

# Corporate Governance in Germany - System and Recent Developments

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#### I. Introduction

The following descriptive overview of the German corporate governance system and the current debate is structured as follows. Part II will give some information on the empirical background. Part III will describe the formal legal setting as well as actual practices in some key areas. Part IV will then deal with some issues of the current debate.

#### II. The Empirical Background

##### 1. Number of firms

Obtaining new reliable data on all firms in reunified Germany is not yet possible. The only data I can offer here are as of 1990 and concern only the firms in former West Germany<sup>1</sup>. There were roughly 2,100,00 firms in Germany. Of these more than one and a half million were run by a sole proprietor, about 250,00 by partnerships and a slightly larger number (265,00) by corporations. As the corporate governance issue is mainly, from a practical point of view, an issue involving large, publicly-held corporations, let us break these numbers of corporations down into those of privately and of publicly-held corporations.

Of the 265,000 corporations about 263,000 were private companies with limited liability and less than 1,800 were stock corporations. Of the latter only about 80 are widely held<sup>2</sup>. However, most of these corporations with widely distributed ownership are among the 100 largest firms in Germany<sup>3</sup>.

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**Table 1**

Sole ownership	1,545,264
Partnerships	
- Offene Handelsgesellschaft	173,294
- Kommanditgesellschaft	85,219
Corporations	
- Aktiengesellschaft (1)	1,717
- GmbH (2)	263,341
Other (3)	35,139
<b>Total</b>	<b>2,103,974</b>

Numbers as of 1990. Source: See footnote 1. The numbers cover the turnover-tax paying firms in former West Germany. Most farmers, doctors, dentists and several other professions are excluded.

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- 1) Stock corporations (includes Kommanditgesellschaften auf Aktien).
  - 2) Gesellschaften mit beschränkter Haftung (private companies with limited liability).
  - 3) Including Erwerbs- und Wirtschaftsgenossenschaften, firms in public law form, branches of foreign firms.

## 2. Structure of Ownership

We can already gather from these numbers that the description of the German corporate governance system as "bank-orientated" is a misnomer if we look at all firms. The bulk of our industry is still made up of small and medium-sized firms (the "Mittelstand") which are owned by sole proprietors, families or partners. Banks play a particular role in corporate governance

only in our comparatively few "stock corporations" with small, scattered shareholders. I will get back to the role of banks in corporate governance in these companies later.

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First, let us have a more detailed look into the structure and distribution of ownership in our firms. Participations or shares can be held by:

- private owners or families;
- other firms;
- the public sector;
- financial institutions;
- foreigners.

Exact data for all firms are not available. The following table shows the distribution of ownership of foreign as well as domestic shares in public companies limited by shares (Aktiengesellschaften) held by German investors. This chart gives us at least a rough impression of the distribution of ownership in the group of firms which is of interest here with respect to the corporate governance issue.

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**Table 2**

Distribution and development of ownership  
in domestic shareholdings<sup>1)</sup> (in %)

<b>Sector</b>	<b>1960</b>	<b>1970</b>	<b>1980</b>	<b>1990</b>
Private households	27	28	19	17
Firms	44	41	45	42
Public sector	14	11	10	5
Foreign firms/investors	6	8	11	14
Banks	6	7	9	10
Insurance companies/ Pension Funds	3	4	6	12

1) Source: Monatsberichte der Deutschen Bundesbank, Oct. 1991, at p. 28.

How are these data to be interpreted?

a) Private households

The table shows that shareholdings of private households declined steadily since 1960. There are various factors which contributed to this development:

- conservative savings patterns in our households (in 1991 shares made up only DM 1.1 billion as compared to a total of DM 3,098 billion in assets for all West German private households<sup>4</sup>);
- peculiarities of our social security system<sup>5</sup>;
- a still smaller and less-developed securities market than, e.g., in the U.K.

b) Firms

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Other firms are by far the most dominant group of shareholders. A study recently estimated that as much as 90 % of all domestic stock corporations and more than 50 % of all German partnerships are members of groups of two or more firms which are locked to each other by personal and/or capital links<sup>6</sup>. This feature leads to special problems in terms of corporate governance, and our German company law developed an extensive set of rules, the "Konzernrecht", which especially deals with groups of companies<sup>7</sup>.

c) Foreign investors

Our numbers reveal that, since 1960, foreign investments in German stock corporations increased steadily. This increase again poses some new policy questions with respect to corporate governance, as foreign private and institutional investors tend not to vote their shares but to remain passive<sup>8</sup>.

d) Banks

German banks may hold stock in non-bank firms for their own account<sup>9</sup>. Our figures here show that banks in 1990 held about 10 % of all domestic or foreign shares held by German investors. These holdings range from small stakes up to controlling blocks in single cases. The credit sector as a whole held in November 1993 4,310 participations of 10 % or more of the equity capital of non-bank firms<sup>10</sup>.

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e) Insurance companies; pension funds

According to table 2 insurance companies and pension funds together held 12 % of all shares in 1990. This statistic may surprise foreign observers, especially as far as pension funds are concerned. Private pension funds with huge amounts of shares like, for instance, in the U.S. or the U.K., do not exist in Germany. Our pension payments system rests on three pillars: the public security system, private pension savings, and, third, business-related pension money. But this pension money is kept mainly by the business firms in their treasury and invested within the company. The companies that have promised pension payments to their employees are legally bound to contribute to a kind of mutual reinsurance which guarantees the payments. Out of the total of DM 345 billion in pension obligations of German companies in 1990, only DM 82.5 billion were funded through external pension funds<sup>11</sup>.

3. An example: Siemens Aktiengesellschaft

Let us end our empirical overview by taking a closer look at one more or less typical example of a large stock corporation with scattered shareholders, Siemens Aktiengesellschaft.

In 1990, Siemens had a stock capital of DM 2,608 million and about 583,000 shareholders. 52 % of the share capital was held by German investors, 43 % by foreign investors (5 % remained unclear); cf. figure 1. That makes it clear to what extent our capital markets especially in Europe have already grown together. If we break these numbers down into various groups of shareholders, the following picture emerges (cf. figure 2, below):

By far the highest amount of the share capital (45 %) was held by private owners (still among them the Siemens family with a stake of about 10 % preferred shares).

The next group is made up of insurance companies, investment funds, and banks with holdings of about 26 %. They are followed

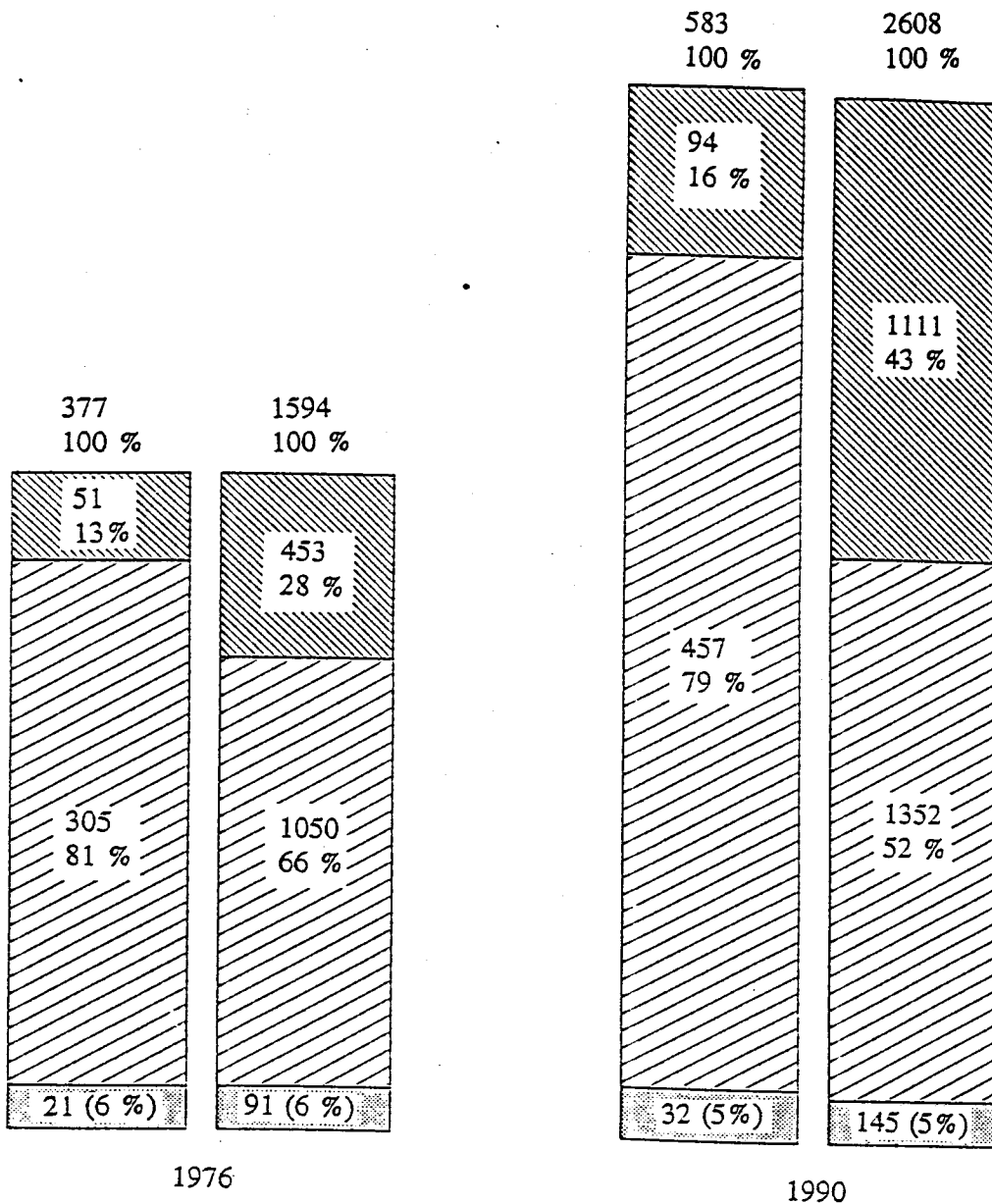


by equity links between Siemens and other firms (about 7 %) and other investors (7 %).




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**Figure 1**




Number of shareholders and capital distribution in Siemens Aktiengesellschaft<sup>1</sup>



Numbers of shareholders  
(in thousands)

-  foreign
-  domestic
-  unclear

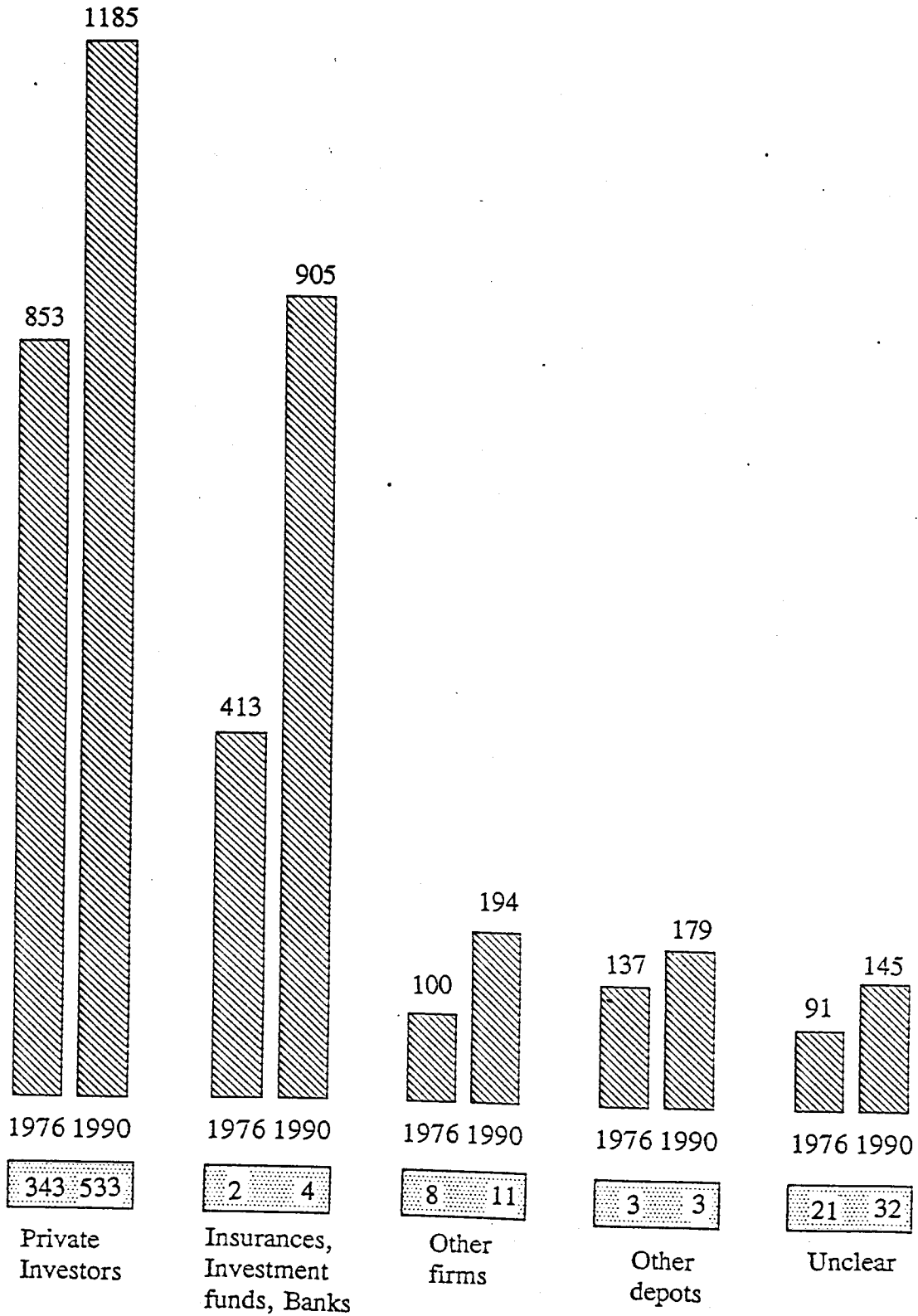
Capital distribution  
(DM millions)

-  foreign
-  domestic
-  unclear

<sup>1</sup> Source: Siemens AG (ed.), Aktionärsstruktur der Siemens AG (1990).

**Figure 2**

Distribution of ownership in Siemens Aktiengesellschaft<sup>1</sup>



▨ Capital distribution (DM millions)

▩ Numbers of shareholders (in thousands)

<sup>1</sup> Source: cf. Figure 1.

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I should mention at this stage how the shares are voted in the shareholders' meetings of Siemens. In 1987, about 60 % of Siemens' shares were represented at the meeting. Of these almost 90 % were represented and voted by banks, which act mainly by virtue of proxies given to them by shareholders. Among these the biggest German bank, Deutsche Bank, voted 17,8 %; Dresdner Bank 10,7 %; Commerzbank 4,1 %; all other banks 32,5 %<sup>12</sup>. These figures show that the banks together clearly dominate the field; and it means, on the other hand, that no single bank alone holds - at least at the Siemens' meetings - a controlling block.

### III. The Corporate Governance Structure

In the following I will first try to describe the formal legal setting as far as stock corporations are concerned and to the extent necessary to understand the instruments and the functioning of corporate governance in these corporations.

#### 1. The legal framework

Stock corporations or public companies limited by shares (Aktiengesellschaften) are regulated under the Stock Corporation Act (Aktiengesetz) of 1965<sup>13</sup>.

This Act contains for the most part binding rules concerning the foundation and constitution of such corporations, the organs and their duties, the rights of shareholders, rules concerning the (fixed) capital of the corporation, the issuance of shares, the dissolution of the company and other matters. Further parts of the Act deal with the law of groups of companies ("Konzernrecht") as far as stock corporations are involved; furthermore with mergers and transformations into other legal forms. Right now the federal authorities (Federal Ministry of Justice) are considering an amendment concerning the rules for mergers and transformations<sup>14</sup>.

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Other important acts which supplement the Stock Corporation Act are the Codetermination Acts (Mitbestimmungsgesetze) and the Commercial Code (Handelsgesetzbuch).

## 2. The Stock Corporation as a legal entity

According to German law, stock corporations are legal entities. They have to have at least one shareholder. As in principle only the corporation and not its shareholders can be held liable for the company's debts, the shareholders have to invest a fixed (published) minimum amount of money (fixed capital; "Grundkapital", at least DM 100,000); and there are binding rules which protect the company's funds from attempts by the shareholders to distribute or dilute this protected capital stock.

The concept of the stock corporation as a legal entity has still another aspect which is of interest in our context here.

Formerly, in the early nineteenth century, jurisprudence and legal scholars held the view that stock corporations were based on a contract among the shareholders, and that these shareholders should, at least "internally" or "materially", be considered to be the true owners of the company's assets. The famous legal scholar *Friedrich Carl von Savigny*, professor of law and, in 1843, as a minister in Prussia in charge of the new legislation for stock corporations, expressed this view as follows: "Für diese Auffassung spricht der Umstand, daß ursprünglich [i.e., before incorporation by the government, T.B.] gewiß eine reine Sozietät (also Miteigentum der Einzelnen) vorhanden ist, und daß die spätere Erteilung der Korporationsrechte gewiß nicht dazu bestimmt ist, das innere Rechtsverhältnis wesentlich umzuändern"<sup>15</sup>. This doctrine had remarkable consequences like, e.g., a contractual duty of fair treatment and consideration for the other shareholders. And it had also clear consequences for their rights as "true co-owners" vis-à-vis the company's management<sup>16</sup>. Whether this doctrine of the corporation as a set or web of contracts ever reflected the details of the legal framework, the opinion of the courts and

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the actual behaviour in practice, seems doubtful. In any event, at least after the first World War, this legal doctrine was abandoned. The political and social reasons for this development cannot be described here<sup>17</sup>. Pathbreaking was a small essay by the industrialist and later German foreign minister, *Walter Rathenau*<sup>18</sup>.

Today the participation and role of the employees in corporate governance, the "codetermination", bars any doctrine or notion of the stock corporation as strictly a convention of, or a web of contracts among, its shareholders. Other stakeholders, especially the employees, are considered to be "members" of the firm ("Unternehmen") as well, although with different rights. One consequence of this development for corporate governance is that management is held to also take the interests of the other stakeholders into consideration<sup>19</sup>, which means in practice that management is given more leeway to make decisions at its discretion. According to German law, management is not obliged to maximize the value of the shares. Whether this is an economically sound and recommendable structure is, of course, another question.

As we are among lawyers here I cannot forgo to add that micro-economic theory apparently lags long behind legal theory: Microeconomics discovered the "Firm as a Nexus of Treaties" or a web of contracts among all stakeholders only recently<sup>20</sup>.

### 3. The company organs

Stock corporations have three organs: the shareholders' meeting ("Hauptversammlung"), the supervisory board ("Aufsichtsrat"), and the management board ("Vorstand"). The supervisory board is supported by independent auditors who have to check the annual statements of account. A more detailed picture would reveal a complex structure of balance of powers between these three organs. Some key points should, however, be mentioned.

#### a) The formal regulation

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The *shareholders' meeting* is not considered to be the highest or the chief organ of the stock corporation. Its powers are limited to clearly defined basic decisions such as changes of statutes, approval of the annual statements of accounts, distribution of (half of) the annual balance-sheet profits, consent to some specific structural changes such as mergers, issuance of new stock and the like<sup>21</sup>. It elects the members of the supervisory board, as far as these are representatives of the shareholders and not to be appointed by the employees' side. But it is not entitled to give any instructions either to the supervisory or to the management board. Let me add that the position or legal *rights of the single shareholder* vis-à-vis management and the members of the supervisory board could still be improved. There is, for instance, no derivative suit in German law<sup>22</sup>.

The German *two-tier* or *dual boards system* which distinguishes between a management board and a separate supervisory board was already established in 1870. Originally the supervisory board was designed to represent the shareholders vis-à-vis the management of the firm, and control it in lieu of the shareholders. Today it has a different function. It represents - at least in all larger stock corporations - the employees as well.

The *codetermination system* involves members of the supervisory board who are elected by the employees or appointed by the trade unions. In firms with more than 500 employees, one third of the members of the Aufsichtsrat is elected by the employees. In companies with more than 2 000 employees, this number goes up to one half of the members of the supervisory board. Among the representatives of the employees at least two are appointed by the labor unions<sup>23</sup>. In groups of firms ("Konzern"), the employees of the dependent firms are, other than the shareholders of such firms, entitled to co-elect the board members of the top (governing) company.

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The *supervisory board* appoints the members of the *managing board* (mostly for five years) 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 except in times of financial distress of the firm. To accomplish its duties, the board has the right to receive comprehensive information. 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.

The *chair of the supervisory board* has a particularly influential position. He prepares the - comparatively infrequent<sup>24</sup> - meetings of the board, proposes the agenda, and stays in steady contact with the management. Management has to brief the chair immediately on all important decisions. If there is a stalemate in a vote by the board under a codetermination regime (a rare event), the chairman who is elected by the shareholders and not by the employees, breaks the tie.

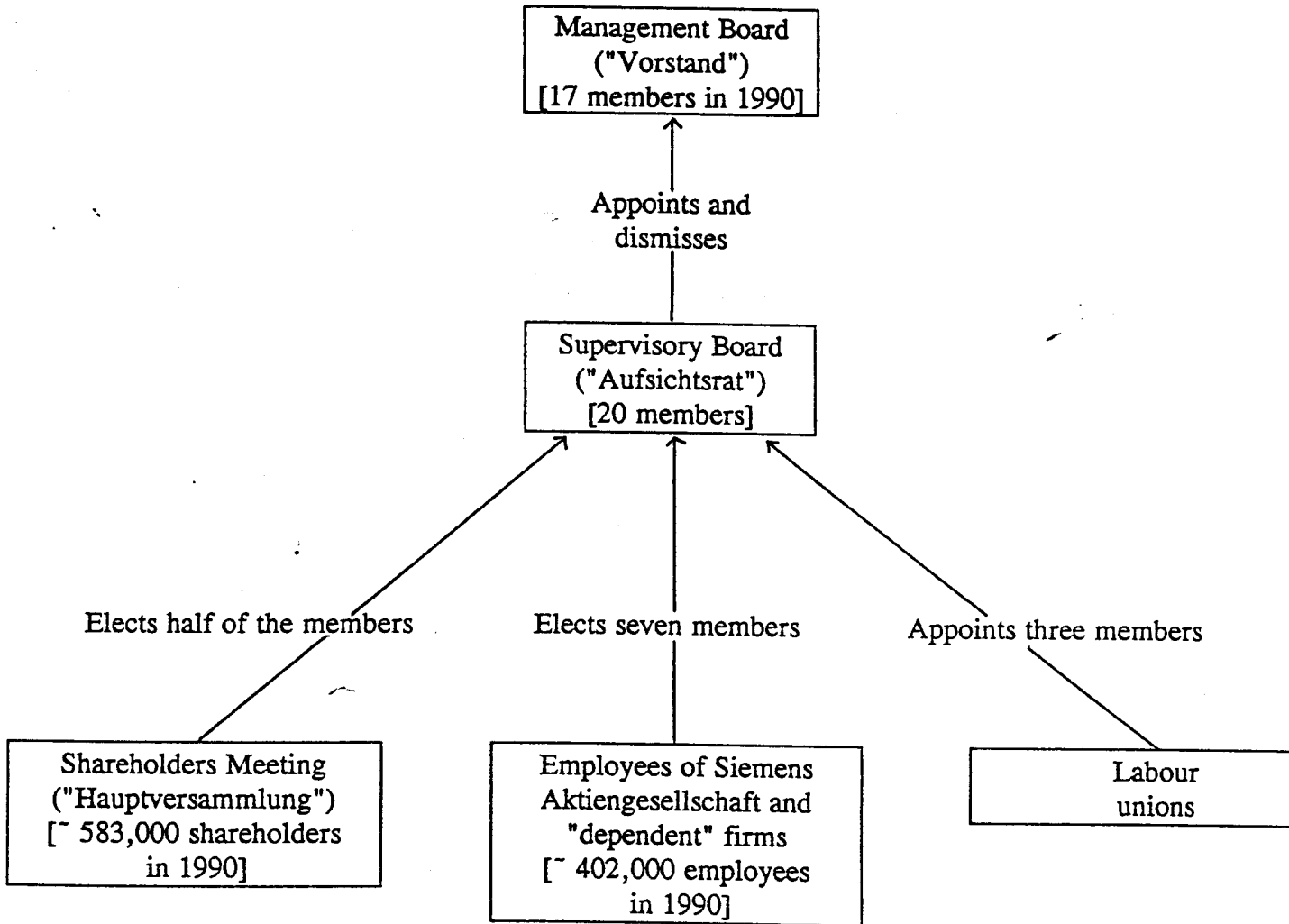
b) Practical example: Siemens Aktiengesellschaft

Figure 3 below shows the corporate governance structure of Siemens Aktiengesellschaft. The structure is not the same one for every stock corporation, as the number of the members of the supervisory board and the representatives of the labour unions vary with the number of employees of the respective company.



**Figure 3**

Corporate Governance Structure of Siemens Aktiengesellschaft



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#### 4. The Practice of Internal Monitoring

In the following section I will try to describe briefly how corporate governance works in practice in large widely-held stock corporations.

Here we should look, first, at the role of the banks, and, second, at the role and performance of the main internal monitor of management, the supervisory board<sup>25</sup>.

##### a) The role of the banks

Banks play a role in corporate governance in Germany especially in big-widely-held firms in several respects:

- as creditors (the importance of loan finance for big firms and the relevance of credit finance for corporate monitoring is omitted in the following<sup>26</sup>);
- as shareholders;
- as proxy holders;
- by personal interlocks with the respective firms.

##### aa) Bank control of proxies

Banks vote the stock of clients who have deposited their shares with them. In order to do so they need a special written power of authority. This proxy cannot be given for more than fifteen months, and it is revocable at any time. Before a shareholders' 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. 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 shareholders' meetings, however, a bank may only vote stock if it receives explicit instructions from its shareholders<sup>27</sup>.

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The following table 3 shows the voting blocks at the shareholders' meetings of 33 widely-held stock corporations among the 100 largest firms in 1986. Note that this statistic adds own holdings of banks, the holdings of bank subsidiaries, and the banks' proxy holdings.

According to *Gottschalk's* study, banks represented more than four-fifths (82.67 %) of all votes present in the meetings. Consequently, they were able to elect the members of the supervisory board as far as these are elected by the shareholders. The breakdown in our table shows also that the voting rights are highly concentrated in the three largest private banks (Deutsche Bank, Dresdner Bank, Commerzbank).

Table 3

Voting blocks of the banks at the shareholders' 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	Commerzbank	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	16,92	31,60	63,48	98,34
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	97,23
13 Mannesmann	50,63	20,49	20,33	9,71	50,53	95,40
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	2,59	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
98 Hapag-Lloyd	84,50	48,15	47,82	0,39	96,36	99,50
on average	64,49	21,09	15,30	9,05	45,44	82,67

\*Source: A. Gottschalk, Der Stimmrechtseinfluß der Banken in den Aktionärsversammlungen von Großunternehmen, WSI-Mitteilungen, 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 account, their proxy holdings and the shares held by investment companies which are subsidiaries of the respective banks.

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bb) Banks as shareholders

I have already mentioned that, according to German banking law, credit institutions may acquire and hold participations in non-bank firms<sup>28</sup>. The real extent of such holdings, especially in big firms, is still unclear, as these holdings have only to be disclosed if they exceed 20 % of the respective firm's capital<sup>29</sup>. This threshold will be lowered to 5 % in the near future<sup>30</sup>. Table 3 above comprises the votes which come from shares held by banks on their own account.

Participations in non-bank firms can be held either directly by a bank or by a subsidiary. An important role for our issue is played by so-called "Vorschaltgesellschaften". These are firms in which financial as well as other firms hold small stakes of, say, 10 %. The Vorschaltgesellschaft itself holds a stake in a publicly-held corporation. This structure serves as an antitakeover device; I will get back to it later.

Another important source of influence of banks by votes stems from the holdings of investment funds which are subsidiaries of banks. According to German banking law, banks and insurance companies may set up and run investment funds, which then may acquire and hold equity stakes in firms. Although the law asks investment fund managers to vote the shares themselves and not to give proxies to third parties<sup>31</sup>, this provision does not exclude an informal agreement between the fund manager and the parent bank about how to vote.

cc) Personal interlocks

Considering the extent of influence of banks at the shareholders' meetings, it should not be surprising that there are personal interlocks between seats on the supervisory boards of the respective firms and the representatives of banks. Influence on management, its decisions, its appointment and dismissal is not exercised directly by the shareholders but by

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the supervisory board, as has been shown above.  
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. Table 4 shows the personal interlocks  
among firms and banks within the group of the largest  
100 German companies in 1990.

**Table 4**

Personal direct interlocks between firms and banks  
(both out of the group of the 100 largest enterprises)

Rank of the firms	Year	Bank (B)	Number	
			into whose supervisory board B sent its managers	which sent their managers into the board of B
14	1990	Deutsche Bank	35	2
20	1990	Dresdner Bank	19	1
23	1990	Commerzbank	16	4
36	1990	Bayerische Vereinsbank	3	2
52	1990	Bayerische Hypo- theken- und Wechselbank	2	4
73	1990	Westdeutsche Landesbank	5	1
93	1990	DG Bank Deutsche Genossen- schaftsbank	5	0

Source: Neuntes Hauptgutachten der Monopolkommission, Bundestags-Drucksache 12/3031, at p. 228-232.

dd) Policy issues

The role of the banks in corporate governance has been discussed and questioned since decades. This discussion centers mainly around their own holdings and the "accumulation of power" stemming from the various sources of influence. However, as far as the depositary voting system is concerned, almost no one really wants to do away completely with the proxies for banks and choose another system, like, e.g., proxies for management, as found in the U.S.<sup>32</sup>. The present debate centers around certain improvements like disclosure of conflicts of interests, disqualification of banks from voting in certain cases, reports to the shareholders, and others. On Dec. 8, 1993, a hearing was held by the Committee on Economic Affairs (Wirtschaftsausschuß) of the Federal Parliament where these issues were discussed<sup>33</sup>.

b) Performance of supervisory boards

Although the supervisory board in the German system is separated by law from management, and although it is the shareholders (the depot institutions and other shareholders) as well as the employees who elect the members of the supervisory board rather than management itself or even a CEO, there is growing dissatisfaction with the way supervisory boards work and perform<sup>34</sup>. Apart from some more anecdotal evidence, however, reliable empirical work on the performance of our supervisory boards is scant<sup>35</sup>. The Committee on Economic Affairs (Wirtschaftsausschuß) of the Federal Parliament recently dealt with this issue. Various policy recommendations have been put forward in the literature, but no legislative action has been considered thus far. The whole issue is politically sensitive as the system of codetermination could be affected.

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## 5. External Monitoring

### a) External vs. internal monitoring

Theoretically, there are several instruments and devices which can serve to align the interests of management with those of the stockholders, employees, and creditors of a firm:

- “ monitoring of the management by the supervisory board;
- “ pressure from the product markets as far as these are competitive;
- “ competition in the market for managers;
- “ incentives in contracts, with the compensation of managers tied to their performance;
- “ monitoring by creditors;
- “ the threat of bankruptcy and the loss of prestige and reputation;
- “ legal rules under which managers must act with loyalty and reasonable care with respect to the firm and its various stakeholders;
- “ the threat of hostile takeovers ("market for corporate control").

Not all these devices are thought of as pursuing the same goal. The liability rules, for example, are more concerned with misbehaviour such as self-interested conduct by management, rather than with monitoring managerial efficiency.

In the following I will not deal with all of these instruments for "internal" and "external" monitoring but will confine myself to hostile takeovers within our corporate governance system.



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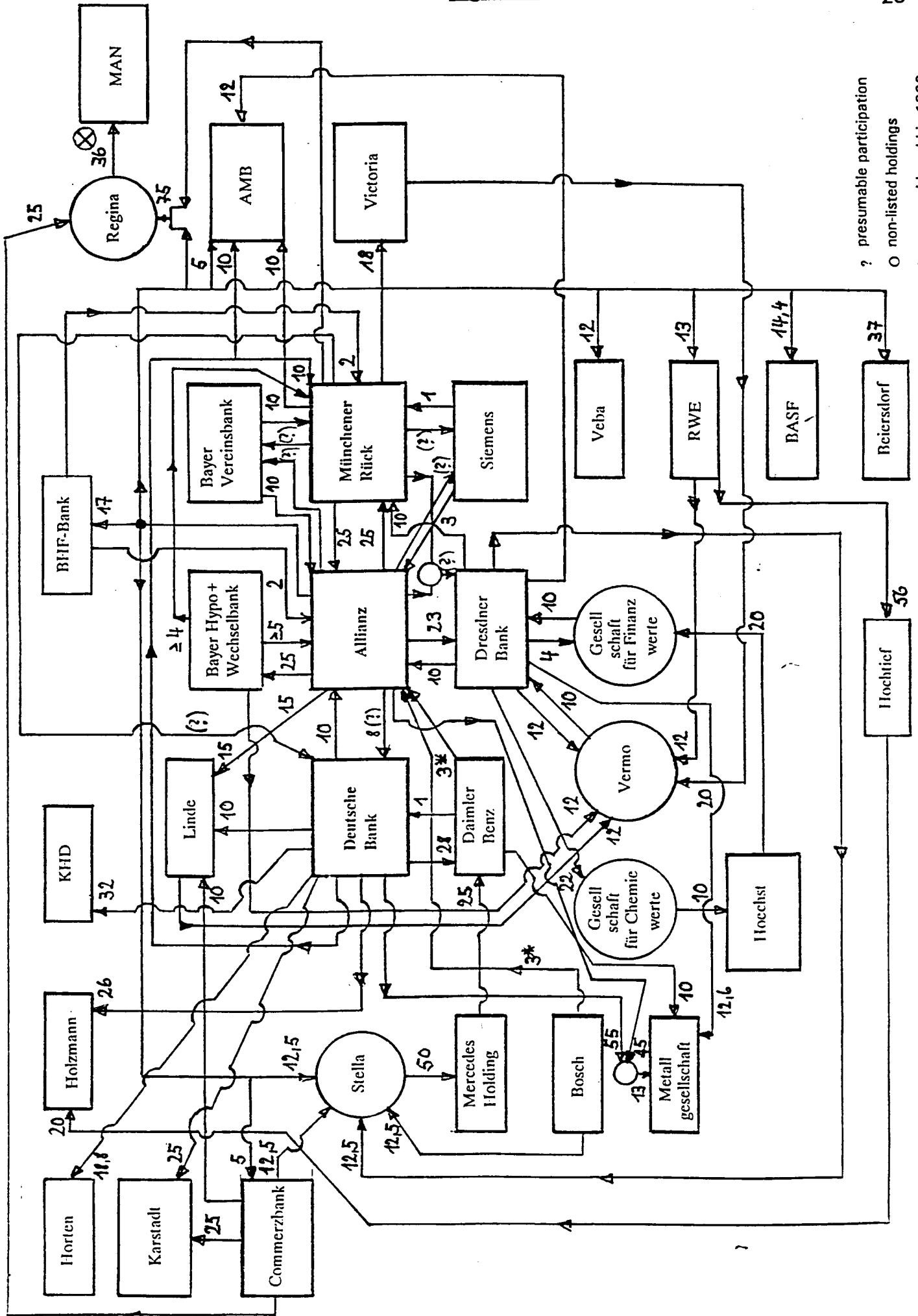
b) Public hostile takeover bids

To date, no public hostile takeover bid has been successful in Germany. The attempt of the French company AGF to take over the insurer AMB has recently been settled by an agreement, and the attack launched by Italy's Pirelli on the German tire maker Continental AG has been warded off successfully by the support of German banks and the government of a Federal State<sup>36</sup>. The reasons for these few attempts and the impediments to hostile takeovers have been described in depth already<sup>37</sup>. Let me mention only some few of them:

- There are comparatively few possible targets for public hostile takeovers on the German market.
- The role of banks in the respective firms as large proxy holders makes hostile takeovers unlikely.
- Further impediments are the two-boards structure and the role that employees play in corporate governance in Germany.
- There are statutory provisions against hostile takeovers, particularly caps on voting rights ("Höchststimmrechte"), especially in our large widely held stock corporations<sup>38</sup>.
- Many large corporations with widely-distributed stock have equity links to each other by means of small holding companies ("Vorschaltgesellschaften") for the purpose of acting as a white knight in case of a hostile takeover attempt (see figure 4, below).

German industry as well as our government has always, until today, blocked plans of the EC-Commission to introduce legislation that would ease hostile takeovers. The debate whether and under what conditions hostile takeovers should be permitted ist still continuing<sup>39</sup>.

Figure 4



? presumable participation  
 O non-listed holdings  
 • presumably sold in 1993  
 ⊗ votes (in %)

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#### IV. The Present Debate and Ongoing Work

What are the issues of the current corporate governance debate in Germany? What is on the agenda and which questions or reforms can be expected to come to the forefront in the near future?

There are, to my knowledge, three major issues which can be identified in this respect.

##### 1. "Finanzplatz Deutschland"

A remarkable effort has been made to promote "Finanzplatz Deutschland" by both the government and the (financial) business community for quite some time. This effort has certainly been given a boost by the decision of the EC to place the European central bank in Frankfurt. These circumstances have a lot of impact on, and bring quite a lot of changes for, our large firms, the way how they are financed, disclosure requirements, and the traditional bank-firm relationships in Germany. Let me just mention a few points.

A draft of the "Zweites Finanzmarktförderungsgesetz" as of August 1993 provides that a new Federal office will be established with the task of supervising the securities markets. The same draft act provides for binding insider rules and contains disclosure requirements. In former acts the Federal Parliament has already lifted impediments to immediate market financing of firms by debt or equity securities.

The relationships between our large firms and credit institutions have been in a state of flux for years because of increasing competition from foreign institutions as well as changing financial conditions and new or improved financing instruments. All this has, of course, influence on corporate governance within these large firms.

##### 2. The Hearing of the Committee on Economic Affairs on the "Power of Financial Institutions" of Dec. 8, 1993

As I have mentioned earlier, on Dec. 8, 1993, the Committee on Economic Affairs of the Federal Parliament held a public hearing

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on the "Power of Banks and Insurance Companies". The Committee put a list of questions to legal and economic scholars as well as to several Federal authorities and lobbyists. The list concerned questions like

- whether equity holdings by financial institutions in non-bank firms should be limited;
- whether and how the actual depositary voting system in Germany should be changed or amended;
- what steps should be taken in order to improve the performance of our supervisory boards;
- whether and how personal and capital interlocks between financial firms should be treated.

As one might expect, views on these topics and on the need for reform were not unanimous. Whether and in what direction the Federal Parliament will act in this or that respect remains completely unclear. Changes cannot be expected in the next future.

### 3. The Law of Groups of Firms

A separate set of elaborated rules for "Groups of Firms" is a favorite child both for our legislation and for German legal scholars. There is an eminent body of literature on how corporate governance works and is affected within groups of companies. What are the rights of shareholders if management decides to set up separate units and conduct the business of the group in subsidiaries rather than in the parent companies? How can the rights of the supervisory board of the parent company in such a case be preserved? How does the influence of a parent company on the management of a subsidiary influence the rights of the subsidiary's shareholders and its supervisory board? How can these new agency problems be solved? This discussion is still in full flux both in the academic literature as well as in the rulings of the Federal Civil Court<sup>41</sup>. A report about this

discussion would, however, require another  
comprehensive article.

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\* Dr. jur., Professor, Universität Osnabrück/Germany; Director, Institut für Handels- und Wirtschaftsrecht, Universität Osnabrück, Katharinenstr. 15, D-49069 Osnabrück. Paper, presented at the Corporate Governance Forum, Stockholm/Sweden, on Dec. 10, 1993.

<sup>1</sup> Source: Statistisches Jahrbuch 1993 (ed. Statistisches Bundesamt, Wiesbaden), at 572.

<sup>2</sup> 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).

<sup>3</sup> Cf. the list of the largest 100 firms in: Bundestags-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. 2).

<sup>4</sup> Source: Monatsberichte der Deutschen Bundesbank, 1992, at p. 23.

<sup>5</sup> For a short overview see M. Hauck, The Equity Market in Germany and its Dependency on the System of Old Age Provisions, in: Baums/Buxbaum/Hopt (eds.), Institutional Investors and Corporate Governance, 1993, at p. 555 ff.

<sup>6</sup> M. Theisen, Der Konzern, 1991, at p. 1. Most recently cf. H. Görling, Die Verbreitung zwei- und mehrstufiger Unternehmensverbindungen. Ergebnisse einer empirischen Untersuchung. Die Aktiengesellschaft 1993, p. 538 ff.

<sup>7</sup> For a description and analysis in English cf. U. Immenga, Company Systems and Affiliation, in: Int'l Encyclopedia of Comparative Law, Vol. XIII, Business and Private Organizations (ed. A. Conard), chapter 7 (1985).

<sup>8</sup> See Baums, Foreign Financial Investments in German Firms - Some Legal and Policy Issues. Arbeitspapiere Institut für Handels- und Wirtschaftsrecht der Universität Osnabrück 8/93 (1993).

<sup>9</sup> For a detailed description see Baums, The German Banking System and Its Impacts on Corporate Finance and Governance, in: Aoki/Patrick (eds.), Japanese Finance and the Main Bank System, Oxford University Press, 1994, chapter 12.

<sup>10</sup> Source: Hearing of the Committee on Economic Affairs (Wirtschaftsausschuß) of the Bundestag on "Macht der Banken und Versicherungen" on Dec. 8, 1993, Written Statement of the Bundesaufsichtsamt für das Kreditwesen, at p. 6.

<sup>11</sup> For more information see M. Hauck, supra N. 5.

<sup>12</sup> Source: A. Gottschalk, Der Stimmrechtseinfluß der Banken in den Aktionärsversammlungen von Großunternehmen, WSI-Mitteilungen, 1988, at p. 298. - Gottschalk adds up the shares of banks held by them on own account, their proxy holdings and the shares held by investment companies which are subsidiaries of the respective banks.

<sup>13</sup> Aktiengesetz vom 6. September 1965, Bundesgesetzblatt  
1089.

<sup>14</sup> Bundesministerium der Justiz, Referentenentwurf, 15. April  
1992, Gesetz zur Bereinigung des Umwandlungsrechts.

<sup>15</sup> Cf. T. Baums (ed.), Gesetz über die Aktiengesellschaften  
für die Königlich Preussischen Staaten vom 9. November 1943,  
Scientia Verlag, 1981, Introduction, at p. 43. - A free  
translation reads as follows: Before its incorporation by the  
authorities a stock corporation is a partnership ("Sozietät")  
with its partners as co-owners, and the act of incorporation  
certainly does not intend to change this interior structure and  
relationship between the shareholders substantially.

<sup>16</sup> For the legal doctrine on the position of managers as  
"mandataries" of the stockholders see T. Baums, Der  
Geschäftsleitervertrag, 1987, at p. 9 f.; for an assessment of  
the factual distribution of powers between stockholders and  
managements at that time, however, R. Wiethölter, Interessen und  
Organisation der Aktiengesellschaft im amerikanischen und  
deutschen Recht, 1961, at p. 66 ff.

<sup>17</sup> Cf., e.g., E.J. Mestmäcker, Verwaltung, Konzerngewalt und  
Rechte der Aktionäre, 1958, at p. 12 ff.

<sup>18</sup> W. Rathenau, Vom Aktienwesen. Eine geschäftliche  
Betrachtung (1918).

<sup>19</sup> Cf., e.g., H.J. Mertens, in: Kölner Kommentar zum  
Aktiengesetz, 2nd. ed. 1989, at p. 21 ff. (§ 76 notes 7 ff.).

<sup>20</sup> M. Aoki/B. Gustafsson/O.E. Williamson (eds.), The Firm as a  
Nexus of Treaties (1990).

<sup>21</sup> See § 119 Stock Corporation Act.

<sup>22</sup> The instrument of a "derivative suit" for individual  
shareholders might be, admittedly, still more important within a  
system where management gets proxies from shareholders, and  
where no independent and powerful supervisory board exists.

<sup>23</sup> For further details see H. Wiedemann, Codetermination by  
workers in German enterprises, The American Journal of  
Comparative Law 28, 1980, at p. 79 ff.

<sup>24</sup> 3-4 times per year; cf. K. Bleicher/H. Paul, Das  
amerikanische Board-Modell im Vergleich zur deutschen Vorstands-  
/Aufsichtsratsverfassung - Stand und Entwicklungstendenzen, in:  
Die Betriebswirtschaft 46, 1986, at p. 263 ff.

<sup>25</sup> The following section relies very much on former  
publications of mine on the issue: Baums, Corporate Governance  
in Germany: The Role of the Banks, Am.J. Comp.L. 40, 1992, at  
p. 503 ff.; same, Takeovers vs. Institutions in Corporate  
Governance in Germany, in: Prentice/Holland (eds.), Contemporary  
Issues in Corporate Governance, Clarendon Press, Oxford 1993, at  
p. 151 ff.; same, The German Banking System and its Impacts on  
Corporate Finance and Governance, in: Aoki/Patrick (eds.),  
Japanese Finance and the Main Bank System: Its Relevance for  
Developing and Transforming Economies, Oxford University Press  
1994, chapter 12.

<sup>26</sup> Cf. specifically on this issue, Baums, in: Aoki/Patrick,  
supra N. 25.

<sup>27</sup> Cf. §§ 128, 135 Stock Corporation Act (Aktiengesetz).

<sup>28</sup> For a discussion of the policy questions connected with this regulation cf. Baums, *Verbindungen von Banken und Unternehmen im amerikanischen Wirtschaftsrecht*, Siebeck & Mohr, Tübingen 1992; same, *Should Banks own Industrial Firms? Remarks from the German Perspective*, in: *Revue de la Banque/Bank-Financiewezen* [Belgium], 1992, at p. 249 ff.; Baums/Gruson, *The German Banking System - System of the Future?*, *Brooklyn J of Int'l Law*, XIX, 1993, at p. 101 ff.

<sup>29</sup> § 285 Nr. 11 Commercial Code. Data for 1986 are given in table IV in Baums, *supra* N. 26.

<sup>30</sup> With the transformation of the "Transparency Directive" of the EC into German law; cf. § 21 Draft of the "Zweites Finanzmarktförderungsgesetz".

<sup>31</sup> Cf. § 10 Gesetz über Kapitalanlagegesellschaften.

<sup>32</sup> For a detailed description and discussion see J. Köndgen, *Duties of Banks in voting Their Clients' Stock*, in: T. Baums/R. Buxbaum/K. Hopt (eds.), *Institutional Investors and Corporate Governance*, de Gruyter Verlag, Berlin/New York, 1993, at p. 531 ff. For comparative studies see, e.g., R. Buxbaum, *Comparative Aspects of Institutional Investment and Corporate Governance*, in: Baums/Buxbaum/Hopt, *op.cit.*, at 3 ff.; M. Roe, *Some Differences in Corporate Governance in Germany, Japan and America*, in: Baums/Buxbaum/Hopt, *op.cit.*, at 23 ff.; W.C. Kester, *Banks in the Board Room: The American vs. Japanese and German Experiences*. Working Paper, Harvard Business School, July 1992.

<sup>33</sup> See Baums, "Macht von Banken und Versicherungen", *Schriftliche Stellungnahme für die Sachverständigenanhörung des Wirtschaftsausschusses des Bundestages*. Universität Osnabrück, Arbeitspapiere 10/93 des Instituts für Handels- und Wirtschaftsrecht.

<sup>34</sup> Cf. in the media: "Aufsichtsräte am Pranger", *manager magazin* 8/1993, at p. 32 ff.; Ogger, *Nieten in Nadelstreifen*, Droemer Verlag, 1991.

<sup>35</sup> For an overview see Baums, in: Aoko/Patrick [supra N. 25] at part III. 5. A report of former studies as well as on an own project can be found in: M. Theisen, *Die Überwachung der Unternehmensführung*, C.E. Poeschel Verlag Stuttgart, 1987, at p. 137-177. See furthermore St.N. Kaplan, *Top Executives, Turnover and Firm Performance in Germany*, Working Paper, Graduate School of Business, University of Chicago and NBER, February 1993.

<sup>36</sup> For an empirical study on the latter case see T. Baums, *Hostile Takeovers in Germany. A Case Study on Pirelli vs. Continental AG*. Arbeitspapiere Institut für Handels- und Wirtschaftsrecht der Universität Osnabrück 3/93; see also E. Cata/J. Geysen/P. Vennis, *The Pirelli vs. Continental takeover battle*, Working Paper, Solvay Business School, Brussels, June 1993.

<sup>37</sup> M. Lutter/B. Lammers, *Hostile Takeovers: Possibilities and Limitations according to German Law*, in: J.M.M. Maeijer/K. Geens (eds.), *Defensive Measures against Hostile Takeovers in the Common Market*, Martinus Nijhoff Publishers/Graham & Trotman, Dordrecht/



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Boston/London 1990, at p. 113 ff.; Baums, in: Prentice/Holland  
[supra N. 25].

<sup>38</sup> Cf. T. Baums, *Höchststimmrechte, Die Aktiengesellschaft*  
1990, at p. 221 ff. with further references; for a different  
view, e.g., Zöllner/U. Noack, *One share - one vote?, Die*  
*Aktiengesellschaft* 1991, at p. 117 ff.

<sup>39</sup> Cf., e.g., M. Adams, *Höchststimmrechte, Mehrfachstimmrechte*  
und sonstige wundersame Hindernisse auf dem Markt für  
Unternehmenskontrolle, *Die Aktiengesellschaft* 1990, at  
p. 63 ff.; Baums, *Höchststimmrechte, Die Aktiengesellschaft*  
1990, at p. 221 ff.; same, in: Prentice/Holland [supra N. 25];  
same, *Feindliche Übernahmen und Unternehmenskontrolle -*  
*Anmerkungen aus deutscher Sicht. Arbeitspapiere des Instituts*  
*für Handels- und Wirtschaftsrecht der Universität Osnabrück*  
1/93; H.J. Mertens, *Förderung von, Schutz vor, Zwang zu*  
*Übernahmeangeboten?, Die Aktiengesellschaft* 1990, at p. 252 ff.;  
D. Hahn, *Die feindliche Übernahme von Aktiengesellschaften.*  
Florentz Verlag München 1992; R. Lüttmann, *Kontrollwechsel in*  
*Kapitalgesellschaften.* Nomos Verlag Baden-Baden 1992; most  
recently K.P. Martens, *Der Einfluß von Vorstand und Aufsichtsrat*  
*auf Kompetenzen und Struktur der Aktionäre -*  
*Unternehmensverantwortung contra Neutralitätspflicht,*  
*Festschrift für Beusch,* 1993, at p. 529 ff., with further  
references.

40 Source (fig. 4): M. Adams, *Schriftliche Stellungnahme zur*  
*Sachverständigenanhörung des Wirtschaftsausschusses des Bundes-*  
*tages am 8.12.1993 zum Thema "Macht der Banken und*  
*Versicherungen"* (on file with the author, T. B.).

<sup>41</sup> A collection of materials is contained in the three volumes  
edited by H. Hirte, *Der qualifizierte faktische Konzern,* Verlag  
*Kommunikationsforum Recht Wirtschaft Steuern,* Köln 1991  
(Vol. I). 1992 (Vol. II); same, *Der Vertragskonzern im*  
*Gesellschaftsrecht,* *ibid.,* 1993; s. also  
P. Hommelhoff/J.N. Druey, *Empfiehl es sich das Recht faktischer*  
*Unternehmensverbindungen neu zu regeln?, Gutachten G/H zum*  
59. Deutschen Juristentag. Beck Verlag München, 1992.