Chapter 6

CHRISTIAN KELLERMANN

DISENTANGLING DEUTSCHLAND AG

1. INTRODUCTION

The expression “Deutschland AG”\(^1\) (“Germany Inc.”) is commonly used for the tight entanglements between private banks and industrial corporations, which are typical for the German Model (“Modell Deutschland”). These entanglements take the form of a vast network between the financial and industrial sector consisting of personal, as well as financial ties. Often the German Model is also described as “organized capitalism” (Streeck & Höpner, 2003, p. 15), because these networks allowed for the steering and the protection of the economy to a relatively high degree – in contrast to the Anglo-Saxon Model, which is more open-market-oriented. Deutschland AG’s networks originate in the early post-war reconstruction era and helped to initiate the German “Wirtschaftswunder”, the economic miracle of the 1950s and 1960s. Its long-standing success is often credited to the institutional complementarities of capital and labor having promoted a “dynamic efficiency in production and incremental innovation in products and process” (Jackson, 2003, p. 261), reinforcing a stable path of organizational learning and growth. Such institutional configurations determine the center of gravity of an economic system, either in a more corporatist direction or in a more liberal one. At the core of Germany’s steep and steady way to become one of the leading economies in the world lies its unique system of corporate governance, which encompasses all major stakeholders (unions, banks and industry) and enables long-term oriented corporate policies.\(^2\) Deutschland AG and its distinctive mode of corporate governance are the key components of the German Model (see the introduction to this book for a detailed description of the characteristics of the German Model); since the 1990s this system has come under considerable pressure to adapt to a more market-oriented system, like the U.S. type.

This pressure is primarily rooted in the German financial sector, which is traditionally characterized by the existence of large universal banks that are heavily engaged in cross-shareholding and debt-financing of corporations. With the onset of the 1990s these banks aspired to become global investment houses (like their U.S. competitors) initiating a fundamental dynamic of change in the relationship between finance capital and corporate industry. This dynamic can be summarized as a “pressure to liberalize Deutschland AG’s corporate governance institutions in line

\(^{1}\) S. Beck, F. Klobes, C. Scherrer (Eds.), Surviving Globalization?, 111—132.
\(^{2}\) © 2005 Springer. Printed in the Netherlands.
with prevailing Anglo-American practices to promote greater transparency and shareholder returns” (Jackson, 2003, p. 302). Additional pressure came from the increasing role of capital markets for corporate financing and from the perception of the superiority of the U.S. model, especially in light of the success of the “New Economy”.

Although it is almost unanimously agreed on that there are substantial changes of Deutschland AG and its mode of corporate governance, there is no consensus on how far this process might go. Some analysts argue that national characteristics will prevail observing more of an incremental, path dependent change (e.g. Vitols, 2003a; 2003b), while others ascertain a major degree of international convergence towards a U.S. style shareholder model (Kellermann, 2002). Outside the academic field, this matter is discussed comparatively passionately, a fact that is attributable to the ideological power of shareholder value symbolizing socio-economic doom for critics and cure for supporters. Critics of an increasing focus on shareholder value fear that this process will ultimately lead to the break-up of the compromise expressed in the system of Deutschland AG. As a result corporate short-termism and hostile takeovers will escalate, and the economy as a whole will be much more prone to market caprices. Advocates of shareholder value in contrast call for this change, as Deutschland AG’s “insider control system” would encourage a profligacy of resources and obstruct necessary reforms. They stress Deutschland AG’s disadvantages against more flexible, market-based systems of corporate governance like the U.S. “outsider control system”. Germany’s relatively low competitiveness in new growth industries like bio- and information technologies, entertainment and the service sector is taken as empirical validation (Nassauer, 2000, pp. 243-287).

Irrespective of this ideologically charged debate, the hypothesis of this article is that of a far-reaching convergence of the German and Anglo-Saxon systems. To approach this topic, I first outline the characteristics of Deutschland AG, before analyzing the various moments of change in the financial, legal and corporate sphere. The most striking example of change was the hostile takeover of Mannesmann by Vodafone in 1999; this case is also looked at in greater detail. Before drawing a conclusion on the future of Deutschland AG, I look at some of the main features of change and discuss some of the inherent risks of the ongoing process.

2. CHARACTERISTICS OF DEUTSCHLAND AG

The German Model codifies the integration of different groups into corporate decision-making, which is one reason why Deutschland AG is often dubbed as a stakeholder system (stakeholders such as the workers, a bank or the state), whereas the Anglo-Saxon model is typically labeled a shareholder system (i.e. many anonymous shareholders). Within the latter system equity markets play a much more dominant role in the relationship between owners (shareholders) and the management (agents) of companies. Deutschland AG’s stakeholder system, by contrast, is characterized by strategic long-term investments of a private bank in
large industrial companies as well as institutional rules that allow for an investor’s representation in a company on the supervisory board.

Three main pillars characterize the German system of corporate governance:

(1) The dominating role of banks in corporate financing and on supervisory boards;

(2) the system of industrial relations with its codetermination (Mitbestimmung) at the plant and at the supervisory board level, and

(3) a company- and production-centered management system (Jürgens & Rupp, 2002, p. 2).

I will focus on (1), the relationship between banks and industrial enterprises called the Deutschland AG, but will also look briefly on how changes in this relationship have an impact on (2) codetermination and (3) management systems and other issues of corporate governance such as corporate law and accounting standards.

The German Model of corporate finance demonstrated its full strength in the reconstruction period after World War II. As capital markets would not provide for the financing of industrial reconstruction (two lost world wars had impoverished the German bourgeoisie), bank capital became the vital factor of growth, and, hence deeply entangled with industry. Tax policies, which bolstered bank loans and discouraged equities or bond issues for industrial corporations (cf. Vitols, 2003a, pp. 250ff.), as well as many other institutional features of the German economy, such as concentrated ownership, bank proxy votes and supervisory board seats, the two-tiered board structure, voting rights restrictions, accounting and disclosure rules, codetermination, and German corporate culture, reinforced the importance of bank loans vis-à-vis stock markets and led to the specific main bank relationships typical for Deutschland AG.

The private so-called Big Banks, currently the Deutsche Bank, Dresdner Bank, HypoVereinsbank, and Commerzbank, predominantly finance the corporate sector. They offer a variety of financial services to their customers, such as the taking of deposits, consumer and commercial lending, securities underwriting, mutual fund operations, and investment advising. This diversification of business areas centers around the classical credit- or interest-based fields of action, which suggested the term universal banks.

The public savings banks (Sparkassen/Landesbanken) and the non-profit cooperative banks (Genossenschaftsbanken) actually make up for the largest market share in Germany’s banking system. The main reason (among others) for creating such institutions was to support regional development in structurally weak regions and the financing of small and medium-sized enterprises (SMEs). The prevalence of loans and of the non-profit banking sector for SMEs allowed companies to focus on
long term organic growth; this is a central characteristic of Deutschland AG, apparent in the ability to deal with business cycles in a more steady way, since banks have vital interests in the “survival” of the companies they are entangled with. Renewed capital flows and/or the temporary management of the company are more likely to succeed in the restructuring of the company for a “new start”. One major effect of this relative steadiness is the encouragement of incremental innovation through the possibility of continuous capital investments as well as research and development (R&D) (Soskice, 1999). Another is the fact that layoffs can be avoided keeping know-how in the company (Streeck, 1997).

2.1. Signal of Change: The Hostile Takeover of Mannesmann by Vodafone

In the past the capital and personal networks of large banks and corporations made hostile takeovers very unlikely. No foreign hostile takeover took place despite a relatively low market valuation of potential takeover candidates (cf. Emunds, 2003, pp. 198ff.; Windolf & Beyer, 1995, pp. 22-25). But the walls of “Fortress Germany”, as some, mainly Anglo-Saxon, commentators used to characterize Deutschland AG, began to crumble with the successful hostile bid of British Vodafone on Mannesmann in 1999/2000 – an event of systemic relevance (Höpner & Jackson, 2001).

Mannesmann used to be a paradigmatic company for Deutschland AG, with diverse industrial activities and close entanglements with bank capital. The chairman of the supervisory board was the CEO of its house bank (Deutsche Bank), and the representation of Mannesmann employees on the board followed the most expansive codetermination model, the Montan-Mithbestimmung. With its traditional steel business in decline, Mannesmann had started to transform and focus on new businesses, first on mechanical engineering and automotive technology, and later, in the mid-1990s, on telecommunication, with astonishing success (Jürgens & Rupp, 2002, pp. 1-2 and 55-56). In October 1999, Mannesmann had agreed to buy U.K. mobile operator Orange, in November, that is in reaction to that move, Vodafone made a counter-bid for Mannesmann, mainly for two reasons: On the one hand Mannesmann’s successful telecommunication business fitted into Vodafone’s global aspirations (with Vodafone taking over AirTouch earlier in 1999), on the other hand Vodafone saw its own strategic interests threatened by Mannesmann’s plans in Britain.

One major sign of the erosion of this Deutschland AG-relationship was the fact that Mannesmann’s main stakeholders, Deutsche Bank and the workers’ union IG Metall, followed the takeover with a “benign neglect”; in fact they not only accepted the takeover bid, they silently approved of it: “There was no mobilization of Deutschland AG”, says Ulrich Jürgens (ibid., p. 56), an expert on German manufacturing. One reason for this “silence” can be traced back to Deutsche Bank’s unfortunate role in a takeover-battle prior to this case, between Krupp and Thyssen in 1997, which severely conflicted with its new focus on the investment business. That was because on the one hand Deutsche Bank had a seat on the supervisory board of Thyssen, and on the other hand they supported Krupp in its strategy to take
over Thyssen, provoking not only angry public protests, but also a basic conflict on the board itself between traditionalists ("universal bankers") and investment bankers. Since the latter won this controversy, they pressed for "neutrality" of their house in the takeover-battle between Vodafone and Mannesmann (cf. Höpner & Jackson, 2001), but neutrality in this case was synonymous with silent support.

Two aspects are important for understanding the union’s behavior: First, Mannesmann’s business fields were extremely heterogeneous at that time, with an immense overweight in telecommunications at the expense of the other fields of activity. Unions and labor representatives pushed a plan to split up the corporation in order to reconstitute an independent development of Mannesmann’s traditional business divisions. Until then the “conglomerate discount” made necessary acquisitions more expensive, hence securing the support of shareholders as well as labor representatives (cf. ibid.). Second, Klaus Zwinkel, head of IG Metall and member of the Mannesmann supervisory board, stated that since the chairman of the supervisory board, at that time Deutsche Bank’s CEO Klaus Ackermann, had a double voting right he could not stand against the takeover including the bonus payments ("golden handshake") of around Euro 60 million. to the Mannesmann-CEO Josef Esser and other executives, who are currently under trial (2004) for bribery. Just as the takeover demonstrated the beginning of the end of Deutschland AG, the trial reflects the frictions between Corporate Germany and the shareholder system.

Furthermore, the takeover was managed via the capital market in form of stock swaps, which manifested the beginning dissolution of bank and industrial capital in Germany in a curious way:

“Mannesmann’s size, excellent share performance, and use of less transparent accounting standards failed to protect it from takeover through a cashless share swap from its smaller but highly capitalized U.K. competitor.” (Jackson, 2003, p. 284)

To sum up this hostile takeover’s systemic implications for Deutschland AG, it is notable that its usual features to discipline the management were ineffective, such as the concentrated ownership structures, the power of the large banking institutions, the insider system of corporate governance, and the strong position of unions and labor representatives in a company. Earlier attempts for hostile takeovers (e.g. Continental by Pirelli or Thyssen by Krupp) failed for some of those reasons, and not the least on moral grounds. During the Mannesmann case there was no question of legitimacy about the takeover itself.

This often-cited example reveals many moments of change within Deutschland AG: First, the growing importance of financial markets in Germany, second, the tendency of large commercial banks to withdraw from their traditional role as house bank to industry, third, concentration of a diversified company on the most profitable core business, and fourth, the loss of power of traditional stakeholder groups such as workers’ representatives in corporate governance. The key driving force behind this change is the growing importance of shareholder value rooting in the financial sector and having considerable spill-over effects on Corporate Germany spurring consolidation and strategic alignments of business fields.
The hostile takeover of Mannesmann by Vodafone marked only the beginning of a new at-arms-length relationship between banks and industry and not the end of it. In fact there is still a relatively high degree of mutual stakeholding in Germany’s 30 largest companies. In 2002, large chunks of the stocks of half of these 30 companies were either held by the founding family (e.g. the Siemens family held 6.9% of Siemens AG) or by another company (e.g. Siemens AG held 71.9% of Infineon). A bank, an insurance company, or the state held large stakes in the other half (cf. Vitols, 2003b, pp. 141-142.). Encouraged by the elimination of the capital gains tax in 2002, most of these stockholding institutions announced plans for disengagement. A broad-based trend towards dissolution of the intercompany shareholdings is in the making (O’Sullivan, 2003, p. 47).

3. FINANCIAL DYNAMICS

Change of the German Model began with dynamics in the financial sector a decade or so before the Mannesmann-bid by Vodafone. The most important market changes promoting a refocusing of banking activities can be summarized with the following five trends (cf. Börner, 1998, p. 35ff.):

Globalization: Many banking activities and business areas expanded from the national to the international level. This was mainly caused by the introduction of new information and communication technologies (ICTs), which allowed for a further dematerialization of banks’ main asset, money. Money, unlike other goods or products, is highly mobile. Globalization of financial institutes’ business areas and range of action further correlates with globalization trends in industrial capital. Large companies can attract capital on international financial markets under more favorable conditions, which promoted the growing tendency of disintermediation, that is the marginalization of banks in their original role as credit/money-intermediaries. The structural prerequisite for the globalization of finance capital was the political deregulation and liberalization of capital markets (cf. Swary & Topf, 1992), the break-up of the Bretton-Woods system of a fixed exchange rate regime and the abolition of capital controls. Before that, trans-border financial activities were highly regulated, in many cases impossible (cf. Huffschmid, 1999; Guttmann, 1994).

Securitization and investment banking: The increasing substitution of credit money by recourse to financial markets for corporate bonds and equity capital increased the importance of the Anglo-Saxon model of investment banking in Germany, because this market was primarily controlled by foreign investment houses. This trend was further reinforced by a wave of mergers and acquisitions (M&As) within the industrial sector, privatization of state firms (cf. Huffschmid, 1999, pp. 74-78) and the booming business of initial public offerings (IPOs) which gained momentum particularly after the establishment of the Neuer Markt, the stock market segment for start-up companies; the years 1998, 1999 and 2000 were all record-breaking years (by the measure of IPOs and in comparison to the main market – “Amtlicher Handel”) (O’Sullivan, 2003, p. 48).
**Trading**: Commercial banks’ own trading activities became more important; this happened in the context of modern ICTs and the globalization of their business:

“The growing competition within the banking system rendered trading around the clock, around the world as a special field of investment banking an essential cornerstone of banks in general.” (Börner, 1998, p. 35)

Indicators for the growth dynamic as well as the high degree of competition in the trading business are strong volume growth rates and the emergence of all kinds of financial innovations such as derivatives.^[6]

**Differentiation and rationalization of distribution channels**: Retail banking in particular is under pressure for restructuring, whereby ICTs again play a central role, as they provide the basis for the multiplication of distribution channels for financial services (telephone banking, electronic direct banking etc.) (European Central Bank [ECB], 1999, pp. 5ff). The thinning-out of branch networks in, as often stated, “overbanked” Germany has been observable since 1992 (Koch, 1997, p. 78). Customer advisory services and transaction settlements are removed and back-office fields are centralized, rationalized and transformed into so-called bank factories (ECB, 1999, p. 7; Ruff, 1999). One motivation for these processes is a relatively low return on equity (RoE) of German banks compared to international standards. At the end of the 1990s RoE was at about five percent, one of the lowest values internationally compared (Europäische Kommission, 2001).

**Shareholder value**: The focus on shareholder value relates with the trends of globalization and investment banking. While this practice is not confined to the financial sector, it is deeply rooted in the banks’ concern to restructure and consolidate in the wake of the above challenges. In practice shareholder value is a management concept, whose central criterion for an effective corporate policy expresses itself in an above-average increase of return on equity for the proprietors of the capital stock (Rappaport, 1986). Banks focused on the increase of shareholder value according to Alfred Rappaport’s concept for several reasons: To create a powerful “currency” in the form of their own stocks for takeovers of other banks, to defend against hostile takeovers themselves, and to justify their new focus on investment banking with the corresponding restructuring and layoffs.

4. PRIVATE BANKS AS THE MAJOR ACTOR

The above-mentioned trends led to widespread changes in the German financial system during the 1990s. Foremost, the Big Banks adopted new business strategies and, together with the emerging new institutional investors, forced change on the non-profit financial sector and on industrial enterprises.

4.1. From Universal to Investment Banking

Germany’s universal banks underestimated for long the growing importance of investment banking. Next to some considerable degree of managerial neglect, this can structurally be traced back to historical particularities in the banking systems, especially if compared to the U.S. system. One key feature of universal banks has
always been the possibility for a bank to be engaged in the deposit, credit and securities business at the same time. By contrast, the U.S. as well as the U.K. banking systems were affected by the experiences during the great banking crisis in the 1930s, which led to the creation of a separated and therefore highly specialized banking system, according to which banks could either be engaged in the deposit and credit or in the securities business (Glass-Steagall Act of 1933). Deutschland AG’s main characteristic of industrial shareholding rendered obsolete for a long time the development of investment banking as an individual field of action for German banking institutes. This explains in part the dominant position of U.S. investment houses in Germany and elsewhere (cf. Huffschmid, 1999, p. 79).

It was not before the 1990s until Germany’s Big Banks aspired to expand into the then highly profitable field of investment banking and asset management, with considerable spill-over effects on Deutschland AG and the German Model. Sigurt Vitols aptly emphasizes:

“In Germany, reform has been driven for the most part by the large banks, which desire to create a home base supportive of global-player investment banks on the U.S. model.”

(2003a, p. 259)

Being “multi-specialized” means the end of universal banks’ old “vendor’s tray principle” and a focus on the most profitable business areas. Single business areas that cannot meet capital costs no longer get cross-subsidized, since cross-financing conflicts with the concept of shareholder value – the dominant benchmark for financial institutes since the onset of the 1990s:

“Banks have to respect […] – like any other company – the interests of investors more and more. They have to orientate themselves – to use a highly controversial and emotionally loaded term here – by the shareholder value”,

says Deutsche Bank’s Chief Economist Norbert Walter (Walter, 1999). The investment focus also urged banks to divest from large stakes in industrial corporations, since too tight entanglements may lead to conflicts of interest between a bank’s investment strategy and insider information.

The prevailing strategy to close this gap between the German and U.S. system and to meet the new competition were mergers and acquisitions (M&As). Since the mid-1990s, a growing number of mega-mergers in the sector were observable. Mergers were mainly characterized by national outreach, and whenever there was a cross-border merger, it was a large bank taking over a smaller institute, as in the case of the acquisition of the derivatives branch of the British National Westminster Bank by Deutsche Bank (cf. Huffschmid, 1999, p. 69). Those M&As were largely driven by the expectation to profit from economies of scale and synergetic effects. The concentration in the financial sector is further being accelerated by the unification of the European financial market. There were 215 M&As in the period from 1991 until 1998 in the German banking sector; in the years 1997/98 banking M&A activity made up 54.6% of M&As in all industries (compared to 11.2% for the U.S.; source: White, 1998, p. 37). Banks’ reorientation and consolidation in the course of the concentration on the investment business and shareholder value corresponded with and promoted the growing importance of capital markets in Germany. This in turn was the
precondition for new financial actors, specialized on investment and asset management, to emerge.

4.2. The Emergence of Institutional Investors

There are three large groups of institutional investors: Capital investment groups (e.g. unit trusts, but also highly leveraged institutions like hedge funds), pension funds (receiving their capital from financial pension contributions of employers) and insurance companies. The U.S. example demonstrates the degree of power and influence institutional investors are able to wield. In the second half of the 1990s professional U.S. institutional investors managed more than 50% of the cumulative financial assets, while in Germany this proportion amounts to only 19% (cf. International Monetary Fund [IMF], 1997, p. 135). The largest group of institutional investors in Germany is the insurance industry (Bank for International Settlements [BIS], 1998, pp. 94-99). As can be observed from the U.S. example of capital coverage of retirement provisions and the dominant role of such pension funds in an economy (Huffschmid, 1999, p. 88), there is a strong trend for M&As in Germany to achieve similar dimensions. The acquisition of Dresdner Bank by Allianz Insurances in 2001/2002 is the latest and most striking expression of the most obvious strategy to reap the enormous potential of the German pension reform. This merger allowed the marketing of all kinds of pension products from one source (cf. Deutsches Aktieninstitut [DAI], 2001). Similar endeavors of insurers and banks are observable with other institutes: Münchener Rückversicherung, the second big insurer in Germany, took over Allianz shares in HypoVereinsbank, and Commerzbank also has existing interconnections with an insurance company (Generali in Italy) – a trend that is commonly called “all-finance” (Allfinanz) or “one-stop finance”.

4.3. The Future of Public Banking

As has already been mentioned, the German financial system features two more types of banking institutes: The public savings banks – Sparkassen (municipal savings banks) and Landesbanken (regional savings banks at state-level) –, which account for approximately one-half of all banking system assets, and the credit cooperative banks (Genossenschaftsbanken), which account for about 20% of banking system assets (cf. Vitols, 2003a, p. 251).

The main reason (among others) for creating such institutions was to support regional development in structurally weak regions and the financing of SMEs, a central feature of the German Model. For this purpose there existed a warranty liability (Gewährträgerhaftung) and the institution burden (Anstaltslast) of the public owners, which allowed for smaller equity capitalization and the granting/extension of loans to weaker enterprises; within the latter, savings and regional banks have a market share of about 75% (Beck & Scherrer, 2003, p. 744).

Currently public banking is under pressure to adapt to market orthodoxy, stemming both from within the savings banks, notably the large ones, and from the private banking sector. The latter accuse the public sector of distorting the national
market due to their “social contract”, and therefore of being jointly responsible for private banks’ high losses and unprofitability by the turn of the millennium. Due to EU competition policy, the German system of savings banks is being changed in a way that the warranty given by the state as bearer of risks, that is constituting a prompt deficiency suretyship, is discarded. This policy is the consequence of a complaint of the European Banking Association (EBA) with the EU-Commission in 1999 (EU-Beihilferecht or EU Law on Government Aid). The process began with the transformation of the Landesbanken: The abolition of the state warranty increases borrowing costs on financial markets for those regional banks, which in turn bear the refinancing of most savings banks; hence, their core business, the commercial lending business with SMEs, is now more costly and consequently handled more restrictively, having contractive effects on the performance of the German economy (cf. “Without Credit”, 2003), particularly in East Germany (cf. Beck & Scherrer, 2003, p. 744).

The structural and operational dynamics in Germany’s financial sector led to the emergence of very large and powerful financial institutions that exert considerable influence on the economy as a whole and also on the legislative process. Another major driving force for change in financial regulations in Germany in the 1990s was a shift in Big Banks’ interests, with the National Association of Private Banks (Bundesverband deutscher Banken) taking the lead in making policy proposals (Vitols, 2003a, p. 252); a closer look at these innovations is necessary.

5. LEGISLATIVE INNOVATIONS

From the 1990s until today there have been a number of legislative initiatives that led to an erosion of Deutschland AG’s pillars. The way that these legislative changes were brought about clearly showed that

“[…] political interests seem to be influenced in an important way by the economic context in which they operate. […] There is a need to look at the actual power that various interest groups have in the corporate economy as well as in the political system.” (O’Sullivan, 2003, pp. 63-64.)

The role of the government was mainly reduced to arranging the legislative process and drafting various versions of the following laws (cf. Vitols, 2003b). 13

There is a whole canon of Laws that has been initiated: The Second (1994), Third (1997), and Fourth Financial Markets Promotion Laws (2002) (Zweites, Drittes, Viertes Finanzmarktförderungsgesetz). The Second Financial Markets Promotions Law marked “the most important step toward establishing U.S.-style regulation of capital markets” (Vitols, 2003a, p. 252), as it established an independent regulatory agency (Bundesaufsichtsamt für Wertpapierhandel) for surveillance of the financial market, modeled on the U.S. Securities and Exchange Commission (SEC), and a set of rules for dealing with insider information (cf. Sablowski & Rupp, 2001). The Law on Transparency and Control in Corporations (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich, KonTraG) in 1997 authorized stock option plans and the buyback of shares (an initiative of industry and banking associations); a number of provisions increased shareholder value’s
influence within the German Model, such as multiple voting rights and the removal of voting rights restrictions. Furthermore, banks could no longer use proxy votes if their direct shareholding exceeded five percent; and the supervisory board was strengthened (cf. Jackson, 2003, p. 270). According to the Association of the German Industry (Bundesverband der Deutschen Industrie, BDI) KonTraG increases the efficiency of company bodies in line with financial market requirements (BDI & PricewaterhouseCoopers [PWC], 2001, p. 36). Additional innovations were the Law on Reform of Commercial Law (Handelsrechtsreformgesetz), the Law on Registered Shares and the Facilitation of Voting (Gesetz zur Namensaktie und zur Erleichterung der Stimmrechtsausübung, NaStraG), the Law on Acquisition and Purchase of Securities (Wertpapiererwerb- und Übernahmegalgesetz, WpÜG), and the Law on Facilitating the Raising of Capital (Kapitalaufnahmeerleichterungsgesetz, KapAEG). At the beginning of 2004 the Law on Modernizing Investment (Investitionsmodernisierungsgesetz), which has considerable consequences for alternative asset investments, took effect: For the first time in Germany, the distribution of so-called hedge funds was allowed. This change affects Dachfonds (funds of funds) as well as investing in single or target funds (Zielfonds). Unlike other investment funds, hedge funds are largely unregulated; they “move in a regulatory and supervisory no man’s land” (Deutsche Bundesbank, 1999, p. 38; translation: CK). They can take high risks without hedging (the name hedge fund is therefore very misleading), which might yield extraordinary high returns, but sometimes also spectacular losses (e.g. Long Term Capital Management, LTCM, in 1998). According to the National Association of Alternative Investments (Bundesverband Alternative Investments, BAI), the Investitionsmodernisierungsgesetz is the most liberal regulation in Europe (“Bundesregierung lockt”, 2003). Alternative investment classes have proved increasingly popular, as equity returns have suffered. According to Deutsche Bank Research, European hedge funds’ assets under management more than doubled form just under 14 billion U.S. dollars in 1998 to 30 billion U.S. dollars in 2001. Hedge fund industry assets are forecast to continue to grow and have average annual rates in excess of 10% per annum over the next five years (source: http://www.dbresearch.de).

5.1. Privatization of the Pension System

An especially far-reaching legislative change was the reform of the pension system. While this already drove consolidation in the financial sector (e.g. in form of the acquisition of Dresdner Bank by Allianz Insurances), it may further change the parameters with major consequences for the German Model.

A small but institutionally important first step towards the privatization of the German pension system was taken in 2001 with the co-called “Riester-Rente”, named after the Minister of Labor who initiated this reform (for details, see Kai Mosebach’s chapter in this book). Here, the main point of the pension reform is the further strain on Deutschland AG as a consequence of increased orientation towards capital market-based provisions and instruments. Focus on shareholder value is
more and more important in Germany, since a strong flow of household savings strengthens the stock market (cf. Jackson, 2003). The pension reform has a catalytic effect on the German financial system: In the former combinatory pension scheme of generational apportionment and capital coverage banks cashed in in their function as fund managers in the first place. With the reform of the pension system, private pension provision in form of regular payments in (pension) funds became a vital systemic feature. Since Germany’s Big Banks have always dominated the market with mutual and restricted funds, these are basically “arrangements of large financial institutes for large financial institutes” (Bundesverband Deutscher Investment-Gesellschaften [BVI], 1998, p. 52). Four-fifths (Euro 194 billion at the end of 1998) of public fund money is managed by three large commercial banks (Deutsche Bank, Dresdner Bank and HypoVereinsbank) and the central offices of the mutual savings banks (ibid.). Hence the pension reform constitutes a major job enlargement of existing banks in their function as asset managers:

“As soon as investment banks join into the business with capital market-based pension schemes, they move closer in the direction of the third big group of financial market actors that determines the events on national as well as international capital markets. They become institutional investors.” (Huffschmid, 1999, p. 82; translation: CK)

And as interest in shareholder value mounts, so does pressure on Corporate Germany.

6. SHAREHOLDER VALUE AND CORPORATE GOVERNANCE

The dynamics in the national financial sector have substantial effects on the corporate sector of the German economy. Yet, increasing international competitive pressure that German corporations are exposed to on commodity and production markets, as well as the enhanced recourse to international financial markets, which demand stronger attention of (international) investors’ interests, also exert a considerable strain on the German system of corporate governance by the appreciation of shareholder value issues (cf. Dufey & Hommel, 1997; Organization for Economic Co-operation and Development [OECD], 1995; Lazonick & O’Sullivan, 2000; O’Sullivan, 2003; Yamamura & Streeck, 2003; Vitols, 2003b; Jackson, 2003). In this context, the question is what this new market for corporate governance and control means for Deutschland AG and the German Model? To what degree is Germany about to adopt the Anglo-Saxon Model and give up its corporatist achievements? And would that be a deterioration or improvement for Germany? To answer these questions, a closer look at the application of shareholder value is necessary.

As a management concept shareholder value is rooted in microeconomic calculations: Simplifying the assessment procedure and financial accounting is at the core of this method in order to create an objective benchmark for the comparison of corporation’s different strategic options (Copeland et al., 1993). For this purpose, the measurement category “profit” is regarded as an unreliable and therefore inappropriate indicator for the evaluation of a company; a new indicator, the “discounted cash flow” (DCF) is introduced. The DCF is the “sum of liquid
resources that is at a corporate disposal for new investments and in particular for the distribution to capital providers in the form of interest and dividends.” (Hirsch-Kreinsen, 1999, p. 323; translation: CK) The key aspect of this measurement instrument is the suggestion of an ex-ante view by discounting expected future cash flows on the basis of the bank rate to obtain the present value (Becker, 2001, p. 48). Applying this indicator, a direct comparison of heterogeneous business fields is claimed to be possible, and branch-specific “value-drivers” become the focal point of any management (cf. Black et al., 1998). In this sense, shareholder value is an expression of a commodification of the control and coordination mechanisms within a corporation (Sauer & Döhl, 1997), leading to the concentration on core businesses. The sale or closing down of a business that is not profitable enough and not belonging to the core business therefore became a typical feature of the M&A-wave during the last half of the 1990s in Germany (a characteristic example is the chemical industry, cf. Menz et al., 1999; Becker, 2001; 2003). Deutschland AG’s conglomerates or multi-product group corporations were increasingly regarded as being unprofitable and undervalued in capital market terms, since cross-subsidizing of activities not belonging to the core would diminish the company value. The concept says that the company value of a multi-product conglomerate is less than the sum of its single business fields, hence the pressure to restructure.

The rationale behind shareholder value are neo-classical principal-agent assumptions, emphasizing micro-economic allocative efficiency eventually leading to macro-economic welfare enhancement. Defenders of the concept claim that corporations that devote themselves to shareholder value act efficiently and in the long-term interests of their shareholders, but also of their employees and clients, that is their stakeholders. The old modus of corporate governance under Deutschland AG, so they say, was too static, as an equal consideration of all stakeholders’ interests is not practicable and realizable in any microeconomic praxis. The integrative attempt must lead to a significant deterioration of profitability and the company’s market value, while on the other hand a rising market value is the basis for new investment activities (cf. PricewaterhouseCoopers [PWC], 1999). Former measurement categories of traditional accountancy are regarded as unsuitable and ineffectual, as they are not reliably interlinked with a corporation’s share price. Additionally, the previously existing margin in accountancy would complicate the international comparison of corporations, and finally the conventional system of indicators is exclusively based on past data and experiences (Becker, 2001, pp. 46ff.). To make sure that the management of a corporation is committed to shareholder value, wage components consisting of stock options and worker participation in the capital of the company are deployed – a crucial signal to financial markets that a corporation is striving to increase its shareholder value (cf. Rosen, 1996). Obviously shareholder value has an impact on German corporations and their governance system.
7. INDICATORS OF PERMANENT CHANGE

In order to be able to speak of a major and permanent change of the German Model, three aspects need to substitute for the old Deutschland AG’s mechanisms and entanglements:

1. The stock market must play a pivotal role;

2. Stocks must be held by investors, whose interests are focused primarily on corporate governance strictly in line with shareholder value principles, and


The first aspect, the forces that boosted the stock market in Germany, has been looked at in detail in the first part of this article. The legal initiatives in the 1990s were a strong impetus for the deepening of the German financial market and the creation of a German equity culture (cf. Sablowski & Rupp, 2001, pp. 46ff.). In the period from 1997 to 2001 shares held directly or indirectly by households nearly tripled to 21% (Leven, 2001, p. 1). A major innovation in this context was the already briefly mentioned Neuer Markt. Its main index, Nemax50, was renamed in 2003 and is now called TecDax as a consequence to the particularly spectacular boom-to-bust-phenomenon and the corresponding loss in reputation (O’Sullivan, 2003, p. 56). Despite the substantial bust of this market segment, the wider implications, such as equity markets’ role in raising venture capital and the corresponding boom in investment banking, marked a major change for the German Model, for example, the proliferation of U.S. accounting standards (see below). The Neuer Markt helped to boost the importance of Germany’s financial market in general – notwithstanding the recent decline, in which Mary O’Sullivan sees a “first test of the extent to which a U.S.-style ‘shareholder value’ regime will become an enduring reality of corporate governance in other countries.” (2003, p. 66)

This development coincides with Germany’s Big Banks’ new investment orientation, supported by the tax reform initiated by the SPD that made capital gains tax-free in 2002, which leads to the second aspect: The emergence of institutional investors, which is a key momentum for the dissolution of the Deutschland AG, as their investment focus is fundamentally different from a house bank’s stakeholder interest in a company. The growing short-term orientation of institutional investors has significant spill-over effects on the German system of corporate governance. Institutional investors pool and professionalize former diversified equity holding and savings (Streeck & Höpner, 2003, p. 31), increasing the sums of capital invested by institutional investors. Basically they face two corresponding options regarding a shareholding: “Voice” and “exit”. On principle, institutional investors rarely intervene actively to remedy poor corporate performance, preferring exit over voice.
But it is increasingly impossible to separate “voice” and “exit”, since “shareholder voice [...] depends on the threat of exit. Institutional investors consult with management largely outside formal institutions.” (Jackson, 2003, p. 283; cf. also Strange, 2002) To exit from an investment, that is to sell a large block of shares, becomes all the more difficult, the larger this block is, as the sale would provoke high price losses. With the amount of invested capital constantly growing, institutional investors tend to use their voice, that is their option to influence a corporation’s management to focus on shareholder value (cf. Nassauer, 2000, p. 263). An illustrating example are the “Good Governance Guidelines” set up by the California Public Employees’ Retirement System (CalPERS), telling a management how best to enhance shareholder value – hence, institutional investor’s voice differ fundamentally from Deutschland AG’s main bank relationship.

Another expression of the growing role of stock markets and corresponding market actors is the accommodation to U.S. standards in accountancy rules with the introduction of GAAP (U.S. Generally Accepted Accounting Practices) and IAS (International Accounting Standards) – referring to the third aspect in the above list. These accounting rules are “significantly more shareholder-oriented by stressing market valuations and more precise definitions of profits”, while Germany’s traditional accounting rules allow asset valuation at cost rather than market value (Jackson, 2003, pp. 271-272). Since accounting methods according to U.S. standards prioritize the disclosure of profits and losses to shareholders, they accentuate short-termism (cf. Becker, 2001). Institutional investors demand the adoption of Anglo-Saxon accounting rules to allow for cross-country comparisons of corporations (cf. BDI & PWC, 2001, p. 21). By the year 2005 IAS will be compulsory for all 6,700 listed European corporations’ consolidated accounts – a development taking place in the context of the harmonization of Europe’s stock markets within the Single European Market.

A further aspect referring to the reorganization of Corporate Germany is the role of codetermination, that is workers’ participation in corporate decision-making processes in works councils and the supervisory board (for details: Bertelsmann Stiftung & Hans-Böckler-Stiftung, 1998). The disentanglement of Deutschland AG exerts enormous pressure on codetermination, since a marketization of company management and control via the shareholder value principle replaces the stakeholder orientation with its codetermination. Codetermination and shareholder value are opposing ideas by definition:

“As a criterion of business rationality, shareholder value runs contrary to the participation rights and sharing of organizational rents that characterize nonliberal models. The exclusive focus on shareholders contradicts the egalitarian or solidaristic normative notions of the firm embodied in codetermination or enterprise community.” (Jackson, 2003, p. 285)

Deutschland AG’s system of codetermination had a limiting effect on the scope of shareholder value (see for example O’Sullivan, 2003, pp. 50ff.; Jürgens & Rupp, 2002). But to what extent trade unionists’ systemically entrenched power will endure, is arguable. Obviously strain on the principles of codetermination is increasing with the internationalization of corporate strategies and with ongoing
mergers. In the course of this, the German Model’s unique negotiating system is being broken up, and the negotiating position of trade unions that are active largely at the national level is weakened. Nevertheless the Association of the German Industry, BDI, laments “the internationally high degree of German codetermination is often an obstacle to investment.” (BDI & PWC, 2001, p. 25) The actual power of workers has de facto declined due to a “weakening of the operational effectiveness of the system of codetermination”, as O’Sullivan (2003, p. 50) concludes. The main reasons are discussed in Fichter’s chapter in this book. Going back to the Vodafone-Mannesmann example, the result indicates that “codetermination did not play the role of a poison pill to prevent the takeover.” (Jürgens & Rupp, 2002, p. 55)

Another aspect referring to the third moment of organization changes is taking place in the composition and bias of many large corporations’ management. Traditionally, Germany’s industrial management was rather technology-oriented:

“The somewhat ‘de-economized’ view which German managers have of the business enterprise is central. The idea that a firm is not a ‘money making machine’ but a place where products get designed, made and eventually sold, with profits ensuing, tends in Germany to restrict the allure of accountants and financial controllers and to dignify the makers and those associated with them.” (Lawrence, 1980, p. 131)

Management careers have been changing, showing in the average tenure, which declined from thirteen years in the 1980s to just six years in the 1990s, and the number of directors with outside work experience, which increased from 17 to 35% (Jackson, 2003, p. 292). With this new internationally trained generation of managers like Detlef Schrempf (DaimlerChrysler) or Jürgen Dormann (Hoechst/Aventis, now at ABB), a “gradual diffusion of an shareholder value paradigm as a new managerial ideology” is noticeable (ibid., pp. 291-292.).

In sum, there are a number of elementary changes in the German Model and Deutschland AG, which can be explained alongside the rise of the phenomenon of shareholder value in the 1990s. Those changes refer to the relationship between banks and industry, its organic long-term perspective, potential for innovation and codetermination providing for a relatively high degree of stability and continuity. National as well as international pressure on the German system of corporate governance altered the parameters between capital and labor in favor of the former. Politically escorted disintermediation and the new centrality on capital markets supported the break-up of the old compromise, shifting corporate focus on short-term results.

7.1. Inherent Risks of Shareholder Value

Despite its popularity with financial operators, the concept of shareholder value is beset with problems. First, the shareholder value system of financial indicators offers only a reductionist perspective that is unable to integrate all dimensions of entrepreneurial value added. In praxis, this leads to a reduction or even stop of necessary expenditures in productive capital that might not instantaneously yield above-average returns, but that might however be essential for maintaining the competitiveness of a company in the longer run, as for example the qualification of
employees (Kaplan & Norton, 1996, pp. 22-23). Another critical aspect is the assumed objectivity of those financial indicators. But since the calculation of these indicators is based on premises that lie in the future, any form of objectivity is illusionary.

“Basically all variables that determine a shareholder value oriented evaluation of the company are dependent on subjective estimates.” (Sablowski & Rupp, 2001, p. 60; translation: CK)\textsuperscript{14}

After all, the implied microeconomic signification of this management concept is only valid on the assumptions of the theoretic neo-classical assumption of capital market efficiency, which is highly controversial (Sablowski & Rupp, 2001, pp. 47-50; Becker, 2001, pp. 74-84). Premises about stock market movements and their actors’ behavior are modeled in laboratory-like surroundings; shareholder value’s effect on the actual market value remains a modeled deduction. Moreover, financial market movements and price formation processes of securities are embedded in social micro-contexts and networks on one, and social macro-contexts on the other side. An eventual “success” of increasing shareholder value with recourse to this concept might be more of a self-fulfilling prophecy than of capital market efficiency. There is a high degree of “herd behavior” of investors on financial markets due to standardization of information and benchmark indicators, constantly resulting in “irrational exuberances” on securities markets (cf. Shiller, 2000).

For these very reasons it is not surprising that econometric research could not verify a significant positive correlation between a corporate shareholder value-orientation and enhancement in market value for “converted” German companies (cf. Blies, 2000, pp. 249ff.). This suggests that shareholder value is more of a political instrument for the strengthening of capital owners, but also a means to attract mobile capital in a competition with Anglo-Saxon-type market regimes, so that national actors may initiate market-oriented reforms. Clearly, this current systemic change “reflects changing interests and coalitions among state actors, the investment community, and corporations.” (Jackson, 2003, p. 268) The losing faction in this “game” is labor: A survey by PricewaterhouseCoopers (1999) spotted a significant correlation between labor costs and shareholder value. Labor costs are a major factor relative to overall operating costs that have to be focused on the specific value drivers in a second step. In the long run this can result in a decline of the wage level as well as the increased usage of precarious labor contracts (cf. Hirsch-Kreinsen, 1999, pp. 326ff.).

The struggle for shareholder value in Germany is today’s class struggle between the capital owners and workers. There are significant alterations in the German model of corporate governance that is at the heart of corporatist Deutschland AG. Two of its special achievements, the social partners’ autonomy in matters of wage policy and worker codetermination at plant level and in operations, face widespread pressure for being changed at the expense of workers’ influence. Thus, apart from the inherent limitations of the concept of shareholder value, there is a risk of sacrificing the organic stability of the German Model.
8. CONCLUSION: FROM DEUTSCHLAND AG TO “FINANZPLATZ D”

The process of disentangling Deutschland AG has to be interpreted in the context of a number of structural changes during the 1990s: The liberalization of financial markets, the rise of investment banking, stiffer competition at a global scale, to name just a few. Banks, industry, and the Federal Government responded with abandoning the old ways of cooperation among the main stakeholders. The result is a gradual transfer of Anglo-Saxon properties into the German Model, reflecting a general discursive shift towards market solutions away from corporatist approaches.

The key strength of the German Model was its socio-economic stability combined with long-term adaptability and international competitiveness, achieved through a highly integrating power of Germany’s institutions, such as codetermination. A major pillar of Deutschland AG was its priority of bank capital to industrial needs, which had a stabilizing and protective effect on Corporate Germany and the economy as whole. In the 1990s, Deutschland AG began to disintegrate in the wake of universal banks’ new investment focus, the development of capital markets as sources of corporate finance and the institutional investors’ demand for a focus on shareholder value.

The importance of shareholder value and commodification of corporate governance is connected with the neo-liberal notion to improve international competitiveness of businesses and the attractiveness of Germany as a business location for foreign capital investors. However, all institutional and legislative adaptations, which began during Chancellor Kohl’s tenure and were continued and deepened by the current Red-Green government, could not lower unemployment or stimulate growth rates. Nevertheless, pressure for the introduction of even more market elements is not likely to cease, since ongoing privatization and liberalization processes enhance the power of institutional investors, which demand continuing reforms of corporate governance. Today, talk about Germany’s economic health is no longer about the industrial might of the “Deutschland AG”, it is about the “Finanzplatz Deutschland” (Financial Center Germany), about creating conditions congenial to finance capital.

Christian Kellermann, doctorate candidate at the Department of “Globalization & Politics”, University of Kassel, Germany, studied political science and economics in Würzburg, Oxford and Frankfurt. He is a scholar of Friedrich Ebert Foundation.

NOTES

1 The grammalogue AG stands for the German word “Aktiengesellschaft”, meaning “incorporated (Inc.)”.
2 The term corporate governance comprises the institutional embeddedness of an economy’s main actors (capital, labor and management) and their relation towards each other defined through corporate law, accounting standards, financial regulation, pension schemes, and industrial relations.
3 A main bank relationship or, as it is also called, relationship lending (Hausbankbeziehung) is definable as a “long-term relationship between a bank and its client firm, the holding of both debt and equity by the bank, and the active intervention of the bank should its client become financially distressed.” (Allen & Gale, 2000, p. 103)
Montan-Mitbestimmung, also called “parity codetermination”, means that there is an equal number of workers and capital representatives on the supervisory board of a company belonging to the mining or steel and iron industry, Mannesmann’s traditional business focus. The “neutral member” in crucial votes could only be appointed with the approval of the union. As Mannesmann moved out of its traditional business during the 1980s, it also moved outside the reach of the law on Montan-Mitbestimmung. A special law, Lex Mannesmann, provided for the continued application of Montan-Mitbestimmung to Mannesmann, but this law was declared unconstitutional by the Federal Constitutional Court in 1999. Thereafter, a weaker version (the codetermination law of 1976) was applied. “Anyhow during the takeover battle Mr. Sigmar Sattler, from the union IG Metall appointed personnel director, was still on the executive board, which indicates that the debate about the Montan-codetermination was rather symbolic.” (Höpner & Jackson, 2001, p. 557; translation: CK)

A financial system is viewed as a “set of institutions and organizations at the center of the monetary economy that mediate the flow of savings and investment between nonfinancial sectors of the economy (i.e., the household, nonfinancial company, and state sectors)” (Vitols, 2003a, p. 242).

In 2002, turnover of derivatives in Germany was Euro 111 billion, in 2003 about Euro 145 billion (source: http://www.dbresearch.de).

Deutsche Bank is a good example of this trend, since there is a concentration on two main businesses observable, one consisting of corporate finance and investment banking plus trading, the other comprising private clients and asset management.

For example, the investment banks that processed the acquisition of Mannesmann by Vodafone were Goldman Sachs and UBS Warburg (for Vodafone) and Morgan Stanley, Merrill Lynch and JP Morgan (for Mannesmann).

One major national merger was between Bayerische Vereinsbank and Bayerische Hypotheken und Wechselbank in 1998, creating HypoVereinsbank, the second largest bank (Deutsche Bank is the biggest bank in Germany, cf. Bundesverband deutscher Banken, http://www.bdb.de).

A survey by Goldman Sachs estimates that up to Euro 300 billion could flow into the funds of institutional investors as an effect of the pension reform (Goldman Sachs, 2000).

Companies with fewer than 500 employees account for 65% of manufacturing employment in Germany (cf. Vitols, 2003a, p. 245).

For example, the savings banks of Hamburg and Bremen will merge into “Norddeutsche Retailholding” to achieve economies of scale. Frankfurt’s savings bank (Frankfurter Sparkasse) wanted to go a similar way (and merge with Naspa in Wiesbaden), but the plan was vetoed by major stakeholders, such as the City of Frankfurt (“Sparkassen in der Zwickmühle”, 2003). The savings banks of Hamburg, Bremen and Frankfurt are among the ten largest banks in Germany.

For example, in February 2002 a government commission developed a German Code of Corporate Governance (http://www.corporate-governance-code.de), which follows many private codes of best practice (cf. Jackson, 2003, p. 274).

On the basis of the usage of beta-factors alone (these measure the company-specific risk) a substantial discretionary scope accrues for the underlying capital costs of the invested capital, which is in turn a measurement category for of the discounted cash flow (cf. Taetzner, 2000).

REFERENCES


