
Corporate Governance in Three Economies: Germany, Japan, and the United States

Introduction

The basic structure of corporate governance is that there is a set of representatives selected by the stakeholders, who in turn select management to run the corporation. While the basic structure is the same, the manner with which it gets implemented varies from country to country. The variation is in how stakeholder is defined and in the relationship between the supervisory board and management. Part of those differences is cultural, but a large part is due to historical happenstance. For example, the role of banks as stakeholders varies internationally. In the United States, banks play almost no role in the corporate governance of firms. In Japan and Germany, however, banks are major players. A good part of this is due to the way banks were chartered in the United States by individual states and were prohibited from having branches in other states. In some cases, U.S. banks could only have branches in a limited area within a state. At one point just before the stock market crash in 1929, there were more than 17,000 commercial banks operating in the United States. Even in 1950, there were more than 14,000 commercial banks in the United States, while Germany had little more than 200, and Japan had only about 85. This lack of a national banking system made using bond and equity markets more attractive in the United States versus access to the large banks found in Germany and Japan, where banks provided most of the long-term financing. Consequently, banks play a much larger role in corporate governance in German and Japan than in the United States. Although this type of factor does not fully explain all the differences seen across markets, it does represent the kind of indirect influence that results from other types of decisions.

In the following sections, we will explore some of the basic differences that can be seen in the corporate governance structure across countries.

German Corporate Governance Structure

There are a number of different forms that business units can take in Germany. These include sole proprietorships, partnerships, cooperatives, and limited liability companies. The limited liability companies are closest to the U.S. and UK corporate forms. The other forms do not have limited liability. There are two kinds of limited liability companies in the German economic system. The first and most numerous (more than 438,000 in 1999) is the *gesellschaft mit beschränkter haftung* or GmbH, a partnership with limited liability. These firms usually do not issue shares, and transfer of ownership is difficult. The other form is *aktiengesellschaft* or AG, a limited liability company that issues shares. The proportion of total sales by each legal structure is shown in **Table 1**. It is obvious from **Table 1** that the average size of the GmbH is much less than the AG, even

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though GmbHs do account for the larger proportion of total sales. Although there are some very large firms that maintain the GmbH structure, most large firms are AGs.

Table 1. Average sales by corporate form 2012.

Range of Sales (Millions of Euro)		AG			GmbH		
From	To	Number*	Total Sales**	Average Sales	Number*	Total Sales**	Average Sales
0.02	0.05	552	18	0.03	50,551	1,650	0.03
0.05	0.10	467	34	0.07	53,175	3,909	0.07
0.10	0.25	908	153	0.17	96,739	16,109	0.17
0.25	0.50	791	293	0.37	83,974	30,396	0.36
0.50	1.00	878	626	0.71	81,584	58,404	0.72
1.00	2.00	867	1,242	1.43	64,078	90,620	1.41
2.00	5.00	1,090	3,506	3.22	51,513	160,463	3.12
5.00	10.00	641	4,533	7.07	20,656	143,968	6.97
10.00	25.00	634	10,091	15.92	13,866	213,062	15.37
25.00	50.00	349	12,540	35.93	4,902	169,955	34.67
50.00	100.00	260	18,682	71.85	2,623	182,062	69.41
100.00	250.00	257	40,804	158.77	1,655	253,266	153.03
250.00	more	343	936,108	2,729.18	881	879,585	998.39
	Total	8,037	1,028,630		526,197	2,203,449	
* Number of taxpaying entities							
**Sales of company, excluding VAT in millions of euros							

Source: Statistisches Bundesamt, Statistisches Jahrbuch 2014: Table 9.13.1 (In German).

The corporate governance structure of the AG and the GmbH are somewhat different. For small GmbHs with fewer than 500 employees, there is a simple governance structure. The shareholders appoint a managing director, the *geschäftsführer*, who is responsible for the management of the firm. For GmbHs with more than 500 employees and all AGs, there is a management board called the *vorstand*. This group is jointly responsible for all aspects of the management of the firm. Separate from the *vorstand* is a supervisory board called the *aufsichtsrat*, which appoints the members of the *vorstand*, and approves capital expenditures, strategic acquisitions, closures, and dividends. Of this list, appointing the members of the *vorstand* is the most important, since the *vorstand* is the group that will manage the firm. In the case of all GmbHs and AGs with less than 2,000 employees, the membership of the *aufsichtsrat* consists of two-thirds shareholders' representatives and one-third employees/union representatives. For larger AGs with more than 2,000 employees, the proportion of shareholders to employee representatives is 50:50, and a neutral individual is the chair. It is important to note that the employee/union representatives do include white-collar as well as blue-collar employees. To the extent that shareholders wish to limit the impact of employees, there is a substantial incentive for a large firm to remain under the GmbH form for a long time.

The shareholder representatives on the *aufsichtsrat* are appointed for four years by the general meeting of the shareholders. This raises the question of just who the shareholders are. From **Table 2**, there is quite a bit of difference regarding which sector owns shares when comparing Germany, Japan, and the United States. The distinction is in the roles of banks and other enterprises. Historically, German corporations have received the majority of their outside funding from large banks. From their very beginnings, German banks operated as a combination of commercial bank, investment bank, and investment trust. They were planned primarily as

institutions for financing industry.¹ The result was that as the association between the companies and the banks grew, German banks took on equity stakes in order to monitor the firm. In 1995, banks held about 10% of the outstanding shares in German companies; however, in 2002, there was a change in capital gains taxation that allowed banks to divest their equity holdings without paying capital gains taxes. Consequently, bank equity holdings in nonfinancial firms decreased substantially. Yet it is interesting to note that while bank ownership declined, bank representation on the board declined only modestly and was about 8% of total board membership across a large sample of firms.² Thus **Table 2** shows that U.S. banks hold essentially no shares, and there is almost no bank representation on boards of directors for U.S. companies.

Table 2. Percentage of market capitalization held by investor type-2010.

Type	Germany*	Japan**	United States***
Households	13%	20.3%	36.6%
Nonfinancial investors	19%	21.2%	1.0%
Banks	2%	18.2%	0.3%
Mutual funds and pensions	6%	6.2%	37.4%
Insurance companies	2%	6.4%	7.1%
Other investors	3%	1.0%	4.2%
Foreigners	55%	26.7%	13.3%
*Ownership structure in the German equity market: general trends and change in the financial crisis: <i>Deutsche Bundesbank Monthly Report September 2014</i> .			
** <i>Tokyo Stock Exchange Shareownership-2014</i> .			
***Source: <i>Statistical Abstract of the 2012 Census: 1201-Equities, Corporate Bonds, and Treasury Securities—Holdings and Net Purchases, by Type of Investor</i> .			

In addition to banks holding shares, there is a tradition of crossholdings in Germany, which results in firms holding each other's shares. While most discussions focus on crossholdings in Japan, we actually find a large component of German AGs; shares are held by other firms. Therefore, there is a great deal of crossholding of shares between German firms. In these cases, it is common for two firms to each have a representative of the other firm on the supervisory board.

This ownership translates into representation on the supervisory board. But it should be noted that banks have much more influence than their actual holding would represent. Because most shares of German AGs are bearer shares, there are complex rules that result in banks having control of a much larger share of the votes through proxies held for other shareholders. The result of all this is that the shareholder representation on the *aufsichtsrat*, or supervisory board, is heavily weighted toward banks and other firms.

¹ For a more complete description of the role of banks in the industrial development of Germany, see G. Stolper, K. Häuser, K. Borchardt, *The German Economy 1870 to the Present*, trans. Toni Stolper (New York: Harcourt, Brace & World, Inc., 1967).

² Ingolf Dittmann, Earnst Maug, and Christoph Schneider, "Bankers on the Boards of German Firms: What They Do, What They Are Worth, and Why They Are (Still) There," *Review of Finance* 14, no. 1 (2010): 35–71.