises spread a ‘great confusion’ of sorts, leaving actors without their usual compass directing them on what behaviors are appropriate or even in their interest. One important way firms regain their footing is through following the lead of large, successful companies—role models that are seen as ‘best practice’ examples of how to cope with the crisis and the uncertainty surrounding it. Called mimetic isomorphism, this process tends to occur for its uncertainty-reducing properties: “Individuals and organizations deal with uncertainty by imitating the ways of others whom we use as models. The underlying logic is often one of orthodoxy: We seek to behave in conventional ways, in ways that will not cause us to stand out or be noticed as different. Also involved are status processes. We attempt to imitate other whom we regard as superior, as more successful” (Scott 1995, p.45). Organizational isomorphism is of course not limited to situations of crisis but occurs for different reasons in a number of forms. Organization studies has shed light on the question why firms often exhibit similar behavior despite the large variety of institutional contexts and possible behaviors, with explanations generally focusing on legitimacy, reduction of uncertainty and taken-for-granted practices (Meyer & Rowan 1977; DiMaggio & Powell 1991).

An important contribution to understanding mimetic isomorphism, Smith and Meiksins (1995) present a model synthesizing previous research. They consider three sources of external pressure to conform to certain work organizational practices, (1) system effects stemming from the economic mode of production, (2) societal effects arising from historic legacies and institutional settings, and (3) dominance effects resulting from best practice of the global ‘poster child’ economy of the time. All three sources are present at all times, but their order of importance varies with time and between countries (Smith & Meiksins 1995).

System effects arise from a country’s political economic system, i.e. its variety of capitalism. While common to all capitalist systems, national varieties impart
certain ways of doing business. Societal effects refer to “societal contexts through which ‘modes of production’ emerge, develop and get reproduced. It is a level of institutionalisation which encultures systemic forces with unique qualities” (Smith & Meiksins 1995, p.254). Historic choices play an important role hereby, mediating inherent forces towards convergence and divergence. Dominance effects result from an international hierarchy of economies, whereby “those in dominant positions have frequently evolved methods of organising production or the division of labour which have invited emulation and interest” (Smith & Meiksins 1995, p.256). They argue that such borrowing of what is perceived to be ‘best practice’ is intensified with increasing global economic integration. This implies that the effect is stronger in highly internationalized sectors, say the financial sector or in mass manufacturing of consumer goods, than in other, less integrated sectors. An important vehicle for the diffusion of the best practice of the time are MNCs, who transplant their home practices to host countries, albeit with some local ‘flavor’ to make them compatible with local legal and normative requirements. Hence, dominance effects “create pressures to diffuse best practice, but competition between dominant countries means there is never a single model of this, and uneven development ensures that there is a turnover in practices” (Smith & Meiksins 1995, pp.258-259). Dominance effects are likely to become stronger in times of crisis, as some economies suffer more than others, potentially establishing a new hierarchy of economies. Since the 2008 financial crisis and the ensuing global economic downturn, Germany has often been heralded as a new role model, having performed better than most other advanced capitalist economies. Some governments such as the British, have voiced their aspirations to become more Germanic, i.e. export-led economies with strong apprenticeship and training systems (Volkery 2013; Groom 2013). This perhaps signals that the German economy as a whole, as well as the practices of German firms now exude stronger dominance effects than before the crisis, when Anglo-Saxon-style capitalism was the undisputed role model.

An inherent risk of imitating successful strategies of foreign firms is that the imported practices are suboptimal due to differences in institutional contexts. Hence, practices should be subjected to a process of ‘due diligence,’ aimed at assessing whether the seemingly successful way of organization, or of dealing with the crisis, is actually appropriate in the domestic context. Such a process consumes time and resources, which are both scarce during a crisis. It is therefore likely that firms not only import practices that are efficient in the domestic context, but also import inefficient practices as well as reject efficient ones. Abrahamson’s (1991) model of the diffusion and rejection of managerial fads and fashions offers an explanation. Fads and fashions hereby refer to administrative technologies including strategic planning units, job enrichment, decentralization and joint ventures. Abrahamson argues that such structures are often adopted as ‘easy solutions’ that promise to boost performance without great effort, but are often implemented haphazardly, and sometimes even inefficient choices given the organization’s circumstances.
Appropriate, as in efficient, choices are only likely when actors “within a group can freely and independently choose to adopt an administrative technology” and when they “are relatively certain about their goals and their assessments of how efficient technologies will be in attaining these goals” (Abrahamson 1991, p.590). As elaborated before, situations of crisis lead to actors being anything but certain of their goals, thus removing part of the foundation for being able to make rational choices. In situations of uncertainty, when organizations are more likely to imitate others (DiMaggio & Powell 1991), they are hence likely to copy practices regardless of whether they are efficient choices or not.

Under such circumstances, where imitation processes drive the adoption or rejection of practices, Abrahamson’s (1991) model distinguishes between two scenarios: the fad perspective and the fashion perspective. The difference between the two is whether organizations within (fad perspective) or outside a group (fashion perspective) determine the diffusion and rejection of practices within the group. In the fashion perspective, fashion-setting organizations such as consulting firms, business schools or business mass media promote certain administrative technologies as part of their business. Organizations adopt their recommendations because of the trust they inspire, the knowledge they exude, and the reach they have. Abrahamson argues that because the practices promoted by these opinion-leaders are not necessarily efficiency-enhancing, but also serve an innovation-signaling purpose that tends to lead to rejection over time as they lose their innovative edge. In times of crisis, this driver of mimetic isomorphism is also likely to be highly relevant. Consultancies, business media, business associations and other opinion-leaders provide guidance and advice on how to react to the crisis, how to ensure compliance with legislation that may be under particularly close scrutiny by regulators after the crisis et cetera.

The fad perspective emphasizes the imitation of other organizations within the group, so the immediate peers of the firm. Explanations of this behavior have focused on gaining legitimacy by adhering to emergent norms (DiMaggio & Powell 1991; Meyer & Rowan 1977) or on economic interests by avoiding the risk that competitors might gain a competitive advantage through an innovation (Abrahamson 1991). Reputation-based explanations, whereby firms imitate others with better reputations than their own (DiMaggio & Powell 1991) have also been advanced for political actors, showing that policy diffusion in the US spreads after highly-reputed states implement a new policy (J. L. Walker 1969). Such within-group mimetic isomorphism, both for corporate and political actors, can also be expected to play a crucial role in situations of crisis, mainly for its uncertainty-reducing properties discussed above.

To what extent processes of mimetic isomorphism actually occurred during the global financial crisis needs to be subject to empirical investigation, of course, but there is evidence that firm behavior did indeed converge in some regards (Kern 2012). Kern’s (2012) analysis of firm-level finance and corporate governance
indicators across the US, UK, Germany and Switzerland for the time period from 2001 to 2011 showed no significant differences in behavior between the countries on a number of measures related to net-value-added distribution in the crisis years of 2008 and 2009. The post-crisis years saw a partial return to pre-crisis, national patterns of firm behavior. While far from complete or conclusive, the findings highlight the importance of investigating changes of firm practices during and after the crisis more thoroughly.

If times of crisis and uncertainty indeed lead to increased imitation of practices, the question arises how this impacts the institutional environment. Within-country mimetism, whereby firms model their behavior after domestic peers, is likely to change average firm practices only incrementally. The practices of role models are likely to be sufficiently different to be perceived by others as innovative, or particularly appropriate in reaction to the crisis situation, but they are still conditioned by the same national institutional system and thus unlikely to be radically different from average firm behavior. Opinion-leaders, on the other hand, may conceivably be champions of somewhat more radically different best practice. It is in the business interest of consultancies, advisory bodies and the specialist media to sell advice that is far enough from common wisdom to be perceived as a ‘product’ or ‘solution’, yet not too unorthodox as to attract unwanted regulatory scrutiny. Whether firms imitate their domestic peers or domestic opinion-leaders, the resulting change in corporate practices will feed into bottom-up channels of institutional change.

With increasing global integration of business and trade, mimetic processes may not be limited to the nation-level. Indeed, MNCs may not have any domestic peers, making it likely that they orient themselves towards their international peers and international opinion-leaders. If firms imitate practices originating in other countries, friction with home-country institutions can be expected. Practices imported from other institutional contexts may be very different from domestic norms, but to what extent they may run afoul of domestic rules will depend on the home-country’s regulatory system. The UK’s ‘comply or explain’ approach to corporate governance regulation, for instance, is much more permissive of deviant behavior than other, more prescriptive systems. While such international-level mimetic isomorphism may make comparatively more radical change in firm practices possible, or even likely, than national-level equivalents, corporations have little interest in straying too far from the norm, as doing so is costly and against their vested interests. Then again, if a crisis is severe enough, actors may not even know what their interests are anymore, as discussed earlier. Ultimately, this question needs to be answered through empirical study, but for now we can assume that international-level mimetism has the potential to lead to more radical change in firm practices than the national-level equivalent.

As the mimetism-induced changes in corporate practices spread and reach critical mass, they become institutionalized on the firm level, where they contribute
to change in informal institutional arrangements in the first instance, and consequently feed into bottom-up channels of institutional change, through which they affect formal institutions.

How firms may have the power to change institutions through their practices alone is fairly straightforward when it comes to informal institutional arrangements that firms themselves are the ‘guardians’ of. Culpepper (2011) points to the example of French firms’ own undoing of takeover protections during the 1990s, when firms created institutional change by eroding ownership concentration and cross-shareholdings. The low-salience nature of some issues is the cause of informal institutions’ continued existence, as lawmakers show deference to managers’ expertise. When salience rises though, managers would oppose any government intervention into privately regulated issues (Culpepper 2011). In times of crisis, this also presents an opportunity for businesses: if corporations address perceived issues through self-regulation, they can make a credible case to policymakers that no further regulation is needed. Policymakers, whose agendas are dominated by macro-economic concerns in times of crisis, may be inclined to accept self-regulation efforts as a sign of the efficiency of markets. However, the change required for this does not necessarily come easily. Normative pressures make deviant behavior not only costly, but also frowned upon by their peers. A critical mass of firms changing their behavior—either defecting from an existing informal institution, or converging on a new practice—is therefore a necessary precursor to such changes taking hold. The crisis and the mimetic isomorphism it triggers, however, are an ideal catalyst to make widespread incremental change in firm practices happen. While these mechanisms of change apply to informal institutions, a similar case can be made for formal institutional change.

Corporate practices can affect formal institutions in a number of ways, most importantly through reinterpretation (conversion), defection (exhaustion), displacement, or preemption.

Reinterpretation of the law, or ‘conversion’ in Streeck and Thelen’s (2005b) terminology, is hinged upon the gap between institutions on paper, i.e. laws and regulations, and the way they are followed in practice (cf. Meyer & Rowan 1977). The real impact of a piece of legislation is not fully determined by its text, but by its organizational interpretation. Hence, firms can exploit ambiguities in the law or pursue a judicial strategy, battling out lawsuits when they expect a decision in their favor, thus creating new legal precedent (Funk & Hirschman 2012). Interpretations and expectations of the law become even more important when new ambiguous legislation is passed. In such situations, firms look towards each other in search of best practice in complying with the new law: “These field-wide efforts to reduce environmental uncertainty lead organizations to develop common signals of compliance - such as formal policies and procedures - even when they are not legally mandated” (Funk & Hirschman 2012, p.5). The same logic can also be applied to situations of crisis. Governments, who only have limited resources, will prioritize the
most salient issues on their agenda, which are likely to be emergency countermeasures to the crisis, crowding out other matters of lower priority. If new legislation directly affecting corporations is passed during crisis, it is likely to have been conceived under severe time and resource constraints, making it likely more ambiguous than if it had been conceived under different circumstances. Whether corporations interpret new legislation or reinterpret existing law, the crisis affords them a window of opportunity to establish new forms of compliance ‘under the radar,’ i.e. while governments are occupied with other problems. Organizational interpretations of formal rules, once they reach ‘critical mass’ within a field or are followed by a small number of highly influential firms (Funk & Hirschman 2012), become institutionalized among corporations and eventually recognized by courts as legitimate ways of compliance. This process, often termed ‘endogenous legal change,’ can be summed up as “everyday organizational practices, routines, and structures subtly influence legal thinking, legal categories, and legal logic” (Edelman et al. 2011, p.890). It has the power to shift the meaning and impact of legislation over time based solely on firm practices, i.e. without direct interference in the policymaking-process.

Defection refers to large-scale deviance, or several powerful firms ignoring a rule or regulation, which may contribute to an institution’s exhaustion (cf. Streeck & Thelen 2005b). Over time, the rule might cease to be enforced or taken off the books entirely. It is usually assumed that firms prefer stable institutional environments, which would counter the idea that firms intentionally destabilize legal institutions they have learned to deal with. Funk and Hirschman (2012) argue that firms are willing to cause destabilization when it promises to further their interests or when another related field is already destabilized. These ‘cascades of change’ are thus more likely the tighter the connection between two fields. Firms might, for example, deviate from norms on employee relations or even formal labor regulations during a financial crisis, arguing that labor protections harm their competitiveness and threaten more job losses if the firm goes bankrupt entirely. Situations of crisis therefore represent an opportunity for firms to defect from established institutions under the guise of a ‘desperate times call for desperate measures’ mantra.

Displacement refers to ‘dormant’ institutional forms, i.e. “possibilities of action that institutions neither prescribe nor eliminate,” replacing the dominant form (Streeck & Thelen 2005b, p.20). These secondary logics of action may come from exogenous sources in form of imported institutional forms, which is of particular relevance in times of crisis given the increased likelihood of mimetic behavior among firms. Institutional displacement can also arise from reactivating “suppressed historical alternatives” (Streeck & Thelen 2005b), which in a crisis could mean the reactivation of more prudent approaches. Finally, displacement can result from innovating around the law, taking advantage of policy drift (cf. Streeck & Thelen 2005b), for example to design new financial investment products not covered by existing legislation.
Preemption is not so much a method for changing formal institutions as it as a way of inhibiting the formation thereof through self-regulation on the firm level. Issues may be kept outside of formal regulation entirely through setting up industry-wide sets of rules along with professional bodies that can enforce those rules and sanction transgressions (Culpepper 2011). An example for such ‘self policing’ would the Institute of Chartered Accountants in England and Wales (ICAEW), which has the right to first address its members’ lapses, before they are conferred to the governmental accounting disciplinary board.

Some of the methods discussed above rely on courts to approve of new forms of compliance, but predisposition of courts in times of crisis is less than clear. It could be argued that courts are stricter vis-à-vis corporations if blame for the crisis falls on them. Hence, courts may seek to reign in deviant behavior that may have passed as appropriate before the onset of the crisis. On the other hand, an argument can be made that courts become more lenient in order to avoid even larger fallout from the crisis. Firms could argue that they need to pursue more radical strategies in order to remain competitive, stave off bankruptcy and avoid mass job losses. Courts could therefore side with business interests for the sake of the overall economic situation. Future research should therefore investigate the role of courts in times of crisis.

Once firm-level changes reach the ‘top,’ they may have a somewhat larger impact on formal institutions than they normally would, as crises affect institutional strength in a number of ways. Levitsky and Murillo’s (2009) model of institutional strength distinguishes between two dimensions—enforcement and stability. Enforcement refers to “the degree to which [formal] rules are complied with in practice,” while stability is defined as the “degree that [institutions] survive not only the passage of time but also changes in the conditions—i.e., underlying power and preference distributions—under which they were initially created and reproduced” (Levitsky & Murillo 2009, p.117). Highly developed nations typically feature high enforcement and high stability, but crises can chip away at both.

Weak enforcement of rules can result from ‘window dressing,’ i.e. law or regulation enacted primarily to appeal to others without intention of enforcing it (Levitsky & Murillo 2009). In a crisis, policymakers could engage in window dressing as a way of signaling to the public that the government is doing what is morally right, e.g. by capping executive pay, while at the same time putting business interests at ease by implementing weak monitoring and enforcement mechanisms. Such behavior is facilitated by mimetism on the firm level, which governments could interpret as effective self-regulation, as argued earlier. Weak enforcement may also be a result of governments lacking the power to enforce even if they wanted to. The reach of the state might be lower in some sectors than in others—highly internationalized and ‘footloose’ sectors such as finance come to mind, or highly complex sectors such as investment banking. Finally, when actors perceive rules as unfair, they are more inclined to not comply with them, making effective monitoring and enforcement more costly and in turn rule violations more likely. Lawmakers, who might be
inclined to crack down on the perceived causes of an economic crisis, such as ‘exotic’ financial trading, lack of oversight, or corporate governance failures, thus risk higher violation rates if firms do not perceive the new rules as fair.

Institutional instability may also result from a number of sources. Time is one of those factors and highly relevant to situations of crisis. Levitsky and Murillo (2009, p.123) argue that “the pace of institutional design may affect stability,” as quickly-designed ‘emergency legislation’ does not give actors enough time to calculate its potential impact and how it affects their interest, increasing resistance to the new rules. Finally, institutional borrowing from abroad may weaken institutions. Just as corporations seek to reduce uncertainty through imitating best practice of their peers, policymakers may also adopt what they perceive as the best way of handling the crisis. As governments scramble to keep their economy from collapse, borrowing perceived ‘best practice’ solutions from other countries allows them to boost confidence among businesses, investors and consumers, regardless of how fitting the rules may be to the domestic context. These imported policies may have the desired effect, but are also prone to being exposed for what they probably are—ill suited to the domestic context.

Whether institutions are weakened by poor enforcement or instability, Levitsky and Murillo (2009) argue that it makes them more liable to change. Bearing in mind that Levitsky and Murillo’s model is based on weak institutions in the context of developing countries, where weak institutions are often systemic, leading to institutional change of a “breakdown and replacement” type (Levitsky & Murillo 2009, p.128), such dramatic change cannot be expected in developed nations. Here, the magnitude of institutional weakening is much smaller and of shorter duration, and should therefore be seen as a catalyst for incremental change rather than radical change.

Conclusion

Processes of endogenous legal change occur at all times, not solely in times of crisis. Yet the nature of crises and in particular the uncertainty they create make these bottom-up methods of change more potent. First, the process of reaching a critical mass of firms exhibiting the new practice in question—crucial for any bottom-up change to gain traction—is sped up through mimetic isomorphism, which firms engage in as a means of reducing uncertainty. Second, bottom-up processes of change, which are usually limited to producing incremental change, may lead to more profound change in times of crisis due to the import of practices from other institutional systems. Further contributing to the power of bottom-up change in times of crisis is the institutional weakening that may occur due to poor enforcement of rules and instability resulting from incoherent institutions. Taken together, these
mechanisms should not be seen as necessarily capable of producing radical change, however. With policymakers’ attention and resources tied up with enacting emergency legislation aimed at saving the economy, leaving little to no concern with more fine-grained areas of law directly relevant to corporations, bottom-up processes become the driver of incremental change.

The argument advanced in this paper provides an explanation for the continued incremental mode of change during and in the immediate aftermath of the global financial crisis. In specific policy areas, where policymakers accept changes on the firm-level as evidence of self-regulation and thus perceive no need to legislate in a meaningful way, bottom-up processes may also explain the absence of radical change. Generally, however, it cannot answer the question why governments did not pursue a more radical overhaul of financial market regulation or the economic system as a whole. As a fundamentally political question, other authors have given this issue considerable attention (cf. Crouch 2011; Schmidt & Thatcher 2013). While such political accounts surely provide the most accurate and detailed answers, they are limited by their specificity and post factum nature. We should therefore aim to also improve existing models of institutional change, as they are more generally applicable.

By showing how situations of crisis affect processes of bottom-up change, this paper seeks to contribute to a larger research agenda aimed at contextualizing our understanding of institutional change. If we think of change as an ongoing process, cyclically interrupted by periods of capitalist crisis, we need to develop a better understanding of how these two phenomena are related without seeing one as a precondition of the other. Hence, our goal should be a process-oriented model of institutional change that takes all relevant actors into account, but is also sensitive to context, i.e. how crisis and uncertainty affect the dynamics of institutional change—the balance of power between various political and corporate actors, the origin of change, and the methods used to bring about change. Political actors are much better understood than corporate actors, which are often only considered in terms of how they influence policymakers through lobbying, interest groups or framing of the public debate, with little research exploring how firm practices may impact the creation of change. The literature’s shift towards actor-centered approaches is a positive development, but has not opened up the firm level to the same scrutiny as the policymaker level yet. A deep focus on firm-level processes of change should provide answers.
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