

Guinnane, Timothy W.; Streb, Jochen

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Creating a new legal form: The GmbH

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ECONOMIC GROWTH CENTER YALE UNIVERSITY

PO Box 208269
New Haven, CT 06520-8269

<https://egcenter.economics.yale.edu/>



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Timothy W. Guinnane
Department of Economics
Yale University

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Timothy W. Guinnane

Department of Economics
Yale University

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Abstract

The most common business enterprise form in Germany today is the *Gesellschaft mit beschränkter Haftung* (GmbH). The GmbH offers entrepreneurs the partnership's flexibility combined with limited liability, capital lock-in, and other traits associated with corporations. Earlier enterprise forms such as the partnership and corporation were codified versions of longstanding practice; the GmbH, on the other hand, was the lawgiver's creation. Authorized in 1892, the GmbH appeared during a period of ferment in German enterprise law and was an early example of the "Private Limited-Liability Company" (PLLC) prevalent in many economies today. This paper traces the debates and the legislative process that led to the GmbH's introduction. The new form reflected challenges created by the corporation reform of 1884, problems in German colonial companies, and the view that British company law had put German firms at a competitive disadvantage. Many new enterprises adopted the GmbH, but significant sections of the financial and legal community harbored strong reservations about this legal innovation.

Die deutsche Gesellschaft mit beschränkter Haftung ist eine rationale Neuerfindung zum Ersatz der für die Zwecke kleinerer und familienhafter, speziell erbengemeinschaftlicher Unternehmungen rechtlich nicht adäquaten, speziell durch den modernen Publizitätszwang unbequemen Aktiengesellschaft.

-- Max Weber¹

In 1892, Germany introduced an entirely new legal form for business enterprises, the *Gesellschaft mit beschränkter Haftung* (company with limited liability; hereafter GmbH). The new form, which reflected a period of ferment in German (and broader) thinking about organizational forms, combines elements of the partnership and the corporation, allowing entrepreneurs to tailor the firm's organization to their specific needs and still enjoy limited liability and locked-in capital. The GmbH proved popular; by 1912, some thirty percent of new enterprises took this form and GmbHs had a presence in a variety of sectors. Today the GmbH is the most popular enterprise form in Germany.²

The pressure for a new enterprise form reflected three intersecting issues in the 1870s and 1880s. First, the introduction of general incorporation in 1870 had led to a stock-market bubble due in part to abuses of the corporate form. Reform legislation enacted in 1884 made the corporate form less suitable for smaller enterprises. Second, Germany acquired colonies starting in 1884. Existing commercial law made it difficult to create the enterprises necessary to exploit colonial business opportunities; several early proposals for a new enterprise form focused on the colonies. Finally, both the colonial enterprise debate and discussions of more general enterprise law took place against a backdrop of rising rivalry with Britain. German critics argued that British abuse of the corporate form put German firms at a competitive disadvantage.

¹ Weber (1947, p.441). („The GmbH is a rational invention that substitutes for the corporation, which is legally inadequate especially for smaller, family-like enterprises and enterprises that continue a founder's efforts, and is especially inappropriate given modern publicity requirements.”)

² About half of all multi-owner firms paying the turnover tax (*Umsatzsteuer*) in 2017 were GmbHs. Only one percent were corporations (*Aktiengesellschaften*). See <https://www.destatis.de/DE/Themen/Staat/Steuern/Umsatzsteuer/Tabellen/voranmeldungen-rechtsformen.html> retrieved 2 October 2019. In 1992, the last year Reckendrees (2015, Table 2) reports statistics taken from firm registrations, there were 3219 corporations and nearly 550 thousand GmbHs. The average corporation had a capital of 27.1 million Euros compared to the average GmbH's 229 thousand Euros.

Underlying most discussions of business forms and the proposed GmbH in this period was a conception of limited liability and its connection to other features of company law. Both proponents and opponents of a new form recognized a distinction between associations of people (or “individualistic” forms) and associations of capital (or “collectivistic” forms). Associations of people, such as partnerships, place individual effort and reputation front and center. Their rules presume the identity of owner and manager.. Associations of capital such as the corporation lack close ties to specific individuals. Shareholders can change without altering the enterprise, and their managers are employees who can come and go. The GmbH’s advocates recognized that only associations of capital had enjoyed limited liability in the past. One way to understand their goals and the resulting new form is to see it as the first (German) business organization that had complete limited liability combined with many characteristics of a partnership.

This paper traces the origins of the GmbH to World War I, focusing on debates over the new form. The 1870 and 1884 Corporations Acts bookended one stage of a long set of debates about the corporate form. Germany also reformed its cooperatives law in 1889 (Guinnane (Forthcoming)). Both the corporation and the reformed cooperative law played a role in the 1892 GmbH statute. For most of this period, the intention to introduce a new civil code (*Bürgerliches Gesetzbuch* or BGB) and commercial code (*Handelsgesetzbuch*, HGB) influenced the pace of other legislation. The HGB’s introduction had to wait for the long-delayed BGB; both took force in 1900.

This paper defers treatment of two important issues. First, the GmbH reflects broader conversations about reforms to company law taking place in Britain and other countries. Establishing just who influenced whom goes beyond the scope of the present paper.³ Second, the present paper defers in-

³ Thiessen (2006)’s subtle analysis serves as a warning: he argues that German ideas of limited liability as reflected in the GmbH were adopted by other countries, who modified them considerably. German reform efforts later reflected those modified versions of German notions. The later enterprise forms that Guinnane et al (2007) call the “Private Limited-Liability Company” all owe something to British law (in the form of the 1862 Corporations Act and then the 1907 Private Limited Company) as well as to the GmbH. Guinnane and Rosenthal (2012) discuss the French *société à responsabilité limitée* (SARL) created in 1925; Guinnane and Martínez-Rodríguez (2018), the Spanish *Sociedad con Responsabilidad Limitada* (SRL) which dates from 1920. Neither is a copy of the GmbH, but both were strongly influenced by its example. The Austrian GmbH (1906) is based largely on the German version.

depth quantitative analysis. Section four below presents a brief empirical overview demonstrating the weight of GmbHs in the German economy prior to World War I. The companion paper (Guinnane (in preparation)) focuses on how enterprises used the GmbH's tremendous flexibility. The primary source for that paper is a large sample of the articles of association (*Gesellschaftsverträge*) for enterprises formed before World War I.

The paper contributes to two related literatures. The first pertains to the role of the corporation in economic development. Following Alfred Chandler (1977), many economic and business historians hold the corporation essential to the formation of the modern economy. More generally, economists have paid most attention to issues that pertain only to large, publically traded firms. A growing literature stresses the prevalence and importance of enterprises other than corporations as well as innovations in company law during the nineteenth and early twentieth centuries.⁴

1. Before the GmbH: the menu of enterprise forms

Most German states adopted the 1861 *Allgemeine Handelsgesetzbuch* (ADHGB) as their commercial code. Entrepreneurs establishing a multi-owner firm under the ADHGB had two basic options, the partnership or the corporation.⁵ There were three types of partnership. All owners in an ordinary partnership (*Offene Handelsgesellschaft* or OHG) bore unlimited liability for the firm's debts and could participate in running the enterprise. A limited partnership (*Kommanditgesellschaften* or KG) had general partners who ran the firm and bore unlimited liability for the firm's debts, as well as limited partners who ordinarily did not participate in management but whose losses were limited to the amount of

⁴ Guinnane and Schneebacher (2019) survey this literature.

⁵ The Reich dates from 1871. Written under the auspices of the *Bund*, the ADHGB is one example of common legal rules adopted by most *Bund* members. The 1900 commercial code (*Handelsgesetzbuch*, HGB) did not significantly alter the rules described here. Here, I ignore some details discussed elsewhere. Briefly, (1) some enterprises were formed under the civil law rather than the business law. Civil-law firms tended to be very small or established for a short-term end. (2) Until 1900, there was legal heterogeneity across Germany and even within some Germany states for *civil* law. The civil law matters for some related issues, such as the inheritance of shares, but I set those issues aside for this paper. Guinnane (2018) provides an overview of German company law in the nineteenth century. Today the menu of forms available to German firms is much larger, and civil-law firms are more popular than in the period this paper studies.

their investment.⁶ Under the ADHGB, a registered partnership enjoyed several advantages over partnerships in Britain or the United States. They had some “entity” protection. They could also act in their own name, buying land, taking on debt, etc.⁷

The German corporation (*Aktiengesellschaft* or AG) shared the basic attributes of corporations today: all owners had limited liability and the enterprise locked-in capital. Before 1870, most German governments required concessions to create a corporation.⁸ General incorporation came in 1870, soon followed by a huge capital inflow in the form of France’s prompt payment of its war indemnity. The result was a stock-market bubble (*Gründerboom*) and then crash (*Gründerkrach*). An index of Berlin stock prices (1870=100) reached 186 in November of 1872 and fell to 75 in 1877. The index did not reach 100 again until the end of that decade.⁹ Critics held the 1870 Act largely responsible. Some corporations created during the bubble had a limited future as operating entities; their promoters had found ways to profit from creating an under-capitalized corporation. The years following the crash saw calls for significant reform to corporation law. The 1884 Corporations Act introduced or strengthened rules intended to protect investors and corporate creditors and, in so doing, made the corporate form more expensive and cumbersome to use, especially for relatively small firms.

These reforms strengthened a distinctive feature of the German corporation: rules that emphasize the preservation of corporate capital to protect the firm’s creditors. A corporation has a fixed number of shares, and, after 1884, could not register until all those shares were subscribed. A new corporation

⁶ The German rule forbidding the limited partner’s involvement in management is weaker than its French counterpart, the *défense d’immixtion*. See Röder (2014, pp. 145-148).

⁷ The concept of “entity shielding” is due to Hansmann et al (2006). They argue that the ability to protect a firm’s assets from its partners’ personal creditors was historically prior to and economically more important than limited liability for investors, which protects an investors’ assets from obligations created by the firm. §119 ADHGB prevents an owner’s private creditors from seizing the firm’s assets to satisfy debts; the creditor can only claim the debtor’s share of the firm’s profits. On the other hand, the OHG automatically becomes bankrupt if any owner is personally bankrupt (§123-3). The code gives partnerships the right to act in their own name (§111 ADHGB).

⁸ A variant on the KG resembled a corporation. The limited partnership stakes in the “share partnership” (*Kommanditgesellschaft auf Aktien* or KGaA) could be traded on markets. Share partnerships were popular in some places where they did not require a concession. Some German states required concessions for the KGaA after 1861, and the ADHGB and later legislation strictly regulated the KGaA form, reducing its attractiveness. An analogous form was much more popular in France (Freedman (1979)).

⁹ The index is Donner’s, as reported in Burhop (2004, Abbildung 1, p.28)

needed at least five shareholders, each with at least one share of 1000 Marks (about £49 or \$250 in 1884).¹⁰ Registration required that at least 25 percent of the capital be paid-in. Increasing the firm's authorized capital was difficult; the only practical way to acquire more capital was to call for more paid-in capital on outstanding shares, which shareholders resisted. British firms organizing under the 1862 Companies Act, on the other hand, stated an authorized capital, but only required seven subscribers to start. There was no minimum share value and the firm could later sell additional shares if it wanted to. Levin Goldschmidt (1892, p.334) gives a hypothetical example of an English company that has £10,000 capital divided into 100 shares of £100 each. The required seven owners could each buy a single share and the firm could begin with £700 in capital. When it needed more capital, this British company could issue additional shares, up to its authorized capital (Goldschmidt 1892, p.338).¹¹

The choice of a legal form and decisions about details within that legal form reflect entrepreneurs' judgment on the best way to deal with contracting problems in a multi-owner firm. The firm faces a trade-off detailed in Guinnane et al (2007). Untimely dissolution implies that firm-specific, illiquid investments may not realize their full return if an investor's death or withdrawal can provoke the firm's demise. The problem could be hold-up, but more generally reflects the difficulty of contracting in a firm that ordinarily dissolves with an owner's death. Partnership agreements (even those that specified a term for the enterprise) were effectively at-will. Business people entering into such agreements could not credibly commit to staying in the enterprise. Partners could also die.¹²

¹⁰ German per-capita NDP in 1884 (using 1913 prices) was about 420 Marks. From Hoffmann (1965, pp. 454-455 and pp. 172-174).

¹¹ Goldschmidt was a leading commercial lawyer and served on the committee of experts (*Sachverständigenrat*) for the 1884 Corporations Act and the 1889 Cooperatives Act. The practice of issuing corporate shares with only some of the nominal value paid-in was not restricted to Germany. See, for example, Turner (2018). The 1884 Corporations Act in Germany strictly regulated the transfer of shares whose value had not been fully paid in.

¹² §124 ADHGB limits an owner's ability to withdraw from the firm prematurely. But §125 lists capacious grounds for dissolving the partnership early, including the impossibility of attaining its goals or misbehavior or incapacity of an owner. The partnership agreement could provide for the firm's continuation even if an owner died (§123-2). The significantly higher mortality rates prevailing in the 1880s warrant stress, as some simple calculations show. The chance that two male 45-year old partners would both survive 5 years would be about 80 percent. Calculation assumes independent chances of death and the Coale-Demeny Model "West" Level 10 male model life table, $e_0 = 39.696$.

The corporate form, on the other hand, protected owners from the risk of untimely dissolution. Shareholders might withdraw from the enterprise by selling their stakes, but they could not force the firm to dissolve or refund investments.¹³ This protection came at a cost, however, because corporations subjected their members to the risk of minority oppression. Minority oppression arises when one group of investors cannot prevent others from engaging in actions with private benefits that reduce the value of the shares owned by the minority.

The GmbH differs in several ways from the OHG, but contemporaries saw the core issue as limited liability, which was central to many debates over enterprise law in the nineteenth century. As Veit Simon (1888, p.133) argued, “The core difference between the corporation and the OHG lies in the liability structure of owners; the firm’s organization is just the internally necessary consequence of the liability structure.” Some legal scholars today downplay the importance of liability rules, arguing that a firm can obtain limited liability by contract. This view abstracts from transactions costs, as Posner (2007, p.422) notes: “In principle, the enterprise could include in all its contracts with customers and suppliers a clause limiting its liability to the assets of the enterprise. But the negotiation of such waivers would be costly. And it would be utterly impractical to limit most tort liability in this way.” Owners of limited-liability firms could and did waive this limitation on a case-by-case basis, usually as a condition for obtaining credit.

2. Pressure for a new enterprise form

Calls for a new enterprise form preceded the 1884 Corporations Act, but restrictions on the corporation introduced that year played a central role in advancing debate. Most German states had been slow to adopt general incorporation, and many thought the corporate form should be available only to ventures that required unusually large sums of capital and that served some public end. In 1888, the *Handelstag* noted with disapproval that many corporations were essentially private organizations with the

¹³ Blair (2003) and Blair and Stout (2005) emphasize capital lock-in as an essential feature of the corporation.

minimum number of investors.¹⁴ Esser (1886, p.8) wanted incorporation restricted to firms large enough to list their shares on equity markets. Bähr (1892, p.3) thought the 1884 Corporations Act should have excluded enterprises that did not appeal to “*großer Kapitalien*” exclusively.

The 1884 reform forced businesses to choose between partnerships that were inappropriate for some ventures and a corporate form that had been made especially unsuitable for smaller firms. The new form’s proponents used the metaphor of a “gap” (*Lücke*) between the partnerships and the corporation. Some pointed to the efforts various enterprises adopted to avoid being an 1884 corporation, citing examples of firms that went to ludicrous lengths to organize as a mining company, which was a more flexible form (see below). For example, the GmbH *Begründung* mentions a manufacturer of steam boilers that had bought a tiny, worked-out iron mine to qualify (p.128).¹⁵

Wilhelm Oechelhäuser saw the partnership’s unlimited liability as the core issue.¹⁶ He and others stressed two related situations. To play an active role in a small firm’s management, an investor had to be a general partner and thus shoulder unlimited liability. This requirement discouraged the formation of firms with investors who cannot devote full time to the activity. Unlimited liability thus prevented some forms of diversification. A second problem involved family firms. Some critics of corporations objected to heirs creating a corporation to carry on a founder’s enterprise after that entrepreneur died. This kind of firm could not really be a corporation, as the critics saw it, even if it followed the rules of the company law; it lacked the public character they thought essential to the corporation. The only practical alternative was to liquidate the firm. If the heirs could not run the firm themselves, the partnership form would force

¹⁴ The *Handelstag* is the national association that represents the city- or district-level *Handelskammer*. The latter is usually translated as “Chamber of Commerce,” but the German institution has a semi-official status the U.S. counterpart lacks.

¹⁵ When proposing legislation, the government produced an “explanation” (*Begründung* or *Motiv*) that elucidated the law and explained drafting choices.

¹⁶ Oechelhäuser (1820-1902) was a member of the Prussian House of Deputies 1852-53, and of the Reichstag 1878-93. Oechelhäuser (1878) summarizes his proposals for a reformed corporation law. Contemporaries referred to him as a “*Grossindustrieller*,” he was not seen as someone with a personal stake in small enterprises. Von Geldern (1971) is a biography. Hein’s (2018) engaging account of the GmbH’s creation assigns a central role to Oechelhäuser. He is called, in fact, “the father of the GmbH,” but it is less clear to me that Oechelhäuser had much influence over the final law.

them to assume unlimited liability for an enterprise run by a manager.¹⁷ In their statements on the possibility of a new form, the *Handelskammer* in Saarbrücken and Schweidnitz called attention to this problem and to the larger social benefits of preserving family firms (*Deutscher Handelstag* 1888c, p.10).

The *Handelstag* claimed that the existing law discouraged creating some types of new enterprises. Because partnerships do not lock in capital, they did not work well as a vehicle for research and development, which is especially vulnerable to hold-up problems. A corporation could use intellectual property to meet its capitalization requirements, but after 1884 this practice required an external evaluation that might not assign much value to “ideal” property such as a patent (*Verein zur Wahrung* 1891, p.100).

The 1884 Corporation Act’s publicity rules also came in for considerable criticism. The 1884 reforms required the enterprise to publish balance sheets. These publicity requirements seemed attractive after the abuses of the early 1870s, but forcing corporations to make their results public was unusual at the time. Although a strong critic of the GmbH, Bähr (1892, p.3), sympathized with objections to publicity rules that gave “every competitor a free view into the enterprise.” The *Handelstag* claims that publication of successful results would immediately lead other firms to try to reverse-engineer the source of the success (p.129).

A final argument again turns on something a partnership could do and corporations could not. Some German corporations had tried to make ownership of their stock conditional on the investor providing some service to the firm, or agreeing that the firm would be the investor’s exclusive buyer or seller. Several sources mention sugar-beet processors in eastern Prussia. Local beet producers wanted to create their own processing plants and require that all owners also contribute raw beets. Otherwise, outsiders could take over the firm and reduce the price they paid for inputs. This danger reflects a classic

¹⁷ See *Deutscher Handelstag* 1888c, p.11.

hold-up problem.¹⁸ German courts in the 1870s and 1880s had struck down such provisions in corporations as contrary to the idea of corporate securities, which must be freely tradable.

The legal problem of colonial enterprises

The first detailed proposals for a new enterprise form stem from the organizational-law problems enterprises faced in German colonies. Germany acquired its first overseas colony in Southwest Africa (now Namibia) in 1884. By the end of the nineteenth century, Germany had acquired additional colonies in Africa, Asia, and the Pacific, but this empire remained smaller than the British, French, or even Dutch empires. The colonies, at times, played an important role in domestic politics, providing one justification, for example, for the creation of a significant navy. Germans concerned about extensive emigration viewed the colonies as a place to send people who would create “New Germanys” and thus not be absorbed by the U.S. “melting pot.” To some business people, the colonies offered export markets and investment opportunities.¹⁹

Bismarck was a late and reluctant convert to the wisdom of empire (Pflanze (1990, pp.114-127)). He saw colonies as enormously expensive and unlikely to yield returns justifying their costs. For this reason, he and Germans of many political views stressed the importance of colonial business development. German commercial law applied in the colonies. Most discussions dismiss the partnership forms as unsuitable to raising significant capital for ventures thousands of miles from the oversight of German investors. Germans knew that Britain and other colonial powers had successful corporations operating in their colonies, but thought the 1884 law made such corporations unworkable. Two problems received the most attention. First, colonial firms struggled with the corporation’s fixed capital requirement, which forced them to predict in advance the capital their project would require. Colonial firms could also suffer significant losses of equipment due to weather or other unforeseen events. Thus

¹⁸ The cooperative form did not suit this end. Until 1889, German cooperatives had to have unlimited liability, and a cooperative has “variable capital” in the sense that when a member leaves, the cooperative has to refund his shares.

¹⁹ Most of the German colonies were “protectorates” (*Schutzgebiete*); I use the general term “colony” as a shorthand. For general discussions see Conrad (2012) or Speitkamp (2014).

some proposals advocated a mechanism to increase capital. Second, under the 1884 Act's governance provisions, members of the supervisory board especially faced civil and criminal penalties for false statements on the mandatory financial reports. In a world of slow travel and expensive communications, a firm headquartered in Germany would have to certify results it could not meaningfully verify.²⁰

No colonial firm organized under the 1884 Corporations Act. Rather, four large firms created in the period 1885-7 obtained special charters granted by the German *Kaiser* (in his capacity as Prussian King) under the provisions of the Prussian General Code (the *Allgemeine Landrecht* or ALR) (Simon (1888, pp.88-90). Simon (1888, p.115) noted that these concessions reflected both the political importance of the enterprises and the “tough and narrow” (*scharfen und engen*) restrictions of the 1884 Corporations Act. Critics viewed this approach as unwise. Ring (1887, p.37) and Simon (1888, pp.118ff) argued that after the 1884 Act, Prussia did not have the right to charter enterprises whose structure contravened Reich law. Chartering special firms also put the King's ministers in an uncomfortable oversight role, an important reason German states abandoned the chartering system in the first place.²¹

The 1888 colonies law authorized the Federal Council (*Bundesrat*) to charter limited-liability enterprises in the colonies (§8-10).²² The law specifies little structure for these firms; each firm was to negotiate an individual charter with the government. As such the 1888 Act marked a step backward to the days of corporate concessions and codified the government's role in overseeing such corporations. On the other hand, the 1888 amendments created the possibility of small, flexibly organized, corporation-like firms in which investors had limited liability. They just had to be in the colonies.

²⁰ See the comments by Hammacher. (Reichstag 29 Sitzung 4 February 1888, p.711).

²¹ Rießer (1887, p.293) quotes an 1886 resolution of the *Deutsche Kolonialverein* noting that the ALR would be replaced by an all-German civil code (the BGB), after which special charters granted under the ALR would not be possible. The first BGB's first draft was completed in 1888 and badly received; the final version was not in force until 1900. Actors in the mid-1880s doubtless did not anticipate this long delay. John (1989) is a history of the BGB.

²² *Gesetz wegen Abänderung des Gesetzes 1888.*

Rivalry with Britain

Critics of German company law did not need to point to abstract alternatives; they were acutely aware of British law. Discussions of the colonies and other matters reflect the sense that Britain's company law gave its firms an unfair advantage over German enterprises. Such complaints have to be set in the broader context of a rivalry that took many forms. To some Germans, economic development would provide the basis for true Great Power status. James (1989, Chapter 3) stresses the centrality of economic development in nationalist visions of the second half of the nineteenth century. Comments on some signs of German economic backwardness have overtones of humiliation. Oechelhäuser was not alone in viewing emigration (and capital export) as signs of weakness in the German economy. The literature's emphasis on "relative British decline" and the debate over possible British policy responses should not obscure the fact that German entrepreneurs, while enjoying considerable success, felt that some British policy put Germans at an unfair disadvantage.²³

The new form's proponents held British company law in special contempt. In its reply to the 1888 inquiry, the Offenbach *Handelskammer* argued strongly against any changes to corporation law, citing a fear of the excrescences (*Auswüchse*) of the English approach (*Verein zur Wahrung* 1891, p. 89-92). German critics stressed two aspects of the rivalry with Britain. The UK's 1862 Companies Act, they claimed, allowed British firms to establish corporations that were really a single entrepreneur and six straw men. This was a "formal abuse" (*formelle Mißbrauch*) of the corporate form.²⁴ In his comments for the 1884 Corporations Act, Oechelhäuser refers dismissively to English corporations as relying on "three or four strawmen" to achieve the required seven initial investors, and to British companies "not bothering at all to observe the requirements of a corporation."²⁵ He worried that German firms might follow suit if

²³ Pollard (1991) summarizes a vast literature. He does not mention British company law. Intellectual property rules were another area of legal contention. Richter and Streb (2011) stress that U.S. firms felt ill-treated by German patent law.

²⁴ See Bähr (1892, pp.1-2). This claim precedes Britain's 1897 Solomon case, which upheld a company in which there was really a single entrepreneur and six strawmen (in this case, the owner's wife and children).

²⁵ Reichstag 11 Sitzung 24 March 1884; Reichstag 48 Sitzung 28 February 1888. The latter statements appear in his appeal to the Prussian *Handelskammern*; see *Verein zur Wahrung* 1891, p.55.

there was no legal way to compete with the British. The popularity of the corporate form in Britain lent strength to the case; in 1892, for example, the government counted more than 14 thousand operating companies registered under the 1862 Act.²⁶

Germans also argued that foreign and, more specifically, *British* firms would be eager to capitalize on the newly-required corporate financial statements. “As soon as an industrial corporation succeeds in bringing about a new idea and informs its shareholders of this in public, the competing foreign countries hasten to direct their manufacture to the same goals which have given us success.”²⁷ Comments on this issue often refer to innovative sectors such as chemicals, where Anglo-German competition was especially notable.

Oechelhäuser argued that the corporation rules made some potentially valuable firms unworkable. This loss cost Germany; instead of producing in Germany and selling products abroad, Germany sent capital and labor overseas:

The significant relief afforded by this new company to the union of capital with human intelligence and industry must also contribute to counteracting the increasing outflow of German capital abroad over the last few years, and to the increased export of German goods and products in place of the emigration of capital and people.²⁸

His remark about emigration reflects a recent upswing in overseas migration; Marschalck (1984, Table 5.1)’s third emigration wave (1880-1893) saw 1.78 million Germans emigrate overseas. The total population in 1880 was about 45 millions. A business form better suited to the needs of the day, Oechelhäuser thought, could keep capital and labor at home.²⁹ Even Goldschmidt (1892, p.337), no fan of

²⁶ This figure is for companies registered in London alone. It omits companies without a share capital. See United Kingdom (1892, p.187). The German claim that British firms ignored their law may reflect misunderstanding of British law. Company law there was highly contractual; the 1862 Act requires little of corporations (Guinnane, Harris, and Lamoreaux (2017)). At the debate over the 1888 colonies act, Schelling, the Reich Justice Secretary, alludes to this misunderstanding when he points out that unlike England, Germany, with its fixed legal forms, could add flexibility only by adding a new form. (Reichstag 29 Sitzung 4 February 1888, p.712).

²⁷ *Deutscher Handelstag* 1888c, p.6. Rießer (1887, p. 318)

²⁸ From Oechelhäuser’s remarks to the annual meeting of the *Deutsche Handelstag*, printed in *Wahrung* 27, p.23.

²⁹ His remarks were at the 11th meeting, 24 March 1884, pp.220-2. He came back to the same points in the final debate on the 1884 Act (44th meeting, 28 June 1884, p.1149).

the GmbH, acknowledged that “there are undertakings for which the provisions of our Corporations Act appear impracticable or at least inexpedient, although these operations can only be carried out under the limited liability of all parties involved.”

3. Debating and drafting

Perhaps the first call for what became the GmbH came in Ludolf Parisius (1876)’s analysis of German cooperative law. He advocated allowing all firms to organize as mining companies (*bergrechtliche Gewerkschaft* or bG). This apparently odd idea reflects the bG’s flexibility. In 1865, Prussia codified this medieval organizational form as part of its reformed mining law. Other states such as Saxony had similar forms. A bG issued a fixed number of limited-liability shares (called *Kuxe*). A *Kux* entitled the owner to a share of the mine’s profits and participation in governance. Unlike a corporation’s shares, transferring the *Kuxe* requires the enterprise’s permission. The bG could also require owners to make additional capital contributions (*Zubüße*). The flexible capital calls allowed a mine to cope with the natural unpredictability of its costs and returns (Friedrich 1979, p.195). The enterprise could also return the *Zubüße* to investors. Thus the bG has, in contrast to the corporation, no fixed capital.³⁰ The bG would serve as one of two models for a new enterprise form, the other being a version of the OHG where the owners had limited liability.

Proposals for what became the GmbH were thus in the air, but first enjoyed widespread public discussion in connection with the 1884 Corporations Act. That Act’s *Begründung* (p.237) raised the question of whether a new form based on the bG should be added to the commercial code. During the three required readings of the draft bill, several Reichstag members took the opportunity to push for a new enterprise form. Oechelhäuser did so during the first reading, calling the creation of a new form possibly as important as the corporation reform. In a theme he would repeat several times over the next years, he

³⁰ See Isay and Isay (1919). The *Reedereigesellschaft* is a form intended for shipping companies. It also allows *Zubüße*. Discussions of the GmbH typically stress the bG in this regard.

argued that “the country that offers the safest, simplest and most diverse legal forms for the combination of capital and people will enjoy an advantage over other nations.”³¹

Prior to the final reading of the 1884 law, Oechelhäuser published a proposal for an OHG with limited liability. In 1888, he published an address to the Prussian *Handelskammer* defending his proposal. He also supported allowing any firm to organize as a bG.³² Four other, more detailed proposals provided templates for public discussions. The first three owed their readership to the colonial issues discussed above, but their authors had larger aims. Esser (1886)’s proposal for a “*Gesellschaft mit beschränkter Haftung*” was printed at the urging of colonial interests. Ring (1887) and Veit Simon (1888) paid more attention to the companies operating in the German colonies. Rießer (1887)’s more general discussion of a revised commercial code included a new enterprise form available to all enterprises.

The proposals differed in important respects. Esser (§3) required at least five owners, each investing a minimum of 5,000 Marks. He defends the capitalization figure as necessary to keep out “*klein Kapital*” (1886, p.11). (Oechelhäuser’s proposal, true to partnership rules, had no minimum capitalization.) Esser also suggested (§3) a minimum of five owners (the same as for a corporation) to guarantee the enterprise’s “seriousness” (*Ernstlichkeit*) (1886, p.15). Rießer (§1) contemplated a much smaller firm; his proposal requires at least two owners who each contribute at least 3000 Marks. Ring (1887) called for a new enterprise form with a total minimum capitalization of one million Marks, with each share at least 5 thousand Marks. Both the share sizes and total capitalization vastly exceed the 1884 Corporation Act’s requirements. Ring’s firm, however, could have *Zubusse* and would not have to publicize its results. Simon (1888)’s proposal resembled Ring’s but would be restricted to the colonies. The four proposals were reacting to different problems. Esser and Rießer proposed an enterprise form that would offer some of the corporation’s features to a much smaller enterprise than was workable under the 1884 Act. The other two authors focused on a more flexible corporation.

³¹ Reichstag, 11 Sitzung, 24 March 1884, p.221.

³² The text is printed in *Verein zur Wahrung* (1891, pp. 51-61). Schubert (1982, p.605, note 40) notes that in the discussions between the Reich’s Justice and Interior Offices, Oechelhauser’s proposal received little attention.

These proposals reflected concern about the legal status of enterprises operating in German colonies. Friedrich Hammacher, who was deeply involved in colonial affairs, used the debate over the 1888 colonial reform to discuss problems of colonial enterprises and to push for expansion of the menu of legal forms available to firms operating in the Reich.³³ He preferred a new enterprise form based on the bG (Reichstag, 29 Sitzung, 4 Feb 1888, pp. 710-711). At this measure's second reading, Oechelhäuser added to the voices calling for colonial reforms, but these remarks were just a warm-up to a repeated call for one or more new enterprise forms for German firms (Reichstag, 48 Sitzung 28 Feb 1888, pp. 1155-1156).

The government initiated a formal consultation process in April of 1888, sending a circular to individual *Handelskammer* asking whether German firms needed an additional enterprise form. Of the 38 *Handelskammer* expressing an opinion, 31 "more or less" called for a new enterprise form. Only two said it would be a bad idea. Overwhelming support for something new, however, did not provide clarity on what the new form should look like. Most approved of something based on the bG, while the Berlin *Aeltestenkollegium* took Oechelhäuser's view that Germany needed a variant on the ordinary partnership that had limited liability.

The Reich Justice Office developed the general principles for the new form, after which the Reich Justice and Interior offices worked out a draft. The draft went to the *Bundesrat* in February of 1892, and the Reichstag undertook its first reading on 19 February 1892. A vote sent the draft to a committee for revisions discussed below. The committee reported back, and the second reading took place on March 19th. The Reichstag accepted the revised bill *en bloc*. The official version appeared on the 20th of April of 1892. Oechelhäuser praised the government's work, even though that version all but ignored his preference for a new partnership form. The extraordinary speed with which the measure passed reflects

³³ Hammacher (1824-1904) was elected to the Prussia House of Deputies in 1863 and represented several *Reichstag* constituencies intermittently in the period 1871-1898. He was a leading National Liberal and served 1885-92 as the vice-president of the *Kolonialverein*.

the extensive earlier debate and the draft bill's subtle accommodations to many concerns raised earlier. The delay until 1892 reflected the ministry's preoccupation with the 1889 Cooperatives Act.

Legislation

The GmbH's *Begründung* dealt specifically with the nature of the new legal object and implicitly explains drafting decisions that differ from earlier proposals such as Esser's. The *Begründung* avoids saying whether the GmbH is a legal person; the question is "mostly theoretical." The law instead assigns to the GmbH rights using the same language as appears in the corporation and cooperative acts.³⁴ The GmbH had capitalization rules analogous to the corporation's, with an authorized capital (*Stammkapital*) of at least 20,000 Marks, of which 5,000 Marks had to be paid in at the firm's creation.³⁵ Capital was divided into shares (called "quotas" (*Anteilen*) in this case) that could be of unequal size. A quota had to be at least 500 Marks, and the minimum paid-in capital for any quota was 250 Marks. German partnerships had no minimum capitalization.

The GmbH owners' had limited liability with some exceptions. They faced joint, several, and unlimited liability for the consequences of misstatements at the commercial registry (§9). The same applied if the firm paid out its capital as dividends (§31). If any owner failed to pay their required capital contributions, the other owners were required to make up the difference (§24). These requirements reflect the desire to offer creditors clarity on the GmbH's capital. These rules differ significantly from the corporation's: there, if an investor paid in 50 percent of a share's value, they were liable for, at most, the other 50 percent.

³⁴ *Begründung* 1892, p.3737. §13 of the GmbH statute is identical to §213 of the 1884 Corporations Act and to §17 of the 1889 Cooperatives Act. It differs from §111 ADHGB (concerning the partnership) in adding the phrase "as such has its independent rights and obligations." Schubert (1982, p.593) suggests the GmbH *Begründung* was being coy; most people thought of the corporation as a legal person, so using Corporation Act's §213 suggested the same for the GmbH.

³⁵ Per-capita GDP in Germany in 1892 was 470 Marks, so the GmbH's minimum capitalization was equal to 42 times the per-capita income (Hoffmann 1965 Table 248, p.825 and Table 1, p.172).

Members could and did use physical assets or intellectual property to make their capital contributions. The articles of association (*Gesellschaftsvertrag*) had to list such in-kind contributions (§5). Many firms organized as GmbHs following an earlier incarnation as a sole proprietorship or partnership. Real assets owned by the earlier firm could serve as the *Stammkapital*. New GmbH's also used "ideal" property such as patents as capital, although the practice was controversial. After 1884, any corporation using such assets as paid-in capital had to provide independent verification of their value. There was no such requirement for the GmbH.³⁶

The term "quota" reflects the nature of the firm: the GmbH is a contract among *specific* persons, like a partnership. (A corporation's shares are *Aktien*). Corporate shares had to be transferable, and some were listed on exchanges. Transferring ownership from one person to another in a GmbH, on the other hand, required a notarial contract, and the quotas could not be listed on exchanges. This provision reflected an effort to tie the owners more closely to the firm and forms the core of the "individualistic" aspect of the new form. On the other hand, the law required that GmbH shares be alienable and heritable. The articles of association could limit transferability in several ways, such as by requiring agreement of the other owners if a share was to be sold to someone not currently an owner.

The GmbH's capital is more flexible than a corporation's. A GmbH can reduce its capital so long as it observed rules pertaining to its creditors, but could never go below the 20,000 Mark minimum stated in the law (§59). The firm could also (optionally) require that members pay in capital in addition to their quotas (§26). These payments (*Nachschüsse*) resemble the bG's *Zubüße*, except the GmbH's articles of association must state when additional contributions can be called and the conditions under which that occurs. The articles of association can specify either limited or unlimited contributions. The firm can return the extra capital to its owners (§30).

The firm must start with at least two owners, but owners can buy each other out. While not a subject of discussion during the drafting stage, the "one-man GmbH" quickly emerged as a point of

³⁶ In one corporation abuse in the 1870s, a promoter over-valued his in-kind contributions. The 1884 law required external evaluation of such contributions. Esser's §4 would require similar evaluations for the GmbH.

controversy (see below). Germans criticized British company law for allowing an entrepreneur to assemble six strawmen and achieve the benefits of incorporation; the GmbH dispensed with the need for strawmen.³⁷

The Reichstag's revision committee introduced some modification to the original draft. §4 originally forbade using a personal name in the company name. The *Bundesrat* had wanted this provision to avoid confusion with the OHG or KG, the names of which must include the personal name of at least one owner (ADHGB §17). The Reichstag committee worried that this rule would deter older enterprises with valuable reputations from using the new form and stressed that the requirement to add "*mit beschränkter Haftung*" (with limited liability) to each firm's name should be enough. The committee also modified §42 to require that GmbHs in the banking sector publish their balance sheets annually, the only GmbHs facing this publicity requirement.³⁸

The GmbH relies heavily on default rules. Governance and distribution of returns are largely contractual. In one of the only governance requirements, the firm had to have a manager (*Geschäftsführer*) (§35) who could be one of the owners or an outsider. The firm's articles of association could not, however, require that a specific person serve as manager permanently; the firm has to be able to dismiss the manager (§38). Thus a GmbH could not have the permanent "dictator" that characterized partnerships, where a partner could retain control of a firm even if his capital share was less than half. GmbHs could, however, adopt rules that made it difficult to remove a manager. For example, hiring or firing the manager could require a super-majority of shares, owners, or both.³⁹ In Esser's proposal (§9), managers had to be owners, but there is no such provision in the 1892 legislation.

The GmbH could, if it wanted, adopt a control structure much simpler than the corporation's, dispensing with any formal leadership other than the manager. The firm could also go the other direction;

³⁷ The 1980 reform to the German GmbH allows the formation of a one-owner firm. Zöllner (1992, p. 382) doubts the one-owner GmbH created any real problems.

³⁸ See Kommission 1892.

³⁹ Hachenburg (1913, pp. 441-442) stresses that the manager's tenure depended on the owners' "whim." (*Willkür*). Many GmbHs, of course, had a majority owner who retained control over the firm even under the default rules.

it could have a management committee (*Vorstand*) and a supervisory board (*Aufsichtsrat*), but neither was required (§53). The default rules assigned one vote to each share, but firms were free to declare different voting schemes (§48). A GmbH could even specify different control rights for specific decisions such as purchasing land, contracting debt, etc. Even under these default rules, minority shareholders had one recourse: at any time, owners representing at least 1/10th of the firm's capital could demand a special shareholder's meeting, and if not satisfied, could ask a court to inspect the firm's records and, potentially, wind up the firm.

The GmbH could require its owners to have a relationship with the firm beyond contributing capital (§13). One owner might be required to provide services, while another might be required to provide particular inputs. Such provisions were forbidden to corporations until the revised HGB introduced in 1900. Partly in consequence, the firm could also list conditions under which minority shareholders can be forced to sell their shares.

The GmbH, like the corporation, counted as a commercial firm (a *Handelsgesellschaft*) but could be used for any legal purpose (§1). Some critics of existing corporation law had objected to the practice of using the corporate form to organize not-for-profits (such as fraternities).⁴⁰ There were some complaints about this feature of the GmbH as well. Prussia's representatives in the *Bundesrat* insisted on a provision (§62) that allowed the government to suppress any GmbH whose activities harmed public welfare. This language also appears in the 1889 Cooperatives Act, and should not be surprising in a time and place where freedom of association had only a tenuous legal hold (Brooks and Guinnane (2017)).

The *Begründung* stresses that the compromise between the partnership and the corporation lies at the heart of the new form and accounts for some of the specific rules. The GmbH locks-in capital, just like a corporation. The *Begründung* argues that partnership forms make it difficult for firms to execute long-term investment plans because owners can withdraw from the firm. On the other hand, the draft

⁴⁰ In his remarks to the *Handelstag*, for example, Hammacher made light of the various private and religious organizations that had used the corporate form (Deutscher Handelstag 1888c, p. 3). The *eingetragener Verein* used by German not-for-profits today dates from the 1900 BGB.

recognized that efforts to limit dissolution increased the chance of minority oppression. Several provisions of the GmbH law reflect efforts to reduce the problem of minority oppression. For example, §54 requires that if the GmbH increases the obligations of any owner, that owner has to agree to the change. Advocates of a new form had worried about the bG template on these grounds; the majority could demand *Nachschüße* the minority could not afford, driving out the latter. In its report to its members, the Bremen *Handelskammer* (1888, p.23) refers to the danger of the bG form where “by majority decision, owners can be required either to increase their capital investment or to sell their shares.”⁴¹ The requirement that GmbH owners be able to sell their shares reflects the rights of (personal) creditors as well as the need to avoid minority oppression (p.36, 60). The *Begründung* also defends the provisions that forbid permanent managers. A manager who could never be fired raised the possibility of a minority owner who controlled the firm (p.88). The GmbH’s ability to craft complex voting rules is also contrasted to the corporation’s (p.96) on these grounds.

The GmbH’s flexibility permits the firm to take a wide variety of shapes. Some came close to a corporation: they were large, had many owners with relatively small shares, and used the management and supervisory committees required of corporations. Others crafted their rules to more nearly resemble a partnership in which all owners had limited liability. The GmbH could not *quite* be a corporation (most importantly, it could not sell its shares on exchanges) and it could not *quite* be a partnership (unlike a partnership, a GmbH’s manager had to be dismissible), but law created a flexible form that enabled entrepreneurs to craft a structure to fit their needs.

4. Some GmbH empirics

How many GmbHs were there in the first decades, and how did they compare to firms organized in other ways? Sources allow us to look at both the flows (the number of gross registrations using each legal form) and the stocks (the number of firms reported in the census). Guinnane et al (2007, Figure 1)

⁴¹ This concern also came up in the responses from the *Handelskammern* discussed above; see Deutscher Handelstag (1888c, pp.6-7).

reports enrollment in Prussian business registries in January and September of years ending in ‘2’ and ‘7.’ The GmbH accounted for about 10 percent of new firms in 1897, five years after its creation, and about 35 percent of new firms by 1912. The GmbH’s popularity came mostly at the OHG’s expense.⁴² For selected years, we can use the establishment and industry census (*Betriebs-und Gewerbezahl*) to examine the stock of existing firms, which provides a better idea of the GmbH’s weight in operating firms.⁴³ Figure 1 includes the important reminder that the overwhelming majority of business firms have a single owner. Among multi-owner firms, GmbHs had a serious foothold before World War I but did not achieve their current role in business life until later.⁴⁴

The fear that the GmbH would displace the corporation formed part of the opposition to the new form. Goldschmidt (1892, p.336) saw this fear as overblown; the GmbH could not compete for firms that wanted to list their shares on markets. Unfortunately, no systematic source allows us to address this question directly, but it appears corporation-to-GmbH transformations were rare.⁴⁵ Many more GmbHs had seen some earlier incarnation as partnerships or sole proprietorships.

Advocates of a new enterprise form often speculated on the kind of enterprises expected to organize this way. Table 1 reports the distribution of enterprise forms for all firms and for several of the establishment census’s standard sector categories. The census of 1895 and 1907 were the only two enumerations of this type prior to World War I. The ordinary partnership dominated multi-owner firms overall and all of the sectors reported in the table. The GmbH’s popularity in transportation and

⁴² The German sources do not yield comprehensive micro-level evidence on partnerships, unfortunately, so we cannot study the substitution patterns in detail. Guinnane and Martínez-Rodríguez (2018) use firm-level data for Spain to show that the SRL displaced ordinary partnerships above all, but also had some effect on the adoption of corporations and limited partnerships. We cannot assume the same would hold in Germany, where the corporation was less common and flexible than in Spain.

⁴³ The registrations summarized in Guinnane et al (2007) are for all firms, while the establishment census is limited to “*Gewerbe*,” roughly, industry. Some GmbHs do not qualify as *Gewerbe*.

⁴⁴ Hannah (2017) studies the GmbH and other German enterprises in the Weimar period. Wartime inflation and the 1921-1923 hyperinflation reduced the real value of the minimum capitalization for GmbHs (as well as corporations) and was in part responsible for a large increase in the number of such firms.

⁴⁵ The source underlying the Prussian data in Guinnane et al (2007, Figure 1) is a published abstract of the notice a firm files with the commercial registry. In many (but not all) cases, the notice mentions a prior firm. Only 6 of the 578 GmbHs formed in the 1907 sample indicate they were previously corporations. I pursue this (complex) evidence in the companion paper.

distribution would not have surprised anyone in 1892. The form's popularity in "high tech" sectors such as machinery and chemicals might be less expected. The GmbH, in general, worked well for developing new technologies, especially patents. Founders could claim a patent's estimated value as part of the GmbH's *Stammkapital*. The GmbH also did not have to disclose financial results to anyone but its owners.

The various GmbH proposals anticipated enterprises of differing sizes. We have two measures of the sizes of GmbHs in published data, neither ideal. No aggregate source reports financial comparisons (such as capitalization) for all enterprise forms. Table 2 reports a proxy, the number of employees. By this account, by 1907, the GmbHs are on average smaller than limited partnerships and much smaller than corporations. In a few sectors (such as textiles) there are GmbH firms with more than 1,000 workers. Comparing 1895 to 1907 shows that in its very first years, the GmbH form attracted (among those counted here) some unusually large firms; as more firms entered, the average number of employees declined.

Several published sources report financial information on the GmbH and the corporation alone, and thus allow some comparisons for these two forms. Table 3 summarizes a particularly detailed report from 1909. By this year, there were more than three times as many GmbHs as corporations in operation. The GmbHs were much smaller; 21 percent had the minimum capitalization of 20,000 Marks (compared to a handful of corporations of that size). About 3 percent of GmbHs had capital of a million Marks or more, compared to almost half of corporations. The most important stock markets (Berlin and Frankfurt) required a minimum capitalization of a half-million Marks for local firms and one million Marks for others (Burhop and Lehmann-Hasemeyer 2016, Table 3); few GmbHs could have listed even if they had taken the corporate form. The smallest GmbHs exist in every sector, and even in textiles, the sector with the most large GmbHs, the corporations' capitalization dominates the GmbH's.

Critics anticipated the form would attract small, poorly-capitalized enterprises. The official tabulations do not provide much detail beyond Tables 1-3. As part of its discussion about adding the GmbH to the enterprises subject to an income tax, the Prussian *Landtag* assembled information on

GmbHs operating in Berlin in 1906. These can hardly stand as representative of Germany as a whole, if for no other reason than the popularity of real-estate investment vehicles organized as GmbHs in the capital. The figures are nonetheless useful. About 10 percent of the 1125 GmbHs enumerated had a single owner; another 65 percent had two. Thirty-eight percent of firms had less than 50,000 Marks capital.⁴⁶

5. From 1892 to 1914

The new form did have its opponents. Some lawyers had (and have) theoretical objections: as a “creation” (*Schöpfung*) of the legislature, the GmbH was outside the logic of the law. Legal academics thought that commercial law’s purpose was to codify long-standing practice, not to invent institutions that had no historical basis. As Neukamp (1889, p. 337) put it, an economic institution was the *Prius* and the legal institution the *Posterius*; but the GmbH switched those roles. Goldschmidt (1892, p.322) referred to the GmbH as “never before tried anywhere in the world.”

Between its enactment and the outbreak of World War I, several important developments affected the GmbH’s popularity and use. A chief worry was creditor protection. Several *Handelskammer* had raised this concern in the 1888 consultations (*Deutscher Handelstag* 1888c, p.12). Bähr (1892)’s widely-cited attack on the GmbH reflects worries about limited liability in general but stresses that the GmbH law lacked some of the rules that protected a corporations’s creditors. He spoke bluntly about the GmbH being a vehicle for “swindles.” Most firms had to grant their customers or suppliers some form of credit, if only short-term trade credit. A partnership’s creditors had the pledge of unlimited liability to assure repayment; the GmbH had the corporation’s limited liability without the corporation’s strict rules about capitalization. The GmbH’s critics claimed that it was too easy for GmbH owners to pay in capital that was real but over-valued, or to rely on fictitious valuations of immaterial assets such as patent rights or contracts. Bähr acknowledged that *informed* lenders had little to fear from the GmbH, but argues that “*Dummen*” required protection. Greulich (1906) notes that many of the largest German banks had lent to

⁴⁶ Haus der Abgeordneten, 1906. Drucksache Nr 9 pp.77-78.

GmbHs by the time he wrote, but the borrowers he lists are relatively large firms and he does not say how many of these firms had pledged additional security such as an owner's perassets. The GmbH's critics pointed to the fact that firms organized this way were more likely than corporations to end up in bankruptcy, although there was considerable debate over which types' creditors fared better.⁴⁷

The GmbH generated considerable jurisprudence (*Rechtsprechung*) in its first years, which is probably not surprising for a new enterprise form. Some of the issues reflect the statute's application of corporate-law language to something rather different. Two issues were especially important. The GmbH's drafters thought of the manager as taking the place of a corporation's management committee (*Vorstand*). The analogy is imperfect; many GmbH managers were both employees and owners of significant portions of the firm's equity. Courts had to sort out these two distinct roles. The valuation of capital paid in kind was another difficult issue. In the absence of an external valuation of such contributions, there were difficult questions of how to treat contributions that were not worth what had been stated in the articles of association.⁴⁸

Two important changes in the early twentieth century altered the way the form was used. Several German states taxed legal persons in 1892, but those taxes were limited to bGs and corporations. At first, GmbHs did not pay the enterprise tax (*Körperschaftsteuer*). Income taxes at first treated GmbHs like partnerships: the firm's owners paid tax on the income from the firm, but the firm itself paid no income tax. This favored status changed as the GmbH became more common. Prussia, for example, started taxing GmbHs as entities starting in 1906.

This new tax treatment led to a significant legal innovation. In the late nineteenth and early twentieth centuries, there had been attempts to combine enterprise forms (*Typenmischung*), for example, allowing a corporation to be a partner in an OHG. The law was unclear on the matter; the ADHGB's language implied that a partner could be a legal as opposed to a natural person, but firms that attempted to

⁴⁷ Lindemann (1911) estimates the proportion of all firms of a given form that were bankrupt in 1906. He concludes that about one in 200 corporations were bankrupt in that year, compared to about 1 in 75 GmbHs. Much of the difference reflects a few sectors that have almost no corporations, such as business in the hospitality industry.

⁴⁸ Reidnitz (1918) and Freymuth (1917) summarize the jurisprudence and provide references to the cases.

set-up this way found themselves rebuffed by the commercial register. The taxation of GmbHs made the question more urgent. If a GmbH is the general partner (*Komplementär*) in a limited partnership, the firm can assign most of the profits to the limited partnership, thus reducing or eliminating the enterprise tax. The resulting “GmbH & Co KG” reduces taxes. Combining the forms in this way has other uses, however. Sometimes, the owners of the GmbH and the partnership are not identical. A single GmbH can serve as general partner in several GmbH & Co KGs, with different limited partners who invest in different but related projects, for example. In 1912, the Bayerisches Oberstes Landesgericht ruled this combination of forms legal. The Reichsgericht followed suit in 1920.

6. Why the GmbH?

Most accounts of the GmbH’s introduction stress the problems created by the 1884 Corporations Act’s strict rules. This interpretation is true so far as it goes, but it cannot account for some of the history. Ideas for a new entity were in play before the 1884 Act, and the government claimed to be considering the issue even as it presented the 1884 legislation to the Reichstag. Here I have stressed two features of the discussion which have been largely lost. The problems facing firms trying to operate in German colonies created an opportunity to think about more flexible enterprise forms. The role of such enterprises in the debates about a new enterprise form was often doubtless rhetorical, but the colonial project’s importance lent these discussions a legitimacy they might otherwise lack. The growing commercial rivalry with England made it easy to point to the supposed advantages its company law offered to business people.

The GmbH reflects a trend we might not, from our historical vantage point, fully appreciate. Oechelhäuser and other advocates talked about the extension, over time, in the use of limited liability. Before 1870, most German firms with limited liability were corporations. They required State concessions because the corporate form (and especially limited liability) were viewed as privileges granted only under limited circumstances. The 1870 Act waved these concessions, but limited liability still came bundled with detailed rules concerning formation and operation in the corporation law. In 1889,

Germany extended limited liability for the first time to much smaller organizations, its cooperatives.

Cooperatives are, like corporations, associations of capital, but this development reflected the growing sense that limited liability without strict regulation made sense for organizations that did not participate in equity markets and thus had little capacity to harm the broader public. Cooperatives could not take the place of many business organizations, however.

The GmbH takes this development a step further. The *Begründung* stresses that the GmbH reflects a compromise between the OHG, a form with an “individual basis” (that is, an association of people) and the corporation, which has a “collective basis” (and is an association of capital). The law adapts the basic notions of limited liability in an association of capital to make the form flexible and thus suitable to a wide variety of mostly smaller enterprises. Oechelhäuser did not get the “ordinary partnership with limited liability” that he wanted. Yet he got the result he wanted, an enterprise form that offered limited liability to smaller enterprises and did not require all the formalities of the corporation.

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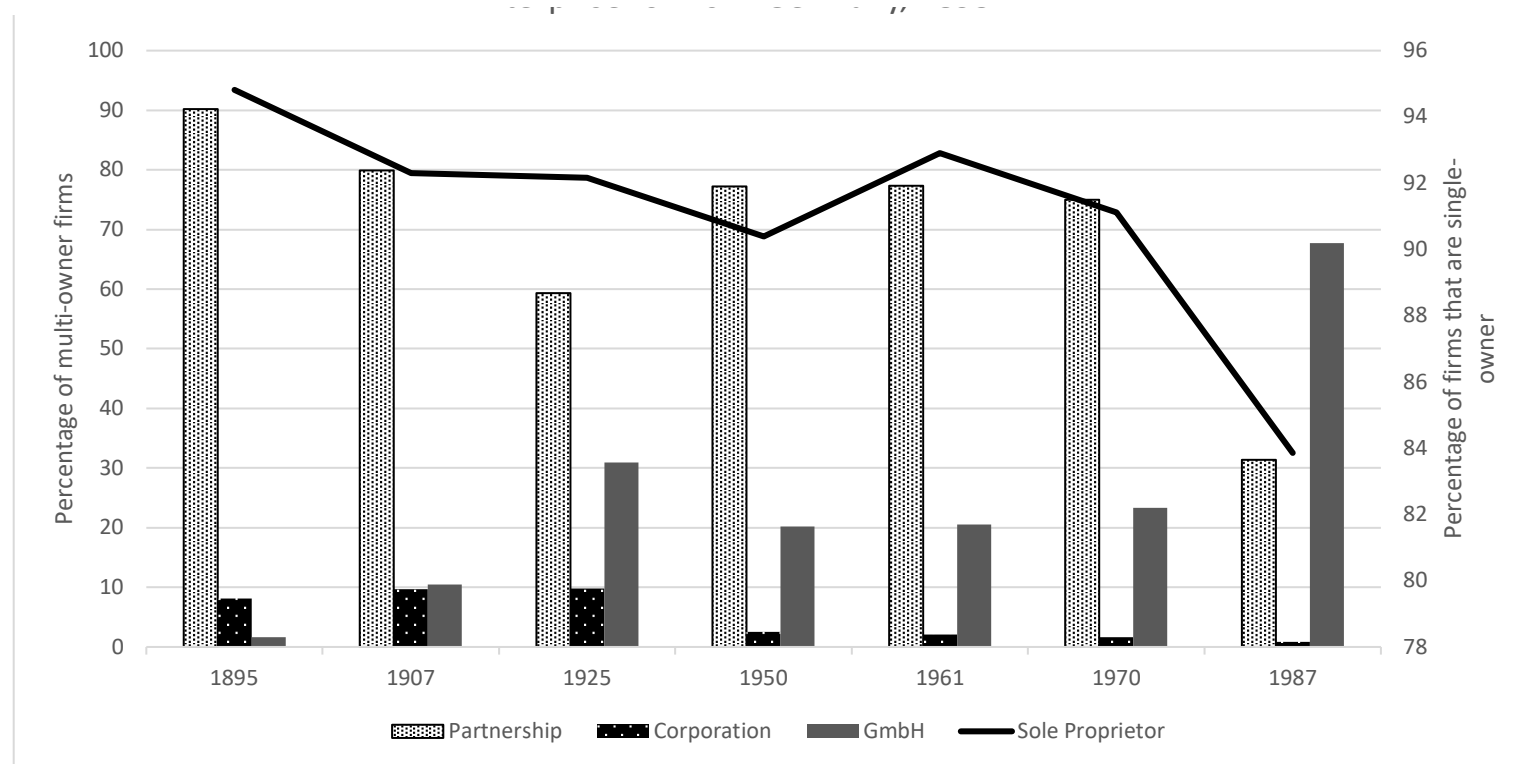
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Figure 1: The legal form of enterprise in Germany, 1895-1987



Note: Partnerships combine the ordinary and limited partnerships (OHG and KG); corporations includes share partnerships (KGaA).

Table 1: Percentage of firms organized as partnerships, GmbHs, or corporations, 1895 and 1907

	1895				1907			
	Partnerships:		GmbH	Corporation	Partnerships:		GmbH	Corporation
	Ordinary	Limited			Ordinary	Limited		
All sectors	88.9	1.8	1.6	7.6	78.6	1.6	10.5	9.4
Selected sectors:								
Metal processing	95.0	1.6	0.9	2.5	85.1	1.3	9.1	4.5
Machinery	82.4	2.6	1.6	13.1	62.6	1.9	18.9	16.6
Chemicals	69.7	4.7	4.0	21.6	52.3	2.8	24.0	20.8
Textiles	88.6	3.5	0.8	7.1	79.2	3.5	7.1	10.1
Construction	97.1	0.3	1.2	1.4	92.3	0.5	4.5	2.6
Trade	92.1	1.8	1.6	4.5	78.9	1.9	11.1	8.1
Transportation	76.3	0.6	1.5	21.5	69.4	1.1	11.1	18.3

Note: Source is the *Betrieb- und Gewerbezahlung*. The source covers industry (*Gewerbe*) alone and thus excludes firms that, for example, own real estate. The number of employees includes owner-employees where relevant. In 1895 and 1907, the table category “ordinary partnership” corresponds to “*mehrere Gesellschafter*,” which is imprecise. The denominator is the sum of firms organized using one of these forms, and thus excludes the bG, cooperatives, share partnerships, etc. “Corporations” limited to *Aktiengesellschaften*. The Roman numerals correspond to the source’s industrial classification scheme.

Table 2: Average number of employees by enterprise form

	1895				1907			
	Partnerships:				Partnerships:			
	Ordinary	Limited	GmbH	AG	Ordinary	Limited	GmbH	AG
All sectors	26.7	80.7	64.3	168.7	26.1	79.4	48.6	178.9
Metal processing	35.7	143.9	181.1	352.6	38.5	163.5	94.1	528.2
Machinery	48.6	151.5	91.0	296.4	56.7	134.6	91.4	359.4
Chemicals	35.4	52.0	80.6	174.3	31.3	64.9	56.7	219.4
Textiles	94.3	171.5	367.5	446.7	92.9	164.7	167.4	406.1
Construction	32.3	64.5	122.0	77.5	29.9	127.9	99.0	168.4
Trade	9.1	11.8	9.8	18.3	11.1	19.9	12.0	24.5
Transportation	15.9	67.4	63.4	172.4	17.4	81.3	26.8	166.7
Note: See Table 1.								

Table 3: Sizes of GmbHs and corporations, firms operating in 1909

	GmbHs						Corporations				
	Number of firms	Percentage of firms with a Stammkapital:					Number of firms	Percentage of firms with a nominal capital:			
		20 thous	20-50 thous	50-100 thous	100 thous-1 million	1m plus		< 25 thous	25-100 thous	100 thou - 1 mil.	1m plus
All sectors	16508	21.07	25.82	19.76	26.23	2.81	5222	2.30	7.22	44.47	46.02
Selected sectors:											
Metal processing	708	13.56	24.15	19.77	34.22	2.82	160	0.63	0.63	48.75	50.00
Machinery	1869	14.34	24.61	20.01	32.58	3.42	547	0.00	2.56	42.78	54.66
Chemicals	581	18.93	21.34	18.76	29.94	3.96	150	0.00	1.33	38.00	60.67
Textiles	413	7.99	15.98	16.95	36.56	9.93	357	0.28	0.84	40.62	58.26
Construction	476	25.00	33.61	16.18	20.17	2.10	49	2.04	6.12	46.94	44.90
Trade	5371	31.80	26.81	17.26	19.4	1.99	793	4.67	12.86	33.29	49.18
Transport	518	22.20	27.41	18.15	22.59	5.98	477	1.26	6.92	36.27	55.56

Note: Corporations include share partnerships (the KGaA). The source does not disaggregate the two forms. While the sector definitions here correspond to those used in the source for Tables 1 and 2, the universe of firms does not. The source for this table is cited as “*Die Geschäftsergebnisse 1908/1909*”