

The New Corporate Governance Code in Germany

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Several committees on Corporate Governance have been formed and have – more or less successfully – performed their work. In 1999, the OECD has created some “Principles of Corporate Governance.” In Germany, the DVFA has created a “Corporate Governance Scorecard” for analysts and investors – a kind of safety inspection for stock corporations. This scorecard has found a positive echo not only in Germany, but in various emerging markets, too. The “Frankfurter Initiative,” led by the Prof. Baums (“Baums Committee”), finished a “Code of Best Practice” in January 2000, followed by the “Berlin Initiative” which presented its proposals in August 2000. Finally, a committee formed by the Federal Government saved the corporate world with its definite “German Corporate Governance Code.”

I. What is Corporate Governance?

The term Corporate Governance sounds high-flown, but to find a clear definition seems to be impossible. One could read Corporate Governance as “the ways in which suppliers of finance to corporations assure themselves of getting a return on their investment” (The Journal of Finance, Shleifer and Vishny 1997 p. 737) – what a revelation in clarity! I would rather define it as a basic set of principles for value-oriented management and control of publicly traded companies.

II. Do we need a Corporate Governance Code in Germany?

At first glance, a detailed set of corporate governance rules seems somehow redundant in Germany. Other than in the US, where the laws on corporations are rather thin and incomplete, Germany has a very dense statutory set of corporate law rules – the Stock Corporation Act alone has more than 400 sections, some of them

running through pages; what can a 5-page corporate Governance Code do facing such omnipresent overload of regulations? Many provisions of the Corporate Governance Code merely repeat sections of the Stock Corporation Act. Most principles of the Code apply by operation of law anyway (such as equal treatment of all shareholders). Nevertheless, investors expect such a “Bible of Corporate Governance Principles,” in particular in an international investment framework. A Code of Best Practice can – whether or not regulated in the laws – provide for precise and vivid guidelines for the management. Studies demonstrate that companies that have adopted corporate governance principles are valued substantially higher (Study of McKinsey and World Bank 2000: 20%).

III. Main Principles of the Corporate Governance Code:

The Code particularly deals with the following issues:

A. Shareholders and General Meetings

All shareholders need to be treated equally; preference shares or “golden shares” with special rights are outlawed. The shareholders shall be informed on a broad basis, both on shareholder meetings and on the Internet about the business affairs and financials of the company.

B. Management

The management shall act in the best interest of the company and install an efficient risk management system. The remuneration of the management shall be connected to the short and long term success of the company, and also contain a fixed component; the management’s compensation scheme and salary shall be published, in an individualized form. D&O insurances shall include appropriate deductibles. Conflicts of interests shall be disclosed and avoided.

C. Supervisory Board

The supervisory board shall efficiently control the management, especially with respect to fundamental business decisions. It shall obtain broad information from the management and openly discuss the business affairs with the

management. The supervisory board shall form special committees for an efficient control over the management, in particular an audit committee.

D. Transparency

The management shall publish all events and facts that may have a substantial impact on the financial situation or the business operations of the company.

IV. Comply or Explain

Today, the Corporate Governance Code is a self-regulatory body of rules with no statutory legal basis. However, the legislature plans to enact provisions (“Transparenz- und Publizitätsgesetz“) that will contain the principle of “comply or explain,”¹ i.e. public companies will not be under a duty to comply with the Corporate Governance Code; a company may flexibly deviate from the Code if it deems such deviation appropriate as regards to its specific situation. However, in this case, the management must disclose and explain such deviations.

V. Privately held Companies

The Code is designed for listed companies. However, it is recommended that privately held companies comply with the Code as, in specific areas, the provisions of the Code are beneficial for non-listed companies, too (e.g., conflict of interest rules).

VI. The DVFA Corporate Governance Scorecard

This scorecard is a checklist for companies in order to allow them to assess their level of compliance with recognized corporate governance rules. The different criteria of corporate governance, which are part of the “total score,” have certain weights (corporate governance commitment: 15%; shareholders’ rights: 20%; transparency: 20%; management: 30%; audit: 15%).

¹ § 161 Stock Corporation Act (Aktiengesetz).