The Disintegration of Organised Capitalism: German Corporate Governance in the 1990s

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In comparative perspective, the consensus-oriented political system of Germany is not susceptible to radical policy shifts. Constancy and continuity are also key features of the German economic system, which in the past was regarded as a role model for other nations.¹ Institutional stability may be attributed to high coherence of the institutional configuration.² But today, in the face of an internationalised and thus more competitive world economy and the additional economic problems related to German unification, institutional stability is more often interpreted as a burden than as an advantage. In 1997, the expression Reformstau (reform jam) was voted ‘word of the year’, due to its frequent use in political debate. Reforms seemed to be impossible although most citizens perceived them as necessary. Nevertheless, there are fields of substantial change that do not fit the image of it being gradual at best in Germany. The sphere of corporate governance turned out to be highly dynamic in Germany, undergoing rapid changes towards market orientation in the 1990s after several decades of institutional stability. How was this possible?

Corporate governance in the ‘organised’ German economy was characterised by structures of company control that limited the influence of shareholders and distributed power among managers, employees, investors, regional authorities, suppliers, customers, creditors and co-operating companies; deep linkages between industrial and financial companies that could be used as a mechanism to achieve common goals; sheltered infrastructural sectors such as telecommunications, energy and transport, in which competition was limited to a minimum and state ownership and influence were high; and political regulation that promoted a dispersion of power between shareholders and other interests and protected the company network against invasion from outside.

German corporate governance remained stable throughout the post-war period, although impulses for change existed well before the 1990s.
However, they remained isolated and resulted in adjustments within the logic of the German corporate governance arrangement. In the 1990s, intensified institutional change departed from the logic of organised capitalism. We argue that the German variant of capitalism changed towards greater market orientation because of simultaneous and reciprocally reinforcing, complementary developments. Thus, in our view, complementarity is not only a factor of stability, but it is also important in times of change.

Indications of change include the increasing shareholder orientation of companies; the strategic reorientation of the big banks from the Haushalt paradigm to investment banking that resulted in a loosening or abandoning of ties with industrial companies; the withdrawal of the state from infrastructural sectors via privatisation; and the break of continuity in German company regulation that supported and accelerated shareholder orientation and network dissolution.

We distinguish three phases. First, there were isolated and limited impulses for change up to the 1980s. In the second phase, from the mid-1980s to the mid-1990s, first indications of multiple and mutually reinforcing change appeared. The break with organised capitalism came in the second half of the 1990s. The most important events were the repositioning towards shareholder orientation of companies like Bayer, Hoechst, Daimler-Benz and VEBA, starting around 1995; the takeover battle between Krupp and Thyssen in 1997, when a hostile takeover attempt was supported by one of the three German big banks for the first time; the privatisation of Deutsche Telekom in 1996; and the KonTraG of 1998 that outlawed most forms of unequal voting rights. Changes started at the firm level but were soon translated into political change at the regime level, which then led to a reformulation of regulations.

This article is organised as follows. The first four sections discuss the disorganisation process in each of the spheres that characterised corporate governance in organised capitalism. The final section shows how the four spheres are linked with each other and how disorganisation processes in one sphere reinforced similar processes in others. The paper concludes with a brief discussion of the consequences for the German variant of capitalism, in particular for the willingness of companies to internalise public interest.

SHAREHOLDER VALUE

Social responsibility traditionally played a prominent role in the German ideal of entrepreneurship. Industrial leaders of the past like Werner von
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Siemens, Ernst Abbe and Hugo Stinnes were admired both for their success in business and their public spirit. The concept of the embedded firm influenced German business law and is deeply rooted in German society. It was so prominent that in the 1970s accountants began to discuss methods of ‘social accounting’.

In the 1980s, academic discourse changed towards financial indicators. But it was not until the mid-1990s that some of the largest companies began to experiment with elements of a shareholder-oriented strategy. The starting point for the adoption of shareholder-oriented practices was different in each. The management of the formerly state-owned VEBA (energy, now RWE) used elements of shareholder value strategy to change the bureaucratic spirit of the company; Jürgen Schrempp’s proclamation of shareholder value principles enabled him to change the strategic orientation of Daimler-Benz (now Daimler-Chrysler) completely; the management of highly diversified Bayer (chemicals and pharmaceuticals) increased the transparency of company reports to demonstrate that the disinvestments many analysts called for were not necessary; Jürgen Dormann, on the contrary, refocused and merged Hoechst (chemicals, now Aventis) in the name of shareholder value; and Gerhard Cromme introduced an aggressive takeover approach as an offensive strategy to overcome the technological backwardness of steel giant Krupp (now ThyssenKrupp).

In following years, more and more companies declared shareholder value to be a main factor guiding their operation. In the late 1990s a clear pattern evolved. Shareholder orientation was more pronounced not only in companies where ownership by institutional investors (investment and pension funds) was large, but also in companies affected by international product market competition or exposed to the takeover market. Causal relations like these make shareholder value appear to be pushed by external forces. But there are also indications that shareholder value is a strategy managers themselves may choose, regardless of external pressures.

Shareholder value strategies enjoy a high reputation among top managers. This has to do with the characteristics of the new managerial elite. While German managers once tended to have technical know-how but relatively little financial expertise compared to Anglo-American top management, this difference no longer holds true. In the 1990s, a trend towards professionalisation, greater emphasis on economic and financial issues, recruitment from external labour markets and shorter in-house careers was observed. These changes influenced the perceptions and value orientations of managers, including their attitudes towards shareholder value.
Another reason why managers themselves may be interested in a shareholder-oriented company policy is that it legitimates higher pay. One side effect of a shareholder value policy is an increase in the variable part of managerial compensation, particularly in the form of stock options. The reasoning involved is that managers will be more attentive to shareholder interests if their pay fluctuates in accordance with returns on equity. Managers usually receive stock options in addition to their fixed salaries. Shareholder value strategies thus tend to increase manager’s salaries.

In the late 1990s, the fixed parts of managerial compensation increased rapidly as well. Among other things, this had to do with the decreasing bank monitoring (see below). In the past, bankers’ board membership had significantly lowered managerial remuneration. The impact of shareholder orientation on top management compensation demonstrates that managers themselves may have an interest in a reorientation of company policy. Not by accident, the shareholder value phenomenon appears at a time when the extent of internal control over management seems to be declining.

The orientation towards shareholder value in many companies reduced the commitment to take societal and collective aspects into account. Daimler-Benz, which used to be deeply involved in the German system of organised capitalism – shielded against unfriendly takeovers, on the one hand, and acting with national responsibility in the integration of bankrupt AEG, on the other – has now merged with Chrysler to become a company with a global focus. Whereas its former CEO Edzard Reuter had refused to use a particular method to reduce taxes (Schütt-aus-Hol-zurück-Verfahren), arguing that companies of the size of Daimler-Benz should be socially responsible, his shareholder value-oriented successor Schrempp had no qualms about using this and other tax avoidance strategies. In 1995, he proudly declared that Daimler-Benz, although highly profitable, did not pay any taxes at all. Daimler-Benz/Daimler-Chrysler’s tax status has not changed since then.

Another example is Siemens, which is engaged in electronics and electrical engineering. In the past Siemens provided secure life-long employment. Now, after the adoption of a shareholder value philosophy, it responds highly flexibly to weakening demand and has reduced employment drastically. The company has spun off several of its segments and discontinued cross-subsidisation of its business units.

Shareholder-oriented companies in general reduced employment costs considerably in the 1990s. Comparative analyses show, as expected, that the distribution of value-added changed significantly in favour of share owners. However, employees in shareholder value companies did not lose out in pay.
Labour cost reduction was achieved by a new orientation among the conflicting aims of company growth and profitability growth. This increased unemployment and exacerbated the financial problems of the social security and pension system, as many companies reduced the number of employees via early retirement schemes. Especially important is the reduced willingness of companies following shareholder value principles to keep employment constant in times of economic crisis.

NETWORK DISSOLUTION

The cohesion and density of the German network of interlocking directorates and ownership ties decreased significantly in the late 1990s, thus drastically undermining opportunities for co-ordinating economic interests. In the past it was said that managers acting in the centre of this network were capable of controlling economic and political processes far beyond the boundaries of their own companies. The term Deutschland AG (Germany Inc.) was often used as a label for this special feature of the German economy. It implied that the managers involved pursued not only the economic interest of their own companies, but also considered general interests of the national economy.

Opportunities for co-ordinating company behaviour were rooted in a combination of structural components that made co-operation among potential competitors easier. An essential feature of this structure were high density networks within branches of industry. This factor was associated with several additional features favouring co-ordination: a high degree of ownership concentration, meaning that firms were mostly ruled by other firms (Konzernierung); high congruence between interlocking directorates and capital relationships, whereby personal ties exceeded the scope of the ownership network; and a frequent overlap between official business and employers’ associations, on the one hand, and the ‘multiple directors’, the individuals most integrated into the network, on the other. The core of this structure was made up of a centre integrating the largest German companies into a network denser and more closely knit than almost anywhere else in the Western world.

Financial companies, particularly Deutsche Bank, Dresdner Bank, Allianz and Münchenere Rück, were traditionally most involved in the network of capital-based relationships and had a dominant role within personal networks of interlocking directorships. Financial companies established a link between the economic activities of industrial companies and the state. The financial companies acted in the ‘shadow of hierarchy’.
and were often pressurised by the state to use their funds to help firms in crisis and to prevent influence from outside the company network.

Deutschland AG was characterised by a connection between the economic strategies of the state, the banks and industrial companies. The latter profited from the internalisation of risks by the company network, could rely on their Hausbanks to prevent bankruptcies, and could concentrate on growth of sales as they were protected from hostile takeovers. Banks had freedom of action in industrial policy and company monitoring, initiating restructuring in several sectors, while the state could normally abstain from direct intervention and, in the case of company crises, helped build anti-crisis cartels. In such exceptional situations, finance companies were sometimes forced to make concessions to prevent bankruptcies. Extensive personal links existed between the state and large banks, especially with respect to foreign economic policy. In the Landesbanken, like West LB and Bayerische LB, which were intensely engaged in regional industrial policy, regional authorities were directly involved as shareholders.

Because financial companies were at the centre of the company network, the issue of interlocking capital was closely linked to that of the power of banks. In the mid-1960s, discussion about the multiple supervisory board mandates held by bankers led to a legal limitation of the permitted number of mandates per person (Lex Abs). Although this resulted in a restructuring of the network of interlocking directorates, it did not change the position of the main financial companies inside the network. Supervisory board mandates were passed to other representatives from the same banks. The structure of the network remained the same until the 1990s.

Extensive restructuring of the corporate network started in the late 1980s and picked up speed in the mid-1990s. Until the mid-1980s, the extent of interlocking directorates between the 100 biggest German companies was stable; starting in 1984, it began to decline from 12 per cent of all possible interlocks to less than seven per cent by 1998. Capital ties between financial and industrial companies also began to dissolve in the late 1990s. Between 1996 and 2000, the number of capital ties between the 100 biggest German companies declined from 169 to 80. Deutsche Bank and Dresdner Bank moved from the centre to a more peripheral network position. Deutsche Bank’s retreat from the monitoring of non-financial firms was especially noteworthy. In 1996, 29 of the supervisory board chairmen of the 100 biggest firms were representatives of Deutsche Bank. Only two years later, this number had declined to 17. In its corporate governance principles published in 2001, Deutsche Bank announced that it would resign from supervisory board chairs altogether.
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Why do banks stop monitoring industrial companies even though supervisory board seats provide access to information and influence? The explanation lies in the reorientation of the big banks towards investment banking, which broke up formerly coherent banking strategies. Investment banking conflicts with main bank activities because close relationships with domestic industrial companies interfere with reputation-building on international financial markets and impair the ability of a bank to acquire orders from foreign customers. One of the main fields of activity of investment banks is the arrangement of mergers and acquisitions, which includes hostile takeovers. Reputation-building in this field would be impossible if a potential supplier of such services defined the protection of its domestic relations with domestic industrial firms as a goal of its business activity. While credit banking and close relations with industrial companies can be combined, investment banking and organisational ties to non-financial companies cannot.

The reorientation towards investment banking was caused by a combination of push and pull factors. The risk-reducing effect of ties with industrial companies diminished as internationalisation increased bankruptcy risks and altered their nature. A trend towards higher transparency additionally reduced the relative advantage of internal control. Moreover, retail banking, formerly the main source for capital mobilisation, became more costly. At the same time, investment banking became more attractive. Fields of activity for investment banks grew because of rising demand for consultancy services in mergers and acquisitions, privatisation and rising public debt making states sell more bonds.

A watershed event for the behaviour of German banks happened in 1997 when Deutsche Bank supported a hostile takeover attempt for the first time, even though it had a representative on the supervisory board of the takeover target. The takeover battle between the steel companies Krupp and Thyssen was accompanied by a power struggle inside the management board of Deutsche Bank in which the investment bankers prevailed over the traditionalists. The battle transformed the strategy of German banks and made them dismantle ties with industrial companies to avoid conflicts of interest.

At the end of 1999, the Schröder government decided to support the dissolution of the ties between banks and industry and moved towards a more market-orientated corporate governance system by abolishing the capital gains tax on sales of stock. However, the initial impetus to weaken the ties between banks and industry had come from the market and was not political. In addition, existing ties changed their nature. In 2001, most
managers in the centre of the network of interlocking directorates represented financially-oriented concepts, such as Paul Achleitner (Allianz), Rolf-E. Breuer (Deutsche Bank), Gerhard Cromme (Thyssen-Krupp), Heinrich von Pierer (Siemens) and Jürgen Schrempp (DaimlerChrysler), indicating an important change with regard to the economic and political function of the network.

Privatisation

Privatisation in Germany accelerated in the 1990s, extending even to those parts of the infrastructure where state ownership had once been regarded as indispensable. In interaction with complementary processes, privatisation was a catalyst for the alteration of the German corporate governance regime. Particularly important was the initial public offering of the privatised telephone monopoly Deutsche Telekom in late 1996. In an extensive advertising campaign the shares of Deutsche Telekom were presented as Volksaktien (‘people’s stock’). Generous special offers for those who subscribed early, and even a kind of investment insurance to protect small shareholders from major losses in the first years, were introduced by the German banks that acted as stock brokers.

The campaign was very successful. After one year Deutsche Telekom announced that it had sold 90 million more shares than anticipated, for a total of DM21 billion. Many investors purchased stock for the first time. In the following years the attitudes of the German population towards stock ownership changed fundamentally. From 1997 to 2001, the share of those owning stock or having invested in mutual funds rose from 8.9 per cent to 20 per cent. Many firms followed the example of Deutsche Telekom. The number of initial public offerings at the German stock exchange increased continuously. In 1983, only 436 German companies had been listed, but by the end of the 1990s their number had risen to 933. Obviously the German population had shed their notorious risk aversion of former times.

The extraordinary efforts made in the Telekom campaign had to do with the failure of the first German privatisation programme from 1959 to 1965, which was held to be partly responsible for the lack of confidence in stock ownership. The failure of the first privatisation programme played an important role in shaping the perceptions of subsequent governments. Consequently, efforts to privatise state-owned firms remained marginal until the 1980s.

When the government of Helmut Kohl committed itself in 1983 to privatisation, it was reacting to ideological pressures from neo-liberal circles in the Christian Democratic Party and especially the Free Democrats.
The programme focused mainly on a reduction of state ownership in industrial companies. National monopolies in telecommunications, postal services and the railroads remained untouched. Furthermore, only in very few companies was state ownership eliminated altogether by the federal government (Salzgitter, VEBA, VIAG, Volkswagen).27

Due to its limited range, the privatisation programme of the mid-1980s was criticised as ‘half-hearted’ or largely ‘symbolic’.28 Many observers had the impression that the only point on which the coalition was united was the need to sell parts of the ‘family silver’ in order to raise money for the state budget.29 It is not surprising that the privatisation of state ownership at that time had only limited effects on the German stock exchange or the corporate governance system as a whole. At the end of the 1980s, further steps towards deregulation and privatisation seemed unlikely.30 The symbolic policy had pacified the liberals, and political and societal opposition to privatisation appeared strong enough to inhibit further reforms.

However, the widely predicted deadlock in privatisation did not occur. In the late 1980s, the European Commission and the European Court of Justice enforced measures to enhance market integration and competition in telecommunication, postal services, air and rail transport, and energy and water supply (based on Art. 90 of the European Treaty), which had traditionally been shielded from competition and were confined within national boundaries. A number of directives were issued prohibiting member states from maintaining monopolies in various markets, especially telecommunications. The German government was forced to align itself with European legislation, and privatisation seemed the most viable option. In other industries such as energy and railroads, the European Commission did not pressurise member states to deregulate but intervened strategically to influence the decision-making of the Council of Ministers in favour of liberalisation.31 The German government was thus required at the European level to take steps towards liberalisation that would have been impossible to achieve nationally.32

While European initiatives kept privatisation on the political agenda, it was German unification that put it on top of the priority list. All of a sudden more than 8,000 nationalised firms and holding companies with 4.1 million workers had to be converted into private sector firms in a market economy. The German government decided to sell off East German firms through a federal agency, the Treuhandanstalt. Vouchers or other forms of privatisation were not considered. Therefore, the direct effect of the denationalisation programme on German corporate governance remained
small. As it turned out, the privatisation methods of the Treuhandanstalt produced gigantic losses instead of the expected profits, which increased the need to reduce state deficits and indirectly paved the way for privatisation in the west.

In combination with European liberalisation, German unification ended hesitation regarding the denationalisation of the monopolistically organised sheltered sectors of telecommunications, postal services and the railroads. On the one hand, it would have been difficult to legitimate both deficit-making state monopolies in the west at a time of harsh privatisation in the east. On the other hand, given increasing public deficits, the German state was not able to finance the rebuilding of the telecommunication and railway systems of East Germany without external capital. In addition, the Maastricht Treaty, in effect since 1993, made deficit reduction a higher priority.

Previous discussions on the modernisation of the federally operated Post Office, the Deutsche Bundespost, accelerated and shifted radically towards the privatisation option in the 1990s. The Bundespost was divided into three parts, which were converted into incorporated companies (Deutsche Telekom AG, Deutsche Post AG and Deutsche Postbank AG). Prolonged discussions about how to reform the state-operated railroad, the Deutsche Bundesbahn (now Deutsche Bahn AG), also gained momentum after unification. Deutsche Telekom, as mentioned above, went public in 1996, and state ownership was further reduced in several steps to the present level of 30.9 per cent. Deutsche Post was listed on the stock exchange in 2000; 28.8 per cent of the stock is now privately owned and a second public offering is expected in the near future. Deutsche Postbank was sold completely to Deutsche Post in 1999, and Deutsche Bahn is preparing to go public in the next few years. These cases of privatisation, along with many others, such as Deutsche Lufthansa, the airports of Hamburg and Frankfurt, and even the Bundesdruckerei, the government printing office whose business includes the printing of bank notes, identity cards and passports, generated DM37.6 billion in revenue between 1994 and 2000 (see Figure 1).

Whereas European directives and rising deficits increased the pressure on the German state to privatise assets, political and social opposition against privatisation began to diminish in the 1990s. The liberal conception of safeguarding the accessibility, equality, continuity, security and affordability of services of general interest by regulation instead of state ownership gained dominance in the German political arena. Social democrats, formerly often in alliance with trade unions against the restructuring of the public sector, changed their position. In accordance with
a general European tendency away from interventionism and toward a regulatory state, they summed up their changed ideas on the role of the state in the catchword of the 'activating state'. The Red–Green coalition government of Chancellor Gerhard Schröder continued to follow the route of privatisation the Christian-democratic–liberal government had opened up. Unions such as the Eisenbahn­gewerkschaft (German Railway Workers’ Union) no longer opposed plans for privatisation in general and focused on the protection of the working conditions of employees. While the Länder occasionally opposed specific aspects of privatisation, they did not veto it the way the CSU government of Bavaria had prevented the privatisation of Deutsche Lufthansa in the 1980s.

The effects of privatisation on capital markets, the banking sector and German corporate governance in general were not taken much into consideration in the political decision-making processes of the 1990s. The mostly unintended effects of privatisation are nevertheless significant. The privatisation of Deutsche Telekom stimulated the development of the German capital market. Furthermore, many of the privatised companies are at the forefront in adopting shareholder value practices. In the previously sheltered sectors we can now observe tough competition, a global market orientation and a radical reduction in employment. Traditionally a
counterpart to the internationally competitive export sectors, and as such an integral element of German organised capitalism, these sectors have changed almost beyond recognition.

POLITICAL REFORMS

The co-operative relationship between big German companies, with financial companies in the centre of a network of interlocking capital relations and directorates, was to a considerable extent a product of politics. In the era of post-war reconstruction, the state pressurised banks and insurance companies to give financial support to industrial companies, which led to financial companies holding large equity stakes. Companies were highly taxed on profits from sales of share blocks, while profits on blocks they held on to were taxed favourably. Company monitoring was conducted by insiders, while the influence of the capital market was limited by corporate law and accounting regulations. Most notably, company law allowed unequal voting rights, thereby protecting companies from hostile takeovers by foreign companies. Co-determination law allowed employees and unions to participate in company policy. In sum, company law protected the dispersion of power, both among company network participants and groups of stakeholders.

German organised capitalism was never politically undisputed. Points of attack were the power of the banks and the co-operative links between corporations, criticised by both leftists and liberals. But attempts to limit the pivotal role of the banks inside the network remained marginal. Generally speaking, company regulation was remarkably stable in the post-war period, apart from the strengthening of employee rights by the Co-determination Act of 1976. This changed in the mid-1980s, when a series of reforms, which aimed to add a more active capital market to the German model without changing its fundamental corporate governance practices, were introduced in stock market and company regulation. In 1986, a reorganisation of the stock exchange system was initiated, combined with a slight increase in the protection of minority shareholders.

However, the move towards a corporate governance system more strongly driven by capital markets did not start before 1996 and 1998, when the Corporate Sector Supervision and Transparency Act (KonTraG) was negotiated and passed. The Liberal Party was the driving force behind the KonTraG whose main objective was to abolish most of the unequal voting rights and legalise share buybacks and stock option plans. With the KonTraG, Germany was one of the first in Europe to adopt a ‘one share, one vote’ rule. Another significant development in 1998 was the passage of a controversial
law that allowed joint stock companies to adopt capital market oriented accounting standards (IAS or US-GAAP) instead of the German HGB rules, which deregulated accounting in Germany. A spectacular reform was introduced in 2001 when the capital gains tax on sales of share blocks was abolished. Further capital market-oriented reforms were the introduction of the corporate governance code of practice in 2001 and the takeover law to protect minority shareholders in friendly or hostile takeovers in 2002.

The KonTraG represented a departure from a long tradition. In the Stock Corporation Act of 1937, management was obliged to guide the company not only in the interest of owners, but also in the interest of employees and the company as a whole. When the Federal Constitutional Court dismissed the suit of the employers against the Co-determination Act of 1976, it pointed out that managers have to protect interests that are not necessarily the interests of the owners. This tradition was cut off abruptly by the KonTraG. The commentary on the KonTraG lacked any reference to the stakeholder view of the firm. It explained that the purpose of the law was to put the shareholder value front and centre and that there was no alternative to this.

How can this change in regulation and interpretation be explained? The agreement to create a Single European Market in 1986 led to a debate about Germany as an investment location. While it began as a discussion over German competitiveness on international product markets, it ended up including capital markets as well. The weak development of the German capital market was increasingly viewed as a competitive disadvantage, and the competitiveness of German companies on international capital markets was regarded as limited. Until the mid-1990s, the political goal of strengthening internal capital markets was pursued without relating it to issues of corporate governance. The debate intensified when international institutional investors demanded more investor-oriented corporate governance standards for European companies.

German companies began to compete for capital market orientation, which for decades had been considered practically irrelevant. As a consequence, the coherence of economic policy seemed to vanish. Suddenly interlocking directorates, insider-oriented accounting standards and limited minority shareholder protection were inconsistent with the political goals of an emerging ‘competition state’. The takeover wave in the USA illustrated the importance of share prices in competition between companies. In 1990, a tyre producer, Continental, became the first German target of a hostile takeover attempt. In this situation the CDU – encouraged by its coalition partner, the Liberals – changed towards a more sceptical view of German corporate
governance. Various spectacular company crises – Klöckner, Bremer Vulkan, Metallgesellschaft, Schneider – added to the willingness to reform.

The move towards a more market-driven corporate governance system was made possible by a specific constellation of actors. The competition-limiting institutions of German organised capitalism were politically attacked from two different directions. The Left, including trade unions, criticised interlocking directorates and ownership networks because of the power they gave to banks.47 Liberals, both politicians and mainstream economists, interpreted such institutions as welfare-reducing rent-seeking arrangements.48 Coming from different ideological points of view, both sides agreed that banks should be barred from owning blocks of industrial shares.

When the KonTraG was debated in the Bundestag, it turned out that the Deutschland AG no longer had political supporters. Liberals complained that they unfortunately could not push the CDU towards more radical reforms. The SPD called the KonTraG a law to protect managers against shareholders and demanded a stronger shareholder orientation. The Greens argued that the capital market should be transformed into a market for corporate control, and even a speaker of the post-communist PDS complained that interlocking ownership eliminated competition.49 In the late 1990s, there was no political party or movement in sight that would have been willing to veto the reforms – as long as the points of reference were capital ties, the power of banks, transparency, supervisory board organisation and the reduction of capital market restrictions. Even social democrats and trade unionists opted for more market-driven arrangements. In contrast to this, any attempt to restrict co-determination of employees would have immediately been blocked by trade unions, social democrats and the trade union wing of the CDU. In the discussion about a more market-driven corporate governance system, the CDU came closest to being the party of traditional organised capitalism, pointing out that the German system was not worse than the American system. In the debate on the takeover law in 2001, it was the CDU that wanted managements to have more powers in defending companies against hostile takeovers.50

Two possible paths existed to move away from interlocking capital and especially from industrial capital held by banks. The first, mostly demanded by the Left, was to make it illegal for financial companies to own more than five per cent of the shares of an industrial company. Liberals insisted that this was only possible in combination with lower taxes on profits from the sale of share blocks, which was the second possible path. Otherwise, they argued, a law against industrial ownership of banks would be an act of
expropriation.\textsuperscript{53} It was a surprise for all observers, including capital market participants, that the Schröder government opted for the total abolition of capital gains tax without linking this to a prohibition act. It was a ‘Nixon goes to China’ situation\textsuperscript{44} that made this decision possible. Under the Kohl government, even a reduction of the tax was thought to be politically unfeasible.\textsuperscript{55} Schröder and his finance minister used an opportunity to disentangle interlocking capital by strengthening forces that already existed, without having to fear the opposition of large companies.

**THE DYNAMICS OF CHANGE**

We have argued that the German variant of organised capitalism changed towards greater market orientation because of simultaneous and mutually reinforcing developments. Impulses for change in corporate governance already existed before the mid-1980s, but they remained isolated and resulted in adjustments within the logic of the old regime. The path of institutional reproduction was not left until the mid-1990s. From that time on, changes in privatisation policy, company regulation, shareholder orientation and corporate network density intensified. Initially, the parallel processes in the different fields were independent from each other. They had different external and internal causes. Privatisation was set in motion by the European Union, by increasing state deficits and a shift from state intervention to regulation, while the orientation of German companies towards shareholder value was related to competition in product and capital markets, growing importance of markets for corporate control, and the link between shareholder value practices and the compensation of managers. After a while simultaneous external and internal causes combined into an intensifying co-evolutionary process. In isolation each causal factor might not have made much of an impact. As in the past, discussions on the power of banks would have come to nothing or privatisation would have been mostly symbolic. However, simultaneous complementary influences led to a deep transformation of the German corporate governance regime. This began when the different processes started to stimulate each other. Interaction effects existed in several respects.

The interaction between privatisation and shareholder orientation was twofold. The sale of blocks of shares held by the state exposed companies like VEBA to the market for hostile takeovers, which forced them to become more share price-oriented. Additionally, the deregulation of infrastructural sectors led to increased competition and the need for restructuring. In this situation, managements used the shareholder value
concept to enforce restructuring internally. VEBA, RWE, Viag and Deutsche Telekom rapidly adopted international accounting, stock option programmes, intensive investor relations and profitability targets for the business segments or the company as a whole.

Privatisation also had an impact on the strategic change of banks towards investment banking as investment banks received lucrative orders to organise privatisation. As banks changed their behaviour towards hostile takeovers, they added to the willingness of managers to become investor-oriented. There were also links between the reorientation of the banks, the sale of company stocks and the shareholder orientation of non-financial companies. As financial companies became more shareholder-oriented by themselves, they began to reorganise their investment portfolios to raise short-term profitability. In this way they passed on the pressure for more profitability to the non-financial companies. When financial companies sold their non-financial share blocks, the number of shares potentially available for hostile bidders rose.

These processes, in turn, changed the interests of the banks in company regulation. As banks did business in privatisation, their interest in more privatisation grew. Big financial corporations demanded a tax reduction on profits from sales of stock. Their changing behaviour stimulated regulatory reforms in yet another manner. As banks withdrew from company monitoring, most notably from the chair positions in supervisory boards, they needed the capital market to monitor companies. Non-financial companies also promoted regulatory reforms. Daimler-Benz in particular pushed the act that deregulated accounting, having disgraced itself by publishing two completely different balance sheets in 1994, one saying the company had earned DM600 million under German HGB accounting, the other indicating a loss of nearly two billion DM under US-GAAP. Political reforms, of course, aimed at supporting shareholder orientation and company networks by removing unequal voting rights, higher transparency, facilitating share buybacks and stock options, and abandoning capital gains tax. In this way, growing market orientation in given spheres reinforced similar tendencies in others that in turn produced feedback for them. Complementarity between different fields of corporate governance enhanced the dynamics of change and made substantial change possible.

The disintegration of organised capitalism affects the ability and the obligation of the state to exercise influence over corporations. This is obvious in the case of the privatised companies in infrastructural sectors. The times when public authorities and state-owned companies guaranteed stable employment for a large part of the German workforce are definitely
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over. The privatised companies are no longer able and willing to take responsibility for the societal problem of unemployment.

The shareholder value trend in many of the largest industrial companies also affected the relationship between corporations and the state. In the past, managers of large companies often emphasised their responsibility for their employees, their region and society as a whole. Even if this was lip service in some cases, in others there are indications that companies did act with a degree of social or national responsibility. For good or bad, shareholder value-oriented companies no longer have any need or legitimacy to do this, and the state is no longer able to appeal to their responsibility. These are now obliged only to satisfy shareholder interests. The same holds true for the financial sector. As banks abandoned their interlocking directorates and ownership ties, they also got out of reach of the state, which could no longer use them as vehicles to influence companies in line with common goals, such as industrial policy. Today, there is no economic or political reason for banks to continue to provide for the co-ordination of the German economy. Banks now refuse to be guarantors of the public or national interest.

The disintegration of organised capitalism in the field of corporate governance seems irreversible. German company law supported and accelerated the trend towards a new corporate governance system and now makes a return to the former system unlikely. Regulatory decisions, such as on the prohibition of unequal voting rights, cannot be reversed easily. Furthermore, change did not happen on the periphery of the German economy. Those companies that once were at the centre of 'Deutschland AG' – the largest private banks and financial companies and the highly internationalised industrial firms – have adopted new strategies and will not return to their past strategies.

What impact does change in corporate governance have on other parts of the German institutional order? Changes in corporate governance have gone further than in other fields. As a result, we may be observing a process of hybridisation of the once highly coherent German institutional system. Market orientation in corporate governance increased while other institutions stayed intact or changed only marginally. We already have indications that shareholder value strategies of firms and more market-oriented forms of corporate governance do not necessarily jeopardise the existence of co-determination and sectoral collective agreements. Simultaneously, the same trends will probably change the distribution of value added in favour of shareholders. It thus remains to be seen if the co-evolutionary process we are now observing will end in a stable configuration. The substantial changes in corporate governance in the 1990s...
certainly made it clear that not all German institutions are as stable as many observers believe.

NOTES
3. Our impression is that there is no obvious hierarchy among disorganising forces. It is not possible to identify one starting point (for example, privatisation) that leads to the disorganisation of all other spheres.
4. Werner von Siemens (1816–92), inventor and entrepreneur, founder of Siemens Corporation; Ernst Abbe (1840–1905), inventor and entrepreneur, founder of Carl-Zeiss-Stiftung; Hugo Stinnes (1870–1924), industrialist, founder of several companies, including Stinnes Corporation and RWE.
5. We define ‘shareholder value orientation’ as a company strategy that targets market capitalisation. Indications for shareholder orientation are profitability goals, transparency, investor relations activities, and stock options.
6. Afterwards it turned out that Schrempp’s internationalisation strategy definitely had not maximised shareholder value, and one can doubt if his strategic choices, such as the merger with Chrysler, were really motivated by the intention to enhance the profits of shareholders.
10. Formerly conglomerate (predominantly electronics and electrical engineering). Before its bankruptcy and subsequent integration into Daimler-Benz, AEG was one of the largest German companies.
17. Section 100 (2) of the Stock Corporation Act of 1965.
20. Based on Monopolkommission, Marktrückgang unifassend verwirklichen. Zwölftes
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27. At Volkswagen and VIAG the Länder of Lower Saxony and Bavaria did not follow the federal example and retained their shares.
29. Esster, ‘Germany’.
34. In early 1990, a potential revenue from privatisation of DM1,365 billion was estimated. This was changed by Treuhand's president Rohwedder to DM600 billion a few months later. In 1992, when the opening balance sheets were released, they indicated a value of DM81 billion an increase in opening and closing costs of DM215 billion. See M. Cassell, How Governments Privatize: The Politics of Divestment in the United States and Germany (Washington: Georgetown University Press 2002), p.181.
36. The state-owned bank, Kreditanstalt für Wiederaufbau, owns an additional 12.3 per cent.
39. Bavaria opposed the privatisation of Deutsche Lufthansa in the mid-1980s because the CSU government feared that it could undermine the close links between Lufthansa and the aircraft and aerospace industry located in Bavaria. See Esser, ‘Germany’, p.113.
40. By comparison, they had played much more of a role in the debate of the 1950 and 1960s.
43. Gesetz zur Kontrolle und Transparenz im Unternehmensbereich.
44. International Accounting Standards (IAS) or General Accepted Accounting Principles (US-GAAP).
45. Handelsgesetzbuch, the German Commercial Code.
46. Section 70 (1) of the 1937 Stock Corporation Act obliged the to rule the company ‘so wie das Wohl des Betriebes und seiner Gefolgschaft und der gemeine Nutzen von Volk und Reich es erfordern’.
51. See the statements by Lambsdorff (FDP), Bury (SPD), Wolf (Bündnis ’90/Günter) and Heuer (PDS) in the debate about the KonTraG. Plenarprotokoll Deutscher Bundestag 13/222, 5 March 1998.
53. See the statement of Lambsdorff (FDP) in the debate over the KonTraG.
55. See Monopolkommission, Leitlinien, p.118.
56. Kapitalaufnahmeleichterungsgesetz (KapAEG).
57. See Höpner, Unternehmen.
58. See Beyer and Hassel, ‘Effects’.