

# Families, Groups, and Pyramids: Long-Run Patterns of Corporate Ownership and Control in Germany

Caroline Fohlin\*

## I. Introduction: the hypothetical development of corporate ownership and control

Corporations begin with people, and people begin with families: thus, families provide the starting point of the long-run evolution of corporate ownership. Whether in Germany—the focus of this study—or in any other country, common patterns of changing ownership and control almost necessarily unfold.<sup>1</sup> Throughout history, family-owned corporations have appeared as a way to insure the life of a business beyond the founding individuals and to limit individual or family liability; that is, to separate and protect family wealth from the vicissitudes of the business environment. In the hypothetical ideal, a corporation is founded with all shares remaining in the hand of the founding individual or family. This can be a true start-up or a family-company simply changing its juridical status as a firm. One would expect this to happen in times when there are generally a lot of start-ups (post-1870, for example, in the German case) or when the form of an AG becomes more attractive (such as the aging or retirement of the founder). From then on, it is almost necessary, that both share-ownership and control of this company will leave the hands of the original family. There are two mechanisms that cause this to happen:

- 1) In order to raise additional capital the family will at some point be forced to place additional shares, watering down their control;
- 2) Inheritance of shares (if they have not been sold before) will divest the ownership within a few generations.

This process of divestment from the family leaves shares in the hands of people who have little or no attachment to the company and who are more likely to sell their shares. In Chandler's vision, this irreversible process both reduces ownership concentration and puts operational control into the hands of managers. Even if the family-divestment forces come into play, ownership concentration may remain unchanged, if old shareholders are directly replaced by new shareholders. In the German case, inter-corporate equity holdings play a significant part in the process; and the interests of corporate blockholders could differ from those of independent shareholders.

Thus, the idealized course of corporate ownership is not completely determined.<sup>2</sup> There are quite a few parameters to the family divestment mechanism, and they can dramatically alter the path of corporate ownership structure—determining whether the family loses control at all, and if so, whether ownership becomes dispersed. In the first area, there are two sorts of forces: those relating to the need

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<sup>1</sup> Similarly: The life-cycle-model of a family-enterprise in Klein (2000), S. 276ff. E.g. according to Goehler: Cycle in three phases; phase 1: Foundation by an highly involved owner-entrepreneur, problems of succession; phase 2: aging of leaders, same structures as in phase 1, lack of qualification of the leaders; phase 3: watering down of capital, leading and controlling organs blocking each other, conflicts of interest among shareholders, little risk-taking.

<sup>2</sup> Related questions naturally arise: whether we only find these starting points in the past, and whether the family played a certain historical role in the late 19th century that made it so important but which has since faded. And if the conditions for founding of family-controlled firms have deteriorated, what exactly are these conditions? One should be careful to make the scheme without modifications the model for the long term development: From time to time it is argued that manager-controlled corporations with highly dispersed share-ownership is a recent phenomenon, which only came after and developed out of family-companies, where family and shareholders held key positions. But there have been from the beginning on large corporations, whose capital was thrown together by many people. Especially the early railroad companies were not financed by few families or associates but rather by a great number of private persons, that neither wanted nor were capable of managing. Also, only corporations with dispersed ownership received concessions. [...]Also even in the early 19th century, there existed corporations where managers could more or less do what they wanted to without being restricted or controlled by the shareholders. Still these types of firms must have been a minority then. (Pross 1965, p.60f.)

for external finance, and those stemming from concerns about inheritance. For the second area, the structure of the financial system plays the predominant role.

1. Factors influencing the need to raise capital for family ownership and control:
  - i) Laws on voting rights associated with shares, particularly deviations from 'one-share, one vote' principals play a critical role. If for example it is legal to give out shares that come without voting rights, or to reserve shares with multiple votes, or if the number of votes per share increases in the number of shares in the hand of the voting person, it may be possible to raise money by selling stocks and still preserve control.
  - ii) The need for new capital may vary between industries. Little need for capital may result in stronger and longer family control.
  - iii) Family-held corporations may also prefer debt instead of equity to finance their investments.
2. Factors influencing the importance of inheritance for family-ownership and –control:
  - i) Founders may not pass their shares on to heirs for financial reasons. Incentives for one or the other possibility can be set through taxation of inheritances and taxation of selling shares (especially important in the German context: foundations (*Stiftungen*)).
  - ii) An heir may be disinterested in close involvement in the family firm. Instead of exercising the power associated with his stake, he might want to sell his shares. In this case, family-control and ownership would deteriorate faster. The wish to or not to continue on, is to be analyzed in historical-sociological terms of the prevalent concepts of identity, family, class, mobility etc. This disposition also obviously depends on founders' attitudes, since the wish of an entrepreneur to see a family member take over the firm would most likely manifest itself in the inculcation of heirs from early on. Also, unlike in point i), the entrepreneur may want to pass the firm on to family members for reasons of his concepts of identity, family and class, not only for purely financial reasons.
  - iii) It may also be, that a founder or a controlling heir considers it advantageous to have family members working in his firm, e.g. for reasons of reliability, loyalty, etc. This could lead to lower transaction costs. This would strengthen the wish to pass control and shares on to family members.
  - iv) The legal structures of control of a corporation (AG, in the German case), provided by corporate law, can be more or less advantageous for family control. The dualistic German form of management and supervisory boards (*Vorstand / Aufsichtsrat*) may permit greater family control over shares without having to take active management roles.
  - v) Legal provisions of inheritance can have a major impact on the degree and progress of dispersion.
  - vi) Demographic developments, especially the number of children spur or limit the possibility of continued family control. The sharp decrease in children and pregnancies is also inseparable from the changing role of women in society.
  - vii) Singular political and other historical events play an important role as well. In the German case, two examples from the Nazi era come quickly to mind: first, the aryanization of the economy (*Entjudung der deutschen Wirtschaft*) destroyed many family enterprises or family traditions in enterprises, and second, the nazis actively favored family control as opposed to anonymous managerial control. These explanations take center stage later in the discussion.
3. Even in cases of family divestment, corporations may retain concentrated ownership structure. The founding family can sell to blockholders who then trade only in large blocks. In this scenario, ownership concentration stays high.<sup>3</sup>
  - i) A primary factor in the dispersion process is active and liquid equity markets. Their absence could hinder the dispersion of ownership, since relatively uninformed outsiders prefer the reassurance that they can easily sell shares from their portfolio. In addition, the sale of large blocks brings about the issue of revealing private information. At the same time, blockholdings are also adverse to market liquidity.

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<sup>3</sup> For Germany in the recent past, Köke (2002) and Jenkinson and Ljunqvist (2001) found evidence for an active market in large blocks. Goergen and Renneborg (2003) show that after an IPO of a German corporation, new shareholders have significantly larger blocks in recent IPOs than in the UK. Later sections of the paper return to the modern evidence.

In a related vein, Becht Bolton and Roell (2003) identify the legal protection of minority shareholders as one of the reasons that lead to dispersed ownership, since it increases the costs of block holding. In the absence of such legal protection the blockholding becomes more prevalent. La Porta et al. (1999) identifies the reason for weak investor rights as the civil law tradition in Germany and in other European countries. As Coffee (2001) shows, however, in the beginning of 20<sup>th</sup> century there was little legal protection for minority investors and abundant private benefits in US as well, but still dispersed ownership arose.

The following sections of the paper analyze the historical record in Germany in order to assess the relative importance of these forces, beginning with the early stock companies (*Aktiengesellschaften*) of the first half of the 19<sup>th</sup> century and continuing up to the present. As a first step, however, we need to address the scarcity of data available on early corporate ownership and draw what conclusions we can about patterns over time. The next section investigates legal and political factors that contributed to the patterns found for Germany. Ultimately, economists tend to worry about corporate ownership structure because of its possible implications for firm performance and shareholder rights. Thus, the final section assesses the available empirical evidence on the consequences of ownership structure on corporate performance in Germany.

## **II. Patterns of ownership and control in German firms**

Because of the principle of data privacy in Germany and the manifestation of that principle in the anonymity of shareholders for most of the history of shareholding—primarily through the use of bearer shares, rather than registered shares—data on share ownership and therefore corporate ownership structure is almost completely absent until after World War II. This data shortage presents obvious problems for gaining a general, long-term view for Germany, however some conclusions may still be drawn from the available data.

### *The first phase of corporations: second half of the 19<sup>th</sup> century*

Beginning in the second half of the 19th century, two main patterns of German corporate ownership began to take shape. First, the actual formation of share companies and the accompanying growth in managerial control began after 1870. Still, this process took time: In the early years, the importance of the AG grew slowly in comparison with the personal enterprise. The latter had been the main important economic motor transitioning from home industry and manufacture in the 1840s. Before 1850, only very few AG's were founded: estimates put the numbers at only 16 in Prussia between 1800 and 1825, and 112 between 1825 and 1850; in the Bavarian Kingdom just 6 between 1838 and 1848, and 44 more in the following decade. The ranks of AG's expanded faster after 1850, with 336 AG's founded in Prussia up to 1870; and 57 in Saxony, where just 10 existed in the year 1850.<sup>4</sup> The real boom in foundations came between 1870 and 1873, with the liberalization of company laws and the formation of the German Empire: 928 new AG's were founded with a total nominal capital of 2,81 billion RM (Henning 1993: 210). Yet even by 1882, private firms accounted for nearly 95 percent of all enterprises in Germany (Gömmel 1992, p. 35).

Free incorporation as of 1870 and the creation of the limited liability company (GmbH) form in 1892 became the primary means for separating ownership from control. Not surprisingly, the big enterprises took to the AG form of organization more quickly than average. Personal enterprises already were of minor importance among the large firms at the end of the 19<sup>th</sup> century: already in 1887, four out of five of the largest companies were organized as AG's (Siegrist 1980, p. 88 and Wehler 1995, p. 627). According to Pross (1965, 75) power struggles between capital lenders and capital administrators arose early on. The original authority to dispose of management was in the hands of majority stockholders, their representatives, and higher-level managers. Though numbers on the quantity of manager-controlled enterprises remain elusive, impressionistic accounts suggest that they were in the minority. It has to be assumed that more often, the authority to dispose was in the hands of majority stockholders and their representatives, which let the managers do their job according to law and statutes: a job of a leading employee with important, but legally and *de facto* limited

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<sup>4</sup> Laux (1998) mentions 454 AG's for Prussia up to 1870. See Pross 1965.

authorization. In this early phase of the history of corporations, the generation of owners of enormous fortunes—those who had founded, enlarged and made competitive the mighty enterprises—ruled the roost. Viewing from the large biographical literature, the “captains of industry” of the heavy industrialization period—Krupp, Thyssen, Stinnes, Wolff, Stumm, Klöckner, Siemens, Bosch—possessed both the necessary equity and the personal authority to maintain solid control and impede any acts of disobedience. As towering as these figures remain, professional managers outside the ring of major shareholders also arose and clearly belonged to the economic elite. These employee managers, such as Emil Rathenau, Georg von Siemens, Dernburg, Kirdorf and others, wielded formidable influence despite their limited personal stock ownership.

The growing use of the corporate form, and of managers to run operations, facilitated the second main pattern: cooperation and concentration among firms. The first buds of cooperation between enterprises emerged through the formation of trade and production cartels and through the early steps toward building up concerns (Pohl and Treue 1978, p. 7). The process of concern-building started quite late in the century: in 1887, fewer than 20 of the largest 100 industrial enterprises took on the form of a concern (Siegrist 1980, p. 86). Most of the cartels appeared in the economically prosperous years between 1888 and 1891, and the institution rose to great economic importance in the period between 1895 and 1900. Before 1865 there existed just 4 cartels, and a decade later, that number was still only 8. By 1885, however, there were 90 cartels, and that number more than doubled (to 210) by 1890. By 1905, a total of 366 industrial cartels had formed (Sombart 1954, p. 316).

### *Early 20<sup>th</sup> century*

After the turn of the century, these two main trends continued with new vigor. Before WWI, the total number of AG's grew, while the share of AG's among the biggest German enterprises remained stable. In 1902, there were well over 5,000 AG's with a total nominal capital of 12 billion marks, and those numbers grew almost continuously in the pre-war years. In 1907, as in 1887, 80 percent of the biggest companies were organized as AG's (Henning 1993, p. 210). And in 1907, the majority of enterprises still were “entrepreneurial” enterprises, in the sense that they had a small group of owners, mostly a family, owning the majority of the equity and controlling strategic decisions, but already letting managers decide on daily business. The dynastic character of the economic elite was still “quite pronounced” at this time, with almost all industrial ‘big linkers’ (more than 14 mandates in supervisory boards of corporations) still holding the role of owner-entrepreneurs, with no manager and typically (about 2/3 of the time) representing an industrial dynasty of sorts (Ziegler 2000a).

Still, the managerial enterprise, with a widely spread ownership and salaried managers, had clearly gained importance and continued to do so in the pre-war years (Siegrist 1980, p. 88). The trends toward concentration, cooperation, and size continued unabated; and the large AG's became more and more dominant. According to one study, in 1904, fewer than 1 percent of AG's held nearly a quarter of the capital stock, and fewer than 10 percent (400 of 4740) owned nearly two-thirds of the capital (Pross, 1965).

As active as the concentration process was in the early 20<sup>th</sup> century, World War I gave new impetus for these trends. Cartels in particular were encouraged and enforced through governmental intervention, and mainly vertical connections sprang up (Pohl and Treue 1978, 20). At the same time, a new round of incorporation fever arose and then dissolved as rapidly: while more than 8,000 AG's were created between 1870 and 1918, by the end of 1919, just 5710 AG's remained registered. At least 2,700 AG's disappeared during the period. The growing tendency toward incorporation extended the AG form farther and farther down the size distribution, so that in 1919, just six percent of all German AG's (326 of 5710) exceeded five million marks of share capital

### **Figure 1. Number and share capital of AG's (total and listed only) up to 1918**

#### *The Weimar Republic*

After WWI, centrally managed concerns increased in importance and expanded their linkages via treaties and arrangements. The tendencies towards both concentration and oligarchy continued with new vigor. During the inflation years between 1919 and 1923, AG's formed at breakneck speed: there were more than 16,000 AG's in 1923, more than three times more than 1919. In 1925, already 13,010

AG's were registered with a total nominal capital of 19.1 billion Mark. Nevertheless, many small family enterprises remained in the market, and personal enterprises still accounted for 90 percent of all enterprises in 1925 (Gömmel 1992, p. 35). To some, managerial capitalism took over in this period, when large concerns often dominated the markets and the cartels, with rationally organized leadership structures, enterprises with many production plants, coordination among management teams, and ambitious sales strategies (James 1988, p. 166). While managers clearly emerged as a major force, the underlying ownership structure remains somewhat mysterious. It is assumed, though probably improvable with the data that exist, that the big enterprises came more and more under the control of a small oligarchy of major stockholders and managers (Pross 1965, p. 76). Both types of control, that maintained by majority stockholders and that turned over to managers, could be found within the leading enterprises. While manager-controlled concerns likely remained a minority among the big enterprises, they emerged as a growing and important minority (Ziegler 2000a, p. 42). Although the data are truly too sparse for certainty, Ziegler hypothesizes that the share of dynasties in the German economic elite fell markedly in the early 20s and was replaced by 'new' families from the bourgeoisie (Ziegler 2000a: 42).

Patterns of corporate structure and control also varied among the sectors of industry and across the size distribution. AG's clearly dominated in the financial sector, in which 93 banking and insurance companies with more than 10 million marks of nominal capital each; the mining and steel industry had 72 AG's of this magnitude, and the electrical and machine industry together had 55. There were 30 AG's with more than 10 million marks nominal capital in transport, and another 18 in the chemical industry. the remaining 70 German big AG's were dispersed in different branches. Yet the majority of all Ag's were in the food and luxury food industry sector (1919=905), but just 7 big AG's.

Especially in the heavy industry and the chemical industry, the trend towards horizontal industry concentration quickened: prominent examples are Thyssen, Rheinische Stahlwerke, GHH, Krupp, Hoesch and in 1925, the foundation of IG Farbenindustrie AG as the biggest German enterprise in terms of stock capital. Of 12,392 AG's in 1926, with a total nominal capital of 20.4 billion marks, 1,967 AG's (with a total nominal capital of 13.3 billion marks) were part of a concern. In other words, the stock capital bound up in concerns constituted 65 percent of the total at that time; a figure that rose to 69 percent the next year, and to almost three-quarters by 1930 (Laux 1998, p. 129). Overall, 85 percent of the total nominal capital of all German AG's was held by concentrated companies, and it is claimed that in 1927, virtually all of the 100 largest industrial enterprises had become concerns—many in the form of holding companies (Siegrist 1980, p. 86). Independent, unlinked AG's had become the exception, while the concern had emerged as the norm. (Pross 1965, p. 50).

Perhaps a natural by-product of these changes in industrial organization, managerial enterprises became prevalent in the mining, iron and metal industry, and in the chemical industry; and managers dominated in the biggest industrial enterprises regardless of sector: of the 10 largest industrial enterprises with a nominal capital greater than 100 million marks—Deutsche Erdöl, Harpener, Vereinigte Stahlwerke, Mannesmann, Krupp, Siemens, AEG, I.G. Farben, Burbach, Wintershall—only Krupp and Siemens remained 'entrepreneurial' enterprises; the rest were already 'managerial' enterprises (Siegrist 1980, p. 88).

During the 30s, implementation of managerial capitalism continued: more and more, the leaders of enterprises were managers without a dynastical background, and the founders or controlling shareholders retreated into the oversight role of supervisory board membership (Ziegler 2000a: 46). Meanwhile, capital became increasingly concentrated, and the absolute number of AG's fell: in 1930, there were 10,970 AG's with a total nominal capital of 24.2 billion RM, and in 1932, there were 9,634 AG's with a total nominal capital of 22.3 billion RM. Fewer than two percent of these AG's held well over half of the total nominal capital.

### *The Nazi-Regime*

The period of national socialist regimen to some extent reinforced the power relationships within the concerns. Because of their social views, the Nazis encouraged and assisted gentile founder families to retain control over their firms (Joly 1998, p. 111). Before the Nazis came in power, the number of stock corporations was 9,634 as of 1932. With government incentives, many AG's went private during

the period, and their numbers dropped to pre-WWI levels (about 5,500 in 1938) and dwindled slightly after that. In 1943, there were a total number of 5,359 stock corporations. For this period, data on ownership and control is still sorely lacking, and nothing very precise can be said.<sup>5</sup> Because of the underlying political and legal machinations of the period, the remaining discussion of the Nazi years is left for the next sections.

### *The Post-War Years (1945-2002)*

After the war, the AG regained favor among the large firms: in 1957, 87 of the 100 biggest companies (in terms of business volume) were AG's. Another nine took on the GmbH forms, and the remaining four remained in other forms (Pross 1965, p. 52). More broadly, however, the negative war-time influences on incorporation persisted: Whereas, in 1943 there were still more than 5,000 stock corporations, the number fell nearly 50 percent to 2,627 by 1960 (DAI factbook)—approximately the status of the late 1880's. Moreover, despite the rapid growth of the German economy, the number of stock corporations continued to fall until 1983. The decreasing importance of the legal form can also be seen in the falling number of stock market listings over the same period (figure 3). Private households also turned their backs to the stock markets: the percentage of households investing in stock markets steadily declined. In 1950 46.8% of all households held shares. But, until quite recently, this number declined steadily: In 2001 only 15.3% of all households held shares. (In 2000 this 8.3% of total population which compares to 25.4% of total population in the USA, see 08.6-1-a.) Strikingly, the proportion of shareholdings of private households went down by the same proportions: In 1950, private households held 48.6% of all shares. In 1996, this number was down to only 16.76%. At the same time nonfinancial firms became dominant shareholders in Germany. The proportion of shares held by nonfinancial firms went up from 18.17% in 1950 to 41.36% in 1996.

### **Figure 3. Number and share capital of AG's (total and listed), 1943-2002**

As the next section explains in great detail, the preference of Nazi government for private firms over stock corporations explains the great part of the decline in the AG population up to 1943. The further declines shortly following the war likely stem from the disruptions of World War II. However, the disruptions due to the war probably cannot explain the continuous downward trend in AG numbers until 1983. The pattern is consistent with a fundamental economic force: concentration of power. Companies seem to have used stock markets to accumulate shares in other corporations in order to establish capital linkages.<sup>6</sup> At the same time, private investors and foreign investors found the stock markets increasingly unattractive. This tendency then led to de-listings and illiquid capital markets as companies held on to sizable equity stakes in order to establish long-term relationships. However, there seems to be some trend towards revitalising stock markets in Germany since the 1980's and especially the 1990's. Whether this trend will resume following the recent burst of the new economy 'bubble' remains to be seen.

Clearly, the de-concentration efforts of the allies—both in terms of equity ownership and in terms of industrial organization—failed generally and over the long-run. The capital stock concentration of the AG's was higher than before WWII, but other organizational forms, especially personal enterprises, retained their importance and position in the post-war economy. In 1950, the average AG was bigger (average nominal capital 1925 1,5 million RM, 1957: 10,3 million RM) and employed more persons (1925: 307, 1950: 790) than in former times, but the share of AG's of all German companies stayed almost the same: of all companies in 1950, just 0.1 percent were AG's. In the same year, over 90 percent of all companies—that is, capital and personal companies—were owned by one or only a few owners (Pross 1965, p. 53).<sup>7</sup>

The ongoing concentration process in post WWII Germany emerges most prominently among the large, listed AG's. Among these firms, concentration increased from the 1960s to the 1980s, and extricated themselves to some extent from family domination (Iber, 1985). Despite their loosening of ties, families and individuals remained important shareholders. The percentage (as measured by number and nominal capital) of corporations with a qualified majority shareholder (more than 75

<sup>5</sup> though research efforts with new archival materials are underway and seem promising.

<sup>6</sup> See Iber (1985) and monthly reports by the Bundesbank over the period.

<sup>7</sup> Unfortunately, Pross does not give exact numbers.

percent) increased between 1963 and 1983, as did the percentage of corporations with a simple majority shareholder. This concentration process slowed somewhat toward the end of the period, and appears to have begun to move in the opposite direction at the end of the twentieth century.

Still, ownership remains relatively concentrated in Germany, and families take prominent roles, particularly for non-financial firms, unlisted companies, and smaller firms generally (Faccio and Lang, 2002). Non-financial firms also take a primary role as blockholders, and one can see a shift in the importance (as dominant shareholders) from families to enterprises and to banks starting by the 60s and 70s (figure 4). Contrary to commonly held beliefs, and despite their active presence in a few firms, banks tend not to hold dominant stakes.<sup>8</sup> There is also strong evidence that controlling owners tend to be alone (see Faccio and Lang, 2002 or Becht and Boehmer, 2003).

#### **Figure 4. Ownership and control of AG's over time**

The facts of the German case challenge the traditional view that companies are first dominated by founding families which then slowly lose control, giving way for widely-held corporations. While ownership concentration appears to have progressed as expected up to the Nazi era, the tendencies appeared to reverse from there up to the 1980's. The most recent figures suggest a possible return to a pattern of gradual diffusion of ownership, but only time will tell for sure.

A look at today's firms highlights the persistence of family ownership in Germany and the impact it has had on accumulated wealth. Seventeen of the 21 biggest German private fortunes (more than 3 billion DM in the 1990's) derive from family founded enterprises.<sup>9</sup> Of the 274,139 enterprises with more than 2 million DM business volume in 1995, 3.1 percent were founded before 1870, and 12 percent between 1871 and 1913.<sup>10</sup> In the first group, 74.5 percent are still family enterprises, and in the second group, 72.1 percent are family owned. Thus, among pre-WWI survivors, family ownership is key. Families did lose some importance in corporate ownership after the war, but they remain a significant force: Despite the decline in ownership by households generally, families or individuals are often dominant shareholders. That is, families are central to the ownership of many firms, but equity ownership is unusual among the population at large.

#### **Figure 5. Family versus non-family ownership of modern firms, by period of foundation**

A large number of German corporations consistently have average block sizes well above 50 percent, even in corporations listed on the stock exchange. Blocks tend to be higher in smaller and unlisted firms. But even in large and listed companies, large shareholdings are a common feature.<sup>11</sup> These stakes are probably held for control purposes, as the empirical distribution of stakes is clustered around important control thresholds of 25, 50, and 75 percent (Becht and Boehmer, 2003). Because of the right to veto certain decisions, the 25 percent threshold (blocking minority) and consequently the 75 percent threshold are crucial. In more than 80 percent of companies listed above a certain size, some shareholder held a blocking minority in the years 1963, 1973 and 1983. At the same time this concentration increased during that period (Iber, 1985). This is even more striking as Iber looks at bigger listed firms, where one would expect a more dispersed ownership.

The estimates of the prevalence of pyramids vary between different studies: Köke (2002) finds that about half of the firms in his sample are controlled through pyramids, while for example Gorton and Schmid (2000) finds much smaller numbers. Faccio and Lang (2002) also find that financial firms use pyramids to exert control much more often than private households. These studies covering varying time periods and samples, and it is therefore difficult to draw strong conclusions about the trends in the use of pyramids.

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<sup>8</sup> See the evidence reviewed in Fohlin (2003).

<sup>9</sup> Joly (1998), p. 29. Joly unfortunately does not provide information, if these fortunes derive from family enterprise foundations of the pre- or post-WWII-period.

<sup>10</sup> It is assumed that during this period, apart from cooperatives (*Genossenschaften*), nearly all enterprises were founded as (potential) family enterprises. Evidence comes from the many personal enterprises cited in Klein 2000, p. 33.

<sup>11</sup> See the evidence in Becht and Boehmer, 2003; Faccio and Lang, 2002; Iber, 1985; Köke, 2001, 2002; Lehmann and Weigand, 2000).

### III. Underlying causes of the German patterns of corporate ownership

#### A. Legal factors in the German patterns of family-ownership and control

Founders and founding families have tried to preserve ownership and control of their corporations in the face of the multiple countervailing factors outlined in the introduction. Some of these attempts are of course restricted by law governing corporations. Legal provisions concerning voting rights, the relationship between the organs of an AG and shareholder rights are of particular importance here. These influences have evolved over time, and the history of thought on legitimate interests of a stock company is enlightening. These ideas manifest themselves in many ways in corporate law and elsewhere; one of the most important manifestations is the history of voting rights associated with shares.

The standard liberal notion of a stock company runs something like this: The individuals owning the stocks control the firm. They exert such control indirectly by putting professional managers, which are supposed to in some sense maximize the returns of investment, in charge and by controlling them. If this is the whole story about stock companies, then they have the following features: first, stock companies exist essentially in the realm of private entrepreneurship; states and governments are only involved in that they collect taxes and watch over the compliance with laws and regulations. This is an essentially liberal feature. Second, major decisions (those that are not delegated to the managers) are made according to some fair aggregation of shareholder preferences. This feature can and has been considered a manifestation of the democracy-principle. In the Anglo-Saxon world, these two features seem to adequately describe reality. In Germany, however, there is a long and strong history of deviating thought (and legislation). These influences have altered the patterns of corporate ownership in Germany relative to other countries with which Germany has otherwise developed on par. At some points, particularly, that noted earlier for the Nazi period, the deviations were even directly associated with the encouragement of family control.

German thought and legislature about stock companies deviates from the standard account for two main reasons: true deviations peculiar to the German case, and the general inadequacy of the standard account for any observable case (that is, it fails for other countries as well). The size and activities of stock companies bring with it consequences for an array of people not legally associated with the company (stakeholders) and for the state as a whole. In the German view, suffering consequences makes it *prima facie* plausible to call for influence, and the interest of the general public and the government can therefore be seen as a justifiable co-determinant of stock-companies.

The history of criticism of the standard account of stock companies is almost as old as stock companies. From early on, critics noted that the *de jure* primacy of the general meeting of shareholders (*Generalversammlung*) is *de facto* overridden by the management board (*Vorstand*), a situation that, mostly due to information asymmetries, can hardly be controlled even by the organ created for this purpose, the supervisory board (*Aufsichtsrat*). Other descriptive inadequacies concern the democratic aggregation of the shareholders' preferences or interests and the indifference of minority shareholders.<sup>12</sup> Using these basic ideas as guideposts, the following surveys the German (Prussian) thought and legislature on stock companies since the appearance of the first stock companies in the early 19<sup>th</sup> century.

#### The history of German thought and legislature on stock companies

##### *The first century: liberalisation*

The historical roots of German stock-companies can be found in the early 19<sup>th</sup> century in Prussia's so-called *Octroi*-system.<sup>13</sup> Some legal provisions for stock-companies existed in the *Allgemeines Landrecht für die preußischen Staaten* (ALR) from 1794 and, where it was valid, the French *Code de Commerce* from 1807. Since these provisions were very rudimentary, foundation, organisation and persistence was highly dependant on governmental interest. Legal provisions included the grant of the

<sup>12</sup> Discussion appeared as early as 1837 from the banker, David Hansemann. See Pross (1965), p. 65.

<sup>13</sup> These first couple of sections are based on [Laux \(1998\)](#)



right of incorporation. The status as a juridical person and of limited liability (§ 25pp. II 6 ALR) to a company founded for business purposes was only possible as an exception (§ 16 II 6 ALR). A necessary condition for the grant of these rights was the proof of activities serving the public benefit (§ 25 II 6 ALR). Providing such evidence came more easily for insurance companies. It usually took one to two years for applications to be processed; this was referred to as the “Kampf um die Konzession” (“fight for concessions”). But the unregulated and potential haphazard practice of granting or not granting concessions was one of many influences the government held. A still more direct way of influencing the AG was through a “Gouvernör” or “Kommissar” supervising the *Vorstand* with the authority to directly influence the AG’s operations in order to align them with the government’s interests (Laux, 1998, p. 42). In the first third of the 19<sup>th</sup> century the Prussian government readily used the rules of the *Octroi*-system in order to control the power of corporations and thereby controlling the growing power of the *bourgeoisie* after the French revolution (Laux (1998) and [Pross \(1965\)](#), p. 46).

In 1838 the Prussian railroad law (PrEisenbahnG) was introduced. This marks the beginning of the acknowledgement of the essential usefulness of stock-companies: only AG’s could possibly raise enough capital to build railroads. The interest of the Prussian government in codifying corporate law was from this point on not only control of the bourgeoisie but also economic, business- and welfare-considerations. The PrEisenbahnG still required the proof of the corporation serving the public benefit, since they were incorporated according to the abovementioned paragraphs of the ALR. Also, the Prussian government still reserved the right to send a supervising “Kommissarius” with substantial powers. In 1843, however, the Prussian stock law was introduced (PrAktG). It was valid for all corporations founded after its introduction and did away with the public-benefit-clause. Incorporation still required a concession of the government. The granting-practice was quite restrictive at first, moving along the lines of the *Octroi*-system and still arguing in the spirit of public benefit. This changed in 1856, when general guidelines for granting concessions (“Circular-Verfügungen”) were introduced. The granting of concessions was from now on a merely formal act. Hoping for benefits of free and self-regulating forces of the market, the Prussian government overcame its fear of the loss of control.

This liberal spirit was strengthened further in the first extensive codification of corporate law in the *Allgemeines Deutsches Handelsgesetzbuch* (ADHGB). The law provided, for example, that the Prussian provinces could decide whether or not they wanted to require a concession for incorporation at all (Art 249 Abs. 1 S. 1 ADHGB). Some states in fact opted not to. The ADHGB of 1861 also cancelled all traces of public benefit clauses. The first revision of the ADHGB in 1870 completely did away with the system of concessions and voided all laws of the *Länder* requiring concessions. The revision also for the first time required companies to have *Vorstand*, *Aufsichtsrat* and *Generalversammlung*. Thus, the thrust of this revision seems to have been to cancel the last traces of government involvement and at the same time strengthen the means of the shareholders of effectively controlling the *Vorstand*.

Liberal tendencies remained strong when reforms of the provisions of corporate law were introduced in 1884, after a multitude of foundations of undercapitalized firms and more than the normal amount of fraud led to a stock market crash: Although many blamed the 1870 laws and called for reforms, this did not lead to tighter government control. In a letter from 1873, the Prussian minister for trade, commerce and public work (*Handel, Gewerbe und öffentliche Arbeiten*) asked the Prussian *Handelskammern* for greater information transparency, stronger liability of founders, and responsibility of the managers, as well as the strengthening of the *Aufsichtsrat* and the *Generalversammlung* and the addition of another (in addition to the *Aufsichtsrat*) controlling organ. He did not however, ask for more government control. Thus, the 1884 revision required firms to publish more information about the foundation of an AG and the individuals involved, increased the liability of the founders, and strengthened the position of the *Aufsichtsrat*. The new *Handelsgesetzbuch* (HGB) was introduced in 1900 but, in fact, changed little.

The history of corporate law from early Prussian AG’s to WWI is a history of liberalization. The restrictive legislature and concession practices of early 19<sup>th</sup>-century Prussia can be seen as institutions motivated by the government’s interest in limiting the power of the *bourgeoisie*. AG’s were for that reason considered more than just a private enterprise and thus the government reserved far-reaching rights of control. Over the decades the necessity of providing a legal framework for financing capital-intensive enterprises and the liberal persuasion (Ricardo, Smith, Mill) led to a complete liberalization. At the same time, legislature on objective criteria for foundations, liability,

publicity and the corporate structure (*Aufsichtsrat*) were extended to provide the necessary legal framework for efficient entrepreneurship.

### *The Weimarer Republik and the Lehre vom Unternehmen an sich*

There were no major revisions of corporate law during the time of the *Weimarer Republik*. But this epoch is still highly relevant to its later development. The *Weimarer Republik* was an epoch of political and economic instability and many mistrusted the liberalism of pre-WWI. This and the experience of government-involvement in the heavy industries for purposes of concentrating resources for the war are the background for discussions about corporate law in the interwar years.

The intuition of the criticism of the liberal tendencies sketched above is the following: It is quite obvious that if a company is set up as a partnership of natural persons, the interest of the company can be considered the interest of some kind of aggregation of the partners' interests. Also, a partnership is not a juridical person. AG's however, are juridical persons and the possibility of large amounts of capital being highly dispersed can suggest that the interest of the AG is not only the aggregation of the shareholders' interests, but something else. Many scholars ascribed an interest to the AG that was independent of the interest of the shareholders. Oskar Netter e.g., one of the leading scholars in corporate law during the *Weimarer Republik*, claims the necessity of ascribing a "sort of a metaphysical essence" ("eine Art metaphysische Wesenheit") to the AG. Somewhat indiscriminately employing the Kantian term "Ding an sich" ("thing in itself"), theories of this type were labeled *Lehre vom Unternehmen an sich* (*LUAS*, doctrine of the company in itself).

It is not pure coincidence that the *LUAS* was discussed extensively in the 1920's. As early as 1931 Nußbaum, another leading corporate law scholar at this time, argues that the discussion of the *LUAS* was spurred by the economic and political destabilization of this epoch: "The doctrine of the 'Company in itself' could never have been introduced in times of a flourishing economy and frequent emissions. It is the typical product of an age of disintegration and fusions – corporate law's philosophy of decay."<sup>14</sup> Laux concludes that it seems reasonable to look at the *LUAS* as a theory that was targeted at stabilizing the economy through the publicly beneficial restriction of individual rights shareholders have.

At first sight, thinking about the AG as not exclusively serving the shareholders as an investment, is clearly anti-liberal. It is still illiberal at second sight, but the picture is more complex than that. The *LUAS* was first brought forward in 1917 by Walther Rathenau (not under his name) and introduced a decade later by Haußmann. Writing "Vom Aktienwesen" ("About Stocks"), Rathenau drew heavily from his experiences in the "war-raw-material-division" of the Prussian Ministry of War.<sup>15</sup> This experience suggested a conception of an ideal economy as one that was directly linked to the public interest of the government and the people.<sup>16</sup> Rathenau argues, that the shareholder perspective was an approach that suited the family enterprises at the earlier stages, but that had lost validity for two reasons: first, AG's have gained a great importance for the state (research, production of civil and military goods, competition with other states) and the people. They have grown out of the

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<sup>14</sup> Nußbaum 1931, Pp. 492, 502. Quote in Laux 1998, p. 22. Laux confirms this today, observing a general attractiveness of community-focused as opposed to individual-focused thinking in the 20s, where liberalism was associated with economic crisis (Laux 1998, S. 21f).

<sup>15</sup> Walther Rathenau was born in 1867 as son of AEG-founder Emil Rathenau; earned a PhD in sciences; held various positions in *Vorstand* and *Aufsichtsrat* of different companies, among them AEG; in 1914 became head of the "war-raw-material-division" of the Prussian Ministry of War. In 1918, he co-founded the *Deutsche Demokratische Partei*; in 1921 he became *Wiederaufbauminister* (Secretary of Reconstruction); in 1922, he became Minister of Foreign Affairs; and he died in a political—probably anti-Semitic—murder in Berlin 24. June 1922. (According to [www.walther-rathenau.de](http://www.walther-rathenau.de), Rathenau was being driven in a convertible to the *Auswärtiges Amt*, when a car with three men passed him. One shot approximately ten times with a machine gun, the other one threw a hand grenade into the car. Strangely, the driver did not get hurt severely and first thought, a tire had blown up. Rathenau was heavily wounded by five bullets and died on the way to the hospital—a nurse waiting for the bus witnessed the killing and told the driver to take Rathenau to the hospital. The killing seems to have been well organized and is linked to the O.C., *Operation Consul*, an apparently large (up to 5000 members) and well organised nationalist, anti-democratic and anti-Semitic militia. Its predecessor was prohibited after its participation in the *Kapp-Putsch* in 1920. One of the three murderers was arrested (the driver), one was shot in an attempt to arrest him, the third committed suicide. There was a lawsuit against the driver and other helpers. Its files were lost for a long time but were found a couple of years ago in a Russian archive.)

<sup>16</sup> However, it seems to be difficult to characterize Rathenau's conception of this economy, since it unites pieces of the war-economy, socialist conceptions and capitalistic views.

sphere of private interest and into the sphere of public interest. Second, while earlier the shareholders had been attached to their AG's and were interested in the AG itself, AG's were by then (in Rathenau's time) partly owned by people who are solely interested in their shares as an investment.

Rathenau concludes that the *Vorstand* therefore has to acknowledge and take into account the interests of the state and the people. He argues that there exists a convergence of interests between shareholders, AG's, state and people and that non-converging, "egoistic" interests of speculator-shareholders should not be protected by law. This deviation from the standard liberal perspective on AG's obviously differs in nature from the early Prussian government-control: While the Prussian government drew its legitimization from a political and economic power-struggle, Rathenau argues for the public benefit. Also, the *LUAS* can not generally be associated with the expropriation or marginalization of shareholders as is often held by critics. The concept of an interest *does* mean on the one hand, that the majority of the votes is no longer the criterion for legitimate interests and it seems strange today to call speculative interests "egoistic" and illegitimate. But then again, the concept of convergence of interests was meant to protect the rights of (non-speculative) minority shareholders as well, by aligning the interests of a company with public interest.

These thoughts fell on fertile ground during the Weimar Republic, given the rapid concentration process and increasing tendency away from democracy (*Entdemokratisierung*), as well as the decline of the power of the *Generalversammlung* due to the growing separation of share ownership and voting power.<sup>17</sup> This dissociation was possible through the then legal use of stocks associated with multiple votes (*Mehrstimmrechtsaktien*) as well as by proxy-voting—quite typically by banks.<sup>18</sup>

Thus, although the Nazis picked up readily on these sorts of arguments, they were firmly rooted in socialist political theories and were, ironically, introduced into the corporate governance debates by the liberal Jew Rathenau. The adoption by the Nazis required some adaptation to fit their particular goals. The protagonists of this revision were mostly strongly influenced by NS-doctrines, changed key aspects of the theory and tried to disguise its (Jewish) provenance.

### *Corporate law during National Socialism*

The Nazi adaptation of the *LUAS* paid little attention to its intention of protecting minority shareholders.<sup>19</sup> It emphasised instead the idea of an interest of the AG that was independent of the shareholders, but in line with the Nazi economic system. Similar to the intentions of the founders of the *LUAS*, the *Vorstand* (referred to as "Führer" of the AG) is thought of as being restricted in its actions by a public interest. This interest however, is specified in terms of the Nazi political state: The *Vorstand* is restricted by duties that "are imposed on him as a trustee of a part of the German economy with respect to the general public."<sup>20</sup> In this rendering, very much in contrast to the tradition of the Weimar Republic, the rights of the *Vorstand* were enormously strengthened through the application of the "*Führer-Prinzip*": The *Vorstand* must "not depend on some kind of majority votes of an even anonymous power, but has to lead ["führen"] however it thinks is correct."<sup>21</sup>

The NS-concepts of community (*(Volks-)Gemeinschaft*) also cast suspicion on the anonymous character of an AG with highly dispersed ownership. This sense fuelled the further sentiment that the importance of the *Generalversammlung* had to be decreased. In the same spirit, calls began for the exclusive use of *Namensaktien* (personally registered shares) (Riechers, p. 155, 159). The relationship between shareholders and the AG is defined by the "Treupflicht"-concept.<sup>22</sup> Kurt Ballerstedt

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<sup>17</sup> Minority shareholders are thus both regarded as part of the problem ("egoistic") and as victims of ("Entdemokratisierung"). For further elaboration, see Laux, p. 124-130.

<sup>18</sup> On banks' role in proxy voting, see Fohlin (2003).

<sup>19</sup> This section is based on several arguments in Riechers (1996).

<sup>20</sup> Danielcik (1934), p. 658

<sup>21</sup> Danielcik (1934), p. 658. Another author using an *LUAS* for an NS-theory of corporate law is Werner Bachmann. He argues for example that it is most important to integrate the AG into the NS-state. The power of the *Generalversammlung* is to be strictly limited. He suggests to send a representative of the state into the *Aufsichtsrat*, whose defeat in any vote would be "unimaginable". Yet another author of this kind is Wolfgang Siebert, who emphasises that the shareholders have duties not towards an abstract juridical person [as claimed by the *LUAS*, TC], but towards "a company that draws its sense, justification and tasks from its position as one part of the people's economy and serves the people (my (bad) translation. The original sounds much more fascist: "Gliederstellung in der völkischen Wirtschaft", Riechers S. 156)

<sup>22</sup> literally: "duty to be faithful"

summarizes (already in 1949) its career from Rathenau to its NS-adaption as a process that started out aiming against the power of shareholder-majorities and ending after 1933 in subduing everyone putting in capital to the absolutist enterprise (Riechers, S. 157).

It is sometimes argued, that the 1937 reform of corporate law is an essentially national-socialist piece of legislature. This however, doesn't seem to be the case, since it heavily draws on discussions and drafts from the *Weimarer Republik*. As early as the end of 1933, the *Akademie für Deutsches Recht* had the task of renewing the German law in the spirit of the Nazi agenda. The Academy's section on corporate law wrote two reports, published in April 1934 and June 1935 that used little Nazi vocabulary and argued, that Nazi proposals for changing corporate law were either unrealistic (e.g. arguing that Keynes has shown, that it is impossible to fight against the tendency towards shareholder-anonymity in modern corporations) or legally impossible (e.g. the relations between companies and the general public could not be regulated through corporate law but only by public law). Though criticized by Nazi advocates, these reports triggered a tendency towards less ideology. This trend was strengthened and maintained from then on by the November 1935 speech of the economic minister (*Reichswirtschaftsminister*) and president of the central bank (*Reichsbank*) Hjalmar Schacht at the *Akademie für Deutsches Recht*. In criticizing the reports, he argued in favor of freedom in trading of shares and against the "opinion, that a company, once it has been founded and financed by shareholders, thereafter leads an independent life that takes place outside of the shareholders." Schacht, seeing the AG primarily in its function as serving capital-intensive enterprises, therefore argues in favor of the traditional, liberal conception of AG's.

There are, however, traces of both the LUAS and of Nazi ideology in the 1937 Aktiengesetz (AktG), in particular, through the reintroduction of a public interest clause (*Gemeinwohlklausel*) in §70 AktG.<sup>23</sup> This clause does not seem to have been of practical relevance. And other features suggested by the LUAS, like (shares associated with more than one vote) *Mehrstimmrechtsaktien* were prohibited.<sup>24</sup>

### *Corporate law after 1945*

The public interest clause (*Gemeinwohlklausel*) was abandoned in the reform of the German Aktiengesetz in 1965. Yet legal thought often holds that, because of the German *Grundgesetz*, something similar still remains in force after this reform:

"This general public benefit clause (*Gemeinwohlklausel*) was not included in the *Aktiengesetz* in 1965, because it was – according to the reasoning of the law's draft – self-evident. Jurisdiction and "ruling opinion" ("*herrschende Meinung*" in German law, the term for the scientific consensus) argue, that the general public benefit clause is a manifestation of the social obligation of property, established in article 14 II of the German constitution (*Grundgesetz*) and as such still valid." (Kübler, 1994, S. 163)

This article states, "Property imposes obligations. Its use ought to serve the welfare of the general public." (Art. 14 II GG). This discussion continues even today and was further spurred by the introduction of American "shareholder value" approaches to thinking about corporations. These arguments are also important in understanding recent developments in the German stock corporation act and in the work of a commission to prepare new legislation with respect to problems of corporate governance:

"After Mülberg, stating his commitment to the formal juridical goal of profit-maximization as the only operational one, restarted the discussion and challenged the magic formula of the 'Unternehmensinteresse' [literally: "interest of the company"] with respectable arguments, the revelation of the position of the Commission would have been interesting. Similar things holds for the notion of aiming at maximizing the market-value of the AG (serving the interests of the investors), the shareholder value and the group interests (or other interests), which the management can or ought to take into account. The 'herrschende Meinung,' continues to

<sup>23</sup> According to Pross (1965), p.89, "It has sometimes been argued that the new law regulating corporations strengthened the rights of the *Vorstand* at the expense of the *Aufsichtsrat* and *Generalversammlung*. The situation in the 1920's and 30's, however, shows that the '*Führerprinzip*' did not have to be introduced, since it already existed. It was only confirmed by the 1937-law."

<sup>24</sup> I don't exactly understand this argument of Riechers: Why would *Mehrstimmrechtsaktien* be something the LUAS should generally favor?

support the notion, that the *Vorstand* ought to, without any definite order, take into account the group interests (shareholders, employees and other stakeholders) as well as those of the public.” (Schwark, 2002, p 79)

Thus, in considering the functioning of the German corporate governance system, particularly in the realm of protecting shareholder interests, the underlying philosophy of the system—it’s social and political backbone—must come directly into play. The laws on corporations have at their core the goals of the political forces of the time, which may relate to varying degree to the underlying views of society. In the German system, it is fairly clear that the corporate governance system began with some intention of safeguarding the individual shareholder but moved away from that purpose after World War I. In this view, shareholders are just one, if perhaps the most important, group. Their interests are evaluated with other stakeholders’ interests if it comes to conflicts.

### **The relationship between share ownership and voting rights**

Democratic intuitions, liberal traditions, and today’s market-orientation trends suggest that one share should be associated with one vote. In Germany however, there have been and still are exceptions from the one-share-one-vote-principle. The most important ones appeared in the interwar period. These deviations from one-share/one-vote are of great importance for questions of separation of ownership and control, and to the fate of family ownership, because the disassociation of ownership and control allowed founders to control their firms longer than they would have otherwise.

#### *Multiple-vote shares (Mehrstimmrechtsaktien)*

*Mehrstimmrechtsaktien* are quite literally shares that are associated with multiple votes. This means that a few shares and little capital investment can lead to a lot of voting power. In the interwar years, this instrument was extensively used. It was usually justified as means of fighting internal and external ‘over-alienation.’ “The introduction of *Mehrstimmrechtsaktien* was triggered by the need for capital after WWI, when many companies had to switch from war-economy to peace-economy. They feared an ‘alienation’ through foreign and domestic investment.” Pross (1965), p. 84.

Based on a large sample of AG’s studied by the national statistics office (*Statistisches Reichsamt*), 842 out of 1595 AG’s in 1925, and close to 40% out of 913 in 1934 used *Mehrstimmrechtsaktien*. The votes per share ranged between 20 and 250 times higher than the normal voting right. These shares, usually associated with just a small fraction of the overall capital, were loaded with as many votes as necessary for the domination of the *Generalversammlung*. Usually these privileged shares were given to members of the *Aufsichtsrat* or to banks that committed themselves to vote according to the controlling group. The rest and the future shareholders had effectively lost all power. According to the *Statistisches Reichsamt* study, ownership of 10% of the shares was sufficient to control more than 40% of the votes in 388 companies in 1925. Due to the generally poor attendance at the general meetings of shareholders (*Generalversammlungen*), 40% of the available votes usually meant the majority of the votes present (ibid, p. 86).

Multiple vote shares were prohibited by the reform in 1937, however, the Nazis apparently made exceptions favoring family enterprises—a topic that appears again in the next section. The new AktG from 1965 allows *Mehrfachstimmrechte* but only after a special concession to be issued by a federal minister (Paragraph 12 AktG).<sup>25</sup> Today they are of little importance, and, in fact, the new law on control and transparency in the business sphere (KonTraG 1998) explicitly prohibits the issuing of *Mehrstimmrechtsaktien*.

#### *Vorratsaktien and Vorzugsaktien*

*Vorratsaktien* (“depot shares”) were another instrument heavily used in the time of the *Weimar Republic*. According to Menke (1988), these shares were issued without granting a right to buy them to the stockholders. Officially they were created to help the company react quickly when needed for mergers or acquisitions. Until their final use they were kept by someone who was bound not to sell them. Their actual purpose was different, though: “Pretty soon it became clear that the reason for issuing *Vorratsaktien* brought forward initially was only a pretext. In reality they were misused in that

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<sup>25</sup> It would also be interesting to examine the cases in which *Mehrstimmrechtsaktien* were used after the war: with the influx of ‘oil-dollars’ from Near Eastern countries in the 1970’s, these shares may have been used to prevent control losses to governmental investors from Near Eastern countries.

they were loaded with multiple voting rights in order to keep the control over the company in the hands of the controlling group or an associated shareholder without having to invest huge amounts of capital.”<sup>26</sup> This misuse led to legal changes in 1937. Vorratsaktien were not prohibited but incentives were set in a way that made them unattractive and vanish thereafter.

*Vorzugsaktien* (“preferential shares”) were created for financing corporations in trouble. They are shares that come with a right to preferential treatment with respect to the payment of dividends. This right was offered as an additional incentive for someone interested in investing into a company that was in trouble. Since a lot of capital can be required in such cases, the shares came without voting rights in order to raise money without losing control of the firm. The 1937-reform of the AktG strengthened the right of holders of *Vorzugsaktien*: not more than 50% of the capital can be issued in *Vorzugsaktien*, they have to have all other rights associated with shares except for voting and they regain their voting right, if the corporation is one year late with the payment of the preferential dividend.

#### *Höchststimmrechte and other restrictions*

*Höchststimmrechte* (maximum-voting rights) are rules that say, that there is a limit to the number of votes a shareholder can have. This can either be achieved directly by allowing less votes than the number of shares of an important shareholder has suggests or indirectly by prohibiting the purchase of more than a certain fraction of the shares.<sup>27</sup> *Höchststimmrechte* have a long tradition in Germany. Many of the corporations of the early 19<sup>th</sup> century had *Höchststimmrecht* clauses in their constitutions. But from the start, these rules proved ineffective, since it is not difficult to only formally have someone else hold stocks and still control their votes. This instrument can be used to limit the power of majority shareholders, but it also works as an effective threat against hostile take-overs. This restriction of the market for corporate control has been criticized and after legal changes through the recent 1998-reform *Höchststimmrechte* have been phased out by now. The capital market actually rewarded this change: the prices for stocks from companies with *Höchststimmrechts*-clauses jumped when the legal changes were announced. The AktG 1965 had still allowed them and even today Aktiengesellschaften whose shares are not traded at stock exchanges are not subject to the prohibition of *Höchststimmrechten*. The rationale is to preserve control of founders—in many cases families—who are still be involved, albeit with reduced ownership stakes, in smaller *Aktiengesellschaften*. Of course, there are other related restrictions, such as minimum stake requirements, on voting shares and even on attending the general meeting of shareholders.<sup>28</sup>

#### *Codetermination*

The idea that management of a stock corporation should not only be responsible to the shareholders but also to other stakeholders can also be seen in the codetermination laws. Employees send representatives to the supervisory boards in stock corporations. By giving employees voice without actual ownership, these rules cause a major deviation from the rule of one-share-one-vote. Of course, codetermination was introduced in order to represent employees’ interests in the supervisory boards, regardless of the implications for shareholders’ rights. Codetermination may have limited ownership dispersion, because shareholders attempt to counter balance the power of the employees and prevent the damages that can occur if management and employees collude.<sup>29</sup> Roe argues that, because of codetermination, the managers and large blockholders circumvented the supervisory board by making decisions outside the boardroom—largely obviating the supervisory board as a governance device. In addition, he argues that codetermination and blockholding are complementary. That is, dispersed ownership fits poorly with codetermination, because it prevents blockholders from selling their blocks to the public and also scares off potential minority investors. Codetermination evolved over two post-war regulatory episodes in 1951 and 1952 and then in 1972 and 1976. While theoretically appealing,

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<sup>26</sup> See Menke (1988), p. 98.

<sup>27</sup> This section is based on [Emmerich \(2000\)](#) and Fey (2002).

<sup>28</sup> See Emmerich (2002) and Pross (1965).

<sup>29</sup> See Roe (2000).

studies that examine the effect on the shareholders of employees in the supervisory board find little or no effect of codetermination.<sup>30</sup>

### *Blockholding and other forms of monitoring*

Given this background, shareholders are left with only one possibility to effectively control management: blockholding as a monitoring device. Dispersed ownership creates managerial agency problems, such as conflict of interest between investors and managers.<sup>31</sup> There are several mechanisms that can mitigate these costs. Roe (1999) argues that there are 4 main monitoring mechanisms: market competition, takeovers, good board of directors, and blockholding. In his view, Germany has few takeovers, is weak at competition, and does not have strong boards. Hence, he argues, large blockholders are the only control device for monitoring managers. If there is diffusion of ownership, no internal or external control device for the management will exist. When taken into account with the agency costs in corporate governance the different mechanisms of monitoring are plausible. As effective as block-holding may be, it is far from clear that it remains the only way of monitoring in Germany. Based on his empirical study, for example, Köke (2002) argues that lenders use financial pressure to exert influence. “financial pressure from creditors has a positive impact on productivity growth. We find weak evidence that productivity grows faster for firms showing a large fraction of bank debt, and strong evidence that productivity grows faster when bank debt is high and at the same time performance is poor. Hence, creditors seem to be in a position to influence management decisions, which in turn affect productivity growth” (Köke, 2002, p. 128).

### **B. Political influences on family ownership and control**

Legal thought and legislative action on corporate ownership and control stem largely from political institutions and their underlying cultural and social forces. In the German case, political influences on corporate law are clear from the start. With the founding of the empire in 1871, and the victory of Prussia in the Franco-Prussian war, the German economy began to grow rapidly and stock speculation spread. The boom ended in a prolonged crisis from 1873 to 1879, the effects of which prompted immediate political pressure for restructuring the economy and particularly for addressing the state of shareholder laws. The ensuing ups and downs in the markets and the broader economy spurred periodic revisions to the law, most of which had relatively minor impact in an era of overall prosperity and, given the context, liberal political thinking.<sup>32</sup>

### *The Weimar Republic*

The introduction of the war economy involved a high degree of state control over imports, allocations of raw materials, and also production. After 1918, the state control was gradually relaxed, and industry and commerce were faced with adjustment to new, unfavorable economic conditions.<sup>33</sup> Debates over socialism (“*Sozialisierungsdebatte*”) began as early as 1920, with calls for socialization of key industries. But at that time, entrepreneurs such as Silverberg and Stinnes won the day with arguments that only an economic system based on private capitalism would bring prosperity.<sup>34</sup> In 1923, the inflation made it possible for entrepreneurs such as Hugo Stinnes to repay their debts or to get loans very cheaply and to expand their business.<sup>35</sup> The inflation and the impact of the depression led the way for government interventions into economic affairs.

The 1924 Dawes-Plan acknowledged Germany’s inability to repay its war debts and introduced an installment plan. The interest for the obligations had to be paid for by the companies. Thus, the abbreviated ‘Golden Twenties,’ lasting from 1924 until 1928, were bought on credit. With the onset of economic crisis in 1929 and the Young-Plan (revision of the Dawes-Plan) in 1930, the

<sup>30</sup> See Becht, Bolton & Roell (2003) for a review, including Svejnar (1981, 1982), Benelli et al. (1987), and Baums and Frick (1999).

<sup>31</sup> Again, see Becht, Bolton & Roell (2003) for a more thorough review.

<sup>32</sup> See Fohlin (2001) for a review of the pre-WWI laws and regulations concerning the stock exchanges and corporations.

<sup>33</sup> See the review in Moss 1987, 323.

<sup>34</sup> See Neebe 1981, 24ff.

<sup>35</sup> He also was a member of the parliament and vowed to always fight any attempts to stabilize the Mark. See Neebe (1981) and Feldman (dates?) *Iron and Steel and Stinnes*.

German economy buckled under the burden.<sup>36</sup> When Hitler took over power in 1933 (“*Ermächtigungsgesetz*”), the Nazi regime profited from a recovering economy in the form of greater acceptance of their policies and laws. In the aftermath of the banking crisis of 1931, during which governmental support had kept a number of institutions afloat, political intervention in management increased.

### *The Nazi era: 1933-1945*

Of course, the Nazi era policies are overwhelmingly characterized by the oppression of Jews and the removal of people of Jewish descent from positions of political and economic power and influence. Secondly, after the banking crisis, people who were blamed for the crisis were also removed from power (James 2001: 24).<sup>37</sup> These dismissals may also have stemmed from anti-Semitic tendencies as well, though debate over these policies continue. For example, Ziegler opposes Joly’s findings in regard to the analysis of the year of 1933: While Joly sees a lot of continuity in the German economic elite—and goes as far as to state that not until 1942 were the first resignations forced on Jews in leading positions—Ziegler marks the beginning at 1933 (Ziegler 2000: 16).<sup>38</sup> Even earlier, the role of Jews in the German economy in general began to decline in the Weimar Republic, when increased state interventions in economic affairs and the rise to the “last wave of ‘Depression’ anti-Semitism” contributed to this (Moss 1987: 8).

The National Socialist New Order extended the network of controls inherited from the Depression government.<sup>39</sup> Although the principle of private ownership was left intact, with the major exception of the expropriation of Jewish property, there was essentially no market mechanism at work during the Nazi regime.<sup>40</sup> The basis for the new economic doctrines of management and control through party and state was laid by Hitler in the 25-point NSDAP Party Programme of 1920.<sup>41</sup>

The continued application of the *Führerprinzip* in companies also supported the traditional authority of head of the company. The period of the Nazi regime did not always overturn the power relations within the enterprises. Indeed, as noted in the last section, the prevalent ideology favored a capitalist system carried out by families, rather than one based on anonymous stakeholding. And this tendency motivated the regime to help large founder families (*Gründerfamilien*) to keep control over their companies. The Siemens family for example used an exemption permit issued by the Economics Ministry in order to evade the 1937 ban on shares with multiple voting rights (Joly 1998: 111).

In 1936, Göring became administrator of the “Four-Year-Plan,” the goal of which was the economic readiness for war within four years. With those purposes in mind, the private economy fell at least partly under regime control—particularly in matters such as wages, prices, and investments. In contrast to a planned economy, however, the Nazi version of controls related only to areas of relevance for arms production. The new policies, nonetheless, seriously circumscribed the autonomy of the private economy well outside these strict parameters. The founding of the “Reichswerke Hermann Göring” (RHG) in 1937, which became the largest European coal, iron and steel company,

<sup>36</sup> In 1931, the Hoover-Moratorium de facto revised the Young-Plan when it called for a suspension (Neebe 1981: 95).

<sup>37</sup> Ziegler found evidence which confirms that the “Entjudung” of high positions began even before the Nazis took over power (cf. Hayes 1994). However, “Entjudung” is not to be confused with anti-Semitic tendencies (Moss 1987: 8).

<sup>38</sup> An interesting case is Hjalmar Schacht, a high-ranking Jew: He was the former President of the National Bank and entered public service in 1934 when he became Economics Minister. He was able to use his strong political influence to protect the Jewish community until he lost his position in 1938. Until then it had been the official policy of the Economics Ministry NOT to interfere with Jewish businesses (Moss 1987: 374; Hayes 1994: 259; and Rosenbaum, Eduard, 1958, Albert Ballin: A Note on the Style of his Economic and Political Activities, Year Book III of the Leo Baeck Institute, London). However, the policies differentiated between small-scale and large-scale Jewish proprietors, favoring the upper level because substitutes were harder to find and foreigners might have noticed something (Hayes 1994: 260).

<sup>39</sup> In 1934 a system of managed trade was introduced as well as the restrictions of dividend payments and after 1936 prices were regulated (James 2002: 15).

<sup>40</sup> James (2002), p. 15. On expropriation of Jewish business owners: exact data comparing the Jewish numbers to the totals are difficult to come by. Generally, between 1933 and 1938, Jewish-owned economic operations declined from 100,000 to ca. 40,000 (Hayes 1994: 256; Barkai 1988: 123). E.g., in Baden and Wuertemberg 60% of the large-scale enterprises were owned by Jews until 1938/39 (Barkai 1988: 84). Genschel (1966) provides a lot of statistics concerning the share of Jews in regard to certain trades and a table on the shares of Jewish companies regarding the banking sector in Germany.

<sup>41</sup> Again, see James (2002), p. 18f. This program e.g. called for an immediate communalisation of the large Jewish department stores and cheap rents for small businesspeople (in contrast to large companies which were left intact until 1934). For example, the brothers Tietz sold their shares and left the company which was renamed into “Hertie AG.” The family Wertheim in Berlin also lost their property (Barkai 1988: 83).



marked a direct governmental intervention into production sectors and posed a threat to the old private companies (Vereinigte Stahlwerke).<sup>42</sup>

Disappointment at the eastern front and difficulties with supplies led to reforms in 1942; passing supervision over the economy from the Economics Ministry over to the newly founded Ministry of Arms and Production headed by Albert Speer. This change created a new complex structure of planned economy. While the system actively suppressed the interaction of firms in the marketplace, the regime did not generally interfere with the internal management of companies. For example, the government apparently did not press for the admittance of loyal public servants into the boards of directors of the private companies.<sup>43</sup> There seemed to be a consensus that as long as the companies played by the rules—that is, the exclusion of Jews as well as critics from the relevant boards—the companies maintained the right to select their future elites. Thus, (non-Jewish) company managers hardly noticed a disruption to their positions, mainly because their contribution to the German war economy was so important.<sup>44</sup>

Circa 1933, even before the “Entjudung” movement, Jews were already underrepresented in the top positions of large companies, but they participated actively in the banking business and in the textile and leather industries.<sup>45</sup> The greatest effort toward the expulsion of Jews from all segments of the economy seems to have come between 1935 until 1938 (Moss 1987: 11, 329). In late 1937 and early 1938, three key shifts occurred: First, and most important, governmental pressure for “Aryanization” at the upper level of the economy rose; second, resistance to cooperation on the part of the major companies declined; and third, both the willingness and capacity of corporate buyers to make fair sales offers diminished.<sup>46 47</sup>

A string of regulations, all aimed at stripping Jews of their ownership and control rights, appeared in close succession. By 1937, it became illegal to keep men of Jewish origin on company boards (Moss 1987: 375), and by 1938, virtually all Jewish board members of major companies had lost their posts (Hayes 1994: 266). On April 26, 1938 the “*Verordnung über die Anmeldung des Vermögens von Juden*” (Decree for the reporting of Jewish property/capital) forced Jews to report their complete property and capital to the authorities (Genschel 1966: 294ff.). On June, 14, 1938 the “*Dritte Verordnung zum Reichsbürgergesetz*” (Third Decree concerning the Law regarding Citizens of the Reich) stated that a company (or *Offene Handelsgesellschaft*) was to be considered “Jewish” if one or more partners or board members are of Jewish descent or if Jews own more than ¼ of the shares or hold half of the complete votes (Ibid. 298f.). On November 12, 1938 the “*Erste Verordnung zur Ausschaltung der Juden aus dem deutschen Wirtschaftsleben*” (First Decree for the elimination of Jews from the German economy) banned self-employed work for Jews and ordered the firing of employees without compensation (Barkai 1988: 151). Thus, 1938 stands out as the crucial year in the dispossession process against German Jews. Perhaps emblematic of the crisis, the Economics Minister Schacht, who had successfully protected Jews from economic exploitation, was fired the same year. His replacement, Göring, enacted continued measures against Jewish participation in the economy (Hayes 1994: 266). In James’ view, the most important laws against Jews were introduced that year, which to him can be seen as the “last step of Aryanization.”

The Aryanization of the German economy pushed the progression towards both managerial capitalism and industry concentration. The process appeared most noticeably to the decreasing significance of the private banks—a sector in which people of Jewish descent were disproportionately represented (about 60%) (Ziegler 2000a: 48f.). The Jewish private banks were turned over to non-Jewish owners or merged into one of the great banks. A partial exception appears in the form of the

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<sup>42</sup> See Erker (1993), p. 24.

<sup>43</sup> Joly (1998), p. 126. Erker, however, remarks that after 1942 the NS-Regime did try to influence internal management to recruit loyal party members (Erker 1993: 32).

<sup>44</sup> A notable exception was Fritz Thyssen, who was the only member of the Reichstag denying his approval of the declaration of war in 1939 and whose shares were taken over by the Nazis after he had left Germany (Joly 1998: 118, 133). See also Fear (2004, forthcoming).

<sup>45</sup> Despite Jewish family-businesses such as the “Caro-Group” and the Hirsches, the form of a family-dominated firm like Krupp, Thyssen, Siemens etc. was rather rare among major Jewish industrial firms in the age of full industrialization (Moss 1987: 134f.).

<sup>46</sup> James remarks that this phrase includes three different meanings: First, it refers to discrimination by “ordinary Germans”, second it refers to administrative measures (such as to revoke a licence) and finally to legal interventions which began in 1936/37 and culminated in 1938 in the complete removal of Jews from the German economy (James 2001: 37f.).

<sup>47</sup> See Hayes (1994), p. 265. At the Hossbach Conference of 1937, Hitler informed his advisors that war for “*Lebensraum*” was in sight and that the preparations for it had to be accelerated. This also led to the firing of Schacht (Hayes 1994: 265).

Banking House Sal. Oppenheim jr. & Cie. Because of their great long-term importance to the government, in 1933, the bank received a certificate stating that it was mainly owned by the Christian families Oppenheim and Pferdmenges and therefore the bank was to be left alone by the Nazis. Although three Jewish partners had to leave in 1936, two were able to remain as general manager and limited partner until they had to emigrate.<sup>48</sup> The Oppenheims were also able to avoid the loss of seats in supervisory boards, of which they had gathered a record amount, by replacing themselves with their “pure Arian” partner Robert Pferdmenges. In 1938, Waldemar von Oppenheim remained the only member of Jewish descent in the economic elite. In contrast to their Jewish partners who were not part of the family, the brothers Oppenheim were able to remain partners (with personal liability) even after 1938. However, the name had to be changed into “Pferdmenges&Co” and nothing was to indicate the founding year of the bank.<sup>49</sup> In broad terms, the elimination of the Jewish elites from the German economy added to the general trend of declining dynasties, though it is argued that these dynasties would have eventually declined on their own (Ziegler 2000: 18).

In the Nazi period, most, but not all of the changing patterns of corporate ownership involved the removal of Jewish ownership. The other main tendency related to inheritance policies and institutions, such as taxes and foundations. Dynasties like the Thyssen and Siemens families successfully took advantage of foundations in efforts to preserve the dynasty and minimize tax obligations. The inheritance tax could be avoided for that part of the capital which was transferred to a foundation which had been founded exclusively for this purpose.<sup>50</sup> This instrument allowed the families to keep their control over the shares through controlling the “*Stiftungskuratorium*” (board of trustees of the foundation) which exercised the voting rights of the shares.<sup>51</sup> In this manner, the Thyssen and Siemens families “neutralized” the shares that could not be passed on to the next generation. Altogether, the instruments of foundations helped dynasties to survive longer than they otherwise would have; yet even the foundations could not prevent their decline. During the time period in question (1933-89) two of five *Gründerfamilien* who had owned a large share of the capital disappeared (GHH and Krupp). The three others, Siemens, Bosch, Thyssen, survived with drastically reduced shares. In 1989 they only held one or two seats in the supervisory boards of Bosch and Thyssen.<sup>52</sup>

#### *The Post-WWII era: 1945 to 2002*

Political forces, of course, continued to shape patterns of corporate ownership and family control after the war as well. The sudden shift of power created, at the same time, a number of unexpected effects throughout the economy. At the Potsdam Conference of 1945, the Allies agreed upon the destruction of the arms potential of Germany. The process would entail strict control over industries related to metals, chemical products, and mechanical engineering—some of the primary productive sectors of the economy to that point. The German economy was to be reformed by a reduction of the concentration in trusts, cartels and other consortia (“Demontage” and “Entflechtung”).<sup>53</sup> The allies tried to restructure the German economy, for example, by breaking up concerns such as IG Farben, GHH, and the steel industry centered around Thyssen (which replaced the Vereinigte Stahlwerke). Yet, in fact, the attempt to break up the big companies was incomplete; it related only to the great banks, the coal and steel industry, and the chemical industry. The Allies arguably desired a strong industry and had no intention of weakening companies that were transferring activities to West Germany and especially into the American zone.<sup>54</sup> Bosch, it is argued, was the only large company to come under real fire due to its concentration in 1948, but an agreement in 1952 saved the company from a serious break-up.

In general, the restructuring process related very directly to the Marshall-Plan, the philosophy of which involved rebuilding Germany and not weakening it. The multiple aims of the Allies, to

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<sup>48</sup> Treue, W., 1983, *Das Schicksal des Bankenhauses Sal. Oppenheim jr. & Cie. Im Dritten Reich*, Wiesbaden, p.17.

<sup>49</sup> See Ziegler (2000a) and Treue (1983).

<sup>50</sup> The expenses of the foundation had to serve a public interest in order to justify the exemption from taxes. The heirs lost their shares but were compensated by dividends.

<sup>51</sup> If no family member was able to prevail in the board, however, the control was taken over by the managers (Joly, 1998, p. 33).

<sup>52</sup> See Joly (1998).

<sup>53</sup> See Joly (1998), p. 136 and ff. for an overview.

<sup>54</sup> *Ibid.*, p. 138f.

denazify and to break-up the large companies as well as simultaneously rebuild Germany, came into direct conflict with one another. As a pragmatic compromise, the non-political elites were returned to business (Zapf 1965: 58). Nearly two-thirds of all board members withdrew from their positions after WWII, yet many returned after the denazification (Ziegler 2000: 15f.). Moreover, most managers of the large companies were able to keep their positions, because the absence of a qualified “counter elite” left the Allies hardly any alternative (Zapf 1965: 58 and Joly 1998: 13). Even in cases of association with the Nazi regime, the allies meted out mild punishments.<sup>55</sup> Generally it appears that, aside from some restructuring of leading positions, the majority of the German economic elite remained after WWII and also kept their autonomy over the recruitment process. The economic sphere was therefore left relatively intact by the “cleanings,” and the real de-nazification took place within the political ranks.

Meanwhile, and in stark contrast to the Allies, the Soviet Occupation used the denazification process to completely replace one elite with another (Zapf 1965: 57). Private property was also confiscated in the East, and the large companies were placed under state control. By 1947, only one third of the Eastern industry was privately owned. In the iron and steel industry  $\frac{3}{4}$  of the already very low capacities were disassembled (Buchheim 1991: 58f.).

While the eastern portions of the country fell into totalitarian rule and full-blown communism, the Allied areas took a less drastic path. Still, as in a number of other post-war European countries, the forces of socialism took hold. The echoes of the past socialist movements could be heard along many parts of the political spectrum, and the implementation in Germany created a new set of forces to buffet the re-budding market economy. In social democracies generally, the gap between managers and shareholders is arguably larger, and the political structure prevents firms from closing the gap. The result, at least according to (Roe, 2000) is more concentrated corporate ownership. Coffee (2001, p.8) summarizes Roe’s (2000) argument as follows “...concentrated ownership and low transparency are part of a defensive stance assumed by investors in these left-leaning countries, where the government characteristically favors employees over shareholders and might expropriate corporate assets (to a greater degree anyway) if fuller transparency were required.” Coffee (2001) disputes Roe’s explanations of ownership concentration in European democracies with the following argument: “...if concentrated ownership were an important defense mechanism against ‘social democracy,’ then ‘social democracies’ should logically seek to encourage ownership dispersion by, for example, enhancing transparency... In principle one should observe across Europe private investors opposing the development of securities markets while the left advocated their growth. The reverse is probably closer to the truth.”

As entrenched as the social democracy viewpoint became over the third quarter of the twentieth century, something of a digging out began towards the end of the century. A new wave of corporate governance reform arrived in the late 1990’s, as Germany sensed a decline in its national welfare and sought new access to world markets, particularly the US financial markets. As ever, competing political interests have spiced up the debate over reforms, yet many of the expected positions seem to have become reversed. Indeed, Höpner (2003) identifies something of a paradox in the debates: German Social Democrats (liberals) favor more corporate governance liberalization than do the Christian Democrats (conservatives).

Kogut and Walker (2003) point out that the recent stagnation of the German economy compared to the US and the adoption of more Anglo-Saxon type of management styles (focusing on shareholder value) and the discourse about ‘globalization’ makes it easier for actors to defect from their traditional institutional roles. The legal reforms in corporate governance could lead to a disintegration of the German corporate governance network: “Recent German history reveals a pattern of correlated events: globalization, institutional changes—especially in the sphere of corporate taxation and corporate governance law—and restructuring of capital ties. The reduction of holdings by particularly prominent financial institutions reinforces the inference that a kind of percolation threshold has been passed. These trends point to a disintegration of the German ownership network” (Kogut and Walker, 2003, p. 16). They find, however, that this view is not generally supported by the facts up to that point: overall, the German corporate network appeared to be stable, confirming Bebchuk and Roe’s (1999) finding that “corporate governance is lodged in fairly stable and path-

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<sup>55</sup> The continuity was especially apparent in the electronics industry where after the denazification the structures were hardly questioned (Joly 1998: 155).

dependent relationships.” In light of that idea, Kogut and Walker (2003) question the efficacy of corporate law as a determinante of corporate governance. Their conclusion is that the reason for the limited efficacy might relate to the power that is “maintained by state-owned banks and local state governments who continue to exercise control through well-structured cross-holdings” (Kogut and Walker, 2003, p. 18). Such a conclusion is certainly still open to debate, and, as the more distant history shows, Germany itself enjoyed a relatively long period of at least decent functioning of its markets. It was, to the contrary, a string of legal actions that began in the aftermath of World War One—clearly motivated by strong political leanings of various sorts—that caused the German economic system to veer off course. To be sure, tendencies toward ownership and industrial concentration pre-date 1918, but similar patterns can be found throughout the world.

*A non-representative example of inheritance and family control: The Krupp Family*

The non-existence of a law with an egalitarian tradition in Prussia underscored the success of family-led companies. And firm of Krupp provides an enlightening, if not representative, example of the great family dynasties in Germany. Friedrich Krupp, who founded the company in 1811, had four children; Friedrich Alfred Krupp, who was the only child of Friedrich’s first-born son, became the sole shareholder in 1901. When he died only one year later, the capital was kept together until the 4<sup>th</sup> generation. His will ensured that only his oldest daughter Bertha inherited his shares: his wife and youngest daughter received other compensations. In 1920 two changes became an obstacle to this practice. First, the inheritance tax was raised and second, a new law prohibited the principle of a “universal inheritance” if the deceased had more than one child. Bertha and Gustav Krupp, however, had seven children. In 1943, a personal exemption signed by Hitler authorized their oldest son Alfried as the only heir. Furthermore, the Krupps were exempted from all inheritance taxes—arguably a reward by Hitler to one of his most important suppliers of war arms (Joly 1998: 22). On an ideological note, this move also extended the idea of the “Führerprinzip”, i.e. the concentration of power in the hand of one person, to the economy. The Krupp experience also partly explains the general notion of support for a capitalistic system carried by family-led companies during the Nazi regime (Ibid. 111). When Alfried Krupp was sentenced by an American tribunal in 1948, his property was completely confiscated. The Krupp family tried to annul the exemption granted by Hitler in order to prove that Alfried Krupp had never been the legal owner of the company and the property therefore could not be confiscated (Ibid. 22). This charge was dropped by the family in 1951 when Alfried was pardoned.

In 1967 the company was in serious financial trouble and the only son Arndt was not able to pay the inheritance tax after Alfried had passed away (Ibid. 23).<sup>56</sup> Therefore, he transferred his inheritance to a newly created foundation which meant that in the 6<sup>th</sup> generation the family dynasty had come to an end. When the Krupp Foundation became the owner of the company in 1967, the “manager” Berthold Beitz was able to secure the power and control the capital (Ibid. 33ff.). The young (40 years of age) and unknown Beitz surprisingly emerged as the general manager of Krupp in 1953. Apparently, the former head of a Hamburg-based insurance company rescued several hundreds of Jews from a concentration camp in Poland where he headed a fuel company by forcing the SS to leave them at his company. He enjoyed the trust of the British, who gave him control over the insurance companies in their zone in 1946. This was meant to demonstrate the new peaceful image of the Krupp company using Beitz as a charming mediator (Ibid. 166).

In 1967 the will of Alfried Krupp stated that his assets were to be administered by three executors which included Beitz. Beitz was able to convince Alfried’s son Arndt who wasn’t very interested in the business to give him his vote. Beitz developed the statute for the newly founded foundation which gave him control over the capital. He created a board of trustees and made himself chairman of this board. He included the former member of the executive board and friend Max Gründig as well as representatives from the academic world and regional politicians (Ibid. 34). None of the members posed a threat to his authority, and in any case, the statute stated that the chairman could only be replaced if five members voted against him. The members of the board of trustees served a lifelong and the chairman nominated their successors (Ibid. 35).

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<sup>56</sup> Another possibility was to gradually get rid of areas of the company with low profits (Joly 1998: 28).

### C. Sociological parameters to family-ownership and control

Forthcoming.

### D. Macroeconomic parameters to family-ownership and control

Forthcoming.

“The transformation of a family business into a Kapitalgesellschaft or the fusion with another company was most of the time a problem-ridden enterprise for the families involved. Even more so, when – like it was the case in the decade following the outbreak after WWI – it occurred under the pressure of economic crises. War-economics, inflation and the stability-crisis meant complex, contradictory and hardly calculable challenges which had an influence of the relation between family enterprises and entrepreneur-families [...] There are tendencies observable that suggest a causal explanations for the sharp rise in the number of AG’s and the induced loss of ownership and control for entrepreneur-families. One explanation is that large corporations were more successful under the conditions of war-economics with its fights for raw materials and restrictions on production. Additionally, especially the manufacturing industries had to cope with problems of acquiring credit, where again family-companies and small firms had disadvantages compared to large *Kapitalgesellschaften*. And, as an important pull-factor, it became easier and easier to place emission of new shares in times of inflation.”<sup>57</sup>

## IV. Consequences of German Patterns of Corporate Ownership and Control

Many have argued that the poor legal protection of minority stockholders has led to concentrated ownership found in Germany. Such concentration can affect firms in a variety of ways, though the theoretical issues are less than clear-cut. One possible benefit from concentrated ownership is better monitoring of management and improved performance. But ownership concentration could also permit blockholders to reap private benefits at the costs of minority shareholders. Examples of private benefits of control given by Leuz et al (2003) range “...from perquisite consumption to the transfer of firm assets to other firms owned by insiders or their families”. Blockholders seek to protect their private benefits; and these benefits appear as values that are enjoyed only by insiders.

The empirical evidence casts some doubt on these interpretations. Dyck and Zingales (2002) find a relatively small private benefit for Germany compared to other countries. And while there does seem to have been an ongoing concentration process after the war until the 80ies, other than the codetermination laws, there was no weakening in minority shareholder protection. Thus, the German pattern is not explained well by changes in shareholder protection. The civil law tradition is also a weak explanation, because the German legal tradition remained fundamentally one of civil law throughout. The history set out in the previous section suggests a wide range of political movements that seem to go much farther in explaining the German case.

Despite the obvious pattern of ownership concentration in Germany, it is difficult to find any robust conclusion about the effects of this structure on corporate performance. Köke (2002) finds that ownership concentration in combination with fierce product market competition increases productivity growth. Other authors including Cable (1985) find a positive relationship between ownership concentration and corporate performance. Lehmann and Weigand (2000) find that the positive relationship depends on the type of (direct) owner and they also find an overall negative relationship. Gorton and Schmid (2001) also find a positive relationship. Edwards and Nibler (2000) argue that minority shareholders gain benefits from an increase in ownership concentration (this however does not hold for non-bank firms and public sector bodies) and that the presence of second and third large shareholders is generally beneficial (except again for non-bank firms). This could point to a clash of interests that also Iber (1985) describes. Another question is of a more dynamic nature: Audretsch and Elston (1997) pose the question of whether the German system is capable of financing new innovative

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<sup>57</sup> Schaefer (2000), Pp.159/160. See Lindenlaub, D., *Maschinenbauunternehmen in der deutschen Inflation 1919-1923*, Berlin 1985, p. 74-81.

firms. The question remains whether there is truly a negative impact on the firm or economy level, even though the stock markets have clearly lost considerable ground since the inter-war years. Franks and Mayer hold that while patterns of ownership do differ markedly between German companies on the one hand and U.K. and U.S. firms on the other, corporate control is similar. They also find little relation between concentration of ownership and the disciplining of management of poorly performing firms, and between the type of concentrated owner and board turnover." (Franks and Mayer, 2001, p. 974)

These findings for the recent period echo the historical findings for Germany: in the two decades before WWI, when the German economy combined large-scale, universal banking with active markets, managerial turnover is highly sensitive to the performance of firms.<sup>58</sup> Moreover, firms with listings on the Berlin stock exchange—that is, those that were most likely to be owned by external shareholders rather than founding families or other blockholders—react even more to performance. In general, listed firms performed better, earning higher ROA and paying far higher dividends (Tables attached).

## V. Preliminary conclusions

This paper patches together the sometimes spotty evidence on the structure of corporate ownership and control in Germany since the beginning of free incorporation (1870) and demonstrates several ups and downs that correspond largely to manifold political and economic events and crises. In light of these patterns, I argue that, while law matters, political, social, and economic factors constitute the proximal causes of change. Moreover, combining recent evidence offered in the corporate control literature with my own study of an extensive panel of German corporations from the pre-WWI period, I argue that German ownership structures have not, in times of stability, produced the negative consequences predicted in much of the law and finance literature.<sup>59</sup> Indeed, the long-run perspective on Germany—particularly the wide swings in corporate and industrial concentration, along with positive findings on corporate performance in the pre-WWI and post-WWII eras—casts doubt on the notion that civil law traditions *per se* consistently undermine market functioning. In the German case, the string of disastrous political institutions and movements in the aftermath of World War I and culminating in the Nazi regime dismantled the rich, highly-functioning, hybrid economy of the Second Empire—a system that has yet to be rebuilt to this date.

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<sup>58</sup> See Fohlin (2003b). These findings stem from the regression of managerial board turnover on various indicators of firm performance (ROA, dividends, and dividend-adjusted stock returns) plus a series of control variables and indicator variables for various sub-populations, such as firms with and without stock market listings and firms with and without bank directors on their boards.

<sup>59</sup> Evidence on the period between 1918 and 1970 or so are sorely lacking.

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