Shares as financing and investment instruments

The debate on the role of shares as financing and investment instruments in Germany received fresh impetus from the floating of Deutsche Telekom in November 1996. Against this background, the present article identifies special features of the German share market in an international comparison and analyses major trends in equity financing and share ownership in the past few years.[1] At least some of the supply-side and demand-side factors which are responsible for the relatively restricted proliferation of shares in Germany have meanwhile diminished in significance. In future, increasing globalisation and growing international competition in the financial and goods markets, as well as the tendency towards greater capital funding of retirement pensions, could promote the use of shares as financing and investment instruments.

The German share market by international comparison

Major differences in market capitalisation …

In absolute terms, the German share market is the fourth-largest in the world – albeit a long way behind the United States, Japan and the United Kingdom. The market value of all listed domestic shares ("market capitalisation"), with the floating of Deutsche Telekom in November 1996, exceeded DM 1 trillion for the first time. This was only a fraction

1 The Bundesbank last dealt with this topic in Deutsche Bundesbank, The significance of shares as financing instruments, Monthly Report, October 1991, pages 21 – 28.

Market capitalisation in selected OECD countries

End-November 1996

Country	Shares in circulation in DM billion 1	Market capitalisation coefficient 2
United States 3	13,354	122
Japan 4	4,881	63
United Kingdom	2,544	152
Germany	1,002	27
France	892	38
Canada 5	756	88
Switzerland	624	135
Netherlands	555	93
Italy	386	23
Sweden	357	103
Spain 6	332	39
Belgium	180	44
Denmark	105	40
Finland	90	47
Norway	85	38
Austria	48	14

Sources: Fédération Internationale des Bourses des Valeurs and own calculations. — **1** Market value of domestic listed shares. — **2** Shares in circulation as % of the 1995 nominal gross domestic product. — **3** New York stock exchange and NASDAQ. — **4** Tokyo stock exchange. — **5** Toronto stock exchange. — **6** Madrid stock exchange.

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of the market capitalisation in both the United States and Japan towards the end of 1996, with the equivalent of DM 13½ trillion and DM 5 trillion, respectively. Relative to macroeconomic production, the German share market ranks low in the table of OECD countries. Near the end of 1996 the ratio of domestic enterprises' market capitalisation to nominal gross domestic product came to 27 % in Germany, compared with figures often way above 100 % in the United States, the United Kingdom, Switzerland and Sweden.

... and in issuing activity

In spite of the overall sharp increase in share prices since the beginning of the eighties and radical changes in financing and investment conditions caused primarily by the growing internationalisation of the financial and goods markets, there has been next to no change so far in the relatively minor role played by the share market in Germany. Between 1991 and 1996 only 77 domestic public limited companies (PLCs) were newly listed on Germany's stock exchanges; in the United States this figure came to well over 3,000 enterprises in the same period. In terms of aggregate volume, US incorporated enterprises concurrently raised thirty times more than German enterprises through stock exchange issues. Hence the issue volumes of US enterprises were considerably smaller on average than those of German firms. This highlights the fact that a far greater number of smaller and medium-sized enterprises find their way to the stock exchange in the United States than in Germany.

The importance of public limited companies

The lesser significance of equities and of the share market in Germany compared, say, with the Anglo-Saxon countries reflects the fact that in the Federal Republic of Germany legal forms such as sole proprietorships and partnerships, as well as private limited companies, play a far greater role. Of the estimated total of three million enterprises (subject to turnover tax) in Germany at the end of 1996, only about 3,900 were public limited companies. However, the proportion of turnover of all enterprises accounted for by public limited companies came to roughly 20 %; in other words, it is mainly large enterprises that are organised in the form of PLCs. With reference to the importance of the share market, it should also be noted that the choice of the public limited company as the legal form is not necessarily synonymous with a stock exchange listing. Barely one-sixth of all German public limited companies were listed on a

International comparison of share ownership profiles

Percentage of total shares in circulation held by different sectors in the respective country, end-1995

	United States	Japan	Germany	France	United Kingdom
Households	36.4	22.2	14.6	19.4	29.6
Enterprises	15.0	31.2	42.1	58.0	4.1
Public sector	0.0	0.5	4.3	3.4	0.2
Non-financial sectors	51.4	53.9	61.0	80.8	33.9
Banks	0.2	13.3	10.3	4.0	2.3
Insurance enterprises and pension funds	31.3	10.8	12.4	1.9	39.7
Investment funds and other financial institutions	13.0	11.7	7.6	2.0	10.4
Financial sectors	44.5	35.8	30.3	8.0	52.4
Rest of the world	4.2	10.3	8.7	11.2	13.7
Total	100	100	100	100	100

Sources: Board of Governors of the Federal Reserve System, Bank of Japan, INSEE, Office for National Statistics and Bank of England plus own calculations.

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German stock exchange at the end of 1996; they accounted for more than half of the domestic participatory instruments in circulation.

Share ownership of households and institutional investors

Mirroring the relatively small volume of share capital tradable on the stock exchange, households and institutional investors, by international standards, play only a modest role as direct injectors of capital in Germany. In view of their traditional financial surplus resulting from their saving activity, households are the “natural financiers” of the corporate sector as a whole and hence of public limited companies, too. In Germany they held only 14½% of the total shares in circulation at the end of 1995; this corresponded to approximately 5% of their total financial assets. The proportion of total shares in circulation held by households in Japan and France is of similar order of magnitude (22% and 19½%, respectively). Households in the United States, by contrast, account for more than one-third of total shareholdings. Similar differences exist for institutional investors (insurance enterprises, pension funds and investment funds), which need a broad spread of liquid assets. At the end of 1995 they accounted for only about 20% of all shares held in the Federal Republic of Germany; in the United States and in the United Kingdom this proportion came to well over 40% and 50%, respectively. A major investor group in those countries are the pension funds, which are still uncommon in Germany, and which in the United States, for example, invest up to 80% of their funds in shares.

Shareholdings of enterprises and banks

In contrast to other countries (with the exception of France), corporate participating interests in the form of shareholdings are widespread in Germany. At the end of 1995 approximately 40 % of all equities in this country were in the hands of German enterprises, while French firms held almost 60 % of France's total. According to OECD estimates, the corresponding figure in the United States is about 15 %. In the universal bank system prevalent in Germany, credit institutions, too, are traditionally significant shareholders. At the end of 1995 their equity interests accounted for just over 10 % of the total shares in circulation in Germany. In the portfolios held by Japanese banks the proportion of shareholdings in other enterprises was slightly higher. In the United States and in other Anglo-Saxon countries, by contrast, virtually no shares are held by credit institutions, owing to statutory prohibitions.

Different systems of influencing corporate performance in the United States …

The divergent issuing and investment patterns, which manifest themselves particularly vividly in comparing the situation in Germany with that in the United States, ultimately also reflect differences in the way risk capital is provided and in the manner in which ownership rights associated with shareholdings are used to exert an influence on enterprises. In the case of US public limited companies, the provision and use of equity capital are steered to a relatively high degree by "the market". This is connected with the idea that price signals emanating from the buying and selling of shares prompt the firm's management to pursue a policy aimed at maximising the enterprise's market value, so as to optimally accommodate the shareholders' interests. This influencing of corporate performance by share price movements is often reinforced by linking the management's salaries to the share price trend. Further pressure is applied by the fact that, if the share price drops, the danger of a takeover increases, which usually entails a loss of influence for the management and may even jeopardise their jobs.

… and in Germany

By contrast, German public limited companies are characterised by the fact that business activities are managed by a group of economic agents who have longer-term links with the enterprise; apart from a firm core of shareholders, this includes other parties such as the lending banks and the employees. The fact that various sets of interests are represented within the controlling bodies (particularly on the supervisory board) encourages a corporate policy that also explicitly takes account of the objectives of groups other than the shareholders. Under this business philosophy, which, in contrast to the "shareholder value" concept (which aims at maximising the market value), is denoted by the term "stakeholder value", price signals emanating from the share market have more of a supplementary function. In addition, the overall system of corporate financing in Germany, owing to the great weight of partnerships, but also of smaller incorporated enterprises in the form of private limited companies, is characterised by the fact that the owners are also the managers; in this case, too, long-term relationships between the enterprises and the lending banks predominate.

Enterprises' provision of own funds through equity financing

Little change in the macroeconomic significance of shares …

In view of the fact that the corporate landscape in Germany is largely characterised by sole proprietorships, partnerships and private limited companies, it is hardly surprising that equity financing plays only a minor role in German firms overall. At the end of 1995 the ratio of shares to the total financial resources of producing enterprises came to 27 %, according to the data provided by the financial accounts; this is roughly the same proportion as at the beginning of the seventies. In the financial sector this ratio stood at approximately 5 % at the end of 1995. The vast majority of enterprises have so far remained aloof from the promising revival of issuing activity since the second half of the eighties (on average approximately DM 18 billion per year, compared with DM 5 billion in the seventies) and from the comparative spate of new public offerings by historical standards. The circulation of domestic quoted and unquoted shares, which came to approximately DM 1,400 billion at the end of 1995,[2] increased in step with nominal gross domestic product. To this extent, the macroeconomic significance of shares has remained virtually unchanged over the past two-and-a-half decades.

… or in the sectoral pattern of issuing activity

Domestic producing enterprises are the foremost group of issuers in the German share market; by the end of 1995 they had issued shares to the extent of DM 980 billion. This represented 70 % of the total shares in circulation issued by domestic enterprises. Since the mid-eighties a considerable level of issuing activity has been shown by enterprises in capital-intensive sectors such as energy and water supply, the chemical industry and vehicle manufacture, in particular. Financial sector enterprises accounted for approximately 30 % of the volume of shares in circulation, with insurance enterprises, the share issues of which totalled some DM 240 billion, ranking even ahead of the credit institutions (DM 175 billion). The pattern of issuance has changed only little in the past few years.

Financing structure of producing enterprises *

End-of-year figures

Item	1970	1980	1990	1995
	DM billion			
Total	563.3	1,268.3	2,604.2	3,638.6
of which				
Bank loans 1	263.8	652.2	1,244.9	1,764.4
Shares in circulation	155.0	244.5	604.2	980.2
Pension commitments	26.0	89.4	197.3	252.6
	Percentages			
Total	100	100	100	100
of which				
Bank loans 1	46.8	51.4	47.8	48.5
Shares in circulation	27.5	19.3	23.2	26.9
Pension commitments	4.6	7.0	7.6	6.9

* Outside funds including volume of shares in circulation according to the financial assets and liabilities account; from 1990 onwards Germany as a whole. — 1 From domestic and foreign banks.

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Trends in different size categories of enterprises

The bulk of funds raised through shares was concentrated on a relatively small number of

2 The figures commented upon in the following embrace both quoted shares (valued at end-of-year prices) and unquoted shares (valued at average balance sheet prices, derived from the Bundesbank's corporate balance sheet statistics).

Financing structure of public limited companies of different sizes *

As % of the balance sheet total

	Smaller public limited companies 1		Larger public limited companies 2	
	1987	1994	1987	1994
Own funds 3, 4	30.9	28.8	33.4	33.6
Subscribed capital	16.3	15.6	10.8	9.3
Share premiums	2.4	4.2	7.8	11.9
Reserves 4	12.2	9.0	14.8	12.3
Outside funds, total 4, 5	69.1	71.2	66.6	66.4
Amounts owed to credit institutions	17.8	21.6	4.0	4.3
Provisions for pensions	14.6	12.9	16.7	17.5
Other outside funds 4, 5	36.7	36.8	45.9	44.7
Balance sheet total	100	100	100	100
Memo item				
Number of enterprises	114	114	295	295

* Results of a cylindered sample of public limited companies from the manufacturing, construction and distribution sectors. — 1 Enterprises with a turnover of less than DM 79 million (in 1994). – 2 Enterprises with a turnover of DM 79 million or more (in 1994). — 3 Gross, i.e. without deduction of adjustments and before appropriation of net income. — 4 Including special reserves. — 5 Including deferred income.

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large public limited companies. Thus the ten largest issue launches accounted for almost 25 % of the overall amount of funds raised in the share market between 1990 and 1996. This picture is confirmed by the Bundesbank's corporate balance sheet statistics. According to these statistics, the selling of shares has gained further in importance for larger firms as against external financing through bank loans. Thus the ratio of subscribed capital – plus share premiums – to the balance sheet total for this category of enterprises increased from just under 19 % at the end of 1987 to over 21% at the end of 1994, whereas the percentage of liabilities to credit institutions stagnated at the relatively low level of about 4 %. Provisions for pensions (approximately 17 % of the balance sheet total) established in the context of company retirement pension schemes serve on a sizeable scale as a substitute for equity capital as a form of funding, particularly in the case of large enterprises. In the case of smaller firms, by contrast, the role of bank borrowing has become even more important compared with the raising of equity capital.

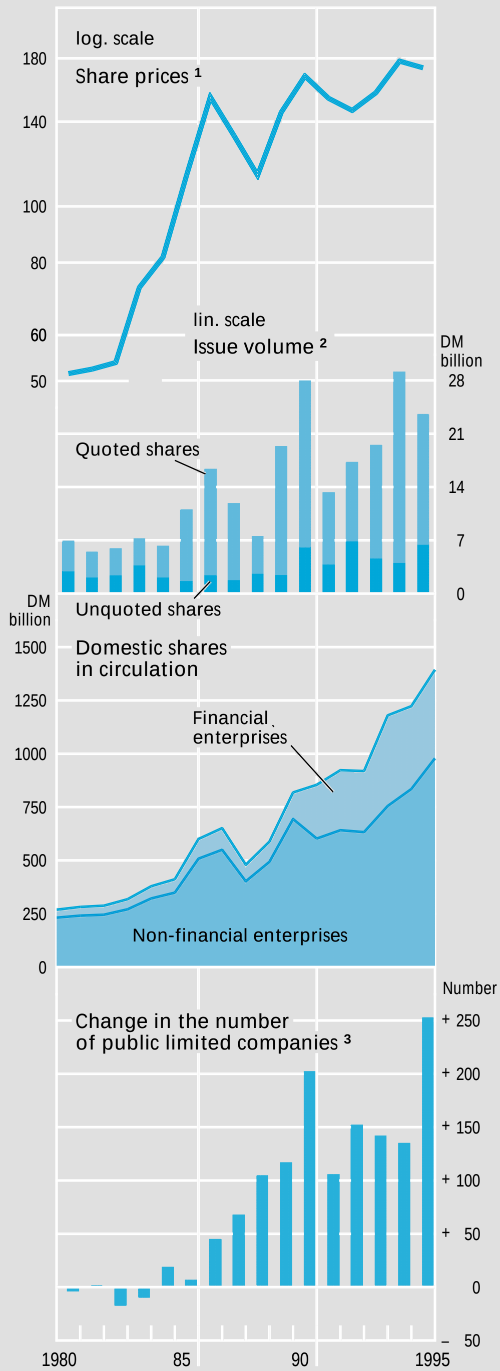
Obstacles due to the legal form ...

The fact that, from the point of view of small and medium-sized enterprises, in particular, major disadvantages were, and in some cases still are, associated with the legal form of the public limited company, has no doubt contributed greatly to the preferred use of shares by larger enterprises. On the one hand, the German Companies Act has traditionally been tailored to large public companies and consequently subjects PLCs to a mass of rules and regulations compared with other legal forms. On the other hand, business start-ups as public limited companies or a corresponding change of legal form to become a PLC have considerable implications for corporate decision-making processes. Until the amendment of the Companies Act in 1994, public limited companies with up to 500 employees were subject to stricter worker co-determination stipulations than private limited companies. In addition, particularly in the case of family-owned enterprises, a sceptical attitude towards granting a say to outsiders may impede a change of legal form. After all, an enterprise's listing on the stock exchange is bound to lead to its opening-up, as this entails, as a *quid pro quo* for improved access to equity capital, more extensive information and disclosure obligations. As a result, the legal form of the public limited company has so far been unable to assert itself against the private limited company; the above-mentioned figure of just over 3,900 public limited companies contrasts with an estimated 450,000 private limited companies that are liable to turnover tax.

... are now smaller

The fairly subdued share price movements in the share market until the beginning of the eighties reinforced the reluctance to establish public limited companies. In the sixties and seventies their number diminished continuously, and only from 1986 onwards was a sizeable number of PLC start-ups once again recorded. Apart from buoyant sentiment in the stock market, positive effects on equity financing emanated also initially from the creation of the second segment, or regulated market (in 1987), for which less strict listing requirements apply than for trading in the

Share market trends



1 CDAX share price index; end-1987=100, annual averages. — **2** Market values. — **3** As included in the share issue statistics; in 1994 excluding 307 east German enterprises recorded for the first time in that year.

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first segment. However, the Companies Act continued to be oriented to large public companies. Against this backdrop, the 1994 reform of the Companies Act aimed at promoting the "small public limited company". Besides simplifying a number of regulations relating, for example, to the formation of a small PLC or to holding shareholders meetings, public limited companies with fewer than 500 employees were put on an equal footing with private limited companies in terms of employees' rights of co-determination. In 1995, the first full year in which the amended Companies Act applied, the number of public limited companies increased by approximately 250 and hence at a faster rate than ever before; it is estimated that a further 160 enterprises were added to this number in 1996. This may be taken as an indication that the attractiveness of the PLC has been increased by the reform of the Companies Act.

Tax influences on the choice of the legal form, ...

Tax regulations have likewise acted as something of a barrier to the dissemination of the public limited company. A particular burden compared with partnerships, until the end of 1996, was the double taxation of PLCs in the form of property tax levied at the corporate level (to the tune of 0.6 % of company assets) and from shareholders (0.5 % of private assets). Since the 1977 reform of corporation tax, the German income taxation system has avoided double taxing domestic shareholders, as both the corporation tax payable by PLCs on their distributed dividends and the investment income tax charged at 25 % are fully deductible from shareholders' individual income tax bills. In addition, individuals' gains from share price rises are exempt from taxation as long as they have held the shares for six months – at least to date.

... stock exchange listing ...

Differences in tax treatment still exist for listed public limited companies vis-à-vis unquoted enterprises in terms of inheritance tax and gift tax. The share price value relevant for determining these taxes is the market price in the case of listed shares, but for unquoted firms it is determined according to the "fair market value", which is estimated on the basis of the enterprise's assets and earnings prospects.

... and the choice of the financing form

In the case of existing public limited companies, tax regulations are responsible for the fact that external financing through loans, as well as internal financing, are favoured over equity financing. The trade tax (on earnings and capital) encourages borrowing in the market as against share issues since capital and earnings are included in full in the tax assessment basis, whereas long-term borrowed funds, i.e. debt interest, are counted at only 50 % of their value. The formation of provisions for pensions depresses the recorded profit and hence leads to a smaller tax burden; furthermore, pension provisions are not subject to a capital levy. However, in view of low capital market rates, the attractiveness of pension provisions has declined in the last few years compared with borrowing. This is compounded by the fact that company retirement pension schemes are weighing more and more heavily on corporate costs, above all owing to a rising life expectancy.

Availability of bank loans

The tax and company law handicaps militate all the more against equity financing as bank loans have proved to be a readily available and cost-effective source of financing for most firms. Besides a pro-competitive climate in the banking sector, which was created through early liberalisation and a stable macroeconomic environment, credit financing has also benefited from the creditor-friendly regulations of German property and bankruptcy legislation. Apart from the possibility of using large parts of a firm's assets as collateral, another attraction is the viability of loan collateral – which has been guaranteed hitherto at least – in the event of bankruptcy. Finally, many entrepreneurs probably find it easier to grant one or several banks, with which long-term business relations have been established, an inside view of the enterprise's situation than to open their books to a large group of shareholders.

Flotation and the role of credit institutions

On the German stock exchanges it is compulsory to involve a credit institution in the admission to first-segment trading of a firm's shares, and it is more or less essential, too, for the second segment as well as for third-segment (over-the-counter) trading. Against this background, the risks for the syndicate banks' good name and their liability for the contents of the prospectus may well prove to be an obstacle to stock exchange listing in individual cases. Given the issuing institutions' need for caution, the obstacles to young enterprises, in particular, for which it is not yet possible or very difficult to prove their readiness for public launching by means of an established track record of good results, become even higher. One indication of this is the fact that the average age of enterprises newly listed on the stock exchange in Germany is very high by international standards.

Investment in and ownership of shares

Low share ownership of households

Just as shares play only a minor role as a financing instrument, so they have met hitherto with little response among large sections of the population as an investment vehicle. It is estimated that shares to the market value of just under DM 250 billion were held in households' portfolios at the end of 1995; as mentioned earlier, this corresponds to approximately 14½ % of domestic shares in circulation and to just over 5 % of households' financial assets, respectively. Even the placement of Deutsche Telekom shares to the market value of approximately DM 8 billion with private investors at the end of last year did little to change the subordinate role which shares play as an investment vehicle among this category of purchasers. In a longer-term view equities have actually lost ground among private investors; thus the proportion of shares in households' financial assets at the beginning of the seventies had been over 10 %.

Little propensity to buy on account of subdued share price trends …

The risk-return profile of equities, which many private investors regard as relatively unattractive, is probably the main reason for their muted involvement in the share market; the possibility associated with share ownership of actively influencing corporate policy, by contrast, is probably only very rarely the key consideration in the investment activities of this category of purchasers. Until the beginning of the eighties the very slow rate of

Financial assets of households *

End-of-year figures

Item	1970	1980	1990	1995
	DM billion			
Total	524.3	1,483.5	3,187.6	4,647.6
of which				
with banks 1	314.3	886.9	1,553.7	2,024.8
with insurance enterprises 2	77.8	246.2	646.6	988.6
in shares	53.6	61.7	175.0	245.6
in debt securities	35.8	152.8	450.7	741.1
in investment fund certificates	10.1	29.5	132.9	353.4
	Percentages			
Total	100	100	100	100
of which				
with banks 1	59.9	59.8	48.7	43.6
with insurance enterprises 2	14.8	16.6	20.3	21.3
in shares	10.2	4.2	5.5	5.3
in debt securities	6.8	10.3	14.1	15.9
in investment fund certificates	1.9	2.0	4.2	7.6

* Including private non-profit organisations; from 1990 onwards Germany as a whole. — 1 Including building and loan associations. — 2 Including pension funds.

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stock price increases overall in the domestic share market was the main obstacle to purchasing shares. The return from dividend payments alone was insufficient to obtain a higher yield than from buying debt securities; without the prospect of sharp share price gains, many investors evidently saw little reason to acquire shares.

... and greater share price volatility

Since the beginning of the eighties there has been a sharp upward trend in prices in the German share market. At the same time, however, price volatilities have increased, too. The normally very pronounced procyclical investment behaviour of households indicates that investors paid relatively great attention to the short-term price trend in the share market, at least in the past. Viewed over long investment periods, however, the fluctuations in share prices are markedly smaller than in the short term, and the total return from shares over the long term – for example, since the mid-seventies, given an investment period of more than ten years – was higher than, for instance, that from debt securities, viewing the market as a whole.

Despite increased "indirect" share purchases through funds ...

However, individual private investors mostly have only limited opportunities to diversify their share portfolios and hence to restrict share price fluctuations to the scale prevailing in the market as a whole. From that point of view, several spectacular business insolvencies have probably further increased people's reluctance to purchase shares. The limits to diversifying shareholdings imposed by the usually fairly small size of portfolios were eased slightly in 1994 by the option given to firms by the Second Financial Market Promotion Act to issue "cheaper" shares with a face value of only DM 5. The introduction of nonpar shares, which are common in other countries, could have a similar effect. Nevertheless, the building-up of a market portfolio continues to be associated in many cases with relatively high transaction costs. Against this background, households' "indirect" purchases in the share market through the intermediation of share-based funds (open to the general public) has gained importance since the beginning of the nineties. The volume of circulation of such investment fund certificates has more than doubled since the end of 1989, and at the end of 1995 the assets of domestic share-based funds invested in equities came to approximately DM 40 billion, of which around DM 30 billion accrued to the shares of domestic enterprises.

... the investment behaviour of households remains somewhat conservative

In spite of the advance of share-based funds, the structure of households' financial assets in Germany still points to a relatively pronounced desire for security. Thus at the end of 1995 almost DM 1,000 billion, or 20 %, of households' financial assets were lodged with insurance enterprises (including pension funds). Savings deposits were of a similar magnitude, followed by investment in debt securities, at DM 740 billion, and time deposits and savings bonds, with a combined total of DM 430 billion.

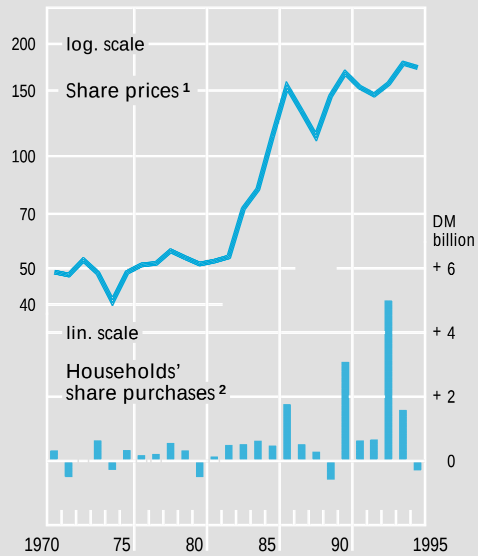
Role of institutional investors and old-age provision

The second investor group whose representation in the share market is below average by international standards is that of the domestic institutional investors. This is due mainly to the fact that in Germany provision for retirement through dedicated pension funds is not common. By far the largest part of old-age pension payments comes from the statutory pension insurance funds, which are financed on a pay-as-you-go basis. Company pension funds and private provision have so far played only a supplementary role. Corporate retirement savings mostly take the form of pension provisions held within the enterprise, whereas external institutions in the form of pension funds and benefit funds, although they have increased in significance, are still negligible in quantitative terms.

Equity holdings of insurance enterprises ...

Private provision for old age is primarily based on (tax-favoured) capital-accumulating life insurance schemes. The investment policy of insurance enterprises is largely determined by the resultant payment obligations, which depend on the duration of contracts or on the relative incidence of particular insurance

Share price movements and households' share purchases



1 CDAX share price index; end-1987 = 100, annual averages. — 2 Change in individuals' deposit holdings of shares launched by domestic issuers (nominal values).

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claims. This requires income which can be reliably calculated in the long run, so that, for example, debt securities typically constitute a fairly large part of insurance enterprises' portfolios. However, insurance enterprises' shareholdings have markedly increased over the last 15 years; between 1980 and 1995 holdings multiplied from DM 16 billion to DM 210 billion. To this must be added the "indirect" share market involvement of insurance enterprises via specialised funds. The equity portfolios of specialised funds launched by insurance enterprises came to just under DM 55 billion at the end of 1995.

... come up against supply-side limits

Limits to insurance enterprises' share market activity are evidently set more by the shallowness of the German share market than by the investment regulations of the Act on the

Supervision of Private Insurance Enterprises; on average, the volume of investment by insurance enterprises in risk capital (which, apart from shares, includes certificates of specialised funds) remained far below the statutory limit of 30 % of their restricted assets. Since the amendment of the Act on the Supervision of Private Insurance Enterprises in 1994, these investment limits basically refer to investment within the European Economic Area; but the domestic market is still of major importance, as 80 % of restricted assets must be invested in matching currencies.

Investment funds

Investment companies' shareholdings increased ten-fold from DM 12 billion at the beginning of the eighties to DM 127 billion at the end of 1995, thus corresponding to 24 % of investment funds' financial assets. In the case of investment funds open to the general public, which at the end of 1995 accounted for approximately DM 45 billion (end-1990: DM 14 billion), this trend primarily reflects households' growing interest in diversified securities portfolios. Specialised funds, whose assets in the form of shares have increased during the nineties from DM 30 billion to DM 80 billion (at the end of 1995), often allow investors a more flexible investment policy than do direct securities purchases. Ultimately, the significance of investment funds as purchasers of shares expresses the investment preferences of their private and institutional clients.

Share ownership of enterprises …

A large part of German shares is in the hands of domestic enterprises in the form of participations. At the end of 1995 German producing enterprises held participations worth DM

Financial assets of institutional investors

End-of-year figures

Item	1970	1980	1990	1995
Insurance enterprises	DM billion			
with banks [1]	11.6	81.1	297.9	493.3
in shares	7.8	15.9	114.9	209.4
in debt securities	16.6	56.2	121.9	204.6
in investment fund certificates	0.7	9.0	71.2	162.9
in other forms [2]	48.9	121.2	218.9	261.7
Total	85.6	283.3	824.8	1 332.0
	Percentages			
with banks [1]	13.6	28.6	36.1	37.0
in shares	9.0	5.6	13.9	15.7
in debt securities	19.6	19.8	14.8	15.4
in investment fund certificates	0.8	3.2	8.6	12.2
in other forms [2]	57.1	42.8	26.5	19.6
Total	100	100	100	100
Investment funds	DM billion			
with banks [1]	0.9	3.7	26.1	32.2
in shares	5.0	12.4	44.5	127.0
in debt securities	4.2	27.9	153.0	330.0
in other forms [3]	.	.	4.3	40.0
Total	10.1	44.0	228.0	529.2
	Percentages			
with banks [1]	8.9	8.4	11.4	6.1
in shares	49.5	28.2	19.5	24.0
in debt securities	41.6	63.4	67.1	62.4
in other forms [3]	.	.	1.9	7.6
Total	100	100	100	100

1 Primarily time deposits, including registered debt securities and claims on banks arising from borrowers' notes. — **2** Mortgages, claims arising from borrowers' notes and book-entry securities as well as participating interests in non-banks. — **3** Primarily loans against borrowers' notes.

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708 billion in the form of shares. At approximately 40 %, their proportion of total shareholdings has remained virtually unchanged in the longer run. It is estimated that three-quarters of the equity interests of domestic producing enterprises consist of cross-holdings – a fact which is especially prevalent among manufacturing firms and utilities. After all, the public sector – in spite of sizeable privatisations over the last few years – still holds considerable participations in producing enterprises, particularly in the sectors transport, storage and communications and in energy and water supply.

… and of credit institutions

Domestic credit institutions accounted for approximately DM 165 billion, or 10 %, of shareholdings held in Germany at the end of 1995. Over time banks' equity interests – as a proportion of their financial assets – have developed more or less in step with book credits and securitised lending. The ratio of shares to banks' financial assets came to 2½ % at the end of 1970, just as did at the end of 1995. In the case of shareholdings held by banks half each are ascribable to participating interests and to share portfolios. Cross-links within the banking sector are behind approximately one-third of the participations. The remaining participating interests are concentrated on producing enterprises; in part these shares were acquired in the context of rescue operations or aid granted to enterprises with insufficient capital stock.

Conclusions

Increased use of shares desirable …

The relatively restricted dissemination of shares in Germany is a reflection of many and varied influences on both the supply and the demand side arising from institutional factors – such as the breakdown of the corporate sector according to legal form, company and tax law or the system of old-age provision, the bulk of which is financed on a pay-as-you-go basis – and from the enterprises' and (private) investors' behaviour. It thus appears quite warranted to speak of different "financing cultures" in Germany and in the Anglo-Saxon countries. Over time increasing international economic integration will probably bring about a certain levelling-off of these evolutionary differences. Over and above the many well proven features of the German financial system, which will no doubt continue to exist in future, greater recourse to shares seems imperative in view of the challenges facing the German economy.

… for enterprises …

In the corporate sector an increased use of equity financing may accelerate structural change. A broader equity base makes it easier for enterprises to assume risks and is hence an important prerequisite for success in international competition and for opening up new markets. In addition, channelling an increasing amount of financial resources through the share market probably tends to increase the efficiency of capital allocation. If the share market assumes incentive and allocation functions to a greater extent than in the past, that is something which should be viewed quite positively. Viewed in the longer run, the differences between the concepts of shareholder value and stakeholder value described at the beginning of this article are probably smaller than is often assumed, for lasting corporate success is hardly conceivable without taking both creditors' and employees' interests into account. Nevertheless, paying more attention to the shareholders' interests might help to sharpen the corporate focus.

... and investors

Complementary to this, the share may make a substantial contribution as an investment vehicle to solving the financing problems arising from society's demographic age structure. Shares can represent a major part of a system of old-age provision organised on a fully funded basis, be it in the form of households' direct investment or in the portfolios of institutional investors. In addition, the issue and buying of shares creates a desirable link between capital provision and corporate responsibility. A more widespread investment in shares would also reflect an overall more positive attitude towards assuming risks and responsibility. In such an environment, in turn, it would also be easier for young and innovative enterprises to tap sources of capital.

Possible ways of promoting shares

Steps in this direction could be aimed, firstly, at reducing the disadvantages of shares compared with other forms of financing and investment stemming, for example, from tax regulations or provisions of company law. Such reforms contribute to reducing allocative distortions and facilitate the organic further development of the German financial system. However, a lasting enhancement of the role of shares can probably only be expected if their acceptance in broad sections of the population likewise grows. From this point of view, the general taxation of share price gains accruing to shareholders would have to be viewed critically. The great public interest in the floating of Deutsche Telekom may be rated as positive. However, in view of the short-term nature of the stimuli that emanated from earlier placements of "popular shares", the success of the Deutsche Telekom flotation should not lead to delusions about the fact that the promotion of saving in the form of shares is a task that requires lasting efforts.