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Corporate Governance in Germany – A New Code

Background

In February 2002, a committee appointed by the German Federal Government issued a new corporate governance code (the "Code"). The committee consisted mainly of representatives of trade and industry in Germany. The aim of the Code is to bring the German corporate governance system in line with other countries such as the United Kingdom and thereby to attract international investors. The main aims of the code are to promote the transparency of corporate governance for the benefit of national and international investors, customers, employees and the general public and to improve the management of listed companies.

Voluntary?

The Code is voluntary. However, if a company announces that it will follow the Code's provision, it must follow such provisions that are not mere recommendations and suggestions. The Code contains many such recommendations and suggestions. Companies who declare that they adhere to the Code can deviate from recommendations and suggestions, but are obliged to disclose if they fail to comply with the recommendations. The aim of this system of different provisions is to provide companies with sufficient flexibility to enable them to reflect sector and enterprise specific requirements. Although the Code addresses listed corporations, it is recommended that non-listed companies follow its provisions, too.

Structure

The Code has six main chapters:

- Shareholders and the General Meeting;
- Co-operation between Management Board and Supervisory Board;
- Management Board;
- Supervisory Board;
- Transparency; and
- Reporting and Audit of the Annual Financial Statements.

Compensation

In the chapters concerning the management board and the supervisory board, the Code gives detailed provisions on the compensation of the board members. It prescribes a system of compensation based on performance assessment and considering any payments by group companies. As criteria for determining the appropriateness of compensation, the Code specifically refers to the responsibilities of the board members, their performance, the economic situation, and the performance and outlook of the enterprise taking into account its peer companies.

Disclosure

In order to promote transparency, the Code prescribes a wider reaching disclosure than previously known under German law. One of the most controversial innovations has been that the compensation of the members of the management board should be disclosed in the notes to the consolidated financial statements, itemising the figures.

Significance

So far, voluntary codes have not been very successful in Germany as, for example, the voluntary Code on Take – Over Offers which was replaced by the Take – Over Act. It was largely discussed whether German corporations are ready for a voluntary corporate governance system similar to the Combined Code in the UK. On the other hand, the pressure on German listed companies from national and international investors could turn the balance. German listed companies are keen to get rid of the negative image of "Deutschland AG". Several large listed German companies have already announced that they will adhere to the Code, amongst them are such heavy-weights as SAP and Deutsche Bank. Additionally, the Statute on Transparency and Publicity in Business *(Gesetz zur Transparenz und Publizität im Unternehmensbereich)* contains a provision which forces listed companies to declare publicly whether they adhere to the Code specifying whether they follow it completely or whether they opt out of the application of the Code's recommendations as, for example, the disclosure of the management and supervisory board members' compensations. It will then become obvious whether or not the voluntary Code is a success.

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