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### THE CHANGING FACE OF GERMAN BUSINESS: CAUSES AND CONSEQUENCES

Germany has become an affluent society and a leading industrial nation during the postwar years. There is much to be admired in this country: prosperity without visible poverty, thriving inner cities, convenient public transportation, an excellent infrastructure, and concern for the environment. In Germany's social market economy the interests of business, government, and society are assumed to be the same (Bowles 22), and accordingly the country maintains a social security net that provides generous benefits: education, health care, unemployment protection, welfare, pensions, and leisure time. Exports have exceeded imports every year since 1951, and by 1989 the Federal Republic had become the world's second largest creditor and largest exporter (Tillier 199). Relationships between employers and employees have been characterized by cooperation and harmony. Banking and business form an industrial-financial alliance that is both stable and highly resistant to takeovers (Albert 108). Government and industry's vocational training system produces a workforce so highly skilled it is the envy of its competitors everywhere (Randlesome 147). In short, Germany has been very successful in striking the right balance between social concerns and economic growth; it is indeed a market economy, but a very humane one (Glouchevich 12).

Is this an acceptable portrait of Germany? Yes, but only through the late eighties. A more accurate description of Germany in the nineties would look like the following.

The cost of reunification has exceeded expectations, taxes have risen accordingly, and unemployment is high. Germany has become the most expensive industrial location in the world and this has serious consequences. Production continues to be moved abroad to take advantage of lower labor costs, leaving Germany's highly skilled but expensive labor

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force to the unemployment lines. Industry and labor have been forced into adversarial positions because of these job reductions. European Union procurement rules mandate that governments seek bids on manufacturing projects from across Europe, not just within national boundaries; companies from other countries with cheaper labor are winning the contracts within Germany (“Germany’s Construction Headaches Build”). European Community member nations are encouraged to begin using common accounting methods to facilitate the exchange and comparison of financial information. German business is not used to, or comfortable with, this degree of disclosure. It gives shareholders a more accurate picture of a company’s financial position, and they are demanding that companies pay more attention to profit and loss. Banking’s traditional role as large shareholders in major industry with seats on their supervisory boards is being criticized. The original system of checks and balances may have turned into one of mutual support and protection. Germany’s small to medium size companies have been failing in record numbers. As suppliers to major industry they have suffered from the vigorous cost-cutting measures undertaken by the industrial giants in the last decade. Inheritance taxes on business assets are so high that heirs are unwilling to take over the family firm (“German Tax Debate”).

None of the changes that have been taking place during the last decade happened suddenly. Whatever changes were in progress in the Germany of the eighties have been exacerbated by three developments: reunification, progress toward European economic union, and globalization. How did Germany get where it is today and what are the consequences of its having done so?

#### THE SOCIAL SECURITY NET AND THE STATUS OF TAX REFORM

The social market economy has two underlying principles: 1) the market should be as free as possible, particularly with respect to prices and wages (Randlesome xi), and 2) market forces alone cannot govern all aspects of society. Germany intends that social welfare measures must be available to those who cannot provide for their own food, housing, health care, and necessary consumer goods (Albert 156). Bismarck took the first modest steps toward creating a social security system to meet the needs of workers at a time of rapid industrialization. It has been developed steadily ever since, funded lavishly by obligatory employer and employee contributions (Drucker, *Post Capitalist Society* 122). It is so gen-

erous that its unemployed often enjoy greater benefits—free health care, for example—than the working poor in the United States (Schlaes, “Germany’s Chained Economy” 117). Paying for these generous social benefits has had consequences, however. Germany now has the highest labor costs, the highest environmental protection costs, the highest personal and corporate taxes, but the shortest work week (Kurland 55), making united Germany the most expensive industrial location in the world, and less desirable as a site for manufacturing.

The contributions that employers are required to make to the comprehensive social security system have increased steadily, adding to the soaring labor costs. The cost of labor in the chemical industry is, for example, over \$40 an hour, twice as high as in the US (Marsh 125). On the average, for every DM 100 of gross pay, the employer pays another DM 84 in social costs; some of these costs are the result of deals between firms and unions, rather than imposed from the government (“Springtime for Germany” 19). The high cost of labor has caused many major manufacturers to reduce their expensive domestic work force and expand internationally to produce goods more cheaply abroad (“Job Losses Soar”); these reductions in the domestic labor force have logically led to higher unemployment.

As unemployment rose during the recession of the early 1980s, government had to spend even more to assist the unemployed. Employees receive about two-thirds of their net wages for up to fifteen months and about 90% of that in welfare cash thereafter. The government also provides retraining programs and offers incentives to public and private organizations to hire the unemployed (Schlaes, “Germany’s Chained Economy” 114). The intensifying debate among labor unions, employers, and politicians about how to stem the exporting of jobs by German companies has produced no solutions, although a few unions have offered to exchange some of their wage demands for promises by companies of job creation or job security (“German Economy Gets More Bad News”).

The cost of health care benefits continues to climb as well. An employee is guaranteed six weeks of sick leave a year on full pay; after that the health insurance takes over with benefits for another eighteen months (Ardagh 199). As the population ages, the payroll tax rate for health insurance will rise considerably if no policy reform takes place (Jacquemin 256). Restructuring of the system is the alternative, but it is understandably a political minefield. Complaints come from not only consumers, but

also powerful interest groups, drug companies, doctors' associations, hospital operators, etc. (Marsh 315).

The average German worker is entitled to about six weeks of paid vacation, plus a dozen or so days off on state and religious holidays. This generous leisure time package for workers means days without production, but days that cost money nonetheless. Tax reformers suspect that too much pampering by welfare services has made people willing to work even less hard; in some cases these benefits are rewards for staying permanently unemployed. Germans have reached the limits of tolerance for tax increases; they are asking for tax reform, and to do so means making cuts in benefits. Proposals have been made that would penalize staying on welfare for those who are largely competent and healthy and whose main incapacity is welfare itself (Drucker, *Managing a Time of Great Change* 327).

A separate, but related, problem is the aging of the German population. This will inevitably lead to severe financial problems for the social security system as well, particularly with regard to pensions. In 1950 only 9.4% of the population was 65 or older (Marsh 309); by the year 2030 the figure is projected to be 37%. The birthrate in Germany has been declining since the early seventies; in 1989 for example there were 16,000 more deaths than births (Federal Republic of Germany 46). With the German "pay as you go" method of publicly funding pensions, the declining birthrate will mean that there will be fewer workers responsible for supporting an increasing number of pensioners (Schlaes, "Germany's Chained Economy" 121).

Spending on social security in 1960 amounted to a reasonable 16% of gross national product (sum total value of goods and services provided) but by 1994 it had risen to 50%. Taken together, the declining birthrate and aging of the population can be expected to bring manpower shortages, social security deficits, and increased expenditure on pensions. The generosity of this social security net in its current configuration may be a luxury Germany can no longer afford (Borrmann 118).

Over the years politicians have debated much about raising revenue by privatizing services. In the early '80s Kohl announced a plan to sell partial or total holdings in some federal assets, mentioning Volkswagen, Lufthansa, Deutsche Telekom, and Deutsche Bundesbahn among many others. This would release large amounts of capital, which could be used to subsidize future-oriented technologies (Randlesome 3). At the same

time a total overhaul of the tax system was discussed, but by 1987 German companies were still paying a total tax of 70% on retained earnings. A small reform was achieved in that year, however: The government rolled back top personal income tax rates from 56% to 53% and corporate tax to 50% (Schlaes "Tax Reform Takes Root"). Privatization did get started, even if slowly, and by the end of the decade the government had reduced the number of companies in which it had direct or indirect holdings from the 1982 figure of 808 companies to 132 companies, raising DM 10 billion in the process (Randlesome 7).

Then the unexpected happened: Reunification (Zapf 35). Kohl's 1990 election pledge not to raise taxes to pay for reunification was partially based on privatizing Deutsche Bundespost Telekom; this would have raised about DM 20 billion, but the government ruled out the idea (Randlesome 9). Instead, measures were announced in early 1991 to raise about DM 30 billion through a dozen or so tax increases. These pushed marginal rates up to around 60% for individuals and higher than that for corporations. On top of everything else came the solidarity surcharge to pay for the east ("Kohl Announces Sharp Spending Cuts"). Unemployment climbed past 10% and the economy retreated into the second recession in three years. Revenue shortfalls were in the tens of billions of marks, raising the national budget deficit to 3.6% of gross domestic product, which became an embarrassing problem. The Maastricht Treaty on European Union specified a ceiling on the national budget deficit for member nations of 3% of gross domestic product ("German Economy Gets More Bad News"). Germany had continually urged its neighbors to keep their budget deficits below the limit so that the 1998 target date for European monetary union would not be threatened ("Germany Won't Meet").

In early 1996 the Germans were finally ready to do more than talk about tax reform. Even "die Forbes Idee," Steve Forbes's flat tax, attracted attention (Schlaes "Tax Reform Takes Root"). Kohl's coalition agreed on a budget-cutting program that would reduce or eliminate a wide range of taxes on business and households and scale back the nation's welfare system. Among other things, the 50-point program would reduce sick pay, eliminate early retirements, raise the retirement age for women, make pension payments less generous, eliminate or reduce local business taxes, cut national inheritance and gift taxes, and support the creation of small and medium-size businesses by improving access to

venture capital (“Germany, France Unveil Economic Plans”). Unemployment benefits would be limited to one year for those younger than 45, and companies would have more discretion in firing workers (“Germany’s Kohl Settles”). CDU economic spokesman Uldall even proposed reducing the top marginal rate on personal income from 53% to 28%, but the immediate reaction by politicians was that such a cut was “not realizable,” falling back on the old habit of not taking into account the stimulative effects of tax reform on the productive economy (“German Tax Debate”). In summer 1996 the discussion was less about welfare reform and a reduction in personal income tax and more about raising the VAT, Germany’s rate of 15% being one of the lowest in Europe (“Meanwhile in Germany”). German businesspeople agree, however, that if the job-destroying tax system remains, German businesses will continue to move production abroad (“German Tax Debate”).

#### THE INTERNATIONAL INFLUENCE ON GERMAN ACCOUNTING METHODS

In the US, where business depends heavily on the stock market for the provision of capital, accounting principles tend to be shareholder-driven. A company demonstrates success by showing high profits; this makes management look good and keeps the share price high. In addition, high share prices help protect against unwanted (hostile) takeovers. In Germany the situation is the opposite; accounting is tax-driven. Companies are motivated to minimize profits because tax authorities use published company financial statements to determine the size of a company’s tax bill. Since German business has traditionally relied on banks to provide capital, accounting principles are oriented toward protecting these creditor banks rather than informing the investor (Randlesome 92–94). Showing high profits would likely mean that more would have to be paid out to the shareholders in dividends as well as to the government in taxes, and companies are already very effectively protected against hostile takeovers by the banks.

Corporate taxes in Germany are much higher than in the US (53% vs. 34%), but German companies get to declare lots of expenses and use very rapid depreciation to minimize profit. Under German accounting principles, companies may also set aside money to cover potential liabilities. These allowances, deductible for German tax purposes, are not under US tax law, so German companies are motivated to reserve the

maximum amount possible under law to reduce the company's tax bill (Corbridge 45). When Volkswagen announced its earnings for the first half of 1996, one analyst noted that they had reserved DM 524 million to cover possible currency loss risk. No wonder VW is therefore still considered Europe's least profitable auto maker, even though its earnings more than doubled ("Volkswagen's Net"). Taxes can be further minimized by assigning historical cost rather than current market value to assets, but accounting for liabilities at current value (Randlesome 77). Keeping the tax bill low allows companies to amass huge, hidden reserves in good times, which can then be used to provide stability in lean times. The bankruptcy rate in Germany is consequently very low, thus protecting creditors.

The German accounting firm KPMG did a comparison study in 1988 of company results for German subsidiaries in the US using both American and German accounting methods. Earnings using the German calculations were only 42% of what they would have been using the American principles (Glouchevich 52). The advantage of this conservative German approach is that nobody receives any unpleasant surprises. A company that looks, from previous years' accounts, apparently healthy does not appear to get into difficulties virtually overnight (Randlesome 92). The disadvantage of this approach, as far as shareholders are concerned, is that profits that could be distributed to them as dividends remain in the company as reserves.

In 1986, new accounting legislation was introduced that prohibited expense deductions that resulted in the hidden reserves of the past (Corbridge 46). In 1995 a securities "watchdog" agency was created; it has recently chastised companies for failing to comply with laws on timely disclosure of news that could affect share prices. Many companies, however, are still following the time-honored practice of not making public negative news, hoping that it will be masked by later positive developments ("German Firms' Disclosure Faulted"). International accounting practices are having more impact than governmental agencies, however. EC legislation recommends that its member nations start getting used to International Accounting Standards (IAS) so that comparisons can already be made across industries and countries by members of the international financial community. (Covill 42-43).

As companies try to raise capital internationally, some want to be listed on the New York Stock Exchange (NYSE), but to do so, they must

use American accounting methods; these are even more stringent than the IAS. In the early 1990s, Deutsche Bank considered listing its shares on the NYSE, but was deterred by the disclosure requirements (Matthews 1–2). Daimler-Benz became the first German company to gain a full listing on the NYSE. A full listing allows the stock to be purchased by institutional investors, insurance companies, and pension funds as well as by individual investors. The price Daimler-Benz paid for the full listing, however, was to produce two sets of accounts, one German and one American. For 1993 this produced a discrepancy of DM 2.5 billion between net profit US-style and net-profit German style, which created concern among shareholders (Covill 43). In 1996 a second German company, SGL Carbon, gained a NYSE listing, with American investors buying 40% of its \$1 billion stock offering. Chairman Robert Koehler said meeting the US accounting requirements took only three months. He felt SGL Carbon could be a model for other companies as they contemplated the hurdles of American accounting, looking for ways to raise capital and restructure loss-making units (“German Ugly Duckling”).

Dresdner Bank gave details about its hidden reserves for the first time as it announced a 17% increase in net income for 1995, reporting untaxed reserves of about DM 9 billion, which was essentially the difference between the historical value and the market value of its holdings of stocks and bonds. This disclosure amounted to a small revolution among German banks, which for decades provided the public with only scant information about their true performance. Now shareholders and analysts looking for the best deal could compare their performance and solidity with that of international rivals (“Dresdner Bank Posts”). Shareholders may also be expecting bigger dividends in the future as a result.

Other firms hope that the EC’s international accounting methods will eventually be accepted as adequate disclosure for a NYSE listing. Major German chemical firms Bayer and Schering published 1994 year-end accounts using the IAS. The Securities and Exchange Commission may indeed be interested in a compromise, since US pension funds are increasingly investing in foreign equities through foreign stock markets, thus bypassing the New York Stock Exchange (Covill 43).

#### THE RELATIONSHIP OF BANKING TO MAJOR INDUSTRY

The major German banks, Deutsche Bank, Dresdner Bank, and Commerzbank, have their representatives sitting on supervisory boards in

more than four hundred major west German companies. These supervisory boards have two specific duties: to hire and fire the management board and approve or deny major financial decisions (Regan 3). The supervisory board together with the management board is supposed to provide a system of checks and balances. Lately banks have failed to spot ballooning problems in several major companies and many are concerned that the system that was originally supposed to provide checks and balances has become one of mutual support and protection (“After Schneider”).

The 1993 collapse of Metallgesellschaft is a good example of the supervisory board failing to oversee management. Chief Executive Officer Heinz Schimmelbusch intended to combine American financial engineering with German industrial know-how. He turned a troubled metals, mining, and trading company into an international conglomerate of 258 companies around the world. When the metals prices dropped by 60% because of cheap imports from the former East bloc countries, he acquired even more companies. In 1992 he used his financial engineering skills to book a profit of \$147 million for the year by selling off assets. He then turned to oil futures, hoping to generate quick revenues, but instead brought on the ultimate collapse (Schaes 48–49). Where was the supervisory board when all this was going on? Instead of insisting on tough enough financial controls, the supervisory board was willing to trust management. The message was not so much to avoid risk, as it was to allow greater transparency in financial matters and more stringent oversight of management by the supervisory board (Schaes 48–49).

German banks are “universal banks,” that is, they combine the roles played in other countries by a variety of different financial institutions: commercial banks, investment banks, merchant banks, savings banks, stockbroker and institutional investors (Mole 33). An American equivalent of Deutsche Bank, for example, would have to look something like this: Chase Manhattan Bank and brokerage firm Merrill Lynch would be rolled into one, with the investment banking operations of Goldman Sachs. They would own 10%–25% of the shares in DuPont Chemical, General Motors, Exxon, and dozens of other major companies and have seats on their boards of directors (Glouchevich 73). These banks develop a long-term relationship with a company by offering them a complete range of financial services.

The power of these banks lies in the size and diversity of their shareholdings in Germany's major companies. The banks typically hold shares for the long term, so they are interested in the financial well-being of the company, not just short term profits (Regan 65). This system has been criticized for giving the banks too much power, but it has provided industry with considerable stability. Supervisory and management boards in the publicly-traded corporations have not had to deal with many of the problems that are all too frequent in the US: the savings and loan disaster, government bailouts of large banks, insider trading, leveraged buyouts, hostile takeovers, junk bonds, etc. (Glouchevich 77).

The close ties between the major banks and industry began in the last century. These banks were founded to finance industrialization, because large amounts of privately held capital did not yet exist. In the immediate post-war years bank finance was about the only source of start-up funding and working capital (Mole 33). The banking system has been very effective in protecting publicly-traded companies against hostile takeovers. German banks can not only vote the shares they own in a company, they are legally permitted to vote the shares they hold for their customer; thus controlling as much as 60% of the voting power in some companies (Drucker, *Post Capitalist Society* 77). As a result, hostile takeovers are nearly impossible because they can simply be blocked (Hill 202). A few recent examples include the rescue of Escom, one of Europe's largest personal computer companies. When its 1995 loss was three times its initial estimate, creditors, led by Commerzbank, put up 40 million marks in cash. The three key shareholders also guaranteed the success of a capital increase that would raise an additional 60 million marks ("As German PC Maker Posts Hefty Loss"). When Arabs threatened to buy a controlling interest in Mercedes-Benz a few years ago, Deutsche Bank intervened on behalf of the German economy to buy up the shares that were for sale, thus protecting the company from takeover (Thurow 34). Deutsche Bank further arranged for Siemens to take over the ailing computer firm Nixdorf with the goal of preserving all the jobs (Albert 108). In 1988 British Steel wanted to take over parts of Klöckner-Humboldt-Deutz, a major producer of machinery and engines. This failed due to intervention by Deutsche Bank (Randlesome 65). This also explains how Deutsche Bank acquired a 48.7% stake in Klöckner.

As competition from international banks and developing financial markets becomes more intense, banks are having to adopt cost-cutting

measures in order to offer attractive financial products to customers. Even in a country where government makes job preservation a top priority, the large commercial banks have entered into negotiations with their works councils to begin employment reductions (Keltner 65). Deutsche Bank is in a multiyear program to eliminate 15% of its staff, mostly through attrition ("High Costs Catch Up"). More interesting, however, is the growing tendency of major banks to reduce or eliminate from their portfolios industrial shareholdings in companies that have had problems recently ("German Machine Maker"). Deutsche Bank's large holdings in Klöckner-Humboldt-Deutz, in the transportation group Daimler-Benz, and in the leading construction company Philipp Holzmann will be trimmed. These actions obviously appealed to shareholders, because Deutsche Bank stock rose almost 1% on news of the possible portfolio divestitures ("Deutsche Bank Decides").

The losses these companies have incurred have resurrected the criticism of the German system of corporate governance in which banks have extensive connections to industry in the form of shareholdings as well as representation on the company's supervisory boards. As European Community legislation continues to loosen regulations, German banks may have to rethink the way they do business and become more dynamic and competitive (Glouchevich 83).

#### THE INCREASING IMPORTANCE OF THE STOCK MARKET AND SHAREHOLDER VALUE

"Shareholder value" is a concept that is gaining a foothold in Germany as international financial competition increases and stock markets gain power. Companies are reducing costs to achieve greater profits, and share prices are rising. This is even happening in state-owned monopolies as privatization gets underway. Budgets are under pressure because new bosses, many from industry, are demanding products and services that customers are willing to buy, and they want speed and efficiency in getting them to market. In many cases, research and marketing departments are talking to each other for the first time. When the head of Deutsche Telekom's optoelectronic-devices research group explained his laser explorations to the management board member responsible for R&D, he heard a new question: "How much money can it make for Deutsche Telekom?" ("European Telecom").

The German stock market is still quite small, but it is growing. The state secretary at the Finance Ministry feels it is the risk-averse nature of German investors that has hampered the development of a more robust market, stating “German investors see risk, while the Americans see possibilities” (“Germany Unveils More Details”). But attitudes have been changing in the last decade. In 1987, only about 5% of the population owned stock. By 1993 the number of shareholders has grown to about 10% of the population in the west. Most of the newcomers are in their twenties and early thirties. They belong to a generation that has not seen their inheritance diminished by war or hyperinflation (Randlesome 70). This increased interest in the stock market influences the way companies do business. Are they going to be more interested in building reserves with long-term stability in mind or in paying big dividends to attract shareholders and raise capital?

Top management positions in German industry have traditionally been awarded to those with age and experience. Many of industry’s leaders began as apprentices in their companies and gradually worked their way to the top. This explains why there has always been an abundance of top managers with technical rather than financial backgrounds and why their investment decisions have been based on technical criteria and a commitment to preserve technical leadership in the industry (Porter 376). Now a generation of younger executives with a financial orientation are moving in increasing numbers into top management positions, and companies starting to think in terms of profit and loss (Porter 376) are turning to international financial markets to raise the capital. Some examples follow.

The privatization of Deutsche Telekom illustrates this trend. Before privatization began in 1996 CEO Ron Sommer had to convince investors that it is a profit-driven competitor and not a bloated former state agency (Lowry-Miller 52). This was difficult. Consider the Essen pensioner who got a \$10,000 phone bill, even though she had averaged \$35 a month for the past 18 years. Since Telekom’s outdated systems could not produce an itemization of the charges, she was not able to rebut them. Telekom cut off the service. Because the woman had diabetes, the family tried to have an emergency beeper installed through a local hospital, but Telekom blocked that because she had not paid the first installment on her bill. Telekom officials denied that they should have handled the case differently (“Continent’s Wake-up Call”). It is not surprising that Deut-

sche Bank, the leading underwriter in Deutsche Telekom's upcoming stock offering, has decided to target the German public with massive media advertising about the benefits of shareholding prior to the offering ("Germany Unveils More Details").

Telekom needs to raise about \$2 billion of this \$10 billion initial offering in the US, but since the US Securities and Exchange Commission must approve a company's financial accounting before granting the right to list shares on the New York Stock Exchange, Telekom will probably have to produce two sets of accounts like Daimler-Benz did, one US-style and one German-style (Covill 42). But this is only one hurdle. Potential investors feel the work force needs to be cut in half for the company to be competitive, which is not easy given Germany's tough labor laws ("Deutsche Telekom's Biggest Sales Pitch"). If pressure keeps employment levels too high, the stock offering could be in trouble (Lowry-Miller 53).

When Jürgen Schrempp became CEO at Daimler-Benz, he immediately initiated cost-cutting measures by selling the biggest loss-making divisions and cutting the staff at corporate headquarters. His goals were "transparency, honesty and immediate disclosure of information." He set a high goal for Daimler's diverse operations: a return on capital of at least 12%, coupled with a requirement to be as profitable as international rivals ("Daimler-Benz Chief Steers"). Ironically, Daimler-Benz is the subject of a lawsuit by an activist shareholder group that says company officials deliberately misled investors into expecting a profit in 1995. Instead the company sustained a DM 5.7 billion loss ("Daimler, After Record '95 Loss"). It was disclosed at the annual shareholders meeting in May 1996 that management was in fact aware of the risk before the profit prediction was made ("Daimler Waited"). Shareholders may have gone without a dividend in 1995, but the members of the management board got a bonus of about DM 600,000 each for the "great burden they bore" in that year. German accounting principles, unlike American ones, do not require that individual salaries be revealed, but altogether the eight board members received nearly DM 11 million in salary for the year ("Daimler Executive Bonuses"). Shareholders were not pleased.

SGL Carbon was an unprofitable subsidiary of chemical giant Hoechst, when the CEO decided to sell it off. Today SGL is the envy of corporate Germany, with huge profits and stock that has tripled in value since its initial public offering last year in Frankfurt. CEO Robert Koe-

hler accomplished this turnaround by “becoming less German.” By changing over to more transparent US accounting methods, the company gained access to badly needed capital with the NYSE listing. Koehler has become one of Germany’s most outspoken advocates of the US concept of increasing shareholder value, calling it “a debate even the unions can’t escape” (“German Ugly Duckling”). During the last ten years, reforms have been underway to deregulate the country’s financial markets with the aim to keep them competitive as integration occurs at the EC level. Large companies have pushed for stock market reforms to help increase share value and to bring German law in line with that of other European countries (“Germany Unveils More Details”). Along with the relatively new futures and options exchange, Frankfurt is well on the way to becoming a world competitor.

#### LABOR AND JOB SECURITY

For most of the postwar period German business has been extremely private. The dual arrangement of supervisory board and management board in the major companies has separated shareholders’ interests from those of management while at the same time safeguarding employees’ needs. The number of jobs a company provides has traditionally been as important as its sales volume or profitability (Bowles 22). Strong unions and strong management form an effective alliance against capital interests, opting for high wages and benefits over profits paid out as dividends to shareholders (Glouchevich 114). It is interesting that the issues that have divided unions and employers recently are more concerned with working hours. This reflects a change away from the high performance society to a leisure society. Time to enjoy life has become more important than overtime in factories (Randlesome 120).

With international competition, the high cost of domestic labor, more transparent accounting methods, and increased shareholder scrutiny, companies have little choice but to adopt cost-cutting measures. Many industries have excess worker capacity, but labor’s strength means that laying off workers is very expensive. Some companies have addressed this problem by shortening the work week to four days at reduced pay. The savings is then used to retrain surplus workers and offer incentives for early retirement. Redividing existing jobs to avoid cutbacks in social services is not uncommon. Nevertheless, nineteen of the twenty largest

firms in Germany reported that they laid off employees in the recession of 1992–93 (Schlaes, “Germany’s Chained Economy” 114–17).

Some companies are finding ways around the unions. The chemical giant Hoechst has put its European fibers division into a separate limited company. In theory, the company will be free to negotiate its own contracts with employees, rather than being subject to the wage agreements and working conditions specified by the German chemical union and employers associations. Another major chemical company, Bayer, has placed its fibers divisions in a separate company paying union wages, but without the lucrative benefits (Williams 18). Early in 1995 comprehensive legislation concerning the restructuring of companies took effect, and changes of this nature are likely to become more common. It will facilitate not only mergers, acquisitions, and unrelated diversifications, but demergers (spin-offs) as well (Stengel 86–88).

Relocation of production outside of Germany is becoming the norm (Schlaes, “Germany’s Unchained Economy” 117) and sometimes it is not far from home. Commerce is intense along the border between Bavaria and western Bohemia. The most common arrangement is simple contract labor, in which a Bavarian company ships components or partly finished goods to Bohemia for finishing or assembly (“Propinquity Pays”). Many feel that if tax reforms do not lessen the social burdens on employers, German industry will concentrate more on exporting jobs rather than goods (Javetski 78). Other companies, however, have taken advantage of lower labor costs while simultaneously establishing a presence in one of their important export markets, for example, the NAFTA countries. BMW built a new manufacturing facility in South Carolina where labor costs are roughly half those at home (Bowles 24). Mercedes-Benz is building a sport utility vehicle in Alabama, which marks the first time the company has produced a new car outside Germany (Foust 100).

#### THE SMALL- TO MEDIUM-SIZE COMPANIES: THE MITTELSTAND

Thousands of small and medium-size companies, many of them family-owned, comprise the Mittelstand. They typically make very specialized products, with world market shares in the range of 80% to 90%. As a whole this group accounts for most of Germany’s enviable trade balance (Bowles 22–23). The names of these companies are not familiar to most people because their products generally form part of the manufacturing process, rather than being the end product itself. For example, the

Rohr company makes floating clamshell dredges for the sand and gravel industry. There are thirty-two of these machines in this country and the Rohr company made thirty-one of them. Companies in this industrial segment get premium prices for their machines; in return the purchaser gets the latest in technical innovation as well as immediate and excellent service.

In the past, Mittelstand companies have had little interest in joint ventures or partnerships with foreign companies, American or otherwise. They preferred to do their manufacturing in Germany and be their own representatives abroad. Now companies are actively seeking ties to US companies. Why? During 1993 alone, some 15,150 companies failed, throwing 200,000 people on the unemployment rolls and piling up \$12 billion in debt (Salz-Trautman 46). These companies dominated the machine tool industry, and as suppliers to an ailing auto industry, they suffered from the car makers' efforts to slash costs. Financing is a problem. If Germany's stock market were more vigorously interested in small shares, new managers could be hired and capital raised more easily. Unions would oppose this, however, because private companies are not required to appoint workers to their boards ("Champions in Pain"). Between 1984 and 1988, for example, just 70 small- and medium-sized companies turned to first-time stock issues as a means of raising funds (Keltner 62). Banking conservatism plus the lack of a stock market receptive to small issues tends to stifle entrepreneurial growth and innovation (Mole 33). The Mittelstand companies account for almost half of the industrial output and retailing, but they need professional managers, new marketing techniques, and easier access to capital in order to survive or avoid being acquired by rivals (Salz-Trautmann 46). One of the points in Kohl's April 1996 tax reform plan was to make venture capital more accessible ("Germany's Kohl ...").

Many older entrepreneurs are ready to retire, but wish to have their businesses survive as private companies with the family name. Often, however, no members of the family are willing to take over. About 300,000 such firms are scheduled to be passed from one generation to the next between now and the year 2000. Inheritance taxes on business assets are so high that four out of ten prospective heirs are unwilling to take the companies over, not wanting to suffer the tax and red tape consequences ("German Tax Debate").

## CONCLUSION

The cost of reunification with the former East Germany as well as the continuing progress toward European economic and political union have forced some changes, while others were already in progress. If reunification and European Union had not been occurring simultaneously, both may have been easier. How long it will take for East Germany to reach the same level of affluence as the West is unknown, but it will likely be achieved in the same way as it was in the West, through manufacturing and export. Tax reform has become a necessity; the social security net is endangered by an aging population and high unemployment. Privatization of former state monopolies and the search for international investment capital has led to more transparent financial accounting. Shareholder scrutiny is forcing companies to pay closer attention to the bottom line, and this often means that workforces have to be substantially reduced or production moved out of Germany. But change is inevitable if Germany is to maintain its position as an industrial powerhouse into the next century. The consequences of these changes will continue to have an impact on the decade of the '90s and beyond.

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