THE MAIN FEATURES OF THE GERMAN CORPORATE GOVERNANCE SYSTEM. CASE STUDY: BAYER AG

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Abstract

Each country has developed, according to the needs and specificity of the environment where the companies operate their businesses, its own corporate governance system. At global level, there are two main models of corporate governance taken into account: *the shareholder system* (United Kingdom, USA); the *stakeholder system* (Japan, most Latin and Continental European countries). The German company Bayer AG has adopted the stakeholder model to form its corporate governance system and, therefore, does not limit itself to the protection of stakeholders, as in the case of the English-American area A specific feature of the German corporate law is the separation between the Management Board ("Vorstand") and the Supervisory Board ("Aufsichtsrat"). This two-tier management system is also adopted by Bayer AG. It is rigorously forbidden to the members of one board to be, also, members of the other board. The German Supervisory Boards are unique due to the German law of co-determination, according to which it is mandatory for these boards to be composed by an equal number of representatives of stakeholders and employees. The role of Bayer AG Supervisory Board (formed by 20 members) is to monitor and guide the Management Board. In order to increase its efficiency in task fulfillment, Bayer AG Supervisory Board set up five committees – the Presidial Committee, the Audit Committee, the Human Resources Committee, the Nominations Committee and the Innovation Committee. The Supervisory Board operate in compliance with the German Stock Corporation Act and the German Corporate Governance Code. In average, the Supervisory Board has about 13 members and 2,3 committees. In the case of Bayer AG company, the Management Board is composed only by intern directors, having the role of company management and representation, while the Supervisory Board is formed exclusively by external directors. Obviously, the share structure is of concentrate type, thus supporting the long term investment horizons.

Key words: corporate governance, stakeholder model, supervisory board, two-tier system

In the specialized literature are various descriptions of the corporate governance. One of them defines the corporate governance as being *"...framework of laws, rules, and procedures that regulate the interactions and relationships between the providers of capital, the governing body, senior managers and other parties that take part to varying degrees in the decision making process and are themselves affected by the company's dispositions and business activities*" (Mendez A. M., 2011). More briefly, the corporate governance is the system of institutions and rules that determines the control and direction of the corporation and that indicates the relationship among the corporation's major participants (Tekin N., 2014).

The corporate governance systems differ in the whole world because of the various laws and cultures among the countries. At global level, there are two main models of corporate governance taken into account: *the shareholder system* (United Kingdom, USA) and the *stakeholder system* (Japan, most Latin and Continental European countries). These two systems have considerably different structures and aims.

The *shareholder model,* known also under the name of *outsider model,* is a market-based system, characterized by the existence of the dispersed shareholders and the prevalence of the shareholders' approach, the financing being mainly accomplished by the participation of investors to the social capital of enterprises. The *stakeholder system* or the *insider model* is founded on the relations among peoples, being characterised by the concentrated structure of the shareholders and the existernce of a low number of creditors and participants to the social capital, the supervision being delegated to the banks (Maassen G.F., 2002).

Germany, a leading country with a large industrial and manufacturing sector, has adopted the stakeholder model of corporate governance

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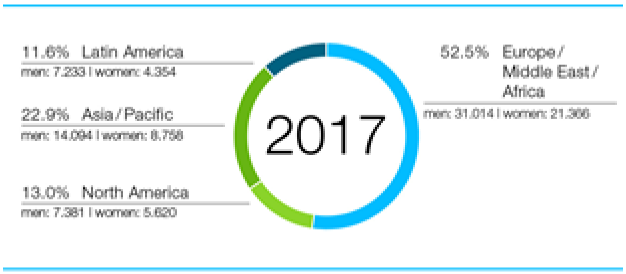
system, with the aim to balance the interests of all stakeholders.

Germany is considered a classic case of "non-shareholder value orientation", whose production-oriented, long-term, risk adverse and consensus-driven values have often been contrasted with the "Anglo-Saxon" approach (Jürgens U., Rupp J., 2002).

One representative company for the German business environment is Bayer AG, a global company with three divisions - Pharmacy, Consumer Health and Culture Science - and a business unit for animal health. In 2017, Bayer Group included more than 237 companies carrying on businesses in 79 countries, having 99.820 employees worldwide (out of which 31,7% in Germany, *figure 1*) and sales figures of 35 billion EUR. The global headquarters are in Leverkusen, Germany.



2016 figures restated; values rounded to the nearest hundred; number of employees in full-time equivalents (FTE)

Figure 1 **Bayer AG Employees by Region and Gender**

Bayer has committed itself to follow the principles of sustainable development and its social and ethical responsibilities as a corporate citizen. Also, Bayer has committed itself to the principles of the German Corporate Governance Code and provides a good example regarding this matter.

MATERIAL AND METHOD

The purpose of this paper was to describe and underline the unique nature of the German system of corporate governance, exemplifying through Bayer AG case. This paper is entirely based on the review and analysis of published international literature. The literature review process is focused on identifying those important features of a Supervisory Board and its members that may contribute to the long-term success of a company. The main elements analyzed relate to: the differences between insider and outsider systems, the shareholder and stakeholder perspectives of corporate governance, the dual system of company management (two-tier system), board size, number of board meetings, composition of the board, board committees, representation of banks in the Supervisory Board, risk management systems and transparency.

RESULTS AND DISCUSSIONS

Types of companies. In Germany, as well as for the variant of operating as a sole proprietor, there are five major forms of company organization as outlined in *figure 2*. According to the German law, like in the case of the majority of UE legal frames, there is a formal division of the Limited Companies in joint stock companies or "Aktiengesellschaften" ("AG") and limited liability companies ("Gesellschaften mit beschränkter Haftung" or "GmbH"). Bayer AG Company is a Public Limited Company and is governed by the Stock Corporation Act (Aktiengesetz), in comparison with the GmbH companies, regulated by the Limited Liability Companies Act (GmbH-Gesetz). Still, some basic principles of the legal framework of commercial societies equally apply for both types.

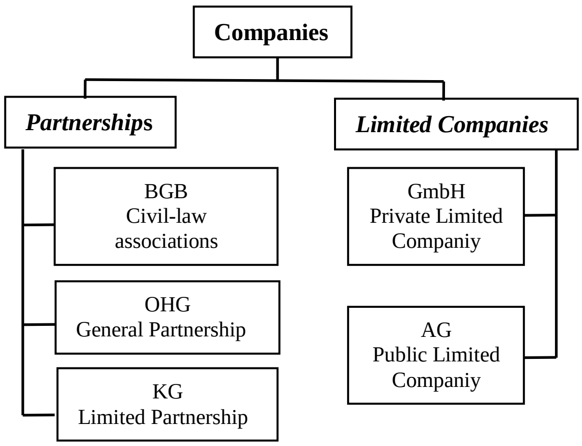


Figure 2 **Major forms of company organization in Germany** (Source: Schmidt, 1997)

Outsider and insider corporate governance systems. The German model of corporate governance has developed in a unique cultural, historical and technological context, and is influenced by the particular national economic and social conditions, such as the financial markets, the banking sector, the structure of ownership and the composition of boards of directors. Sheridan and Kendall (1992) distinguish insider bank-based and outsider market-based financial systems of corporate governance (*table 1*).

The Germany's option regarding the corporate governance is *the insider model*, with a low number of creditors and participants to the social capital (*equity holders*), and the banks have, usually, a persistent presence in the Supervisory Board, where they activate in their double position – as shareholder and creditor. In Germany, the share ownership is heavily concentrated, with over half of all shares being owned by non-financial companies, banks and insurance companies (Jürgens, Rupp, 2002).

Table 1
The Distinction Between Insider and Outsider Systems (Sheridan and Kendall, 1992)

Outsider system (Anglo-Saxon countries)	*Insider system (continental Europe and Japan);*
• dispersed ownership and control	• concentrated ownership
• separation of ownership from control	• the association of ownership with control
• little incentive for outside investors to participate in corporate control	• control by related parties such as banks, partners and employees
• a climate where hostile takeovers are not unusual, and they can be costly and antagonistic	• absence of hostile takeovers; in fact, an aversion to them
• the interests of other stakeholders are not represented	• the interests of other stakeholders are represented
• low commitment of outside investors to the long-term financial strategies of the company	• the intervention of the outside investor is limited to periods of clear financial failure
• takeovers may create monopolies	• insider systems may create collusion and cartels.

The distinctive perspectives of corporate governance - such as the shareholder and stakeholder perspectives - give rise to differences in the definition of boards' roles in the governance of corporations (*table 2*).

Table 2
Shareholder and Stakeholder Perspectives of Corporate Governance (Gedajlovic, 1993)

Shareholder	Stakeholder
executive and non-executive directors are fiduciaries of shareholders;	executive and non-executive directors are fiduciaries of a variety of claimants;
executive and non-executive directors should adopt policies consistent with the maximization of shareholder wealth;	executive and non-executive directors should balance pluralistic claims;
profitability and economicefficiency are the standardsof efficacy;	profitability and economic efficiency are important in addition to survival, long-term growth and stability;
the corporation is subordinate to the interests of shareholders.	the corporation is seen as a superordinate entity.

Two-tier system. Germany promotes the dual system of company management (two-tier board), a specific characteristic of the German legislation regarding the commercial societies being the separation between the Management Board ("Vorstand"), with executive role, and the Supervisory Board ("Aufsichtsrat"), with monitoring role. This two-tier management system was set up in 1870, being mandatory for the joint stock companies and for the limited liability companies. The functional separation of these two boards avoids the conflicts between the personal interests of managers and the interests of their companies.

The Management Board is formed only by internal directors, in charge with the company's management and representation. The Supervisory Board has the task to appoint and monitor the management of society. The members of the Management Board are not allowed to be also members of the Supervisory Board and vice-versa. The members of the Management Board are appointed for a period of maximum five years, by the Supervisory Board. In the same time, this establishes also the remuneration for the members of the Management Board.

Board size. The relation between the size of the Management Board and its effectiveness may be represented by a reversed and flattened "U"-shaped curve (*figure 3*). Thus, the more the board's number increases, this will take benefit from more ideas and knowledge and its effectiveness will increase, but, from a certain threshold, the adding of extra members will generate coordination-related conflicts and problems that will diminish the Board's effectiveness.

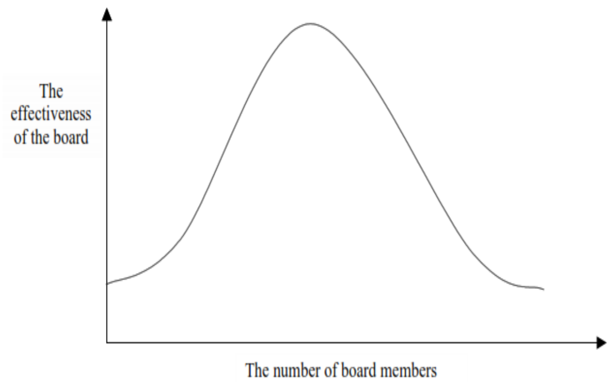


Figure 3: **Relationship between number of board members and the effectiveness of the board** (Leimkühler, 1996)

The Supervisory Board (Aufsichtsrat) is formed by at least three members and maximum 21 members, according to the company's declared capital. In Germany, the average size of the Supervisory Boards was about 13 members at the end of the year 2000. One person can hold up to ten seats within the supervisory boards of other companies, the average number being 2-3 seats per person (Hopt *et al*, 1998). The Supervisory Board of Bayer AG includes a number of 20 members, being very close to the maximum size allowed, taking into consideration the economic dimension of this company.

The average size of the Supervisory Boards in Germany is pretty large, therefore the suspicion that they can be negatively affected by the fact that they are too large. By the other hand, it is not known the threshold of the Board's size beyond which the Board's effectiveness can decrease. In the same time, this threshold may be different according to the nature of businesses carried on by the company (Leimkühler, 1996).

Number of board meetings. The frequency of the German Supervisory Board meetings is relatively low, with an average value of 3.8 times per year. In the case of Bayer AG, the members of the Supervisory Board meet themselves once per quarter, therefore within the limits of the national mean.

A high number of board meetings does not necessarily lead to a more efficient board and a better monitoring, if the meetings are conducted in a way to serve only the form rather than the substance (Schneider and Chan, 2002).

Composition of the board. In German companies with more than 500 employees, under Works Constitution Act of 1952 one third of the Supervisory Board members must be employee representatives. In companies with more than 2,000 employees, the Co-Determination Act of 1976 stipulates that the German Supervisory Boards are made up of an equal number of shareholders and employees' representatives. The representatives of capital retain the right to nominate the chairman of the Supervisory Board who has the casting vote when the two sides are deadlocked.

This situation has the advantage to solve the conflicts between the management and the employees. Therefore, the employees understand better the reasoning of the management's decisions. The employees' participation is not related to the daily management level, but to the enterprise supervision and strategy development level.

In the case of Bayer AG, out of the 20 members of the Supervisory Board, 10 members are representatives of employees, out of them one is the vice-president of the Supervisory Board.

The representatives of shareholders may be internal and external. The internal ones are shareholders by themselves and represent shareholders in shareholder meetings, with authorized voting rights from those shareholders they represent. The external representatives of shareholders are not shareholders of the company, but are members of the Supervisory Board. However, they represent the interests of shareholders in the Board and they vote on behalf of shareholders (*figure 4*).

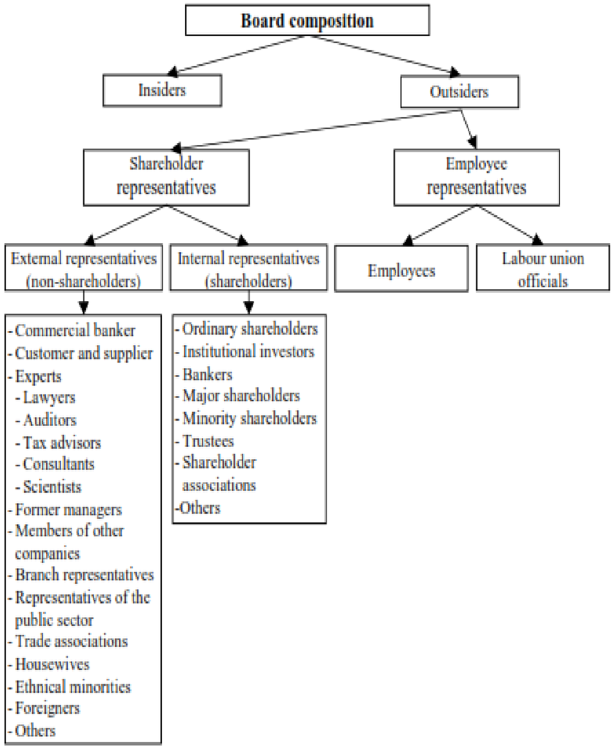


Figure 4: **Composition of the (supervisory) boards** (Schneider and Chan, 2002)

Board Committees. To acquire flexibility, a board may be more efficient in fulfilling its tasks by establishing committees to handle some specific types of duties. There are many different types of committees, whith monitoring functions (audit committee, nomination committee, compensation committee etc.) and management functions (executive committee, finance committee, investment committee, corporate rensponsibility committee etc.). The audit committees are the most popular in Germany. In average, the German Supervisory Board has about 2.3 committees (Schneider and Chan, 2002).

In order to increase its efficiency, Bayer AG Supervisory Board set up five committees:

The Presidial Committee, formed by the president and vice-president of the Supervisory Board, a representative of shareholders and a representative of employees. This has the task to submit proposals to the Supervisory Board regarding the appoitment of the members of the Management Board in the case when the necessary majority of two thirds is not obtained at the first vote within a plenary session.

The Audit Committee, includes three representatives of shareholders and three representatives of employees. The meetings take place periodically, four times per year, having the role to supervise the process of financial reporting, effectiveness and the continuous development of the internal control system, risk management system, internal audit system, compliance system and financial situation audit.

The Human Resources Committee, formed by the president and other three members of the Supervisory Board, the parity of representation between shareholders and employees being mandatory. It prepares the staff decisions of the entire Supervisory Board, that solves the appointments and the nomination revoking of the members of the Management Board. In the same time, it is in charge with the long-term planning of the succession for the Management Board.

The Nominations Committee, formed by the president of the Supervisory Board and the other representative of the shareholders from the Presidial Committee. It makes the preparations to elect the representatives of shareholders in the Supervisory Board.

The Innovation Committee, includes the president of the Supervisory Board and other seven members, with parity of representation between shareholders and representatives of employees. It is in charge with the innovation strategy and management, strategy of the intellectual property protection and the major research and development projects of Bayer AG.

Risk management systems. It has the role to recognize as soon as possible the possible evolution that might endanger "the life" of a company, allowing the adoption of adequate measures. The risk management refers to the activities of monitoring, controlling and defending risks according to plans: risk avoidance, risk reduction and risk limitation (active risk management), risk shifting and risk providence (passive or reactive risk management). (Scharpf, 1997) *Figure 5* presents the elements of a typical risk management system.

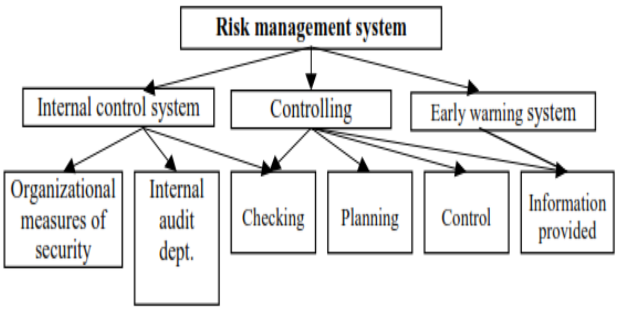


Figure 5: **Elements of a typical risk management system** (Scharpf, 1997)

Opportunity and risk management is an integral part of the corporate management at Bayer AG. Being a global company carrying on a great number of very diverse activities, the Bayer Group is frequently exposed to various factors and numerous events that may have a strong impact on the achievement of the proposed objectives.

The general responsability for the efficiency and the adjustment of operations like the risk identification, evaluation, management and monitoring belongs to the financial director. The establishment of a control system to ensure the risk monitoring in the right time allows the appropriate management of them, based on the appropiate accounting of the commercial transactions and by delivering reliable financial data regarding the company's situation.

Representation of banks. Banks play an important role in the German corporate governance. Historically, this happens due to the fact that bank loans have been for long time a favorite method of large corporations to raise capital (Tekin, 2014). The German banks, especially large banks, hold many shares and are represented in the boards of the largest German public companies. The Bank representatives in the Supervisory Board may represent shareholder or lender interests (Jürgens and Rupp, 2002). A study made by *Boehmer* in the year 1998 pointed out that out of the 231 seats that are destinated to shareholders within the Supervisory Boards of a number of 24 German companies, circa 16 % (meaning 37 sears) belonged to three big banks: Deutsche Bank, Dresdner Bank, Commerzbank.

In the Supervisory Board of Bayer AG, there is only one representative of the banking system (Deutsche Bank), which is also one of the ten shareholders' representatives.

Transparency. Following the recommendations of the Corporate Governance Code**,** Bayer AG delivers detailed information to shareholders, financial analists, mass-media and the general public regarding the fiancial position, business trends, carried out operations and potential risks. The reports are published four times per year, inclusively on internet; in the same time, information regarding the financial situations are given to the interested parts by the occasion of press conferences and meetings of financial analists. The half-year financial report is voluntarily subjected to an audit review by the auditor, whose appointment by the Annual Stockholders' Meeting also relates specifically to this audit review.

In addition to the regular reporting, the Management Board issue ad-hoc statements on development that otherwise might not become publicly known but have the potential to materially affect the price of Bayer stock.

CONCLUSIONS

Germany has adopted the stakeholder model to form its corporate governance system, with a low number of creditors and participants to the social capital. Its focus is to ensure that not just shareholders are represented in decision making processes.

The system of co-determination contributes to the unique nature of the German system of corporate governance. Sizeable and public companies are supposed to have a two-tier board structure in the German corporate governance system: the lower, management board and the upper; supervisory board. This dual system consists of representation of union interests and representation of employer interests, between a third and a half of the supervisory board members have to be employee or trade union representatives.

Another distinctive feature of the German corporate governance model is the representation of banks on the supervisory board. In the Supervisory Board of Bayer AG, there is only one representative of the banking system (Deutsche Bank),

The average size of the Supervisory Boards in Germany is pretty large (13 members), at Bayer AG comprising 20 members, of which 10 are employees' representatives.

The number of board meetings is relatively low, with an average national value of 3.8 times per year. In the case of Bayer AG, the members of the Supervisory Board meet themselves four times per year.

The German Supervisory Board has about 2.3 committees, the audit committees being the most popular. Bayer AG Supervisory Board set up five committees.

Transparency is one of the characteristics of German companies. Bayer AG informs all interested parties about its activities and financial situation through reports published four times a year, press conferences, meetings of financial analists and ad-hoc statements.

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