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Financing Rhenish Capitalism: "Bank Power" and the Business of Crisis Management

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1. Introduction

The German tradition of "house banks" financing industrial enterprises over long periods, often accompanied by capital participations and memberships on supervisory boards, is considered a core element of Rhenish capitalism. Michel Albert described German industry as being controlled to a large part by the few big banks, thus reinforcing the more elaborate concepts of Rudolf Hilferding's *Finance Capital* and of Andrew Shonfield, whose international comparison of *Modern Capitalism* characterized the banks as "prefects" of the German economy. Sociological research on company networks in terms of "Germany Inc." ("Deutschland AG") also came to the conclusion that asymmetrical distribution of power allowed banks to influence the business strategies of industrial enterprises. It was also argued that this influence was executed in industry's favor by accepting moderate but steady shareholders' profits – which, in turn, made it easier to find distributive compromises with trade unions – and by protecting companies against unfriendly take-overs until the dissolution of the network since the 1990s.

In the banks' favor, board memberships and proxy voting rights in shareholders' meetings enlarged their monitoring potential and allowed for interventions if their industrial debtors showed symptoms of crisis. In theory, the house bank tradition thus created trust through continuous personal contacts and through privileged access to information about the customers' financial situation and economic perspectives. The banks' interest in long-term business relations also encouraged a strategy of "voice" (i.e. intervention and financial assistance) instead of "exit" (short-term profit-taking or reduction of losses) in case of liquidity problems or take-over attacks.

To explore the business practice of these dimensions of "bank power" or "bank hegemony" and its limits, the paper will analyze bankers' options and strategies – including the problem of cooperation and competition among banks – in historical situations where large industrial customers were in need of assistance. The short case studies are taken from the time when Rhenish Capitalism had to face the gradual fading of the "economic miracle" and German industry increasingly had to rely on external finance instead of profits (thus presumably even enlarging the banks' influence): the paper deals with the failure of the Schlieker concern in 1962; the liquidity crisis of Krupp in 1967; the establishment of the building concern Bilfinger + Berger from 1969 to 1975; the take-over of Demag by Mannesmann between 1972 and 1974; and the financial restructuring of AEG around 1975.[1]

2. Case Studies

It must be noticed that these examples are of a very limited representativeness with regard to the German financial industry as a whole: we are talking about a few, relatively well researched big banks like especially Deutsche Bank, Dresdner Bank, and Commerzbank, and their customers from big industry. These three banks only had an overall market share of a bit more than 10 per cent around 1970, but dominated certain fields of business like the stock market or credit transactions with big industry. Regarding their influence on these big customers, the dual board structure as a core element of the German system of corporate governance stands center of the bank power argument: banks were represented above average in the supervisory boards which had the task to control the corporate policy of industry's boards of management. But again, one has to be careful in generalization. In the mid-1970s, only in one third of the roughly 2.000 non-bank stock corporations of the Federal Republic, banks' representatives were members of the supervisory board (and we know practically nothing about the financial relations of smaller enterprises except the fact that banks must have done some kind of financing). But among the 66 biggest corporations listed on the stock exchange, nearly 90 per cent had bankers on their boards, and regularly more than one – most of all delegated by the three big institutes already mentioned, but also by Bank für Gemeinwirtschaft, Bayerische Vereinsbank and Bayerische Hypotheken- und Wechselbank.

Until recently, historical research on the role of banks in the 1960s and 1970s has not spent much attention at business practices on supervisory boards of their customers but has rather looked at how they exercised their basic economic task – granting or denying credits. Consid-

[1] The case studies are mainly based upon the following works: Richard Tilly, "Trust and Mistrust: Banks, Giant Debtors, and Enterprise Crises in Germany, 1960-2002", *Jahrbuch für Wirtschaftsgeschichte/Economic History Yearbook* 2005, no. 1; idem, *Willy H. Schlieker. Aufstieg und Fall eines Unternehmers (1914–1980),* Berlin 2008; Lothar Gall, "Von der Entlassung Alfried Krupp von Bohlen und Halbachs bis zur Errichtung seiner Stiftung 1951 bis 1967/68" in idem (ed.), *Krupp im 20. Jahrhundert. Die Geschichte des Unternehmens vom Ersten Weltkrieg bis zur Gründung der Stiftung,* Berlin 2002, pp. 473–589; Bernhard Stier/Martin Krauß, *Drei Wurzeln – ein Unternehmen. 125 Jahre Bilfinger Berger AG,* Heidelberg 2005; Ralf Ahrens/Johannes Bähr, *Jürgen Ponto. Bankier und Bürger. Eine Biografie,* München 2013.

ering the spectacular failures of Carl Borgward, Willy Schlieker and the two Stinnes brothers in the early 1960s, one may come to the conclusion that the maintenance of close and frequent contacts via supervisory boards encouraged the necessary confidence of banks in their debtors. In the cases mentioned, bankers' contacts with industrialists claiming exclusive competences of decision-making ("masters of the house") was not very close, and trust could rapidly overturn into mistrust in times of crisis. The iron and shipbuilding industrialist **Willy H. Schlieker** for example, one of the legendary self-made men of the "miracle" years, failed in 1962 due to a lack of equity capital which was the result of Schlieker's insistence on personal ownership instead of external participators. A rapid intensification of international competition in shipbuilding changed conditions in favor of the ship buyers, the resulting liquidity gaps could not be bridged by equity capital or by the profits of other conglomerate enterprises; some of these enterprises also functioned as securities for short-term credits. When Schlieker became illiquid, his creditors (and also the city of Hamburg that was asked for backup) proved unwilling to extend loans without more detailed information. Schlieker, in turn, was unwilling to present more than his word of honor, which he even broke. After their industrial customer had lost reputation and denied them access to more intense monitoring, the banks finally exercised the exit option and did not prolong credits anymore.

Fundamentally different was the outcome of the existence-threatening liquidity crisis of **Krupp**, though it also had some origins in a lack of trust. The old-established steel concern was completely the Krupp family's property. The holding company was organized as a private firm without formal monitoring institutions open to outsiders, and the whole concern was afflicted by structural income weaknesses which the involved banks had ignored for a long time. When Krupp nearly suffered illiquidity in 1967, the banks helped out with another large credit. But they only did so after the state and federal governments had put loan guaranties, and after the concern's owner Alfried Krupp had agreed to transform the holding into Fried. Krupp GmbH, a limited liability company with a supervisory board. In this case, the banks indeed executed power through conditional lending (and although they held no capital participations), and their control position was strengthened in terms of formal institutions. The professionalization of control structures toward the dual board system was a precondition to exercise their "voice" option, as were the state guaranties that reduced their risk. But soon it became obvious that their power was highly dependent on how dramatic and urgent liquidity problems were, and that it was limited by the rivalry among them: in 1970, Alfried Krupp's executor of a will, Berthold Beitz, was able to dispossess Deutsche Bank's Hermann Josef

Abs as chairman of the supervisory board and to take over the position by himself (and Abs was certainly still one of West Germany's most powerful bankers in terms of supervisory board presence and political connections). Afterwards, the banks that were engaged in Krupp's financing certainly utilized their control possibilities but often they mainly acted as mediators between Beitz and the board of managers instead of redirecting the still unprofitable concern.

The third case, the merger of three medium-weight building companies to one of the big players of that industry: the still-existing **Bilfinger Berger** combine, shows a bank really exercising power and pursuing its own 'industrial policy'. Dresdner Bank held participations in all three companies, i.e. Julius Berger (Wiesbaden), Bauboag (Düsseldorf) and Grün & Bilfinger (Mannheim). The bankers had aimed at a concentration of their interests in the building sector since 1964, but only in 1968 a disastrous slump in the current earnings of Berger in combination with insufficient information policies offered the chance to replace the stubborn CEO by two Bauboag managers. These two were factually delegates of the supervisory board's chairman Jürgen Ponto. After the merger in 1969, Dresdner Bank held 65 per cent of the Berger-Bauboag capital. Ponto remained chairman of the supervisory board and demanded insistently for a second merger with Grün & Bilfinger, but it took six more years and another, this time cyclical, crisis before this final step was done. What we can learn from the Bilfinger Berger case is that fundamental changes in structure and governance of industrial enterprises under certain conditions indeed could be enforced by banks. In this individual case, however, these changes were highly dependent on the personal commitment of one banker and were backed by substantial capital participations of one bank. And even under these general conditions, it took two economic crises and a lot of time to complete the mergers.

The Bilfinger Berger mergers also highlight the importance of the German dual board system. The take-over of Deutsche Maschinenbau-AG (**Demag)** by **Mannesmann** demonstrates how banks could get into conflict about the ways of their industrial partners when two or more of them were represented on the supervisory board. Here, Ponto acted as a person of trust for one fraction that wanted to keep Demag independent, while Deutsche Bank's Franz Heinrich Ulrich backed Mannesmann CEO Egon Overbeck who was pursuing a complete take-over of the machine building company since 1972. Until 1974, their aggressive strategy succeeded, not least because there were no other big investors willing to rival Overbeck. Even Ponto was, for simple commercial reasons, unwilling to let Dresdner Bank buy Demag shares. Loyalty reached its limits where the balance sheet of his own company was affected, and the outcome of the buy-out conflict was obviously not determined by "bank power" but by industrialists' interests and buying potential.

Finally, the financial restructuring of **Allgemeine Electricitäts-Gesellschaft AEG-Telefunken** (AEG) in the mid-1970s demonstrates the limits, and the risks, even of a more or less concurrent engagement of banks. The electrical equipment concern had expanded rapidly in the 1960s, mainly financed by bank loans and without looking at cost-benefit ratios seriously enough. When dividend payments were stopped in 1973, structural deficiencies became obvious and were aggravated by a big loss from the nuclear power branch shortly thereafter. Spearheaded by Dresdner Bank's chairman Jürgen Ponto, who became chairman of the AEG supervisory board in 1975, the banks took high risks to keep one of Germany's industrial legends alive: they transformed short-term into longer-term credits, and they bought the new shares from a capital increase at a price far above their market value. The banks thus opted for an active commitment that requested tight cooperation and trust among them, i.e. the constellation was the opposite of the Mannesmann-Demag case. Moreover, Ponto installed a new chairman of managers – but only to watch the shop morale go down on account of his sharp reorganization measures, while his earnings announcements remained more than overoptimistic. The monitoring potential of the banks remained low, their only power in the last instance was lending money or spending it for shares. But the exercise of this sort of "bank power" did certainly not guarantee the stabilization of an industrial customer: the banks exerted their "voice" option only to see AEG going down further over the next few years and offering a settlement in 1982 in which they realized high damages.

3. Conclusion

In the 1960s and 1970s, West German big industry was facing structural deficiencies and sometimes dramatic crises that required far-reaching reorganizations and the provision of external capital or credit by banks. In general, banks seem to have preferred a policy of intervention and assistance to their customers instead of the short-term reduction of losses in situations of crisis. The Schlieker failure nevertheless demonstrates that this disposition was of course limited by risk analyses and that trust in big debtors could rapidly turn into mistrust. Trust required a minimum of control, and the banks' monitoring potential was increased by the dual board system, where bankers acted as supervisors of industrial managers.

The presence of banks' representatives at supervisory boards, ideally a chairman position, was also a precondition to exert influence beyond the simple 'power' to lend money or not (which was not power per se as long as there were competitors eventually willing to step into the breach for whatever reason). The presence of various banks at the supervisory board of one firm strengthened the banks' influence by trend, but – as the Demag case shows – could also split them into fractions under certain circumstances. Their influence was exercised basically through the choice of management personnel, but also through approval or denial of bigger investment projects. But only in times of severe crises did banks really try to govern industrial companies in the sense of prescribing management decisions. In general, they were neither competent for industrial management nor interested in it. The basic interest of West German big banks with regard to their industrial customers was the maintenance of long-term business relations in their various fields of activity.

Moreover, the cases of Bilfinger Berger and AEG demonstrate that crisis alone was not a sufficient circumstance to enforce a bank's interest successfully: in the first case, the house bank could enforce a merger and thereby initiate an effective restructuring; in the second, a massive collaborative intervention of banks finally resulted in big losses. In a situation like this, the banks were able to take over additional shares of an industrial enterprise, thus increasing their potential hegemony over the management and the other shareholders. But they also bore additional risks, and their potential to redirect management strategies and control their implementation was limited. Where there were no acute financial problems, like in the case of Krupp after 1967, influence on corporate policy was limited even stricter.