

# Corporate Governance Practices in Germany and the United States

Amanda Rinehart

Kevin MacFerrin

Allison Stephens

Rachel Duffield

Neel Patel

*Drake University*

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## Introduction

Germany, officially known as the Federal Republic of Germany, is one of the most populous members of the European Union. The country has a population of over 80 million people and is a major economic and political power with the fourth largest economy in the world. Its economy is primarily comprised of the services industry, and the country is also a net exporter of goods largely in areas such as machinery, vehicles, chemicals and household equipment (CIA World Factbook). Due to some of the rich history of this country, especially its involvement in two World Wars, it has developed some unique corporate governance mechanisms, as well as some widely accepted practices, some of which we will discuss below.

German corporate governance fundamentals and practices are generally based on the provisions of the German Stock Corporation Act (Aktiengesetz), the German Codetermination Act (Mitbestimmungsgesetz), and the German Corporate Governance Code. German Stock Corporations typically have three corporate bodies as well, which are the board of management (Vorstand), the supervisory board (Aufsichtsrat), and the annual general meeting of shareholders in which shareholders can exercise rights granted to them in the Stock Corporation Act (SGL Group). In Germany, the history of the stock corporation dates back to the middle of the 18th Century. However, it wasn't until 1870, when there was a special dispensation from that state available for incorporation. The laws that governed those corporations were part of the General Commercial Code until 1937, when they were separated out into their own law. The German Stock Corporation Act, also known as 'The Act,' is based on the 1937 law but underwent significant revisions in 1965, which more closely aligns with the provisions today. However, since this time the law has undergone many revisions and amendments to its current form. The rules and regulations that are in The Act are quite comprehensive and include many similar issues that are dealt with in the U.S. legal system. These issues range from corporate laws, security laws, protection of creditors, stock exchange regulations, accounting rules and the corporate board structure. For instance, The Act gives shareholders rights to create resolutions for retained profits, election of the auditor, amendments to the Articles of Incorporation, and power to discharge the supervisory and management board. However, one notable difference is that in Germany the local courts take a

much more active role in supervising corporate activities, whereas in the United States that role is primarily taken on by the Securities Exchange Commission (SEC) (Heidenhain, 2000).

Codetermination is actually subject to four different statutes - the Shop Constitution Act, the Codetermination Act, the Coal and Steel Codetermination Act, and the Supplementary Codetermination Act. The statute that applies mostly to large companies is the Codetermination Act. This statute applies to companies with over 2,000 employees and requires that an equal number of employee and shareholder representatives be present on the board. The German Corporate Governance Code (GCGC) applies to publicly traded companies and, like many European countries, works on a “comply or explain” basis. The Code is designed to make the German Corporate Governance System more understandable and transparent. The GCGC contains internationally recognized standards for good and responsible governance practices and seeks to promote trust with investors and the public. While the recommendations are not legally binding, companies are obliged to disclose deviations annually to the public. This is typically done in their annual report. These recommendations help promote transparency by setting standards of disclosing conflicts of interest along with standards regarding supervisory board committees.

## **Executive Compensation Comparison**

We spent a lot of time in class talking about whether executives are paid too much in the United States. Some scholars say yes, and some scholars say no. The public and media think executive compensation is too high, especially when compared to the average worker’s pay. The argument can be made that we pay top executives so much because of what they do for our companies. Then the question, “Do executives really matter?” comes up. With an answer like “it depends,” it’s very hard to analyze in general whether or not we’re paying them too much. Arguments about whether executive compensation is too high or not aside, we are still able to look at the United States compared to other countries. Comparing the U.S. to another country, such as Germany, can help us gain better insight on how other G20 countries handle their executive compensation, as well as highlight any differences or similarities between the two systems.

The United States is infamous for very highly paid top executives. With the growth of international mergers, interest in executive pay practices across the world has increased. When compared to similarly sized companies in other countries, the amount that American CEOs make is substantially higher than the others. This difference is especially evident when looking specifically at the ratio between the CEO and the lowest paid worker. In Germany the ratio shows a 12 times difference. In the US, a CEO is paid somewhere between 300-500 times more than the lowest paid worker. To put this significant difference in compensation using actual amounts, the average German CEO earned €4.5 million in 2010, falling far behind a CEO in the US with an average of €12 million (Executive pay across the world 2012). The lower amount does not mean German CEO’s wages aren’t following the United States’ example of increasing at an increasing rate. Germany’s average wages have increased similar to the U.S. The average employee wages in Germany have increased by 6.1% since 2000, while the salaries of senior executives at companies on Germany’s DAX stock exchange have risen by almost 55% during that same time period (Khazan 2013). From 1980 to 2004 in the United States, the average worker’s pay increased by 36% compared to the increase of 1047% for the average CEO (Bogle 2008). The gap between the pay of the top executives and that of the average employee is growing at a growing rate. This seems to be a trend occurring in both countries.

Although data on German executive pay is not as extensive as data for the United States, German compensation has been shown through various studies to be influenced by certain factors. According to a study done in 2003, executive compensation in Germany from 1970-1986 was mainly influenced by firm size and return on equity. This same study looked at concentrated ownership and bank influence. These factors were found to have a negative impact on compensation levels (Elston 2003). Another study looking at German executive compensation from 1987-1996 found that firm profitability has a positive and significant impact on pay. This study also found that firm risk had a negative influence on compensation and that firms with concentrated ownership pay less, and the pay had less sensitivity to firm profitability (Kraft, 1999). Compensation in the United States is influenced by similar factors, such as firm profitability and size, as well as firm risk. Some studies have found that a large board is positively correlated with greater CEO compensation in the U.S. (Tariq, 2010). Legislation also plays a role in determining United States executive compensation.

German executive compensation is typically less related to stock returns than in the United States. Top U.S. executives' pay is frequently closely linked to how their companies' stocks are doing. The average CEO in the U.S. receives more than double the proportion of options or stock to overall pay than the average CEO of other countries (Fernandes, 2009). In contrast, German executive pay is mainly determined by firm earnings (Heimes, 2011). The same holds true for cash bonuses – German executives get bonuses determined by firm earnings and sales growth, whereas U.S. executives get bonuses depending on stock performance. Generally short term cash bonuses account for a bigger percent of overall compensation in Germany. On the contrary, the U.S. offers a higher amount of long-term oriented compensation in relation to overall pay (Heimes, 2011).

The United States has put various reforms into place to try to help regulate the compensation situation from becoming more outrageous. One of these reforms is the say-on-pay act passed through the Dodd-Frank Act of 2010. This act forces companies to allow shareholder votes on compensation at least once every three years. Shareholders should vote once every six years to determine how often those say-on-pay votes should occur (Hemphill, 2012). By allowing the shareholders to vote, this should help to stop executive compensation from increasing at its current rate, at least in theory. The vote on pay and golden parachutes is non-binding but most companies do pass the vote.

Germany also has a say-on-pay act as of August 2009. It was passed as a part of the Act on the Appropriateness of Management Board Compensation. The supervisory board had historically been involved in setting executive pay, but now shareholders could exert some control. The say-on-pay vote doesn't change the supervisory board's duties, but forces them to justify their decisions with the shareholders. The act also allows shareholders to change the supervisory board's pay (Vesper-Graske 2013). One major difference between Germany's say-on-pay and that of the United States is that in Germany the shareholder vote on pay is optional. In the US, shareholder votes are mandatory.

A few key differences between the governance boards in the US and Germany may be influencing the amount that top executives are paid. This has to do with the fact that duality is legal in the United States. In Germany, it is not allowed. Another important difference is the fact that Germany has a dual board structure while the U.S. has a unitary board structure. Germany's boards are divided into two tiers. The supervisory tier has the ability to decide compensation structure for the managerial tier (made up of executives). Germany's supervisory boards also usually have representation from employees, either through actual employees or union representatives. This representation and separation could explain why Germany has a

smaller pay gap between executives and average employees than the U.S. does. A Swedish study in 2009 found that governance structures do have a strong influence on how earnings are distributed (Martin). This study also found that in European countries, such as Germany, where pay inequality has historically been less, income inequality is lessened by the country's degree of unionization, coordinated bargaining, and left-leaning governments (Martin, 2009). Therefore, Germany's board structure and strong employee representation would be factors decreasing the inequality gap. At the same time, the U.S. may exhibit some factors that could increase the gap. Shareholder right protection and heavy merger and acquisition activity can frequently result in an increased inequality gap (Martin 2009). In countries like the U.S., where top executives' pay is aligned with shareholder value, maximizing shareholder value can lead to even higher compensation for executives. The reason that executive compensation is set up this way is to mitigate agency problems. Even though it may be successful at doing so, it doesn't help rein in extreme executive compensation. Cultural reasons may also play into executive compensation. Germany has more of a stakeholder oriented economy than the United States does.

In an ever-increasing international market like we have today, pay practices across the world may begin to become more and more similar. A convergence between executive compensation mechanisms around the world has already started happening and could increase even more in the future (Fernandes, 2009). Around the world, there seems to be a desire for increasing compensation transparency. With all of this compensation information becoming readily available, more and more studies are able to examine current practices in better detail. We believe that it is through these studies and their subsequent findings that countries will either come to an agreement or disagreement about pay. Time will only tell what each country will do in the future, but at this point it seems as if Germany and the United States are at least headed in the same direction.

## **Executive Compensation Article Summaries**

'Say on Pay' In Germany: The Regulatory Framework and Empirical Evidence by Marvin Vesper-Graske provides a detailed overview of the current 'say on pay' method of executive compensation being practiced in Germany. The legislation leading up to the 'say on pay' act was discussed leading into the author's study of the overall implementation of shareholder voting on compensation by the DAX 30 companies. The DAX 30 companies are the 30 largest corporations in Germany. Although 'say on pay' applies to all companies that are publically traded in Germany or those that have shares that are traded in foreign stock, analyzing the DAX 30 companies should provide a fairly good depiction of the status of the act.

Currently shareholder voting in Germany serves only an advisory purpose, it has no legal implications. The supervisory board can still decide to overrule the shareholders decision despite a majority vote against a proposed compensation plan. However, according to Graske, allowing shareholders to vote will hold the supervisory board accountable for their actions without taking away their power in any way. This will hopefully lead to a more diligent board that adjusts executive compensation based on the status of the company. By not taking away any of their power, this change is aiming to give the supervisory board the slight pressure they need to ensure the best interests of both the investors and the company are being taking into consideration.

Along with providing general insight on the 'say on pay' act, this article also investigated a few key aspects of implementation of the act. The frequency that the 'say on pay' vote occurred was analyzed. The German government did not specify a certain timeframe within which all companies had to cast votes, but during the first three years of the act being passed, all 30 of

the DAX 30 companies had cast at least one shareholder 'say on pay' vote. Since these votes do not need to be cast at every annual shareholder meeting, only those companies that had adjusted their executive compensation plans held more than one vote within the study period (3 years). This indicates that all of the DAX 30 companies are accepting of the change and are willing to incorporate it into their corporate governance structure.

The study also looked into the shareholders' approval rates of the companies' compensation systems. The approval rates for 2010 and 2011 were found to be 91.58% and 93.48% respectively. The author discussed whether these high rates were because the shareholders felt that their vote was insignificant, since it is advisory and did not carry legal implications. However, it was determined that most shareholders actually do agree with their supervisory boards and do not have conflicts with the proposed compensation plans. The article concluded by stating that it is up to the management boards of the company to determine if the shareholder vote is conducted and if their recommendation should be taken into consideration.

The second article analyzed, *Beyond Wall Street: Germany, the United States, and Executive Compensation* by Emilie Mathieu, focused on the 'VorStAG' passed by Germany. Growing dissatisfaction of the public with executive compensation around the world has led to Fortune 500 companies lobbying intensely against pay restrictions for fear of not being able to attract "the best and the brightest." This outrages the public and media even more because it seems unfair that those who "brought the world economy to its knees" continue to receive luxurious benefits. The G20 met in September 2009 to discuss what should be done about executive pay. Efforts to reach a consensus failed and there was not an agreement on comprehensive regulations on compensation. Germany advocated for global reform and was an exception to this failure – they were one country that tried to change its executive compensation structures quickly. Germany had passed its own "VorStAG" earlier in 2009, which set out to change the way executive pay is discussed and structured in all publicly traded companies. The act was also directed at increasing transparency and pushing companies to focus on long term performance and sustainability instead of short term gains. The VorStAG introduced "Say on Pay" measures and holds supervisory boards accountable for compensation decisions. The reform laws were passed with significant backlash from the business community in Germany. The VorStAG is a very good example for other countries to try to emulate, especially because it was passed and put into practice in such a short time frame. The act also stands alone. It is not connected with other larger corporate governance reform. Historically, Germany's economy has used the stakeholder model, instead of the shareholder model like the United States, and the VorStAG emphasizes that executive pay is not to violate this.

This article specifically examined the success of VorStAG by evaluating the achievement of the law's goals, the accuracy of people's predictions about the law, and the improvement in the structure of executive compensation. The goals of VorStAG, as stated in the article, were to increase transparency, create a more sustainable compensation structure, and focus on the long-term view of compensation. It was found that the law exceeded its goal of increased transparency. Compensation discussions have become notably longer and more in-depth, providing a more detailed look at how compensation is calculated. The achievement of the second goal, sustainability, was unable to be officially determined. Although all of the DAX 30 companies changed their company goals to mention sustainability as a determinant of their compensation plans, more time is needed to see if they have made actual structural changes to support these claims. The author fears that achievement of short term goals, such as annual bonuses, will hinder the companies from remaining dedicated to long term thinking and sustainability. With long term sustainability, it is hard to see significant results right away. Therefore, the third goal of focusing more on longer term compensation structures was also

hard to determine. This may be due to the constantly changing compensation structures or the fluctuating stock market. In general, the study concluded that more is being paid out as bonuses rather than long-term compensation.

The second area of the study evaluated initial reactions to the VorstAG. Some people believed that the law would offer no benefit, and they would see no change in executive compensation. Others believed that positive impacts would occur. It was determined that the people who criticized the law were not entirely correct. Increases in disclosure, the hiring of compensation consultants, and heightened descriptions of compensation plans are all a result of the law. Although some practices such as “say on pay” have been implemented in many companies, it is still too soon to tell if the law has stopped all excessive executive compensation. More time will have to pass for the exact net positive results of VorstAG to be established. The final question posed by the study is whether VorstAG successfully changed the structure of executive compensation. It appears that a new structure has resulted from this law, however it is yet to be seen how different it is compared to the old one. Positive advancements have been seen in the area of corporate governance, and compensation strategies have undergone more detailed discussion before being passed. As time goes on, the impact of VorstAG will become more and more evident.

The third article shifted focus from Germany to the United States. The US Shareholder Say-On-Pay Vote: What are the First Year Results, by Thomas Hemphill, examined the impact of the Dodd-Frank act which started ‘say on pay’ in the United States. The article specifically addressed the results of the ‘say on pay’ voting in the first six months as well as what these results indicate for the future of corporate governance in the United States. According to the article, only 1.7% of the Russell 3000 companies failed their ‘say on pay’ votes. This is surprising due to the fact that the consulting company determined that about 13% of the companies should have voted against their proposed compensation plans. It was determined that several factors influence a company’s likelihood to fail their ‘say on pay’ vote including unresponsiveness to previously identified compensation issues, excessively high CEO compensation, excessively high year-to-year increases in CEO compensation, and problematic pay practices. Also, some of the companies that failed their vote have lawsuits filed by shareholders currently in place. The article also emphasized that all aspects of compensation, especially realized pay, should be looked into before making any decisions regarding the compensation structure. Often it can be misleading to look at the estimated compensation that companies propose to offer. Similar to the findings in the Germany ‘say on pay’ article, it remains unclear whether the act is a success. However, changes in transparency and compensation structure can be seen in United States businesses. In addition, compensation structures have been more intently discussed and analyzed due to the shareholders’ ability to vote. Continued studies will need to be conducted as the ‘say on pay’ practice continues to be executed.

## **Board Comparisons**

### **Structure**

The system of corporate governance in Germany has three characteristics which distinguish it from the United States’ system: (1) concentrated ownership, (2) a dual-board structure (supervisory board and management board) and (3) worker representation on the supervisory board. (Vitols, 2005)

Unlike the single-board system in the United States, large German companies are required by law to have a dual-board structure. Board members are not allowed to serve on both boards of

the same company. The TMT is responsible for day-to-day operations, making decisions on basic policy, and is represented on the management board (also known as the executive board). Stakeholders (i.e., shareholders, creditors, employees and major suppliers and/or customers) are represented in the supervisory board, which is responsible for appointing, supervising, and overseeing (appointing or removing) members of the management board. The supervisory board is also responsible for approving key policies and strategic decisions. Additionally the supervisory board is trusted with immediately sharing and publishing insider information regarding the corporation. For instance, as soon as the corporation learns that a shareholder has gained or lost a certain level of voting rights, the board will immediately publish the information (Diederich, 2011). U.S. corporations have a single board with sub-committees, such as the audit committee, remuneration committee, and the nomination committee. The board must have at least five members, and the majority must be outsiders.

Figure 1.1: Sample Diagram of Two-Tiered Structure

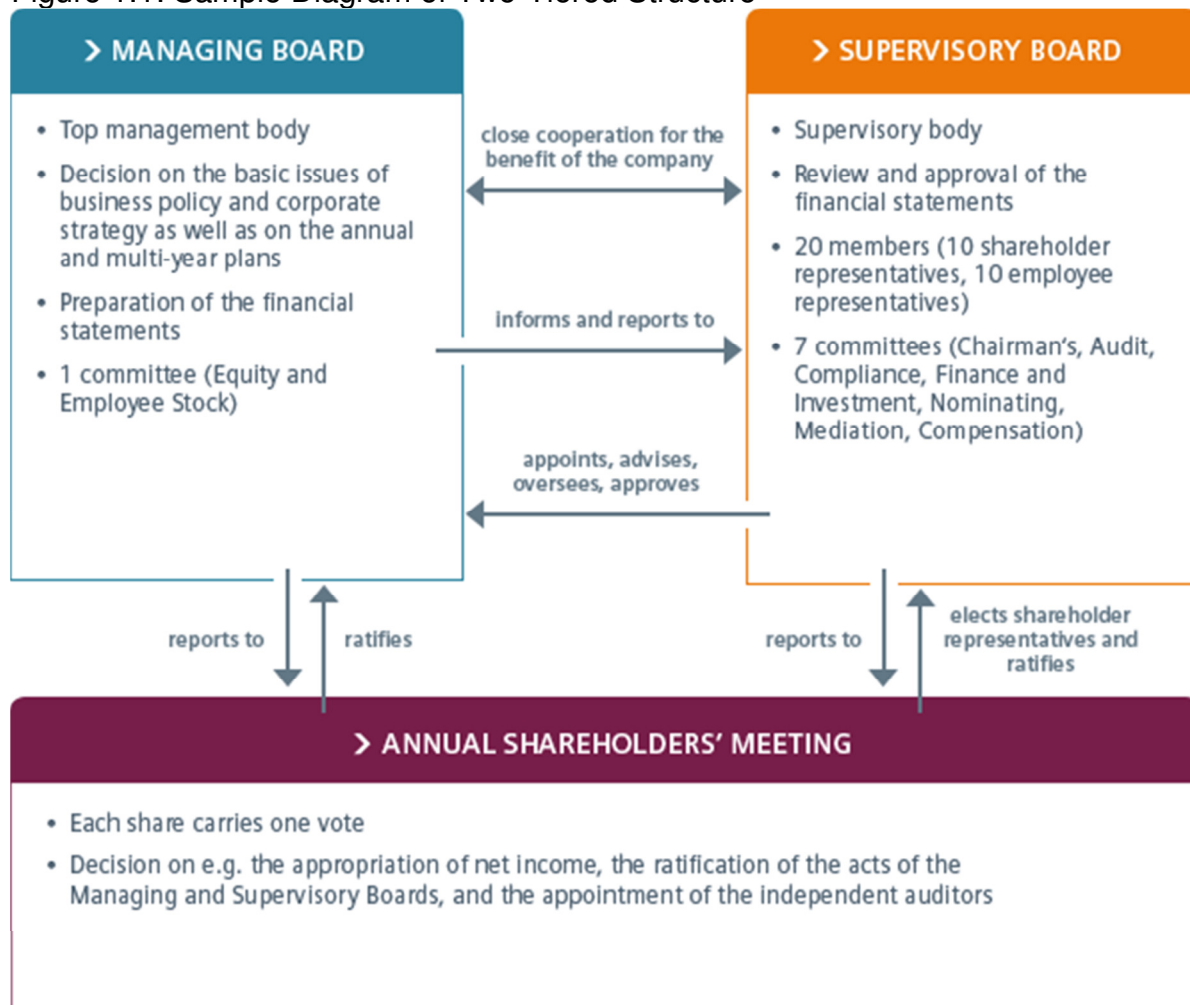


Diagram referenced from the Siemens Global Website: Corporate Governance [http://www.siemens.com/investor/en/corporate\\_governance.htm](http://www.siemens.com/investor/en/corporate_governance.htm)

One of the other roles of the supervisory board would be outlined in Resource Dependency Theory, which asserts that the company should be less dependent on the resources outside the company. In Germany, the banking system has played a significant part in providing preferential access to financing and advice and counsel. Germany's historical development of corporate governance system with respect to its labor force, along with the integral role of banking system banks post-world wars, have led to banks gaining substantial influence in companies. Many times German companies have allowed banks to gain a 'double position' within corporations (holding board positions along with being a major creditor). Due to the foreign investors' perception of the dual board structure and the fact that one-third to half of the board seats are held by the labor force, many outside investors have been hesitant to contribute new capital. Those that do choose to invest tend to at least expect higher returns on their investment for being more risky. This has led to many German corporations to obtain financing from the banking system, which resulted in higher leverage and higher equity ownership by banks. Resource Dependency Theory would indicate that the bankers could provide financial expertise and help monitor because of their financial stake within the company. However, in the past decade the strength of this relationship has decreased due to a change by legislators in 2002. This change allowed banks to divest their equity holdings without having to pay a capital gains tax. As a result, the average ownership in non-financial companies by banks was predicted to decrease by a factor of ten by 2005, and the number of board seats held by banks to drop nearly by half (Dittmann, Maug, & Schneider, 2010).

As noted above, the article "Bankers on the Boards of German Firms: What They Do, What They Are Worth, and Why They are (Still) There" analyzes the role of bankers on the boards of German non-financial companies from 1994 to 2005. The three hypotheses that they look at are that bankers monitor firms, that they provide capital market expertise, and that they promote their own business. The results were inconclusive as to whether there was any increase or improvement in monitoring the firm. Some of the ambiguity could be due to the significant decrease in the banks average ownership over this period due to the change in laws. There was an increase in banks selling more debt to companies in which they are represented on the board. These banks were also more likely to be chosen as the advising firm during merger and acquisitions, showing a correlation with providing expertise and promoting their own business. However, one finding critical of this practice was that the evidence suggests a negative causal effect of the presence of a banker on the firm's board with the firm's performance.

## **Duality**

Duality is defined in the United States when the same person holds both the CEO and the chairperson position on the Board of Directors within in a corporation. In contrast with the duality model in many U.S. corporations, the German dual-board system supports a consensus approach to corporate governance. Duality is not legal in German corporations, but a similar form can exist when the chairperson of a German Supervisory board was the former CEO or executive of the firm (Bresser, Thiele, Biedermann, & Ludeke, 2006). Members of the management board are responsible for decision-making, and the head of the management board is typically referred to as the 'speaker' rather than the 'chair' (Vitols, 2005). This speaker can possibly go on to become a member of the supervisory board.

Previously this switch from the management board to supervisory board was quite common in listed German companies. There has been much criticism that there could be conflicts of interest by having this 'chairman continuity' among the dual boards. One of the perceived risks could be that the former executive could be evaluating matters or strategies that he or she helped form. Therefore, in 2009 the National Legislature introduced an act that called for a



'cooling-off' period of at least two years in order to switch from the managerial board to the supervisory board. This reform was called the Act on Adequacy of the Management Board's Compensation. The act called for the two year cooling period but contained an 'Opt-Out' option that allowed for an immediate move. This move could only occur after a motion from the shareholders holding more than 25% of voting rights was passed. The Opt-Out clause does leave some potential issues when there are family controlled businesses or concentrated power among a certain group of shareholders. (Velte & Stiglbauer, 2012).

There are currently no cooling off periods in the United States for the CEO being on the board of directors, since duality is allowed. However, there are some cooling off periods required before they can be on certain committees on the board of directors. For instance, in the United States there is a three year waiting period before an individual could move from management to the audit committee

### **Shareholder v. Stakeholder Orientation**

German companies are expected to act in the interest of all stakeholders, not just of shareholders. As a result of the dual board structures and the stakeholder-orientation, there can be a conflict of interest between shareholders and employees' representatives. Decisions that increase shareholder value are not necessarily in the best interest of employees, and vice versa (Döscher, 2011). The common conflict in U.S. corporations is between the agency and the principal – known as the agency problem. The board of directors is responsible for representing the shareholders and for aligning the interests of the agents with the principal. The U.S. model focuses on financial performance by building shareholder value and prohibiting the agents from destroying it.

Germans support their corporate governance system, as shown by an opinion survey done in 2004 which found that 82% of Germans had a positive view towards co-determination (Vitols, 2005). Due to the larger presence of stakeholders, primarily labor representatives, in the German two-tiered system, the supervisory board typically has a strong voice and greater incentive in being vigilant in monitoring the management board. However, it is more difficult to prove whether co-determination has a negative or positive impact on firm performance. On one hand, co-determination may be used by workers to increase wage and benefit demands and limit layoffs. On the other hand, co-determination may increase workers' trust in the company thereby improving their productivity and commitment. Although studies suggest that co-determination may have a negative impact on share prices, the majority of newer econometric surveys indicate that codetermination probably has a slight positive impact on productivity and innovation (Vitols, 2005).

In the article, *Over the Long Run: Short-Run Impact and Long-Run Consequences of Stakeholder Management*, the authors explore the effects of stakeholder orientation on financial performance. The authors focused on evaluating costs of stakeholder orientation or "stakeholder management" and the return of investment (ROI) for the firm. For example, offering rich employee benefits, above-average wages, and other employee perks comes at a premium. Stakeholder management policies like these have a negative impact on firm performance in the first few years after the initial investment. The authors concluded, not surprisingly, that stakeholder-oriented management reduces firm value in the short term (Garcia-Castro, 2011).

However, in the long term, the authors found a positive relationship between stakeholder management and firm performance. The commitments and trust-based relationships created as a result of consistent stakeholder-oriented policies reduce the costs for those stakeholder-

oriented firms. As a result, they create higher shareholder value compared with other companies that only put their shareholders first. Stakeholder-friendly management, therefore, does create shareholder value longer term (Garcia-Castro, 2011).

Another study has shown that prudent levels of employee representation have a positive relationship with corporate performance, especially in industries that rely on a high degree of coordination across different functions. This is due to the inherent self-interest of the labor representatives monitoring any potential abuses or conflicts of interest and with a historical balance of seats held by bankers. The natural balance of those two parties helps facilitate an environment more conducive to a proactive or participative management and board relationship. However, too high a degree of labor representation can result in an agency problem where the board's decisions can be too favorable to employees without balancing all stakeholder interests. This causes an inverted U-shaped relationship with employee representation. While this study couldn't identify an exact number, it is likely below the 50% level mandated by large German corporations (Fauver & Fuerst, 2006).

In the United States, the three major players in corporate governance are the top management team (TMT), the board of directors, (BOD) and shareholders. The BOD is responsible for representing shareholders' interests – not stakeholders. The decisions of the TMT and the BOD are based upon building firm value. Employees and other stakeholders are not represented on the board, and other than Corporate Social Responsibility practices, other stakeholders are not typically considered in decision-making.

## **Board Diversity**

German board members, much like in the United States, are on average older, have long tenure, and are unlikely to have specific industry experience according to a study of Germany's biggest listed firms by Russell Reynolds (The Economist, 2009). In contrast to the United States, where the average board size is between nine and ten members, German supervisory boards often have up to 20 members. When the management board is included, this number increases to around 30 members.

In large German firms, co-determination requirements lead to a certain amount of board diversity. This is because of the requirement for employee and union representation, which leads to board members that tend to have a background different from that of shareholder representatives. In addition to employee representation, another co-determination requirement is that the proportion of male/female employee representatives mirrors the proportion of all employees. Co-determination does not require nationality diversity, however, and employee representatives are typically of German nationality (Du Plessis, 2012). In fact, a study found that nationality diversity on supervisory boards is much lower than on management boards, and international diversity on German boards is extremely low compared to other European nations.

According to the article Board Diversity or Gender Diversity, a 2011 analysis of 30 major German stock companies' annual reports showed that 24 of those companies had set a specific target for women's participation in the supervisory board. Meeting these diversity goals has moved rather slowly, though. The most recent review of 160 German listed corporations from October 2012 found that women made up only 15.32% of all supervisory board members. Supervisory board members serve a maximum term of five years, which could account for the slow rate of change. Due to the gender diversity provision in the German Stock Corporations Act, women account for 22.82% of employee representatives. However, only 4.08% of management board members are females (Du Plessis, 2012).

In November 2013, Chancellor Angela Merkel's conservative party and the Social Democrats agreed on a proposal that will require companies listed on the German Stock Exchange DAX to have at least 30% female board members on their supervisory boards by 2016. Several other European countries have passed similar laws, however, the United States hasn't set any requirements or goals for diversity on boards.

### **Board Issues Article**

In the article *Women in the Boardroom: How Do Female Directors of Corporate Boards Perceive Boardroom Dynamics?* the authors, Mathisen, Ogaard and Marnburg, explore the social dynamics of female directors, as opposed to focusing on financial outcomes like most research regarding the topic. They hypothesized that female board directors would experience less justice, lower cohesion and higher levels of conflict within the BOD than male directors. Their sample included 491 directors from 149 boards.

This type of research is important because if female directors have a negative experience and feel like outsiders, they might not feel comfortable enough to share their diverse insights with other directors. According to Resource Dependence Theory, a diverse board including male and female directors broadens the expertise and resources that the board can provide to the firm. While we found several articles relating to female director impact on financial performance – either showing no effects or positive effects – research on the experience of being a female director is limited, and may contribute to the underlying reasons for impacts on firm performance.

The authors used Social Identity Theory to frame their hypothesis. According to Social Identity Theory, people will have a favorable bias toward others whom they perceive as members of their “in-group” and will view themselves as being in disagreement with the “out-group”. As a result, out-group members can be marginalized and therefore have limited influence.

The study was conducted in Norway, which has twice the European average of women on their BODs (17% in 2007). Data was gathered by a written questionnaire given to male and female board members that measured perceptions related to justice, conflicts and cohesion.

Contrary to their hypothesis, they found that there were few differences in the way female and male directors experienced boardroom dynamics. They found that there was a slightly more negative, but not statistically significant, difference in how female directors from nontraditional educational backgrounds (not legal, business, or engineering) perceived dynamics than other female directors. The authors explained that the social identity of female directors could be more centered on their educational and experience backgrounds than their gender. This would mean that being a woman wouldn't automatically make them feel like an outsider. Another explanation offered is that female directors are confident in their abilities and have strong social skills, which could explain why they feel well accepted on the board. The fact that female directors with nontraditional educational backgrounds felt a lower level of justice and cohesion could be because they are perceived as less competent than female directors with a traditional educational background (Mathisen, et al., 2013).

Implications of this research are that female directors are most likely able to present their diverse points-of-view and offer their resources to the BOD in a way that will enhance the board's capabilities. These findings should bring encouragement to future female directors in Germany and in the U.S. Given the recent requirement of public companies in Germany to have

at least 30% female directors by 2016, it is important to continue to monitor the experience of female directors in the future.

### Sustainability Comparison

We've talked quite a bit about sustainability in organizations and what it means, but we've never compared different parts of the globe to one another. Now we are going to examine and compare what sustainability means between two different G20 countries, the U.S. and Germany. When we talk about sustainability in organizations, usually we mean three separate aspects. It can be separated into people, profit, and planet. When we refer to sustainability, we mean that all three of these P's have an impact on how or what organizations do to ensure sustainability. People obviously means the stakeholders involved in the company. This P means taking care of anyone from employees to CEOs and large investors by having things such as pension plans. Profit simply means the money a corporation can make from being sustainable. Planet means to take care of the environment in such a way that it can continue to be used in the future. These 3 P's are more formally known as social, environmental, and economic, also called the Triple Bottom Line.

There are a few reasons why corporations engage in CSR. One could simply be because the company truly cares about sustainability and the environment. More often, though, we see corporations engaging in CSR not because they want to, but because of social pressures. For example, in Scandinavia groups lobbied for more environmentally friendly paper products such as diapers and toilet tissue. As a direct result of this action, local producers started to use unbleached instead of bleached pulp (Campbell 2007).

We will start with the United States. The U.S. has quite a reputation for being sustainable, at least in the environmental aspect. Whether this is good or bad remains to be determined. Over the past 20 years, our role in attempting to have sustainability, as well as trying to enforce it abroad, have increased substantially. Organizations have begun to look at CSR in a different light, using it as a way to gain a competitive advantage (Center for Strategic and International Studies). On the United States Department of State website, there is extensive mention of the CSR team in the Bureau of Economic and Business Affairs. One of the missions is to "[b]uild on this synergy, working with multinational companies, civil society, labor groups, environmental advocates, and others to encourage the adoption of corporate policies that help companies 'do well by doing good'" (US Department of State).

In fact, the United States has an Organization for Economic Cooperation and Development which prints guidelines that give voluntary recommendations to multinational enterprises on CSR (US Department of State). However, the key word here is voluntary. Not only is the United States trying to control companies at home, but it is trying to make sure that U.S. companies don't do anything non-sustainable abroad. The newest and biggest sustainability act in the United States currently is the executive order that President Obama signed in 2009 that called for decrease in petroleum use, increase in water efficiency, as well as many more improvements in environmental sustainability. In addition, our government has invested a lot of money in wind and solar energy.

One aspect that stands out in regard to CSR is that the United States seemed to really only have initiatives related to the environment or planet. There seemed to be little to no evidence about sustainability in people and profit. There seem to be no laws governing this aspect in corporations. For example, there is no law that says pension plans are required.

In Germany it is a little different. There are not many laws that govern sustainability, but instead there are voluntary efforts. They have a set of guidelines that help companies to plan for the future, but there is nothing like the executive order the United States has. “CSR activities in Germany are deeply embedded in the view of the firm. And they are implicit: there is no need to verbalize them” (Campbell 2007). This has to do, in part, with the fact that companies in Germany are expected by the public to take all shareholders into account. In our research, there is a lot more information available regarding sustainability in Germany than there is about the US. This is related to the fact that Germany as a culture is more serious about sustainability than is the United States. Although there are not many actual laws, there are still many sustainability efforts going on in Germany. Companies in the United States may or may not have sustainability practices unless they are required to. Germany has a rather large document called the German Sustainability Code that outlines Germany’s goals in sustainability, as well as a way to measure a corporation’s sustainability performance. The United States has nothing of the sort. We many have organizations that report to the Global Reporting Initiative, but it was not developed specifically for the U.S.

The German Council for Sustainable Development recently put out a report titled “Sustainability-Made in Germany” which outlines Germany’s corporate social responsibility in Europe as a whole, as well as offering recommendations. This was a report that was commissioned by the council, and it is peer-reviewed. They actually paid someone to go through and audit their codes so that the council was satisfied they were doing a good enough job. An interesting aspect of the sustainability report was that it talks about “linking the sustainability transformation and the people.” In fact, it goes in depth regarding how civil society should have a say in the designing of sustainability, as well as how much activism truly matters. In addition, it talks about Germany’s process of “Energiewende,” which is its way of converting to sustainable forms of energy. It is similar to the U.S. in this regard, because it is also having a difficult time getting public approval and figuring out logistics (German Federal Chancellery).

In contrast to the U.S., Germany’s report also talks about many social issues, such as the wasting of food and sustainably grown food. This is something the United States has never had an initiative for. The German report also addresses the issue of demographic changes, such as an aging population, that are going to monumentally change public budgets, social security, and businesses in the near future (German Council for Sustainable Development). Once again, there is no official document of the U.S. that addresses these concerns.

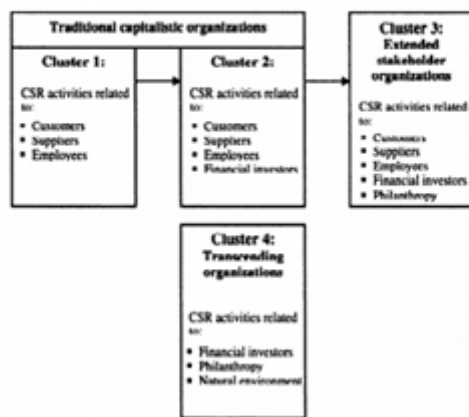
Overall, it seems as if there are many differences between the two countries. However, in a world where there is increasing globalization in the values of sustainability, we can see these countries coming together. Germany has definitely been more proactive in bringing these features to the forefront, but we believe U.S. has more resources and ingenuity to implement them. Historically, our country has been very good at implementing new innovations, and we suspect sustainability will be no different once we reach that point.

## **Sustainability Article Summaries**

The first article talks about United States sustainability. The article analyzed was Corporate Social Responsibility: An Empirical Investigation of U.S. Organizations, which investigated three different questions: 1) What current CSR practices exist, and what relative emphasis do different organizations place on different aspects of CSR?, 2) How do different stakeholders influence organizations’ CSR practices?, and 3) How do different CSR practices relate to different performance outcomes? The authors start off by explaining that multiple possible CSR practices exist, yet studies only focus on certain aspects. Without this true data, it is impossible

for theorists to examine CSR at a detailed level. This article mainly tried to evaluate if CSR is actually worth pursuing, using a sample of 401 U.S. organizations. In terms of being CSR being valuable, the authors evaluate the perceived influence of stakeholders, managers' perceptions of the influence on CSR performance, and organizational performance. Therefore, the authors did their best to tackle the questions from all sides to get a view as unbiased as possible.

They split up the companies into four clusters based on their degree of CSR to answer the first question - what current CSR practices exist, and what relative emphasis do different organizations place on different aspects of CSR? The illustration below shows the clusters and how they are organized. The article goes in depth on how they split the companies, but that's not relevant to the summary here.



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This illustration helped to answer the second research question, of whether stakeholders mattered in the organization's CSR practices. This article confirmed that they do. What the authors found was that in the first cluster, where the CSR activities are related to customers, supplier and employees, there was less CEO influence. In this cluster, there was also less influence from the board of directors. This means that the top managers are influencing CSR practices in the social and environmental sector. The fourth cluster had multiple CSR activities in all three of the P's. The authors speculate that this cluster has all these activities because they also happened to be the bigger organizations, with greater public scrutiny. This means increased media attention and increased regulation, as well as the influence of trade unions and local communities. All of these culminate into increased pressure on the company to act responsibly.

The next aspect that the authors talked about relating to CSR was organizational performance. This is the ultimate answer that the authors were looking for. Does CSR provide an increased profit? The authors evaluated this by asking the respondents objective measures of CSR. Using these measures, they can see if organizations with similar performance levels appear in the same clusters. They found that organizations in the fourth cluster had significantly higher revenues, as well as increased social health and economic health of the local community. Thus the authors suggested a positive link between CSR investments and corporate image. This is somewhat of a contradicted conclusion. Earlier in the article, the authors mentioned that it tended to be smaller, start-up organizations in the first and second cluster, as well as saying

that the fourth cluster (with the largest companies) had increased scrutiny. This leads the reader to believe that it's simply due to the small size of the company, less scrutiny, and less money that don't make it possible for those other clusters to have a large CSR footprint. Of course the organizations with well-developed CSR practices, the larger ones, tend to perform better because they are larger, established, older corporations (ex: The Coca-Cola Company). A start-up couldn't compare to that. Therefore, after critically analyzing the article, concrete evidence of a positive link between CSR and profitability is still absent. A possible future study could use companies within the same cluster, and then compare their CSR footprints to performance to see whether CSR actually makes a difference while controlling for other factors such as firm size.

The second article, *Innovation and Corporate Sustainability: An Investigation into the Process of Change in the Pharmaceuticals Industry*, talks about the process of change in German and UK pharmaceutical firms. This leads to discussion of pharmaceutical firms in the context of German practices of sustainability. The article tries to get at the heart of what drives change, whether it be intra-firm or external, that led to a change in CSR for environmental sustainability. It also analyzed whether the firm changed due to the ecosystem and changing market conditions, or because of sustainable development.

What the authors found was quite surprising. Their results indicated that regulation was the biggest driver of the eco-innovation process. Specifically, it was the EU and national-level regulation that was significant. This is particularly interesting because this industry has many "voluntary" agreements to strive towards sustainable practices. However, the article does mention that just the threat of reform can cause a change in practices. The next biggest driver, in change was technology. New technology means new rules on how to use it. It seems that the German government has a "best available technique not entailing excessive cost" and "best practicable environmental option" policy in relation to regulation. As technology evolves, these two can shift in regards to what is acceptable. The biggest intra-firm driver was employees. There must be some sort of feedback going on between managers and employees that show that recommendations are being honestly considered.

Overall the study concluded that voluntary agreements are essentially useless, at least in the pharmaceutical industry, in influencing sustainability initiatives. They also concluded that as of now, the changing market conditions were the most significant driver of sustainability changes.

The third article examined was *Sustainable transport in Freiburg: Lessons from Germany's Environmental Capital*, which discussed how a city that was once thought to be a booming city for the automobile industry changed itself to become the most environmentally friendly city in Germany. Germany has the highest motorization rate among European countries, as well as the most extensive highway network. The article acknowledges that Germany is just like the U.S. in that regard, but that German cars are more fuel-efficient. Germans also use cars a little less, which gives the country an edge in sustainability. In 2005, the average fuel economy of German cars was 30 mpg while the U.S.'s was only 20. The federal government in Germany offers policies and programs, as well as taxes and regulation, to help provide more sustainable transport. Germany has higher sales taxes on cars, in addition to recently increasing the cost of gasoline to encourage less driving.

The city of Freiburg itself had the highest motorization rate in West Germany until the 1970's policy reversal. Even though the population boomed at 17% vs. Germany's 3%, the number of

cars stayed essentially the same. Employment grew at 11% vs. Germany's 4% during 1996-2005. Multiple expansions in the busing system occurred. During the 1970's, a bicycling network was set up. The old central square that used to be a car parking lot was turned into a farmers' market because cars were banned there in 1970's. All of these shifts encouraged the use of sustainable transport.

The city eventually focused on increased public transport in 1979. They established "no car zones" throughout the city, as well as exorbitant pricing for parking spots. Some of the housing divisions even provided solar energy and rainwater reuse. One of the communities also has a citizen's movement that helps to preserve old trees, mixed land uses, etc. The article goes on to highlight multiple improvements in environmental stable transport in the city

Subsequently, from the article we learn that there are eight lessons to establishing a city like Freiburg.

- 1) Implement controversial policies in stages, i.e., take baby steps
- 2) Plans should be flexible and adaptable over time to changing conditions
- 3) Policies must be multi-modal and include both incentives and disincentives
- 4) Make public transport easier and raise the cost of owning a car
- 5) Fully integrate transport and land-use planning
- 6) Citizen involvement is a must
- 7) Must have support from higher levels of government
- 8) Sustainable policies must be long-term for lasting impact

These cannot always be applied to every city, but it seems that Germany did a pretty good job of implementing them here. Interestingly enough, the article singles out Portland, Oregon as the best example of these kind of practices in the U.S. Clearly there is evidence of this working in the USA, but it will be a matter of changing the culture over time.

## **Conclusion**

In conclusion, the United States and Germany both rely on corporate governance to ensure businesses are operating smoothly. Germany uses a two-board structure, with a supervisory and managerial board to represent shareholders, while the United States has one board of directors for each publically traded company. German companies focus on both shareholder and stakeholder interest, rather than just the shareholder value focus of the US, and have similar board diversity. Both countries have recently adopted a "say on pay" policy that allows shareholders to vote on executive compensation plans. Despite this, Germany and the US both exhibit an increasing gap in the pay of top executives compared to average worker salary. However, the ability of shareholders to vote on executive pay structure aims to decrease this gap. One of the overall goals of both countries' companies is to increase sustainability. The United States has many regulations enforcing sustainability, however Germany has more of a voluntary approach which has shown to be successful. Both the United States and Germany have unique corporate governance structures and practices that will allow them to advance



sustainability efforts in the future. Although the long-term success of these structures remains to be seen, both countries are well on their way to remaining two of the most influential business competitors in the world.

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