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# Universal banking and the performance of German firms[☆]

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## Abstract

We empirically investigate the influence of German universal banks on the performance of German firms. We take into account banks' control rights from equity ownership, banks' proxy-voting rights, and the concentration of control rights from equity ownership (which includes complex forms such as pyramids, cross-shareholdings, and stocks with multiple votes). We also account for voting restrictions and the German codetermination system (under which employees of large firms have control rights that are unrelated to equity ownership). We find that firm performance improves to the extent that equity control rights are concentrated. Moreover, bank control rights from equity ownership significantly improve firm performance beyond what nonbank blockholders can achieve. 

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## 1. Introduction

German universal banks appear to be powerful institutions in that they can own blocks of equity and vote individual shareholders' votes in proxy. This system has been controversial for over a century (e.g., Hilferding, 1910) and is addressed more recently in the report of the Gessler Commission (e.g., Studienkommission, 1979; Krümmel, 1980), but apart from Cable (1985) there has been no empirical analysis of this corporate governance system and there is certainly no agreement about the effects of German banks on the performance of firms.

One view of the German system is that German banks are large, active, informed investors that improve the performance of firms to the extent that they hold equity and have voting power from casting the votes of small investors in proxy. Banks are seen as long-term investors who oversee firms' investments and organize internal capital markets, rather than acting as myopic investors (e.g., Porter, 1992; Grundfest, 1990). The banking relationship mitigates the costs of both external financing and of actively monitoring management. Proponents of this view see German banks as a model of active block shareholders that should be emulated in stock-market-based economies (where shareholders are dispersed and institutional investors are passive). For example, Grundfest (1990) asserts: "In Germany, large banks and industrial combines exercise substantial influence over the operation of many companies and are able to effect management and strategic changes when circumstances warrant" (p. 105).

Critics of universal banking see the enormous power of banks as harmful because of conflicts of interest that a bank faces when it simultaneously is a large equity holder in the firm, is in control of a large number of proxy votes, controls access to external capital markets, and has loans outstanding to the firm. Because banks themselves seem impervious to external control, the concentration of power in banks is seen as allowing them to essentially run firms in their own interests. For example, banks can refuse to allow cash to be paid out of firms in order to maintain "hidden reserves". Or a bank might force a value-reducing merger between a distressed and a nondistressed firm, both of which it controls. Wenger and Kaserer (1998) express this unfavorable view on German banks:

> … German banks do not only provide industrial companies with loan capital but also exercise considerable voting power in stockholder