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Acceptance of Corporate Governance in Germany and Austria

***Wagner, Johannes Martin*[4]**

ABSTRACT: Corporate governance principles comprise significant laws imposed by legislature as well as nationally and internationally recognized regulations set out by companies' owners. They aim at providing a solid and lawful basis for directing and controlling corporate affairs. More than ten years ago, these principles were specified in form of national corporate governance codes in many European countries and have been constantly redefined since then. This paper features an analysis of the current acceptance of corporate governance codes among the largest German and Austrian stock-listed companies. The analysis is based on data provided by the companies in their corporate governance reports of fiscal year 2014. I find that the Austrian code acceptance rate of 98.3% surpasses the rate of 97.2% in Germany. Simultaneously, the average amount of code deviations per company in Austria (1.5) is considerably lower than the German figure (1.8). In Germany, the most quoted deviation applies to the severance pay cap for management. Deviations quoted the most in Austria refer to the setup of management board's compensation, the existence of a nomination committee, supervisory board's prohibition to assume functions on competitors' boards, as well as audit assessments of the effectiveness of the company's risk management.

KEYWORDS: Corporate Governance, Management, Supervisory Board, Code of Corporate Governance, Austria, Germany, GRC

JEL codes: M12, M14, M16

Introduction

Over the last decade, corporate governance has grown to become an essential topic in today's business live. In general, it can be considered as the legal and factual framework for leading and steering companies (v. Werder, 2015). It determines *how* organs of companies (i.e. management and supervisory board) fulfil their responsibilities (Root, 1998). Thereby, it sets the ethical background of business dealings (Wichert, 2015).

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Corporate governance comprises significant laws imposed by legislature as well as nationally and internationally recognized regulations set out by companies' owners and aims at providing a solid and lawful basis for directing and controlling corporate affairs. To work effectively, it should balance the necessity to hold supervisory board and management responsible towards shareholders and the necessity to provide a sufficient level of flexibility to allow good faith business decisions without fearing litigation (Root, 1998).

By complying with corporate governance requirements, companies strengthen trust towards shareholders, customers, employees, and the general public. Also, corporate governance aims at creating transparency and comprehensiveness (Regierungskommission Deutscher Corporate Governance Kodex, 2015). Moreover, corporate governance directs corporate activities towards responsible, sustainable, and long term-oriented value creation (Österreichischer Arbeitskreis für Corporate Governance, 2015).

The beginning of this century was marked by a range of corporate scandals which were characterized by companies as Enron and WorldCom boosting their financial statements and engaging in illegal management practices (Dorfman, 2004). Although not the only cause, these events shifted public attention to topics as governance, risk, and compliance (short: GRC) and accelerated the further development and introduction of laws and standards in these fields. Since its introduction in 2002, the Sarbanes-Oxley-Act has required all companies being listed on the U.S.-American stock exchange to implement internal control systems and to regularly report about its design and operating effectiveness (U.S. Congress, 2002). Furthermore, a range of widely accepted standards, guidelines, and frameworks have emerged over the following years (e.g. COSO for enterprise risk management, internal control, and fraud deterrence to enable good organizational governance, COBIT for governance and management of enterprise IT, ISO 31000 for risk management to provide sound principles for effective management and corporate governance) (COSO, 2015; ISACA, 2015; ISO, 2015). These developed to become global cornerstones for corporate governance and risk challenges for both stock-listed and non-stock-listed companies. In many countries, national legislature has reacted to the increased demand in GRC topics by defining specific principles in form of national corporate governance codes which have been constantly redefined over the years. These codes ask companies to comply with its principles and to report on compliance with the code on a regular basis (European Corporate Governance Institute, 2015).

The following table shows a selection of corporate governance codes and their year of introduction in various European countries.

Table 1.: Selection of corporate governance codes in Europe

	Corporate Governance Code	**Year of Introduction**
Great Britain	UK Corporate Governance Code	2000
Germany	Deutscher Corporate Governance Kodex	2002
Austria	Österreichischer Corporate Governance Kodex	2002
Switzerland	Swiss Code of Best Practice	2002
France	Loi de Sécurité Financière	2003
Netherlands	Nederlandse Corporate Governance Code	2003
Spain	Código de buen gobierno de las sociedades cotizadas	2006

Source: European Corporate Governance Institute, 2015

Problem definition and relevant literature

While the codes' principles outline specific rules for companies to follow, the code itself is only of recommendatory nature. Therefore, companies are not required to comply with them.

Also, the implementation, administration, and continuous development of corporate governance systems require costs and limit management and supervisory board in their corporate activities. Companies may therefore opt not to comply with the code due to commercial reasons.

Although the corporate governance codes differ in their structure and content from country to country, the codes' principles mostly comprise the following kinds of rules:

- Legal rules: These are derived from laws and must be fulfilled by the companies, irrespective of whether they apply the code as a whole or not.
- Comply-or-Explain rules: Companies are asked to comply with these requirements or to disclaim reasons for why they deviate from these.
- Recommendations: Companies are not obliged to comply with these rules, nor are they required to disclaim any deviations.

Thus, even if companies report on corporate governance in accordance with the code of their country, the Comply-or-Explain ruling bears the risk of companies whitewashing deviations from the code and thereby covering up potential shortcomings in their corporate governance structures.

Provided the aforementioned aspects, it is of interest to investigate the acceptance of corporate governance as defined in the national corporate governance codes, especially given the fact that most codes have been active for more than ten years.

Studies approaching this issue were carried out by diverse authors. Annually, the Center for Corporate Governance at the Handelshochschule Leipzig publishes a report on the acceptance of the German corporate governance code among companies listed on the German stock exchange (Rapp & Wolff, 2015). Von Werder and Turkali (2005) published a similar report about the code acceptance and code application among German companies. Hudelist, Wieser, and Gahleitner (2012) published a study on the acceptance of corporate governance in Austria, on the occasion of the Austrian's code being in place for ten years. All three studies focus on a single country only and do not include any comparisons to other countries. While the German studies favour a more quantitative approach, the approach chosen in the Austrian study is a more qualitative one. Therefore, comparing findings of these studies is hardly possible and would not deliver useful insights. The U.S.-American law firm Weil, Gotshal & Manges LLP (2014) carried out a comparison of selected corporate governance codes among the United States, the United Kingdom, France, Germany, the OECD, the Netherlands, Norway, Switzerland, Australia, Brazil, China, Hong Kong, India, Russia, and the United Arab Emirates. This study compares the selected codes based on a wide range of fields (e.g. corporate governance transparency, independent board leadership, shareholder input in director selection). Despite its cross-national character, the study does not incorporate analytical steps in regard to the degree of corporate governance acceptance among the selected countries.

Therefore, this analysis features an in-depth analysis of the current acceptance of corporate governance codes among German and Austrian companies being part of their country's leading share index. The countries Germany and Austria were chosen due to two reasons: Firstly, both Germany and Austria introduced their national corporate governance codes in 2002 and therefore have gained experience over a comparable length. Secondly, the German and the Austrian corporate governance codes possess a high similarity in terms of content and structure and are therefore suitable for comparisons.

In specific, the following research objectives were defined on a per country level:

1. To identify the average acceptance rate indicting the extent to which incorporated companies of either Germany and Austria follow the principles of the respective corporate governance code
2. To determine the relative amount of deviations per application field as set out by the respective corporate governance code
3. To determine the absolute amount of deviations per principle as set out by the respective corporate governance code

Methodology and data

The analysis incorporates all companies of the two countries' leading stock indexes Deutscher Aktienindex (short: DAX) and Austrian Traded Index (short: ATX) as per December 31th 2014.

Table 2.: Overview of companies of leading stock indexes as per Dec. 31st 2014

DAX company (Germany)	ATX company (Austria)
Adidas AG	Andritz AG
Allianz SE	Buwog AG
BASF SE	CA Immobilien Anlagen AG
Bayer AG	Conwert Immobilien Invest SE
Beiersdorf AG	Erste Group Bank AG
BMW AG	Flughafen Wien AG
Commerzbank AG	Immofinanz AG
Continental AG	Lenzing AG
Daimler AG	Österreichische Post AG
Deutsche Bank AG	OMV AG
Deutsche Börse AG	Raiffeisen Bank International AG
Deutsche Lufthansa AG	RHI AG
Deutsche Post AG	Schoeller-Bleckmann Oilfield Equipment AG
Deutsche Telekom AG	Telekom Austria AG
E.ON SE	Uniqa Insurance Group AG
Fresenius Medical Care AG & Co. KGaA	Verbund AG

DAX company (Germany)	*ATX company (Austria)*
Fresenius SE & Co. KGaA	Vienna Insurance Group AG
HeidelbergCement AG	Voestalpine AG
Henkel AG & Co. KGaA	Wienerberger AG
Infineon Technologies AG	Zumtobel Group AG
K+S AG	
Lanxess AG	
Linde AG	
Merck KGaA	
Münchener Rück AG	
RWE AG	
SAP SE	
Siemens AG	
ThyssenKrupp AG	
Volkswagen AG	

Source: Deutsche Börse AG, 2015; Wiener Börse AG, 2015

Required information in regard to the compliance with single principles of the German and Austrian corporate governance codes were drawn from the company's corporate governance reports of fiscal year 2014 or, if the company has an non-calendar fiscal year, of fiscal year 2014/2015. For German companies, also conformity statements indicating the extent of compliance with the corporate governance code on an aggregated level were considered for the same period.

For research objective (1)

To determine the average acceptance rate per country, the acceptance rate per company was determined at first (amount of fulfilled principles over the amount of total principles). Afterwards, the results were added on a country level and divided by the amount of companies per country. This mathematical procedure can be expressed with the following formula:

$$\mathrm{AAR_c} = \frac{1}{Nc} \sum_{i=1}^{Nc} \left(\frac{Xf}{Xc}\right) \tag{1}$$

with X_f = amount of fulfilled principles per company
X_c = amount of total principles per country
N_c = amount of companies per country

Each principle was regarded as equal element, irrespective of its importance to the company, its extent (one or several rules included), or their nature (legal rule, comply-or-explain rule, or recommendation).

For research objective (2)

While the Germany corporate governance code covers six application fields, the Austrian pendant holds only five fields. These are provided in the following table.

Table 3.: Application fields of German and Austrian corporate governance code

German Code	Austrian Code
Shareholders and the General Meeting	Shareholders and the General Meeting
Management Board	Management Board
Supervisory Board	Supervisory Board
Cooperation between Management Board and Supervisory Board	Cooperation between Management Board and Supervisory Board
Transparency	Transparency and Auditing
Reporting and Audit of the Annual Financial Statements	

Source: Regierungskommission Deutscher Corporate Governance Kodex, 2015; Österreichischer Arbeitskreis für Corporate Governance, 2015

For determining the relative amount of deviations per application field, six application fields as set out in the German code were considered. Principles covered in the "Transparency and Auditing" chapter of the Austrian code were split into two parts in accordance with the naming of the subchapters' headings and allocated to either "Transparency" or "Reporting and Audit of the Annual Financial Statements". To determine the relative amount of deviations per application field, all deviations reported by the companies of each country were aligned to one of the six application fields. To account for the different amount of companies per country, the sum of deviations per application field was divided by the amount of companies.

For research objective (3)

To identify the absolute amount of deviations per principle, reported deviations were allocated to the principles as set out by both the German and the Austrian code.

Results

For research objective (1)

Based on the aforementioned formula, the average acceptance rate amounts to 98.3% for Austria and 97.2% for Germany. Moreover, the following descriptive statistics were determined for the data sample:

Table 4.: Descriptive statistics for German and Austrian data set

	Germany	Austria
Minimum	90.5%	95.6%
1st Quartile	95.6%	97.5%
Median	98.4%	98.9%
3rd Quartile	99.6%	99.2%
Maximum	100.0%	100.0%
N	30	20
Mean	97.2%	98.3%
Standard Deviation	0.027088	0.013380

These statistics are depicted in the following figure:

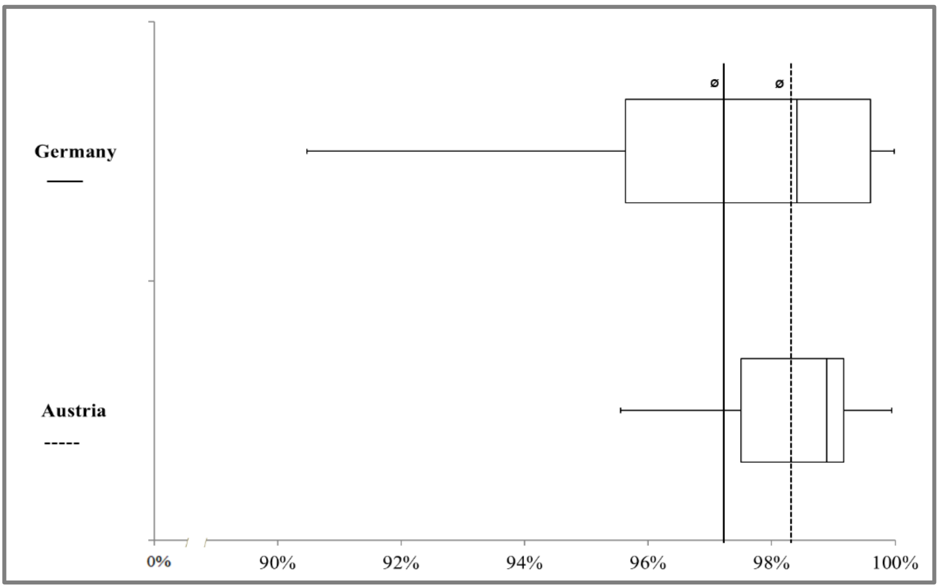

Figure 1.: Box plots for German and Austrian data set

Source: Own investigations

The average acceptance rate for Austrian companies slightly surpasses the value for German companies. At the same time, spread and standard deviation are larger in German data set.

For research objective (2)
The amount of deviations per application field is shown in the following figure:

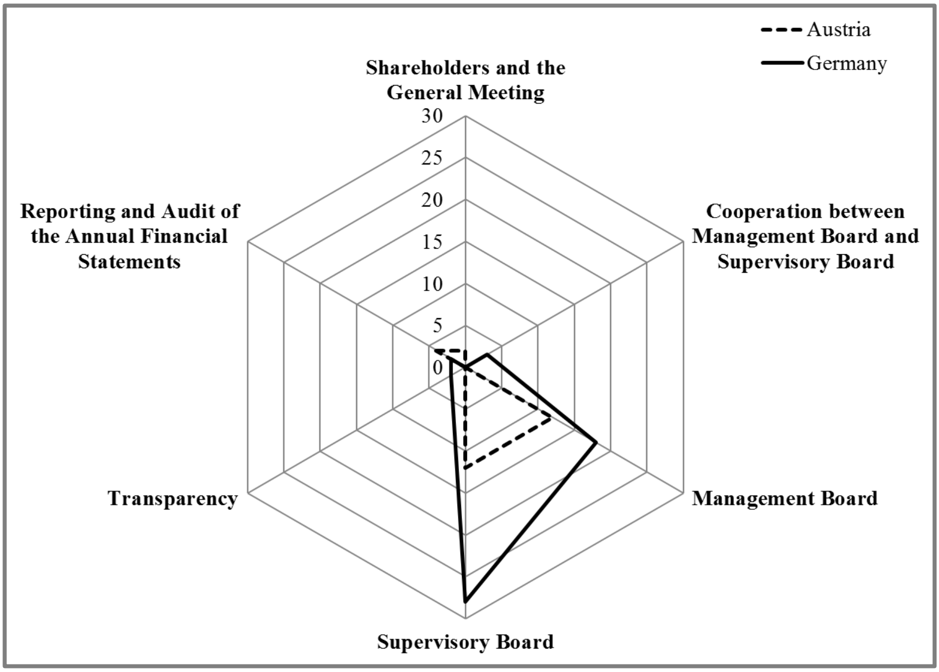

Figure 2.: Absolute amount of deviations per application field per country

Source: Own investigations

On average, each German company reports 1.8 deviations from the codes while each Austrian company reports 1.5 deviations. Accounted for the number of companies considered in each of the two data sets, the relative amount of deviations per application field is presented in the following figure:

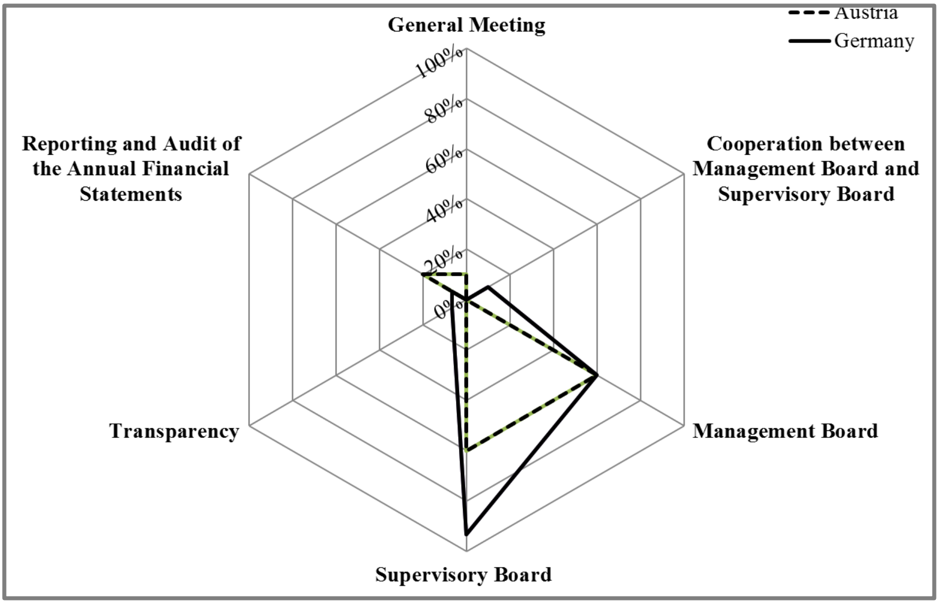

Figure 3: Relative amount of deviations per application field per country

Source: Own investigations

Application fields "supervisory board" and "management board" hold the most deviations from the code in both countries (93% and 60% in Germany, 60% and 60% in Austria). Particularly striking, almost every German company holds a deviation in application field "supervisory board" on average. Regarding application fields "Cooperation between the Supervisory Board and the Management Board", "Shareholders and the General Meeting", as well as "Transparency", companies of both countries hardly deviate from the corporate governance codes (≤10%).

For research objective (3)

The following figure lists the principles most deviated from as well as the amount of deviations as reported by both German and Austrian companies:

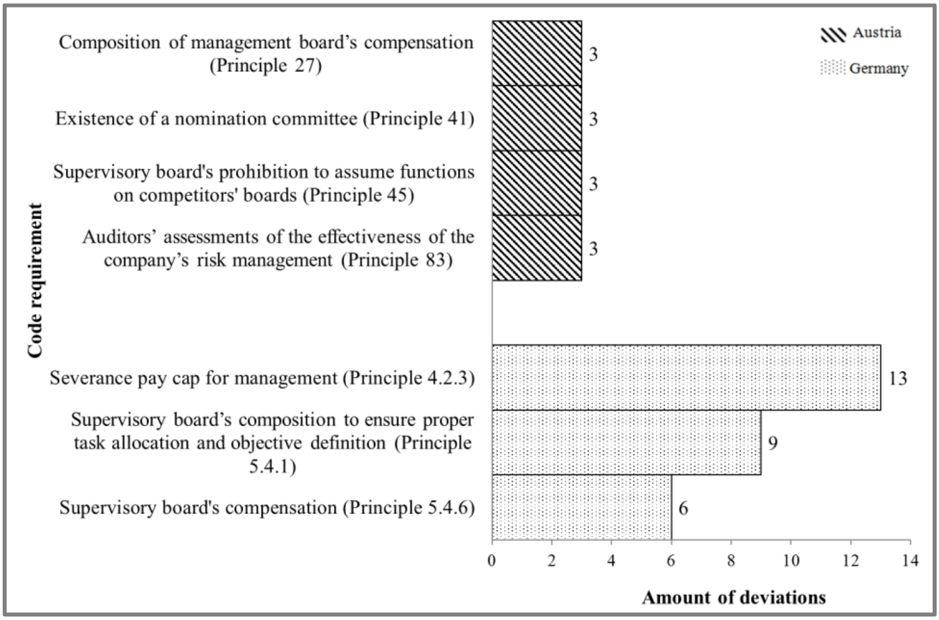

Figure 4.: Most quoted deviations per principle per country

Source: Own investigations

In Germany, by far the most quoted deviation applies to the severance pay cap for management. Also, practices in regard to supervisory board's composition to ensure proper task allocation and objective definition as well as supervisory board's compensation were quoted frequently to deviate from the code. Deviations quoted the most in Austria refer to the composition of management board's compensation, the existence of a nomination committee, supervisory board's prohibition to assume functions on competitors' boards, as well as auditors' assessments of the effectiveness of the company's risk management.

In Austria, five companies (corresponding to 25% of all Austrian companies) do not report any deviation from the code and are therefore fully compliant with the code. In Germany, the same figure amounts to eight companies (corresponding to 27% of all German companies).

Conclusion

Provided the average acceptance rates of 98.3% and 97.2% respectively, the acceptance of corporate governance in Austria and Germany can be regarded as comparably high. Acceptance in Austria was found to be slightly above the acceptance rate in Germany. While the composition of deviations based on application fields appears to be similar in both companies, the setup is different on a principle level. Deviations appear to be more heterogeneous in Austria as most quoted deviations are spread more evenly among several principles. In both countries the application field "management board", especially principles referring the compensation of management hold a comparably high level of deviations.

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