Corporate Law and Corporate Control in West Germany after 1945[*]

I. Introduction

The numerous labels for Germany's coordinated market economy consistently emphasize the role the stock corporation law played for cooperative arrangements within in the economy – most obviously in the model of the "Deutschland AG". It describes structure and dimension of financial and personal interlocking in the postwar West Germany (Streeck/Höpner 2001). Especially the bipartite governance system with an executive (*Vorstand*) and a supervisory board (*Aufsichtsrat*), proxy voting rights, interlocking directorates and – since the 1950s – codetermination are considered as instruments of a corporate governance, which to a large extent was a bank-based and stakeholder-oriented insider system (Dutzi 2005).

In a macro-perspective this governance system enabled cooperative arrangements and communication between stakeholders. Especially bankers, employers and trade union' officials, but also politicians and scientists could as supervisory board members principally influence business strategies by embedding social goals – as indicated by numerous literature (e.g. Streeck/Höpner 2001).

However, from a business history perspective, the practical level of corporate control and corporate governance still deserves closer attention. How did the German stock corporation act affect control arrangements within companies and to what extent could the legislator regulate corporate control anyway?

II. Some remarks on the relationship of law and corporate control

At first glance, the intention of the legislator is pretty obvious: § 111 of the German stock corporation act simply determines, that the *Aufsichtsrat* has to supervise the management. This rule existed from the very beginning of the modern stock corporation in 1870. However, until 1937 the supervisory board's duties could even be extended. For example, it was possible to devolve management's obligation to the supervisory board. This was finally permitted in the 1937 revision of the act.

But this is a rather formal view. The stock corporation act only roughly outlines the definition of property rights within the companies. There are some general rules for

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each body – the shareholder's meetings (*Hauptversammlung*), the executive board (*Vorstand*) and the supervisory board (*Aufsichtsrat*), which only determined a minimum level. The company's statute defines further rights. In combination, law and statute provided the framework for corporate control but did not regulate it in detail.

The supervisory board is the main control body within German companies (Lutter 2007). However, in a juridical perspective the corporations are not organized in a hierarchical but in a collegially way. The competences of shareholder's meetings and especially of the supervisory board thus limited the executive board's scope in two ways: 1.) The companies' statutes usually ruled, that strategic decisions had to be approved by the control body explicitly. In the 1960s, in nearly fifty percent of the stock corporations the supervisory board could even extend its competencies unilaterally. 2.) Moreover, one of the supervisory board's duties was to hire or fire the members of the executive board which implies a cooperative business conduct: Any executive board member that permanently acted against the supervisory board's interests certainly would not maintain its position for a long time.

At this point it becomes tricky, because, in fact, the formal division of management and supervision was thus watered down to some degree. The executive board always had to convince the supervisory board that its prospective strategy was right. Therefore the management had to inform the supervisory board about its plans before it could implement them. Thus, the supervisory board was involved in strategic decision making even though the stock corporation act made this mandatory not up to 1998. De facto, not de jure the supervisory board had to fulfill a dual role: On the one hand the supervisory board was a control body, which had to ensure that the business policy was *legitimate*, and on the other hand it was an advisory body and thus part of strategic management, which had to ensure that business policy was *appropriate*.

Only the first role was regulated by law. The second role was not a priori determined but negotiated by the actors within the company. Accordingly, there was a wide range of internal control arrangements that could differ from company to company. Moreover, for the supervisory board generally acted as a trustee of the shareholders principal agent conflicts – e.g. about strategies or dividend payments – were systemically intrinsic.

However, for several reasons, these conflicts were confined to comparatively small groups of actors during the first half of the 20th Century. The general public was more or less excluded from shareholding due to economic and regulatory reasons. Therefore, in the 1950s several interest groups aimed to reform the stock corporation act for mainly three reasons: At first, the specific Nazi rules, especially the dominant position of the executive board, should be altered. At second, the quick reconcentration process in German industry fostered a debate on publicity; henceforth any equity investment larger than 25% had to be disclosed. At third, economic power should likewise be reduced by facilitating access to stock, especially for retail investors. Therefore, investor's rights and publicity should be increased. E.g. the revision of the stock corporation act in 1965 aimed to hamper the concealing of inner reserves in the balance sheets (Kropff 2007).

But there was no explicit demand to change the system of corporate governance in total. With regard to corporate control, the 1965 stock corporation act only modified some rules but left its structure intact. The most important intervention was the reduction of possible seats in supervisory boards from 20 to 10 per person.

III. Control or Strategic Decision? Some quantitative findings

Formal corporate control as required by law was more or less a routine. Supervisory boards roughly held four meetings a year that lasted two up to four hours each. Legally effective decisions usually were unanimous (Bleicher 1987). But, of course, corporate control went far beyond the legally necessary. In the 1960s, less than ten percent of German stock corporations made use only of the control rights provided by law. Sixty percent had established informal and cooperative forms of control, and another thirty percent even formalized additional reporting standards for the executive boards. The 1965 law did not change this general system of corporate control as table 1 indicates.

Table 1: Use of various control instruments in German Stock Corporations 1960 (n=132) and 1979 (n=295)

Instrument	Use in ...% of Stock Corporations	
	1979	*1960*
Executive Board's reporting (Turnover, state of business)	98	92
Auditor's Report	87	--
Additional reports requested by the supervisory board	42	25
Additional autonomous audit by the supervisory board	8	12
Additional constant consulting	66	
Reports on prospective strategies/business plans	72	75
Additional constant reports on relevant issues	87	

Sources: Vogel (1980), 162; Werth (1960), 47ff.

Obviously, voluntary and cooperative instruments were more important for German corporate governance than legal ones. However, the stock corporation act demanded for such collegial arrangements and the rules laid down were only conceived as minimum standards. This holds also true for the sanctions provided by law.

The Stock corporation act enabled the supervisory board to audit account book autonomously, to query the executive board's business policy in the shareholders meeting, to convoke an extraordinary shareholders meeting, to sue the executive board, and to recall executive board's members for cause. These were severe rights to intervene in theory but in practice they more or less implied compliance. They were rarely used. Only special audits (with about 10 percent) and the right to recall executives (with about 5 percent) were practically relevant in the samples of 1960 and 1979. However, solely group corporations with a dominant shareholder recalled executives. This probably indicates, that this right was rather used to implement new strategic focusses than being a mere control instrument.

Obviously the degree of stock concentration was relevant for internal control arrangements as well. Depending on the companies power relations the supervisory board could overrule the executive board permanently or at least in some cases. This was, of course, not the law's intention but it was legal. According to the already cited contemporary studies (table 2) there is a correlation between stock concentration and the authority to decide within corporations. High capital concentration somewhat fostered a strong position of the supervisory board not intended by the stock corporation act. Otherwise, a widespread structure of shareholders made an ideal-typical control system with a deciding executive board and a controlling (and advising) supervisory board become more likely.

Tab. 2: Power Relations and Authority to Decide in German Stock Corporations depending on Structure of Stock (1960)

Decisive Body	Dominated Corporations		Powerful owners		Widespread stock		Total	
Executive Board only		44,0		50,0		73,3		48,5
Executive and Supervisory board (Prevalence Executive board)	*10,8*		*16,7*		*13,3*		*20,5*	
Executive and Supervisory board equally	*23,7*	= 49,5	*16,7*	= 50,0	*6,7*	= 26,7	*12,1*	= 47,0
Executive and Supervisory board (Prevalence Supervisory board)	*15,0*		*16,6*		*6,7*		*14,4*	
Supervisory Board only		6,5		0,0		0,0		4,5

Sources: Werth (1960), 98. Dominated Corporations = 50 % of Stock and more in one hand; Powerful owners = less than 50, but more than 25 % in the hand of major shareholders.

But widespread shares did not necessarily improve control. The more ownership and control fell apart, the more the management extended its control competencies. This indicates that a comprehensive regulation by law was not possible or at least not practicable. This was – by the way – a main argument of business lobby groups in every discussion about corporate laws.

All in all, the statutory provisions defined only minimal standards and the legal sanctions were mostly instruments of last resort. The more relevant factor for the business policy and its control were the internal arrangements and especially the relationship between executive and supervisory board. The supervisory board was designed by law as a mere control body but its function within the companies went far beyond its legally defined duties. Since the 1870s (members of) supervisory boards always actively took part in strategic decision-making as well. The supervisory board thus was rather an advisory than a control board – not by law but in practice. In the 1970s, for example, nearly every second strategic decision – such as equity or facility investments, and mergers – had its origin in the supervisory board.

The chairman or – where established – a collegial head of supervisory board (*Aufsichtsratspräsidium*) usually acted as the "communicative center" of the control body (s. table 3). They informally either pre-discussed decisions with the executive board or initiated a decision-making process because of information advantages they derived from a central position in business elite networks. Especially this is true for "big linkers" as Hermann Josef Abs (Deutsche Bank) or Jürgen Ponto (Dresdner Bank).

Tab. 3: Specific informal contacts of executive and supervisory board (ca. 1979, N=295); in %[1]

Frequency of contacts	Head of supervisory board	Shareholder's delegates	Employee's delegates
Weekly	15	13	15
Monthly	25	25	31
Several times a year	16	32	28
In Total	66	70	74
Compared to 1960	44		–
No contacts, no accessible information, no formal head of the supervisory board	34	30	26
Compared to 1960	56		–

Sources: Vogel (1980), 181, Werth (1960), 48.

The existence of big linkers and personal interlocking in general often is described as an essential feature of German (or Rhenish) capitalism. Especially the coordinative function and the influence on the distribution of (informational) resources are

[1] The comparable higher quote of informal contacts to employee's delegates from the industrial councils or trade unions resulted from their legal competencies in all social questions, e.g. employment law, social compatibility, or downsizing. This made an early approach reasonable for the management to identify potential conflicts and resistance at an early stage.

highlighted in this regard. Some authors even detected a predominant position of a few numbers of bank directors – and thus mediate a distortion of competition. The supervisory board's chairman had – as a rule – a discrete scope of action, which certainly could be a power resource. But it is rather doubtful, whether the informal communication *as such* was an instrument to exert influence on business policies. But in certain constellations, especially crises, it *could* be a resource: There is some evidence that corporations, which were linked to the financial and personal business networks, had more options in the case of a crisis than companies from the outside (Tilly 2005). But being part of the "Deutschland AG" was no guarantee to overcome business difficulties better. It only provided more opportunity structures.

In an ideal-typical view, in the 1960s and 1970s three types of corporate governance arrangements can be distinguished (Vogel 1980). 1.) The supervisory board as the de facto executive body with a weak and un-influential (but legally responsible) executive board. 2.) The supervisory board as a control body with advisory functions as intended by law. 3.) The supervisory board as a body of representation, which only exercised the legal minimum control. Roughly 60 percent of the sample is counted among the second type, which fully matched the legal norm. The other 40 percent of companies either had a superior supervisory or a superior executive board. However, those 40 percent still acted on a legal basis even though they did not meet the law's expectations.

Anyway, this classification might clarify some dimensions of governance regimes but it does not show, whether belonging to one of the three categories made corporate control more or less effective. Several case studies indicate that an effective corporate control did *not* depend on an ideal adaptation of rules laid down by law. There are on the one hand, e.g., entirely confusing reporting and control structures at the *Metallgesellschaft AG* (Reichel 2008), that had no significant negative impact on the business policy as long as those actors lived, which were used to these control arrangements. On the other hand the *Stollwerck AG* (Kronenberg/Gehlen 2012) nearly had structures in an exemplary manner, which, however, did not prevent the company's failure in 1970/71.

Because not only in this case the management had constantly misinformed their supervisors, the role of personality and personal skills entered the limelight. In manager's and supervisor's views this became the predominant argument in the (short) discussion about a reform of corporate control in the 1970s (as it was in earlier and later times). But, of course, an individual factor such as personality confronts actors and especially the legislator with severe imponderabilities, which barely could be regulated by law (Bleicher 1987).

IV. Conclusion

The German Stock Corporation act had and intensifying effect on the interlocking of the "Deutschland AG" but it did not necessarily guarantee an effective control of legitimate *and* appropriate business politics. Corporate law neither could prevent deficits of business control nor business failures. It provided a structure for the actors - management and supervisors – which led to both, effective and ineffective control arrangements in West German corporations.

The supervision of the legal minimum standards of corporate control simply was business routine. Conflicts usually arose from the shapeable relationship of the executive and the supervisory board, which made an effective regulation of corporate control in Germany rather a task for insiders and businessmen than for the legislator.

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