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Corporate Control and the Financial System in Germany: Recent Changes in the Role of Banks

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Corporate Control and the Financial System in Germany:

Recent Changes in the Role of Banks

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Contents

List of Tables:

Corporate Control and the Financial System in Germany:

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Abstract:

The present paper aims to analyze the major changes in the German system of cross-holdings between banks and industrial or financial companies. After an overview on the role of banks in bank-based versus market-based financial systems, and on the German system of corporate control, we focus our attention on the relationship not only between banks and industrial companies, but also between financial companies in Germany. Discussing the reasons for cross-holdings within the financial sector, we hypothesize that cross-holdings are less efficient than full mergers. We analyze hypotheses about the structure of the "Deutschland AG" and about a different role of cross-holdings at different levels of the German financial system. A test of hypotheses on recent mergers and acquisitions in the German financial system yields that they explain some of the changes in the cross-holdings occurred after 1994. We conclude that instead of the often referred "Macht der Banken" the German financial system is characterized by an increasing importance of insurance companies.

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1. Introduction

The role of German banks in corporate governance has been the subject of many controversial discussions[1]. Until the early nineties of the last century, the banks´ relations with the corporate sector were generally regarded as a positive element [2], ensuring a good deal of long-termism[3], whereas the Anglo-Saxon countries were suffering from excessive hostile takeovers[4], and from focusing on short term results[5]. But as the stock exchange boomed in the second part of the nineties the German system lost its appeal and was regarded as "inflexible and short of creativity...[6]", whereas now, after the stock crises of the new century, a new wave of interest focuses on the German model. The literature tends to make a distinction between two main systems, an Anglo-American system, and a German-Japanese system[7].

The present paper aims to analyze the major changes in the German system of cross-holdings between banks and industrial and in particular, financial companies. It is divided into 6 chapters.

In chapter 2, we discuss the major hypotheses about the role of banks in the two main financial systems: the market-based system and the bank-based system. We consider the features of the relationships between banks and non-financial firms in Germany, one of the corner stones of the so-called "Hausbank model".

In chapter 3, we provide some background information on the "two-tierd system" of corporate control we find in German companies. Our aim is to provide a legal frame for understanding the role of the Aufsichtsrat and of the Vorstand in German corporations, without a specific interest in financial or non-financial companies.

In chapter 4, we analyze the motives for mergers between, and cross shareholdings among, financial companies. Our aim is to understand if there is any theoretical reason for the wider use of cross-holdings among German financial companies if compared to financial institutions in other countries. In the literature we find some hypotheses, in particular, a historical explanation, a self defense explanation, an explanation connected with the "Hausbank model" and finally an explanation which focuses on the German social environment.

In chapter 5, we analyze the major changes occurred in the German financial system since the 1990's. The first part focuses on the distinction between the "core companies of the financial system" and the other companies, also according to Wòjcik's hypothesis that "the loss of block holdings is to be referred to external holdings, while the cross-holdings in the core, among the top owners themselves, remained largely unchanged". In the second part we analyze the major changes according to three different tests: a legal test, which follows the definition of a controlling

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1 For a critical view about the German model see among others: Capasso (1996); Mosetti (1996); Wenger, Kaserer, (1998), 41-78; Berlin (2000), 3-15; Boyd (1999), 655-662; Höfer, Hübner (1994), 106-112; Spaventa (2002).
As supporters of the German corporate organization please see: Albert (1993); Nardozzi (1983), 118; Höpner (2001); Höpner, Jackson (2001); Lütz (2000).

2 The Economist forecasts "a shift away from traditional Anglo-American capitalism to something much closer to the German model." Cited by Schröder, Schrader (1998), 17-35.

3 Guatri, Vicari (1994), 69.

4 Since the Second World War there have been just a few hostile takeovers in Germany, and before the 90's none. Among others see: Deutsch (2002). For a widespread empirical view on takeovers in Germany, please see: Jenkinson, Ljungqvist (1999) and Franks, Mayer (1998), 1385-1403.

5 Empirical studies proved that even if in the short run the ROA of companies with highly concentrated shareholders perform worst, in the long run their ROA shows the highest increase. Lehmann, Weigand (2000), 157-195.

6 N.N. (1996). Among others see also: Wenger, Kaserer (1998), 41-78.

7 Among others please see: Emmons, Schmid (1998), 19-42; Guatri, Vicari (1994).

shareholder according to § 328 AktG, a test of Wòjcik's hypothesis, and a test that reflects Wenger's and Kaserer's hypotheses about the structure of the German financial system. We distinguish two periods, the years before 2000, and the period afterwards, in order to reflect the new attitude in the financial system after some major mergers and takeovers, and more in particular after the hostile takeover of Mannesmann by Vodaphone.

In the last chapter, we draw conclusions about the structure of the center of the German financial system.

2. Financial Systems and the Role of Banks in Corporate Control

The so-called Anglo-Saxon (or Anglo-American) system, even if with some differences[8], is characterized by a huge number of institutional investors who have a short-term approach on investment and, according to it, focus their attention on annual and inter-annual results, and on return ratios (such as Roi, Roe, Rod, Eps, EBITDA,…)[9]. At the same time companies finance themselves first of all through the capital market, while using banks´ credits in particular in order to finance day to day operations. On the contrary, the German-Japanese model is characterized by a small number of sizeable investors, mainly banks and insurance companies, which have a long-term investment approach[10] and are less committed with investigating how the managers manage the company[11]. On the one hand they finance directly the companies´ long-term investments through long term credits, on the other hand they are often among the bigger shareholders of the companies they have financed[12]. Moreover, while in the US it happens seldom that a single investor holds a control block of shares in a floated company, in Germany a vast majority of the floated companies have a single shareholder who owns 25% or more of the voting capital[13], and so has de facto[14] a veto's power on the firm's major decisions[15].

Moreover, in the German system the problems of asymmetric information and moral hazard are limited by the role of the Aufsichtsrat to control the management's behavior, and by the fact that a large part of the Aufsichtrat's members have been bankers[16]: in this way some scholars argued that German banks were well-positioned to monitor corporate management and represent the interest of all shareholders[17].

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8 On the subject of differences between the English and the US systems please see: Franks, Mayer (2002).

9 This is also due to the fact that mutual funds and investment trusts have to report their results to the investors at least once a year, but often every three or six months.

10 As a consequence of this long-term behavior of the investors some authors underline that most of the changes in the company's control occur through block trades, while tender offers are rare. Schmid (2000), 35-46. At the same time it was stated that "Having financial institutions as largest shareholders of traded corporations enhanced profitability". Lehmann, Weigand (2000).

11 Breuer (2001), 544-548.

12 As a matter of fact they can rely on the results of the companies´ day-to-day operations with the bank, but also they have access to information derived from corporate board membership. Wenger, Kaserer (1998).

13 Gorton, Schmid (2002). According to Marco Becht in several countries, the median large voting stake in listed companies is over 50%, suggesting that voting control by large blockholders is the rule rather than an exception, while in no European country studied the median largest shareholder was small enough to fall below 5%. EGCN (1997). Edwards, Nibler (1999).

14 For the implications of § 328 AktG please see the "Regulatory Environment part".

15 For an analysis of the role of minority shareblocks in German corporate governance please see: Jenkinson, Ljungqvist (1999).

16 On the role of bank representatives in the Aufsichtsrat as a counterbalance to employee representatives see Gorton, Schmid (2002).

17 Deeg (1998), 93-101.

Summing up, we can say that bank-oriented systems are normally characterized by less developed financial markets[18], in particular for risk capital, and so the saving is primarily transferred in the form of short-term and long-term credits through banking and savings institutions. On the contrary, in market-oriented systems banks provide primarily short-term credits while long-term funds are gathered through intermediate markets and risk capital[19].

According to these differences some authors speak about a contrast between a market-based model and a credit based model.

Tab. 1: The differences between market-based and bank-based financial systems

	Market-Based	**Bank-Based**	**Bank-Based**
	Arms` Length (U.S.A - U.K.)	**Hausbank (Germany)**	**Main Bank (Japan)**
Total amount of stock market capitalisation as a percentage of the GDP	High	Low	Low
Total amount of bank loans as a percentage of the GDP	Low	High	High
Total amount of stock market capitalisation owned by households (direct+indirect)	High	Low	Low
Total amount of stock market capitalisation owned by banks (direct+indirect)	Forbidden (According to the EU regulations, a UK-based bank can invest in non-financial firms, but not according to Bank of England regulations; In the USA the Gramm-Leach-Bliley Act of 1999 allows banks to invest in commercial enterprises, with wider limits than in Continental Europe)	High	High
Total amount of bank loans as a percentage of the firms' funding	Low	High	High
Market for Corporate Control (Hostile)	Unlimited	Partially Limited	Limited
Information to the Shareholders	High	Limited	Low
Corporate Control	Vigorous, and takeover sanction	Little activity	Little activity
Internal Control/Board of Directors	Primarily outside members with a strong CEO influence	Two-tier board: Vorstand Aufsichtsrat	Insiders
Share Voting	Concentrated through investment funds and strong proxy voting	Banks exercise proxy voting for depositors, as well as for their own shares	Voting by ownership of shares

Source: Neuberger (1999)[20], Halpern (1999)[21]

According to most of the literature the major features of German bank-firm relationships, and so the basis of the so-called Deutschland AG system, are the following:

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[18] Boyd (1999), 655-662.

[19] Berglöf (1991), 117.

[20] Neuberger (1999), 11-26.

[21] Halpern (1999).

- Banks have a considerable influence over, and information about large, publicly traded firms, as they often have seats on the firms´ supervisory boards (Aufsichtsrat).
- Banks hold large portions of shares of non-financial firms.
- According to the “Hausbank model” the same bank provides most, or all, of the financing needs of a firm, which in return uses the services of just one bank. This tying is considered by both parts as a long-term relationship, with no connection with the cyclical up and down of the firm’s business[22].
- The German banking system has the capacity to provide industrial finance, that is, long-term capital for financing fixed assets, like plan and equipment[23].

The influence of banks, through seats in companies’ Aufsichtsräten, the so-called “Macht der Banken” (power of the banks) [24], has been the subject for a lot of studies but also political discussions[25]. The figures reveal that banks can exert influence via their supervisory board mandates, but the impact is easily overestimated, even if their role is still stronger than the one of their counterparts in other countries.

Tab 2: Mandates in the boards of the biggest 100 companies in Germany

	1992	1994	1996	1998	2000
Allianz	25	24	23	21	20
Deutsche Bank	15	11	18	21	20
Dresdner Bank	18	18	21	17	13
Commerzbank	11	13	11	8	7
Münchener Rück	6	20	20	16	16
HVB	10*	12*	15*	7	6
AMB	10	3	3	1	1
Total	85	101	111	101	83

Source: Monopolkommission (1994, 1996, 1998, 2000, 2002)
* We considered the amount of both the Bayerische Hypotheken-und Wechselbank and the Bayerische Vereinsbank

In contrast to their counterparts in many other countries, German banks hold sizeable investments in non-financial companies[26]. This is both a consequence of the “underdevelopment” of the German

[22] Some literature about the role of the German banks as shareholders considers them as main stakeholders nearby the management and the employees. Guatri, Vicari (1994).

[23] According to Vitols the German banks provide most of the corporate long-term loans through credits with a maturity of four to ten years. Vitols (1998), 79-91.

[24] This is in part due to the fact that before the Aktiengesellschaftsgesetz of 1965, which established a maximum number of 10 mandates per person, the most important bankers were sitting in a large number of boards. For example Hermann-Josef Abs, a former chief executive of Deutsche Bank AG, simultaneously held up to 30 seats on supervisory boards. Schröder, Schrader (1998), 20. For a complete knowledge of the role of Hermann Abs in the German financial sector please see: N.N. (1965), 10.

[25] Höfer, Hübner (1994), 106-112.

[26] In the U.S. and the U.K. banks don’t hold portfolios of long-term investments in non-financial companies. In particular see: Berlin (2000). In France most of the present investment took place during the 80’s and the 90’s, due to the privatisation process in that period. It can be related to a preference for a core shareholder group privatisation pattern, even if the banks established preference banking relations with the companies; Magnani (1999), 159. In Italy banks were forbidden to hold investments in non-financial companies till 1991, when the so-called Legge Amato-Carli was passed. The sole exception was Mediobanca, which acted as a special middle-long term bank, and since the 50’s acquired shares in non-financial companies. The author would like to underline that as a matter of fact Mediobanca behaved more like a Hausbank for Italian companies than like a common regulated Italian bank.

equity market, and of the structure of equity ownership, with the proxy voting system[27]. As a matter of fact tables show that, while the number of firms in which banks hold equity positions has increased, there has been a decline in the frequency with which these shares give banks a blocking minority position or an outright control[28]. At the same time we can notice that still in 1997 out of 171 large corporations 85% had shareholders owning more than 25%, and 57% had a shareholder owning more than 50% of the equity: in addition 77% of the median firm voting rights associated with officially traded shares are controlled by large shareholders (owning more than 5%), corresponding to 47% of the gross market capitalisation[29]. Moreover we should remember that a big share of the banks' asset portfolio is invested in un-floated companies, or in holding-companies that remain un-floated, and so the real role of banks is not limited to investors in publicly floated companies.

Another very important feature of the German financial system is the so-called "Hausbank model", where one bank provides most, or all, of the financing needs of a firm, which in return uses the services of just one bank. This relation is supposed by both parts to be a long- term one, with both parties committed to respect it. As a consequence, when firms have financial or industrial problems they look for their Hausbanks' help, also because the lack of other solutions in the long run has transformed the banks in the only financial institutions which can bear the cost of industrial rescues[30]: these rescue operations generally end with banks taking, or accumulating, large numbers of shares[31]. Hence in those cases the banks don't sell off the shares after the difficulties into which the firms had run were eventually overcome[32], and so we can say they turn to be long-term investments[33]. Moreover, according to Das-Nanda[34] the resources invested by a bank in order to build up a long-term relationship would be too costly in the absence of a long-term commitment by the client, but at the same time they make future transactions cheaper and easier, and so there is no direct advantage in letting the client go bankrupt[35].

Furthermore, due to the pressures of stakeholders, in particular union officials and labor representatives[36], on Germans banks, it is very unusual that a bank would let a big company fail, and so the bigger the company, the higher is the probability of a bank holding a large number of shares[37]. As a matter of fact, big universal banks are commonly perceived to act in the public and/or in the national interest, rather than seeking strictly to maximise profits[38]. Another feature of the financial system is the widespread role of regional and local communities, as well as the Federal

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[27] Most of the researchers agree on considering these three elements as the founding elements of the German financial system. Among others see: Nardozzi (1983), 111; Dietl (1998), 66; Schröder, Schrader (1998).

[28] Emmons, Schmid (1999).

[29] Boehmer (1999).

[30] Guatri, Vicari (1994), 39. Please see also Ralph (2002).

[31] It can happen that rescue operations lead to the transformation of banks' credits, or firms' bonds hold by banks, in shares. Guatri, Vicari (1994), 41 and also Neuberger, Neumann (1991), 188-199.

[32] Neuberger, Neumann (1991).

[33] Fiscal optimisation also plays a big role here, as we have to consider that a long- term share block bought in a semi-failed company implies two different fiscal capital gains: the increase in the value of the company and the inflation effect over time. As a matter of fact, when the capital gains tax was abolished in 2000 most of the observers awaited an increase in the disposal of assets by big banks.

[34] Das, Nanda (1999), 863-895.

[35] Das, Nanda (1999).

[36] For an example of public officials´ pressions on banks see the KruppAG-Thyssen merger as analysed in Emmons, Schmid (1999).

[37] Nardozzi (1983). Not all the scholar have the same opinion, e. g. Berlin (2000), 3-15.

[38] Emmons, Schmid (1999).

Government[39], as major bank shareholders: in particular, as these hold big portfolio investments in non-financial assets they use them in order to increase the banks' capital[40].

Finally we would like to underline that, as often referred in relation with a "bank-based model", Germany is characterized by a less developed capital market, compared with Anglo-Saxon countries.

One of the main reasons for the underdevelopment of the German equity market is the absence of long-term investors, first of all pensions funds, as the old age security system rests to a large degree on the pay-as-you-go principle[41], and therefore institutional investors consist primarily of banks, insurance firms, and dependent investment funds[42]. At the same time most of the private accumulated capital is saved through private life insurance and health insurance. As a consequence, this practice reduces the role of the capital market both in the provision of funds and in corporate governance, as it means that, simultaneously, the supply of and the demand for capital via the market is reduced[43]. But we have to consider also the fact that maybe the role of the bank as a financial advisor may also turn in a preference for banking credit, i.e. a stronger relationship and new business for the banks themselves, instead of equity capital[44].

The second reason for the underdevelopment of the equity market is to be found in the huge use of cross-holding agreements[45]. In Germany they developed as "web of cross shareholdings"[46], i.e. when company A holds shares in B and C, B hold shares in C, the latter holding shares in A, and so on, so there is also a wide use of Pyramid schemes[47].

Infact, according to the AktG[48], there is only a limit to cross shareholdings that applies in the case of two companies holding more than 25% of each other's stock: according to it companies are forbidden to exercise more than 25% of the voting right in both directions.

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39 In 1997 The German Federal Government still controls 8% of the gross market capitalization of the German Stock Exchange. Boehmer (1999).

40 This process can pass through the merger between a bank and a holding company. We would like to underline that this is a common feature also in other countries. For example in 1992 the Municipality of Wien, Austria, refinanced the city regional bank, Z-Länderbank, through a merger with its industrial investment holding. As a reasult Z-Länderbank gained possession of a widespread group of non-financial activities, among them the Prater Leisure Park, two of the main city's hotels, an advertisement company, and a large amount of shares of the Austrian second biggest insurance group, Wiener Städtische Versicherung. Another example can be Westdeutsche Landesbank, whose main shareholder is the Land Nordrhein-Westphalia, that has been under scrutiny of the European Commission, because of property deals in the early 1990s, when the Länder transferred to the WestLB the regional agency for housing (WFA-Wohnungsbauförderungsanstalt), through transferring to the bank a portfolio of real estate investments valued 1 billion of Euro. Ruozi, Anderloni (1999).

41 The pay-as-you-go principle is widespread in continental Europe, and is considered responsible for the underdevelopment of the European stock excanges if compared with the ones in the U.K. and U.S., where most of the pensions are paid through pension funds schemes.

42 Boehmer (1999).

43 Schröder, Schrader (1998).

44 Nardozzi (1983). The same idea is shared by Ber, Yaafeh, Yosha (2001), 189-218.

45 Gorton, Schmid (2002).

46 Adams (1999), 80-109.

47 One of the most famous examples of the use of pyramid schemes was Mercedes Automotive Holding, established during the 70's in order to own a 25% block of shares previously owned by the Flick family in the Daimler Group. The company was then owned by the four biggest German banks, and was delisted only in 1994. Another good example of a pyramid scheme in the industrial sector is that of Regina, which owns a 26% shareblock of MAN, a truck factory. Regina is controlled by Allianz Insurance Group, 50%, Münchener Rück Insurance Group, 25%, and by Commerzbank, 25%. We would like to remember to the reader that pyramids are widely used also in other European countries, for example in Italy and in Austria.

48 § 328 AktG.

Anyway we have to consider the fact that 25% is often enough for controlling the AGM (annual general meeting)[49], and at the same time, two companies holding 25% of a third company's shares can easily reach a full control without breaking the legal provision[50]. Empirical evidence shows us that, considering just the biggest three banks in Germany, if the three banks voted[51] together in each other's annual general meeting, they would have commanded a majority of the votes in each bank's annual meeting[52].

A third important reason we have to consider is that according to the German law (AktG par. 135) small investors can give to banks the authorisation, the so-called Depotstimmrecht, to represent them in the company's annual general meeting (Hauptversammlung). The bank is enforced to expose to the shareholder the different possibilities of using voting rights, but as a matter of fact, often small investors just "follow their bank attitude". However, some evidence concludes that usually the banks just support the management proposals, without having an active role in the AGM, that mostly just ratifies with overwhelming majorities the managers' proposal[53], without achieving the shareholder interest[54].

3 Control of German Corporations: the Role of the Vorstand and of the Aufsichtsrat

The aim of the present chapter is to give some guidelines about corporate governance of Germans Aktiengesellschaften (stock corporations), in order to make clearer most of the above statements.

We will focus only on stock corporations, because for all the 90's they represented the biggest share of the 100 biggest companies in Germany, with an increasing role as the "legal form of the biggest companies". Moreover, as we have focused our attention on the relationships between financial and non-financial institutions, and their development in the 90's, we have to remember that in 2000 considering the relevant sample, 54 companies out of 58 had the legal form of an AG (the other four being GmbHs)[55].

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[49] Adams (1999).

[50] Nyborg (1999).

[51] In that case the author considered both own shares and shares they voted in proxy.

[52] Emmons, Schmid (1998).

[53] Wenger, Kaserer (1998).

[54] Franks, Mayer (20002).

[55] Monopolkommission (2002), Tabelle III.12, 212-217.

Tab 3: Legal forms[56] of the biggest 100 companies in Germany

Year	1992	1994	1996	1998	2000
AG	69	66	71	77	75
GmbH	15	15	13	6	6
KgaA	2	1	1	3	2
KG	4	4	4	3	3
OHG	2	1	1	3	5
GmbH&Co.KG	3	3	3	3	4
SpecialPurposeCompanies	5	10	7	5	5
Total	100	100	100	100	100

Source: Monopolkommission (1994, 1996, 1998, 2000, 2002)

Corporate governance is defined as dealing "with the ways in which suppliers of finance to corporations assure themselves of getting a return on their investments"[57]. In particular German corporate governance, even if partially reformed with the KonTraG (Gesetz zur Kontrolle und Transparenz im Unternehmensbereich),[58] is characterized by the fact that corporate law (Aktiengesellschaftsgesetz of 1965, finally amended in 2001) prescribes a two-tier board for joint-stock companies. The law established a strict division of responsibilities in a company's management. Corporate governance is carried out by the supervisory board (Aufsichtsrat), while it is the Vorstand which carries full responsibility for managing the company[59], and enjoys unlimited representative authority. The Aufsichtsrat is also responsible for monitoring the management, although practically it acts as an advisory committee rather than as a monitoring panel, except in times of financial difficulty[60].

Special issues, as for example corporate restructuring, changes in the lines of business and other strategic realignments as well as the determination of the dividend and the acquisition of other firms need the Aufsichtsrat's approval[61], even if companies' founding charts can provide the Aufsichtsrat with wider competencies.

In order to avoid that managers supervise themselves[62], what has been defined as "managerial self-governance"[63], executive directors may not be members of the supervisory board, even if they can join in its meetings. At the same time the Aktiengesellschaftsgesetz prescribes that a member of the Vorstand cannot be a member of the Aufsichtsrat of a company if a director of this second company

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German Legal Form	Explanation
AG	Stock Corporation
GmbH	Limited Liability Company
KgaA	Commercial Partnership Limited by Shares
KG	Limited Commercial Partnership
OHG	General Commercial Partnership
GmbH&Co.KG	Limited Liability Company with the form of Limited Commercial Partnership

57 Edwards, Nibler (1999).

58 Hommelhoff (1998), 249-259.

59 Gorton, Schmid (2002).

60 Baums, Frick (1998), 3.

61 Drukarczyk, Honold, Schüler (1997).

62 We have to notice that according to Adams one of the crucial aims of cross-holdings is " to protect the powerful position of a certain group of managers". Adams (1999).

63 Nyborg (1999).

has a seat on the Aufsichtsrat of the first company, and so the supervisor of the manager is a director itself[64].

The chairperson and the members of the Vorstand are appointed by the Aufsichtsrat, for at maximum five years, even if reappointment is possible, and often takes place.

The Aufsichtsrat appoints, monitors, and if necessary may dismiss the Vorstand, or some of its members. The law prescribes a minimum of two meetings every year, and the average figure is four/five per year[65].

In particular we can underline that the AktG gives to the Aufsichtsrat five distinctive ways to implement control on management behavior:

- According to the § 90 AktG the Vorstand has to provide the Aufsichtsrat with information on the company's business[66], even if some empirical evidences made researchers conclude that this rule is not always fulfilled[67].
- Every single member can request a special report about certain issues.(par 90-3)
- The active participation in planning could be based on the approval of the Aufsichtsrat (Par 111 comma 4)
- All given information can be discussed with the Abschlussprüfer (auditor). (par 171 -2)
- The Aufsichtsrat can control the business of the company by itself or ask for an additional auditor (§ 111-2)

The chairperson of the Aufsichtsrat has a special role, as he, or she, holds the deciding vote if no majority is found in two rounds of voting by the board. As a consequence the chairperson has to be elected according to a two-third majority of the Aufsichtsrat members, thus implying an agreement with the representatives of the work force in the Aufsichtsrat.

We can say that the relationship between the Aufsichtsrat and the Vorstand constitutes the core of the German corporate laws[68], and one of its main difference to the corporate governance in Anglo-American firms.

The second main feature of the German corporate governance is the co-determination system (Mitbestimmung), whose aim is to settle a company's internal conflict between capital (represented by the shareholders) and labor (the employees)[69]: the instrument of this settlement is the Aufsichtsrat[70]. We used the term "co-determination" in order to describe labor representation in the

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[64] § 100 AktG.

[65] "…Aufsichtsrat members will thus have to exercise their mandates more professionally. This means more meetings and- inevitably- fewer seats". Breuer (2001).

[66] In particular the law underlines that information has to cover the following areas of the company's business: financial planning and investment plan, labour organisation, the incomes and so on. Every member of the Aufsichtsrat is entitled the right to have knowledge of the company's situation, and the law states how often (at least) the information has to be given. § 90 AktG.

[67] Wenger, Kaserer (1998).

[68] Schröder, Schrader (1998).

[69] In particular some authors underline that stronger representation of the employees implies the presence of big shareholders which can counterbalance employee representatives' requests: this can be considered both as an "economical and a political" counterbalance. On the matter please see Wòjcik (2001).

[70] The scope of the mandatory codetermination is defined by the MontanMitbestimmungsgesetz of 1951 (breviter MontanMitbestG), MontanMitbestimmungsergänzungsgesetz of 1956, by the Mitbestimmungsgesetz of 1976 (breviter MitbestG), and by the Betriebsverfassungsgesetz of 1952/1972 (Breviter BetrVG).

Aufsichtsrat (Unternehmensmitbestimmung) and without encompassing participation by work council (Betriebsrat) i.e. labor representation at the factory level (betriebliche Mitbestimmung).

According to the German law every company with at least five employees must have a work council elected by the employees and composed just by employees, whose decisions are restricted to personnel and social issues. The function of the council is to assure that the management searches for socially acceptable solutions for economic challenges[71].

More important is instead the BetrVG (Betriebverfassungsgesetz) that regulates the composition of the Aufsichtsrat in companies with more than 500 employees. It requires that one-third of the Aufsichtsrat's members are elected by the employees, but since it has to decide according to a simple majority rule, representatives of the shareholders remain in control.

The goal of parity codetermination is enforced by the MitbestG of 1976 that applies to companies with more than 2000 employees[72]. According to the MitbestG, half of the members of the Aufsichtsrat must be employee representatives, including labor union representatives, and there must be at least one company executive to represent executive employees[73]. One of the main new problem connected with this system is the fact that worker representatives in the Aufsichtsrat are elected just by the German work force and thus fail to reflect the internationalisation of the company. For example most of the employees of both Deutsche Bank AG and Allianz AG don't work in Germany and so according to the regulatory frame don't have any voting right in the Aufsichtsrat[74].

In order to prevent paralysis of corporate decision making, the chairperson of the Aufsichtsrat is granted a second vote in deadlock situations, so after two "ordinary votes" failed in providing a solution. The chairperson of the supervisory board, and all the members of the managing board must be elected by a two-third majority[75], at least with a first ballot. After it, the chairperson of the supervisory board is to be elected among the shareholder representatives with a simple majority vote[76], and so the control of the Aufsichtsrat remains in shareholder representatives' hands.

According to empirical evidences codetermination has substantially reduced the responsibility of the Aufsichtsrat, since its first introduction in 1976[77], and in general mandatory codetermination is to be regarded as economically inefficient, because it deprives shareholders and employees of the right to allocate non-default decision rights to the highest yield user[78]. Some literature focuses on the fact that the involvement of labor representatives in the Aufsichtsrat influenced in a negative way its work as the shareholders can be interested in weakening the role of the Aufsichtsrat in order to exclude the labor side from high quality information and important decisions[79].

At the same time the employees may want to use the firm as an intertemporal insurance vehicle, resisting restructuring, lay-offs, and wage reductions, protecting themselves against the business

[71] On the matter of the relationship between social and economic challenges we can see: Strätling (1997).

[72] § 1 MitbestG. "In Unternehmen, die in Regel mehr als 2000 Arbeitnehmer beschäftigen".

[73] Par 7 MitbestG.

[74] "At the same time the composition of the Aufsichtsrat doesn't reflect the fact that many companies operate internationally, and so their problems are increasingly global problems". Breuer (2001).

[75] § 27 MitbestG. "Der Aufsichtsrat wählt mit einer Mehrheit von zwei Dritteln der Mitglieder,…."

[76] This results in the chairperson representing the most dominant group of shareholders and keeping a much closer contact with the managing board. Drukarczyk, Honold, Schüler (1997).

[77] Schröder, Schrader (1998).

[78] Dietl (1998).

[79] Drukarczyk, Honold, Schüler (1997).

cycle or shocks to the firm[80]. Empirical research shows that codetermination affects the value of the firm, in particular the market-to-book ratio of equity[81], but the results are not unanimous[82].

Summarizing we can consider the existence of five economically significant block sizes as defined by the rights of minorities and the power of the dominant blockholders to influence the votes in the general meeting of shareholders.

A *block of 90%* or more severely restricts the residual rights of minority shareholders, and above 95%, the controlling group can compulsorily acquire the minorities' shares.

A *block of 75%* (super-majority) or more gives the controlling group complete discretion about the elections of Aufsichtsrat members, changes in the company structure or in corporate charter, issue of new stocks, so limiting minorities´ opportunities to special rights, for example to make the Aufsichtsrat or the Vorstand liable for detrimental decisions.

A *block of 50%* or more provides management control to the major shareholders, but is subject to limits due to the possibility of the existence of 25+% minority shareholders, thus entitled with the right of veto.

A *block of 25%* or more gives veto powers on corporate charter amendments, Aufsichtsrat changes, and can provide a substantial influence on the AGM, considering an average presence of no more than 57% of the votes.

A *block of less than 25%* gives relatively little minority protection, even if we have to notice that three shareholders with less than 25% can get together more than 50%, thus controlling the firm.

Finally we would like to underline that according to the present legal frame it is impossible that a single shareholder, even if controlling 100% of the shares, controls all the Aufsichtsrat's seats[83]. This gives a hint that the "takeover threat" to German companies is lowered by codetermination: even in case of mismanagement the new shareholders have to handle "downsizing" through the Aufsichtsrat, and so, through dealing with worker representatives. At the same time codetermination may help the managers to avoid takeovers to the extent that employee interests are more closely aligned with those of management than with those of outside shareholders[84].

4. The Role of Banks as Investors in Financial Companies

Most of the studies on the German banking system focus on the role of German banks as long-term shareholders in non-financial companies as a distinctive feature with respect to other financial systems. But another important feature of German banks, in particular of the so-called Großbanken, is that they have developed a net of cross shareholdings both among themselves, and with the major German insurance groups[85]. Even if the presence of nets of cross shareholdings among financial companies is widespread in the whole of Europe, and so cannot be considered as a particular feature of the German banking system, it is important to understand how it developed there and how it

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80 Gorton, Schmid (2002).

81 Gorton, Schmid (2002).

82 For example Baums, Frick (1993) argued that their studies didn't show a degree of dislike of co-determination in investor so high as commonly reported.

83 This is one of the main differences to other legal environmental where the shareholder who controls 100% of the shares has the right to nominee all the Boards Members.

84 Heinrich (2002).

85 Einecke (2001), 24.

changed in the last years[86]. If we consider the network of cross holdings between large German AGs, as presented by Wenger and Kaserer in 1998[87] we find three different circles in the German financial system.

The inner circle was represented by the two biggest insurance companies, Allianz AG and Münchener Rück AG, holding 25% of each other, and being considered as "the spiders of the web"[88]. The second circle was represented by the so-called Großbanken, Deutsche Bank, Dresdner Bank and Commerzbank, plus a group of other important banks, as Bayerische Hypotheken- und Wechselbank, BHF Bank, and Bayerische Vereinsbank. In the next circle we can find the biggest German industrial companies, Daimler-Benz, Linde, Siemens, Hoechst[89] and big public utilities companies such as VEBA, VIAG and RWE.

To analyse changes within this web, we will consider the acquisition of minority blocks of shares as a first move on the way to a stronger cooperation among two companies[90], (even if empirical evidences demonstrate that this must not be the case[91]). Before doing so we consider M&A in the banking sector, since they tend to generate changes of scale sufficient to modify both the ownership structure of the resulting institution and the efficient allocation of its rights[92].

4.1 Motives for Mergers between Financial Companies

According to financial management theory, mergers are generally based on the following scopes[93]:

- Achieving input efficiencies: in these cases M&A are assumed to lead to more efficient production processes and lower cost per unit[94]. An example is the use of the same back office operations (IT, asset allocation operations, marketing etc.) for a bigger number of customers, or for a wider range of financial services, as for example in case of "banc assurance"[95]. Often, economies of scale can be reaped by downsizing the branch network after a merger, in particular in the retail market field[96] which in most of the countries, and especially in Germany, suffers from excess capacity.
- Achieving output efficiencies: for example, by diversification of risks, expansion of the geographical coverage, or access to new and more profitable markets, and/or by, strengthening

86 Wòjcik, (2001).

87 Wenger, Kaserer (1998). 1998 is the date of the publication, while the data refer to the 1994 situation.

88 Wòjcik (2001).

89 It is important to notice that most of the companies represent "the traditional industrial areas of Germany, in particular Bayern and North Rhein Westfalia", so the area of the "first German industrialization at the end of the 19th century". This gives a hint to historical reasons for the role of banks as industrial investors. On this matter please see Wòjcik (2001).

90 This happens in particular in Continental Europe and can be referred both to regulation and to "political" reasons. For example most of the privatization happened through the selling of minority blocks of shares to a group of selected investors. See the case of France (BNP, Credit Lyonnais, Paribas), and Italy (Credito Italiano, Banca Commerciale Italiana, Istituto Mobiliare Italiano-IMI, Istituto Nazionale delle Assicurazioni-INA, Banca Nazionale del Lavoro).

91 For example in spite of the fact that ING has a minority block of more than 15% of Credit Commercial de France, the latter eventually merged with HSBC of England. This happened also with Bank Austria, that merged with Hypovereinsbank, in spite of the fact that Westdeutsche Landesbank has a 10% minority block and an option to reach 25%.

92 Messori (2002).

93 Millon, Tehanian (1992), 211-234; and also Berger, Hunter, Timme (1993), 221-249.

94 Groeneveld (1999), 369-392.

95 Morrison (2002).

96 De Felice, Revoltella (2001), 4.

the position in the "domestic market"[97] in order to create a financial basis for future expansion[98]. This strategy has been followed by banking groups in narrow national markets (Holland, Scandinavian Countries, Austria) in order to gain the minimal size necessary for operating in international financial markets[99]. At the same time output synergies can be referred to diversification of financial services offered[100].

- A third cause often referred in relation to M&A in financial services is the aim to achieve value-maximization[101], with the presumption that the more efficient institution buys the less efficient one[102].

Tab 4: Reasons for mergers in the financial sector

Value Maximizing Motives	
Cost reduction	Economies of scale (reduction in per-unit cost due to increased scale of operations)
	Economies of scope (e.g. reduction in per-unit cost due to the use of the same customer center for several services)
	Reduction of risk due to geographic or product diversification*
	Reduction of taxes**
	Increased monopsony power allowing the firms to purchase inputs at a lower unit-price
	Allowing a firm to receive a credit rating or to enter new capital markets
Increase in revenues	
	Increased size allowing a bank to better serve large or corporate customers, and enter the wholesale market
	Increased size allowing a bank to serve both small and bigger customers, with a one-stop shopping strategy
	Increased size or market share to attract customers due to reputation effects
	Increased size allowing a bank to operate in new markets, (e.g. OTC market)
	Increased size allowing a bank to operate in more risky markets.
Non Value Maximizing Motives	
The role of the government	The government policy can play an important role in either hindering or facilitating consolidation, both among the same sector, or different ones.
The role of other stakeholders	Other stakeholders can play an important role in either hindering or facilitating consolidation, both among the same sector, or different ones.***
The role of managers	Managers play an important role in hindering or facilitating consolidation, in particular when the firm operates in markets characterized by a „strong human factor" (for example: M&A advising)****

Source: BIS (2001)

*We assume that two markets or products are imperfectly correlated

** According to the national tax system

*** The role of unions or local politicians in the bail-out of failed firms is widely acknowledged.

****As a matter of fact top managers often "vote with their feet", i.e. leave their company to work in another one.

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97 BIS (2001).

98 Groeneveld (1999).

99 In each of these countries the first three groups have a market share of about 60%-70%, while for example in Germany the three Großbanken (Deutsche Bank, Dresdner Bank, Commerzbank) have a combined market share below 20%. For Details see Tab. 6.

100 Messori (2002).

101 De Felice, Revoltella (2001).

102 Berger, Demsetz, Strahan (1999), 135-194.

The different degrees of concentration in the banking system reflect the total number of mergers in the banking sector as we can see from a comparison of the following tables, where we can notice that, in spite of the fact that Germany has the highest number of mergers in the period 1994-2000, it has the smallest degree of concentration.

Tab.5: Mergers in the European banking sector 1994-2000

	1995*	1996	1997	1998	1999	2000 (First Half)	Total 1995-00
Austria	14	24	27	37	20	5	127
Belgium	6	8	7	6	6	0	33
Denmark	2	2	1	1	0	1	7
Finland	7	6	5	5	2	3	28
France	60	61	46	52	51	21	291
Germany	100	117	109	189	240	91	846
UK	2	4	15	16	14	4	55
Greece	0	0	3	7	3	0	13
Ireland	1	1	0	2	0	1	5
Italy	68	56	45	52	64	30	315
Luxembourg	3	1	3	9	6	6	28
Netherlands	2	2	5	0	1	2	12
Portugal	5	5	1	1	0	6	18
Spain	4	4	1	5	5	3	22
Sweden	1	2	2	1	1	0	7
Total	275	293	270	383	414	172	1807

Source: European Central Bank (2000).
*Number of mergers among different banks during the year.

Tab 6: Total market share of the 5 biggest banks

	Loans	Deposits
Sweden	85.30%	83.50%
Netherlands	81.50%	83.40%
Greece	74.50%	81.70%
Portugal	72.90%	79.60%
Denmark	79%	79%
Belgium	80.40%	74.70%
France	46.40%	69.20%
Finland	68%	63.40%
UE Average	57%	58.10%
Ireland	48.20%	51%
Italy	47.60%	46.10%
Spain	47.90%	45.30%
Austria	43.30%	39.60%
Great Britain	30.30%	32.40%
Luxembourg	34.30%	28.10%
Germany	15.80%	15%

Source: Colombo (2001)

4.2 Motives for cross shareholdings among financial companies

We notice that acquiring a minority block of shares doesn't achieve any of the previous goals, as long as we don't assume that such an acquisition is the first step towards a full merger among the two banking institutions[103], even if this position is not unanimous[104]:

- It doesn't increase bank size as long as the two banks remain different legal entities, or don't gather under the same "umbrella group"[105].
- It doesn't result, directly, in any economies of scale, as long as the two banks continue to have separate operations[106], or don't agree that one of them will provide back office services for the other one.
- It doesn't result in any output increase, at least as long as the two banks don't agree on providing services together.

According to this thesis, cross shareholding is less efficient than direct merging. Given the fact that in 2001 big German banks were still lagging behind in the M&A process[107], we would like to understand if any major change happened in the net of cross shareholdings among the major German banks and financial institutions.

As a first step of our research we consider some of the main hypotheses and observations about the role of cross shareholdings in the German financial system :

(1) The cross-holding relationships between the biggest bank and insurance companies have been established at the end of the 19th century, when these companies were established[108]. Empirical studies found out that cross holdings and ownership concentration are higher in the oldest German companies, while they tend to reduce as we approach the 1990's and the "IT industrial age"[109].

According to Gerschenkron, the industrialization of Germany in the second part of the 19th century was made possible by the presence of big financial institutions that acted as suppliers of external capital as a substitute for insufficient internally accumulated funds[110]. This was due in particular to an actively state-assisted process of industrialization, realized with the establishment of "special" banks in order to provide long-term loans to capital-intensive industries[111].

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[103] De Felice, Revoltella (2001). As underlined by Messori acquiring minority stakes can be a way to establish new relations with foreign banks. For example among the major European banks we can remember Credit Agricole-IntesaBCI, Allianz-Unicredito, Royal Bank of Scotland-Banco Santander CentralHispanoamericano (BSCH). Messori (2002).

[104] BIS (2001).

[105] With the word "umbrella group" we address those mergers that pass through the establishment of a holding company which controls the two merging institutions, that remain separate legal entities. Some examples are provided by Intesa-BCI, and Unicredito Italiano in Italy or by the so-called 3Banken Group in Austria.

[106] For example after the merger of Bank Austria and CreditAnstalt in 1997 the two banks agreed, with the so - called 17 January statement, first point, to keep two separate networks of branches till 2002. We would like to underline that the Austrian banking market is characterized by one of the highest numbers of branches every 1000 inhabitants.

[107] De Felice, Revoltella (2001).

[108] As a matter of fact we have to notice that most of the biggest German companies shared also "personal" cross influence: for example Allianz was established in 1890 by Carl von Thieme, a former director of the Münchener Rück Versicherung, and by the banker Wihelm von Finck. One of the prominent founders of Deutsche Bank was Georg von Siemens, who was also the founder of the industrial firm Siemens. On this matter please see: Brendel (2001).

[109] Wòjcik (2001).

[110] Gerschenkron (1968).

[111] Neuberger (2000), 11-33.

Given this historical explanation of today's cross-holdings among German financial companies, we wonder why they haven't been wiped out in more than 100 years, considering also the fact that after the Second World War the biggest German banks were broken up by the occupation forces into a number of "successor banks", each limited to operate in one Land[112]. Moreover, we are looking for an explanation why, while expanding themselves abroad, the big German banks didn't change their home cross-holding system.

(2) A second hypothesis states that cross-holdings acted as self-defense against foreign companies[113], so as a way for consolidating at home before expanding abroad[114]. As a matter of fact cross-holdings began to be wiped out in the second part of the 90's when most of the German companies got big enough to face international competition. We also observe that the acquisition of big German financial companies was never hostile, and that cross-holdings could be used to redistribute resources among the shareholders[115]. A third clue of this attitude is that cross-holdings were eliminated also as a consequence of foreign investor pressure[116], in particular in the case of Deutsche Bank, where after the merger with Bankers Trust around 50% of the shareholders are foreign.

(3) A third hypothesis postulates that the "Hausbank model" requires banks to follow long-term strategies, and so banks need shareholders who share the same long-term attitude in their investment. We can easily presume that no one is a better long-term shareholder of a "long-term financial company" than another "long-term financial company". According to this hypothesis, the growing importance of mutual funds and foreign investors[117] in the biggest German banks goes along with an erosion of the housebank model, the banks approaching a more short-term strategy, and beginning to reduce their holdings[118].

(4) A last hypothesis focuses on the "regulatory environment" and moreover on the "German Milieu", as characterized by an "oligopolistic attitude". In particular some authors focus their attention on the role played by "cooperation" in the German political and social history: according to it they underline that the aversion to oligopolistic and monopolistic behavior is lower in Germany than in other countries[119]. Even if this might have been the case in the 19th century, we do not believe that this holds today.

[112] In 1952 the Federal Republic was divided in three banking areas, where in each a "successor bank" of the former Großbanken operated. After the "restriction of the regional scope of credit institutions" was abolished in 1956, the three banks reconstituted themselves in 1957-1958.

[113] According to Adams the purpose of cross-holdings is to "protect the powerful position of a certain group of managers, whose power was established by widely spread shareholdings and the pooling of voting rights to nominee shareholders, against proceedings for regaining shareholders' control. Protection against hostile take-overs seems to be the system's main purpose". Adams (1999).

[114] Still in 2000 about 85% of the mergers in the financial sector in the EU were of a domestic nature, so being aimed at strengthening the position in the domestic market. De Felice, Revoltella (2001).

[115] Adams (1999).

[116] Neuberger (2000).

[117] Neuberger (1998).

[118] Two examples could be Deutsche Bank under U.S. based funds pressure, and Commerzbank under CoBra investment company pressure.

[119] Among others please see: Beyer (2002); Capasso (1996); Guatri, Vicari (1994).

5. Major Changes in the Structure of the German Financial System

5.1 The Core of the German Financial System

In order to analyze the development of the cross-holdings among German corporations we will test the role of some financial companies in the following way.

We will consider the German financial system as being composed of two different circles: in the inner circle, that we will call the "core of the German financial system" we will find the biggest traditional financial institutions, the so-called "National Champions", while in the outer circle we will find the other financial institutions.

First, we have to give a definition of what are the features, on the purpose of the present research, for being a member of the core of the German financial system. In particular we assume that:

(1) Companies have to be incorporated in Germany.

(2) No foreign company controls more than 25% of the voting rights or of the capital[120]

(3) Each company which according to 2001 data holds more than 10 share blocks bigger than 5% in companies that ranked among the biggest 100 companies in Germany[121] can be considered in the inner circle by definition.

(4) Each company whose directors hold together more than 10 seats in other companies' supervisory boards is considered to be in the inner circle by definition.

The first three rules are always to be satisfied, and so are necessary, while the last one is sufficient.

Using the data of the Monopolkommission concerning mandates and cross-holdings among the 100 biggest companies in Germany[122], we thus identify the following 6 companies as the core of the German financial system in 2001:

- Deutsche Bank AG
- Allianz-Dresdner AG
- Münchener Rückversicherung AG
- E.On. AG
- RWE AG
- Hypovereinsbank AG.

Among these, two companies operate in the public utilities sector, two are banks, one is an insurance group, and one is an insurance and financial group. On the purpose of the present research our aim is to test the following hypothesis of Wòjcik: "The loss of block holdings is to be referred to external holdings, while the cross-holdings in the core, among the top owners themselves, remained largely unchanged".

Notice that our definition contrasts with common sense about the role of the so-called Großbanken: as a matter of fact evidence shows that Commerzbank is not, on the purpose of the present research, at the center of "Deutschland AG", even if it plays an important role.

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[120] Please see La Porta, Lopez de Silanes, Shleifer (1999), 491-517.

[121] Wòjcik (2001).

[122] We will consider only companies that are incorporated in Germany and are not legally controlled (ex § 328 AktG) by any company which is incorporated in another state.

For all the years after 1990 it never fulfilled the rule of 10 blocks above 5%, while it satisfied the rule of ten supervisory board mandates only till 1996.

Blocks bigger than 5%

	1990	1992	1994	1996	1998	2000
Commerzbank	7	7	8	8	6	3

Source: Monopolkommission (1992,1994, 1996, 1998, 2000, 2002).

Now in order to verify the major changes in the web of cross shareholdings among the bigger German financial companies we will apply to the core financial companies as presented by Wenger the following tests:

- Every time that a company member of the “core group” holds more than 25% of another company the second company is also considered a “core company”[123].
- To test Wòjcik’s hypothesis about the stability of the core [124] we consider the relevance of the whole shareblocks held by “core group” companies.
- We evaluate if according to the map provided by Wenger (and based on 1994 data) a company played a relevant role in the German financial system.

In particular in order to test Wòjcik’s hypothesis we will procede in the following way:

If the company A is a core company of the German financial system, the total amount of shares held by other “core companies” in 1994 should not have decreased until 2001:

BLOCK 1994 ≤ BLOCK 2001

If the company A is not a core company of the German financial system, the total amount of shares held by other “core companies” in 1994 should have decreased until 2001:

BLOCK 1994 > BLOCK 2001

On the purpose of the present research we will consider the period 1994-2002, and we will analyse it according to the following division: 1994-2000 and after 2000. This division follows some studies that focus their attention on 2000 as a turning point for the German financial system[125], in particular regarding the takeover of Mannesmann[126] by Vodaphone Airtouch[127] as it was the first Anglosaxon styled takeover[128] in the German history, with no active engagement of German banks[129] in order to reach a commonly shared solution[130].

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[123] As we have already explained, a *block of 25%* or more gives veto powers on corporate charter amendments, Aufsichtsrat changes, and can provide a substantial influence on AGM, considering an average presence of no more than 57% of the votes.

[124] Wòjcik (2001).

[125] Among others please see: Heinrich (2002).

[126] Mannesmann represents a very interesting case history, as it was established in 1890 in the heavy industrial field, in particular the steel and mechanical industry. In 1990 the company entered the telecommunication sector through the establishment of Mannesmann Mobilfunk GmbH which during the 90’s developed the D2 mobile operator. As a matter of fact in 1999 the company represented a mix of traditional interest in heavy industry (Mannesmann Atecs) and in telecommunications (D2, Otelo and Arcor in Germany and Omnitel in Italy).

[127] Höpner, Jackson (2001). For analysis of the relevance of the merger between Mannesmann and Vodaphone in the European telecommunications market please see: Commission of the European Communities (2001b).

[128] At the moment of the takeover more than 60% of Mannesmann shares were held by non German investors, in particular U.K. 25% and U.S. 15%, with Europe accounting for another 18%. These data fit with Wòjcik’s hypothesis of a different role of cross shareholdings in the new so-called high-tech industry with respect to other sectors.

5.2 Changes in the 1990's

As we have already provided a frame for understanding the historical role of banks and insurance groups as investors in non-financial companies, we would now focus our attention on the role of the named investors during the 90's.

We have to understand that one of the main features of the German banking and financial system is the presence of "group competition", as three major banking groups dominate the financial market, and in particular commercial banking: private banks (which include the so-called Großbanken), state-owned savings banks (Sparkassen), and mutual/co-operative banks (Genossenschafts-banken)[131]. While subject to the same general banking regulations, each group is distinct in its legal and organizational basis. On the purpose of the present research we will focus just on one group of banks, the private banks with the legal form of an Aktiengesellschaft, for two main reasons:

- They are the biggest German banks, ranking 11 banks among the 20 biggest banks in Germany in 2001[132]
- The banks in the other two main groups, the Sparkassen and the Genossenschaftsbanken have a legal form according to which it is impossible to have major holders[133] and in particular they cannot be "acquired" by other institutions in a direct way[134].

Within the group of the private banks, mortgage banks (Hypothekenbanken) play a minor role in the reshaping of the "Deutschland AG" as they are controlled by other banks or banking federations[135]. At the same time Hypothekenbanken are forbidden to hold shares in industrial companies[136], and so they are involved in cross-holdings with a smaller degree.

Let us first consider the network of cross-holdings between large German AGs in 1994, as presented by Wenger and Kaserer. At a first glance we can see the presence of three different circles in the German financial system:

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129 Although Allianz was among the major shareholders it behaved just in order to maximize its capital gain and not in order to preserve the status quo. Dohman, Kerbusk (2000), 78-82.

130 Vodaphone finally got control of Mannesmann on 30 March 2000 through acquiring 98.62% of Mannesmann shares. Höpner, Jackson (2001).

131 Deeg (1998).

132 See N.N. (2002), 497-498.

133 I would like to underline that the Spitzeninstitut of the Genossenschaftbanken, Deutsche Zentralgenossenschafts-bank (breviter DZ), is also incorporated as an Aktiengesellschaft. This is a situation common also to the Austrian experience where the two Spitzeninstitute of the Austrian Genossenschaftsbanken RaiffeisenZentralBank-RZB, and ÖsterreichischeVolksbankAg-Övag are incorporated as Aktienbanken. In spite of the importance of the role and of the reform of the Sparkassen sector, I will not consider it, even if I would like to underline that according to the experience of other countries, Italy in particular, it seems possible that if the Sparkassen will be forced to transform themselves in Aktiengesellschaften, they will probably build up "networks" of local banks, that would merge with other banks. As an example of this proceeding please see the following merger: Unicredito+Credito Italiano, RoloBanca 1473+Banca delle Marche, Banca Intesa+Cassa di Risparmio di Parma e Piacenza, and during 2002 San Paolo-Imi+Cardine.

134 BIS (2001).

135 The only big mortgage banks in Germany that are not controlled by another financial institution (not parent company) are Hypovereinsbank-HVB and Depfa Bank. Among the others Allgemeine Hypotheken Bank Rheinboden is controlled by BHW Holding AG and BgaG AG (Beteiligungsgesellschaft der Gewerkschaften), while EuroHypo, the result of the merger of Eurohypo AG, Rheinhyp Rheinische Hypothekenbank AG and Deutsche Hypothekenbank Frankfurt-Hamburg AG, is controlled by the three big banks or financial institutions Deutsche Bank, Commerzbank and Allianz/Dresdner Bank.

136 See §5 Hypothekenbankgesetz.

The inner circle was represented by the two biggest insurance companies, Allianz AG and Münchener Rück AG, holding shares of 25% of each other, so that it is impossible to define an ultimate owner of the two companies[137]. The second circle was represented by the so-called Großbanken[138], Deutsche Bank, Dresdner Bank and Commerzbank, plus a group of other important banks, Bayerische Hapotheken- und Wechselbank, BHF Bank, and Bayerische Vereinsbank. In the next circle we can find the biggest German industrial companies, Daimler-Benz, Linde, Siemens, and Hoechst, and public utilities companies such as VEBA, VIAG, RWE.

If we try to do the same analysis for 2002 we can see that there have been huge changes in the structure of the German financial system and in particular, in the role of the major German banks.

Just considering the most important industrial companies a first group of reasons for the change can be found in some big failures that occurred during the 90's, such as:

Metallgesellschaft in 1993[139]

Deutz AG (KHD) in 1996

These failures involved traditional German companies in the heavy industrial field, so the area where the connections between banks and industries were strongest[140]. We would like to remember that in both cases we can notice a strong presence of financial companies among the shareholders of the failed company[141].

Moreover, some of the biggest German companies merged with foreign companies during the past years, for example:

Daimler + Chrysler to create DaimlerChrysler (car factory) in 1997

Hoechst AG + Rhone-Poulenc to create Aventis (chemicals) in 1998

These mergers reflect an increasing importance of foreign investors, in particular in the case of DaimlerChrysler, where the "acquired company" was U.S. based. As a consequence the traditional role of German banks was balanced by short-term pressure of international mutual funds[142].

When instead we consider the financial sector , we can remember that during the 90's just two big mergers involved German banks:

Bayerische Hypotheken- und Wechselbank + Bayerische Vereinsbank to create Hypovereinsbank in 1997

Deutsche Bank + Bankers Trust (U.S.) to create Deutsche Bank in 1999[143]

On the contrary, several bank and insurance groups have been acquired during the second part of the 90's:

Münchener Rück created ERGO through the merger of Hamburg-Mannheimer/DKV with Victoria/D.A.S. in 1997

SE Bank (Sweden) acquired Bank fur Gemeinwirtschaft-BfG in 1999

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137 Adams (2001).

138 In spite of their size the so-called Großbanken have a market share of just 16%, while the Landesbanken and the Sparkassen have a market share of 36% and the Genossenschaftsbanken of 12%. N.N. (2002), 496-498.

139 For a detailed description of the causes of Metallgesellschaft's failure please see: Frankel, Palmer (1998), 219-242.

140 Wòjcik (2001)-

141 In the case of Deutz AG KHD, the biggest shareholder was Deutsche Bank with a 47.8% share block, while in the case of Metallgesellschaft Deutsche Bank held 16.6% and Dresdner Bank 14.6%.

142 Heinrich (2002).

143 Commission of the European Communities (1999b).

ING Bank (Holland) acquired BHF in 1998[144]
Generali Assicurazioni (Italy) acquired AMB in 1998[145]

Summarising we can state that at the rise of the new century a first transformation has occurred to the German financial system: some important banks and insurance firms got foreign-owned, while, due to mergers, some of the biggest German industrial companies got big groups of foreign shareholders. Anyway, even if some changes took place in the 1990's[146], it would be an error if we considered the process as completed in 2000.

Tab 7: Major M&A involving German companies before 2000

Name of the Company (acquiring)	Name of the Company (acquired)	Sector	Type of operation	Year
Deutsche Telekom	One-2-One	Mobile Communication	Acquisition	1999
Mannesmann	Orange (UK)	Mobile Communication	Acquisition	1999
Rhône Poulenc (France)	Hoechst	Chemical/Drug	Merger	1999
Deutsche Bank	Bankers Trust (USA)	Bank	Acquisition	1998
Krupp	Thyssen	Heavy Industry	Merger	1998
Daimler Benz	Chrysler (USA)	Car Factory	Merger	1998
Bayerische Hypo-Bank	Bayerische Vereinsbank	Bank	Merger	1997
Allianz	AGF (France)	Insurance	Acquisition	1997
Generali (Italy)	AMB	Insurance	Acquisition	1997

To explain the above changes, let us take a closer look at the mergers between financial companies.

The merger between Bayerische Hypotheken- und Wechselbank and Bayerische Vereinsbank:

In 1997 the only big merger among German financial institutions in the 90's took place , the one between the two Munich-based banks Bayerische Hypotheken-und Wechselbank and Bayerische Vereinsbank. The new bank aimed to focus on a "regional strategy" in particular in East European countries and in the traditional mortgage business, following the strategic approach of super-regional banking[147]. This merger is very important according to the following features:

- It was considered as a reaction in order to balance the role of Frankfurt as the leading financial place in Germany. After the merger the two biggest German insurers, Münchener Rück and Allianz, and the second biggest bank would have had their headquarters in Munich.
- Bayerische Vereinsbank used its 10% shareholding of Allianz in order to finance a tax-free merger, thus underlining the importance of capital-gains taxes in the "mergers among Deutschland AG[148]".
- The merger fits with most of the theoretical reasons given for mergers, in particular by implying staff reductions, cross-sellings of financial products, and strengthening of the market position in retail banking in south Germany and in the mortgage markets both in Germany[149] and abroad.

[144] Commission of the European Communities (1998c).
[145] Commission of the European Communities (1998b).
[146] Wòjcik (2001).
[147] Covill (1997), 33.
[148] Dönch (1997), 160-167.

As a consequence of the merger between Bayerische Hypotheken- und Wechselbank and Bayerische Vereinsbank we can observe the following share blocks:

Dresdner Bank: 1.27%, Münchener Rück: 13.29%, Allianz: 6.8%, VIAG:10.5%.

As we can see in the following table, Wòjcik's hypothesis fits to the experience of Hypovereinsbank:

Company	Shareholder	1992	1994	1996	1998*	2000	2002
Bayerische Hypotheken-und Wechselbank	Allianz	24.60%	22.60%	22.60%	17.63%	13.60%	0%
	Münchener Rück	0%	5.80%	5.80%	6.50%	5.05%	25.57%
Total		24.60%	28.40%	28.40%	24.13%	18.65%	25.57%

Source: Monopolkommission (1994, 1996, 1998, 2000, 2002).
Since 1998 Hypovereinsbank

Company	Shareholder	1992	1994	1996	1998*	2000	2002
Bayerische Vereinsbank	Allianz	0%	0%	0%	17.63%	13.60%	0%
	Münchener Rück	0%	0%	5.10%	6.50%	5.05%	25.57%
	VIAG AG	0%	14.40%	10.25%	8.23%	6.59%	6.59%
	Deutsche Bank	0%	0%	4.90%	0%	0%	0%
Total		0%	14.40%	20.25%	32.36%	25.24%	25.57%

Source: Monopolkommission (1994, 1996, 1998, 2000, 2002).
Since 1998 Hypovereinsbank

As the biggest block in 1994 was 22.60% and the block in 2001 is 25.57 %, Hypovereinsbank is a core financial company. Also the 25% rule is fulfilled. In spite of the fact that Hypovereinsbank was not present (as it was established in 1997) in the evidence of Wenger in 1994, we can conclude that after the merger of the two Bavarian banks, Hypovereinsbank increased its role as a "core financial company".

The acquisition of Aachener und Münchener Beteiligungen by Generali Assicurazioni (Italy):

A very important acquisition in the German financial sector, in particular in the insurance field, took place in 1998, even if we can consider it as the result of a 6 years' control battle, the acquisition of the insurance group Aachener und Münchener Beteiligungen (breviter AMB) by Generali Assicurazioni (Italy): as a matter of fact in 1997 AMB ranked among the first three German insurance groups, so through this operation Generali gained a primary position in the German financial sector[150]. The sellers were AGF Group with 33.55%, and Dresdner Bank, Allianz and Münchener Rück[151], with 21.1%, while another 13% was acquired on the market[152].

[149] In particular the new group would have had a 4% market share of the German credit market, with 8% of the mortgage market.

[150] In particular the new AMB-Generali group gained the following market shares: 10% in life insurance, 5.5% in health insurance and 7% in property and casualties insurance, with a market share of 8% of the German insurance market. Assicurazioni Generali Press Release of 23 December 1997.

[151] After the takeover Allianz remained with a 4.6% and Dresdner Bank 5.1%, Münchener Rück 4.8%. AMB Factbook of 1999, 109.

[152] Assicurazioni Generali (1998).

From a strategic point of view this operation fulfilled some of the main assumptions we made on merger motives, in particular rationalization of the structure of the two companies, and an increase in market power. We have to remember that this purchase was part of a big agreement between Allianz Group and Generali Group regarding the takeover of AGF, and the rationalization of the two companies' interests in Europe.

At the moment of the purchase AMB held the following blocks: Dresdner Bank less than 1.27%, BMW less than 1%, Commerzbank 5.25%, Victoria Versicherung Holding less than 3.6%[153]. As a consequence of this purchase Generali Group and Commerzbank agreed on a close relationship[154], which has continued till the present year[155].

We assume that AMB, in spite of being one of the biggest German insurers is not a core financial player in the so-called Deutschland AG.

As a matter of fact, the first test shows that AMB was not in the core of the German financial system both in 1994 and in 2002, as in both cases the role of the core German investors was weaker than the one of other investors.

If we try to apply the 25% test, we face the problem that the only shareholder with a 25% holding, so AGF, was not allowed to vote in the AGM according to an AMB's Aufsichtsrat decision. Hence, we can exclude the use of the 25% test, as there was no other shareholder with a 25% share block.

Also according to the map provided by Wenger for the year 1994 we have to conclude that AMB is not at the core of the German financial system.

Company	Shareholder	1992	1994	1996	1998	2000	2002
AMB	Deutsche Bank	0.60%	5%	5%	0%	0%	0%
	Dresdner Bank	12%	14.70%	14.00%	5.10%	5.10%	5.10%
	Allianz	1.40%	5%	5%	4.60%	4.60%	5%
	Münchener Rück	0%	8.50%	8.60%	4.80%	4.80%	4.80%
	Generali	0%	0%	0%	65%	68%	66%
Total		14.00%	33%	33%	80%	82.50%	80.50%
	AGF		25%	25%	0%	0%	0%
	Fondiaria Assicurazioni	0%	20%	20%	0%	0%	0%

Source: Monopolkommission (1994, 1996, 1998, 2000, 2002).

The foundation of Ergo Versicherung by Münchener Rück:

Another important step in the reshaping of the financial sector is the expansion of Münchener Rück in the field of direct insurance services by merging its subsidiary Hamburg-Mannheimer/DKV with Victoria/D.A.S. in 1997 in order to create the ERGO Versicherung[156]. In particular as Munich Re had an 80% shareholding of Hamburg-Mannheimer/DKV and a 23.5% shareholding of Victoria Versicherung/D.A.S., it gained a majority of the new group[157]. The other big shareholder of ERGO

[153] Monopolkommission (1999), 251-256.

[154] AMB Generali (1998): "Commerzbank und Generali Gruppe vereinbaren enge Zusammenarbeit Vertriebskooperation zwischen Commerzbank und Aachener und Münchener Gruppe".

[155] In 2002 Generali Assicurazioni Spa is among Commerzbank's major shareholders, with 9.9%, and Commerzbank is distributing AMB insurance services through its branches. At the same time Commerzbank holds a 2% block in Mediobanca, that is Generali's major shareholder.

[156] Ergo Versicherungsgruppe AG (1997).

[157] Münchener Rück (1997).

would have been Allianz group, and as a matter of fact after a year the two groups decided to restructure shareholdings: Allianz acquired 15.6% of Allianz America and 3.9% of Allianz Lebensversicherung, transferring to Münchener Rück a 6.5% stake in ERGO and 6.9% of American RE[158].

The merger between Deutsche Bank and Bankers Trust (USA):

In 1998-1999 another important merger took place in the banking sector, the one that involved Deutsche Bank and the U.S. based investment bank Bankers Trust. On the purpose of the present research this merger may be considered in different ways. One approach is to view it as a strong rush in the direction of re-establishing Deutsche Bank as a top investment bank, and thus unwind its traditional relations with the German financial system. However, there is no actual evidence that the named merger was the driver of any massive dismissal of assets respect to other core financial companies in Germany, nor the bank was capable of selling its “retail bank operations”. As a consequence we will not consider the merger between Deutsche Bank and Banker Trust as a turning point for the role of Deutsche Bank in the German financial system.

The takeover of BHF by ING (Holland):

Between 1998 and 1999 we had two operations that involved major German banks, in particular the takeover of BHF through ING (Internationale Nederlanden Group) and the acquisition of Bank für Gemeinwirtschaft (BfG) through Skandinaviska Enskilda Banken (SEB). The merger between ING and BHF can be considered as a major step in the reshaping of the German financial system according to the role that BHF played in the German financial markets[159], in particular in the wholesale banking field[160], and to the identity of its buyer. As a matter of fact International Netherlands Group is one of the biggest European banks, with a world-wide presence, and strongholds both in the BENELUX retail market[161](through the acquisition of Bank Bruxelles Lambert), and in corporate finance through the acquisition of the UK based Baring Bank[162]. In a first moment ING acquired the shares owned by Allianz Group, DG Bank, and Münchener Rück Group, amounting to 41.8%. Then after a year ING decided to acquire all the outstanding shares[163], in order to take private the company, and eventually merge with it. Moreover ING decided to sell some investment of BHF, and for example 10% of IKB[164] (Industrie-Kredit-Bank) to Allianz, 2% of Münchener Rück Group and 1.4% of Allianz[165]. Moreover we remember that BHF held wide investments in Italy, 0.8% of Mediobanca[166], and 1% of Unicredito Italiano, which were also sold.

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[158] Münchener Rück (1998).

[159] BHF is the abbreviation for Berliner Handels und Frankfurter Bank . The bank emerged in 1971 as the result of the merger between two German banks with a strong focus on corporate finance: Berliner Handels Gesellschaft and Frankfurter Bank.

[160] Wholesale banking is defined as the provision of financial services to large corporate customers. Neuberger (1998).

[161] According to the Commission of the European Community the combined activities were 18% of the total market in the Netherlands, and 14% in Belgium. Commission of the European Communities (1999a), 3.

[162] Burgmaier (1998a), 65.

[163] ING (1999).

[164] At the moment of the takeover IKB had a 4% stake in BHF. For a comment of the management about the operation see: IKB (1999).

[165] Wenger, Kaserer (1998).

[166] At the moment of the takeover Mediobanca had a 3.1% stake in BHF.

This was one of the first times that an important German bank was sold by other insurance and banking groups to a foreign investor, that so gained the possibility to enter in the "bulk of the German financial system".

The takeover of Bank für Gemeinwirtschaft (BfG) by Skandinaviska Enskilda Banken (Sweden):

In 1999 a merger was announced that involved the Bank für Gemeinwirtschaft (BfG), a middle size German bank, with retail operations[167] in all the German Länder whose main shareholders were Credit Lyonnais and the German trade unions[168]. At the time of the merger the bank was in a precarious economic and strategical situation due both to managerial problems and to the crisis of its major shareholder[169]. The bidder was Skandinaviska Enskilda Banken (SEB), one of the big Swedish banks, with operations in the whole Scandinavian area, and controlled by the Wallsenburg Group. The merger between SEB and BfG cannot be considered as a major step in the reshaping of the German financial system because of the following features.

- The major shareholder and ultimate seller of BfG, Credit Lyonnais[170], was a foreign bank, while BGAG (Beteiligungsgesellschaft der Gewerkschaften), the financial company of the German trade unions, and the AMB insurance group[171] played a second line role in the operation.
- During the 90's BfG had focused strongly on savings and banking services for private customers more than on corporate finance[172], and it didn't hold any major industrial investment in any of the first 100 German companies[173]. Its merger didn't reflect any major change in the structure of the German banking system[174], as it didn't involve any other German bank, nor any change in the industrial shareholding system. Finally, the purchase of BfG through SEB didn't reflect any structural change in the German financial system as the aim of SEB was to concentrate on the retail market[175], purchasing BfG to build up a network of branches in Germany[176] without bearing extra costs[177].

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167 At the time of the purchase the bank had 177 branch offices in whole Germany, with around 1.000.000 of private customers, and a market share of 1% of the German market: in 1998 it ranked N° 5 among the private commercial banks in Germany. SEB (1999).

168 At the time of the purchase Credit Lyonnais held 50% of the bank, BGAG 25%, and AMB 25%.

169 Burgmaier (1998a), 50.

170 Credit Lyonnais acquired BfG in 1992 as a part of a bigger agreement between AGF (Assurances Générales de France), and AMB Insurance Group. BfG eventually merged with Credit Lyonnais Deutschland in 1993. Anyway the bank never turned to be a profitable investment, and was sold according to the restructuring plan of Credit Lyonnais.

171 AMB (1999).

172 SEB (1999).

173 Monopolkommission (1999), 251-256.

174 According to the Commission of The European Communities the combined activities of BfG and SEB in Germany would have turned to be around 1% of the market share, in any relevant market. Commission of the European Communities (1998a), 3.

175 The retail market is defined as the segment which concentrates on households and small and medium- sized firms. Neuberger (1998), 97-118. The focus on the retail market was underlined also by equity researches. Please see: Ghose, Leonard, Vijayarajah (2001).

176 In retail banking the service has to be offered close to the customers, and so an extensive branch network is a crucial factor of competitiveness. Due to the impossibility of gaining market share by improving the service quality most of the incumbents founded discount brokers and direct banks in the market segment of standardizable services. Neuberger (1998), 97-118.

177 In particular we would like to underline that the wide presence of barriers arising from the feature of the German market made it extremely difficult to build up a significant branch network, without bearing huge sunk costs.

According to Wenger BfG was not a core financial company in 1994. If we test Wòjcik's hypothesis we can see that

BLOCK 1994 > BLOCK 2001.

Moreover, the 25% test shows that both in 1994 and in 2001 the company's main shareholder was not a core financial company, and so this fits with our hypothesis.

Hence, BfG proved not to be in the core of the German financial system

Company	Shareholder	1992	1994	1996	1998	2000	2002
BfG Bank	AMB	50.1%%	25.1%	25.1%	25.1%	0%	0%
	Credit Lyonnais	0%	50.1%	50.1%	50.1%	0%	0%
	BGAG	24.8%	24.8%	24.8%	24.8%	0%	0%
Total		100%	100%	100%	100%	0%	0%

Source: Monopolkommission (1994, 1996, 1998, 2000, 2002).

At the same time we can notice that in this period the impact of mergers and acquisitions was high, and for example[178]:

- 12 blocks disappeared because companies were delisted or liquidated.
- 12 holdings ceased to exist because companies merged with each other.

5.3 Changes after 2000

We have already underlined the importance of the takeover of Mannesmann as a milestone in German corporate governance, which can be considered as a step in the evolution of the so-called Deutschland AG.

One of the major changes in the German financial system occurred when the government eliminated the corporate capital-gains tax on 1st January 2002. Most of the observers agreed that this would have encouraged companies to unwind their cross shareholdings[179] by removing a disincentive to the selling of long held shares[180]. Eliminating the taxation of corporate capital-gains can reshape companies' investment allocations as these will no more be influenced by tax optimization but just by risk allocation[181]. This should change German corporate structure in particular as the big traditional investors, insurance companies and banks, will decide to reshape their portfolios[182], investing tied-up capital to expand core areas, without incurring tax charges[183]. This expectation was limited by the problem compounded with the big size of industrial holdings: if all the banks and insurance companies decided to sell off all their shareholdings at the same time they would just meltdown the market[184]; there are left two alternative ways of disposal, a decrease process in growing markets, or disposals outside the market.

[178] Wòjcik (2001).

[179] Holloway (2001); Breuer (2001), 544-548.

[180] In most of the cases big portfolio investments in industrial companies dated back to before the 80's.

[181] Deutsch, Nassauer, Quitzau (2001).

[182] Deutsch, Nassauer, Quitzau (2001)-

[183] On the matter of the change in companies' evaluations due to the new fiscal frame please see: Tamarowski (2002), 30-32.

[184] In most of the biggest industrial companies the so-called Großbanken plus the biggest insurers own more that 50% of the shares. On the matter please see also Heinrich (2002).

As a matter of fact Deutsche Bank followed the first way by decreasing its 9.9% stake in Münchener Rück held in 2000 to around 5% in 2002, while other big operations took place outside the market through exchanges of stakes, as in the following examples.

Anyway we have to notice that in the years 2000-2001 some major mergers involved important German companies, both in the financial and the non-financial sector (see table 7).

Tab 8: Major M&A involving German companies after 2000

Name of the acquiring company	Name of the acquired company	Sector	Type of operation	Year
Deutsche Telekom	VoiceStream (USA)	Mobile Communication	Acquisition	2001
British Telekom (UK)	Viag Interkom	Mobile Communication	Acquisition	2001
KfW	IKB	Banking	Acquisition	2001
Veba	Viag	Energy/Public Utilities	Merger	2000
RWE	Thames Water (UK)	Public Utilities	Acquisition	2000
Preussag	TUI	Travel Services	Acquisition	2000
Preussag	Thomson Travel (UK)	Travel Services	Acquisition	2000
BellSouth (USA) KPN (Holland)	E-Plus	Mobile Communication	Acquisition	2000
Siemens	Mannesmann Atecs	Heavy Industry	Acquisition	2000
Hypovereinsbank	Bank Austria (Austria)	Banking	Merger	2000
Vodaphone (UK)	Mannesmann	Mobile Communication	Acquisition	2000

To provide examples for the industrial sector:

-VEBA and Viag merged to form E.ON

-Preussag acquired TUI and the English tour operator Thomson Travel[185]

For the purpose of the present research, we are interested in the following mergers which took place in the financial sector.

The acquisition of Industrie-Kredit-Bank (breviter IKB) by Kreditanstalt für Wiederaufbau (breviter KfW)[186]:

A good example of the changed attitude in the German financial system may be the acquisition of IKB, a German bank specialized in long-term financing for middle-sized companies (the so-called Mittelstand). In 1999 as ING acquired the Frankfurter bank BHF, the two banks unwinded their cross shareholdings. In particular IKB sold its 4% block of BHF to ING, while ING decided to sell the 10% held by BHF in IKB to Allianz[187]. As a consequence Allianz doubled its stake to 19.8%%, while Münchener Rück became the second biggest shareholder with a 13.4% stake. Two years later the two insurance companies agreed to sell their stocks to Kreditanstalt für Wiederaufbau (breviter KfW), which became the major shareholder of IKB with 33.2% of the voting rights. At the same time Allianz decided to continue its cooperation in the fields of property insurance and pension

[185] As a consequence in 2002 Preussag merged with TUI, Thomson Travel and Nouvelles Frontieres, and transformed itself in a Travel Company, thus selling all its interests in the heavy industry, and renaming TUI AG.

[186] As the purchase of IKB through KfW was still on we will not apply the Wòcjik test to this operation, but just to the other two ones.

[187] At the moment of the takeover IKB had a 4% stake in BHF. For a comment of the management about the operation see: IKB (1999).

schemes, while Ergo Versicherung entered into a partnership in the field of asset management with IKB[188].

From this example we can draw two conclusions:

- KfW is the most important public bank concerning promotional financing for medium-sized companies. So its purchase of 33.2% of IKB can be considered a strategic alliance in the field of corporate lending for medium-sized companies, and not a mere reallocation of shares among the biggest German financial companies.
- The stakes of Allianz had grown in the years to around 20%, but as the company doesn't have any direct interest in the business of middle/long-term credits, it decided to sell its stake, continuing with an exclusive cooperation in its traditional business, the insurance one[189].

Hence both Allianz and KfW decided to focus on their core businesses. This acquisition can be considered as a hint of the fact that in the financial sector firms can cooperate in their traditional fields of business without owning shares of each other.

According to Wenger, both IKB and KfW don't represent core financial companies. Moreover, as KfW doesn't fit with our definition of a "core company" , if we apply the 25% rule we find that IKB is controlled by a non-core company and so it is also a non-core company.

The merger between Hypovereinsbank and Bank Austria Creditanstalt:[190]

One of the major mergers in the European banking system after 2000 was the merger between the German banking group Hypovereinsbank (breviter HVB) and the Austrian group Bank Austria Creditanstalt.

As a matter of fact in July 2000 the two banks announced that they were going to merge in order to create the third biggest banking group in Europe[191], with a capital of 17.5 billion of Euro and total assets of 667 billion of Euro, more than 65000 employees, 8 million of customers and a worldwide presence[192].

This operation is very important according to the following reasons:

- It was one of the few cross-border mergers in the European banking system[193]: in particular the two banks ranked among the first 3 banking groups both in Austria and Germany.
- In order to merge with HVB, Bank Austria broke a previous agreement with Westdeutsche Landesbank: this is one of the first times, maybe the first one, that a major operation in the German banking system is not based on an "agreement" among all the participants.
- As a consequence of the fact that Bank Austria's shareholders received 20% of the capital of the new bank we can notice that more than 20% of HVB shareholders were foreign, and that AVZ, the former Wiener Sparkasse, got the second biggest shareholder of the bank, with both a seat in the Vorstand and in the Aufsichtsrat[194].

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188 IKB (2001).

189 Allianz (2001).

190 As we have already assumed that Hypovereinsbank is a core financial company, and it ultimately acquired Bank AustriaCreditanstalt, we will not test the role of the new group in the German financial system.

191 "Bank Austria künftig unter bayerischer Flagge. Hypovereinsbank wird Europas Nummer 3". N.N. (2001), 13.

192 Press Release of Bank Austria AG of 28 September 2000.

193 De Felice, Revoltella (2001).

194 According to it one of the major problems was the status of the Österreichische Kontrollbank, which provided special purpose credits according to a special agreement with the Austrian State, for example to the exporters. As a

- The new group would have had a share of 20% of the Austrian financial market, well above the 5% Hypovereinsbank held in the German credit market.

A last major consequence of the merger was that HVB would have controlled also the non-financial investment portfolio of Bank Austria, which controlled about 270 different companies and according to it ranked among the first 5 Austrian industrial groups[195].

The merger between Allianz and Dresdner Bank to create Allianz-Dresdner:

One of he major mergers in the German financial system occurred when the insurance group Allianz, which had long held a block bigger than 20% in Dresdner Bank, one of the German Großbanken, decided to take it over and eventually to merge with it.

This operation emerged to be one of the biggest changes in the "German spider net of cross holdings" as it unwinded a 100 years relationship among some of the most important German companies far beyond the involved companies.

Considering this operation from an industrial point of view the merger was a milestone not only in German but also in European finance as its aim was to create a "one stop shop"[196] or "Allfinanzdienstleister" net[197], so mixing up traditional banking services (Dresdner Bank) plus Investment&Mutual Funds services (DIT-Deutsche Investment Trust) with traditional insurance products (Allianz Versicherung Group)[198] and with new pension scheme financial products[199]. The biggest impact of the merger was on the so-called "Deutschland AG". As a matter of fact the combined portfolio of financial and non-financial shareblocks of the new Allianz-Dresdner Group would have been the biggest in Europe, with an estimated value of more than 66 billion of Euro[200]. It was not a surprise that the regulators welcomed the agreement between Allianz Group and the other Munich based insurer Münchener Rück.

In particular in order to realize the merger, and to avoid to become too powerful on the German insurance market thus blocking the merger[201], Allianz had to reorganize its cross-holdings with other two top level financial companies, the insurer Münchener Rück AG (number 2 in Germany), and the Hypovereinsbank AG (number 2 in Germany)[202].

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consequence of the merger HVB would have controlled the bank with a 49.15% shareblock. At the same time the bank would have been among the biggest shareholders of the Wiener Börse AG, the Austrian Stock Exchange, and of the Österreichische Nationalbank.

195 Among the first companies to be sold there were the Real Estate Company Örag and the beverage company BBAG.

196 We would like to underline that Allianz-Dresdner is not the only insurance and banking group in Europe: other examples are Credit Suisse-Winterthur (Switzerland), Fortis and ING (Benelux) .

197 As the aim of Allianz was to create a wider distribution network for financial services some argued that it purchased Dresdner while needing just its branch network and its DIT mutual funds unit. Wagner (2002b), 130-132.

198 A first move is that more than 1000 Allianz insurers would have moved to Dresdner Banks branches, with 500 Dresdner clerks moving to Allianz insurance points. Schutz (2001b), 58-64.

199 We have to remember that the so-called "Riester-Rentenrefom" aimed to introduce private pension insurances by side of traditional state's pensions. Wagner (2002b), 130-132.

200 Schutz (2001a), 58-64.

201 On the purpose of analysing the effects of the merger on the German insurance market the European Commission considered Allianz and Münchener Rück as a sole player, as a consequence of their 25% cross-holding. The disposal of some of the cross holdings was considered as necessary in order to fulfill competition rules in Germany. Commission of the European Communities (2001a).

202 Reuter (2001a), 100-104.

In particular, just considering the cross-holdings among the 4 groups Allianz AG, Münchener Rück AG, Hypovereinsbank AG and Dresdner Bank[203] we find that:

Allianz bought from Münchener Rück AG :

- 45% of Bayerische Versicherung AG, thus holding 90%
- 49.9% of Frankfurter Versicherung AG, thus holding 99.9%
- 40.6% of Allianz Lebensversicherung AG, thus holding 91%
- 10% of Dresdner Bank.

At the same time Münchener Rück AG bought from Allianz-Dresdner:

- 36.1% of Karlsruher-Lebensversicherung AG, thus holding 90.1%
- 13.6% of HypoVereinsbank from Allianz, plus a further 2.5% from Dresdner, thus holding -25.7% of HVB.

Tab 8: Disposals that involved Allianz and Münchener Rück at the same time*

Year	Seller	Company	Share-holding	Buyer
1997	Allianz AG	ERGO	6.5%	Münchener Rück
	Allianz AG	America Re	6.9%	Münchener Rück
	Münchener Rück	Allianz Lebensversicherung	3.9%	Allianz AG
	Münchener Rück	Allianz America	15.6%	Allianz AG
1998	Münchener Rück	Berlinische Leben	64.6%	Commercial Union plc (UK)
	Allianz AG	Berlinische Leben	30%	Commercial Union plc (UK)
2001	*Allianz AG*	*Industrie Kredit Bank*	*19.8%*	*Kreditanstalt für Wiederaufbau*
	Münchener Rück	*Industrie Kredit Bank*	*13.4%*	*Kreditanstalt für Wiederaufbau*
2001-	Allianz AG	Karlsruher Lebensversicherung	36.1%	Münchener Rück
	Allianz AG	*HypoVereinsbank*	*13.6%*	Münchener Rück
	Münchener Rück	BayerischeVersicherung AG	45%	Allianz AG
	Münchener Rück	Frankfurter Versicherung	49.9%	Allianz AG
	Münchener Rück	Allianz Lebensversicherung AG	40.6%	Allianz AG
	Münchener Rück	*Dresdner Bank*	*10%*	*Allianz AG*

**We use a different print when the purchase involved bank's shares.*

On the purpose of the present research it is important to notice that all the major share transactions took place in 2002, so 9 months later than announced[204]. The reason is that all the participants aimed to benefit from the new German capital gains tax free regulation.

Let us now test the following hypothesis: Dresdner Bank is part of the core of the German financial system.

If this holds true, the shareblock owned by other core companies of the German financial system should have increased between 1994 and 2000/2001. As the block held in 1994 was 27.70% and the block held in 2001 was 100%, Dresdner is a core financial company. Since the company is fully controlled by Allianz, also the 25% test is fulfilled. Both results fit with the evidence of Wenger for 1994.

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[203] Deutsch, Nassauer, Quitzau (2001).

[204] All the announced transactions were carried out on 17 January 2002. Allianz (2002).

Company	Shareholder	1992	1994	1996	1998	2000	2002
Dresdner Bank AG	Allianz	24.00%	23.30%	22.60%	12.30%	21.20%	100%
	Deutsche Bank	0.80%	0.80%	0%	0%	0%	0%
	AMB	0.50%	0.80%	0%	0%	0%	0%
	Bayerische Hypobank	1.30%	1.30%	1.27%	1.27%	1.27%	0%
	Münchener Rück	0%	3.40%	9.87%	9.78%	3.99%	0%
	Victoria AG	2.20%	2.10%	0%	0%	0%	0%
Total		28.8	31.70%	33.74%	23.35%	26.46%	100%

Source: Monopolkommission(1994, 1996, 1998, 2000, 2002).

We can notice that most of the non-core financial institutions, as defined by the present research reduced their block holdings before Dresdner finally merged with Allianz in 2002.

This seems to be an evidence of Wòjcik's hypothesis.

Finally, we would like to underline that during the period we analyzed the unwindening of cross-holdings among big financial institutions went along with the creation of major agreements among banks and insurance groups, the so-call bancassurance[205]. The creation of conglomerates in financial services has been gathering pace for about a decade in Europe[206], and after the accordance of permission to the Travelers-Citicorp merger, also in the USA, and so cannot be considered a feature of just the German financial system. In 2001 all the main German banks enjoyed agreements with at least one big insurance company:

Allianz-Dresdner Bank
Münchener Rück-Ergo-Hypovereinsbank
AMB-Generali-Commerzbank
Parion-Bankgesellschaft Berlin[207]
Gerling-Deutsche Herold-Deutsche Bank[208]

6. Conclusion

The aim of the present research was to analyze the major changes in the German financial system during the period 1994-2001, in particular with a focus on 1994-2000.

In order to do this we tested Wòjcik's hypothesis about a different role of block holdings in big German companies, comparing the results with Wenger's map of "Deutschland AG" and using data of the Monopolkommission on shareblocks among the 100 biggest German companies and supervisory board mandates .

According to our research the spider net of cross-holdings was partially simplified, and in particular we can consider two different levels of change.

The center of the Deutschland AG is still represented by the strong relationships between the two biggest insurers Allianz and Münchener Rück, and two of the biggest banks Hypovereinsbank and Dresdner Bank (now part of Allianz Group). These two "blocks" represent both the major players in

[205] Einecke (2001), 24.

[206] Morrison (2002).

[207] Parion Group has a 2% stake in Bankgesellaschaft Berlin which in return has a 5% stake in Parion Holding Berlin AG.

[208] In 1992 Deutsche Bank purchased the insurance company Deutsche Herold, and focused it on bancassurance products. In the second part of the 90's it reached a 34% share block (24.35% of the voting rights) in Gerling, a German insurer with a strong focus on credit insurance, industrial insurance and reinsurance services.

the insurance market and in the banking market, and can be considered the "core of the German financial system".

On the contrary, if we consider the border of the German financial system we notice that some major changes occurred, in particular:

Two of the biggest private banks with the legal form of an Aktiengesellschaft (BfG and BHF) were purchased by foreign banks, which eventually unwinded most of their cross-holdings with other German corporations. At the same time also two of the biggest insurers AMB and Colonia Versicherung[209] were foreign hold. Two special purpose banks, Kreditansatlt für Wiederaufbau and Industrie- Kredit-Bank decided to intensify their cooperation.

According to our opinion these changes were the results of the following main driving forces:

- Cross-holdings proved to be unable to provide full merger benefits. This attitude was confirmed by Allianz's purchase of Dresdner Bank, and by the disposal of cross-holdings after the BHF-ING merger. Anyway we have to underline that, like in most of continental Europe, cross-holdings have been used to strengthen cooperations in the bancassurance field (Parion-Bankgesellschaft Berlin, AMB-Generali-Commerzbank, Gering-Deutsche Bank).
- The importance of the reform of the capital-gain tax was underlined by the fact that most of the disposals announced after 2000 took place after 1 January 2002, thus enjoying the new fiscal frame, even if since the second part of the 90's the big banks began to disinvest their industrial interests: on this purpose they created special purpose societies that acted as trading units, so enjoying a better fiscal treatment[210].

Finally we would like to underline that the figures reveal that banks can exert influence via their supervisory board mandates, but the impact is easily overestimated[211], and so in spite of a commonly referred "Macht der Banken" (power of the banks), insurance groups emerged as the strongest financial groups at the end of the 1990's.

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[209] Colonia Versicherung was purchased in 1993 by the former French insurer UAP: in 1997 UAP merged with the other French insurer group AXA.

[210] For example in 1998 Deutsche Bank created DB Invest, as a separate legal entity whose aim is to dispose of Deutsche Bank's industrial asset portfolio.

[211] This is in part due to the fact that before of the Aktiengesellschaftsgesetz of 1965, which established a maximal number of 10 mandates per person, the most important bankers sat in a great number of boards. For example Hermann-Josef Abs, a former chief executive of Deutsche Bank AG, simultaneously held up to 30 seats on supervisory boards.

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