

RETHINKING CAPITAL MARKETS REFORM: A REASSESSMENT OF OLSON PROBLEM AND REGULATORY DUALISM IN THE GERMAN CAPITAL MARKETS FROM A VARIETIES OF CAPITALISM PERSPECTIVE

André Ziccardi de Carvalho*

Abstract

Since its proposition by Peter A. Hall and David Soskice the Varieties of Capitalism (VoC) approach has been particularly important to explain the relationship between economic agents and sets of institutional arrangements that, even in regulatory scenarios that Law and Finance's school would consider "less than optimal", are able to generate sustainable economic growth. In this context the VoC approach has been consistently challenging the traditional "one fits all" approach towards capital markets reform usually endorsed by institutions such as the World Bank and the International Monetary Fund, as well as by many scholars and capital markets regulators associated with La Porta's Law and Finance School. As any theoretical framework, however, the VoC approach also faces its own challenges and still lacks the scientific maturity achieved by the Law and Finance School. Consequently a conciliation between the relational view of the firm proposed by the VoC approach and the overview of corporate governance practices throughout the world presented by the Law and Finance School would be instrumental to construe a more clear understanding of the competitive advantages generated by certain sets of institutions and, at the same time, more accurately assess impacts of reforms that, even if implemented with the legitimate goal of promoting firms' transparency and higher corporate governance standards, may counter-intuitively generate unprecedented corporate and capital markets crisis. By analyzing two concepts proposed by Ronald J. Gilson, Henry Hansmann and Mariana Pargendler that have an apparent fundamental link to La Porta's school of Law and Finance (i.e. Olson Problem and Regulatory Dualism) through a varieties of capitalism approach, this study aims at rethinking the traditional "one fits all" approach towards capital markets reform and taking a further step in the direction of conciliating the VoC approach with La Porta's Law and Finance School. The analysis proposed in this article considers corporate and capital markets reforms in Germany between 1950 and 1997 (the year of creation of the Neuer Markt) and also takes into consideration underlying economic factors of the German market economy, which ultimately contributed to the collapse of the Neuer Markt on late 2001.

Keywords: Capital Markets, Olson Problem, Germany

* *Ludwig-Maximilians-University of Munich, Germany*

** *This paper is dedicated to my parents, Eliete and Paulo, and to my aunt Emilia.*

1 Introduction

The *Olson Problem*, named by Ronald J. Gilson, Henry Hansmann and Mariana Pargendler after the influential economist Mancur Olson, is defined as "the opposition of the established economic and political elite to growth-promoting reforms" (Gilson, Hansmann and Pargendler 2007, p. 478). As an alternative to the so-called Olson Problem, the authors presented the concept of „Regulatory Dualism“ (see Gilson, Hansmann and Pargendler 2007, p. 478 *et seq.*). Gilson, Hansmann and Pargendler argue that corporate governance reforms that would "improve investor protection and promote capital market development and growth", are blocked

by powerful interests of controlling owners and managers of established firms, for such reforms could weaken their own positions of influence (see Gilson, Hansmann and Pargendler 2007, p. 478).

According to the authors, Germany should have had, at least until 1997, certain interest groups that prevented investor protection reforms (see Gilson, Hansmann and Pargendler 2007, p. 503). The *Neuer Markt*, introduced in 1997 in Germany, a special privately organized market segment for small and medium-sized enterprises with strong investor protection standards, should have been a strategy of the *Deutsche Börse* (the German Stock Exchange), to circumvent blockades created by these powerful interest groups to investor protection reforms (see

Gilson, Hansmann and Pargendler 2007, p. 504). Consequently the Neuer Markt would be an example of Regulatory Dualism.

As evidence of the existence of these interest groups, which should have blocked investor protection reforms in Germany, Gilson, Hansmann and Pargendler quote the following passage from La Porta et al. (2000, p 22):

"At the same time, the captains of German industry have accepted it [Neuer Markt]: because their firms were not directly affected" (Gilson, Hansmann and Pargendler 2007, p 504).

The quoted statement, however, is profoundly inaccurate and provides no indication of whom the "captains of the German industry" might be. Indeed, in the German stakeholder model of corporate governance, the "captains of the German industry" could refer to a number of interest groups which harmonize their interests inside the firm such as owners and managers of German listed companies, representatives of customers, suppliers or related individuals, who usually, in light of the complex network of cross-shareholdings existent in the Germany capital market, have a seat on the Board of Directors (*Aufsichtsrat*) of German listed companies, but also officials of financial institutions that play a predominant role in the German bank-based financial system, both as a source of funding, as well as strategic shareholders.

Finally, Gilson, Hansmann and Pargendler conclude suggesting that the failure of the *Neuer Markt* may be primarily attributed to enforceability deficits of the Deutsche Börse and to the private nature of the Neuer Markt regulation.

In light of Gilson, Hansmann and Pargendler's referred propositions regarding Olson Problem and Regulatory Dualism and to achieve the proposed goal of conciliating Gilson, Hansmann and Pargendler's approach with VoC approach, this article intends to answer the following questions:

a) Were there interest groups in Germany up until the introduction of the *Neuer Markt* that opposed and successfully blocked investor protection reforms?

b) If so, who were those interest groups and, from a Varieties of Capitalism Perspective, what is their relationship with the German economic regime and the German regulatory framework?

c) Can the failure of the *Neuer Markt* indeed be primarily attributed to enforceability deficits as suggested by Gilson, Hansmann and Pargendler?

d) What can we learn from the failure of the *Neuer Markt* to maximize chances of success in the application of the Regulatory Dualism concept for future reforms?

Structure of this article

In the following section, I provide an overview of the VoC approach and define the concepts of strategic

coordination, institutional complementarity and resistance to institutional reform.

In Section 3, I analyze the German Corporate Governance subsystem according to the VoC approach to identify relevant institutions and legal mechanisms that enable strategic coordination of established "elites" within the German economy. The potential Olson Problem protagonists in Germany are also identified in this section.

In section 4, I shed light on two corporate law reforms, as well as an attempted reform (Corporate Law Commission -*Unternehmensrechtskommission*- from 1971) between 1945 and 1997 in order to analyze the behavior of and positions adopted by the different capital markets agents involved in the reforms, as well as their impact on the outputs of the reforms.

Section 5 analyses the *Neuer Markt* as an example of Regulatory Dualism according to the VoC approach to then explore the most significant reasons for the failure of the *Neuer Markt* while also presenting a new definition for the Olson Problem aimed at conciliating the Olson Problem concept with the institutional complementarity concept of the VoC approach. Section 5 also puts forth a new approach for implementing Regulatory Dualism reforms, taking into account the institutional complementarities within a market economy.

Section 6 concludes the article by summarizing and reinforcing key findings.

2 The Varieties of Capitalism Approach: characteristics of Liberal Market Economies and Coordinated Market Economies

Types of market economies

The VoC approach sees the firm in a "relational view", i.e. in its relations with other economic factors. In order for firms to pursue their purpose, they must build a series of relationships, both internally and externally, with a variety of agents, including competitors, suppliers, customers, shareholders, trade unions, trade associations (*Wirtschaftsverbände*) and governments (see Hall and Soskice 2001, p 7).

These relationships can, in turn, present a variety of coordination problems and the economic success of a firm will ultimately depend on whether the firm is able to coordinate its relations with other actors in an efficient manner (see Hall and Soskice 2001, p. 7). The various strategies developed by firms to solve their coordination problems determine their individual production competencies and the production regime of a certain economy ultimately results from the sum of the individual production competencies of the firms (see, Hall and Soskice, 2001, p. 7, Soskice 2009, p. 204 and Hall 2006, p. 187).

Since the sum of the strategies of firms in terms of economic challenges (or coordination problems) yields the economic performance of a country, the companies are the key actors in a market economy (see Hall 2006, p. 183 and Soskice 2009, p. 241 *et seq.*). Furthermore, based on the VoC approach, the production regime of the most advanced economies may be divided in one of two unique ideal types: (i) the liberal market economy (LME); and (ii) the coordinated market economy (CME) (see Soskice 1999, p. 204 and Hall and Soskice 2001, p. 7).

In LMEs, firms coordinate their activities primarily through markets, i.e. through competition and formal contracting (see Soskice 1999, p. 205, and Hall and Soskice 2001, p. 8). USA, UK, Canada, New Zealand and Ireland stand as examples of LMEs (see Hall and Soskice 2001, p. 21).

The CMEs, however, are of particular importance for this work because Germany represents a casebook example of this production regime¹. In CMEs firms rely more on non-market mechanisms to coordinate their relations with other economic actors. To this end, they set up more cooperative and informal arrangements, in contrast to the competitive and formal contracting tools used by firms in LMEs (see Soskice 1999, p. 205, and Hall and Soskice 2001, p. 8).

In CMEs network monitoring is conducted via private exchange of information between members (as opposed to the exchange of information publicly available on the market in LMEs) and firms rely more on long-term cooperative relations to build their skills as opposed to market-oriented relations and direct competition in LMEs (see Soskice 1999, p. 205, and Hall and Soskice, p. 8).

The coordination requirements of the firms may be basically divided into five sub-systems: industrial relations, vocational training and education, corporate governance, inter-firm relation and employees (see Hall and Soskice 2001, p. 7). Each of these subsystems has a set of institutions that supports the coordination requirements of the firm.

Institutions, complementarity and resistance to reforms

Both LMEs and CMEs have developed institutions and organizations² that support coordination activities in their various subsystems.

¹ Particularly until the middle of the 90's.

² This work will use North (1990, S. 3) definition of "institutions" and "organisations," which has been partially modified by Hall and Soskice (2001, S. 9). Under this Definition institutions are "a set of rules, formal or informal, that actors generally follow, whether for normative, cognitive or material reasons" and organisations are "durable entities with formally recognized members, whose rules contribute to the political economy" (Hall and Soskice 2001, p. 9).

CMEs have institutions that support the activities of the firm by non-market coordination mechanisms under the organizing principle of "strategic cooperation" (Mayntz 2007, p. 384). These institutions typically include powerful business associations and trade unions, extensive networks of cross-shareholdings between firms and legal and regulatory mechanisms that support the private exchange of information and long-term business cooperation (see Hall and Soskice 2001, p. 10 and Soskice 2009, p. 241). LMEs in turn have institutions that support the coordination activities of the firm through market-based mechanisms under the organizing principle of competition (see Mayntz 2007, p. 384). Institutions in LMEs typically include weak business organizations and trade unions and strong legal and regulatory mechanisms that promote competition between companies and combat the private exchange of information³.

According to the VoC approach, institutions and subsystems act complementarily to each other and allow the specialization of firms in one of those two basic production regimes (more on this below). Two subsystems or institutions can be referred to as "complementary" if the presence (or efficiency) of a subsystem or an institution increases the output (or efficiency) of the other subsystem or institution (Höpner 2005, p. 33, and Hall and Soskice 2001, p. 17). Therefore "Complementary Institutions" form a social context of individual parts whose sum is greater than the simple addition of parts (see Fioretos 2001, p. 219 and Hall and Soskice 2001, p. 17)⁴.

In this sense, institutions of LMEs include: (i) a market-based financial system which provides firms with a large amount of risk capital, traditionally supported by highly liquid securities markets and an investor protection law that privileges protection by means of enforcement of individual rights of shareholders (a typical shareholder-value-oriented corporate governance system); and (ii) a complementary deregulated labor market, in which both education and training take place outside the firm and therefore stimulate the high mobility of workers and scientists (see Soskice 1999, p. 206 and Vitols and Engelhardt 2005, p. 4). Through a VoC approach, this complementarity provides strength in

³ This occurs, for example, by means of a strong anti-trust regulation and strict enforcement of the antitrust laws and by strict investor protection laws with extensive disclosure and transparency rules. For an in-depth analysis of these mechanisms and their importance for LMEs see, Soskice (1999).

⁴ A widely accepted example in the literature of sub-systems complementarity is the complementarity between financial systems and labour markets, which will be briefly commented in this work. For an in-depth analysis of the characteristics and implications of this complementarity, see Soskice (1999), Vitols and Engelhardt (2005), Höpner and Steeck and Hall and Soskice (2001).

highly innovative industries such as telecommunications, information technology, semiconductor technology and biotechnology (Soskice 1999, p. 206 and Vitols and Engelhardt 2005)⁵.

In contrast, the banked-based financial systems of CMEs extend firms a predominance of risk-averse capital. The bank-based financial system of CMEs is usually supported by a more concentrated and less liquid securities market and a system that privileges the strategic coordination of actors inside the management bodies of the firm, instead of protecting and enforcing individual shareholder rights (serving as an archetype of stakeholder corporate governance model) (see Soskice 1999, p. 206 and Vitols and Engelhardt 2005, p. 3). Complementary to bank-based financial systems and a stakeholder corporate governance model, CMEs have regulated labor markets and firm-specific education and training systems, which promote firm-specific skills through close interaction between business associations (*Wirtschaftsverbänden*) and corporations, as well as unions and professional associations (*Fachverbände*), from the basic education (*Lehre*) up to the technical colleges (*Fachhochschulstudium*) (Soskice 1999, p. 206) and consequently allow professionals and scientists far less mobility than labor markets of LMEs. The complementarity between a bank-based financial market and a regulated labor market of CMEs enhances skills in established technologies, and especially in those processes related to the engineering and chemical industries, such as machine tools, motors, precision engineering/optics, materials handling, mining engineering, transport and heat methods (Soskice 1999, p. 212).

The importance of this complementarity for institutional change resides in the fact that institutional change (e.g. through legislative reforms) affects the interests of the actors in the maintenance of such institutional arrangements (Hall 2006, p. 191). Actors whose interests are well served by certain institutions in a subsystem (such as industrial relations), will also be interested in having complementary institutions retained in other subsystems (such as corporate governance) (see Hall 2006, p. 191). For example, a change in Germany's institutional framework according to the American LME model could, at least partially, reduce the value of the strategic cooperation skills of the economic agents in Germany (see Soskice 1999, p. 224).

⁵ For substantial evidence supporting this conclusion, see Soskice (1999), who compared data of the Index of Specialization of the European Patent Office, compiled from patent applications presented by American and German industries, and analysed the profile and complementarities of each of these countries financial and labour markets to explain the specialization in certain industries. For more details, see Vitols (2005), Höpner and Steeck (2003) and Hall and Soskice (2001).

Following this idea, in a scenario in which reform proposals threaten modifying the institutional framework in accordance with other organizing principles, such as a change that would promote more competition through strict antitrust laws in a CME and could therefore harm cooperative relations of economic actors, should encounter great resistance from established economic agents that could ultimately prevent this reform (see Hall 2006, p. 195 *et seq.*). Within CMEs strong veto players in this context are usually organizations (such as *Arbeitsnehmerverbände*, *Arbeitsgeberverbände* and business associations, *Wirtschaftsverbände*), that by their active and direct engagement in the political process provide for the establishment of permanent blockade situations and make it difficult to build consensus (Hassel and Trampusch 2003, p. 113 *et seq.*). Consequently, the fate of reform proposals which would result in far-reaching consequences for the well-being of a country, are often not determined by how these proposals affect the well-being of the nation as a whole, but by their distributional effects on influential groups (Hall 2003 p. 196).

In the next section, this article analyses the subsystem of corporate governance in Germany. After discussing the institutional framework in this subsystem and identifying the economic agents that could potentially be interested in preserving this institutional framework, I proceed to analyze reform proposals in the area of corporate law in Germany to investigate whether the economic agents identified in section 3 indeed posed obstacles to reforms and whether they indeed were able to affect the output of those reforms.

3 The German Subsystem of Corporate Governance

According to the VoC approach, the subsystem of corporate governance comprises institutions responsible for coordination of corporate finance relations, relations between shareholders and invested companies, as well as for coordination efforts related to investment monitoring.

A useful classification to obtain an overview of the sub-system of corporate governance in LMEs and CMEs is the distinction between the shareholder and the stakeholder corporate governance models.

In the shareholder model, the maximization of shareholder value is the primary goal of the corporation and only shareholders enjoy strong and legally formal relationships to the top management (see Vitols 2001, p. 337). Capital markets with the shareholder model have generally a predominance of dispersed ownership, *i.e.* small shareholdings held by portfolio investors, who have no permanent interest in the company (see Vitols 2001, p. 337 and Engelhardt and Vitols 2005)⁶. Capital markets under the

⁶ Such as hedge and pension funds.

shareholder model have strong investor protection regulations that favor the protection and enforcement of individual rights of shareholders and allow the monitoring of a variety of small shareholdings of portfolio investors by ensuring access to permanent publicly available information⁷. Capital markets with the shareholder model also usually have very active markets for corporate control with a large number of hostile takeovers. Under the VoC School, the shareholder model is associated with LMEs such as the United States and the United Kingdom (see Vitols 2001, p 337).

In contrast to the shareholder model, in the stakeholder model, a variety of stakeholders (such as workers, banks, suppliers, customers and the community in which the company is located) also have a "voice" within the firm and their interests are weighed in management decisions against each other (see Vitols 2001, p 337). Capital markets with the stakeholder model have generally a high concentration of ownership in the hands of strategic investors who have a continuous interest in preserving their investments in the firm and effectively exercising control over the company and its management (see Vitols 2001, p 337). Capital markets with a predominance of the stakeholder model usually have milder investor protections rules and allow protection of stakeholder rights through strategic coordination between stakeholders groups⁸. Shareholders in these systems always have a recourse to legal courts in extreme cases, but only after their concerns were conveyed either by the board of directors or by a court-appointed representative of the shareholders (see Milhaupt and Pistor 2010, p. 83). Within the stakeholder model, by holding a large shareholding in the firm and participating in business organizations (*Wirtschaftsverbände*), strategic investors have access to important information about the financial situation, control and strategy of a firm that are not publicly available in the market. Finally, capital markets with the stakeholder model have a small and less liquid market for corporate control and hostile takeovers in these markets only rarely occur. The stakeholder model is predominant in CMEs such as Germany, Japan and Austria (see Vitols 2001, p. 337).

Finally, the VoC school links, due to different institutional complementarities, LMEs with market-

based financial systems and CMEs with bank-based financial systems⁹.

The institutional framework of Germany's Corporate Governance subsystem

The VoC approach does not provide a systematized static picture on the institutional framework of the corporate governance subsystem¹⁰. Different analysis of this subsystem by different authors (and, not unusually, by the same author) portray different institutions as integrating this subsystem (primarily depending on the primary focus of the work)^{11 12}.

For the purposes of this article, this section considers as part of Germany's corporate governance framework the institutions of investor protection, ownership concentration, market for corporate control and Germany's bank-based financial system.

The co-determination (*Mitbestimmung*), although it is also part of Germany's corporate governance subsystem and plays an important role in the power balance within the board of directors of large firms in Germany, will not be analyzed by this

⁹ Although financial systems usually have both banks and markets, bank-based systems differ in a number of characteristics of market-based systems: a greater proportion of household assets are held as bank deposits; equity markets, however, are smaller and less liquid and bank loans represent a larger share of a company's liabilities. For an overview according to the VoC approach, see Vitols (2004).

¹⁰ For example, Hall and Soskice (2001, p. 7) consider that the subsystem of corporate governance entail coordination efforts related to corporate finance and firm monitoring by investors, but do not provide a clear institutional framework for this subsystem. Höpner (2005, p. 334) presents ownership, disclosure rules, the presence or absence of hostile takeovers and the banking system as the main elements of the corporate governance subsystem. Vitols (2001, p. 359), in turn, sees the stock market, the co-determination (*Mitbestimmung*) and the management organizations as its main elements.

¹¹ Höpner (2005) analyses the complementarity between the corporate governance system and the subsystem of industrial relations focusing on co-determination (*Mitbestimmung*), Engelhardt and Vitols (2005) examines the complementarity between corporate governance and labour markets with a focus on investor protection and stock markets.

¹² One possible explanation for this is that usually the same institution supports coordination efforts in several subsystems and consequently it is sometimes difficult to assign to, classify and describe an institution within only one specific subsystem. This would be, for example, the case of institutions such as the co-determination (*Mitbestimmung*) and the business organisations (*Wirtschaftsverbände*), which are important for coordination efforts in the subsystems of corporate governance, industrial relations and labour market.

⁷ See, La Porta et al. (1997 and 1999).

⁸ See La Porta et al. about the relationship between strong investor protection mechanisms and stock ownership concentration, as well as Baums and Fraune (1994) for the acute ownership concentration in Germany's capital markets. See also Streeck and Höpner (2003) for an overview of the complementarities between ownership concentration and the different forms of exercise of *network-monitoring* as well Hall und Soskice (2001, p. 23) for network-monitoring inside CMEs.

work. This is especially because the discussions regarding corporate law reforms in the field of co-determination (*Mitbestimmung*) have very particular roots in Germany's economic reality, making it necessary to consider wider social and historical aspects associated with the subject. Unfortunately such a wide analysis would exacerbate the scope of this work.

Finally, even though the business organizations (*Wirtschaftsverbände*) in principle belong to the subsystem of industrial relations, this work will also briefly analyze them within the context of the Corporate Governance subsystem in view of their central role in the coordination efforts of Germany's capital markets agents.

Investor Protection

Until the late 1990s, major shareholders, managers, customers, suppliers and banks from German listed companies had historically had better access to company's information than small individual shareholders (see Engelhardt Vitols 2005, p. 4). These privileged groups also had access to a series of different mechanisms that assured the maintenance of their influential position *vis-a-vis* German listed companies, including for example, mechanisms to avoid unwanted takeovers bids and multiply voting rights (as detailed below).

In light of Germany's historically weak investor protection system, by simply holding a small equity interest and monitoring publicly available financial information (as was the case in the United States and the United Kingdom)¹³ small shareholders were not able to efficiently monitor their investment in companies listed in a German stock exchange.

German law demanded firms to disclose only a small amount of financial information and within sporadic periods of time¹⁴. While in the US it was mandatory that listed companies disclosed their financial information on a quarterly basis (*i.e. every three months*), German listed companies were only obliged to so once a year without being required to, for example, disclose a cash flow statement as an attachment to its balance sheet (Engelhard and Vitols 2005, p. 4). In addition, German firms predominantly used the accounting standards of the German Commercial Code (*Handelsgesetzbuch*), which allowed companies a large room of maneuver to decide on how to report their financial conditions (see Engelhardt and Vitols 2005, p. 4).

In addition, until 1994 it was practically impossible to determine who held the controlling ownership of a German listed company due to the overwhelming predominance of bearer shares

(*Inhaberaktien*) and the very mild disclosure obligations regarding the holding of large percentages of equity interest.¹⁵ Even though §§ 21 and 22 of the AktG established an obligation to any shareholder holding 25% or more of the capital stock of a certain firm to notify the company of its exact shareholding, this notification only needed to be addressed to the relevant company and the company was not required to disclose this shareholding to the market. Additionally, even for the cases for a notification under §§ 21 and 22 AktG would be required, in view of the lack of complementary and more comprehensive disclosure rules (regarding, for example, the obligatory disclosure of ownership held individually by members of the same family) and the existence of a variety of mechanisms for the separation of ownership and control, allowed the ownership control of any firm, privately or publicly held, to be kept secret^{16, 17}.

Until 1998, publicly held companies in Germany were allowed to issue multiple vote shares (*Mehrstimmrechtsaktien*) (see Bayer and Habersack 2007, p. 897). Such multiple vote shares (*Mehrstimmrechtsaktien*), provided its bearer with more than one vote per share under certain circumstances¹⁸ (see FIG. Schuster 2004, p. 174). The multiple vote shares (*Mehrstimmrechtsaktien*) were a particularly effective mechanism in preventing unwanted hostile takeovers¹⁹.

¹⁵ For more details, see Becht and Boehmer (1999) as well as Adams (1999).

¹⁶ For example, the exercise of ownership control of a company by holding less than 25% of cross-shareholding (*wechselseitige Beteiligung*) in strategic partners. See Fey (2000) for further examples.

¹⁷ Even after the comprehensive reform implemented by the Second Financial Market Promotion Act (*Zweites Finanzmarktförderungsgesetz*) in 1994, which introduced many disclosure obligations for Germany publicly held companies (including disclosure requirements concerning control block, custodian voting rights- *Depotstimmrechte*- etc.) the ownership control of innumerable firms could still not be determined. An illustrative example is the case of Herlitz AG. The members of the Herlitz family, which controlled Herlitz AG with a majority shareholding of more than 50% of its capital stock, had distributed their joint participation among 32 family members, and as no disclosure requirement existed for control blocks formed by shareholders of the same family without a shareholders agreement, only the participation of Dr. Klaus Herlitz, who represented more than 5% of the common stock of the firm was reported to the German Securities and Exchange Commission (see Becht and Boehmer, 1999).

¹⁸ For a comprehensive presentation, see Schuster (2004).

¹⁹ For a comprehensive analysis of the use of multiple voting rights shares (*Höchststimmrechtsaktien*) as a mechanism to safeguard shareholder influence in the Austrian example see Kalss (2002).

¹³ See specially Vitols in Hall and Soskice (2001) as well as Engelhardt and Vitols (2005).

¹⁴ For a comprehensive analysis, see specially Tietz-Webber (2005).

Ownership Concentration

From the perspective of ownership concentration, the German subsystem of corporate governance presents a predominance of one or more large shareholders with a strategic motivation for holding shares of the company (rather than purely share value maximization interests) (see Adams 1999, Vitols 2001, p. 342, Baums and Frone 1994 and Boehmer 1998).

Consequently in 1997 90% of all publicly held companies in Germany had at least one shareholder that owned at least 10% of its capital stock (see Vitols 2001, p. 342) and 57% of all shares listed on German stock exchanges were held by shareholders that had an strategic interest as the predominant reason for holding such shareholding²⁰ (see Vitols 2001, p. 342).

This large concentration of stock ownership primarily involved industrial enterprises and served the purpose of coordinating long-term relationships between a company and its competitors, customers and suppliers. The maintenance of cross-shareholdings (or cross-ownership) between enterprises also historically allowed different stakeholders to have a seat and a vote within the board of directors of each other (the so called cross-personnel integration links; *personelle Verflechtung*). The existence of those two structures (cross shareholding and cross-personnel integration links) permitted the formation of implicit or informal contracts regarding rights and obligations of stakeholders towards each other (see Ipsen and Pfitzinger 2003, p. 61 *et seq*) and enabled the alignment of stakeholders interests and the private exchange of information. An illustrative example of this reality was the cross shareholding and cross-personnel integration links (within the board of officers and board of directors) existing between AEG-Telefunken AG ("AEG") and a variety of customers and suppliers such as Mannesmann AG ("Mannesman"), Deutsche Lufthansa AG and BASF AG between 1965 and 1975 (Ipsen and Pfitzinger 2003, p. 70 *et seq*). At that time AEG had a total of 23 direct and indirect personal integration links (*personelle Verflechtungen*) with most of its competitors within the electrical engineering industry (for a detailed portrayal see Ipsen and Pfitzinger *in* Streeck and Höpner 2003, p. 70 *et seq.*)²¹.

²⁰ From this 57%: competitors, customers, suppliers or other equivalent stakeholders holding 42.1% of all shares in the German capital market, banks (holding 10.3%) and government (holding 4.3%). For details, see (Vitols 2001, p. 342).

²¹ The cross-personnel integration links and the cross-ownership between competitors in the German CME aimed in particular at coordinating their cooperative (instead of competitive) relationship, preventing, in turn, direct competition among these agents and ultimately culminating with and incremental innovation and quality-oriented

Another illustrative example was the relationship between the insurance and reinsurance conglomerates Allianz, Munich Re and Deutsche Bank in 1999. In that year Allianz AG held a 25% shareholding in Munich Re, and Munich Re hold a same 25% shareholding in Allianz AG (Adams 1999, p. 107). In addition, Allianz had a 10% direct shareholding Deutsche Bank AG, and Deutsche Bank AG had a 8% shareholding in Allianz AG and a 10% shareholding in Munich Re (Adams 1999, p 107)²².

The cross-shareholding and cross-personnel integration links have also been historically used by German banks, which tend to see their equity investments in firms²³ far more as a mechanism for the protection of their loans and consolidation of their business relationship, than as an income source (see Vitols 2001, p. 342).²⁴ This direct shareholding (potentialized by the custodian voting rights, *Depotstimmrechte*) allowed, among other things, the coordination of rehabilitation and reorganization measures by banks (*Sanierungsmaßnahmen*) in the case of a corporate crisis and also prevented undesired hostile takeovers.

This was the example of AEG during its 1967-96 expansion and corporate crisis. The three major creditors of AEG (Deutsche Bank, Dresdner Bank and Commerzbank), which led the company's credit-funded expansion policy between 1967-1971, held each large portions of the company's equity stock, as well as high volumes of AEG's debt instruments. Deutsche Bank held a 21% participation in AEG's share capital and 17.45% of the total loan financing of the company, Dresdner Bank held 15% and 12.46% and Commerzbank 8% and 9.55%, respectively (Ipsen and Pfitzinger, 2003, p. 80). These three banks also had each one representative in the Board of Directors of AEG and the position of

production industrial system. For a comprehensive description, see Soskice (2009) and Höpner (2005).

²² Perhaps the most famous and extreme case of cross-shareholding was the Iduna case, in which two companies within the Iduna Insurance Group held more than 90% of cross-shareholding each other and the boards of both companies were occupied by practically the same persons. This extreme example of mutual participation caused a dispute, sentenced by Germany's Imperial Court (*Reichsgericht*) in 1935. For a detailed description, see *Entscheidungen des Reichsgerichts in Zivilsachen* (RGZ) 149.

²³ German companies have historically a strong relationship with a particular financial institution that was directly involved in the company and served the purpose of coordinating the company's corporate financing efforts. These banks are often referred to as the "house bank" (*Hausbank*). For more details, see Streeck and Höpner (2003).

²⁴ For example, the Deutsche Bank held in 1993 a direct shareholding of at least 10% in their customers Daimler-Benz AG, Karstadt AG, Allianz AG, Linde AG and Munich Reinsurance (Adams 1993, p. 2).

chairman was year after year (both during AEG's credit financed expansion, as well as during the company's crisis) held by the representative of one of these 3 banks (see Ipsen and Pfitzinger, 2003, p. 80). In 1975, the representative of Dresdner Bank took over the position of chairman of the Board of Directors playing the role of the "house bank" (i.e. "Hausbank") and began an attempt to reorganize and restructure the company, which ended in 1996 with the liquidation of AEG²⁵.

Banks such as Deutsche Bank, Commerzbank and Dresdner Bank were often able to multiply their effective voting rights by the extensive use of custodian voting rights (*Depotstimmrechten*). Usually during the beginning of each year, German banks obtained from its customers an authorization to exercise, at the bank's sole discretion, the voting rights inherent to the shares that were deposited in the bank and, based on this authorization, the banks exercised the voting rights inherent to the deposited shares in the Shareholders' General Meetings of the firms (Bayer and Habersack 2007, p. 817). The multiplication effect of the *Depotstimmrechten* was so extreme that in 1992 the average percentage of the voting rights exercised by banks at the Annual Shareholders' Meeting of Germany's 24 largest listed company was of 72.28% (Baum and Fraune 1994, p. 14)²⁶. This multiplication of voting rights of the banks led, in turn, to further cross-personnel integration links and representatives of German banks held simultaneous positions in management bodies of several companies. In the case of AEG, for example, the representatives of Deutsche Bank (Heinz Osterwind), Dresdner Bank (Eduard von Schwarzkoppen) and Commerzbank (Erich Vierhub) in addition to holding positions in the board of AEG, held each, respectively, 19, 22 and 19 simultaneous mandates in several other listed and non-listed companies (Ipsen and Pfitzinger 2003, p. 73).

Market for corporate control

Until the late 1990s there was only a small number of inter-group mergers and acquisitions and hostile takeovers were a rarity in Germany²⁷. The main reason for the absence of a market for corporate control in Germany was precisely the joint effect of the institutions mentioned above (plus the co-determination, *Mitbestimmung*, from 1970 onwards), that permitted the creation of almost permanent

barriers to hostile takeovers (see Höpner and Jackson 2003, p. 160). In addition, many corporate law mechanisms existed that permitted the stabilization of an influential position and less strict financial disclosure rules also did not allow accurate valuation of companies (posing major barriers to hostile takeovers)²⁸.

Financial system

In the 20th century, bank deposits and bank loans were the main sources of funding for German companies (Vitols 2004, p. 7).

Until the mid-1990s, non-capital-market forms of financing such as bank loans and deposits accounted for 74% of the assets of the financial system as opposed to market-based systems such as the United States, where private banks were only responsible for a quarter of the assets of the financial system (see Vitols 2004, p. 7).

The role of the business associations (Unternehmensverbände)

In Germany business associations (*Unternehmensverbände*) are also fundamental non-market instruments for company's to coordinate their efforts.

In the subsystem of corporate governance, business associations are an important source of non-publicly information about their members and consequently allow the private exchange of information (network monitoring) by strategic investors such as banks, industry competitors and other strategic investors that are part of these networks.

Business associations also act complementary to the wide network of cross-shareholdings and the cross-personnel integration links of German firms to create and maintain long-term cooperative relations and informal/implied contracts amongst firms (see Hall and Soskice 2001, p. 23).

The leaders of the powerful business organizations are usually recruited from the boards of directors and board of officers of large German enterprises associated with those organizations (Soskice 1999, p. 221). Those leaders are also particularly interested in maintaining an institutional environment that potentializes their consolidated technical and business knowledge and that allows the relationship networks to be more closely integrated (see Soskice 1999, p. 221).

Business associations are therefore essential elements in a network of generally accepted procedures, rules and expertise, which are reflected in numerous committees and panels of experts as well as

²⁵ For a comprehensive analysis of the AEG case, see Ipsen and Pfitzinger (2003).

²⁶ Thus, for example, in the year of 1992 more than 80% of the voting rights in the Shareholders' General Meetings of Siemens, Hoechst, BASF, Bayer and Mannesmann were exercised by banks (Baums und Fraune 1994, S. 14).

²⁷ See Köke (2000) and Dietrich (1994) for a comprehensive presentation of the non-existent market for corporate control in Germany and its main constituencies.

²⁸ For an in-depth analysis, see Höpner and Jackson (2003).

in businesses and industry's associations²⁹ within Germany (see Soskice 1999, p. 221)³⁰.

The importance of these institutions to yield coordination efforts in Germany is such that virtually all economic actors, irrespective of size or sector, is a member of at least one of the different types of business associations. The Federal Business Association of the German Industry (*Bundesverband der Deutschen Industrie – BDI*), for example, concentrates alone about 95% of all companies in Germany (36³¹ industry associations and 107,000 companies) (Berger 2009, p. 31).

²⁹ Business organizations are generally divided into three types, employer associations (*Arbeitgeberverbände*), business associations (*Wirtschaftsverbände*) and chambers of commerce and industry (*Industrie- und Handelskammern*), and each of those associations supports a spectrum of coordinating efforts within the German CME. So, for example, the Federal Association of German Employers (*Bundesverband der Deutscher Arbeitgeber-BDA*), as an employer association, plays a key role in the coordination of socio-political interests of its member companies, particularly with respect to the negotiation of collective agreements with the unions, as well as the participation in government bodies, and the Public Social Security System (*Selbstverwaltung der Sozialversicherung*) (Haacke in Leif and Speth 2006, p. 168 and Schroeder 2003, p. 281). The BDI as a national business association of the industry (or „Spitzenverband“ or "umbrella organization", see Berger 2009, p 31) allows the coordination of economic interests of its member companies in relation to each other and also in coordination of political interests towards the federal government (Haacke in Leif and Speth 2006 p. 168). Finally, the regional Chambers of Commerce and Industry, under their umbrella association the German Chamber of Commerce and Industry (*Deutsche Industrie- und Handelskammer - DIHK*), play a fundamental role in the coordination of regional economic interests of the companies towards each other and the coordination of political interests towards the government in a state and municipal levels, fulfilling also particular roles with respect to self-regulation and the exercise quasi-governmental functions (Haacke in Leif and Speth 2006 p. 168 and Schroeder 2003, p. 281).

³⁰ In addition to the functions mentioned above, which are limited to the sub-system of corporate governance, business organizations are important for coordination efforts in other subsystems of the German economy as well. For example, they work closely with trade unions and the German state in the construction and financing of the education and training systems and represent the interests of their stakeholders in negotiations with unions and employee groups (Soskice 1999 Hall and Soskice (2001) and Höpner and Streeck (2003)).

³¹ Following business associations are, among others, members of the BDI: *Verband der Automobilindustrie e. V.* (VDA), *Hauptverband der Deutschen Bauindustrie e. V.*, *Bundesverband Baustoffe – Steine und Erden e. V.* (BBS), *Verband der Chemischen Industrie e. V.* (VCI), *Zentralverband Elektrotechnik- und Elektronikindustrie e. V.* (ZVEI), *Flughafenverband ADV*, *Bundesverband der Pharmazeutischen*

The economic agents in Germany's corporate governance subsystem

Institutions such as investor protection, ownership concentration and business associations allow economic actors in Germany to build long-term relationships so that two or more companies work together without being subject to strict control by formal contracts. Economic agents that are well served by these institutions, should have powerful incentives to protect this institutional framework against reforms (see Hall 2006, p. 191 *et seq.*), because a change in one or more subsystems of this institutional framework would, at least partially, affect coordination skills of these economic actors in a CME (see Soskice 1999, p. 224). It is consequently within this context of reform that intend to shift the paradigm of one subsystem (or even of the whole institutional framework) from a CME to a LME institutional configuration that Olson Problem arises.

In Germany, the economic agents expected to be the protagonists in blocking reforms (named by La Port as “captains of German industry”) are expected to be not only majority shareholders, but also strategic minority shareholders belonging to the wide network of cross-shareholdings in the German capital market (such as financial institutions predominant in the German bank-based financial system), as well as managers of enterprises, which play a central role in the extensive network cross-shareholding and cross-personnel integration links.

Because of the complementarity between the German Corporate Governance subsystem and the subsystem of the German industrial relations,³² the protagonists of the so-called Olson Problem in Germany are expected to come particularly from established technology sectors related to mechanical engineering and the chemical industry. Looking at the presidents of Germany's most influential business association, the BDI, all of its presidents between 1951 (BDI's foundation date) and 1997 (the birth of the *Neuer Markt*) were in fact either simultaneously holding seats in management bodies of companies or other sectorial associations from established technology sectors³³ (related to mechanical

Industrie e. V. (BPI). For a complete list see <http://www.bdi.eu/BDI-Mitglieder.htm>

³² See, Soskice (1999) and Höpner (2005).

³³ Here a crucial paradox exists because a business association, such as BDI, which includes 95% of all companies in Germany should have as members some interest groups that, in principle, do not particularly benefit from a specific institutional framework or even have disadvantages in the current institutional framework (such as, for example, companies from other sectors that are not "established technology sectors related to mechanical engineering and the chemical industry") and should consequently stand up against the instrumentalization of the business association by interests of only certain stakeholders

engineering and the chemical industry) or only occupied the position of President of the BDI but came precisely from leadership positions in other organizations or companies of these established technology sectors (the table in Appendix A consolidates and summarizes the information on the Presidents of the BDI between the period of 1951 and 1997).

In Germany's CME context, differently from most LMEs in which business associations are weaker both in size and in their coordination functions (mostly associated with coordination efforts in the political subsystem), business organizations (*Wirtschaftsverbände*) play a fundamental role not only in the political engagement, but also as a non-market coordination institution within the corporate governance subsystem, as explained above. This "double role" played by German business associations strengthen their representative position and increase their incentives to act as a reform-blocking organization acting in the interest of its leading figures³⁴.

Through their engagement from a very early stage of the legislative process, business associations (*Wirtschaftsverbände*) constrain the building of consensus thus providing for the establishment of permanent decision blockades (see Hassel and Trampusch 2003, p 113 *et seq.* and Olson, 1982, p. 75). In other words, the business associations are powerful instruments of established economic actors within the Olson Problem context. They act in the legislative process not only by providing support to parliamentary representatives, but also through the direct participation in reform commissions, legislative initiatives and publication of open letters and official statements regarding draft bills in the earlier phases of the legislative process. By doing so those organizations manage to, even at a very early stage of the legislative process, obtain strong compromises from parliamentary representatives thus many times materially affecting the reform proposals even before they reach the parliamentary floor (Kübler 1981, p 391)³⁵.

in its engagement in, for example, blocking a reform that would benefit such groups. Olson explores this apparent paradox and defends, however, that associations such as the BDI work analogous to political systems through a network of long-term relationships, self-regulatory functions and institutionalized cultural patterns, which harmonize the values and income from economic actors and minimize intra-group conflicts thus neutralizing "dissenting" interests within the organisation (Olson 1982, p 75 and Kogut and Walker 2001, p. 319 *et seq.*).

³⁴ For an in-depth analysis of the relationship inside these organisations and their role within market economies see Olson (1982).

³⁵ See for example Hasel and Trampusch (2006) as well as Schroeder (2003) for insightful analysis of the relationship

The next section examines the behavior of these business associations within the German legislative process and during German-Stock-Corporation-Act's reform commissions between 1945 and 1997 to investigate the role played by these institutions within a reform context and whether their engagement in the legislative process really attest the existence of the Olson Problem in the German capital market.

4 The corporate reforms in Germany

"Institutions" are formal and informal rules, based on which economic agents behave³⁶. The law, as a set of formal rules, can also therefore be considered as a part of the institutional framework within the economic reality. Consequently, legal reforms modify the institutional framework and the way economic agents to coordinate their relations with other economic agents.

The institutions of the subsystem of corporate governance and its various mechanisms (such as the custodian voting rights, *Depotsstimmrechten*, or transparency requirements) extend to a variety of legal fields and only rarely "rules" of a certain institution are limited to a single law field.

This is, for example, the case of investor protection. Although one could speak about a "Investor Protection Law" law field (*Anlegerschutzrecht*), the investor protection field in the German legal system is actually a straddling discipline that has rules particularly in securities (*Wertpapier-*), stock exchange (*Börsen-*), corporate (*Aktien-*) and accounting law (*Bilanzrecht*) in context.³⁷ The same applies to ownership concentration and the market for corporate control, which have also rules that, in addition to the above-mentioned legal fields, have also competition law rules that play an important role. Given the limited scope of this research, it is not possible to conduct a detailed analysis of the behavior of German economic agents vis-a-vis the Olson Problem in all areas of law that are relevant for the subsystem of corporate governance.

I focus, instead, on reforms and reform attempts in the German Stock Corporation Act between 1994 and 1997, which concentrates the most relevant set of rules for the corporate governance subsystem.³⁸³⁹

between business associations and political parties in Germany.

³⁶ According to the definition of Hall and Soskice (2001, p. 9), derived from North (1990, p. 3), institutions are "a set of rules, formal or informal, that actors generally follow, whether for normative, cognitive or material reasons."

³⁷ For more on this subject, see Hopt (1976) and (1977) as well as Grundmann (1990).

³⁸ Tietz-Weber has done an interesting and extensive research on the influence of economic actors in the implementation process of the 4th directive in the Bilanzrichtlinien-Gesetz through the compilation and

The corporate law reform that resulted in the German Stock Corporation Act (AktG) of 1965

The German Stock Corporation Act of 1965 (*Aktiengesetz*) was institutionalized in 1997 when the Neuer Markt was introduced and it is still the longest standing corporate law in Germany (Kropff 2007, p. 886). The German Stock Corporation Act of 1965 was the result of a comprehensive reform of the 1932 Stock Corporation Act, which began with an initiative of the German Minister of Justice MJ Neumayer for the "promotion of the capital markets and the wider dispersion of ownership of shares" in Germany.⁴⁰

Even though the current 1965 German Stock Corporation Act, when introduced, provided for a stronger influence of the general shareholders' meeting at the cost of the management, as well as stronger individual and minority shareholder protection and stricter disclosure rules when compared to the 1932 equivalent act, the German Stock Corporation Act had actually milder standards in these areas when compared to equivalent laws in

analysis of the different views expressed by the interest economic agents. The research of Tietz-Weber shows that entrepreneurial groups represented by the Umbrella Organisation of the German Economy, *Spitzenverbände der deutscher Wirtschaft*, massively mobilized against the accounting law reform and have been very successful in influencing the output of this reform (the *Spitzenverbänden der deutscher Wirtschaft* in a certain period, managed to have 42.6% of their claims attended). The Olson Problem in the case of the Accounting Directives Act was mitigated to a great extent, because when it came to the implementation of an EC Directive, only a few provisions of the German legislation at the national level could be changed. For more on the topic, see Tietz-Weber (2006).

³⁹ This work solely analyses laws whose proposal and discussions were a result of the German legislative system (*Gesetzgebung*), which excludes the analysis of the implementation of EU directives. However, the consequences of this exclusion to the output of this work should be very limited (if any) specially due to the fact that in the field of corporate law, the law of the European Union has had only a very limited impact on the German law within the 1945-1997 period. Only one guideline, adopted on 13 December 1976 (the so-called Capital Directive 77/91 / EEC), was implemented in the area of the German corporate law. The impacts of this directive were very limited on one hand because the directive was heavily influenced by the German trade law doctrine and therefore the basic principles of AktGs in 1965 have not been changed, on the other hand, because the mechanisms that have been changed by the capital directive, are not particularly relevant in the context of this work. This does not apply to the areas of the stock exchanges and securities law, which were heavily influenced by European legislation, particularly from 1994 onwards, and which resonance can be felt in the area of corporate law.

⁴⁰ See Kropff 2007, p. 701.

France, England and the United States. This fact was already known and had been alerted by Ernst Geßler, the spiritual father of the law, during the course of the legislative process which culminated with the German Stock Corporation Act.⁴¹

The acuteness of the Olson Problem in the context of this corporate law reform becomes apparent by an analysis of the individual reform proposals and the open statements presented by the "Leading Associations of Trade and Industry" (*Spitzenverbände der gewerblichen Wirtschaft*, hereinafter "Leading Associations of German Industry"), an influential coalition of Germany's leading business associations (i.e. the BDI, the BDA, the DIHK and the BvPB, this last one the general association of the insurance industry, *Gesamtverband der Versicherungswirtschaft*) which also included individual companies, especially the *Rhenish-Westphalian Electricitätswerk AG - RWE*),

Together with parliamentary representatives, the Leading Associations of the German Industry very strongly opposed many points of the reform that would constrain corporate law mechanisms that allowed these companies to coordinate their long-term cooperative relations and the private exchange of information. The fierce opposition of this powerful group highly influenced the output of this reform in key aspects. Kropff, who was itself a co-author of the speakers draft (*Referentenentwurfes*) of the German Stock Corporation Act, recognized that "among the comments received [...] the associations comments had a particular weight" (Kropff 2007, p. 744).

The German Federal Ministry of Justice issued on 15 July 1958 a list of 10 main topics that should be regulated by the draft bill and dealt with by the reform commission and throughout the legislative process. Among those principles were the custodian voting rights (*Depotstimmrechten*), the right to vote, the publicity of the corporation, the strengthening of the right to information of the shareholders, the treatment of mutual participation (cross-shareholdings) and the abolition of multiple voting rights shares (see Kropff 2007, p. 738-744).

These main topics "reached and alarmed" the Leading Associations of the German Industry and on 5 September 1958 Fritz Berg, the first president of the BDI, personally wrote a letter to German Chancellor Konrad Adenauer and told him that the German industry had two particular and important concerns in

⁴¹ On that occasion the German Federal Ministry of Justice conducted a research on the existing legislation, as well as planned reforms, regarding disclosure requirements in France and England and also requested comprehensive information and material of the United States Securities and Exchange Commission on the subject. Gessler used this information in the defense of the bill, but was not always successful (Kropff 2007, p 809 et seq.). For more on the content of these research in Flume in Barz et al. (1962, p 181 et seq.).

relation to the list of main points to be addressed by the bill: the "statutory extension of publicity" and "the plans to completely restructure the right of stock corporations" (see Kropff, p. 739). In view of these concerns, Berg urged German Chancellor Konrad Adenauer that it was "absolutely not urgent to threat this bill in an accelerated manner" (see Kropff, p. 739).

At the beginning of the drafting process, the Leading Associations of the German Industry did not even comment on the political necessity of this reform but in 1960 as the first draft of the German Stock Corporation Act had been released proposing critical modifications to important mechanisms for its coordination efforts (such as the abolition of the multiple voting rights shares, the modification of the regime of the custodian voting rights and the increase of publicity provisions for stock corporations⁴²) the Leading Associations of the German Industry publicly and "decidedly rejected the guiding principles and the solutions proposed by the draft bill" (Kropff 2007, p. 744). The Leading Associations of the German Industry claimed that the draft bill presented "very serious approaches that would cause profound disturbances in the economic life and a modification of the economic order" (Kropff, p. 745). In addition to the decisive rejection of each point of the reform and a series of criticisms to specific provisions of the draft bill, the associations defended that minority rights "should only be exercisable due to the holding, by a shareholder, of a certain percentage of the corporate capital and not due to the holding of an absolute nominal amount" (Kropff 2007 p. 745).

The manifestations of opinion of the associations were also not unusually presented to the reform commission in the form of closed brochures and sometimes in the form of working papers, which were made available to the members of the reform commission and often became the focus of deliberations and debates (Kropff 2007, p. 749). These working papers "presented essentially unchanged positions of the business associations and many wishes for amendments, which were mostly very detailed and decisive" (Kropff 2007, p. 749).

As mentioned above, this coordinated engagement of the business associations influenced many aspects of the 1965 German Stock Corporation Act. This was the case, for example, of the multiple voting rights shares (*Mehrstimmrechtsaktien*). The abolition of multiple voting rights per share was one of the main objectives of the corporate reform of 1965 and already appeared within the 10 main topics of 1958 (Kropff 2007, p. 738), being certainly one of the most critical ones. During the meetings of the reform commission, the abolition of multiple voting rights shares encountered, however, a tremendous resistance, not only from the business sector, but also

from the public sector (public utility companies exerted tremendous pressure over parliamentarians in order to preserve the multiple voting rights shares) and at the end, the possibility of issuance of multiple voting rights shares was preserved.⁴³

The arguments for the preservation of the multiple voting rights shares were of various kinds, such as that major shareholders, including municipalities that were shareholders of public utilities companies would lose their significant influence in favor of private investors and that the multiple voting rights shares would be important mechanisms for defending them against "unwanted foreign infiltration" see Kropff 2007 p. 793). Consequently, certain companies should have the right to issue multiple voting rights shares at least in exceptional cases.

After long discussions and the lack of alternatives acceptable to the leading associations, the abolition of the multiple voting rights shares failed and this was primarily achieved by means of the active engagement of the Rhenish-Westphalian Electricitätswerk AG ("RWE") and other stakeholders of the energy sector and family companies, represented by Fritz Burgbacher, senator of the Cristian Democratic Union Party (CDU) (Kropff 2007, p. 794) and previously CEO of the Guild Association of the City of Mainz and employee in other employers' associations in the German State of Nordrhein-Westfalen (see <http://www.h-na.de/ueber-uns/bekannt-mitglieder>).

Another issue which faced great resistance of the Leading Associations of the German Industry was the disclosure requirement in case of acquisition of cross-shareholdings in an amount larger than 10% of the companies' corporate capital, as well as to abolish voting rights of shares in the case of a cross-shareholdings in an amount higher than 10% (see Kropff 2007, p. 801). The objective of these proposals was to prevent the emergence new cross-shareholdings in amounts higher than 10%, as well as to revert the existing structures by limiting the exercise of voting rights under these circumstances. In addition, these proposals were also aimed at providing greater transparency to the dense network of cross-shareholdings existing in Germany, for each shareholder would be required to disclose a notice to the market as soon as the 10% threshold of cross-shareholding was achieved (see Kropff 2007, p. 801).

Although the 10% limitations applicable to cross-shareholdings was a reform particularly defended by Gessler and supported by extensive material and information from the United States Securities and Exchange Commission, as well as additional information on similar (and actually more

⁴² See Barz *et al.* (1962) for the discussions held at that time.

⁴³ Such as the powerful representative of Deutsche Bank that occupied the position of president of the Board of Directors of Rheinisch-Westfälischen Elektrizitätswerk AG (Kropff 2007, p. 738).

stringent) disclosure requirements existing in the United States, France and England, this reform encountered very sharp and decisive positions of the Leading Associations of the German Industry (Kropff 2007, p. 809).

The issue caused great controversy. The Leading Associations of the German Industry called the proposed disclosure requirement for cross-shareholding "a serious breach in the existing economic order" and "one of the provisions of the bill that will make the whole reform questionable and jeopardize the principles of our economic system" (Spitzenverbände, p. 11 and 41). Further concerns from the capital market perspective were also asserted: "[T]he proposed disclosure obligation harms, in the sharpest manner possible, the ability and willingness of the associations to be interested in the bill and is, to say the least, not compatible with one of the main objectives of the bill: more rights for shareholders" (Spitzenverbände, 1959: p. 42). In a 6-page document directed to the members of the German parliament the associations argued that the "interests in a definable public are not necessary to support reason for introducing such a more extensive notification obligations [...] It is difficult to see why a shareholder that benefits from the anonymity of the bearer share (*Inhaberaktie*), will hold equity interests of more than 25%" (Spitzenverbände, 1959: p. 42).

The justification of the Leading Associations of the German Industry was, however, not based in the argument that anonymity was a "foundation of the German economic order." An argument presented by the associations that convinced a majority of the members of the reform commission was that this kind of disclosure requirement would create great room for speculation, hence, making it difficult for example for efforts of financial institutions and controlling shareholders to reorganize and sanitize a company undergoing financial difficulties. The associations argued that, for example, once the information was disclosed to the market that a company was undergoing financial difficulties, the share price of such company would suffer with speculative movements and this would ultimately constrain the reorganization of the company (see *Spitzenverbände* 1959: p. 42). This argument clearly highlights the inclination of German economic agents in protecting institutions that allow them to preserve mechanisms that allow the coordination of efforts according to strategic cooperation principles at the cost of market-oriented coordination mechanisms (such as stringent disclosure requirements)⁴⁴.

The associations even defended along with a few politicians from the CDU and the Free Democratic Party of Germany (Germany's right wing party) for the complete abolition of every disclosure

requirements for individuals (private individuals would therefore not be required to disclose their equity interest in companies) and very limited disclosure requirements for companies, which did not include cross-shareholding disclosure (Kropff 2007, p. 800 et seq.).

On the other hand, other CDU/CSU members, members of the German Social Democratic Party (SPD), the Federal Ministry of Justice (especially Gessler) and legal specialists (especially Flume), defended not only the preservation in the draft bill of cross-shareholding disclosure requirements, but also that the rules presented were not sufficiently stringent especially when compared to France, England and the United States which already had stronger disclosure requirements at that time (Kropff 2007, p. 800 et seq.).

After bitter confrontation, Gessler managed to maintain the disclosure requirements in the draft bill, portraying this requirement as the "heart of the reform" but the threshold for disclosure was raised from 10% to 25% (Kropff 2007, pp 798-804), making the disclosure mechanism highly ineffective in light of missing complementary disclosure provisions.

The resistance of the associations proved therefore largely successful. Not only the threshold was raised to a 25% rate (instead of the initial rate of 10%), but the disclosure notice would only need to be directed to the relevant company (instead of the original proposal, which required the disclosure noticed to be published in newspapers and disclosed to the market as a whole) (Kropff 2007 p. 798-804). The same applies to the limitation of the exercise of voting rights in cross-shareholding, which would also only be applicable to cross-shareholdings in excess of 25% instead of the original proposal of 10% (Kropff 2007, p. 797-800).⁴⁵

This was a decisive defeat for the spiritual father of the 1965 German Stock Corporation Act and it certainly negatively affected the debate on more stringent and complementary regulation such as stricter provisions directed to family controlled companies, *Familienunternehmen*, which had been discussed in the *Frankfurter Publizitätsgespräch*.⁴⁶ An evidence to this was that Flume, one of the most impressive representatives to believe that that the proposed disclosure rules were actually still insufficient, later stated that he had become skeptical about the corporate reform after he noticed that even Gessler was already showing signs of doubt that the provisions applicable to affiliated companies would work (Frankfurter Publizitätsgespräch 1962: p. 183, 186 et seq.).

Other important provisions in the area of group companies law (*Konzernrecht*), especially regarding disclosure requirements, accounting law (particularly on the question of which corporate instance should be

⁴⁴ An insightful work which analyses different sets of relationships between institutions within a legal system is presented by Millhaupt and Pistor (2010).

⁴⁵ For a comprehensive analysis, see Adams (1999).

⁴⁶ See Barz *et al.* (1962, S. 183, 186 et seq.).

responsible for the balance sheet) and custodian voting rights (*Depotstimmrechten*) regarding limitations and more transparency applicable to the exercise of the custodian voting rights by banks) encountered very harsh criticism and opposition of the Leading Associations of the German Industry and were more or less made flexible in favor of the interest of these stakeholders.⁴⁷

Corporate law reforms between 1965 and 1994

Although a few reform initiatives and discussions took place, both in legal doctrine,⁴⁸ as well as in politics,⁴⁹ the 1965 German Stock Corporation Act remained more or less unchanged in its essence until 1994.⁵⁰

In this context in October 1971, the then Federal Minister of Justice Jähn, was authorized by the federal government to create an advisory committee of independent experts to study the problems of modern company law (Kübler 1981, p. 390). The commission was given the mandate to examine the legal issues necessary for the development of a new comprehensive corporate law and the focal points of the study should be the organization of companies, including the rights of owners and workers, the companies' group law and the transparency of businesses and corporations (Kübler 1981, p. 390). The establishment of the Corporate Law Commission (*Unternehmensrechtskommission*) just after six years of entry into force of the 1965 German Stock Corporation Act, which extensively reformed the German corporate law, evidences that the 1965 reform was insufficient and that its output was largely influenced by the Olson Problem, as mentioned above.

Within a period of more than five years (between May 1972 to November 1977), the commission had convened more than 27 working sessions in which presentations were held and working papers extensively discussed and prepared (Kübler 1981, p 390). On January 1979, the German Federal Ministry of Justice prepared a report consolidating the results of the commission, which

was approved in late 1979 by the commission members and published in 1980 by the Federal Minister of Justice Vogel (Bundesministerium der Justiz 1980, p.3 et seq.). Although the Company Law Commission was very active during 5 years, it was unable to create any concrete *Spitzenverbände* reform proposals,⁵¹ mainly due to the blocking role played by the within the commission.

A look at the list of participants in the commission makes it clear that not only the whole spectrum of political views, but also the most influential business associations were represented in the commission. A large part of members of the commission were therefore much more than representatives of organized interest groups, rather than independent experts and that alone provides evidence of the built of decision blockages that did not allow the commission to bring up almost no concrete reform proposal at the end of their work. As demonstrated by Olson, these organizations increase the complexity of the legal provisions and hinder the construction of political consensus (1982, p. 75). The associations acted as veto players in essential points of possible reforms such as discussions on increasing the publicity of publicly held companies and groups of companies, as well as the establishment of the co-determination system.⁵²

In this sense, Kübler also argued, that the abandonment of the vote on specific reform proposals by these stakeholders in the Company Law Commission was portrayed as a lesser evil, compared to the otherwise inevitable alternative which would be to subjugate the vote of the minorities to the vote of the majority of the powerful interest groups represented in the commission (Kübler 1981, p 392).

The Small Stock Corporation Reform (Kleine-AG-Reform)

After almost 30 years without a meaningful corporate law reform, the Law for Small Corporations and Deregulation of the Stock Corporation Law (*Gesetz für kleine Aktiengesellschaften und für Deregulierung des Aktienrechts*) ("Small-AG-reform") was promulgated on August 1994 and represented the first attempt to make the corporation (*Aktiengesellschaft* or simply "AG") attractive for small and medium-sized enterprises and thus make the capital market more accessible to these companies (Deutscher Bundestag, Drucksache 12/6721, 1994, 1 et seq.).⁵³ The legal and political concerns of the Small-AG-reform were therefore to improve the long standing

⁴⁷ See Kropff (2007, p. 798-855).

⁴⁸ See Wiedemann (1977), Hopt (1976) and (1977) as well as Semler, Hommelhoff, Doralt and Druey (1993) for a detailed presentation.

⁴⁹ As, for example, the *Unternehmensrechtskommission des Bundesministeriums der Justiz* (Company Law Commission of the Ministry of Justice) between 1971 and 1979 and the Stock Exchange Experts Commission (*Börsensachverständigenkommission*) between 1968 and 1975 from the German Ministry of Finance (Bundesministerium der Finanz).

⁵⁰ The exception is certainly the Codetermination Law (*Mitbestimmungsgesetz*) dated 04 May 1976, which, as explained above, will not be analysed by this work.

⁵¹ This becomes evident from the analysis of the report of the commission and was also noted by Kübler (1981, p. 391 and 392) and Brickwedde (in CSU 1978, p. 63).

⁵² See Bundesministerium der Justiz (1980) for an overview of the results of the company law commission (*Unternehmensrechtskommission*).

⁵³ For a comprehensive analysis, see Bartone (2002).

inadequate equity base of the small and medium sized companies in Germany, the so-called *Mittelstand*) (Deutscher Bundestag, Gesetzentwurf der Fraktionen der CDU/CSU und F.D.P., *Entwurf eines Gesetzes für kleine Aktiengesellschaften und zur Deregulierung des Aktienrechts*, 01.02.1994, p. 1 et seq.).

In the small-AG-reform, certain procedural requirements of the AG have been simplified. The establishment of the corporation by one person (*Einpersonengründung*, according to § 2 AktG) was allowed, the authentication of shareholder resolutions in non-listed companies simplified (according to § 130 Abs. 1, S. 3 AktG) the possibility to convene the general meeting by registered letter (if the shareholders are known pursuant to § 186, Abs. 3, S. 4), and newly established stock corporations, which did not have the character of a family business and have no more than 500 employees, were not subject to the codetermination system (*Mitbestimmung*). This made the AG and the GmbH equivalent for purposes of codetermination. (see Bartone 2002 and Habersack and Schürnbrand 2007, p. 896).

For publicly held Small AGs, other simplified mechanisms have been introduced, such as the flexibility for exclusion of subscription rights, especially under § 186 Abs. 3 S. 4) or for capital increases paid in cash, if they do not exceed 10 percent of the share capital and the issue price is not significantly different from market price (see Bartone 2002 and Habersack and Schürnbrand 2007, p. 896).

The small-AG-reform, however, did not reform institutions of the German corporate law, which were essential for the coordination requirement of companies, controlling owners and managers in the context of the German CME, such as cross-shareholdings, custodian voting rights, low disclosure requirements, ownership concentration, etc.) and the advantages of the Small AG were also limited to those companies which had a "manageable group of shareholders" (e.g. family companies with few family shareholders) (Deutscher Bundestag 1994a, p. 8-9). This certainly explains to a large extent, why the Small-AG-reform has not raised great resistance of the leading associations.

In short, only a few suggestions have been presented to the German Bundestag for the draft Small AG bill after the hearing on 20 April 1994 (a hearing in which the BDI, the BDA, the DGB, IG Metall were present)⁵⁴ and the Legal Affairs Committee of the Bundestag unanimously recommended the adoption of the bill with the comment that the reform represented a lively and positive response from the small and medium-sized enterprises sector, their consultants and the business

associations to long standing questions (Deutscher Bundestag 1994b).⁵⁵

5 The failure of the *Neuer Markt* as a Regulatory Dualism experience and the proposition of a new definition to Olson Problem from a VoC perspective

As mentioned above, Gilson, Hansmann and Pargendler correctly indicate the existence of an Olson Problem within the German capital markets, and present the *Neuer Markt* as a Regulatory Dualism solution to such Olson Problem. When addressing the main factors which led to the failure of the *Neuer Markt*, however, Gilson, Hansmann and Pargendler fail to analyze a few fundamental characteristics of the German economy which have played a far more important role in undermining the *Neuer Markt* than the legal and reputational reasons indicated by Gilson, Hansmann and Pargendler⁵⁶.

Gilson, Hansmann and Pargendler underscore, for example, the difficulty of the Deutsche Börse to unilaterally modify the rules of the *Neuer Markt* in a crisis scenario (due to the contractual nature of the relationship between Deutsche Börse and the participants of the *Neuer Markt*), as well as mild and rarely enforced penalties against market rule violations, as two of the main reasons for the failure of the *Neuer Markt* (Gilson, Hansmann and Pargendler, p. 504-507 and p. 528-531).

⁵⁵ The same applies to the Committee on the Economy (Ausschuss für Wirtschaft) and the Committee on Labour and Social Affairs (Ausschuss für Arbeit und Sozialordnung), which recommended the submission of the bill to the Bundestag (in their respective meetings held on 13 April 1994 and 25 May 1994). The SPD group members have abstained from voting in these committees "because of open questions in codetermination." However, they emphasized that they in principle welcomed the bill, and only because of opened codetermination questions they would not vote (Deutscher Bundestag, 1994b).

⁵⁶ Supported by the "Agency Theory" of La Porta et al. (2000), Gilson, Hansmann and Pargendler affirm that the inability of the Deutsche Börse to unilaterally modify the rules of the *Neuer Markt* in a crisis situation (due to an alleged contractual nature of the relationship between Deutsche Börse and the participants of the *Neuer Markt*) and that mild and rarely enforced penalties for violations of the *Neuer Markt* regulation by the issuers, were two of the main reasons for the failure of the *Neuer Markt* (Gilson, Hansmann and Pargendler 2007, pp 504-507 and 528-531). The third argument of Gilson, Hansmann and Pargendler for failure of the new market is mainly related to the side effects of the collapse of the Nasdaq bubble because of the focus of the *Neuer Markt* in "high tech companies" (Gilson, Hansmann and Pargendler, p. 529), consequently implying that the *Neuer Markt* was effectively capable of producing high-innovative and high-tech firms similar to the firms listed in the Nasdaq Stock Exchange.

⁵⁴ These hearings had the influential participation of Prof. Dr Dr. Lutter, Dr. Schmidt and Dr. Hoffman-Becking.

However, Gilson, Hansmann and Pargendler's alleged obstacle regarding problems of the Deutsche Börse in unilaterally modifying the *Neuer Markt* regulation was to a large extent only theoretical and certainly contributed very little, if at all, to the failure of the *Neuer Markt*. Although the rules of the *Neuer Markt* had indeed the legal nature of a private law obligation (*privatrechtlichen Schuldverhältniss*) between Deutsche Börse and the issuers as argued by Gilson, Hansmann and Pargendler, the Deutsche Börse had, under general terms and conditions of business (*Allgemeinen Geschäftsbedingungen*) under § 305 of the BGB (the German Civil Code), a possibility of unilaterally modifying the regulation of the *Neuer Markt* and afterwards notifying the issuers by means of a notice of amendment offering the issuer to enter into a new version of the service agreement under a revised set of rules for the *Neuer Markt* (*Angebot zur Fortsetzung des Dienstleistungsvertrages*) (see Neubauer 2002, pp 108-162). Should any of the issuers decline the Deutsche Börse's offering to continue the service agreement under the amended *Neuer Markt* rules, or remain silent during the period of validity of the offering, the obligation relationship between the Deutsche Börse and the issuer would be terminated by means of a termination amendment (*Änderungskündigung*) and the shares of such issuer would have to be delisted from the *Neuer Markt* (Neubauer 2002, pp 129-138). The day-to-day reality of listed companies show that a motivated and legally sustained threaten by the regulator or the stock exchange to delist an issuer's shares certainly exerts a considerable amount of pressure over the issuer and its controlling owners and is to some extent capable *per se* of acting as a preventive measure to adjust conduct. In addition, as acknowledge by Gilson, Hansmann and Pargendler, the *Neuer Markt* firms have not opposed or blocked reforms in the segment and in fact already during the first corporate scandals in the *Neuer Markt* most issuers rather pressured Deutsche Börse to implement reforms and tighten the rules in the segment (see Boudette and Kueppers 2001).

In this context, a strong evidence against Gilson, Hansmann and Pargendler's arguments that "revising the listing standards to address new circumstances also proved to be problematic"⁵⁷ (and that this was one of the main reasons that contributed to the failure of the *Neuer Markt*) is presented by the fact that between October 2000 and July 2001, the *Neuer Markt* regulation was changed three times at a critical moment at the start of the *Neuer Markt* crisis and that these changes included raises in the fines imposed in case of violation of the *Neuer Markt* regulation from 10,000 to 100,000 Euros, as well as the introduction of stricter reporting requirements for the purchase and sale of shares by members of the management bodies

⁵⁷ See Gilson, Hansmann and Pargendler, p. 504-507.

of listed enterprises (see Deutsche Börse 2001a, 2001b and 2001d) and also stricter interpretation rules regarding the notification requirements of the *Neuer Markt* (see Deutsche Börse 2001c)⁵⁸.

Gilson, Hansmann and Pargendler's explanation for the failure of the *Neuer Markt* seem to imply the "theorem" so criticized by Milhaupts and Pistor (which was widely reproduced by transition economies during the 90's largely as a result of pressures from the World Bank and the International Monetary Fund):

"Good law + good enforcement = good economic outputs"⁵⁹

Even though the *Neuer Markt* created a stronger investor protection system, which led to capital market growth and provided an inflow of risk capital to small and medium-sized enterprises in the first moment, the German economy has not been reformed in the complementary subsystems of the labor market and in other elements of the subsystem of corporate governance (see specially Vitols and Engelhardt 2005, p 2).

Successful companies need both capital and experienced managers and scientists who are willing to take on more risks in search of higher returns (Vitols and Engelhardt 2005, p 2). Regarding the subsystem of the labor market in Germany, it lacked a mobile labor market for mid-career scientists and entrepreneurs, which is fundamental for the creation of successful high-growth companies (see Vitols and Engelhardt 2005, p 2). As a result, no company of the *Neuer Markt* has managed to develop "Blockbuster"/disruptive products that would have provided a large volume of sales and permit rapid company growth (see Vitols and Engelhardt 2005, p 2).

As for the other elements of the corporate governance subsystem, those also remained underdeveloped in Germany even with the creation of the *Neuer Markt*. Pension funds, for example, which are the main source of national investment in capital markets of LMEs, for example, remained highly underdeveloped in Germany and stayed in the shadow of the statutory insurance and pension system (see Vitols and Engelhardt 2005, p 2). This highly and negatively impacted sustainable high growth of the *Neuer Markt* firms during the last years of the *Neuer Markt* since the provision of risk capital at its

⁵⁸ For a detailed and comprehensive analysis of the rules and regulations of the *Neuer Markt* seen as general terms and conditions of business (*Allgemeine Geschäftsbedingungen*) under German private law see especially Neubauer (2002) and also in this sense the decision of the Frankfurt State Court LG Frankfurt/Main, „Penny-Stock“-Entscheidung of 16 August 2001 – 3-13 O 110/01 (available in <http://dejure.org/dienste/vernetzung/rechtsprechung?Gericht=LG%20Frankfurt/Main&Datum=16.08.2001&Aktenszeichen=13%20O%20110/01>).

⁵⁹ Milhaupt and Pistor (2010), p. 5.

beginning was mainly made possible in general due to the global Internet euphoria towards the end of the 1990s (see Vitols and Engelhardt 2005, p. 2).

At the end, although the *Neuer Markt* was capable of channeling a considerable amount of risk capital towards new firms and the legal framework of the *Neuer Markt* aimed at increasing the transparency standard for businesses, *Neuer Markt* firms were not capable of reproducing the classic Nasdaq model of growth companies and remained organized and managed according to the traditional German model of „Herrn im Haus“ widely disseminated within the German medium-sized sector (*Mittelstand*). The *Neuer Markt* companies also specialized much more on service-intensive IT or software services and not on high-tech technologies. Companies which offered standardized software, with little or no service personalization, were the majority of the companies in the *Neuer Markt* and all of them performed relatively poorly in comparison to their Nasdaq counterparts⁶⁰. The VoC approach demonstrates that the creation of highly innovative firms in sectors such as telecommunications, information technology, semiconductor technology and biotechnology (i.e. the sectors of the Nasdaq model firms) are a result of the interaction (or complementarity) of different institutions in different subsystems that highly vary from country to country (see Soskice 1999 p. 206 and Vitols and Engelhardt 2005, p. 3). The financial system and the investors protection systems are therefore only two parts in a broad context of institutions and subsystems, whose sum is greater than the mere addition (see Fioretos 2001, p. 219).

In other words, the main reason for the failure of the *Neuer Markt* was the difficulty of individual institutional elements of an LME as the United States to be transplanted to a CME like Germany without performing appropriate reforms in the complementary subsystems of the economy (Vitols and Engelhardt 2005, p 2). That is, reforms in the area of investor protection, which transplant LME-similar mechanisms to CMEs such as Germany, are not always alone capable of promoting economic growth in high-tech industries and can even lead to an institutional *disequilibrium*, causing negative impacts in the economy as a whole⁶¹. This, far more than a weakness in the rules of the *Neuer Markt* ("bad law" and "bad enforcement"), as claimed by Gilson, Hansmann and Pargendler was the decisive factor for the failure of the *Neuer Markt*.

However, this does not necessarily lead to an invalidation of the hypothesis of Regulatory Dualism as a useful instrument for institutional reform, but assumes that reforms under the Regulatory Dualism concept also need to, at least partially, be extended to

other complementary sub-systems and institutions of a market economy. In the case of the *Neuer Markt*, for example, this could mean the deregulation of labor markets (or the introduction of forms of deregulated labour contracts) or the creation of incentives to the development of a parallel private pension system, which allows a sustainable inflow of resources to the capital markets.

In view of the above, this study proposes a new definition for the Olson Problem according to the VoC approach. The Olson Problem should, in this author's view, be defined as "the resistance of economic actors against reforms that affect their interest in the preservation of a particular institutional framework" instead of Gilson, Hansmann and Pargendler's proposed definition as "the opposition of the established economic and political elite to growth-promoting reforms"⁶². Naming this problem after Mancur Olson does not lose significance by this proposed change simply because many of Olson's concepts, such as the concept of "selective interests", are still helpful to the VoC analysis to describe and understand the power balance within economies and large union-related interest groups (such as the BDI in Germany).

6 Conclusion

After an analysis of the German market economy and especially the German sub-system of corporate governance based on a VoC approach, this work has explored a set of legal mechanisms in the German institutional framework, such as custodian voting rights, milder transparency provisions, cross-shareholdings and the issuance of multiple voting rights shares, which could be considered as key mechanisms for the organization of economic actors in the German CME according to the organizing principle of strategic cooperation. In order to reconcile the definition of Olson Problem with the VoC approach, this work further proposed a new definition to the Olson Problem that differs from the one proposed by Gilson, Hansmann and Pargendler, in view of the resistance of economic actors against reforms that affect their interest in the preservation of a particular institutional framework.

This work has also identified the economic agents that would have an interest in the preservation of this institutional framework as possible protagonists of the Olson Problem. These economic agents would be not only the majority shareholders of German enterprises in established industrial sectors, but also strategic minority shareholders who participated in the extensive network of cross-shareholdings in the German capital market. Financial institutions, both as creditors, as well as strategic shareholders and managers of companies that are actively engaged in the network of cross-

⁶⁰ More on this, see Engelhardt (2004), Engelhardt and Vitols (2005) and Vitols (2001).

⁶¹ See Soskice (1999) as well as Vitols and Engelhardt (2005).

⁶² Gilson, Hansmann and Pargendler 2007, p. 478.

personnel integration would also be part of this group of protagonists of the Olson Problem in Germany.

Given the complementarity between the German Corporate Governance subsystem and the subsystem of German industrial relations,⁶³ these interested economic agents should be associated with established technology sectors, related to mechanical engineering and the chemical industry. After an analysis of the presidents of Germany's most impacting business association, the BDI, all of its presidents between 1951 (BDI's foundation date) and 1997 (the birth of the *Neuer Markt*) were in fact either simultaneously holding seats in management bodies of companies or other sectorial associations from established technology sectors, or they were only acting as President of the BDI but came precisely from leadership positions in other organizations or companies of these established technology sectors (see Appendix A for a summary of the data on the Presidents of the BDIs between the period of 1951 and 1997).

This study has then examined the legal reforms and reform initiatives in the case of Company Law Commission within German corporate law from 1945 to 1997 to investigate the behavior of these economic agents represented by business organizations in law reform scenarios and confirmed Gilson, Hans's and Pargendler's hypothesis of the existence of an acute Olson Problem based on the study's revised definition proposed here, in the German capital markets, which contained the passing of legal reforms in the field of corporate law between 1945 and 1997.

In contrast, the corporate law reforms faced no resistance of these interest groups whenever they preserved the original institutional framework and only created a parallel regime, as in the case of Small-AG-Reform, which could also be understood as an example of Regulatory Dualism. This also confirms Gilson, Hansmann and Pargendler's Regulatory Dualism model as a suitable mean to circumvent the Olson Problem.

Finally, by analyzing the *Neuer Markt* through a VoC approach and establishing the real determining factors that led to the ultimate failure of the *Neuer Markt*, this work concludes that a Regulatory Dualism reform has more chance of succeeding in case the reform approach takes into consideration the complementarities between the different subsystems of a certain market economy. For this purpose, Regulatory Dualism reforms shall be ideally implemented simultaneously in complementary subsystems in order to maximize its outputs and chances of success.

Acknowledgement

This paper was the result of a research conducted at the Faculty of Law of the Ludwig-Maximilians

University of Munich (LMU) between 03.2011-03.2012. I am profoundly thankful to Dr. Stephan Morsch LL.M for all the support provided by Linklaters LLP during my stay in Munich and for ensuring me an always-available workplace at Linklaters private equity team. I am also especially thankful to Dr. Tobias Bürgers for the many stimulating and valuable discussions during his lectures on Corporate Finance (*Unternehmensfinanzierung*) at the University of Munich and to Professor Dr. Lars Klöhn LL.M. (Harvard), my advisor (*Betreuer*) during the LL.M Program in Munich. My special thanks also to Professor Dr. Erasmo Valladão Azevedo e Novaes França, from the University of São Paulo, for continuously and enthusiastically encouraging me to engage into the study of the German corporate law. Finally I am also thankful to Professor Dr. Mariana Pargendler, who made herself available from the beginning of the research that culminated in this paper (which sits in direct dialogue with her influential paper on Olson Problem and Regulatory Dualism). Errors in this paper, however, are of my own making.

References

1. Adams, Michael. 1999. 'Cross Holdings in Germany' In Journal of Theoretical Economics (JITE), Volume 155, Mohr Siebeck GmbH & Co. KG,
2. _____. 1993. Macht von Banken und Versicherungen – Wettbewerb im Finanzdienstleistungssektor. 8. Dezember 1993 Deutscher Bundestag. Ausschuss für Wirtschaft. Stellungnahme. Available at: <http://www.wiso.uni-hamburg.de/fileadmin/bwl/rechtderwirtschaft/institut/Veroeffentlichungen/banken.PDF>
3. Bartone, Roberto. 2002. *Die kleine Aktiengesellschaft*. Bielefeld: Erich Schmidt Verlag.
4. BARZ, CARL HANS et al. 1962. *Das Frankfurter Publizitätsgespräch: Vorträge und Diskussionen der gleichnamigen Tagung in Königstein/Ts am 13. Und 14. April 1962*. Frankfurt am Main: Fritz Knapp Verlag.
5. Baums, Theodor / Fraune, Christian. 1994. *Institutionelle Anleger und Publikumsgesellschaft: Eine empirische Untersuchung*. Arbeitspapier 6/94. Available at: <http://www.jura.uni-frankfurt.de/43029219/paper20.pdf>
6. Bayer, Walter / Habersack, Mathias (Hrsg.) 2007. *Aktienrecht im Wandel. Band I: Entwicklung des Aktienrechts*. Tübingen: Mohr Siebeck GmbH & Co. KG.
7. Becht, Marco / Boehmer, Ekkehart. 1999. *Transparency of Ownership and Control in Germany*. European Corporate Governance Network. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=149774
8. Beckert, Jens / Ebbinghaus, Bernhard / Hassel, Anke / Manow, Philip (Hrsg.). 2006. *Transformation des Kapitalismus*. Frankfurt am Main: Campus Verlag.
9. Boudette, Neal E. / Kueppers, Alfred. 2001. *Neuer Markt Faces Mounting Pressure from Members to Tighten Listing Rules* in The Wall Street Journal, 11.

⁶³ See Soskice (1999) and Höpner (2005).

- July 2001, C12. Available at: <http://www.marketwatch.com/story/firms-want-exchange-to-tighten-rules-2001-07-11>
10. Bremer, Heinz. 1976. *Die Börsensachverständigenkommission*. Berlin and New York: Walter de Gruyter.
 11. Bundesministerium Der Justiz 1980. *Bericht über die Verhandlungen der Unternehmensrechtskommission*. Köln: Verlag Dr. Otto Schmidt.
 12. Clemens Von Frentz. 2003. *Die Chronik einer Kapitalvernichtung* in Manager Magazin Online, 1. June 2003, Available at <http://www.managermagazin.de/finanzen/artikel/0,2828,186368-2,00.html>
 13. Christliche Demokratische Union (CDU) (Hrsg.). 1978. *Protokoll des 26. Bundesparteitages am Ludwigshafen 23.-25.Oktober 1978*. Bonn: Konrad-Adenauer-Haus. Available at: http://www.kas.de/upload/ACDP/CDU/Protokolle_Bundesparteitage/1978-10-23-25_Protokoll_26.Bundesparteitag_Ludwigshafen.pdf
 14. Deutsche Börse. 2001a. *Rundschreiben Listing 02/2001 vom 13. Februar 2001*. Available at: <http://www10.deutsche-boerse.com/INTERNET/EXCHANGE/zpd.nsf/Web+Publikationen/HAMN-52XKB9?OpenDocument>
 15. _____ 2001b. *Rundschreiben Listing 04/2001 vom 21. Mai 2001*. Available at: [http://www10.deutsche-boerse.com/INTERNET/EXCHANGE/zpd.nsf/PublikationenID/HAMN-52XHXP/\\$FILE/2001-04+rs-jblb_1.pdf?OpenElement](http://www10.deutsche-boerse.com/INTERNET/EXCHANGE/zpd.nsf/PublikationenID/HAMN-52XHXP/$FILE/2001-04+rs-jblb_1.pdf?OpenElement)
 16. _____ 2001c. *Rundschreiben Listing 07/2001 vom 21. Mai 2001*. Available at: [http://www10.deutsche-boerse.com/INTERNET/EXCHANGE/zpd.nsf/PublikationenID/HAMN-52XJ9D/\\$FILE/2001-07+rs-rw%C3%A4nderung.pdf?OpenElement](http://www10.deutsche-boerse.com/INTERNET/EXCHANGE/zpd.nsf/PublikationenID/HAMN-52XJ9D/$FILE/2001-07+rs-rw%C3%A4nderung.pdf?OpenElement)
 17. _____ 2001d. *Rundschreiben Listing 06/2001 vom 6. April 2001*. Available at [http://www10.deutsche-boerse.com/INTERNET/EXCHANGE/zpd.nsf/PublikationenID/HAMN-52XJ89/\\$FILE/2001-09-04-rw%C3%A4nderung.pdf?OpenElement](http://www10.deutsche-boerse.com/INTERNET/EXCHANGE/zpd.nsf/PublikationenID/HAMN-52XJ89/$FILE/2001-09-04-rw%C3%A4nderung.pdf?OpenElement)
 18. Deutscher Bundestag. 1994a. *Entwurf eines Gesetzes für kleine Aktiengesellschaften und zur Deregulierung des Aktienrechts: Gesetzentwurf der Fraktionen der CDU/CSU und F.D.P. Drucksache 12/6721 vom 1. Februar 1994 (12. Wahlperiode)*. Available at: <http://dipbt.bundestag.de/doc/btd/12/067/1206721.pdf>
 19. _____. 1994b. *Beschlussempfehlung und Bericht des Rechtsausschusses (6. Ausschuss) zu dem Gesetzentwurf der Fraktionen der CDU/CSU und F.D.P. Drucksache 12/7848 vom 13. Juni 1994*. Available at: <http://dip21.bundestag.de/dip21/btd/12/078/1207848.pdf>
 20. Engelhardt, Lutz. 2004. *Entrepreneurial Business Models in the German Software Industry: Companies, Venture Capital, and Stock Market Based Growth Strategies on the 'Neuer Markt'*. Discussion Paper SP II 2004 – 04, Wissenschaftszentrum Berlin. Available at: <http://skylla.wz-berlin.de/pdf/2004/ii04-04.pdf>
 21. Fioretos, Orfeu. 2001. 'The Domestic Sources of Multilateral Preferences: Varieties of Capitalism in the European Community' in Hall und Soskice (2001), p. 213 – 246.
 22. Gilson, Ronald J. / Hansmann, Henry / Mariana Pargendler. 2011., *Regulatory Dualism as a Development Strategy: Corporate Reform in Brazil, the United States and the European Union* in Stanford Law Review, Volume 63, p. 475 – 538.
 23. Grundmann, Stefan. 1990., *Deutsches Anlegerschutzrecht in internationalen Sachverhalten: Vom internationalen Schuld- und Gesellschaftsrecht zum internationalen Marktrecht* in *Rabels Zeitschrift für ausländisches und internationales Privatrecht*, 54. Jahrg., H. 2 (1990), Mohr Siebeck GmbH & Co. KG, p. 283-322.
 24. Haacke, Eva. 2006. *Wirtschaftsverbände als klassische Lobbyisten – auf neuen Pfaden* in *Leif und Rudolf (2006)*, p. 168 – 187.
 25. HABERSACK, MATHIAS / SCHÜRNBAND, JAN. 2007. *Modernisierung des Aktiengesetzes von 1965* in *Beyer und Habersack (2007)*, p. 889 – 943.
 26. Hall, Peter A. / Soskice, David (Hrsg.). 2001. *Varieties of Capitalism: The institutional Foundations of Comparative Advantage*. New York: Oxford University Press.
 27. Hall, Peter A. 2006. *Stabilität und Wandel in den Spielarten von Kapitalismus* in *Transformation des Kapitalismus*, Frankfurt am Main: Campus Verlag, p. 181-204.
 28. Hassel, Anke / Trampusch, Christine. 2006., *Verbände und Parteien: Die Dynamik von Parteikonflikten und die Erosion des Korporatismus* in *Transformation des Kapitalismus*, Frankfurt am Main: Campus Verlag, p. 111-132.
 29. Hommelhof, Peter. 1993. *„Jetzt die „Kleine“ und dann noch eine „AnlegerAG“* in Semler, Hommelhof, Doralt und Druey (1993), p. 65 – 84.
 30. HÖPNER, MARTIN. 2005. "What connects industrial relations and corporate governance? Explaining institutional complementarity" in *Socio-Economic Review*, Ausgabe 3, 2005, p. 331-358.
 31. _____ / Jackson, Gregory. 2003. *Entsteht ein Markt für Unternehmenskontrolle? Der Fall Mannesmann* in *Streeck und Höpner (2003)*, p. 147 – 168.
 32. _____. 2007. *Corporate Governance Reform and the German Party Paradox* in *Comparative Politics*, Band 39, Ausgabe 4, p. 401-420.
 33. Hopt, Klaus J. 1976. *Vom Aktien- und Börsenrecht zum Kapitalmarktrecht? Teil 1: Der international erreichte Stand des Kapitalmarktrechts* in *Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht – ZHR*, 140 (1976), p. 201-235.
 34. _____. 1977., *Vom Aktien- und Börsenrecht zum Kapitalmarktrecht? Teil 2: Die deutsche Entwicklung im internationalen Vergleich* in *Zeitschrift für das gesamte Handelsrecht und Wirtschaftsrecht - ZHR*, 141 (1977), p. 389-441.
 35. Ipsen, Dirk / Pfitzinger, Jens. 2003. *Krise in der Deutschland AG: Der Fall AEG* in *Streeck und Höpner (2003)*, p. 60 – 92.
 36. Kogut, Bruce / Walker, Gordon. 2001. *The Small World of Germany and the Durability of National Networks* in *American Sociological Review*, Volume 66, June 2001, p. 317 -335.
 37. Kropff, Bruno. 1993: *Zur Vinkulierung zum Vollmachtsstimmrecht und zur Unternehmensaufsicht im deutschen Recht* in *Semler, Hommelhof, Doralt und Druey (1993)*, p. 3 – 24.
 38. _____. 2007., *Reformbestrebungen im Nachkriegsdeutschland und die Aktienrechtsreform von 1965* in *Bayer und Habersack (2007)*, p. 670 –

- 888.
39. Kübler, Friedrich. 1981., *Unternehmensorganisation zwischen Sachverstand und Interessenpolitik: Bemerkungen zum Bericht über die Verhandlungen der Unternehmensrechtskommission* in *Zeitschrift für Unternehmens- und Gesellschaftsrecht – ZGR* Band 10, Ausgabe 3, January 1981, p. 377 - 392.
40. La Porta, Rafael / Lopez-De-Silanes, Florencio / Shleifer, Andrei / Vishny, Robert. 2000. 'Investor protection and corporate Governance' in *Journal of Financial Economics*, Volume 58, p. 3-27.
41. La Torre, Massimo. 2010. *Law as Institution*. Heidelberg, London and New York: Springer.
42. Leif, Thomas / Speth, Rudolf (Hrsg.).2006. *Die fünfte Gewalt: Lobbyismus in Deutschland*. Wiesbaden: VS Verlag für Sozialwissenschaften.
43. Luhmann, Niklas. 2011. *Einführung in die Systemtheorie*. 6th Edition, Carl-Auer Verlag: Heidelberg.
44. _____. 2012. *Macht im System*. Suhrkamp Verlag: Berlin.
45. Mayntz, Renate. 2006. 'Systemkohärenz, institutionelle Komplementarität und institutioneller Wandel, in *Transformation des Kapitalismus*, Frankfurt am Main: Campus Verlag, p. 381-397.
46. Millhaupt, Curtis J. / Pistor, Katharina. 2010. *Law and Capitalism: What Corporate Crisis reveal about legal systems and economic development around the world*. Chicago and London: The University of Chicago Press.
47. Neubarer, Sven. 2002. *Zulässigkeit und Grenzen der einseitigen Änderung des Regelwerks Neuer Markt durch die Deutsche Börse AG*. Manuscript available in the Library of the Ludwig-Maximilians-University of Munich (UMA 71127).
48. Olson, Mancur. 1982. *The Rise and Decline of Nations: Economic Growth, Stagflation and Social Rigidities*. New Haven and London: Yale University Press.
49. _____. 1971. *The Logic of Collective Action: Public Goods and the Theory of Groups*. 2nd Edition. Boston: Harvard University Press.
50. Schmidt, Karsten. 2002. *Gesellschaftsrecht*. 4. Auflage. Köln, Berlin, Bonn und München: Carl Heymanns Verlag.
51. Schroeder, Wolfgang. 2003. 'Lobby Pur: Unternehmensverbände als klassische Interessenvertreter' in LEIF, THOMAS / RUDOLF, THOMAS, *Die Stille Macht*, Wiesbaden.
52. Semler, Johannes / Hommelhof, Peter / Doralt, Peter / Druey, Jean Nicolas; 1993. 'Reform Bedarf im Aktienrecht: 4. Deutsch-Österreichisches Symposium zum Gesellschaftsrecht vom 22. und 23. Oktober 1993 auf dem Lämmerbrüchel' in *Zeitschrift für Unternehmens- und Gesellschaftsrecht - ZGR*, Sonderheft 12, Berlin und New York: Walter de Gruyter.
53. Soskice, David. 1999., *Globalisierung und institutionelle Divergenz: Die USA und Deutschland im Vergleich* in *Geschichte und Gesellschaft*, Band 25, 1999, Vandenhoeck & Ruprecht, p. 202 -225.
54. Spitzenverbände Der Gewerblichen Wirtschaft. 1959. *Gemeinsame Denkschrift zum Referentenentwurf eines Aktiengesetzes*. Bonn, 1959. Bergisch Gladbach: Heider Verlag.
55. Streeck, Wolfgang / Höpner, Martin. 2003. *Alle Macht dem Markt? Fallstudien zur Abwicklung der Deutschland AG*. Frankfurt am Main: Campus Verlag.
56. Vitols, Sigurt. 2001. 'Varieties of Corporate Governance: Comparing Germany and the UK' in Hall und Soskice (2001), p. 337 – 360.
57. _____. 2001. 'Frankfurt's Neuer Markt and the IPO explosion: is Germany on the road to Silicon Valley?' in *Economy and Society*, Volume 30, Number 4, November 2001: p. 553–564.
58. _____. 2003. *Negotiated Shareholder Value: The German Version of an Anglo-American Practice*. Discussion Paper II 2003 – 25. Wissenschaftszentrum Berlin. Available at: <http://skylia.wz-berlin.de/pdf/2003/ii03-25.pdf>.
- _____. 2004. *Changes in Germany's Bank-Based Financial System: A Varieties of Capitalism Perspective*. Discussion Paper SP II 2004-3. Wissenschaftszentrum Berlin. Available at: http://papers.ssrn.com/sol3/papers.cfm?abstract_id=517984
59. _____. / Engelhardt, Lutz 2005. *National Institutions and High Tech Industries: A Varieties of Capitalism Perspective on the Failure of Germany's "Neuer Markt"*. Discussion Paper SP II 2005 – 03. Wissenschaftszentrum Berlin. Available at: <http://bibliothek.wzb.eu/pdf/2005/ii05-03.pdf>
60. Tietz-Weber, Susanne. 2006. *Interessengruppen und Rechnungslegungsregeln: Eine Analyse des Umsetzungsprozesses der 4. EG-Richtlinie in das Bilanzrichtlinien-Gesetz*. Wiesbaden: Deutscher Universitäts-Verlag.
61. Wiedemann, Herbert. 1977. 'Der Kapitalanlegerschutz im deutschen Gesellschaftsrecht' in *Beiträge zum deutschen und israelischen Privatrecht*, Neue Kölner rechtswissenschaftliche Abhandlungen, Heft 81, Köln 1977, p. 185 – 219.

Appendix

Presidents of the Federal Association of the German Industry (*Bundesverbandes der Deutschen Industrie - BDI*) between 1945 and 1997 and their relationship to economic sectors in Germany

Term of Office	Name	Industrial Sector	Career
1949–1971	Fritz Berg	Steel Industry	- President of the “Economic Group of the Iron, Steel and Sheet Metal Products Industries” (<i>Wirtschaftsgruppe Eisen-, Stahl- und Blechwarenindustrie</i>) and member of the Präsidium of the “Economic Group of the Metal Products” (<i>Wirtschaftsgruppe Metallwaren</i>) (1943-1947); and - President of the “Chamber of Industry and Commerce of South-Westfalia in Hagen” (<i>Südwestfälische Industrie- und Handelskammer zu Hagen</i>) (1948).
1972–1976	Hans Günter Sohl	Steel Industry	- President of the Board of the “Business Association of the Iron and Steel Industries” (<i>Wirtschaftsvereinigung Eisen- und Stahlindustrie</i>) (1956 – 1969); and - President of the Board of <i>Thyssen AG</i> (1953-1973).
1977 (Jan.–Oct.):	Hanns Martin Schleyer	Steel Industry	- President of the Board Association of the Metal Industry of <i>Baden-Württemberg</i> (<i>Verband der Metallindustrie Baden-Württemberg</i>) (1962 - 1968); and - President of the Board of Federal Association of the German Employers (<i>Bundesvereinigung der Deutschen Arbeitgeberverbände</i> (BDA)) (1973 – 1977).
1978 (Jan.–Sept.)	Nikolaus Fasolt	Precision Engineering	- President of the Board of the “Association of the ceramic Tile Industry” (<i>Verband der Keramischen Fliesenindustrie</i>) (1976-1978); and - Controlling owner and president of <i>Fliesenfabrik Wessel-Werk GmbH</i> .
1978–1984	Rolf Rodenstock	Optic	- Controlling owner and president of <i>Werke G. Rodenstock</i> (1953-1997); and - Co-founder of the Association of Precision Mechanics and Optometry (<i>Fachverband Feinmechanik und Augenoptik</i>) (1947) and until 1964 president of its board of directors and president of the “State Association of the Bavarian Industry” (<i>Landesverband der Bayerischen Industrie</i>) (1955 until 1977).
1985–1986	Hans Joachim Langmann	Chemical / Pharmaceutical	- President of the Board of <i>Merck KGaA</i> (1970-2000); and - President of the Board of the Association of Chemical Industry (<i>Verband der Chemischen Industrie</i>) (1975 – 1976).
1987–1990	Tyll Necker	Mechanical and Plant engineering	- President of the “Association of the German Mechanical and Plant Engineering” (<i>Verbande Deutscher Maschinen- und Anlagenbau</i>) (1980 – 1983); and - President of the <i>Kehr- und Reinigungsmaschinen Hako-Gruppe</i> (1960 – 2001).
1991–1992	Heinrich Weiss	Steel industry (also transport and mechanical engineering)	- President of the Board of the <i>SMS Siemag Group</i> (1974-...); and - Member of the Board of <i>Deutschen Bahn AG</i> , <i>DB Mobility Logistics AG</i> , <i>Thyssen-Bornemisza Group</i> and <i>Voith AG</i> .
1992–1994	Tyll Necker	Mechanical and plant engineering	(see above)
1995–2000	Hans-Olaf Henkel	IT (including chemical/ pharmaceutical, transportation and motors)	- President of the Board of <i>IBM Germany</i> (1987-1994); and - Member of the Board of <i>Bayer AG</i> , <i>Continental AG</i> and <i>Daimler Luft- und Raumfahrt AG</i> .

Sources: *Spiegel Online* (<http://www.spiegel.de/spiegel/>) and *Bundesverband der Deutschen Industrie* (<http://www.bdi.eu/>).

Abbreviation Index

AktG	Aktengesetz
BAWe	Bundesaufsichtsamt für den Wertpapierhandel
BDA	Bundesvereinigung der Deutschen Arbeitgeberverbände
BDI	Bundesverband der deutschen Industrie
BGB	Bürgerliches Gesetzbuch
BvPB	Bundesverband des privaten Bankgewerbes
DIHK	Deutscher Industrie- und Handelskammertag