

## How to Ensure That Directors and Executives Adhere to the Rules of Good Corporate Governance? Lessons from Germany

„Corporate governance related training of board directors and senior managers“  
April 14, 2015

Prof. Dr. Anja Tuschke

Institute of Strategic Management  
Ludwig-Maximilians-Universität München, Germany



# Awareness for the Challenges of Good Corporate Governance increases

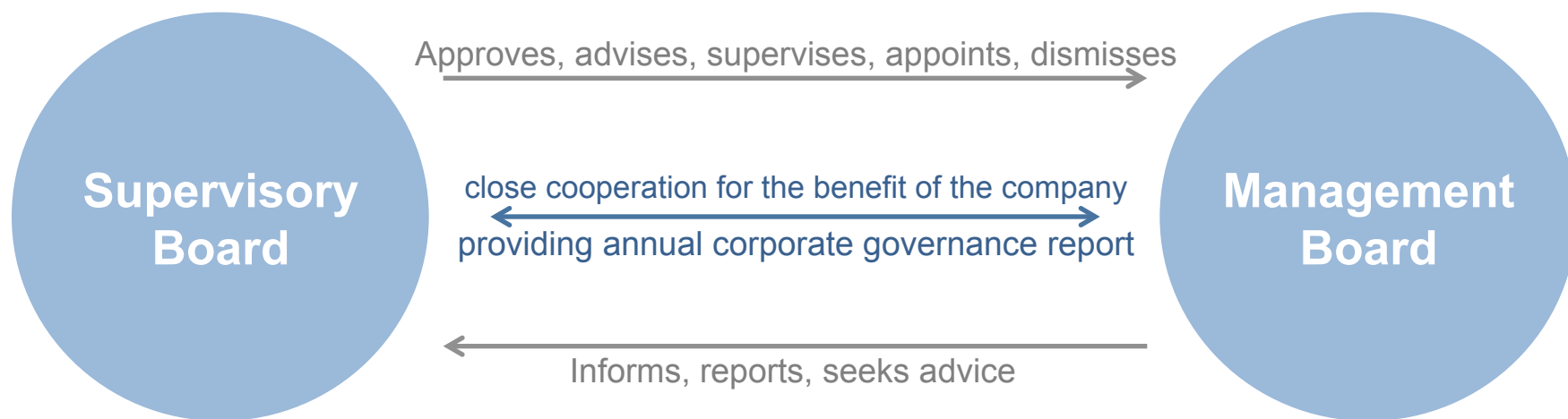
Some Reasons:

- Increased **demands and complexity** for directors as well as executives
- Higher awareness for the role of effective governance for firm-level competitiveness in **global competition**
- Higher need for effective corporate governance due to **corporate scandals**, the financial crisis and related problems



Source: Mundi Advocatus

# Collaboration between Management and Supervisory Board



# Three Pillars of Corporate Governance Regulations in Germany

## German Stock Corporation Act (Aktiengesetz)

- E.g. three corporate bodies – Annual meeting, management board, supervisory board
- E.g. clear separation of management and supervisory board

## German Co-determination Act (Mitbestimmungsgesetz)

- E.g. Up to one half of seats at supervisory boards have to be held by employee representatives
- E.g. work councils in all larger firms

## German Corporate Governance Code

- Published by a government commission consisting of managing and supervisory board representatives, academics, auditors and a trade union federation
- Members are appointed by the German Federal Minister of Justice and Consumer Protection.
- The Code expresses commitment to good corporate governance
- The commission consults the Code with companies and their stakeholders (including politics and the general public)

# German Corporate Governance Code (GCGC)

## Legal regulations

based on the Stock Corporation and Co-determination Act

## Recommendations

for good and responsible corporate governance

## Suggestions

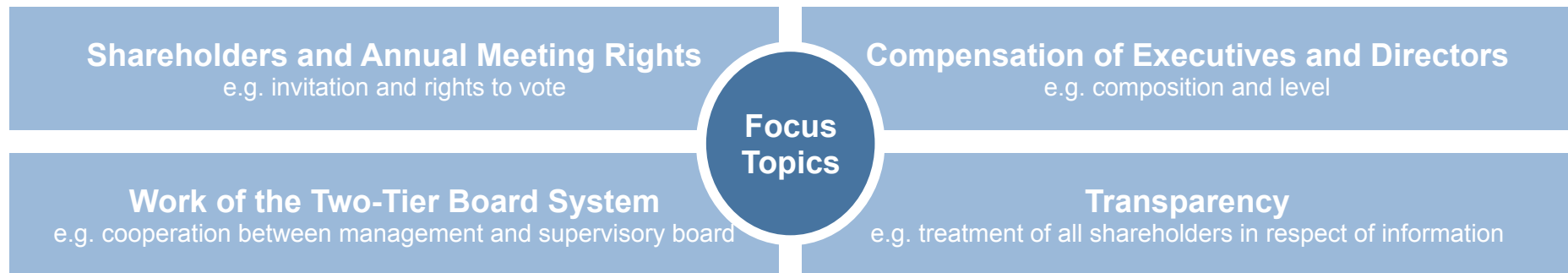
for good and responsible corporate governance

- Clarification of obligations of the management and supervisory board
- Legal Basis: Declaration of conformity to §161 Aktiengesetz (Stock Corporation Act)
- „**Comply or Explain**“ - Recommendations and suggestions are not mandatory. Deviations from the recommendations – not suggestions – have to be disclosed and explained

## Main Goals

- Making the German corporate governance system **transparent** and **understandable**
- Promoting **trust** of **investors, customers, employees** and the **general public** in the management and supervision of listed German stock corporations

# Focus and Development of the GCGC



## Latest development of the German Corporate Governance Code:

- 2002 First version of the German Corporate Governance Code
- ...
- 2012 Supervisory Board members have to **reveal personal and business relationships**
- 2013 Specification under which conditions **deviations from recommendations and suggestions** are explicitly allowed and rational
- 2014 15 new recommendations regarding **management board members compensation (e.g. defining limits)**

# Generally High Acceptance and Application of the GCGC

Data for acceptance and application of the GCGC in 2014

		DAX	TecDAX	MDAX	SDAX	Prime	General	Total
Recom- mendations	Average #	96	87	85	85	73	73	84
	Share of application	92%	83%	81%	81%	70%	70%	80%
Sugges- tions	Average #	5	4	4	4	3	3	4
	Share of application	82%	72%	65%	61%	47%	54%	64%
Total	Average #	101	91	89	89	76	76	88
	Share of application	91%	82%	80%	80%	69%	69%	79%

> 79%

Share of application within all  
stock-listed firms

> 91%

Share of application within  
DAX-30 firms

## Exemplary Areas With Lower Acceptance

Management board compensation should be defined in *vertical relation* to the compensation level of middle managers

- 59% of firms consider the compensation level of managers at the second hierarchical level for the setting of executive compensation levels
- Only 24% consider also the third hierarchical level

Clear regulations for higher independence of supervisory board members

- Consideration of employee representatives as independent directors?
- Nearly 80% of firms consider employee representatives as independent
- Less than 50% of firms have clear quotas for the number of independent directors (at the side of shareholder representatives)
- However, two-tier-board system in itself supports board independence



## Prominent Problems – CEO Chairman Continuity

**GCGC as well as stock corporation act suggest that CEOs should take a „cooling-off phase“ of at least 2 years before entering the supervisory board!**



„I do not want to generalize but for BMW I think this is wrong. In our company, it is well-proven that successful management board members are elected to the supervisory board and the chairman position immediately following their work at the management board“  
*Joachim Milberg, Chairman BMW Group*



- In 2011 long-standing CEO **Josef Ackermann plans to take over the Chairman position** immediately after resigning as CEO in 2012.
- Announcement of the plan were followed by **heavy critics of shareholder representatives and politicians** („Ackermanns role will be that of an absolute monarch“).
- Finally, **Ackermann had to give up** his plan and left Deutsche Bank.

# Prominent Problems – Corporate Illegal Activity

**Increased importance of compliance issues for firms that face criminal activity after accounting and corruption scandals in the 2000s and the financial crisis!**

---

**SIEMENS**



**Deutsche Bank**

- Several **prominent scandals** even within the largest German firms:
  - e.g. incidents of **corruption at Siemens or ThyssenKrupp**
  - e.g. Libor and other **manipulations at Deutsche Bank**
- Some industries have a long history of illegality, similar violation rates and spread of misconduct, which might induce some top managers to tolerate such behavior.

# What can be done to “train” directors and executives in good corporate governance

## Training

Formel and informal training either in-house or external to improve knowledge and skills regarding excellent execution of board or executives roles

## Consulting

Seeking advice for special problems or general board tasks with specialized consulting firms

## Evaluation

External or internal evaluation of board (or TMT) work to help to improve efficiency of board members

## Structural changes

Establishing positions and structures that help providing excellent and efficient corporate governance

# Training

Internal Training, with specialized consulting firms or universities

## By University

Example:



- Corporate Governance and legal requirements **in practice**
- **Obligations** of the board: competences, role and function allocation
- Corporate **monitoring systems** and audit committees
- Specialisation modules (e.g. risk management)

## By Consultancies

Example:



- **Tasks and responsibilities** of the board within **the legal framework**
- Monitoring of the **internal control system**
- Overview of functionality of **Risk management systems**
- Formation of committees

## In-house

Example:

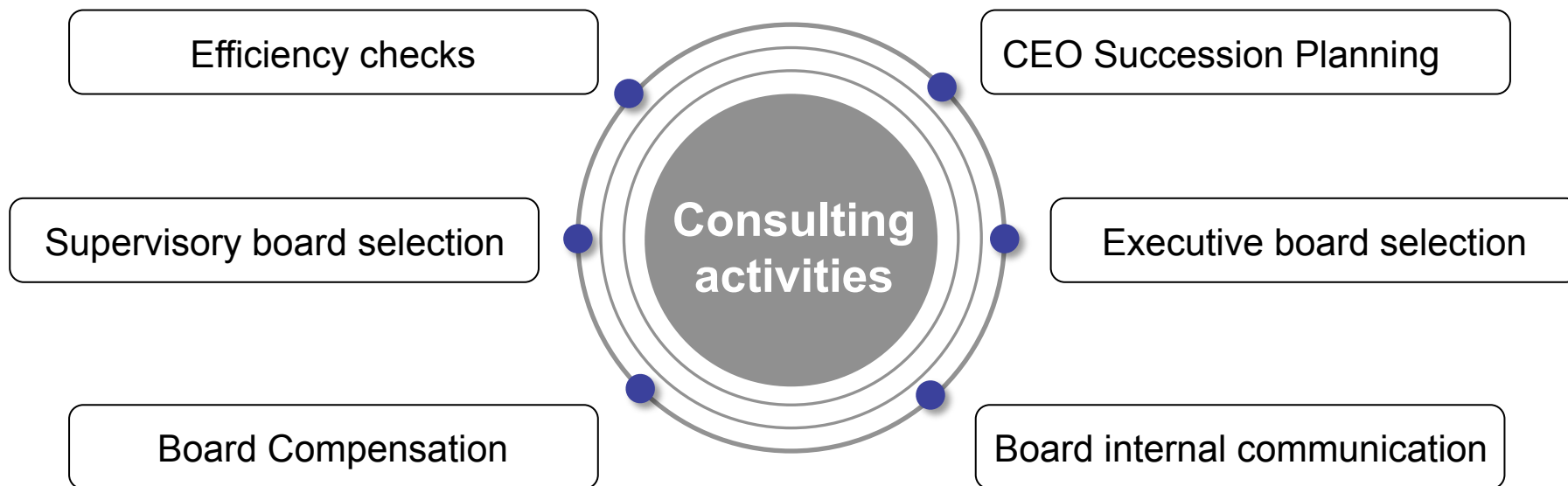


### In-house training in compliance

- Training of all new employees regarding **compliance standards** and Audi **principles of conduct**
- Foundation of the „**Compliance-Akademie**“ planned in **2015**

# Consulting

Typical fields of corporate governance related consulting services by external consulting firms



# Evaluation

“The Supervisory Board shall examine the efficiency of its activities on a regular basis” (5.6 GCGC)

## Self-evaluation

- Usually **responsibility** of the **chairman of the board**
- Standardized **questionnaire** adapted to company specific requirements and **individual interviews**
- Comparison with own targets and previous results



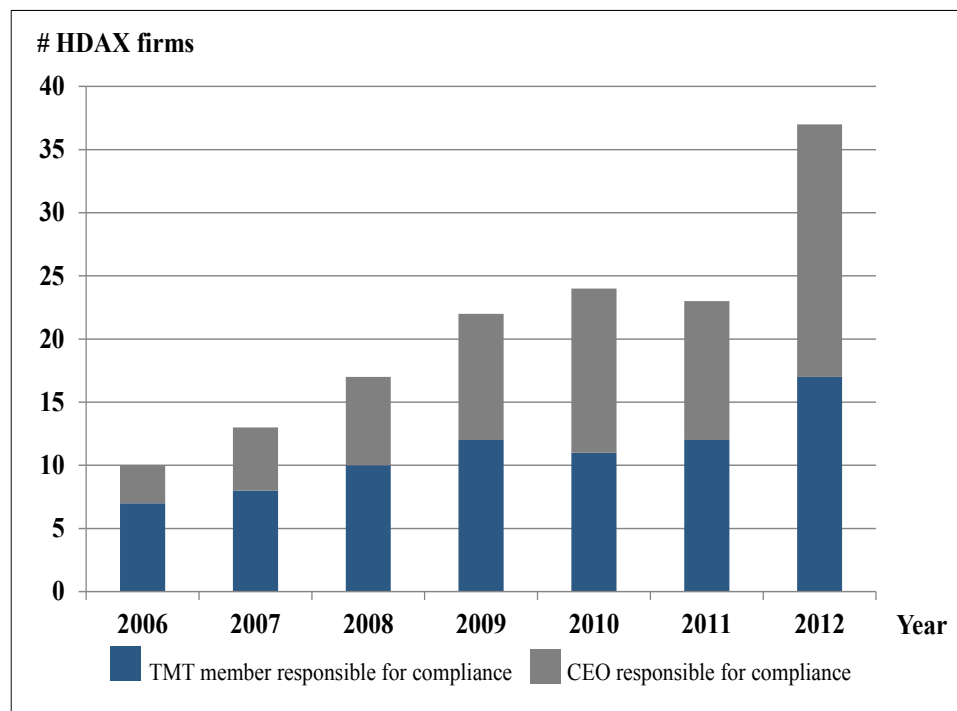
## External evaluation

- Usually done by **external consultants**
- Responsible for **development** of **questionnaire**, conducting **individual interviews** and **final analysis**
- Guarantee of **objective assessment**

*Often regarded as „annoying“ exercise; Regular statement: "The board has reviewed the efficiency and discovered no need for improvement."*

# Chief Compliance Officers

## CCO presence in large German firms



- An **increasing number of firms** have established the position of the **Chief Compliance Officer** in their TMT as a reaction to intra- and extra-firm conditions.
- **CCOs' duties** comprise **leading** a firm's **compliance activities**, ensuring that all employees **adhere** with applicable **law and standards**, **supervising investigations, audits** and related **legal issues** in the firm.

Source: Weber (2006), own data



LUDWIG-  
MAXIMILIANS-  
UNIVERSITÄT  
MÜNCHEN

Prof. Dr. Anja Tuschke  
Institute of Strategic Management

