РАЗДЕЛ 1
НАУЧНЫЕ ИССЛЕДОВАНИЯ И КОНЦЕПЦИИ

SECTION 1
ACADEMIC INVESTIGATIONS & CONCEPTS

GERMAN CORPORATE GOVERNANCE CODE AND MOST COMMONLY UNACCEPTED RECOMMENDATIONS: INTRODUCTION AND SOME EXPLANATION

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Abstract

This study presents an empirical analysis of compliance. In the year 2002 the German Corporate Governance Commission introduced a Corporate Governance Code to companies listed on the German stock exchange. Each company in noncompliance with one or more of the recommendations must explain in writing. Regarding the 2003 amended Code, this study identifies the Most Commonly Unaccepted Recommenations (MCURs). Finally it gives some explanation why some companies have good reason not to follow all the recommendations like the German Corporate Governance Commission want them to.

Keywords: Germany, Corporate Governance Code, Most Commonly Unaccepted Recommandations (MCURs)

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Introduction

German companies faced tremendous changes through recent globalization. Notably there is an increased emphasis on shareholder dependency and corporate ethics. Until recently, economists have described Germany's corporate system as bank-based system (Schmidt, 2001; Hackethal and Schmidt 2000) with only a minor shareholder dependency (Siebert, 2004).

One systematic method of centralizing power was to hide profits. This was largely legal under bookkeeping rules known as continuance principle system (Kontinuitaetsprinzip). Moreover, because German regulations permit banks to invest in companies while making them loans, the banks could control companies. Thus, even Germany's indexed companies did not depend heavily on their shareholders. In contrast to US or British companies, Germany's indexed companies tended to ignore their shareholders.

Nowadays like in US or Britain indexed companies pursue the advantages a shareholder system provides. Economists cite four factors facilitating this shift: 1. competition for global capital, 2. competition for equity listings among stock markets, 3. influence of globalizing consulting and investment banking services and emulation of 4. generally globalizing US firms and their business practices (Useem, 1998; Yoshikawa and Phan, 2001, Yoshikawa and Phan 2003)

In Germany too, a number of disastrous developments of mismanaging and failures in several German Companies like Holzmann and Manesmann were reported (Lange 2004). Especially the small and medium enterprises face tremendous problems, therefore, a special consortium for the small and medium sized companies was established, called: "Bremer Initiativkreis", (http://www.bremer initiativkreis.de). There is support in Germany that companies should follow an ethical approach in regard to their clients, banks, to other companies and especially to their investors. For this reason, in 2002 German Corporate Government Commission established a Corporate Governance Code (the Code) for listed companies where recommendations were given for companies of how they should behave (http://www.corporate-governance-code.de).

This paper serves to point out which recommendations are noncompliant by many companies. The author was motivated to do this study in order to have a clear view where the Code is not followed. Furthermore, it can be argued from this point, whether each of the code recommendations make sense for every single listed stock company.

Theoretical Approach to the Code

The Code can be drawn back of Weber's thought about neo institutional theory. Rational organization leads to isomorphism through three ways: First, through introduction of laws, second through mimetic structures also described as "best practice". Especially when in unsecured situation, companies might copy the behavior of others. Third, isomorphism can be reached through normative similarity of their structure (Weber 1972).

The Code has been developed in the aftermath of the publication of the OECD principles in 1999 (OECD 1999: Steger, T. and Hartz R. 2005) where diverse expert groups in Germany started to implement proper regularities for stock exchange listed companies.

The so called "Grundsatzkommission" (School of Frankfurt) published their principles in January 2000. These initiatives were followed by Berlin commission under Prof. Werder as well as governmental appointed Baums commission. Finally, the commission, who was led by the reputable Dr. Cromme, Chairman at Thyssen Krupp company (Cromme commission) established the Code for many reasons but especially to attract international investors. The Code covers a wide range of issues, starting from juristically regulations up to institutional investors (Powell and DiMaggio 1991; Scott, 1995; Walgenbach and Beck 2003). It consists out of three parts. There are laws from several areas combined together to make it easier for a person concerned to see all the necessary laws in one volume (MUST-part). These laws had to be followed anyway, the only new point is, that one can see them now together in one volume. Second, there are recommendations (SHALL-part) to the companies. This is the part where I focus on in this study. Third, besides recommendations the Code also contains suggestions (CAN-part) of what companies can or could do.

Recently, in Germany many new laws concerning corporate governance got introduced. In the same year of 2002 when The German Corporate Government Commission introduced the Code, a new law "Law of Transparency and Publicity" was established. In the year 2003, reform plan from Baum's commission came into act (Baum's plan 2003).

In 2004 several new laws were released, in Dec. 9th, 2004 BilReG (note), in Dec. 20th, 2004 BilKoG (note) and in Dec. 31st, 2004 APAG law (note). The most important law for corporate governance the "Law of Transparency and Publicity" goes back to Anglo-American "comply or explain" rule (Oser et al. 2004). If a company does not comply one or more of the recommendations made by the commission in the Code, it needs to be written and published. This should give pressure to companies in a sense that investors might change their mind in regard to investment if they see that companies do not comply with the recommendations (Strieder 2004).

Data Sample

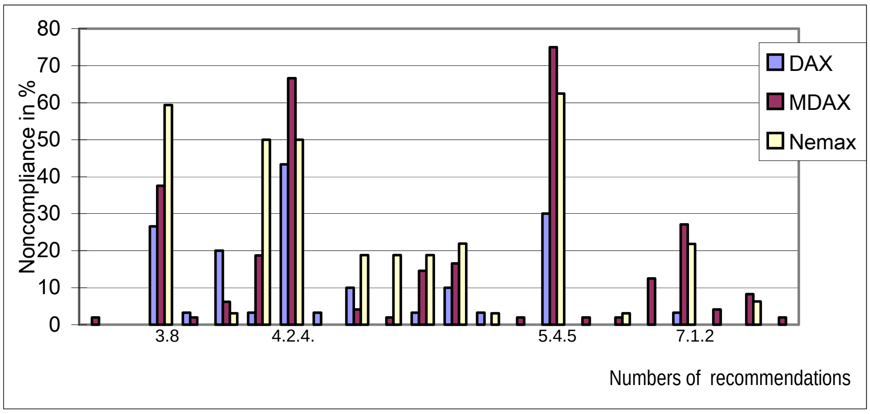
The study compiles for 96 German manufacturing companies, 25 out of them are Dax listed (the biggest companies), 41 are M-Dax listed (the following biggest) and 25 were listed at Nemax (relatively new companies). The "comply or explain" statement for Dax and M-Dax listed companies was partly received by Towers Perrin, for Nemax listed companies they were found directly at companies' homepages. In cases where companies did not give numbers but just words, it was sorted according to the paragraphs (like United Internet). The same was done when companies obviously did a mistake with the numbers (like TelesAG). Companies were given a dummy variable "1" if they followed recommendation, otherwise "0". The code contains several recommendations which were split of in 32 parts. In research of Corporate Governance, however, recommendations can be divided into different numbers of subgroups. Recent research what has been done yet, e.g. Nowak et al. count 61 recommendations (Nowak et al. 2004). Werder et al. even come to 72 because they separate recommendations in every single part (v. Werder et al. 2004). In the homepages of many companies in internet often times recommendations were not separated; therefore, I come up with a number of 32 main recommendations.

Findings

Several studies from different researcher were undertaken to investigate compliance of companies. Oser et al. research at Dax, M-Dax and 32 other at prime standard listed companies and find evidence that the bigger the company the better the compliance of the recommendations (Oser et al., 2004). In another study Nowak et al. show that the compliance with the Code was by 33% of German companies who are listed at the US Stock Exchange in every point, in contrast to only 6.8% of non- US-listed German companies who complied with recommendations in every single point.

Most of the companies follow almost all of the recommendations. According to Edelmann bigger organizations tend to follow public opinion better than smaller ones because they face easier public pressure (Edelmann, 1992).

Hereafter companies are separated, belonging to three separated stock exchanges. First, DAX where the biggest 30 companies are listed, second MDAX, where the following 70 biggest companies are listed. Furthermore, I analyse Nemax, where 50 new companies were listed. As can be seen in the table below, the Most Commonly Unaccepted Recommendations (MCUR's) are four points. All the other recommendations are full or almost full in compliance by the indexed companies.



Source: 96 companies. Figures are obtained from several sources, Towers Perrin and directly from hompages of the companies

Fig. 1. Most Commonly Unaccepted Recommendations (MCUR's) in year 2003

Looking at table 1, one can see that companies comply almost all of the 32 recommendations except to four. The biggest DAX listed companies comply mostly with all of the recommendations. Critical recommendations of noncompliance (MCURs) were 4.2.4 (individualized reporting of compensation with more than 40%) and 5.4.5. (performance orientated compensation with noncompliance of 30%). Smaller MDAX listed companies are in noncompliance with much more recommendations as DAX companies, in four recommendations at more than 20% rate. Nemax listed companies are somewhere in the middle regarding their non compliance of recommendations.

The Code contains four MCURs as flollows:

- Paragraph 3.8: Director and Officer Liability. According to The Code, the company should not cover manager's risk to 100% but many companies do not comply with it (26,6% for DAX, 37,5% for MDAX and 63,3% for NEMAX).
- Paragraph 4.2.4 recommends an individualized open compensation system for Board of Directors (Geschaefts fuehrung) but many companies do not comply with it (43,3% for DAX, 66.6% for MDAX and 50% for NEMAX)
- Paragraph 5.4.5 recommends performance orientated compensation to Auditors (Aufsichtsraete), also many companies do not comply with it (30% for DAX, 75% for MDAX and 66,7% for NEMAX)
- Pargraph 7.1.2 recommends the release of accounting information 90 days after fiscal year is closed and 45 days after quarter fiscal year is closed. At least in MDAX and NEMAX there is a higher rate of non-compliances: (3,3% for DAX; 27,1% for MDAX and 20% for NEMAX)

D&O Insurance. In accordance to neo institutional theory D&O insurance can be seen in contrasting views. A company with high corporate social responsibility will provide security for their managers. That means companies will buy D&O-insurance for their directors (Know, and Maklan 2004). In contrast to this, not having full scale insured managers might stimulate them doing a better and more responsible job. The Code recommends companies in paragraph 3.8. that they should not completely insure manager's behavior through D&O insurance.

Open Compensation System. In Germany Corporate Governance debate is dominated by the discussion that good corporate governance means compensation of BOD-directors should be individualized transparent to the public (Rheinischer Merkur 2005: DWS 203). Companies who open up their compensation system of their directors have more transparency to the public. The Code recommends in paragraph 4.2.4. the release of individualized compensation system for BOD directors to the public.

Performance Oriented Payment of Auditors (Aufsichtsrat). As in German two tier system, BOD is divided in decision maker (Vorstand) and controlling auditors (Aufsichtsrat), in a similar way as the release of individualized compensation system of BOD-directors to the public, paragraph 5.4.5 recommends that BOD auditors (in Aufsichtsrat) should be motivated of checking the company through performance orientated compensation system. The Code recommends in paragraph 5.4.5 a performance oriented compensation system for auditors.

Proper Release of Accounting Information. Nowadays, release of proper accounting information is vital for investors where they can make their decisions about investments. Companies are recommended to disclose their accounting information after 90 days of fiscal year and their quarterly accounting information after 45 days to the public. This recommendation is written in paragraph 7.1.2 and it is shared by European Union who came up with extra transparency rule where as European companies are supposed to disclose accounting information more frequently (Buchheim 2004).

Discussion and Implications

This paper examined Most Commonly Unaccepted Recommendations (MCURs) of German corporate governance code recommendations.

The recommendations of the Code exist out of guidelines offered from scientists, politicians and other pressure groups. As it is not a law but recommendations, the foremost punishment for companies who do not comply with recommendations could be a stock price decline.

This is not in line with recent research of Nowak et al. who show in their research of 337 at Prime Standard in Germany that there is no correlation between listed companies who comply with Code recommendations and to their impact at the capital market. A reason for this outcome – so their finding – is a lack of transparency in the market. That is to say, it is a still early discipline of research and documentation, so that capital market might not yet take enough notice of Corporate Governance at all (Nowak et al. 2004). It is to mention that they included all recommendations. However, for smaller companies with only two or three BOD members it might not make economical sense to establish compensation committees like the Code recommends. In accordance to neo institutional theory, corporations intend to incorporate socially accepted norms (Powell and DiMaggio, 1991; Scott 1995). In this line, neo institutional theorists argue that embedded formal structure rises through institutional expectations. Therefore, accepted norms can give legitimacy, resources and stability to environmental systems (DiMaggio and Powell, 1983). This saying, followers of the recommendations of The Code might be motivated to a less extend through performance for itself but through a gain in legitimacy of a shifting environment. In recent years, German political situation with high jobless rate puts many companies in a sort of "spotlight". Especially bigger German companies like e.g. Siemens could have faced this pressure when individualized compensation scheme of BOD directors became public in Dec. 2004. The government is eager to guide companies to success through correct behavior. In this regard, some companies might accept the Code of not being in public critics even if it is not sure whether complying to these recommendations are helpful for companies economic success or not.

Conclusion

In Germany corporate governance is a very active discussed topic. With establishing The German Corporate Governance Code companies can comply with recommendations or they have to explain if they do not comply. In latter case, they have to report according to 161 stock price company law (Aktiengesetz). There is hope from politicians and big support by labour unions that companies who behave in good faith through complying with the Code, that they will receive better economic success.

In this study, it was focused on the MCURs (Most Commonly Unaccepted Recommendations). In overall companies did not comply mainly four recommendations. In the areas of D&O insurance, open individualized compensation system of BOD directors, performance oriented compensation to auditors and time adequately disclosure of accounting information. Saying this, it is critically to ask, whether all recommendations by the German Corporate Governance Code Commission are helpful for companies in any case. Especially in part of board member transparency of compensation, e.g if companies release individualized compensation system from their BOD directors it might destabilize companies more than it serves for any good. Employees might loose a lot of time and energy for exculpation about their income. BOD directors might have to explain themselves especially in economic difficult times for what they receive the (high) amount of compensation.

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