

# Founding a Company

Handbook of Legal Forms in Europe

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1. Auflage 2010. Buch. xv, 263 S. Hardcover  
ISBN 978 3 642 11258 4  
Format (B x L): 15,5 x 23,5 cm  
Gewicht: 584 g

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# Chapter 2

## Legislative Need for a Handbook on Legal Forms in Europe and Selection of Countries

Michael J. Munkert

**Abstract** In this chapter the author Michael J. Munkert discusses the differences in firm legislation across countries as another important aspect that makes a handbook on legal forms in Europe necessary. He highlights the tension between the European open market and the country-specific rules and regulations for setting up and running businesses and explains the accompanying challenges companies face. Furthermore, he delivers an argumentation for the selection of the ten countries that are included in this handbook and introduces the structure that is used for analysis of each country.

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### 2.1 Differences in Firm Legislation and Need for a Handbook on Legal Forms in Larger Europe

Through the process of the European integration and due to the age of globalization, the false impression that diverse legal systems in different countries have been simplified and adjusted can easily arise. However, there are still various striking dissimilarities between the countries, which often cause legal conflicts. Of course, it is obvious and indisputable that the Hague Convention (see Hague Convention

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1961, Art.12) enabled debureaucratization and eased legal relations between countries. Thereby, near worldwide legal relations could be established without needing diplomatic services.

The other side of the coin is that all countries still have different regulatory frameworks regarding economic and cultural aspects. The prevailing difficulties lie in language barriers, lettering and firm legislation. The phrase “different strokes for different folks” hits the nail on the head and demonstrates that there is still diversity between the European countries. Many companies and founders are not aware of this fact and thus, are often surprised when unexpected problems concerning firm legislation arise and are confronted with the harsh reality. Hence, a need for a handbook on legal forms in larger Europe that provides a clear, structured overview over ten different European countries is apparent. In addition, this handbook can be very helpful in order to prevent unpleasant side effects of incorporation.

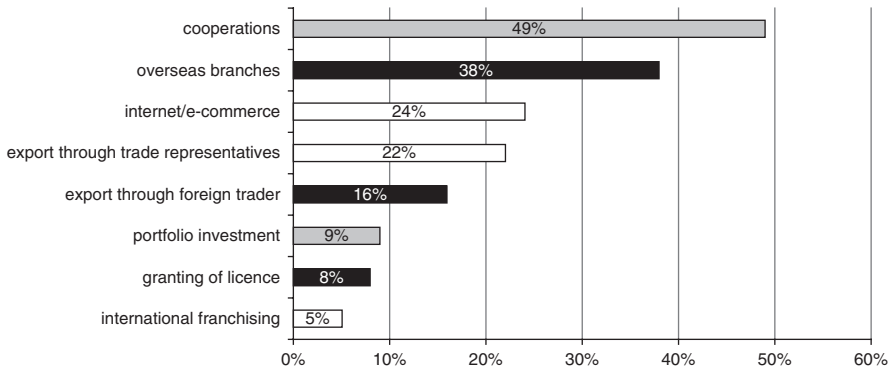
On the one hand, the handbook on legal forms addresses people who dream of starting their own business and being their own boss. Unfortunately, these people often show a lack of the required detailed know-how and for many, it is a mystery as to which legal and fiscal premises are necessary. Especially, when you want to start a business in a country that is not your native land, you have to be informed sufficiently and must acquire accurate knowledge about the legal system in the foreign country. There are many aspects one has to consider when incorporating. This handbook details the most important facts and alleviates the introduction into this complex field of legal forms in a comprehensible way.

On the other hand, established companies seek to expand their scope and seek subsidiaries in different countries. Through the globalization of markets, the incorporation process has become easier, but it is more important to expand one’s horizon and to cooperate beyond borders. The possibility to break into new markets provides growth opportunities for enterprises. However, this involves several risks and influencing factors that are often not kept in mind and are generally underestimated. Therefore, current information is constantly essential. To conclude, the language, different legal forms and missing information propose an enormous challenge.

Figure 2.1 shows that 38 percent of service industry companies have subsidiaries abroad. Consequently, a certain trend and popularity for this form of internationalization can be assumed. But the cooperation is still the favoured form with 49 percent. This can be attributed to the fact that there is still a high inhibition threshold to incorporation because of the higher risks and challenges.

Table 2.1 shows that the number of investment plans in German industrial enterprises abroad has steadily increased and the amount of non-planned investments has declined over the past several years. Therefore, it becomes clear that the German industry still has its focus on internationalization. The share of investing enterprises abroad is 41 percent. This number is well above the results from the previous 10 years (about 30 percent). From these enterprises, 40 percent seek to increase their engagements in foreign countries and only 11 percent are planning a reduction.

Figure 2.1 and Table 2.1, accompanied by the previously mentioned assertion, illustrate that there is a high demand for incorporation and internationalization in other countries. For this reason, this handbook on legal forms in greater Europe



**Fig. 2.1** Forms of internationalization of service industry companies

**Table 2.1** Investment plans of German industrial enterprises abroad as percentage<sup>a</sup>

Industrial enterprises for the year	2000	2001	2002	2003	2004	2005	2006	2007
Investments abroad	36	34	38	43	40	41	43	41
No investments abroad	64	66	62	57	60	59	57	59

Industrial enterprises which seek to invest in countries abroad in comparison to the previous year	2000	2001	2003	2004	2005	2006	2007	2008
Higher investments abroad	33	34	35	31	42	43	40	40
Same amount of investments abroad	52	54	44	50	46	47	52	49
Less investments abroad	15	12	21	19	12	10	8	11
Balance	18	22	14	12	30	33	32	29

<sup>a</sup>Until 2000 only industrial enterprises from western Germany; since 2001 industrial enterprises from Western and Eastern Germany; no survey in 2002 regarding investments abroad

has been published in order to meet this demand. It serves as a guideline for the selection of the best legal form in each individual case. It names the pros and cons and explains the steps that have to be taken to found a company in a given country.

## 2.2 Approach and Selection of Countries

The handbook on legal forms in Europe deals with ten different countries and analyses their most relevant legal forms. For this reason, 12 criteria with an important influence on the legal form selection have been identified, as tabulated in Table 2.2. First, it is vital to know if the chosen legal form has legal capacity and power of agency. Second, the whole process and the requirements of incorporation are

**Table 2.2** Overview on analysis criteria for each legal form

Legal capacity and power of disposition	Regulations concerning corporate name
Process and requirements of incorporation	Transfer of shares/regulations in the case of death of a shareholder
Requirements for associates/shareholders and regulations concerning shareholders' meetings	Liability of shareholders and directors
Articles of Association	Applicable accounting standards
Minimum contribution/initial capital	Disclosure requirements
Commercial register	Employee participation

explained in detail. Another crucial aspect is whether there are requirements for partners and regulations concerning shareholder's meetings. The articles/memorandum of association are then described. Furthermore, it is important to know if a minimum contribution or initial capital is required. Another section broaches the issue of the commercial register. It is also significant to know if there are any regulations concerning the corporate name of this legal form. Moreover, it is relevant to know what will occur in the case of shareholder death. Additionally, questions regarding the liability of shareholders and directors will be discussed. Applicable accounting standards is another topic. In addition, it is necessary to know if any disclosure requirements exist. Finally, it is also important to clarify if employees can or have to participate in this legal form. All in all, these different aspects cover the most crucial facts about one legal form – tax issues aside.

It is clear that one can only decide between these various legal forms if the advantages are contrasted with the disadvantages. Therefore, this handbook outlines the pros and cons of different legal forms. By the same token, an objective recommendation including tendency statements is given depending on the individual case for each country.

But why exactly did we choose the ten countries discussed in this handbook? First of all, these countries have economic and fiscal advantages, which make them very interesting for German enterprises to invest in. The countries with high economic interest and power are France, Germany, the United Kingdom, Spain and Italy. Additionally, the neighbouring countries Austria, Swiss and the Netherlands, are attractive for German companies. Moreover, the Netherlands and Switzerland have mainly fiscal advantages.

In 2007, German enterprises invested more than EUR 122.5 billion in their subsidiaries abroad. That is about EUR 47 billion more than 2006. The money was invested mainly in the Netherlands (EUR 25.5 billion), the United Kingdom (EUR 14 billion) and Switzerland (EUR 13 billion). Furthermore, the profits of EUR 30 billion were invested again. This can be ascribed to the profitability of the subsidiaries.<sup>1</sup> Figure 2.2 shows the “big foreign trade partners” for Germany.

<sup>1</sup><http://www.spiegel.de/wirtschaft/0,1518,541947,00.html>, version. Accessed 4 Mar 2009  
Deutscher Industrie und Handelskammertag (2008) Ergebnisse einer DIHK-Umfrage bei den Industrie und Handelskammern Frühjahr 2008, [www.dihk.de](http://www.dihk.de). Accessed 4 Mar 2009

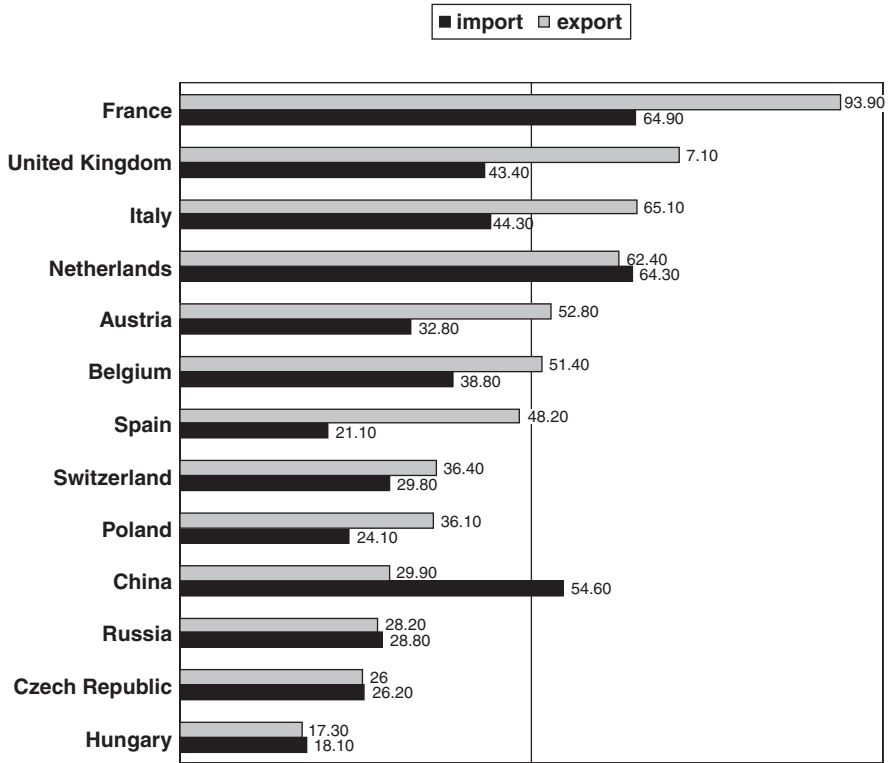


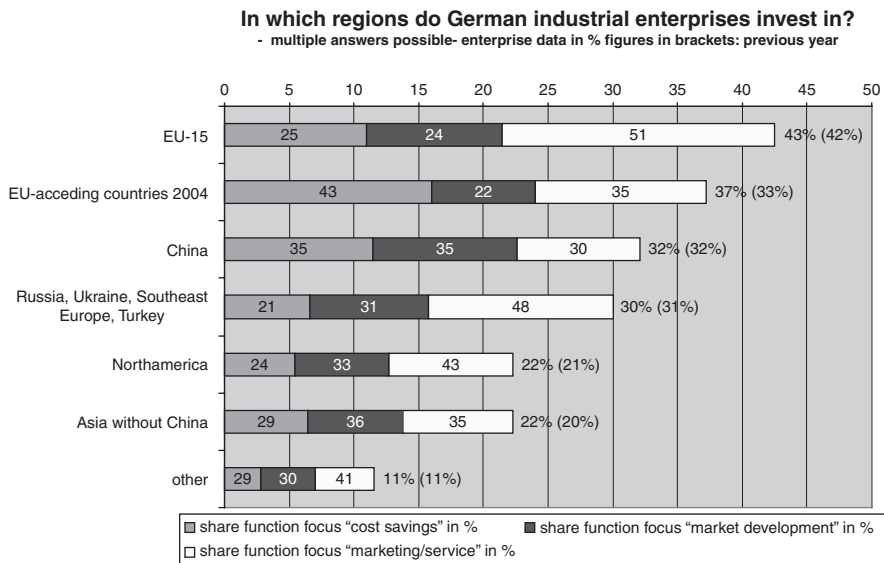
Fig. 2.2 The most important trade partners of Germany – 2007

The coalescence of the European domestic market attracts many enterprises. About 43 percent of companies name the EU-15 as their main goal (see Fig. 2.3). The reasons for this are mainly the positive economic activity, the advantages of a nearly unitary currency area, and the secure legal framework of the domestic market. The proximity of the home country is also a vital influencing factor.

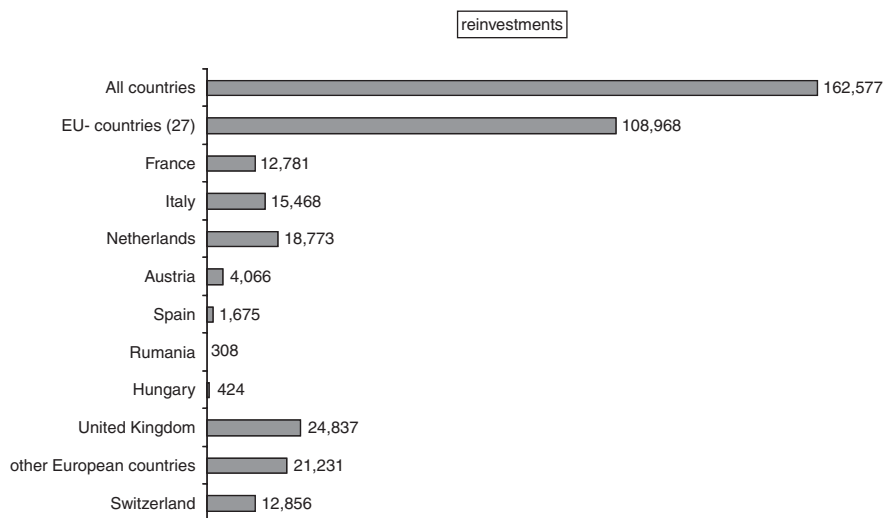
Figure 2.3 illustrates that new EU member-states, mainly from Central and Eastern Europe are getting more and more attractive for German enterprises (37 percent). Therefore, Romania and Hungary can be seen as representatives of these new EU member-states. One motivation for investors to start business in one of these countries is the low costs of production. Thus, the new EU member-states are gaining importance.

Moreover, these countries are now close to the category “countries of the old EU-15” which is, however, still the most relevant destination for investments abroad (43 percent).

Figure 2.4 illustrates the reinvestments made by German enterprises in the year 2007 abroad and emphasizes the importance of the EU-countries (27) to German investors. From a total of EUR 162,577 million, EUR 108,968 million of the reinvestments were made in EU-countries.



**Fig. 2.3** In which regions do German industrial enterprises invest in?



**Fig. 2.4** German portfolio investments abroad in 2007 – in m €

To sum up, these countries have been selected due to their economic or fiscal benefits, their location and their recent EU membership. All these named criteria make them attractive for foreign investment and incorporation.