The German Banking System and Its Impacts on Corporate Finance and Governance

Theodor Baums

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Theodor Baums*

The task of this paper as originally described in the outline of the current project was to compare the German banking System, as one type of "relationship banking", with the Japanese main bank System. This was, of course, not simply meant in the sense of a mere description and comparison of different institutions. A meaningful contribution rather has to look at the functions of a given banking system as a provider of capital or other financial Services to their client firms, has to ask in what respect the one or the other system might be superior or less efficient, and has to analyze the reasons for this. Such a thorough analysis would have to answer questions like, for instance, to what extent investment is financed by (long or short term-)bank loans, whether German banks have, because of specific institutional arrangements like own equity holdings, seats on Company boards or other links with their borrowers, informational or other advantages that make bank finance cheaper or easier available; how such banks behave with respect to financial distress and bankruptcy of their client firms, and what their exact role in corporate governance is. While preparing this paper I found that in order to give reliable answers to these questions there had to be several other conferences comparable to the present one that had to focus exclusively on our domestic System. Hence what this paper only can provide for at this moment is a short overview of the German banking system and its special traits ("Universalbankensystem" and "Group Banking"; part I), describe and analyse some aspects of bank lending to firms (part II), and the role of German banks as delegated monitors in widely held firms (part III).

A description of the *historical development* of the specific links between banks and industry and their impact on the economic growth of Germany during the period of the industrialization and later on would be specifically interesting within the framework of a Conference that discusses the lessons and relevance of banking Systems for developing market economies and for transforming socialist economies.

However, historical remarks had to be omitted completely, not least because of lack of own knowledge, time and space, but also because this history is already well documented and available in English publications, too.[1]

Part I.
Universal Banking and Group Banking

Table 1 lists the German banks, their numbers and balance sheet totals as of April 1991.

Table I: Structure of the Banking System in Germany (as of April 1991)

Bank Group	Number of banks	Balance sheet total[1] DM billion	%
1. **Universal Banks**			
Big banks[2]	5	481	9.1
Regional banks and other commercial banks	192	770	14.7
Branches of foreign banks	60	82	1.5
Private bankers	83	67	1.2
Total Commercial Banks	340	1,400	26.5
Central giro institutions	11	773	14.8
Savings Banks	760	1,080	20.6
Total Savings Banks Sector	771	1,853	35.4
Cooperative central banks	4	193	3.7
Credit cooperatives	3,342	592	11.3
Total Cooperative Sector	3,346	785	15.0
2. Special-Purpose Banks			
Private mortgage banks	28	466	8.9
Public mortgage banks	8	152	2.9
Total Mortgage Banks	36	618	11.8
Banks with special tasks[3]	17	518	9.9
Postal giro and postal savings bank offices	16	72	1.4
Total all bank groups	4,526	5,246	100.0
For information: foreign banks[4]	140	218	4.1

1) excluding assets and liabilities of foreign branches
2) Deutsche Bank, Dresdner Bank, Commerzbank and their Berlin subsidiaries
3) i.a. Reconstruction Loan Corporation, Landwirtschaftliche Rentenbank, AKA Ausfuhrkredit-GmbH, Privatdiskont-AG
4) total of legally independent banks included in other bank groups and majority-held by foreign banks and the group of "(legally dependent) branches of foreign banks"

Source: Statistische Beihefte zu den Monatsberichten der Deutschen Bundesbank. Reihe 1: Bankenstatistik nach Bankengruppen. Juni 1991 Nr. 6.

The banks are divided into two groups: universal banks and special purpose banks; the latter (like mortgage banks and others) are omitted in the following.[2] Universal banks may offer the whole palette of financial Services "under one roof". This includes the classical banking business as well as the investment and securities business (floating and trading stock; depository or custodial Services for shares, voting shares and owning stock on own account; setting up and owning investment funds); trading with real estate, organizing rescue operations for firms in financial distress, doing business in the M&A sector, etc. The group of universal banks can be divided into three subgroups: The commercial banks ("Geschäftsbanken"; because of their much broader powers not to be confused with their American counterparts), the savings banks ("Sparkassen") and, third, the sector of cooperative banks ("Kreditgenossenschaften"). As will be shown later, especially the savings banks as well as the cooperative banks cooperate among themselves to a large extent ("group banking"); competition is more vigorous among these three groups of universal banks than especially inside the group of the savings banks and the cooperative banks, respectively. The most important group - by numbers of banks (771) as well as by balance sheet total (DM billion 1,853) is the savings banks. The commercial banks sector consists of 340 banks with a balance sheet total of DM billion 1,400; whereas the cooperative sector is formed by a traditionally large number (3,346) of small banks (balance sheet total: DM billion 785).

1. Commercial banks (Geschäftsbanken)

This group of universal banks is the most inhomogeneous one and comprises the "three big" banks (Deutsche Bank, Dresdner Bank, Commerzbank) with their Berlin subsidiaries and a market share of about 11 percent of the total universal banks sector, a large number of more regionally centered private credit banks, and the private bankers, that is, banks that are run by a partnership or a sole proprietor.

The core of the business of this group of universal banks lies traditionally in the credit and securities business. Credits of all commercial banks to non-bank firms make up for about 65 per cent of their balance sheet total (long-term loans: 30 %). Our large firms formerly had their "house banks" from

this group;[3] and there are still close relationships between these large firms and the top commercial banks, as will be shown later.

2. Savings banks (Sparkassen)

Almost all of these institutions are owned by local municipalities and are hence restricted to the respective area. Common tasks are solved by regional or central institutions (central giro institutions and Landesbanken; Deutsche Girozentrale - Deutsche Kommunalbank). Traditionally these banks refinance themselves for the most part by saving deposits of private households. Long-term loans (to households, municipalities as well as to private non-bank firms) make up for more than 50 % of their balance sheet total. Whether and under what conditions savings banks may acquire nonbank firms depends from the laws of the respective federal state. Personal interlocks with client firms seem to be less frequent compared to the interlocks between commercial banks and firms. Savings banks are important as financiers for small and medium-sized firms and can, as sole financier, even play the role of a "house bank" of such a firm. - The regional "Landesbanken" are less restricted in their powers and activities than the local savings banks and may and do acquire participations even in large firms and provide for financings and financial services that exceed the resources or powers of a savings bank.

3. Cooperative banks (Kreditgenossenschaften)

Cooperative banks historically were and still are extremely important for the development of the "undergrowth" of our industry. If you compare our industry with a brushwood with some few big, many medium sized trees ("Mittelstand") as well as the underbrush (handicrafts, shopkeepers, small farms), then the role of a provider of start-up capital and finance to the "underbrush" can traditionally, especially on the country side, be ascribed to the cooperative banks. The credit business of these cooperations was formerly limited to their members; this restriction has been repealed. Because of the familiarity of a huge number of small scattered banks with the local conditions, characteristics and riskiness of their client firms these

banks have informational advantages.[4] Central functions and tasks that cannot be solved by a single bank are, comparable to the savings bank sector, taken on by central institutions (central cooperative banks; Deutsche Genossenschaftsbank).

Part II.
Corporate finance and banks

The German system of investment finance as weil as the corporate governance system is very often described as "bank-based" as opposed to market-oriented Systems like, for instance, those in the U.S. and the U.K. And this structure is said - interestingly often by observers from these countries - to lead to considerable benefits especially in two respects:

- availability of cheaper and longer-term bank (mainly loan) finance for firms;

- better corporate governance in terms of less agency Problems.

To start with, classifying existing financial Systems into broad categories such as bank-oriented and market-oriented[5] does not exhaust the Universe of possible Systems or dimensions along which Systems can be characterized, and it will be one task of the following considerations to check whether the German corporate finance and governance system fits into this scheme. The distinction between bank-oriented and market-oriented or market-based and credit-based Systems disregards the role of internal finance as well as alternative corporate governance Systems and control devices. Firms within a given financial system might, e.g., rely to a much greater extent on internal finance than on either bank loans or securities finance. In such a case it seems improper to describe this system as "bank-oriented" only because credit finance plays a comparatively more important role than securities finance. The same is true for the corporate governance aspect. Although such a dichotomy might be a helpful tool in understanding variations in corporate governance Systems, it excludes other devices of corporate control as well as Systems which do not or to a lesser extent do rely on either market instruments like, e.g., hostile takeovers, or on banks as institutional monitors.

In the following I start with a discussion of the corporate finance issue. To proof the idea that there are advantages because of a specific structure of bank-firm relationships we should first have a look at the underlying

theoretical arguments (1.) and then ask whether there is empirical evidence for the assumptions made and the alleged advantages (2.).

1. Theory

Usually these advantages are derived from one or the other kind of additional close links between an universal bank and a client firm or even a combination of such links. German banks are seen as being much more closely involved with the firms they supply funds to than banks in "market oriented" Systems are. As such links are considered: own equity investments in a borrowing firm; personal interlocks with a client firm; voting shares deposited with the bank at the shareholder meetings of firms; serving as exclusive provider of funds and other financial Services to a firm ("house bank").

a) Debt-equity finance

Universal banks may and do acquire equity participations in industrial firms.[6] There have been several propositions put forward in the literature concerning the benefits of a combination of debt and equity finance in one hand. For instance, financiers typically have less information about firms than the entrepreneurs or managers, and they are subject to various types of moral hazard after the conclusion of the credit contract. What does a combined debt-equity finance contribute to lessen these Problems, are there clear advantages compared to mere debt (credit) finance? I start with a discussion of the moral hazard Problems.

aa) Moral hazard

Financiers are subject to various types of moral hazard ex post: moral hazard concerning the riskiness of the borrowing firm's strategies, moral hazard concerning managerial effort, moral hazard by distributing assets of the borrowing firm to its shareholders irrespective of the position and interests of its creditors; and moral hazard concerning reported return realizations ex

post. These problems of moral hazard cause difficulties for the Provision of finance to industry[7].

As banks may, according to German banking law, acquire and hold equity participations in firms, they could, by providing debt as well as equity finance to a borrower at the same time, exclude or lessen these moral hazard Problems. Two propositions have been made in this respect: First, the position as an equity (stock-)holder could give the bank the means to control the borrower's or his management's behavior more effectively than as a mere creditor[8]. Second, to the extent to which a bank holds an equity participation and takes part in the possible outcome of an ex post riskier behavior of the borrowing firm (its shareholders or managers), the incentives for the other shareholders or managers to engage in riskier projects will fade[9]. These propositions should be discussed for each type of moral hazard separately.

a) Incentives for *riskier behavior* of the borrowing firm (its owners and managers, respectively) may be particularly strong in two cases:

The firm has a low own equity capital compared to its debt. In a firm with limited liability of its owners (corporation) losses will be borne increasingly by the firm's creditors the more its debt/equity ratio increases whereas gains from riskier projects will completely accrue to the owners ("heads I win, tails you loose").

The firm is in financial distress, and management has to fear to loose its job when the firm goes bankrupt.

These incentives could be lessened if a bank grants equity rather than debt finance or splits up its funds into a debt and an equity position ("strip finance") under the following conditions: The bank's equity stake is large enough to get better information about the projects and behavior of the firm than it has as a mere creditor, and it can, as an equity owner, influence the behavior and the projects of the firm (the other shareholders and managers) better than it could as a mere creditor. Or, the equity position and, by that, the bank's participation in the "upside potential" of new projects is large

enough so that the outcome of riskier projects has to be shared to a sufficient extent with the bank[10].

Whether a bank would get better information as a "strip financier" or shareholder than as a mere creditor with the same total amount of funds granted to the firm is doubtful as long as the firm is run by a separate management (even seats on supervisory boards seem not to provide for better information than a large creditor has[11]). But there may still be, at additional costs, better means for a shareholder than for a creditor to control and to avoid hazardous behavior of the firm, depending on the size of the equity stake and on the legal form of the firm (German corporate law grants, e.g., much more influence on management to shareholders of companies with limited liability than to those of stock corporations).

I omit possible new risks and disadvantages for a lender that are connected with an own equity position in the borrowing firm for the moment[12] and pass on to the other types of moral hazard first.

ß) As to *moral hazard conceming* the borrower's (or his management's) *effort* similar considerations apply: First, the equity stake has to be large enough to provide for the necessary means to control the borrowing firm and its management effectively. Second, if the owners of the firm have to share the outcome of increased effort with the bank as a shareholder the incentives to such increased effort will be diminished accordingly. Third, the disciplining functions of debt finance (the claim of the creditor to fixed payments and the threat of a call of the loan or even bankruptcy) fade to the extent to which equity instead of debt finance is Chosen.

γ) The *distribotion ofassets* to the shareholders leads to a higher gearing of the firm and, in a corporation with limited liability, to two further risks for its creditors: First, the owners of the firm get an increased incentive to riskier behavior. Second, the residual funds that are to be distributed to the creditors in the case of bankruptcy of the firm are diminished. An equity participation of a creditor may help if it is large enough to avoid distributions

irrespective of the interests of the creditors and thus smooth out the interests of shareholders and creditors that diverge especially in times of financial distress of the firm.

δ) *Moral hazard concerning reported return realiza tions* ma y make creditors believe that there is no reason for them to call the loan, adjust the conditions of the contract to a deteriorated Situation of the firm, by, for, instance, asking for more collateral, or even file for bankruptcy. Splitting up the funds that a bank is willing to give to a borrower into a debt and an equity part would only help if this strip finance would provide the financier with better information than a mere lender has which is doubtful.[13]

After all, it seems safe to say that there are tradeoffs and very restrictive conditions under which a combination of debt and equity finance might be a superior Solution for moral hazard problems than mere debt finance.
Furthermore, a financier who plans to choose "strip finance" rather than mere debt finance has to take additional risks into account: As the equity capital may not be reclaimed from the firm itself like a loan if the firm is in financial distress such a participation can only be sold on the market. That means that the debt part of the "strip finance" might also be "locked in" either because the financier does not want to give a negative signal to the market by calling the firm's credits or because he wants to avoid the respective firm to get still more into trouble before the participation is sold. There is still another risk. If the firm goes bankrupt, not only the equity stake of the bank but also the credit capital extended to the firm by the bank that is also a major shareholder[14] may well be subordinated to other debt, even if its loan was secured by collateral.
The empirical part will show whether there is evidence for a widespread use of strip finance rather than mere debt finance, or whether our doubts vis-à-vis the alleged advantages of this finance technique as a means to overcome moral hazard problems are confirmed.[15]

bb) Hidden information

Financiers are subject to moral hazard, and they typically have less information about firms than the entrepreneurs or managers.
Despite a careful evaluation of a loan application there remains a residual imperfect information of the bank about the riskiness of the loan. In such a setting, the lender is unable to raise the contract interest rate to fully offset the expected risk of the contract without adversely attracting risky projects ("adverse selection").[16] *Pozdena* has argued that "strip finance" permits the debt component to be priced at a smaller premium than the one required in a pure debt contract. This lower loan rate would help retard the tendency for the lender to attract projects of offsetting riskiness.[17] But why should a bank ask for a lower loan rate for the debt part of its strip finance? Only if additional assumptions are made. For instance, the willingness to acquire a participation in the firm could provide the bank with better information about the riskiness of the project because, say, the entrepreneur or the managers of the firm are more willing to disclose information to a future shareholder than to a creditor. That might happen under very special conditions (which depend on the size of the equity stake and the legal form of the firm), and we have again to take the aforementioned possible disadvantages of such a strip finance into consideration.

cc) Strip finance as a commitment device

Strip finance, a combination of debt and equity finance, could serve as a commitment device.[18] An equity participation of a bank could exclude competition by other offerors of financial Services (credit finance) either because the bank as a shareholder could threaten management of the firm credibly with a punishment if it switches to an other financier or because the competitors of the "house bank" of the firm would consider this "house bank" to have better information about the firm and, hence, be very cautious or even reluctant if asked to finance a certain project that the house bank does not finance. This mitigation of competition could lead to a commitment of the firm to its bank and, in turn, allow the bank to finance projects at comparatively lower costs because it can be sure that it will be compensated in later stages for the risks that it took initially. That could be

especially important in cases of venture finance or in rescue operations. - Here again special preconditions have to be fulfilled (is the equity part of the funds large enough, and does Company law give the financier effective means to bind the management?). Furthermore, there might be drawbacks connected with such a structure: Normally we think of competition as a mechanism of protection, so any lessening of competition from other financiers should expose the firm to the possibility of an abuse of power by the "strip financier". In the absence of effective competition from other financiers, why shouldn't the bank raise the interest rate it demands and thus exploit its position?[19]

b) **Banks and board membership**

Debt-equity or "strip finance" is only one of the specific arrangements that are widely believed to contribute to advantageous finance conditions for German firms. The widespread memberships of bankers on their clients' boards are another. These personal interlocks are said to provide the financier with better information and better means to control the behavior of the borrowing firm's management.[20]

aa) **Informational advantages**

According to German corporate law there is (in all stock corporations and all companies with limited liability to which the codetermination laws apply) a management board and a separate supervisory board. Management has to report to the supervisory board periodically; if a bank's representative holds the chair of the supervisory board there will be even a steady contact with the firm's management and a continuous flow of information to this representative. That could give the bank that is represented on the supervisory board better information about the plans and prospects of the firm, the riskiness of its projects and the abilities of its management. The bank could become an "inside" rather than an outside financier and be better able to assess risks and adjust the conditions of finance to the specific structure of the respective firm. - Whether there is evidence for this will be asked later.[21] Here it has only to be mentioned that this argument is not

without doubts. First we have to consider the completely different structure of the German two-tier board system compared to a U.S. or U.K. style one-board system. The flow of information to a separate so-called supervisory board might be much smaller than to the directors of a firm in a one board-system especially if the representatives of the employees sit on the board as is obligatory if the codetermination laws apply to the firm. Secondly, members of the supervisory board have to keep the information they get in that capacity confidential. Board members are normally well aware of this because the breach of this duty is a criminal offense. On the other hand, if we define "information" in a broader, more general sense, familiarity with the firm and its leading persons, then a board position of the financing bank may well have influence, may create or strengthen personal relationships with the owners or managers of the firm and improve the understanding of influential bank representatives for interior problems of the firm, the knowledge about the ability and skills of the management and hence help to assess risks and adjust the conditions of finance better.

bb) Influence on management's behavior

Information about somebody may as such influence that person's behavior if the person is aware of it, and may keep it away from risky and hazardous actions. Does a board membership give the representative of a bank and his bank, respectively, additional means if risky and hazardous behavior against the interests of the bank can be observed? The supervisory board could recall the incumbent management or - more practically - not prolong its contract after its expiration (mostly after a five-years term). Although this instrument is available only to the supervisory board as a whole (to its majority), not to single members, such single members clearly have a say in this depending on the size of the board and the position of the respective member as, for instance, a chairperson, the size of the equity stake of the bank and the importance of it as a creditor of the firm. Hence a personal interlock may indeed help to mitigate conflicts between the firm and its managers or owners on one side and its creditor on the other, and the advantages might exceed the costs of such a board representation. The empirical part will try to assess whether and to what extent this is in fact the case.

c) The "house bank" as soie financier

Until now two single techniques or arrangements, debt-equity combinations and personal interlocks, were described and analyzed with respect to our question separately. They can also be combined and will then reinforce each other. And they are significant indicators or elements of a specific structure that, at least historically was, typical for bank-firm relationships in Germany, the so-called "house banks" of firms. This role of a house bank has to be looked at more closely in the following.
Such a house bank relationship has some special traits:[22]

- It is a long-term relationship between a bank and a firm. This conveys thorough information about the firm to the bank.

- The "house bank" has the biggest share in the credit and the other financial business of the firm (if it is not the sole financier anyway).

- The "house bank" has a special responsibility for the firm in times of financial distress, especially for the rescue and reorganization of the firm.

- The special role as "house bank" of the firm is documented by the representation of the bank on the supervisory or advisory board (Aufsichtsrat, Beirat) of the firm.

The empirical part will show that such house bank relationships are fading and only of a limited relevance today. They can still be found between smaller firms and banks. Interestingly, the economics of such long-term and more or less exclusive relationships between banks and firms have been analyzed only recently. One could think of explanations such as scale economies in monitoring or the advantage that there is no necessity to reveal confidential information to more than one institution or even to the open capital market. *Colin Mayer* and *Klaus Fischer,* however, have stressed another point. In his article on "New Issues in Corporate Finance" *Colin Mayer* suggested that Japanese banks are more willing to engage in corporate rescues than financiers elsewhere because the bank - firm relation in Japan involves a mutual long-term commitment.[23] This explanation has

been analysed and developed further by *Klaus Fischer* who asks whether this notion of a long-term bank - firm relationship as a mutual commitment is the rationale that underlies and explains the Hausbanken-structure in Germany, too.[24]

Fischer starts with the Observation that a serious threat to long-term investment finance by a bank is due to competition from other financiers even after the conclusion of the contract when it is already clear that the new venture or the rescue Operation that has been financed was successful, but the returns have not yet been fully reaped. Competition among the financiers at this stage might drive the future profits which ought to serve partly as a compensation for the previous financier as a consideration for his "start up" support in the first phase to zero; i.e. all surplus from these later periods stay with the firm. Hence this outside competition has to be lessened, the borrowing firm has to commit itself to the financing bank if it is to get the necessary funds for a long-term investment with low returns in the beginning at all. According to *Fischer,* a house bank relationship in which a bank serves as the sole financier provides exactly for this lessening of competition and commitment of the firm to the bank. A house bank that finances a firm as sole financier in the first "thirst" period subsequently gains better information about the firm, the quality of its management, the riskiness of its projects etc. This informational advantage mitigates the competition from outside financiers in later periods as these other financiers are afraid of a "winner's curse". Hence the previous financier retains the contract for future periods and is able to appropriate some of the surplus of the project, and this supports the financier's initial willingness to supply funds to the firm, support a rescue Operation or provide startup capital to the firm.

First note that *Fischer* addresses only one threat to (long-term) credit finance. He does not deal explicitly with all moral hazard problems and informational asymmetries that were discussed earlier (on the other side, the instruments that were discussed above - debt-equity finance; personal interlocks - could also be explained from *Fischer's* perspective as a commitment device). Second, if this house bank structure brings about the advantages that *Fischer* describes, why didn't this structure emerge in other economies, in the market-oriented finance Systems? There could be regulatory or other impediments. But that does not explain why the house

bank structure is increasingly fading in Germany, too. As the empirical part will show, for all but the smallest companies, exclusive financing by a single bank is the exception rather than the rule.[25] We will have to get back to possible explanations for this empirically observable financing pattern of larger firms later.

2. *Evidence*

The following part will ask whether there is empirical evidence pro or contra the various hypotheses that were described and discussed above.

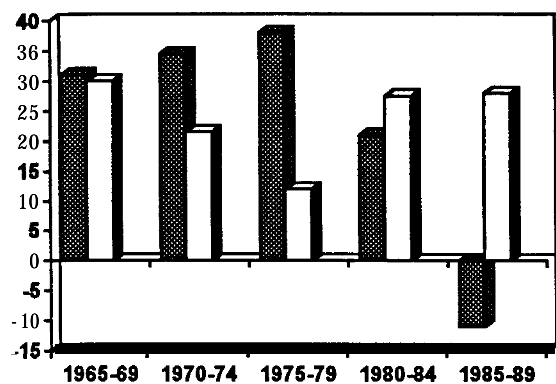
a) Debt-equity finance

Is there evidence for a widespread use of strip finance (debt-equity finance) rather than mere debt finance, and if so, is this finance technique used because of its alleged advantages (lessening of moral hazard; improvement of information; commitment of the borrowing firm to the creditor[26])?

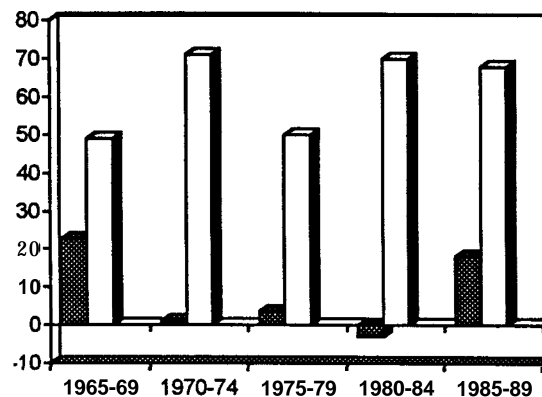
aa) Figure 1 displays the sources of net external funding of nonfinancial businesses for the U.S., U.K., Germany and Japan (flow of funds data). It shows the percentage of business financing that comes from domestic securities markets (Stocks and bonds) and from domestic banks[27]. The residual includes financing from all other sources.

Figure 1. Percent of Total (Net Extemal) Business Funds Raised through Securities and Bank Loans, 1965-89

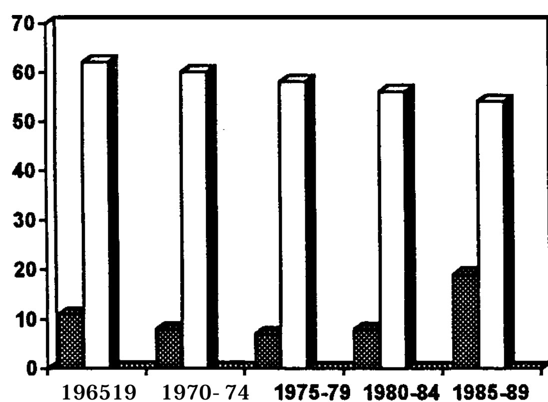
Percent



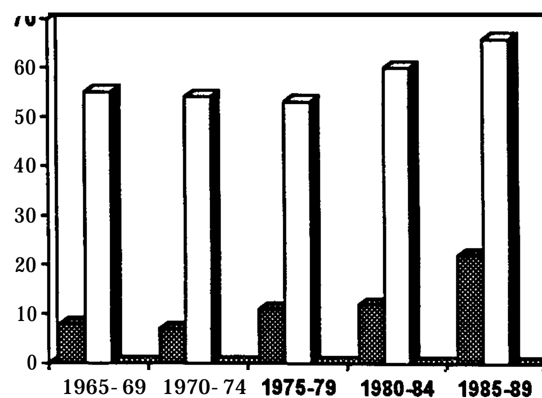
Percent



Percent



Percent



- Funds raised through securities
- Funds raised through bank loans

These data support the frequent characterization of the German system as an example of a bank-oriented system. If we look at external sources of finance only, banks still continue to provide about twice the funds that direct securities markets (stocks as well as bonds) provide.
However, things look different if we include internal sources of funds. Table II presents estimates of gross financing proportions (i.e. all sources of funds) for the period 1983-87 for the U.K., Japan and Germany.[28]

Table II: Gross Financing Proportions, 1983-87 in % of Total Sources

	U.K.	Japan	Germany
Retained earnings	66	53	72/65[1)]
Share issues	10	3	3
Direct investment	1	0	0
Total debt	22	44	22
- credit institutions	18	40	14
- securities	*4*	*5*	*2*
- trade credit	*0*	*4*	*0*
- other	*0*		*6*
Residual			3

Retentions were the most important source of funds in all countries. German firms did not raise a substantial amount of finance from securities markets. Although bank finance was the dominant source of external finance, it represents a surprisingly small Proportion of German corporate financing, especially when we compare it with the numbers for Japanese firms.

The numbers in Table II reveal already that there has, if any, only limited use been made of debt-equity finance during this period. This becomes still more evident when we look at the data and the extent to which finance by taking

on participations in firms was provided by banks. *Roggenbuck* has recently anaiyzed the participations of banks in firms (partnerships as well as corporations) with an own (stock) capital of DM 1 Mill. or more.[29] He counted only participations of 5 % or more; participations in bank-related firms (firms that own bank premisses etc.) were excluded. *Roggenbuck* found (for 1985) only 160 such participations. The respective firms belonged to the group of small and medium-sized enterprises (38 % of these firms had a capital of less than 10 Mio DM) as well as to the group of the largest firms (15 % of the respective firms had a capital of more than 100 Mio DM).[30] The participations of the banks ranked from 5 % up to 100 % in single cases.

Regrettably, *Roggenbucks* data do not tell us what his findings mean for the relative extent of equity participations of banks in all firms. A compilation of the Deutsche Bundesbank for 1989 shows that all banks together held 4,69 % of all shares issued by stock corporations (Aktiengesellschaften) and 7,8 % of all shares in companies with limited liability (Gesellschaften mit beschränkter Haftung).[31] Although these numbers might be somewhat too low as the participations of the bank-owned investment funds are excluded,[32] a clear picture emerges from these data with respect to our question: Equity finance plays a negligible role if compared to credit finance, and the amount of equity participations of all banks together in firms lies, although important in single cases, well below 10 % on average. There is, hence, no support from these data for a widespread use of debt-equity finance by German banks.

bb) One could argue that not only true participations but also quasi participations should be taken into consideration. As will be shown later, banks act to a considerable extent as proxy-holders of their clients, vote their clients' stock, and are rarely given any instructions how to vote.[33] Such "quasi-participations" provide banks with all instruments and means available to a real shareholder and should hence be added to their real equity positions. This position as a proxy-holder does play a role only in stock corporations (Aktiengesellschaften), mainly with scattered small shareholdings. Interestingly, however, especially in these firms with a high degree of "quasi participations" of banks, bank loans as a source of finance

play a minor role. Large corporations raise much less bank finance than the corporate sector as a whole.[34] That does not square well with the hypothesis that equity participations should lead to a higher degree of bank finance than without such an equity participation because of the alleged advantages of such a finance technique.

cc) If banks do not acquire and hold participations in the first line in order to profit from such participations in the way that was described above, what then are the reasons and motives for their acquisitions? *Roggenbuck* has analyzed the acquisitions of stakes in nonbank firms of 25 % or more by banks during the period from 1976 - 1989.[35] Of all (21) cases six can be assigned to the placement business (large German commercial banks may and do act as investment banks, take over and hold stock until it can be floated). In three cases the bank took over a participation in a borrowing firm that was in financial distress. These latter cases are certainly interesting from our perspective and deserve further research and attention.[36] In most cases, however, other reasons and motives prevailed. In about half of all cases the bank acquired a participation from the founding family or the sole proprietor who apparently could not find a buyer at the moment they would have liked to, and the bank apparently found it profitable either to act as an "interim holder" and look for a buyer on its own or even keep the participation in its portfolio in order to "deepen" already existing business relationships and/or simply hold them as a means to spread risks and have another profitable source of income.

Certainly such a participation and the influence that it gives to the shareholder is used by the respective bank to support its business relationship with the firm once this additional instrument is available to the bank. But it seems safe to say that participations in nonbank firms are normally not taken over in order to support the finance (credit) business with a borrowing firm from the beginning. Firms in financial distress might make an exception. Another interesting case in this respect seems to be the Provision of credit finance as well as equity finance (the latter provided by a bank subsidiary that acts as a venture finance Company - "Unternehmensbeteiligungsgesellschaft") to new firms.[37] On these latter cases we simply lack thorough studies.

b) Banks and board membership

Is there evidence for the hypothesis that bankers' representation on the boards of their client firms improve the bank's information, exclude or lessen risky or hazardous behavior from the borrowers' side, and that this leads to better (cheaper, easier available) credit finance for those firms? *Edwards* and *Fischer* have tested this hypothesis by comparing the extent of loan finance of corporations with a supervisory board with that of all firms. [38]
The obligatory supervisory board system in Germany applies only to special types of incorporated Company: the stock corporation (Aktiengesellschaft) and the Company with limited liability with more than 500 employees ("Gesellschaft mit beschränkter Haftung"). In all other cases (limited liability companies with less than 500 employees; partnerships) the two-tier-board system is not obligatory.
Edwards and *Fischer* examined the question whether stock corporations with an obligatory supervisory board (and, hence, very likely at least one banker on it[39]) use relatively more bank borrowing than other legal forms of enterprise in Germany. They found that especially this form of enterprise (which is the typical form for the largest firms in Germany) relied hardly at all on bank borrowing as a source of investment over the period 1971 - 1985, and instead were largely internally financed. Bank loans were more important as a source of finance for the producing enterprises sector as a whole than for stock corporations with a supervisory board,[40] from which it seems reasonable to deduce that enterprises in Germany without supervisory boards made more use of bank borrowing than did enterprises with supervisory boards over the period 1970 - 1985. -

However, this does not say much about whether or not bank representation on supervisory boards in Germany reduces problems of asymmetric information between borrowers and lenders. First note that although there are no supervisory boards in smaller firms, these smaller firms very often have so-called advisory boards (Beirat) with a representative of one or more banks on it (data on this are not available). Hence it is not clear to what extent large and small firms differ with respect to the representation of the borrowing bank(s) on their boards. Secondly, the fact that large firms rely more on inside rather than on bank finance need not contradict the view that bank representation on a firm's board reduces problems of asymmetric

information. Maybe these large firms have still better, more efficient possibilities to finance their investments (inside finance; easier access to immediate market finance) than by bank loans even if this bank finance to such a large firm is less fraught with informational problems because of a membership on the firm's board. Or maybe management in these large firms prefers other finance techniques than bank finance as far as possible because bank finance puts a tighter rein on management.[41]
Similarly, international comparisons that show that large German firms with banks' representatives on their boards rely less on credit finance than their foreign counterparts without such a representation on their boards like, e.g., in the U.K.,[42] do also not say much about our question as the managements of these foreign firms might have less chance to rely on internal finance than German large firms.
After all, our question has to be left open to further research.

c) "House banks"

Is there evidence for "house bank"-relationships between banks and firms in Germany with the special traits and consequences described above?[43] There have only few empirical studies been made. The most thorough one is that of ***Klaus Fischer*** (1990).[44] In its empirical part it bases on interviews and gets to the following results:

For all but the smallest companies, exclusive financing by a single bank ("house bank") is the exception rather than the rule. The large, publicly traded companies can avail themselves of organized markets for their securities and even give short-term credits to each other without the intermediation of a bank. They have a conscious policy of maintaining relations with 5-10 so-called principal or main banks and quite some other banks.[45] The market for credits especially to good borrowers is described as highly competitive.[46] The same applies to medium-sized firms with a turnover of about more than DM 500 Mio. In smaller medium-sized firms the large commercial banks tend to achieve the role as sole financier if the borrower is a "good risk". On the other hand, especially in such cases these firms themselves prefer relations with a handful of competing banks in order

not to endanger their independence. Apart from the large commercial banks, the other banking institutions act as sole financier or "house bank" to a much lesser extent except for very small firms.[47]
Furthermore, there is - according to *Fischer's* study - no evidence that banks have informational advantages that enable them to avoid bankruptcy risks,[48] and the "main bank" relation seems not to be considered as a binding commitment to support the respective firm in financial distress. As to the reorganization and restructuring of firms which are in financial distress or went bankrupt, evidence indicates wide variety between different (large and smaller) banks' behavior.[49]

What are the reasons for this increasing emancipation of firms from close banking relationhips, and, as mentioned above, the increasing reliance especially of large firms on inside finance, bank competition or direct market finance?
Hellwig has reported and offered some explanations for this development:[50]

The risk-averse intermediary may have a diversification incentive to share the risks of the firms it finances.

Reliance on outside finance decreases as more agency-tost - free inside finance is available.

Management in large firms may have a bias to excessive retentions.

This is not the place to further discuss this development and the reasons for it. The above remarks should, however, have shown that the description of the German corporate finance system as "bank oriented" as opposed to a market-oriented corporate finance system is one-sided as this distinction is based on two sources of finance only. Furthermore, some of the widespread assumptions about specific features of the German corporate finance system (the role of equity finance by banks; the role of bankers on firms' boards; the role of the Hausbanken) and their benefits for corporate finance seem doubtful partly because these features are, from an empirical point of view, not as important as assumed (debt-equity finance) or increasingly fading (housebank-relationships), partly because some of the underlying hypotheses concerning the benefits of this structure are hardly convincing theoretically.

Part III.
Banks and Corporate Governance in Large Firms

7. *In troduc tion*

a) Corporate finance, corporate governance and the banking system

The specific features of the German banking system and the bank-firm relationships concern corporate finance as well as corporate governance. In the previous part the question was whether and to what extent equity holdings of banks, their position as proxy-holders and their interlocking directorates with firms, instruments that are normally looked at and analyzed from the corporate governance perspective, do help corporate finance, too. As we turn now to the role of banks in corporate governance, we could similarly put the question the other way around and ask for the role of debt finance in corporate governance (scrutinizing of the borrowing firm before granting or extending a credit; monitoring during the credit relationship; pressure of the claim to fixed payments irrespective of the unsteady flow of returns to the borrowing firm; threat of bankruptcy).[51] These means and devices available to a bank as a creditor, however, are not a specific feature of corporate governance in German firms only and hence do not stand in the center of our interest in the following. Nevertheless we will have to consider to what extent the banks' role in corporate governance, especially when acting as proxy holders on behalf of their clients, will be reinforced or hampered by their other role as creditor(s) of the firm.

Like the corporate finance System, the German corporate governance system is also often described as "bank-oriented" as opposed to other, market-oriented Systems, namely the U.S. and the U.K. That is true in a limited sense only. Banks play a particular role in corporate governance only in "stock corporations" with small scattered shareholders. The following part will only deal with this comparably small number of firms. To be sure, banks may and do hold participations in firms with other legal forms (partnerships, companies with limited liability), too, as was mentioned already earlier. In such a case they will exercise their regular rights like any other shareholder. Another channel to influence managements of non-stock corporations may

emerge from advisory or supervisory board positions. Although we lack recent studies on this issue, it seems safe to say that this influence will be mostly restricted to an adivsing rather than a monitoring or controlling function. For the structure of the shareholdings and hence the composition and tasks of the supervisory or advisory board will normally not allow for an influence similar to that in a large stock corporation with scattered shareholders.

The notion of the German corporate governance system as 'bank-oriented' refers to still another point. A 'market for corporate control' in terms of public hostile takeover bids does not exist. But that does not mean that there are no hostile takeovers. The management of Hoesch AG, the shares of which were recently taken over by Krupp, would probably have liked to hinder this shift of control if there had been a chance to do so. Resistance to a hostile takeover is not always possible,[52] and will become particularly difficult for a management if it loses the support of one or even several depot banks (i.e., the banks that hold proxies and vote the shares on behalf of the shareholders). That means that especially the large depot banks play an important, if not decisive role on this 'market' for corporate control.

Part III[53] is organized as follows. The next sections provide the reader with the necessary information about the legal structure of the stock corporation (b, c). The following sections will then describe the various links between firms and banks and the instruments of control available to the latter in detail (2.-4., infra) and ask for their impact on the respective firms and their managements as well as for the possible advantages and drawbacks of this particular corporate governance structure (5., 6.). A final part will try to compare the monitoring potential of a system that relies on a "market for corporate control" with a bank- or institution-oriented corporate governance system (7.).

b) Legal forms of firms and distribution of ownership

In Germany firms can be organized and run either by a sole proprietor, a partnership[54] or by a corporation. The most important forms of corporations are the private company with limited liability[55] and the stock corporation.[56]

The following remarks will only deal with the publicly held stock corporations, the stock of which is either owned by scattered individuals or by institutions. While only focussing on these publicly owned corporations we have to keep in mind that although we are speaking of a small number of firms, they are also Germany's largest firms: In 1990 there were about 2 million firms in Germany; of these about 430,000 were private companies with limited liability and less than 2,700 were stock corporations.[57] Of the latter only 665 are quoted on a stock exchange,[58] and of these 665 about 80 are widely held and traded.[59] However, most of these corporations with widely distributed ownership are among the 100 largest firms in Germany[60].

c) The three "Organs" of the stock corporation

To understand corporate governance in these large stock corporations and the role of the banks in this respect, it is necessary to mention some special features of German corporate law.

First, the two-tier or *dual boards System,* which was established in 1870. It consists of a management board and a separate supervisory board. Management is appointed, mostly for five year terms, and is dismissed by the supervisory board.[61] The management runs the day-to-day business of the firm independently and can only be recalled for cause. Complete power rests with neither the management nor the supervisory board. A more detailled picture would show a complex structure of balance of powers between these two organs. The powers of the shareholders' meetings are restrained to basic decisions such as changes of the Statutes, approval of the annual Statements of accounts, distribution of (half of) the annual balance-sheet profits, election of (half the) members of the supervisory board, consent to some specific structural changes as mergers, issuance of new stock and the like.

Second, the *codetermination system*[62] involves members of the supervisory board that are neither elected nor appointed by the shareholders. In firms with more than 2,000 employees, half of the members of the supervisory board are elected by the shareholders and the other half by the employees (blue and white collar as well as lower-ranking management) and labor

Unions. Hence, the members of the supervisory board and the management board are considered to be agents of all stakeholders in the firm rather than of the shareholders only.[63]

Third, the ***voting process.*** There is no proxy system with proxies for the management. In the shareholder meetings shares are either voted by the shareholders themselves or - in the case of smaller shareholdings - by institutions, mainly banks, which act as custodians for the shares. This voting power of a few banks, sometimes not more than three or four, each with a large block of votes, gets their representatives on the supervisory boards (alongside the representatives of the employees and trade Unions). This will be described in more detail in the following section.

2. *Bank Control of Proxies*

a) The proxy system

The typical large German firm with dispersed shareholders finds its shares in voting blocks which are voted by a few banks and which, if aggregated, comprise up to 30 % or more of all votes.[64] This voting power, which helps place representatives of the banks on the supervisory board,[65] comes from different sources: from directly owned stock,[66] from investment companies controlled by banks,[67] or from voting the shares held by banks as custodians for their clients.

Since the Separation of commercial banks and securities firms is unknown in German banking law, banks are allowed to trade stock. They may also offer their customers custodial or depository Services for those shares, administer them (e.g., collect dividends), and vote them at shareholder meetings. Shares of German publicly-held corporations are predominantly bearer shares; smaller shares are mostly part of a single global document. A shareholder who wants to hold actual stock certificates will have to pay additionally for them. This drives stock into institutions.
Banks need a special written power of authority to vote the deposited shares. There is no ceiling or cap limiting the exercise of the voting rights by banks to a certain percentage of the firm's stock capital. The power of

authority for the bank, or proxy, cannot be given for more than fifteen months, and it is revocable at any time. Before a shareholder meeting, banks have to recommend to their customers how to vote, and must ask for special instructions. As a practical matter, special instructions are extremely rare.[68] If the shareholder does not give the bank special instructions, the bank is to vote according to its recommendations. Generally, banks can vote their customers' stock on any matter. In its own shareholder meeting,[69] however, a bank may only vote stock if it receives explicit instructions from its shareholders.[70]

Banks do not charge extra fees for voting their clients' stock. There is only a basic fee for their depot (custodial) Service.

b) Statistics

There are several older empirical studies on banks as proxy holders.[71] The most recent ones were published by *Gottschalk*[72] and by *Böhm*.[73] *Gottschalk* selected those companies from the list of the 100 largest firms in 1984 where more than 50 % of their stock was either widely held or owned by banks. These 32 companies, with a (nominal) equity capital of DM 29.5 billion, represented about a quarter of the nominal capital of all German stock corporations. Among them were seven of the ten largest[74] firms of the Federal Republic. *Böhm* extends this study on a smaller sample of firms.[75]

Table III

Voting blocks of the banks at the shareholder meetings of the 33 widely held stock corporations among the 100 largest firms in 1986'

Rank of Company in 1984		% of shares present at the meeting	% of shares voted by Deutsche Bank	Dresdner Bank	Commerz-bank	All 3 big banks	All banks
1	Siemens	60.64	17.84	10,74	4.14	32.52	79,83
2	Daimler Benz	81,02	41,80	18.78	1.07	61.66	69,34
	Mercedes-Holding	67,20	11,85	13.66	12.24	37.75	57,35
3	Volkswagen	50.13	2.94	3,70	1.33	7,98	19.53
5	Bayer	53,18	30,82	16,91	6,77	54,50	95,78
6	BASF	55.40	28.07	17,43	6,18	51.68	96.64
7	Hoechst	57.73	14,97	16.32	31,60	63.48	38.34
9	VEBA	50.24	19.99	23.08	5.85	47.92	98.18
11	Thyssen	68.48	9.24	11,45	11,93	32,62	53.11
12	Deutsche Bank	55.10	47.17	9,15	4.04	60,36	37.23
13	Mannesmann	50.63	20.49	20.33	9.71	50.53	35.40
18	M.A.N. (GHH)	64.10	6.97	9.48	13,72	30,17	52.85
21	Dresdner Bank	56,79	13.39	47,08	3,57	64.04	98,16
27	Allianz-Holding	66,20	9.91	11.14	2.35	23,41	60,08
28	Karstadt	77,60	37.03	8.81	33.02	78.86	87.27
29	Hoesch	45.39	15,31	15,63	16,73	47,67	92,39
34	Commerzbank	50,50	16.30	9.92	34,58	60,81	96,77
35	Kaufhof	66.70	6,29	13,33	37.18	56.80	98.45
36	Klöckner-Werke	69,13	17.30	3.78	3,55	24.63	53,00
37	KHD	72.40	44,22	3.82	1,50	49.54	85.29
41	Metallg'schaft	90.55	16,42	48.85	0,35	65,62	75,95
44	Preussag	69,58	11.15	5,60	2.53	19.34	99.68
51	Degussa	70.94	6.86	33,03	1,89	41,79	67,09
52	Bayr.Vereinsbank	62.40	11.42	2.71	3.59	17.72	68.69
56	Continental	35.29	22.77	9.99	6.04	38.81	95.55
57	Bayr. Hypobank	67.90	5,86	7.05	1,20	14,11	92.09
59	Deutsche Babcock	67.13	7,58	9,67	5,29	22.54	97.01
67	Schering	46.60	23,86	17.46	10.17	51,50	99.08
68	Linde	52.99	22.76	15,73	21,36	59.87	90.37
73	Ph. Holzmann	82,18	55.42	0,91	6,49	62.82	74,81
94	Strabag	83.02	6,80	19.15	1.37	27,32	95.24
96	Bergmann	99.12	36,89			36.89	62.15
38	Hapag-Lloyd	84,50	48.15	47.82	0.33	96.36	99.50
on average		64,49	21,09	15,30	9.05	45.44	82.67

*Source: Gottschalk (1988) p. 298. "Widely held" are corporations whose stock is either held by shareholders with a stake not larger than 5 % or held by banks. - The numbers for Siemens, Veba and Continental refer to the 1987 meeting. The list adds up the shares of banks held by them on own aocount, their proxy holdings and the shares held by investment companies which are subsidiaries of the respective banks.

Unlike *Böhm, Gottschalk's* study adds up the voting power of the banks' own shares, their depot shares, and shares held by investment companies, which are bank subsidiaries. His study shows the following results:
on average, banks represented more than four-fifths (82.67 %) of all votes present in the meetings. With one exception, they represented at least a majority (more than 50 %) of those votes present. Consequently, they were able to elect the members of the supervisory board elected by the shareholders (as opposed to those elected by the employees). Changes of the Statutes of the corporation could not be effected against their votes. In 22 or two-thirds of the firms, the banks voted more than three-fourths of the stock present and thereby could change the Statutes. No other shareholder could block these decisions. Note that most of these corporations (by the votes of these very banks) have adopted provisions in their Statutes to the effect that no one shareholder may vote more than (typically) 5 % of all shares of the company.[76] This rule, however, does not apply to banks in their capacity as proxy holders voting for different clients.

The breakdown in *Gottschalk's* study shows that the voting rights are highly concentrated in the three largest private banks (Deutsche Bank, Dresdner Bank, and Commerzbank). Together these three banks voted on average approximately 45 % of the stock that was represented at the general meetings of the 32 companies.[77] In almost half of these cases (15 firms), they together held the majority; in a further one-third (10 firms) they had a blocking minority. In individual cases, one or another of the big banks dominates; in most cases the votes are distributed roughly equally among them, or the other two banks together have about the same number of votes as their competitor.

The extent of coordinated behaviour of these banks in the voting process[78] has not yet been empirically determined. A government commission in its report of 1978, noted that "the banks mostly vote in the same sense".[79]

3. Banks as Shareholders

a) Legal framework

A second source of influence of banks in corporate affairs is their position as stockholders for their own account. According to German banking law, credit institutions may acquire and hold stock in nonbank firms for their own account; there are no rules which forbid or limit such holdings to a certain percentage of the firm's capital. There are only caps or limits with respect to the bank's capital to protect the depositors and creditors of the bank: a single participation in one firm may not exceed 15 %, nor all holdings together 60 % of the capital of the bank.[80]

b) Data

The data on the participations of German banks in all firms irrespective of their legal form have already been reported above.[81] Here we have to break these numbers down into holdings in (large) stock corporations and other firms.

By the end of 1989 German credit institutions directly and through subsidiaries held 4.69 % of all shares of domestic stock corporations[82] (this number includes subsidiaries of banks, such as corporations that own bank premises, etc.). For the issue of "banks and corporate control" this number alone is not very informative. It does not tell us to what extent and in which banks these holdings are concentrated; in how many cases these holdings are mere portfoiio investments rather than controlling blocks of shares; whether they are acquired only for short term, for placement or trading purposes, or as a long-term investment; or what the structure of the remaining shares is (i.e., whether they are widely dispersed or concentrated).

In his recent study *Böhm* analysed the shareholdings of banks in the 100 largest industrial firms (measured by turnover).[83] In 1986 *12* credit institutions held participations in 22 of these firms. The list shows that the holdings on own account have little relation to the blocks of shares voted by

banks in the name of their clients. Second, the size of the holdings is not distributed equally; they rank from about 5 % (holdings of all banks in one firm) up to more than 50 % (holding of a single bank in one firm). Third, the holdings are rather stable over time. This impression is confirmed when we compare recent with older data.[84]

Table IV
(Source: Böhm [1992] p. 225, 226)
Stockholdings of banks
in the 100 largest industrial firms in 1986
(% of nominal capital)

Nr.	Rank (size of turnover)	Company	Nominal capital Mill.DM)	Deutsche Bank	Dresdner Bank	Commerz-bank	Other banks	All banks together
1	1	Daimler Benz AG	2.116	28,5	1,6	1,6	3,2	34,9
2	8	Thyssen AG	1.565			> 5		> 5
3	12	Klöckner Werke AG	469,3	7,2	3,2	3,2	16,4	30
4	14	BMW AG	750		5-10			5-10
5	19	Metall-ges. AG	280	11,25	16,5		0,56	28,3
6	21	MAN AG	674,5		>	8,25		> 8,25
7	26	AEG AG	931,2	16	0,9	0,9	1,8	19,6
8	27	Degussa AG	284		>10			>10
9	32	Preussag AG	401,6				43	43
10	37	Ph. Holz-mann AG	90	35		7,55		42,55
11	41	VEWAG	1.000	6,3			10,46	16,76
12	43	MBB GmbH	600		5-10	> 0,3	5,0	10-15
13	46	Hochtief AG	200			>16,25	>25	>41,25
14	47	Dt. Babcock	250				> 5	> 5
15	49	Conti-nental AG	312,1	>10				>10
16	54	AGIV	80				44	44
17	58	Linde AG	237,7			>10		>10
18	80	Strabag AG	55,1				>50	>50
19	81	PWA AG	200				44	44
20	83	Bilf. u. Berger AG	70		>25			>25
21	91	Fichtel u. Sachs	128			35		35
22	99	Dyckerhoff u. Widmann AG	57	6,72		1,45	13	21,17

4. In terlocking direc tora tes

a) Regulation

Influence on management, its decisions, its appointment and dismissal is not exercised directly by the shareholders but by the supervisory board. Therefore, seats on the supervisory board are crucial for every shareholder or institution that wants to have a say in corporate governance, obtain relevant information, etc. Banks influence or strengthen their influence on firms by appointing members to the supervisory board of the companies. One can find bank managers and other professionals on these boards who are appointed to multiple boards with the votes of the same institution, but such "informal" relationships between a bank and these professional supervisory board members are difficult to identify; however, interlocks with firms by board members of the bank must be disclosed.[85]

Members of the managing board or the supervisory board of a bank can be members of the supervisory board of a firm, be it as a consequence of the equity participation of the bank, its position as holders of proxies, or as a consequence of its business relationship with the firm, especially a long-term credit relationship. That does not mean that management does not also try to influence the selection of its Supervisors to a certain extent. As mentioned earlier, the members of the supervisory board are - except of those elected by the employees - elected by the shareholders. A single person may not be a member of more than ten boards at the same time. This rule, however, does not restrain the institution which he or she represents. There is no rule in German law that prohibits Service on boards of competing firms. Direct Cross-interlocks (the member of the supervisory board of Company A sitting on the management board of Company B and vice versa) are forbidden.[86]

As mentioned above, the supervisory board appoints the members of the managing board and may dismiss them though only for cause. It is responsible for monitoring the management, although practically it acts as an advisory committee rather than as a monitoring panel[87] except in times of financial distress of the firm. To accomplish its duties, the board has the right to receive comprehensive information. The management must report to

it periodically on all important questions, and the supervisory board may always ask the management for reports. The supervisory board reviews the annual reports and balance sheets of the firm. The board may require management to obtain its prior approval before entering into certain important transactions, such as obtaining (or granting) loans above a specific amount. Board members must treat Company information confidentially.

The chair of the supervisory board has a particularly influential Position. He prepares the meetings of the board - which are less frequent than, for example, board meetings in the U.S.[88] - proposes the agenda, and stays in steady contact with the management. The management has to brief the chair immediately on all important occasions. If there is a stalemate in a vote on a board under a codetermination regime (a rare event), the chairman breaks the tie.

b) Statistics

Comprehensive data on personal links between firms and banks in Germany do not exist. Various studies have been done at different times in different sectors.[89]

Let us have another look at the list of the 100 largest firms which has been provided by *Böhm*.[90] 92 of these firms had a supervisory board (numbers as of 1986); banks were represented on 75 (= 81 %) of these boards. They held more than 10 % of all seats and more than 20 % of the seats of the shareholders' side of the board. On average they had more than 2 representatives on each board. The three Großbanken held more than 61 % of all banks' seats; the Deutsche Bank alone held 54 seats in 44 of these largest firms. The key position as president of the supervisory board was held by banks' representatives in 1986 in 20 of the 92 firms.

Although these numbers, which refer only to direct personal links between a bank and the large firms, do not give us the whole picture of the potential influence which can be exerted by banks through the supervisory boards, it is safe to say that there is a significant potential for banks to get information, give advice and monitor management in most of these large

firms. But do banks really exert their influence and, if so, to what extent and with what results? If these questions cannot be answered satisfactorily, can we at least say something about the incentives and disincentives to monitor or behave in a way which might be advantageous for the bank, but disadvantageous for the other shareholders, among them the bank's clients?

5. *Control, incentives and disincentives to monitor*

a) In which way control?

"Control" can mean various grades on a scale that starts with the right of a shareholder or a bank to information, which in turn causes management to refrain from certain actions, and ends with the power to recall the incumbent management. In the following we consider (aa) control by means of better access to information; (bb) influence by giving advice to management on an ongoing basis; (cc) influence by appointing the members of the management board; and (dd) interim and ex post monitoring.

aa) *Information* about somebody may influence that person's behaviour if the person is aware of it. As mentioned above, the management board must report to the supervisory board on a continuing basis. Hence information about the firm and its management, so far as it is given to the supervisory board at all, is almost always immediately available to at least one bank on the supervisory board. Thus, information about the plans and the quality of the firm's management can be disclosed to these institutions without the need to make this information public" - information which the banks perhaps would not get otherwise.

However, it is doubtful whether this argument is valid. Remember the rather infrequent meetings of the supervisory board.[92] A poll of banks done by *Fischer* shows that a bank does not expect to get any better or more thorough information from its representatives on the board than it already has as the firm's creditor.[93] In addition, members of the supervisory board must keep confidential the information they get in that capacity.[94] Board members are normally well aware of this because the breach of this duty is a criminal offence.[95]

In all, it does not seem very likely that the information which a bank gets from its position on the supervisory board puts a tighter rein on management than would be the case without board membership.

bb) Bank representatives on supervisory boards have specialized knowledge, particularly in the field of finance. Very often they have an office back in their bank with special facilities, such as the help of an assistant, to support them in their work as a board member. The large banks have departments specialized in corporate finance, analyzing the financial markets as well as the financial needs of their client firms. This information, too, is available to the representatives of these banks. Thus, these representatives can provide the respective firms *with specialized advice, financial knowledge and Information.* In addition, banks should be able to, by exercise of their stock voting rights, appoint other professionals to the supervisory board which in turn can provide management with information and experience in other fields.[96] A poll done by *Bleicher* shows that nine of ten board members in his sample believe that the actual influence of their advice on management is "strong."[97] This belief, of course, does not mean that this is in fact the case, especially given the rather infrequent Sessions of the supervisory board, although there is some evidence that there are informal contacts between the board and management between the sessions.[98] Certainly one also must make a distinction between the chairman of the supervisory board and the members of certain subcommittees on the one hand, and the "regular" members on the other.

cc) Where advice cannot be given because of institutional impediments (infrequent Sessions, for instance), and where the supervisory board cannot monitor the management (see subsection (dd), below), the more important is the question of whether the supervisory board is capable of *sorting out managers from the beginning* who appear capable of doing a good job - because of the pattern of their behavior in the past, their career and previous success - even if their efforts cannot be observed on an ongoing basis. This seems, indeed, to be the most important task of the supervisory board, and banks seem to play some role in this respect.

It has already been mentioned that the members of the management board are appointed by the supervisory board and that - in large German corporations - one half of the members of the supervisory board is elected by the shareholders. That means that in our sample[99] all banks together determine who sits on the shareholders' side of the supervisory board, even if there are no personal interlocks. Furthermore, if there is an open conflict between shareholders' and employees' representatives on the board, the shareholders could push their management candidate through, because of the tie-braking vote of the chairperson.[100] That means that banks have a decisive influence on who gets into the management boardroom even though the members of the supervisory board are legally independent and may - should a conflict arise - act independently. To the extent one bank dominates the shareholders' meeting, is represented on the nominating committee of the supetvisory board or holds the position of chairperson, its influence will be greater accordingly.[101]

In their roles as creditors, shareholders, proxyholders and their multiple representation on many supervisory boards, banks should know the market for managers quite well. Nevertheless, bankers' influence on the appointment of managers could be detrimental if only one institution, with perhaps doubtful knowledge about the firm's particular sector, had to decide. But that seems not to be the case. If we keep in mind that the three big banks often have similar voting holdings or that two of them can outweigh the other, that the members of the supervisory board are not bound to follow the instructions of the shareholders, and that the shareholders' representatives would think long and hard before they pushed a candidate through against the vote of the employees, then it becomes clear that a candidate for the management board has to pass several tests of qualification and approval and is not simply appointed by one dominating institution. In this context it would also be interesting to know the extent to which managers are selected from within the firm as compared to those who come from the outside; that could also serve as a measure of the relative influence of the supervisory board as compared to that of the incumbent management on the nomination process for new top managers. Here we lack - to my knowledge - empirical studies.

dd) With regard to monitoring management, it is useful to follow Professor *Aoki's* differentiation[102] between ex ante, interim and ex post monitoring. *Ex ante monitoring* refers to the nominating process which has already been treated . *Interim monitoring* can occur especially in cases where the management must ask the supervisory board for its consent, like, for instance, if the management plans to shut down a plant, enter into a loan agreement and so forth. [103] Another case where the supervisory board is likely to interfere is when the firm is in financial distress. Apart from these cases, "interim monitoring" activities seem to be limited.' [04]

But the supervisory board may be able to measure the Performance of the management by its results at the end of certain periods (i). If so, there may be incentive for management to perform well even if it is not monitored continuously, if management can be recalled in the case of disappointing results (ii). At first sight, ex *post monitoring* in this sense does not seem to be directly related to the role that banks in particular have in corporate governance, and could theoretically occur without them. There is, however, a link between the ex post monitoring role of the supervisory board and the existence of depot institutions. It becomes evident when one considers the difference between a board system with outside directors on the board who are there because of the influence of the managing directors, the chairman or the CEO on one side and a two-tier system on the other where you have "outside" supervisory board members who are appointed by large influential institutions in the shareholder meetings rather than by the incumbent management. The readiness of the supervisory board members to act and, if necessary, even to dismiss or not to prolong the contracts of the members of the management board should be stronger because of the independence guaranteed through the existence and role of influential institutions in the shareholder meetings.

(i) How does the supervisory board measure the Performance of the incumbent management? According to German law management must prepare and publish the firm's balance sheet and profit and loss Statement annually. Both are reviewed by independent public accountants who are responsible to the supervisory board and report to it. There are additional obligatory interim reports that are provided to the supervisory board only.

The supervisory board can then put further questions to the management, compare the results of the firm with past results as well as with those of the firm's competitors (to the extent that such information can be obtained) and thus get at least a partial picture of the Performance or mistakes of the incumbent management as a whole and perhaps also of individual members of the management board.

The Observation that this internal monitoring system relies very much on comparisons with previous results, plans and the results of the industry competitors hints at a limitation of such an internal monitoring system which will be examined later, in the context of and the comparison with, a market-oriented corporate governance System. A potential outside bidder may have information about, say, a new technology which the board of a specific firm does not have. Is "outside" governance by (hostile) takeovers which forces a firm to react to technological changes before the competitive process on the product markets will do so a necessary Supplement to an internal monitoring system which fails in such cases?[105]

(ii) Can boards react, and do they really react, if they observe bad Performance? If so, this can be anticipated by management and give it an incentive to try harder.

A member of the management board can be recalled only for cause before the expiration date of his or her term.[106] For this reason, as well as because of the attendant bad Publicity, such recalls occur only in cases of criminal offences, etc.

Practically, there is the more subtle threat of not renewing the contract after its expiration (a manager's term may not last longer than five years; at that point, the supervisory board must explicitly decide whether or not to renew it).[107] *Poensgen* and *Lukas* have published an interesting empirical study in which they show that there is significant involuntary "fluctuation" of management board members not only in cases of very serious problems or financial distress of the firm,[108] but also in "lighter" cases in which the supervisory board was not content with the Performance of individual managers or with the management board as a whole.[109] To be sure, the fact that there is significant involuntary fluctuation does not by itself say

anything about the monitoring "performance" of the supervisory boards. Did they react too late, did they dismiss the right people, on what signals did they react, and are there certain directions in which their incentives might drive management? *Kaplan* recently tested for differences in the management board turnover-Performance relations in firms controlled by large shareholders and firms whose voting rights are controlled primarily by banks. He did not find any systematic difference.[110] This issue certainly deserves further research.

To get closer to an answer to this question we also need to take the incentives and disincentives for institutions like banks for corporate control into consideration. The following sections try to address this.

b) Incentives for control

Why do banks get involved in corporate governance, act as proxy holders and hold positions on supervisory boards?

aa) Banks are compensated through *fees for their custodial Services.* But that alone does not explain why banks vote their own and their clients' stock, appoint their managers to the supervisory boards of other firms, and spend money to support their monitoring work. Banks could (as owners of stock) free-ride, and their customers could redeposit their stock with institutions that promised no monitoring but also no expenses.
As to the latter, such Services are not offered in the market. Banks could easily drive such competing institutions out of the market by cross-subsidizing their depot business. Further, investment companies that are subsidiaries of banks will not try to dilute the position of their parent banks.

bb) There may be other incentives or advantages that accrue to banks from their governance activities. First, they can try to *protect their own equity Investment.* As our overview has shown, banks hold, besides their position as proxy holders of their clients, equity stakes that rank from stakes as small as 1 % of a firm's stock up to more than 50 %.[111] The right to

vote their clients' stock (at low additional costs) gives banks leverage to protect or strengthen their own investment without making capital infusion. For instance, if a bank holds an equity position of 12 % of a firm's stock and commands another 15 % through its clients' deposited shares, it has a blocking position against the issuance of new stock and the elimination of shareholders' preemptive rights[112] that it would not have as a 12 % owner alone. Of course, this incentive has to be ruled out in all cases in which banks have proxy voting power without holdings of their own,[113] and for these cases we have to look for other incentives for banks to act in shareholders interests.

cc) Banks could try to *protect their other (credit) investment in the firm.*

α) Creditors face the problem of "asymmetric information", both before the conclusion of a loan contract and thereafter. It is often argued that an equity stake of a bank in the borrowing firm will improve the information for the bank, and reduce the problem of asymmetric information.'[14] That is doubtful. As already mentioned, a shareholder will typically not receive earlier or better information than would a creditor bank (although, to be sure, a small creditor and a majority shareholder with immediate access to the management should not be compared). Even if the bank is represented on the firm's board, this will normally not provide the bank with better or earlier information than it already has as creditor.[115]

ß) If these positions do not provide the bank with better information, they may nonetheless help to exclude or minimize risks for the bank during the course of a credit relationship and thus lower the agency costs associated with debt.

There is no doubt that a bank can improve its position as creditor in certain aspects if it is equity owner or votes stock of the firm for its clients at the same time. A creditor commanding 51 % of the votes in the shareholders' meeting of this borrower can choose who manages the firm. Perhaps the creditor is not capable of electing the best managers, but at least they will

choose people who implicitly promise not to harm the interests of the creditor by engaging in risky projects, distribution of assets to shareholders, etc., without the bank's approval. As the threshold at which the bank's own equity investment is able to command a majority will be normally too high, the addition of the depot shares of the bank's clients seems to be a perfect arrangement to get the necessary leverage on the management to protect the bank's own (equity as well as) credit investment. Certainly, this power usually has to be shared with other banks, but as creditors of the firm they have, at least to a large extent, parallel interests with regard to the management.

If this is so, we can expect that credit finance plays a more important role for these firms (in terms of availability and costs of credit finance as well as higher leverage) than it does for firms in an environment in which banks do not have a comparable Position. However, as shown above, large corporations raise significantly less bank finance than the German corporate sector as a whole,[116] and Mayer and *Alexander* have shown that stock corporations in Germany use less bank loan finance than do comparable large U.K. public limited companies where banks have neither proxy voting power nor board seats.[117] Although these findings do not rule out completely that banks would take advantage of the means that Company and banking law grants them to protect their investments if necessary, these results apparantly prove that these regulatory advantages do not lead to higher bank finance of these firms from the beginning. The possible explanations for this increasing emancipation especially of our large firms from close bank relationships have been mentioned above already.[118]

dd) Another incentive for a bank to take on the costs of voting stock on behalf of small shareholders and to send representatives on the boards of firms could be to at least try to Capture *all or a part of the firm's financial business.* If banks do use their position in that way they seem not to be very successful: recall the comparably low extent of bank finance, and remember *Fischer's* findings about large firms and their bank relationships.[119] However, *Fischer's* study does not analyze the question whether there are syndicates rather than exclusive business relationships with a single bank, as has always been contended in the literature, especially for the fee-based

business like underwriting,[120] and whether these syndicates reflect the shares of their members in the shareholders' meeting. Normally, a management board will think long and hard before it chooses to give a considerable part of its financial business, such as raising capital through issuance of bonds or shares, to the competitors of those banks represented in its shareholders' meeting if the latter offer the same services on roughly the same conditions.

ee) To conclude, although there may be - apart from reputational reasons - no clear incentives discernible for banks to act in their clients' interests as their proxy holders and representatives, it is, on the other hand, not obvious that these banks follow their incentives to protect or promote their other finance business by means of their position as depot institutions.

c) Disincentives

Are there disincentives to banks in engaging in corporate control activities?

aa) A bank which is an institutional shareholder and offers other (financial) services at the same time could be eager *to get into or keep up a business relationship* and therefore refrain from being a nuisance to management at least as long as things run comparably well.[121] This depends on questions that differ in each individual case: what position do the offering banks and other banks have regarding management and can management independently decide to prefer a competitor or an "outside" bank?

bb) Another disincentive could come from *implicit management coalitions*. The large banks themselves are generally corporations with widely distributed ownership.[122] That could lead to the same "sympathetic" understanding of how corporate governance should function, or even to certain "arrangements". The most simple way would be to have cross-interlocks (manager A sits on the supervisory board of company B and vice

versa). That, however, is forbidden.[123] In the past, banks have helped managements of other large firms, whose stock they vote, to protect their own and the other managers' interests against takeovers, by changing the statutes of the respective corporations.[124] Again, this may have been done to protect the banks' position as proxy holders and thereby the banks' own equity investments, or to protect or promote such banks' business relationships rather than to do the management of these firms a favour.

A last remark on disincentives to monitor should be made with respect to the banks themselves. As our statistics prove, managements of these banks can either support or punish each other to a certain extent because they hold and vote roughly the similar amounts of proxies for voting shares in the other banks.[125] Hence there seems to be a strong disincentive at work in monitoring and controlling the other banks' managements.

6. Drawbacks

As we analyze institutions which represent small investors in shareholder meetings and on boards and act as corporate monitors in the shareholders' place, we should ask three questions: What are their incentives; are there conflicts of interests or other drawbacks, and how, in turn, are these institutions monitored themselves? So far I have only tried to describe the role of banks in corporate governance, their instruments, incentives, and disincentives. This may be accepted as a substitute for the more precise measurements of their performance which our economists still owe us. The following part will deal briefly with the question of whether there are drawbacks connected with this governance system (other than those already mentioned as possible disincentives). "Drawbacks" means disadvantages for the shareholders as well as for the respective firms. They may result from conflicts of interests on the part of the depot banks. Or there may be disadvantages for the shareholders that are clients of the depot banks if these institutions, which are thought to control management on behalf of their clients, remain uncontrolled themselves.

a) Financial dependence of the firm?

As was shown in part II above, there are no "exclusive" bank relationships between large firms and one single banking institution that would be able to bind the respective firm to itself by means of its stock and proxy voting power and, by that, could "exploit" the firm. As there are several large banks represented in the general meetings, the question rather is whether these banks share at least a part of the respective firm's business. Such an oligopolistic behaviour is often contended in the literature for the fee-based underwriting and floating business.[126] As to the lending business, "exploitation" through the imposition of interest rates above the market price seems highly unlikely.[127]

b) Maximization of profits or growth?

Another charge in this context is that institutional proxy holders who are also creditors *do not support* a profitable, innovative (and - perhaps - more risky) policy aimed at *maximizing shareholder value*. Or, to put it differently, banks may influence investment decisions of the firm to protect an already existing credit relationship, and they may prefer projects which need (higher) external (credit) finance rather than preferring projects with a comparatively higher net present value for the firm (rather than the banks) and which are of greater benefit for the shareholders.[128] Banks may indeed have this preference if they are not shareholders themselves. And if the assertions of the managerialists are correct that corporate managers do not pursue profit maximization, but rather size or growth maximization,[129] then there seems to be an implicit agreement between managers and depot banks on a mutually favourable pattern at the expense of the shareholders.[130] On the other hand, debt is always looked at as a device to discipline management.[131] So why should management yield to its alleged incentives for growth maximization with the help of credit finance? Here we simply need a more systematic analysis of the relation between the financing patterns of large firms and the underlying interests.

c) Dividend policy

A related issue concerns the *dividend policy* of firms. Management may prefer to retain earnings rather than distribute them as they accrue since this provides a way to conceal fluctuations in future earnings and thereby to reduce management's accountability for losses. And retained earnings give management the means to achieve growth maximization without being monitored by outside financiers, even at the expense of the shareholders (i.e., through "free cash flow").[132] It is contended in the literature that banks support this restrictive dividend policy of managements either because they want to get at least a share of the firm's financial business[133] or - and that seems to be the main argument - in order to protect their credit investments.[134] On the other hand, retaining dividends means that managements become increasingly independent and "emancipated" from external finance the larger the internal funds grow. But perhaps banks tend to neglect this long-term development in order to protect their present interests. Furthermore, there are limits to the "emancipation" of managements because of the role which banks play in their function as proxies in shareholder meetings and on supervisory boards. Here again one would like to see more theoretical and empirical studies on this point, with reference to the tax and other cost issues which affect a firm's dividend policy.

d) Concluding remarks

Even if there is no abuse there is, as our summary has shown, certainly a potential for it because of conflicts of interests. There is a longstanding discussion about how abuse can effectively be avoided without destroying the advantage of having an institutional arrangement which overcomes shareholders passivity and serves as a professional monitor. It is not necessary to go into this discussion here in detail; suffice it to say that the existing rules and provisions against potential abuse seem not to be sufficient and could and should be amended. Another problem which can only be mentioned here is how the efforts and the performance of these institutions which monitor managements on behalf of small investors can themselves be measured and controlled. By installing an institution to solve

the "principal-agent" problem on the level of the corporation, we get a new "principal-agent" problem on the level of the intermediary. Do we have similar problems (i.e., asymmetric information, collective action, etc.) on this second stage too, and how can these be solved?

Although these questions concerning the monitoring performance of the depot institutions as agents of the shareholders remain unanswered, in the following a first attempt is made to compare this institutional solution with a market solution, more specifically, with the threat of hostile takeovers. This threat has often been claimed in the literature to align adequately the interests of shareholders and managers, and to address the problem of managerial inefficiency.[135] This comparison should help to evaluate the monitoring potential of our institutional monitoring solution and shed some more light on this specific structure.

7. Comparison of Institutional and Market Control

A comparison between market and institutional monitoring systems has to start with a caveat.
Such a comparison is necessarily narrowly focused in that it picks out only one instrument from among several which are meant to cope with managerial inefficiency, self-dealing and related problems, and which are meant to supplement each other within a given legal system. If, for instance, the takeover market cannot deal with individual instances of management selfdealing but the institutional control of managers perhaps can, there may be, in a system which relies on market rather than on institutional control of managers, supplementary instruments available which may be even more capable of dealing with this specific problem. Hence the following comparison should be understood as theoretical considerations rather than as a comparison of two really given different corporate governance systems.

a) Divergence of interests of shareholders and managers

A good starting point for a comparison is *Professor Eisenberg's* list of cases in which the interests of shareholders and managers diverge.[136] *Eisenberg*

differentiates between "shirking," "traditional conflicts of interests" and "positional conflicts." If efforts of an agent cannot be observed, and his performance not be controlled, he has no disincentive to work at a slack pace and to avoid the effort and discomfort involved in adapting to changed circumstances ("shirking"). "Traditional conflicts of interest" means the potential interest of agents in diverting the principal's assets to their own use through unfair self-dealing. The third potential divergence of interests are "positional conflicts": the interest of top corporate managers in maintaining and enhancing their position even at the shareholders' expense. Positional conflicts may occur in a great variety of ways: among other measures, managers can make it particularly difficult to monitor their performance, impose high barriers to their own removal, seek to increase corporate size or "free cash flow" in order to maximize their power, prestige and salary rather than to maximize the firm's value. How do both hostile takeovers and institutional monitoring through banks cope with these problems?

aa) To start with, neither device is aimed at prohibiting or lessening problems like shirking and self-dealings if these are problems at all. Most top managements will certainly refrain from *shirking* because their self-esteem is tied to work and accomplishment, and the selection process on the management market as well as the mutual control among agents[137] tends to exclude this pattern.

bb) Also, most top managers will probably refrain from *unfair self-dealing* because they have internalized the rules of social morality.[138] The takeover market likely has very little impact on such traditional conflicts of interest. A hostile takeover bid does not succeed unless it includes a premium that is significantly above the market price.[139] A hostile bidder must also pay large fees to advisors such as lawyers, investment bankers and others. Hence, a takeover bid would not be economically justified if the bidder's only aim is to end unfair self-dealing by managers.[140] That means that other legal provisions must deal with this particular conflict of interest, and the same is true for a system which relies on institutions like banks rather than on takeovers as a monitoring device. If a supervisory board finds out about

unfair self-dealing of management, that does not happen just because banks have representatives on the board.

cc) Much more interesting are the effects of takeovers and institutional control on *positional conflicts*. It seems clear that takeover activity is, among several other factors like synergy gains etc., also motivated by the inefficiency of the target's management.[141] Here the first question is whether the "outside" bidder has information about the inefficiency of incumbent management. An "inside" monitor like a bank may have an informational advantage in this respect. The next question then is whether and under which circumstances an outside bidder and an inside institutional monitor will react when they observe inefficiency. Putting to the side for the moment other factors such as synergy gains, etc., the bidder will only act if a takeover and replacement of incumbent management will produce sufficient gains to justify the huge premium and out-of-pocket transaction costs required - something that does not seem very likely if management is not excessively inefficient.[142] An "inside" monitor who is represented on the supervisory board can act without incurring these costs. The problem here, however, is that an institutional monitor with personal business interests in the firm has incentive not to act in cases in which "inefficiency" of the management, such as seeking to increase corporate size or maximize cash and other resources at the disadvantage of the firm and its shareholders, is favourable to the monitor.[143] Hence it is not very likely that initiatives for restructuring, disposing of underperforming subsidiaries, or splitting up a conglomerate will come from banks' representatives as long as the firm is not in financial distress.[144]

b) Ex ante, interim and ex post monitoring

A further difference is remarkable. Institutional and market control by threat of hostile takeover differ also in that control by management replaces by way of a takeover is merely *ex post control* whereas institutional control is not. To be sure, the idea of control by the threat of replacement is thought to give management incentive in advance to try harder. But it works differently from the *ex ante, interim* and *ex post monitoring* by an inside

institutional monitor. As *Eisenberg* has pointed out, the threat of takeover will not affect the behaviour of managers who do not realize they are inefficient, and do their best as they see it: they are already doing all they can.[145] Especially in such cases a system should be preferred which does not react only after the firm has incurred considerable losses. Identifying competent managers from the beginning, gathering information continuously and familiarity with the qualifications of management could avoid this.

c) Turnover vs. "relational" monitoring

The notion that the governance system which we are examining is based on a long-term relationship between a few depot institutions and the respective firms reveals another contrast to a system in which no "intermediaries" stand between management and institutional or private shareholders, shareholders who themselves are not active in corporate governance except by "voting with their feet," especially in the case of a takeover. Private shareholders, like institutional shareholders, may have short "shareholding horizons." That may be because they have to sell their shares, in the case of an individual, for purposes of private needs for liquidity or, in the case of, say, a pension fund, because its managers are interested in a high turnover. Or shares may be sold because the investor or fund manager believes he has identified a mispriced share, or because the shareholder is offered a higher price than the actual market price by a bidder. Short shareholding horizons and a high turnover in a firm's shares make it difficult for the company to establish meaningful relationships and two-way communications with its shareholders. Short term investments in a firm's stock do not only make it difficult for shareholders to influence a company's affairs, leaving the takeover mechanism as the major corrective device to align the interests of management with those of constantly changing shareholders. It may even lead to the question of extent to which shareholders who own stock only for a comparably short period of time should be given influence and say in corporate affairs at all by those who formulate the charter, by-laws and applicable regulations of the corporation. In a system where proxies are given to "professional" institutions which remain the same over time irrespective of the turnover in the underlying shares, long-term relationships and two-way communications between management and such interested

and responsive proxyholders can be established, and there may be more willingness to give more information and to concede more rights and influence to shareholders represented by such institutions. Of course, the question arises again of whether and to what extent such stable relationships between management and professional proxyholders with own business or equity interests in the firm are favourable or detrimental to the small investors because of the conflicts of interests or the lack of control in the relationship between these intermediaries and the shareholders, as mentioned above.

d) Long-term vs. short-term

How do managers behave in a system without stable long-term relationships with their shareholders and the threat of a hostile takeover above their heads? Do they, in order to satisfy the greediness of the investors and to keep the stock prices high, slash expenditures which pay off only in the long-term? That has frequently been contended in the literature as well as in the political debate, and Anglo-American scientists and policy-makers apparently become increasingly concerned about the short-term issue.[146]
Research and development expenditures of firms in various nations are compared, and specific institutional features like quarterly reports, interim dividends, or the investment policy of pension funds and other institutional investors are blamed for forcing managements to take short term views. Hostile takeovers are said to contribute to this, too. The plans of the EC Commission to abolish caps on shareholder voting rights and dual class voting ("Höchststimmrechte" and "Mehrfachstimmrechte") under the Fifth EC directive has been strongly opposed by German industry, especially on the grounds that (hostile) takeover activity would lead to short-termism and have negative impacts on resource allocation and the German economy as a whole. Is a bank-oriented corporate governance system (without hostile takeovers) advantageous in this respect?
As to hostile takeovers, the debate among economists seems to date to be unsettled. In one version investors are short-sighted and behave myopically to sacrifice long-term benefits for immediate profits. As a consequence, firms that engage in long-term planning and make substantial investments in research and development (R & D) are supposedly undervalued by the

market and become takeover targets.[147] *Shleifer* and *Vishny* have argued that the short time horizon of arbitrage investors, who focus on short-term assets because they are relatively less expensive to arbitrage, may result in market underpricing of a corporation's equity. This phenomenon in turn is said to impose a short time horizon on managers, who thus avoid long-term investments that depress share prices over the short term and make the corporation vulnerable to a hostile takeover.[148] *Stein* has developed a formal model in which the threat of takeovers encourages myopic behaviour on the part of managers. A central prediction of this model is that firms that construct barriers to takeovers are able to increase profitable long-term investments such as research and development (R & D).[149] There is, however, empirical evidence that firms actually decrease R & D intensity after the introduction of shark repellents, thus failing to support this prediction. These findings suggest that takeover impediments may even reduce incentives to engage in long-term investments.[150] Furthermore, there is evidence that the market responds positively to announcements of increases in R & D and other capital investment expenditures[151] which, on the other hand, does not mean that there informational asymmetries between the markets and firms with respect to such expenditures may not still remain, such as instances where management does not want to communicate commercially sensitive information to the market. And it may well be that managers, in order to avoid undervalued stock which might lure hostile bidders, shift from profitable long-term investment to short-term projects - although this hardly seems to be a good defence against unwanted bids.[152]

As this debate cannot be continued from the outside, would it be possible at least to establish that the corporate governance structure in German large firms supports long-term views of management? Although to my knowledge there are no empirical data available with respect to these large firms, my guess certainly is that management in these firms are encouraged to maintain a focus on the long term: firstly, managers in these firms are usually elected for five years, and can be recalled prior to the expiration of their term only for cause.[153] Secondly, the equity holdings of banks as well as the amount of proxies which are given to them remain rather stable over time irrespective of the fact that the underlying stock is traded. That means that the monitoring institutions remain the same over time. Thus, long-term

projects can be discussed and explained to them, and this discussion can be a dialogue rather than merely giving a "signal" to an anonymous market which will "mirror" it by pricing the firms value. On the other side, we must also take into account the incentives of banks as creditors. Banks might, as creditors, prefer projects which are comparatively less profitable.[154]

In short, there is no clearcut answer to our question as to whether the elements of the governance systems discussed here favour rather than discourage long-term investments with higher net present values.

e) Adaptability to change

It has already been mentioned that in order to assess the efforts and results of the management an internal monitoring system must rely on a comparison of actual results with the results of the firm for former periods, the firm's plans and the results of the firm's competitors within the same industry. This hints at a limitation of such an internal monitoring system where "outside governance" may have an advantage.

aa) A potential outside bidder may have information about, say, a new technology which management and the supervisory board of a firm do not have and which is not yet in use within the industry. Is outside governance by (hostile) takeovers which forces a firm to adapt and react to technological changes a necessary supplement to an internal monitoring system which fails in such cases?
In this respect one should differentiate between the mere dissemination of information on one side and the reluctance of the incumbent management and supervisory board on the other. Hostile takeovers are not necessary to disseminate new information about, e. g., new value - increasing technologies. Information can be sold to the firm or shared with it in other ways.

bb) Management and the members of the supervisory board may, however, be reluctant to make changes that raise the market value of the

firm even if the steps that have to be taken to raise the value are known. This may be because the required changes in a declining industry, such as layoffs, wage reductions, investment cutbacks, or divestitures, would harm the employees who are considered more important to the organization than shareholders, or because members of the supervisory board fear the negative publicity or problems with local authorities that would result from such unpopular decisions, or simply do not see the necessity or other possibilities because the whole respective industry is ailing. In such cases, a hostile bidder could buy the firm and implement profit-increasing changes against the wishes of both the board and the top management of the target. More generally, takeovers could play a role in bringing about a necessary shift in a firm's policy and in replacing managers whom the supervisory board is unable or unwilling to force to take the necessary steps.

There is interesting empirical evidence especially for this role of hostile takeovers during the merger wave of the eighties in the U.S. *Morck, Shleifer* and *Vishny* examined the circumstances under which a company's poor performance leads to an internal governance response - the incumbent board replacing management - as opposed to the external governance response of a hostile takeover. Tracking a sample of 454 of Fortune 500 companies over the period 1981 - 1985, the authors concluded that an internal governance response is more likely when a company performs poorly compared with industry competitors, but that hostile takeovers are predictable based on poor performance of the entire industry. In cases in which whole industries (e. g., airlines, steel, or oil) were performing poorly corporate boards apparently were reluctant to take the necessary steps to increase the value of the firms by removing irresponsive managers. Instead, this function has been accomplished by hostile takeovers. Apparently takeover organizers have taken advantage of opportunities raised by the ineffectiveness of internal control devices.[155]

IV. Concluding Remarks

The paper has taken us a long way through the details and discussion of various aspects of the German banking system and its impacts on corporate finance and governance in German firms. A few concluding remarks should sum up the main findings:

- The description of the German corporate finance system as bank-oriented as opposed to a market-oriented corporate finance system is one-sided as this distinction is based on two sources of finance only. Furthermore, some of the widespread assumptions about specific features of the German corporate finance system (the role of equity finance by banks; the role of bankers on firms' boards; the role of the Hausbanken) and their benefits for corporate finance seem doubtful partly because these features are, from an empirical point of view, not as important as assumed (debt-equity finance) or increasingly fading (housebank-relationships), partly because some of the underlying hypotheses concerning the benefits of this structure are hardly convincing theoretically.

- The description of the German corporate governance system as "bank oriented" is misleading, too, as only a small number of banks act as monitors of management on behalf of widely dispersed shareholders in a small number of stock corporations only. And even in these cases their role is empirically unexplored enough to suggest great care in drawing conclusions. For all other firms we lack empirical data and thorough studies on the extent to which German banks play, as providers of funds to firms, a role in corporate governance that differs markedly from the monitoring role of the credit institutions in other countries.

* Dr. iur. Theodor Baums, professor at the University of Osnabrück/Germany, director, Institut für Handels- und Wirtschaftsrecht, Katharinenstraße 15, D-49069 Osnabrück/Germany. Paper, presented at the World Bank Workshop on the Japanese Main Bank System, Center for Economic Policy Research, Stanford University, Cal., April 8-10, 1993. Helpful comments have been given by Masahiko Aoki, Jeremy S. Edwards, Koichi Hamada, Christian Harm, Hugh Patrick, Ernst-Ludwig v. Thadden, and the participants of the conference.

1 See Gerschenkron, A. (1962), Economic Backwardness in Historical Perspective; Neuburger, H./Stokes, H. (1974), German Banks and German Growth 1883 - 1913: An Empirical View, 34 Journal of Economic History, p. 710-31; Harm, C. (1992), Historical Notes on the Development of the German Banking System (Working Paper New York University); Tilly, R. (1966), Financial Institutions and Industrialization in the Rhineland 1815 - 1870; Tilly, R. (1986), German Banking 1850 - 1914: Development Assistance to the Strong, 15 Journal of European Economic History, p. 113-52; Tilly, R. (1989), Banking Institutions in Historical and Comparative Perspective - Germany, Great Britain and the United States in the 19th and 20th Century, 145 Journal of Institutional and Theoretical Economics (Zeitschrift für die gesamte Staatswissenschaft), p. 189-209; Tilly, R./Fremdling, R. (1976), German Banks, German Growth and Econometric History, 36 Journal of Economic History, p. 416-27; Schmitz, C. (1992), Cooperative Managerial Capitalism: Recent Research in German Business History [Review article], 10 German History, p. 91-103.

2 The following description is an extract from the more detailed report in: Baums, T./Gruson, M. (1993), The German Banking System - System of the Future?, XIX Brooklyn Journal of Int.l Law, p. 101-129.

3 To the role and function of a "house bank" part II, infra.

4 On the economics of cooperative banks cf. the interesting study of Bonus, H. (1987), Die Genossenschaft als modernes Unternehmenskonzept (Genossenschaftswissenschaftliche Beiträge. Vorträge Heft 10); cf. also Bonus, H./Schmidt, G. (1990), The Cooperative Banking Group in the Federal Republic of Germany: Aspects of Institutional Change, 146 Journal of Institutional and Theoretical Economics, p. 180-207.

5 Cf. Rybczynski, T. (1984), Industrial Finance System in Europe, U.S. and Japan, 5 Journal of Economic Behavior & Organization p. 275, 277-280.

6 Cf. III. 3., infra.

7 Jensen, M./Meckling, W. (1976), Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure, 3 Journal of Financial Economics, p. 305-60.

8 Berglöf, E. (1990), Capital Structure as a Mechanism of Control: a Comparison of Financial Systems, in: Aoki et al., The Firm as a Nexus of Treaties p. 237, 238; Pozdena, R. (1987), Commerce and Banking: The German Case, Fed. Reserve Bank of San Francisco Weekly Letter Dec. 18 (1987); Charkham, J. (1989), Corporate Governance and the Market for Control of Companies, Bank of England Panel Paper No. 25 p. 8, 9; Cable, J. (1985), Capital Market Information and Industrial Performance: The Role of West German Banks, 95 The Economic Journal, p. 118, 121; McCauley, R./Zimmer, St. (1989), Explaining International Differences in the Cost of Capital: The U.S. and U.K. vs. Japan and Germany, Federal Reserve Bank of New York Research Paper No. 8913 p. 51, 52; Frankel, A./Montgomery, J. (1991), Financial Structure: An International Perspective, 1 Brookings Papers on Economic Activity p. 293.

9 Pozdena, R. (1990), Why Banks Need Securities Powers, Fed. Reserve Bank of San Francisco Working Paper p. 9-11; Kim, Sun Bae (1990), Modus Operandi of Lender - cum - Shareholders Banks, Fed. Reserve Bank of San Francisco Working Paper p. 15, 24.

10 However, an equity participation without monitoring could lead to less effort on the side of the borrowing firm.

11 Cf. N. 91-94, infra.

12 Cf. N. 14 and accompanying text, infra.

13 Cf. N. 11, supra, and bb), infra.

14 According to the competent Federal Court (Bundesgerichtshof) this depends, inter alia, on the legal form of the respective firm. If it is a publicly held stock corporation ("Aktiengesellschaft") this rule does not apply to shareholders who hold an own equity stake of less than (normally) 25 % of the stock corporation's capital (Entscheidungen des Bundesgerichtshofes in Zivilsachen [March 26, 1984] vol. 90 p. 381-399). Voting proxies for banks given to it by other shareholders do not suffice and are not to be added.

15 Cf. 2. a), infra.

16 Cf. Stiglitz, J./Weiss, A. (1981), Credit Rationing in Markets with Imperfect Information, 71 The American Economic Review p. 393-410. Stiglitz and Weiss explain credit rationing by this. There may be other kinds of information asymmetries; cf., e.g., Myers, St./Majluf, N. (1984), Corporate financing and investment decisions when firms have information that investors do not have, 13 Journal of Financial Economics p. 187-221.

17 Pozdena (supra N. 9) p. 8, 9.

18 Cf. Fischer, K. (1990), Hausbankbeziehungen als Instrument der Bindung zwischen Banken und Unternehmen. Eine theoretische und empirische Analyse. Diss. rer.oec. Bonn p. 144.

19 See also Hellwig, M. (1991), Banking, financial intermediation and corporate finance, in: Alberto Giovannini/Colin Mayer (eds.), European financial integration p. 35, 56.

20 Cf., e.g., Cable (N. 8) p. 119-121; McCauley/Zimmer (N. 8) p. 50-52.

21 Cf. 2. b), infra.

22 See Fischer (N. 18) p. 3-4.

23 Mayer, C. (1988), New Issues in Corporate Finance, 32 European Economic Reviews p. 1167-89.

24 Fischer (N. 18, supra).

25 See 2. c), infra.

26 See 1. a), supra.

27 Source: Frankel/Montgomery (supra N. 8) p. 267.

28 Source: Borio, C. (1990), Leverage and Financing of Non-Financial Companies: An International Perspective (BIS Economic Papers No. 27) p. 13. Cf. also the data in Mayer, C. (1990), Financial Systems, Corporate Finance, and Economic Development, in: R. Glenn Hubbard (ed.), Asymmetric Information, Corporate Finance, and Investment p. 312.

29 Roggenbuck, H. (1992), Begrenzung des Anteilsbesitzes von Kreditinstituten an Nichtbanken - Gesetzliche Regelungen, empirischer Befund sowie anlage- und geschäftspolitische Bedeutung p. 154-162.

30 Cf. also Table IV.

31 Deutsche Bundesbank, written testimony for the hearing before the Committee for Economy of the Federal Parliament (Bundestagsausschuß für Wirtschaft. Anhörung vom 16. Mai 1990) of April 16, 1990 p. 9.

32 Cf. also Edwards, J. and Fischer, K. (1991), Banks, Finance and Investment in West Germany since 1970 (CEPR London Discussion Paper Series No. 497) p. 24 who include the shares owned by the bank-owned investment funds and estimate bank equity holdings of 10.3 % in 1984 and 11.6 % in 1988. Empirical data on shareholdings of bank-owned investment funds in Roggenbuck (N. 29) p. 357 ff.

33 Cf. pt. III. 2., infra.

34 Cf. Monatsberichte der Deutschen Bundesbank Oktober 1992 p. 31; also Mayer, C./Alexander, I. (1990), Banks and Securities Markets: Corporate Financing in Germany and the United Kingdom, 4 Journal of the Japanese and International Economies p. 457 ff.

35 Roggenbuck (N. 29) p. 165 ff.

36 Cf. Fischer (N. 18) p. 124-141 with further references.

37 Cf. the remarks in Roggenbuck (N. 29) p. 386-404 with further references.

38 Edwards/Fischer (supra N. 32) p. 18-22.

39 Cf. the data pt. III. 4. b), infra.

40 Cf. Edwards/Fischer, op.cit., and the tables on p. 12, 20.

41 Cf. also the considerations in Hellwig (N. 19) p. 57-61 on the "emancipation of large firms" from bank finance.

42 Cf. Mayer/Alexander (N. 34) p. 468.

43 1. c), supra.

44 Cf. N. 18, supra.

45 Fischer p. 102.

46 Fischer p. 102.

47 Fischer p. 104, 105.

48 Fischer p. 79-81.

49 Fischer p. 79-81; for an empirical study on the role and behavior of credit institutions in case of financial distress or insolvency of their client firms see Gessner, Volkmar/Rhode, Barbara/Strate, Gerhard/Ziegert, Klaus A. (1978), Die Praxis der Konkursabwicklung in der Bundesrepublik Deutschland p. 232-267.

50 Hellwig (N. 19, supra) p. 54-61.

51 Cf. Williamson, O. (1988), Corporate Finance and Corporate Governance, 43 Journal of Finance p. 567-591; Aghion, P./Bolton, P. (1989), The Financial Structure of the Firm and the Problem of Control, 33 European Economic Review p. 286-293; Mayer, C. (1990; supra N. 28); survey of various articles in Allen, F. (1989), The Changing Nature of Debt and Equity: A Financial Perspective, in: Kopcke, R./Rosengren, E. (eds.), Are the Distinctions between Debt and Equity Disappearing? Fed. Reserve Bank of Boston, Conference Series No. 33 p. 12-38; Mathis, P. (1992), Mechanismen zur Kontrolle von Managern in großen Kapitalgesellschaften. Eine ökonomische Analyse. Doctoral thesis Univ. Saarbrücken p. 108-113 with further references.

52 Overview over possible antitakeover devices in Baums, T. (1993), Takeovers vs. Institutions in Corporate Governance in Germany, Oxford Law Colloquium 1992 Proceedings (forthcoming); cf. also same (1993), Hostile Takeovers in Germany. A Case Study on Pirelli

vs. Continental AG. Institut für Handels- und Wirtschaftsrecht Universität Osnabrück Arbeitspapiere 93-3.

53 Part III is an updated version of parts of my article on antitakeover devices cited in N. 52.

54 Unlimited partnership ("offene Handelsgesellschaft"); limited partnership ("Kommanditgesellschaft").

55 "Gesellschaft mit beschränkter Haftung" or "GmbH".

56 "Aktiengesellschaft".

57 Numbers as of Dec. 31, 1990: Gesellschaften mit beschränkter Haftung (GmbH) 433,731; Aktiengesellschaften (AG) and Kommanditgesellschaften auf Aktien 2,682. Numbers of GmbH as of May 31, 1992: 509,949; of AG as of May 31, 1992: 3,052. Source: Statistisches Bundesamt, Wiesbaden, oral information; Hansen, AG-Report (1993), at R 64; same, GmbH-Rundschau 1993, at 146.

58 Source: Arbeitsgemeinschaft der Deutschen Wertpapierbörsen, Jahresbericht 1991 p. 141 (numbers of 1991).

59 More than 50 % widely held: about 80 companies; more than 75 % of stock widely held: 38 companies (Source: Saling, Aktienführer, 86. ed. 1993 [numbers as of Sept. 1992]; Commerzbank [ed.], Wer gehört zu wem?, A guide to capital links in German companies, 17. ed. 1991).

60 Cf. the list of the largest 100 firms (measured by their value-creating potential ["Wertschöpfung" = surplus or loss of the firm corrected by additional factors]) in: Bundestag-Drucksache 11/7582 p. 176 ff. and the list of German firms and the structure of their ownership in: Commerzbank (ed.), Wer gehört zu wem (N. 59).

61 Cf. the detailed description by Conard, A. (1984), Comparative Law: The Supervision of Corporate Management: A Comparison of Developments in European Community and United States Law, 82 Mich.L.Rev. p. 1459 ff., and Meier-Schatz, C. (1980), Corporate Governance and Legal Rules: A Transnational Look at Concepts of International Management Control, 13 Journal of Corporation Law p. 431-480.

62 Cf. thereto Wiedemann, H. (1980), Codetermination by workers in German enterprises, 28 The American Journal of Comparative Law p. 79-82. Although the present codetermination laws came into force after the end of the Second World War, there is an older tradition of obligatory representation of employees on the supervisory boards.

63 In the German system employees are stakeholders in a firm not only in the regular and usual sense as partners of long term (labour) contracts and relationships with the corporation but also because their pension capital is - unlike the practice in the Anglo-American countries - to a large extent kept within the employing firm and

serves as an important source of capital of the firm. "Codetermination" finds its legitimation also in this specific structure.

64 Cf. Table III.

65 See 4., infra.

66 See 3., infra.

67 German banks may own investment companies and do so to a large extent. Data in Gottschalk, Arno (1988), Der Stimmrechtseinfluss der Banken in den Aktionärsversammlungen von Großunternehmen, WSI-Mitteilungen p. 295, 296; data on the engagement of investment funds in corporate stock most recently in Roggenbuck (N. 29) p. 357 ff. and Mühlbradt, F. (1992), Kennziffer Fondsengagement, Die Bank p. 72-77. Other than for banks (cf. N. 80, infra), there is a 10 % ceiling on shares of a portfolio firm for investment companies (Gesetz über Kapitalanlagegesellschaften, § 8 a). Investment companies have to vote the shares in their portfolio personally and may not give a general proxy to another person or institution (Gesetz über Kapitalanlagegesellschaften, § 10 I). This provision does not exclude, however, that an investment company and its parent company bank agree to vote in the same sense.

68 Only in 2-3 % of all cases; Immenga, U. (1978), Beteiligungen von Banken in anderen Wirtschaftszweigen (Studien zum Bank- und Börsenrecht) 2nd ed. p. 103; Gottschalk (N. 67) p. 296. Things are, however, apparently different in the banks' own shareholder meetings; cf. the data in table III, infra. I was not able to get an explanation for that.

69 Especially the large banks which act as proxyholders are (or until recently were) corporations with widely held shares themselves.

70 Cf. §§ 128, 135 Aktiengesetz (Stock Corporation Act).

71 Monopolkommission, Zweites Hauptgutachten 1976/77, Fortschreitende Konzentration bei Großunternehmen (1978) p. 283 ff.; Bericht der Studienkommission "Grundsatzfragen der Kreditwirtschaft (1979) p. 111. This commission concluded that in 1974/75 in 74 stock-exchange listed companies (with a nominal capital of at least DM 50 millions) 52,5 % of the present shares were voted by banks or investment companies as proxy holders and another 10,2 % as owners, Report p. 290-291.

72 Gottschalk (N. 67).

73 Böhm, J. (1992), Der Einfluss der Banken auf Grossunternehmen.

74 Measured by their "Wertschöpfung" (= surplus or loss of the firm corrected by additional factors). The contribution of the largest 10 to the "Wertschöpfung" of all firms in the national economy was about 8 % in 1986.

75 Böhm (N. 73) p. 242.

76 "Höchststimmrechte"; cf. Baums, T. (1990), Höchststimmrechte, Die Aktiengesellschaft p. 221-242.

77 This corresponds with the data of the Bundesbank according to which by the end of 1988 the three Großbanken held 43 % of all depot shares in their custody; Die Aktiengesellschaft, AG-Report p. 412 (1989).

78 Cf., e.g., Immenga (N. 68) p. 103-104; Gottschalk (N. 67) p. 300.

79 Bericht der Studienkommission (N. 71) p. 171.

80 § 13 (5) Kreditwesengesetz (Banking Act). Further limits concern all illiquid assets (participations are enclosed), § 13 (1) KWG, and large credits (participations have to be added), § 19 (1) (6) KWG.

81 Part II, 2. a).

82 Source: Deutsche Bundesbank, written testimony for the hearing before the Committee for Economy of the Federal Parliament (Bundestagsausschuß für Wirtschaft. Anhörung vom 16. Mai 1990) of April 16, 1990 p. 9. - Edwards/Fischer (supra N. 32) p. 24 quote 8.1 % in 1988.

83 Böhm (N. 73) p. 231-238.

84 Cf., e.g., Bundestag-Drucksache 10/1791 (1984) p. 114-117; Bundestag-Drucksache 1/2677 (1988) p. 137-141.

85 § 128 (2) (5) Aktiengesetz (Stock corporation Act).

86 § 100 (1) (3) Aktiengesetz. As this rule does not apply to mere advisory boards ("Beiräte"), especially the large commercial banks have established even several (central as well as regional) of such boards in order to "commit" the leading managers of their client firms to the banks. Data in Roggenbuck (N. 29) p. 424.

87 Cf. in more detail 5., infra.

88 3-4 times per year; cf. Bleicher, K./Paul, H. (1986), Das amerikanische Board-Modell im Vergleich zur deutschen Vorstands-/Aufsichtsratsverfassung - Stand und Entwicklungstendenzen, 46 Die Betriebswirtschaft p. 263-288.

89 Cf. Bericht der Studienkommission (N. 71) p. 122-126 and the tables on p. 440-445 and on p. 585-598; Immenga (N. 68) p. 109-109; Informationen des Bundesverbandes deutscher Banken, Zur Diskussion um die "Macht der Banken" (1989) p. 20; Gottschalk (N. 67) p. 299 ff.; survey in Fischer (N. 18) p. 148-149 with further references; Edwards/Fischer (N. 32) p. 28-32; Biehler, H./Liepmann, P. (1988), Personelle Verbindungen und intersektorale Finanzbeziehungen zwischen den größten deutschen Unternehmen, Jahrbuch für Nationalökonomie und Statistik, Vol. 204/1 p. 48-68; most recently Roggenbuck (N. 29) p. 424.

90 Böhm (N. 73) p. 194-196 and p. 257-263.

91 Empirical study on the flow of information to the supervisory board: Vogel, E. (1980), Aktienrecht und Aktienwirklichkeit - Organisation und Aufgabenteilung von Vorstand und Aufsichtsrat.

92 Cf. N. 88, supra.

93 Fischer (N. 18) p. 80-81, 149.

94 §§ 116, 93 (1) Aktiengesetz (Stock Corporation Act).

95 § 404 Aktiengesetz.

96 For empirical data on the composition of the supervisory boards cf., e.g., the study of Gerum, E./Steinmann, H./Fees, W. (1987), Der mitbestimmte Aufsichtsrat. Eine empirische Untersuchung.

97 Bleicher, K. (1987), Der Aufsichtsrat im Wandel p. 57.

98 Bleicher (N. 97) p. 54.

99 Cf. Table III, supra.

100 Cf. § 32 Mitbestimmungsgesetz (Codetermination Act).

101 On the role of the nominating committee (Vorstandsausschuß) and the nominating process, e.g., Brinkmann-Herz, D. (1972), Entscheidungsprozesse in den Aufsichtsräten der Montanindustrie.

102 Aoki, M. (1993), Historical Conditions for Monitoring Roles of the Japanese Main Bank System. Working Paper, University of Stanford.

103 Cf. thereto the empirical study of Gerum/Steinmann/Fees (N. 96, supra).

104 Cf. Brinkmann-Herz (N. 101) p. 81, 82.

105 Cf. 7. e), infra.

106 § 84 (3) Aktiengesetz (Stock Corporation Act).

107 § 84 (1) Aktiengesetz.

108 Poensgen, O./Lukas, A. (1982), Fluktuation, Amtszeit und weitere Karriere von Vorstandsmitgliedern, 42 Die Betriebswirtschaft p. 187, 188.

109 Cf. same p. 183, 184, 188, 190.

110 Kaplan, St. (1993), Top Executives, Turnover and Firm Performance in Germany. Working Paper, University of Chicago.

111 Table IV, supra.

112 Cf. § 186 (3) Aktiengesetz (Stock Corporation Act).

113 Only 12 of the AGs in Table III, supra have banks as shareholders, according to Table IV, supra.

114 See the discussion in pt. II, 1. b), supra, with further references.

115 See p. ..., supra.

116 P. ..., supra.

117 Mayer/Alexander (N. 34) p. 457.

118 Supra N. 50 and accompanying text.

119 P. ..., supra.

120 Cf., e. g., Böhm (N. 73) p. 154-155 with further references.

121 Cf. Böhm (N. 73) p. 138-141.

122 Cf. Commerzbank (ed.), Wer gehört zu wem, A guide to capital links in German companies, 17. ed. 1991.

123 § 100 (2) (3.) Aktiengesetz (Stock Corporation Act). This rule can be, however, circumvented by establishment of mere "advisory boards". Cf. N. 86, supra.

124 Cf. N. 76, supra.

125 Cf. Table III, supra. There are, however, no personal interlocks between the three Großbanken. Cf. Saling Aktienführer (1993) p. 180, 212 f., 259.

126 Cf. Böhm (N. 73) p. 154-155 with further references.

127 See also Fischer (N. 18) p. 102.

128 Böhm (N. 73) p. 142, 144.

129 Cf. Klein, W./Coffee, J., Jr. (1990), Business Organization and Finance. Legal and Economic Principles, 4. ed. p. 161, 162 with further references.

130 Cf. Böhm (N. 73) p. 142, 144.

131 See, e.g., Jensen, M. (1989), Agency Costs of Free Cash Flow, Corporate Finance, and Takeovers, in: Clifford W. Smith Jr., The Modern Theory of Corporate Finance, 2nd ed. p. 660.

132 Cf. Jensen, op. cit. p. 659. For an empirical study on dividend payments of German stock corporations see Hort, H. (1984), Zur Dividendenpolitik der Aktiengesellschaften des verarbeitenden Gewerbes der Bundesrepublik Deutschland - Ein empirischer Beitrag -. Doctoral thesis Univ. Saarbrücken; König, R.J. (1990),

Ausschüttungsverhalten von Aktiengesellschaften, Besteuerung und Kapitalmarktgleichgewicht.

133 Böhm (N. 73) p. 139, 140.

134 Immenga (N. 68) p. 121; Böhm (N. 73) p. 143, 144, 149 with further references.

135 Discussion in Baums, T. (1993), Feindliche Übernahmen und Managementkontrolle - Anmerkungen aus deutscher Sicht. Universität Osnabrück, Institut für Handels- und Wirtschaftsrecht Arbeitspapiere 93-1.

136 Eisenberg, M. (1989), The Structure of Corporation Law, 89 Columbia L. Rev. p. 1471-1474.

137 Varian, H. (1990), Monitoring Agents with Other Agents, 146 Journal of Institutional and Theoretical Economics p. 153-174.

138 See also Eisenberg (N. 136) p. 1473.

139 Jensen, M. (1988), Takeovers: Their Causes and Consequences, 2 Journal of Economic Perspectives p. 22, 28.

140 Eisenberg (N. 136) p. 1498.

141 Jensen (N. 139) p. 28; a recent thorough overview is given by Romano, R. (1992), A Guide to Takeovers: Theory, Evidence, and Regulation, 9 Yale Journal on Regulation p. 119-180.

142 Eisenberg (N. 136) p. 1497; evidence on management turnovers after takeovers in Romano (N. 141) p. 129, 130.

143 Cf. the discussion under 5. b). and c), supra.

144 Cf. also e), infra.

145 Eisenberg (N. 136) p. 1498.

146 See the report in The Economist, June 27, 1992 p. 77-78; discussion in Mathis (N. 51, supra) p. 89-100 with further references.

147 Cf. Lipton, M./Rosenblum, St. (1991), A New System of corporate Governance: The Quinquennial Election of Directors, 58 The University of Chicago L.Rev. p. 208-209 and p. 213-214 with further references.

148 Shleifer, A./Vishny, R. (1990), Equilibrium Short Horizons of Investors and Firms, 80 The American Economic Review p. 148-153.

149 Stein, J. (1988), Takeover Threats and Managerial Myopia, 96 Journal of Political Economy p. 61-79.

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