

Bankkredit oder Kapitalmarkt: Alternativen der Industriefinanzierung in Deutschland [Bank Credit or Capital Markets: Alternative Methods of Industrial Financing in Germany]. Wissenschaftliche Beirat des Instituts für bankhistorische Forschung e.V. Bankhistorisches Archiv: Zeitschrift zur Bankengeschichte, Beiheft 40. Stuttgart: Franz Steiner Verlag, 2002. 101 pp. €20. ISBN 3515080627.

Reviewed by Jeffrey Fear

*Bankkredit oder Kapitalmarkt* provides a clear, highly succinct state-of-the-art overview of the history of the German financial system from the 1870s to the present, omitting only the period of the Third Reich. The edited collection, which contains three articles by leading banking experts and features a debate among active bankers, represents the results of a conference, held in June 2001, that was sponsored by the IKB Deutsche Industriebank AG, a leading provider of financing to Germany's small and medium-sized businesses. Each contribution cites the relevant historiography. The clear need for German banks to redefine their long-standing role in the German economy presented the conference participants with several questions to consider: Will Germany's bank-based system of financing transform itself into a capital market-oriented one, and if so, how will this be accomplished? What form will the universal banking model take? Will other types of financing continue to emerge? Haunting the proceedings was the specter of the Basel II Accord, which "directly struck the nerve of German finance culture" (p. 8) by requiring a higher level of equity to cover the traditional long-term credit extended by German banks. Basel II is expected to take effect in 2007, and banks are already adjusting to the new requirements. The lively discussion, reprinted in the final pages of the collection, reveals some of the possible implications of Basel II.

Two historical essays, by Harald Wixforth and Paul Thomes, indicate just what a profound challenge the future holds for German banks, whose financial intermediation has been a significant source of enterprise financing for over a century. In tracing the role of banks from 1871 to the mid-1930s, Wixforth shows that Germany began to develop an equity culture before a wave of Enron-like scandals led to the 1873 "founding crash," which discredited the stock market. Thereafter, Germany permanently shifted to a bank-intermediated credit system built on "relationship banking" and universal banks. Then, as now, controversy quickly arose about the dominance of German banks over industrial firms and the relative efficiency of banking intervention versus capital markets. In line with arguments he has made in his earlier work, Wixforth stresses that banks in general had little power over industrial firms; at most, they had

leverage at certain times. The 1920s saw the nadir of banking power over industry; as in the 1990s, German firms turned to U.S. investment houses. Before 1914, the author argues, universal banks were efficient and acted as a “motor of growth.” After the stabilization of the Reichsmark in 1924, however, banks became a “crisis factor” because of their poor business policies. Wixforth suggests that, by the 1920s, large banks were not paying enough attention to small and medium-sized businesses, a complaint heard again today. However, he emphasizes how little historians still know about individual bank strategies or their relationships with small and medium-sized firms. He might have included a discussion about how the rapid growth of savings banks and cooperatives affected German finance. In terms of sheer assets and credit volume, these institutions challenged commercial banks, and by the 1920s they had depressed the loan margins and profits of the great Berlin banks (p. 35)—a complaint that is also voiced today.

Paul Thomes focuses more intently on the type of financing activated by German enterprises. Like Wixforth, he reminds readers that the financial relations of large companies have fundamentally distorted scholars’ view of Germany’s financing methods. He argues that financial constraints and credit demands of post-World War II reconstruction created a “path dependency” that anchored German industry to long-term bank credits. By 1945, Germany no longer had a capital market, but it did have rather suspect banks, which stood under the shadow of denazification and decartelization. By necessity, this tended to promote self-reliance among firms; to this day, enterprises rely mostly on internally generated cash flow for their financing. Political difficulties, the relative expensiveness of issuing securities, and the dominance of public securities (especially utilities), crowded out direct access to capital markets. As late as 1981, German capital markets traded almost exclusively in public or banking securities (p. 52). This allowed traditional methods of bank financing to return to the fore (pp. 44–6), particularly as specialized institutions like the Kreditanstalt für Wiederaufbau and the IKB extended crucial Marshall Plan credits through banks to private industry. Credit laws only reinforced a transition from short-term bank credits to long-term credits; together they accounted for a stable 60 percent share of aggregate enterprise financing between the 1960s and the 1990s (p. 50). Ultimately, Thomes argues that Germans resorted to “customary, traditional patterns instead of using the new beginning in an innovative fashion, for instance to ease direct access to capital markets,” a tendency that was “consciously or unconsciously” a result of public policy (p. 49). Thomes might have spent a few more paragraphs on the politics of these important public policy choices, especially since there were early attempts to “democratize” the shareholding of large industrial firms, and some officials did desire a more active role for capital markets. Interestingly, Thomes shows that although money markets became internationalized in the 1970s, with capital markets

following suit in the 1980s, the largest German banks were so entrenched that they only strengthened their intermediary role between capital markets and industry by offering a rapidly growing palette of financial instruments (p. 51). Not surprisingly, the dominance of banks in the credit business resulted in a massive inquiry in the late 1970s about their power and inspired attempts to revitalize stock markets, especially after the election of Helmut Kohl. As one measure of the stagnation of German equity culture, the emission of shares for just twenty-one new joint-stock companies in 1984 is presented by Thomes as a major turning point.

Bernd Rudolph discusses the “structural change in industrial financing since the 1990s,” which, in his view, is driven by the “forces of a liberalized and globalized capital markets” (p. 67). He focuses on the palette of new opportunities provided by various credit derivatives, which he argues will lead to convergence. Rudolph makes much of this trend to securitization, but he does not adequately address the implications for banks; this is surprising, because he is careful to distinguish between securitization and disintermediation. For instance, banks themselves are driving formal reforms of Germany’s capital markets, presumably because such reforms offer greater profit potential, not because the banks wish to make themselves dispensable. On the other hand, large enterprises with good credit risks do not have to rely on banks to the same extent, leaving banks with low-profit businesses or firms with poor credit ratings (p. 64). Yet, as late as 1998, bank credits accounted for just under 75 percent of all external financing for nonfinancial enterprises (p. 58), a figure that surprisingly *increased* rather than decreased during the 1990s. Is this a convergence or a sign of resiliency of classic German financial intermediation? Rudolph envisions that small and midsized businesses, which once relied largely on their house banks, will access bond markets directly in the future, thus depriving banks of another crucial base of customers. In both cases, the margins of these bank loans will fall, requiring greater attention to risk and possibly further constricting credit. He concludes, “The classic bank credit is in retreat” (p. 65). Yet, surprisingly, he voices doubts about whether there is a “crisis in the credit business”; the “negative perception” is merely a “signal for a transformation in market conditions, which the traditional credit business of the banks had so far imperfectly realized” (p. 67). Given the lively discussion among bankers that follows his contribution (especially on page 79), such a benign formulation seems out of place.

In Rudolph’s opinion, globalization makes the consequences of differing financial systems more obvious (p. 59), which will lead to their convergence. In the symposium discussion, he notes that he prefers the distinction between “arms length” versus “relationship” rather than between a capital market-oriented versus a bank-based system, but he avoids the question that

should have been addressed, at least briefly, of whether “relationship banking” has special advantages (p. 61).

The discussants challenge him on this point (pp. 71–2). Most of the bankers felt they could combine classic relationship banking with “target-oriented” investment banking based on shareholder value. Yet one discussant questioned whether banks could have it both ways (p. 72); in response, Rudolph acknowledged that a symbiosis of both systems would not be easy to achieve (p. 77). Furthermore, he sees convergence toward a capital market model as inevitable but does not clearly state whether he considers this to be inevitable or desirable. What is lost and what is gained by convergence? One leading Mittelstand entrepreneur felt there was no reason to shift entirely to a capital market model (p. 72). Others questioned whether they would even have a choice, which might mean the end of relationship banking (p. 76, 79). Another felt that “securitization” was not enough reason to develop an American-style capital market-oriented system. Although clearly globalization is one of the “forces” driving change, Rudolph does not touch on the considerable efforts by German and European Union regulators to push through this change. One director of a major bank stressed that political agreements like Basel II homogenize financial systems (p. 77). Finally, although shareholder value is clearly on the ascendancy, is it an automatic process driven by globalized capital markets, or is it propelled by someone or something else? Given the high priority that he places on political regulation, what sort of politics does Thomes think might mediate these globalizing forces?

All in all, this book is an excellent introduction to the history and present circumstances of a controversial and rich subject. All the contributions concentrate on the private commercial banking sector; yet the savings banks and cooperatives are barely discussed, despite the fact that their combined total assets and credit to industry are equal to, or larger than, those of private industry. Following Thomes’s lead, a more precise discussion of the political regulatory institutions that have allowed Germany to maintain a universal bank-credit system, to the detriment of its capital markets and its pace of change, would be most welcome.

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