New System of Industrial Concentration Based on Industry-Bank Relationships in Germany after World War II

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Abstract

This paper discusses the development of a new system of industrial concentration based on industry-bank relationships in Germany after World War II. Industry–bank relationships are important issues related to the system of corporate governance and German capitalism’s cooperative characteristics. These relationships developed through various mechanisms such as banks’ credit and securities businesses, the shareholdings and deposited stock system, assignment of directors from banks to corporations, and the advisory board system. We analyze new developments in Germany’s industrial systems based on industry–bank relationships from the perspectives of mechanisms of corporate inter-firm relationships and corporate governance. Drawing on this discussion, we clarify significance of new development in industry-bank relationships after World War II.

Keywords: Industrial concentration, Inter-firm relationship, Industry–bank relationship, Universal banking system, Corporate governance

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I Research Problems

As Japan did after World War II, Germany developed its enterprises, industries, and economy by establishing systems of industrial concentration in their own ways while deploying and adapting technology and management methods from the United States. Industrial concentration exhibited new postwar developments in Germany. German characteristics of industrial concentration, which were based on prewar industry–bank relationships, included new developments in the industrial system that coordinated interests and shared information between industry and banks and between corporations. Monopolies that had been dissolved by the postwar occupation policy reconcentrated. In addition, the system of large corporate groups began to re-emerge and re-concentrate, and with it came new developments in the system of large corporate groups. The system played a crucial role in the formation of the German capitalism’s accumulation structure, the cornerstone of industrial concentration.

This phenomenon represented the transformation of the prewar system of industrial concentration that controlled markets on the basis of massive trust and wide-ranged cartels, which encompassed the entire industrial sector in the 1920s. From the perspective of market control, this new system, based on industry–bank relationships and large corporate groups, was an important element supporting the development of postwar productive forces and accumulation structures. Industrial concentration developed as an important process in the progress of German corporations while exhibiting new characteristics of cooperation in German capitalism. Above all, industry–bank relationships served as a cooperative system between industries and banks as well as among corporations themselves. Industrial system based on industry-bank relationships is also deeply related to the system of corporate governance in Germany. Therefore, it is very important to clarify the mechanisms and significance of the postwar system of industrial concentration and the cooperative nature of German capitalism. Many studies approach this theme from the perspective of economic and business histories, business management
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studies, and financial economics. However, these studies do not always identify strategic functions that industrial systems based on industry-bank relationships have for business management.

In this paper, we will consider inter-firm relationships as a problem that was deeply connected with that of postwar German business management. We will explore the issues of inter-firm relationships between industries and banks in an “organic” industrial system and describe the significance of new developments in Germany’s industrial concentration. “Industry” here refers not only to the manufacturing industry but, in a broader sense, to non-financial industries, including distribution and service industries. The industrial system based on industry–bank relationships was fundamental to the development of financial capital interests, which was based on a market control system for large corporations.

When examining the characteristics of postwar industrial concentration in Japan and compare them with those in Germany, in Japanese six large industrial groups, enterprises were concentrated by interlocking stockholding and forming large corporations, which were horizontally rather than vertically joined within capital groups and had substantial holdings of other companies’ stocks. The large corporate groups formed in postwar Japan spanned several industries, with industrial corporations, banks, and trading companies at its core. The industrial groups comprised a full set of industries and conducted financing, interlocking stockholding, mutual business transactions, and joint investments internally. Banks and trading companies played a significant role in this scheme. These groups coordinated among themselves through an organization, the Network of Presidents, with decisions primarily made by those in a certain position, such as presidents of group companies. However, banks did not always enjoy an absolute advantage, even though financial institutions formed the core of the Network of Presidents. Moreover, although industrial groups comprising full sets of industries were broadening, from the standpoint of inter-
firm information sharing, the Network did not always adopt mechanisms that supported banks–industry relationships, as was the case in Germany. However, among these types of industrial groups, interlocking shareholding stabilized shareholders.

The industrial groups comprised large banks that were designated main banks to each group. These banks flexibly and resiliently supplied payment and settlement money needed for credit creation. These banks adopted the *keiretsu* financing system and capital procurement methods because Japanese corporations tended to use indirect financing in the postwar era. These banks also advised the large corporations on external financing\(^3\). *Keiretsu* financing was, from the viewpoint of the six industrial groups’ main banks, a way to distribute risk and avoid extreme concentration of borrowers; moreover, it enabled the expansion of lending while saving banks’ screening and monitoring costs\(^4\). In addition to corporate financing, another important function of the main banking system was corporate governance and monitoring\(^5\). In corporate governance, Japanese banks and corporate groups functioned as a defense against external pressures by interlocking stockholdings within the groups. However, although Japanese banks executed financial functions within industrial groups, they failed to develop binding relationships with the large corporate groups and had rather weak control over the industries. Close examination of the banking system reveals that the Japanese banks were not universal banks and could not exercise voting rights using the deposited stocks system. Top management in Japanese corporations followed a one-tier system, which comprised board of directors who controlled management mechanisms and the assignment of directors from banks.

Compared with Japanese banks, banks in Germany broadly associated with large corporate groups rather than with a specific corporate group\(^6\). These ties were significant for the mechanisms and functions of information sharing and coordination, particularly in the interest of industrial system-based relationships between industries and banks.

We will examine industrial system mechanisms based on inter-firm relationships in Germany (Section II), analyze them from the perspective of corporate governance (Section

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III), and explain the significance of the postwar development of industry–bank relationships (Section IV). In addition to the primary focus of this paper, which is the period from the 1950s to the 1970s, we will further consider the period that immediately follows as well as more current circumstances.

II Industrial System Mechanisms based on Industry–Bank Relationships

1 Banks’ Influence on Corporations through Credit and Securities Businesses

Let us now examine bank credit and securities businesses and the influence of banks on corporations based on these businesses. O. Jeidels (1905) noted that, in bank and industrial alliances, the formation of regular business relationships that were primarily financial in nature was the most basic type of alliance, and personal links through the assignment of directors to supervisory boards was a method complementing these relationships. Regarding creditor–debtor relationships, a 1979 report by the Gessler Committee, an advisory council to the Ministry of Finance, noted that most large corporations were able to procure capital outside of bank credit. In addition, the 30 largest corporations receiving credit had a considerable number of creditor–debtor relationships with financial institutions and credit organizations. Thus, we surmise that, apart from crises with debtor corporations, banks could not exert much influence on corporations through the supply of credit and house bank relationships did not exist in large corporations. However, H. Gerhardt (1982) noted that creditor–debtor relationships between banks and their debtors were not sufficiently examined by the Committee. He emphasized that credit-based financial relationships were strongly influencing corporate business policy. In addition, although H.O. Eglau (1989) mentioned instances of banks assigning supervisory board members to family-owned private corporations and German

10) Ebenda, S.107.
subsidiaries of large foreign corporate groups, the positions of supervisory board members usually depended on long-term house bank-like relationships with the corporation\textsuperscript{11).} It was likely that banks’ exercising of management functions was facilitated by its character as a creditor and its supervisory post\textsuperscript{12).} For example, large banks and corporations formed close alliances through the creditor–debtor relationship and proposals presented at annual meetings were generally coordinated in advance\textsuperscript{13).}

Regarding securities business in financial institutions, the Gessler Committee reported concentration in only few large banks and ties between large corporations and banks, with securities business functioning as intermediaries. From the period of the 1950s to the 1970s, specifically 1966–1975, top 10 financial institutions accounted for 44.7\% of financial institutions participating in the Consortium for Issuance of Securities; domestic issuers of stocks, convertible bonds, and option bonds totaled 58.3\% and foreign issuers totaled 70\%.

Among the 71 publicly traded companies, the three large banks—Deutsche Bank, Dresdner Bank, and Commerz Bank—accounted for more than 98.6\% of issuances among all banks. These three banks accounted for a high percentage of consortium leaders and co-managers at 81.7\% and 80\%, respectively\textsuperscript{14).} J. Edwards and K. Fischer (1994) revealed that the leaders of securities issuance syndicates were normally corporate house banks of joint stock companies, namely the three abovementioned banks\textsuperscript{15).}

Because the securities business grew in scale, house bank functions in the creditor–debtor relationship and the security issue business became an important pillar of the industry–bank relationship. For example, Deutsche Bank had considerable power in both corporate finance and the overall economy because it offered payment of copious accounts, working capital, and fixed investment capital and made possible the underwriting of corporate capital increases and bond issues as a universal bank\textsuperscript{16).}

Regarding industry–bank relationships, in addition to the functions of the house bank

16) K. Aizawa, op. cit., p.4.
in the security issue business and the intelligence that banks obtained by acting as intermediaries in the credit business, banks also exerted influence by exercising voting rights through bank-owned and deposited stocks; this laid the foundation for close ties. Thus, it is critical to comprehensively examine the interplay between the credit and securities businesses.

2 Banks’ Influence on Industry through Shareholdings and the Deposited Stock System

Let us now examine banks’ influence on industries in relation to bank shareholdings and the deposited stock system. According to the 1976/1977 report by the Monopoly Committee, the provision of essential competitive information to corporations by financial institutions, which owned stocks in those corporations, and the voting rights through proprietary ownership stocks or deposited stocks that were supplementary thereof, enabled banks to exert direct and indirect influence on the business policies of non-bank corporations. Such stock deposits in banks and banks’ proxies exercising the voting rights were a long-standing practice in Germany, and were legalized by the 1937 Corporations Law. However, before World War II, a portion of shares deposited in banks was not exercised in annual meetings and large private shareholders often exercised their own shares. The exercising of voting rights as an industrial system based on industry–bank relationships and banks’ assignment of members to supervisory boards were not significant until after World War II.

Regarding the banks’ influence on corporations, the impact of banks exercising voting rights through the deposited stock system was more important than the banks’ shareholding itself. However, even in this case, the influence from deposited stock voting rights was more often dependent on the shareholder ownership structure of these corporations, and this was most likely for publicly traded corporations with scattered

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holdings and no control over shareholders\textsuperscript{21}.

Shares of individually or family owned corporations that were dispersed among small individual shareholders were sold through banks, which had cooperative relationships with the share issuing companies; often the voting rights associated with those shares were entrusted to the banks due to the friendly relationships with the issuing companies. The cooperative relationships between the banks and corporations were based on the latter’s direction. Such reciprocal relationships could also be observed in corporations with widely distributed shares. In contrast, among management-controlled corporations with widely distributed shares, the board of directors had a commanding position over the supervisory board, particularly in the top-level decision making and selection of supervisory board members from banks during the annual meeting; there were instances where the banks cooperatively exercised voting rights with the management\textsuperscript{22}.

Regarding the exercise of voting rights including bank deposited stocks, the total value of deposited stocks for instance increased from DM 28.9 billion at the end of 1970 to DM 36.5 billion by the end of 1975. At the end of the 1970, 73.7% of those stocks were deposited in credit banks, and by the end of 1975, the number declined to 71.3%, which was nonetheless a high rate\textsuperscript{23}. According to a report by the Monopoly Committee, in terms of revenue, of the top 100 companies 56 corporations had 5\% or more of their voting rights held by banks in the mid-1970s. Of those, 18 corporations had 75\% of their voting rights held by banks, 12 between 50\% and 75\%, 11 between 25\% and 50\%, and 15 between 5\% and 25\%\textsuperscript{24}. In addition, examining the ratio of banks’ voting rights in representative corporations effective 1975, we see that AEG had 89.29\%, Hoechst 88.62\%, BASF 87.15\%, Siemens 81.02\%, and Bayer 79.09\%, all rather high figures. August Thyssen held a relatively low rate at 45.28\%. However, the proportion of owner-held stock voting rights held by banks in these corporations was not greater than 1\%\textsuperscript{25}, whereas banks exercising voting rights through the deposited stocks system were significant.

\begin{itemize}
\item[\textsuperscript{22}] N. Sakuma, Dotsu no Kigyo Touchi (Corporate Governance in Germany), M. Nakamura (ed.), Kigyou Rinri to Kigyo Touchi (Business Ethics and Corporate Governance), Tokyo, 2003, pp.69-70, p.75.
\item[\textsuperscript{23}] H. Hansen, Die Wertpapierdepots der Bankkunden, Die Aktiengesellschaft, 22.Jg, Nr.6, 20.6.1977, S.161-2.
\item[\textsuperscript{24}] Monopolkommission, a. a. O., S.296.
\item[\textsuperscript{25}] Vgl. Ebenda, S.560.
\end{itemize}
According to a survey by A. Gottschalk on the 32 of the 100 largest corporations with widespread shareholding or bank-owned stocks at 50% or more, in terms of added value in 1984, the percentage of voting rights for all banks in 1986 (or for a portion of the corporations in 1987) was on average 82.67%. For 22 of those corporations, banks held voting rights greater than the 75%, required to make decisions on critical issues such as amending by-laws. Of the 32 corporations, the top three banks on average held 45.44% of the exercisable voting rights and over 50% in 15 corporations. A 1992 survey by T. Baums and F. Fraune, which analyzed in terms of added value 24 of the largest 100 public corporations that had a majority of widespread shareholding, showed that the percentage of voting rights held by banks at these companies’ annual meetings was on average 84.09% and those through the deposited stocks system was 60.95%. In addition, there were 11 corporations with greater than 75% of voting rights through deposited stocks alone, 18 corporations with banks holding 75% of their voting rights, and 17 corporations at more than 90%. A 1994 research by J. Edwards and K. Fischer also showed that German banks, in particular the top three banks, had a great deal of control over voting rights in corporations, and this control was primarily through proxy voting rights through the deposited stocks system.

3 Assignment of Directors from Banks to Corporations

The impact of exercising voting rights based on the deposited stocks system and bank shareholding was further realized though the assignment of directors from banks. The most secure foundation for banks to exert influence was built through personal ties with corporations, the assignment of supervisory board members that acted as information conduits, selection of directors, and the involvement in business policies. Thus, close ties between non-bank corporations and banks were the most important factor in generating the power held by banks. The influence of two particular factors, capital holding and voting rights through the deposited stocks system that were executed by supervisory board
members, began to be felt, and these positions became a mechanism for the transfer of this power\textsuperscript{30}. Therefore, we will next consider this point.

The supervisory board, which held a central role in the assignment of directors from banks to corporations, appointed and dismissed directors, provided the board of directors with guidance on business management, and functioned beyond deliberation by approving rights in various critical matters. According to A. Herrhausen (1973), supervisory boards at the time were transforming from supervisory to advisory bodies for boards of directors; they exerted necessary control on the decision-making process to proactively avoid erroneous actions or measures\textsuperscript{31}. This observation was noted in the 1986 annual report of Deutsche Bank as well\textsuperscript{32}. Supervisory boards could indirectly influence business management through the appointment and dismissal of directors\textsuperscript{33}. The supervisory board was also involved in corporate policy decision-making by means of deliberation\textsuperscript{34}. Corporate law regulations allowed for the involvement of the supervisory board in business policy decision-making through the approval of rights by specific board of directors by means of by-laws or supervisory board decisions. In these cases, the supervisory board formed a second decision-making body along with the board of directors\textsuperscript{35}. For instance, if the supervisory board executed its advisory function and delivered an opinion on the board of directors’ decision making, the chairman of the supervisory board played an important role as corporate policies were collaboratively created\textsuperscript{36}. Although explicit guidance by the supervisory board to the board of directors was forbidden by corporate law, it was regularly observed; in fact, some research notes the significant gap between the law and actual practice\textsuperscript{37}. Nevertheless, the relationship between the supervisory board and the board of directors assumed diverse forms depending on the company.

\textsuperscript{32} Deutsche Bank AG, \textit{Geschäftsbericht für das Jahr 1986}, S.17.
\textsuperscript{36} J. Böhm, \textit{a. a. O.}, S.206.
(1) Information Sharing System and Banks’ Assignment of Directors

We will first examine information sharing systems enabled by the assignment of directors from banks to corporations. By integrating finance-based information with that obtained from the assigned supervisory board members, it became possible for banks to fill an advisory and leadership capacity in these corporations and obtain information valuable to external borrowers. By obtaining information on borrowers, corporate sales, and financial statuses of supplies of credit, banks could gather substantial inside information on multiple corporations; it enabled them to act as storehouses of information and information conduits. Specialized financial information and experience and guidance necessary to help the board of directors avoid mistakes were important factors in strengthening the role and significance of supervisory board member positions. Regarding corporations being assigned supervisory board members from banks, the preferential status of easier access to good information sources helped them form closer relationships.

From a corporation’s internal functional perspective, banks sharing information, particularly know-how, often acted as a type of corporate consultant. On the other hand, for external functioning, this system of information sharing among corporations, with bank representatives on the supervisory board acting as intermediaries, spread further contingent on the likelihood of contact between corporations and the supervisory board, that is, mainly through bank-assigned supervisory board member.

The assignment of supervisory board members was also important for coordination among various departments, and the most decisive point for the overall system. Banks were familiar with issues within industries and provided advice and guidance for decision-making to corporate borrowers across the broad categories of management. For corporations receiving the directors, the assignment of directors from banks was very significant for obtaining opinions on the overall management as well as for procuring capital. Although relatively few banks were represented on the supervisory board, banks

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38) T. Uetake, Kinyu Kikan to Kigyo (Financial Institutions and Enterprises), T. Takahashi, T. Onishi (eds.), Doitsu no Kigyo (German Enterprise), Tokyo, 1997, p.104.
42) Ebenda, S.238.
performed overall coordination in the best manner possible; however, this allowed the control of large banks’ positions through supervisory board representation. The supervisory board chairman could obtain all sorts of important and internal information through the directors’ reports on critical matters. If a bank representative was assigned to a corporation and later appointed the chairman of the supervisory board, the representative could exert tremendous influence on decision-making in the corporation as opposed to other supervisory board members.

(2) Assignment of Directors and Collaborative Relations among Banks

We will now examine the assignment of directors that were based on collaborative relationships among banks. For example, we see that the top three banks, being the largest shareholders, could exercise voting rights through the deposited stocks system. Furthermore, these banks created collaborative relationships with combined capital complementing the voting rights of banks. This could be seen in the banks’ annual meetings with banks exercising voting rights. A. Gottschalk’s survey analyzed the total number of shares and deposited stocks owned by investment firms and their parent banks and noted that the percentage of Deutsche Bank’s voting rights in 1986 was 47.17% and that for the top three banks was 60.36%. Dresdner Bank’s percentages of shares and deposited stocks were 47.08% and 64.04%, respectively, while Commerz Bank’s percentages were 34.58% and 60.81%, respectively; these were considerably high rates. In addition, against the total rate of voting rights, the 1992 research by T. Baums and F. Fraune revealed that Deutsche Bank’s rate of voting rights was 32.07% and that among the top three banks was 49.24%. At Dresdner Bank these percentages were 44.19% and 53.66% and at Commerz Bank they were 18.49% and 48.27%. Thus, the top three banks held a very high percentage of shares with voting rights, enabling them to collaboratively and effectively control their annual meetings. H. Pfeiffer observed that the controller of large banks were the large banks themselves.

46) T. Uetake, op. cit., p.106.
48) Vgl. T. Baums, C. Fraune, a. a. O., S.106 (Tab.11).
49) J. Böhm, a. a. O., S.75.
50) H. Pfeiffer, Großbanken und Finanzgruppen. Ausgewählte Ergebnisse einer Untersuchung der
relationships laid the foundation for control over large banks and such control influenced and controlled many industrial corporations.

In addition to the collaborative relationships that could be found in joint funding between banks\(^{51}\), in the exercising of voting rights through the deposited stocks system, banks could transfer voting rights deposited by customers to third parties such as other trusted banks\(^{52}\). Even the transfer of voting rights through the deposited stocks system from smaller banks to large banks strengthened the influence of these collaborative inter-bank relationships on corporations\(^{53}\).

Banks had similar collaborative systems for financing because, in the case of the top three banks' consortium for issuance of securities, positions, rankings, and allocations were approved in a fixed fashion\(^{54}\). J. Edwards and K. Fischer's 1994 research noted that for a long period of time the structure of this bank syndicate was extremely stable\(^{55}\). The top three banks acted collaboratively in the exercise of voting rights at annual meetings, and for the most part, were immovable as supervisory positions in the companies with which they dealt\(^{56}\). Other banks also tended to collaborate with the top three banks\(^{57}\). Further, voting rights and deposited stocks provided opportunities to constrain and suppress industrial relationships and competition among banks for industry work\(^{58}\). This served an important role even in activities that included the assignment of members to the supervisory board. On this point, the creation of a “strong shareholder” system based on the universal banking system was important for the selection of supervisory board members, who acted as capital-side representatives during their annual meetings\(^{59}\).


\(^{57}\) Ebd., S.300, Bundesministerium der Finanzen (Hrsg.), *a. a. O.*, S.173.

\(^{58}\) A. Busse, *a. a. O.*, S.64, S.66.

Assigning of supervisory board members occurred in financial institutions as well\(^{60}\). The collection and exchange of valuable information regarding borrower corporations or corporations to which supervisory board members had been assigned based on personal ties were extremely critical.

(3) Assignment of Directors between Banks and Industries

In examining the assignment of directors between banks and industries, we find that, for example, according to a Monopoly Committee 1976/1977 report, among 51 surveyed corporations, there were 137 instances of supervisory board members being selected from financial institutions and 57 instances of financial institution assignees being chairmen or vice-chairmen. The numbers coming from the top three banks were 76 board members and 35 chairmen or vice-chairmen, accounting for more than 55.5% and 61.4%, respectively, of the total assignees from financial institutions\(^{61}\). For these 51 corporations, if financial institutions had more than 25% of the voting rights, they had without exception secured at least one supervisory position, and if the financial institutions had more than 25% stock holding, they procured chairman or vice-chairman positions on the supervisory board. Among the largest 100 corporations, 31 had financial institution representatives serving as chairmen of the supervisory board, 35 corporations had representatives serving as vice-chairmen. The top three banks had 21 chairmen and 19 vice-chairmen in these corporations\(^{62}\). The Gessler Committee reported that, in 74 publicly traded corporations surveyed in 1974 and 1975, 182 had supervisory board members assigned from financial institutions and 37 had chairmen of the supervisory board from financial institutions. The numbers of supervisory board members and chairmen assigned from the top three banks were 101 and 25, and respectively, accounted for 55.5% and 67.6% of those assigned from financial institutions. Of these 74 publicly traded corporations, that is, where a bank held at least 25% of the voting rights in a particular corporation, the same banks also held chairmanship of the supervisory board in many instances, and in an overwhelming number of cases, two supervisory positions\(^{63}\).

In subsequent periods as well, the A. Gottschalk survey noted that in 1986, bankers or

\(^{60}\) Vgl. Bundesministerium der Finanzen (Hrsg.), a. a. O., S.591.
former bankers had 69 (27%) of the 256 supervisory positions within 27 non-bank corporations. Of these, 50 positions, or roughly three-fourths, were populated by representatives of the top three banks\(^\text{64}\). According to R. Ziegler, two if not all three of the top three banks had representatives serving as supervisory board members among larger manufacturers. One decisive factor in the banks having so many representatives was the economic importance of the companies accepting the representatives\(^\text{65}\). H. Pfeiffer in 1993 found that the top three banks had assigned 1,053 directors to other corporations’ supervisory boards in the 1990s, with 170 of them acting as supervisory board (or other management) chairmen, and 92 as vice-chairmen\(^\text{66}\). At least one bank representative served as a supervisory board member in the 261 publicly traded corporations surveyed by H. Hansen in 1993, and 372 supervisory board members were assigned from financial institutions. Of these, 192 (51.6%) were from the top three banks and 59 companies had bank representatives serving as supervisory board chairmen. The corporations comprising the DAX30 had 73 supervisory positions filled by bank representatives, with 13 corporations having bank directors in the supervisory board chairman position. The top three banks had a total of 56 supervisory positions in the DAX30 corporations, or 76.7% of the total\(^\text{67}\). In roughly the same time period, one-fourth of the total market value of German stocks was owned by foreigners, with more than one-fifth being owned by private investors. However, the percentage of supervisory board positions in the DAX30 accounted for by these two groups of investors was no greater than roughly 5% each\(^\text{68}\).

The mutual assignments of directors from industries to banks was also common; H. Pfeiffer (1993) noted that there were up to 5,286 cases including assignment of (1) directors and supervisory board members from non-bank corporations to the supervisory boards or boards of directors of the top three banks, (2) supervisory board members from the top

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64) A. Gottschalk, Der Stimmrechtseinfluss der Banken in den Aktionärversammlungen von Großunternehmen, S.300.
three banks to the supervisory boards or boards of directors of non-bank corporations\(^{69}\). Further, cases of corporate representatives participating in bank committees and other organizations existed as well. For example, the chairman of the board of chemical giant BASF belonged to a Deutsche Bank committee, and BASF’s supervisory board chairman traditionally belonged to a similar organization at Commerz Bank\(^{70}\). Thus, supervisory board assignments from the top three banks to non-bank corporations and vice versa accounted for many of the personal ties between banks and industries.

### 4 System of Corporate-Bank and Inter-Corporate Information Sharing through the Advisory Board System

The banks’ personnel exchange structure for the sharing of information had an important role in complementing industry–bank relationships through the assignment of directors from banks. The advisory board, created for banks’ head offices and for each region, functioned as a focal point of information exchange between corporations and banks as well as among corporations themselves.

Major corporations assigned members to a central advisory board, where industry leaders regularly reported to each other on their markets’ conditions. As they performed their board roles, they received advice and guidance on various business issues\(^{71}\). The central advisory board acted as a coordinating body between banks and industrial corporations and could be seen in Dresdner Bank prior to 1966. These boards were established by banks to maintain the level of personal ties, previously enjoyed in response to the 1965 Corporations Law’s regulation on the number of supervisory board members\(^{72}\). Region specific advisory boards had existed in Deutsche and Dresdner Banks since before the war and postwar in Commerz Bank. Regional advisory boards included management representatives from various corporate sectors that served large banking customers and their regional organizational units. One reason for the existence of regional advisory boards was that they strengthened relationships among various corporations across

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business sectors and in each region for matters of business policy. \(^{73}\) H. Pfeiffer’s 1993 research states that, among many medium-sized businesses, the supervisory board’s functions of regulation, consultation, and guidance were undertaken by the advisory board. \(^{74}\) Persons appointed by the top three banks to the supervisory or an advisory board were considered “friendly.” \(^{75}\) For example, it was important for Deutsche Bank’s advisory board to create strong ties with the banks’ customers through its business and propose new operations through those ties. \(^{76}\)

In addition, several hundred business associations shared ties with banks through the top three banks’ supervisory board, central advisory board, or regional advisory board members. \(^{77}\) With these personal organizational ties, close relationships between banks and industries created information conduits, and were not only based on direct relationships between the two groups but also complemented by intermediary relationships of economic associations such as business and industrial associations and industry–bank relationships. \(^{78}\)

### III Corporate Governance and Industry–Bank Relationships

#### 1 Collaborative System of Corporate Governance Based on Industry–Bank Relationships

The industrial system based on industry–bank relationships created a collaborative system of corporate governance that has German characteristics, a phenomenon we will now examine.

The German segregation of authority into a two-layered system of top management for supervisory boards and boards of directors facilitated debates between those outside the

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74) H. Pfeiffer, *Die Macht der Banken*, S.142.
75) A. Gottschalk, *Der Stimmrechtseinfluß der Banken in den Aktionärversammlungen von Großunternehmen*, S.301.
corporation offering much valuable advice and those actually running the business. This
dynamic’s ability to expand corporations’ views and clearly delineate responsibility was
significant\(^{79}\). As bank representatives acting as supervisory board members offer guidance
on the basis of the banks’ wealth of information and know-how, this German management
system demonstrates its importance and effectiveness as an industrial system based on
industry–bank relationships. With such decision-making mechanisms, functions to
monitor and regulate are exhibited by business functions centered on the board of
directors.

The high percentage of voting rights held by banks, including voting rights through
deposited stocks, the assignment of supervisory board members, and industry–bank
relationships based on personal ties through representatives on advisory boards, enabled
defensive mechanism against capital market pressures. Here, we see German
characteristics in the corporate governance systems. With the progress of financial
globalization since the 1990s, there was pressure on shareholder value-oriented
management through investment funds, execution of business strategy, and selection of
supervisory board members at annual meetings. Compared with other European countries,
the US, and Japan, conditions in this environment reveal that the German industrial
system enabled banks to secure management stability not only in corporations in which
they held shares but also with borrowers.

However, with greater capital market pressures in today’s financial globalization, this
stable system is sometimes rocked to its foundation. Beginning in the 1990s, large banks
transited from their traditional lending business toward investment banking, and the
assignment of directors from banks to corporations declined. Further, banks began
accepting fewer corporation representatives for the positions of a supervisory board
chairman\(^{80}\). These changes by banks were another step toward globalized capitalism, and
banks themselves were regulated by changes in the conditions for capital accumulations.
From the perspective of corporate relationships, banks were forced to intensify their
relationships based on “selection and concentration” to achieve greater efficiency.

\(^{79}\) K. Winnacker, \textit{Nie den Mut verlieren. Erinnerungen an Schicksalsjahr der deutschen Chemie},
Düsseldorf, 1972, S.467.

\(^{80}\) Vgl.R. Zugehör, \textit{Die Zukunft des rheinischen Kapitalismus. Unternehmen zwischen Kapitalismus und
2 Codetermination and Collaborative Systems of Corporate Governance in Industry–Bank Relationships

It is important to consider the relationship between issues of corporate governance based on close ties between industries and banks and the codetermination system at the supervisory board level.

The authority of the supervisory board chairman was expanded under the 1976 Law on Codetermination. The law granted two votes to the chairman in cases of conflicts between shareholders and labor representatives on the supervisory board. Conditions that were in the interest of the investors were important for coordinating interests with the supervisory board chairman. In addition, the number of labor representatives on the supervisory board being equal to that of shareholder representatives necessitated the formation of groups. Also, the supervisory board chairman held authority that enabled governance of certain types of opinions within the groups. Primarily based on this, when bank representatives served as supervisory board chairmen in corporations, they found it easier to demonstrate the governing and coordinating functions of their role on the basis of abundant data.

With the deployment of the 1976 Law on Codetermination, the supervisory board would regulate its meetings that were occasionally conducted to eliminate controversial issues from discussion; however, some have pointed out that the supervisory board tended to lose its authoritative position in matters of corporate policy being discussed in a critical fashion. Rather than an expansive board, the supervisory board chairman often took on the role of a critical debater for the board of directors. In these circumstances, when bank representatives took over the position of the supervisory board chairman, it became easy to coordinate group interests based on, both internal and external, critical corporate information, obtained by the supervisory board chairman from banks, which were information sources.

The codetermination system decreases the rate of investors in the supervisory board and provided opportunities for autonomous corporate management. In particular, with the Codetermination Act for the Coal, Iron and Steel Industries and the 1976 Law on Codetermination requiring the proportion of labor representatives to be half of the supervisory board, the number of external members in the board fell. From the latter half of the 1970s, the 1976 Law on Codetermination tended to reduce the number of bank representatives.

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82) Ebenda, S.166-7.
representatives on the supervisory boards representing German corporations. Corporations used this as an opportunity to reduce potential external influence and involvement.

However, the decrease in supervisory positions held by shareholders allowed for conditions of easier fulfillment of banks' interests, with banks and inter-bank alliances holding a superior position in exercising voting rights through deposited stocks. Further, through collaborations between banks and the corporations to which they assigned directors, the latter had greater decision-making ability, including those regarding the remaining supervisory board members and suppressing outside influences. For these reasons, collaboration with banks took on further significance for corporations.

As mentioned, the codetermination system created conditions for a more strong functioning industrial system based on industry–bank relationships, while suppressing the influence of external shareholders. For banks, this was a mechanism for regulating their own interests and fulfilling bank interests in corporations to which banks assigned directors.

Under the codetermination system, opportunities for corporations to collaborate with labor representatives on the supervisory board were fortified as a defense mechanism against external pressures, which were heavily oriented toward the pursuit of short-term interests and represented by investment funds in present-day terms. From the objectives of labor, it secured soundness and security in employment and corporate management. This feature further strengthened collaboration between corporations and labor. For capital supervisory board members, there is an industrial system based on industry–bank relationships in the form of collaborative network for broad personal ties. In this type of industrial system collaboration with supervisory board comprising capital members, such as bank representatives, the exercise of a defensive function becomes even stronger.

Thus, preconditions for effective, direct control through the assignment of bank representatives to corporate supervisory boards are met within joint-stock and limited liability companies under the 1976 Law of Codetermination or the Codetermination Act for the Coal, Iron and Steel Industries. The Act requires corporations to have codetermination with equal labor representation. In corporations with this type of codetermination, supervisory positions that banks held as creditors were effective for surveillance and

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providing approvals required by the management\textsuperscript{84}.

From the foregoing discussion, we see that Germany developed a system that had functions similar to that of corporate defense, developed to counter external pressures, and contrasted that of interlocking stockholdings, which characterized postwar Japan. This type of corporate system was supported by the industrial and codetermination systems based on industry–bank relationships at the supervisory board level, forming an important characteristic of German corporate governance.

\textbf{IV Significance of New Developments in Industry–Bank Relationships}

Our discussions to this point have examined new developments in postwar industry–bank relationships and the industrial system upon which they were based. We will discuss the types and possible significance of future developments that were different from those in the prewar era.

First, we will establish the development of an industrial and corporate governance system based on banks exercising voting rights through the deposited stock system. The issuance business was prominent in the securities business that was based on the prewar universal banking system. However, in the postwar era, with the expansion of general investments in securities, the position of the securities business in the secondary market also grew. As a result, a system of bank agents exercising voting rights through the deposited stocks system was fully established. This practice built the essential foundation for both capital and personal ties for the postwar development of industrial concentration and the establishment of a uniquely German industrial system, facilitating information sharing between industries and banks and regulating their interests.

Second, we will observe the full-scale development of a network for sharing information between banks and industries and among corporations through the bank’s advisory board system and a system for regulating interests through that network. Although there were prewar cases of regional advisory boards, in the postwar period, central advisory boards were established and became the cornerstone of the advisory board system. Through the

combination of central and regional advisory boards, a national and regional system of information sharing between banks and industries and among corporations themselves was established. These systems differed from those based on the assignment of directors and were used for regulating interests between banks and investors and those among corporations.

Third, the weakening influences and pressures from external shareholders, which emerged due to the codetermination system program proposing equal labor representation on the supervisory board, established and strengthened a corporate governance system based on industry–bank relationships; its roles differed from those featured during the prewar era. In addition, the strengthened industry–bank relationships and the industrial system on which they were based revealed the system’s importance.

Examining the significance of new postwar developments in industry–bank relationships and the cooperative characteristics of German capitalism, reveals that the strong influence exerted by banks on industries was due to the collaborative relationships between the two groups, rather than the banks’ desire to control the industries. The framework for bank shareholdings, the assignment of supervisory board members according to the exercising of voting rights based on the deposited stocks system, and the advisory board system resulted in information sharing and a support system dependent upon advice from banks and collaborative relationships with industrial corporations. Banks’ involvement in the joint responsibility for industrial policy and several corporate business policies was an important element supporting the collaborative system, through which banks regulated inter-corporate interests. Directors from banks and insurance firms often played an important role in the formation of personal ties among competing corporations. Further, the German-style system of corporate governance based on the codetermination system and the inter-corporate collaborations that the system supported complemented this industrial system’s collaborative structure. The industrial system was further complemented by the inter-corporate assignment of directors and interlocking of directorates. This postwar German-style industrial system based on industry–bank

86) A. Busse, a. a. O., S.61.
relationships combined these elements and functioned in a framework that deeply connected each element.

Although major changes can be seen in the 1990s and thereafter, this collaborative structure in the postwar era enabled corporate management to not only plan for business expansion from a long-term perspective but also suppress the influence of external shareholders and the pressures of the capital market. This structure constituted significant German development within the Americanization of business management, as management pursued business expansion with a long-term perspective in line with German and European market structures, which were central to German exports.

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