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Corporate Governance Reporting

Compliance with Upper Limits for Severance Payments to Members of Executive Boards in Germany

Alexander Dilger/Ute Schottmüller-Einwag

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Abstract

This paper examines how corporate governance reporting corresponds to actual conduct regarding severance payment caps for prematurely departing members of companies' executive boards in Germany. For this purpose, we first evaluate the declarations of conformity for all companies listed in the CDAX between 2010 and 2014, which we use to determine conformity and deviation rates, and analyse reasons for deviation. In a further full survey, we assess the compensation amounts of all severance payments made and published by DAX companies to their executive board members who were prematurely terminated, which allows us to compare the respective severance ratio with the cap recommended by the German Corporate Governance Codex (GCGC). We find that more than 20% of companies listed in the CDAX declared deviation in the declaration of conformity, and one-third of all deviations were justified by a rejection of the normative decision of the recommendation. Moreover, in 57% of actual severance cases where DAX companies had previously declared their compliance, the cap was exceeded; yet, none of the companies that had exceeded the cap in a severance case disclosed this in the following declaration of conformity. In the years under review, for the majority of severance cases in companies listed in the DAX, the GCGC's cap did not have any factual binding effect. Finally, in most cases the corporate reports deviated from reality and therefore could not serve as a suitable basis for decisions by the capital market.

JEL-Codes: D86, G34, G38, J33, J63, J65, K12, K31, M12, M52, M55

Corporate Governance Berichterstattung

Einhaltung von Abfindungsobergrenzen für Vorstandsmitglieder in Deutschland

Zusammenfassung

Dieser Beitrag untersucht, wie die Corporate Governance Berichterstattung mit dem tatsächlichen Verhalten hinsichtlich Abfindungsobergrenzen für vorzeitig ausscheidende Vorstandsmitglieder in Deutschland übereinstimmt. Dazu evaluieren wir zuerst die Entsprechenserklärungen für alle im CDAX gelisteten Gesellschaften zwischen 2010 und 2014, um die Raten des Entsprechens und Abweichens zu bestimmen sowie Abweichungsgründe zu analysieren. In einer weiteren vollständigen Erhebung bestimmen wir den Umfang der Abfindungszahlungen, die von Gesellschaften im DAX veröffentlicht und an ihre vorzeitig ausgeschiedenen Vorstandsmitglieder gezahlt wurden, um die Abfindungsrelationen mit der empfohlenen Begrenzung des Deutschen Corporate Governance Kodex (DCGK) zu vergleichen. Wir finden, dass mehr als 20 Prozent der Gesellschaften im CDAX eine Abweichung erklärten und ein Drittel dieser Abweichungen mit einer Ablehnung der normativen Entscheidung der Empfehlung begründet wurde. Außerdem wurde in 57 Prozent der Abfindungsfälle, in denen vorher Entsprechen erklärt worden war, die Obergrenze überschritten, was jedoch keine der Gesellschaften in ihrer nachfolgenden Entsprechenserklärung angab. In den betrachteten Jahren hatte die empfohlene Abfindungsobergrenze in den meisten Abfindungsfällen von DAX-Unternehmen keine faktische Bindungswirkung. Schließlich wichen die Unternehmensberichte in den meisten Fällen von der Realität ab und konnten deshalb nicht als geeignete Basis für Kapitalmarktentscheidungen dienen.

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Corporate Governance Reporting

Compliance with Upper Limits for Severance Payments to Members of Executive Boards in Germany*

1. Introduction

The increasing globalisation of economic activity, as well as the collapse of large companies, such as the US company Enron in 2001 due to massive falsification of financial statements and the Italian food group Parmalat in 2003 due to financial fraud, has led to an increasing number of demands worldwide for regulations on corporate governance and its corresponding reporting. As a result, corporate governance regulations have been developed for Germany as well as numerous other countries (see Aguilera and Cuervo-Cazurra 2009 as well as Cuomo et al. 2016 for overviews of international research on corporate governance codes). However, at least in Germany, the underlying facts that formed the basis of the regulations were not sufficiently empirically researched (cf. Welge and Eulerich 2014, p. 34), nor were the regulations based on any coherent theories (cf. Theisen 2014, p. 2063). One possible reason for these omissions is that the term *corporate governance* implicitly means "good" corporate governance, which involves subjective assessments of how a company should operate. In fact, the official recommendations for what constitutes good corporate governance are "at best a formulation of what, according to the subjective ideas of a majority of members of the government commission, would be good governance" (Krieger 2012, p. 211; these and all following citations from German sources are translated by the authors of this article). Further, the German Corporate Governance Code (GCGC, the English version is online at https://www.dcgk.de/en/code.html) describes that "internationally and nationally accepted standards of good and responsible governance" should be adopted. However, this poses considerable difficulties because different international corporate constitutions have different rights and obligations for executive bodies and interest groups.

In Germany, there is no legal definition of the term *corporate governance*. A frequently used definition by Axel von Werder defines corporate governance as the "legal and factual regulatory framework for the management and supervision of a company". In contrast to the corporate constitution, which only describes the order within a company, corporate governance encompasses both an internal and an external governance perspective. The "internal govern-

* This discussion paper is based on the dissertation of Ute Schottmüller-Einwag (2018), which was supervised by Alexander Dilger. We both have been actively involved in this contribution and we both are responsible for any remaining errors while we thank Celeste Brennecka for language editing.

ance perspective" encompasses "the respective roles, competencies and modes of operation as well as the interaction of corporate bodies such as the executive board and the supervisory board", while the external governance perspective shapes "the relationship between corporate management and the main reference groups of the company (stakeholders), with particular importance being attached to the shareholders in the circle of stakeholders" (Werder 2009, p. 4).

The extent that a company complies with corporate governance regulations falls under the subject of corporate reporting. Corporate governance reporting contains information on the corporate governance of a company so that the company can be assessed externally (cf. Ceschinski et al. 2018, p. 278). Thus, managers use corporate reports to give information about the company's status primarily to shareholders but also to other interested groups, such as employees, customers, suppliers or other capital market participants. By making the extent of the company's compliance with corporate governance regulations transparent to the capital market, such reports are intended to influence the market's decision-makers. In Germany, this principle was formulated by Gerhard Cromme, former Chairman of the Government Commission on the German Corporate Governance Code, when the GCGC was introduced: "Those who do not comply with the Code will be punished by the capital market" (Sturbeck 2001, p. 13). Thus, corporate reports give current and potential investors an idea about a company's compliance so they can base their investment decisions on that, among other things (cf. Hommelhoff and Schwab 2009, p. 80; Goette 2013, § 161 AktG recital 37). According to this concept, if reports show that a company does not follow the recommendations or only does so to a limited extent, this will cause investors to sell their shares or not to buy any new ones, leading to price discounts (cf. Ihrig and Wagner 2002, p. 2514; Hoffmann-Becking 2011, p. 1174). However, the authors do mention a major caveat to these expected outcomes: they lack empirical evidence. To date, the assumption that good corporate governance has a positive impact on the success of a company has only been proven in part but not in full (cf. Werder 2009, p. 24; Werder and Grundei 2009, p. 630).

In institutional economic terms, corporate governance reporting should function to reduce the principal-agent conflict between shareholders and management by reducing information asymmetry (cf. Leyens and Arbeitskreis Corporate Governance Reporting der Schmalenbach-Gesellschaft für Betriebswirtschaft e. V. 2016, p. 2131). Conflicts between shareholders and management occur because of the separation of ownership and control (cf. Berle and Means 1932, p. 116). The information available to the management (who controls the company; the

agent) cannot be obtained by shareholders (who own the company; the principal), or can only be obtained at high costs (see Richter and Furubotn 2010, pp. 173 et seq.). Due to this information asymmetry, the principal incurs agency costs (see Jensen and Meckling 1976, p. 308). This conflict is expected to be reduced by efficient corporate governance reporting, as it should increase the transparency with regard to the actions of the executive board and supervisory board and thus reduce agency costs both for the agent, by avoiding redundant information in various publication instruments (cf. Buhleier et al. 2018, p. 2125), and for the principal, by reducing effort to obtain the information (cf. Kuhner 2005, p. 151; Bassen et al. 2006, pp. 379 et seq.; Zöllner 2007, p. 3; Buhleier et al. 2018, p. 2125). However, Nowak et al. (2005, p. 259) noted that this positive view of corporate governance reporting requires that the participants in the capital market access the information in these reports and also react to it.

This article examines the following research questions for the German corporate governance system: How is corporate governance reporting carried out regarding companies' compliance with the recommended cap for executive boards' severance payments? What content is reported? Does the reported content correspond to the reality of severance payments to executives? What changes are necessary with regard to both content and corporate governance reporting on the issue of severance payments to executive board members in order to provide the capital market with better decision-making aids?

To assess the discrepancies between how companies should act regarding severance payments, based on whether they conform with the GCGC severance payment caps, and how they actually carry out severance payments, we first describe and analyse the system of declarations of conformity with the GCGC in Chapter 2. Then, Chapter 3 contains the empirical results of both the declarations of conformity and the actual severance cases, which is followed by an analysis of the match between reported content and actual severance cases. Chapter 4 discusses the results, after which Chapter 5 draws conclusions and identifies areas for improvement, both in terms of content and corporate governance reporting.

2. System of Declarations of Conformity with the GCGC

Sections 2.1 to 2.3 of this Chapter explain the various regulatory instruments and their interaction, Section 2.4 classifies them legally, and Section 2.5 classifies them with regard to corporate governance effects.

2.1. GCGC

While corporate law in Germany is governed by a large number of laws, the majority of corporate governance regulations are contained in the GCGC. The Code was developed in 2002 by an independent government commission and published by the Federal Ministry of Justice in the official section of the Federal Gazette (*Bundesgesetzblatt*). It contains three different types of rules. Firstly, in order to improve communication with investors, it contains already existing essential legal regulations from different laws (descriptive function). Secondly, it provides recommendations, and, thirdly, suggestions without commitment (constitutive function). This distinction is relevant for the obligation of companies to submit a declaration of conformity pursuant to § 161 (1) AktG (German Stock Companies Act).

The declaration of conformity, which must be submitted annually, contains two parts: one about the past, regarding how the company has previously complied with the GCGC's recommendations, and one about the future, where the company must declare their intention to comply with the Code's recommendations in the future. Although the recommendations are not legally binding and companies may deviate from them, companies are legally obliged to issue this declaration of conformity. If the recommendations were not complied with, companies must also disclose which recommendations they disobeyed and why (cf. Hüffer and Koch 2016, § 161 AktG recital 18). This comply-or-explain principle is intended to make internal corporate governance decisions – such as how much severance pay executive members will receive upon termination – transparent for the capital market and the general public.

The recommendations apply to all German listed companies, i.e. to listed German stock corporations and partnerships limited by shares as well as to European stock corporations domiciled in Germany (Strieder 2005, p. 165). Pursuant to § 161 (1) sentence 1 AktG, the declaration of conformity must be issued uniformly by the executive board and the supervisory board. If one of the two boards deviates, or even if just one member of one of the two boards deviates, a total deviation from the recommendation must be declared (see Bayer and Scholz 2019, recital 45). Pursuant to § 161 (2) AktG, companies must make the declaration of conformity permanently available to the public on their websites.

Since 2012, the preamble to the CGCG has also included the idea of a deviation culture, whereby a well-founded deviation from a code recommendation can be in the interest of good corporate governance. Accordingly, the government commission on the GCGC regularly reviews whether the recommendations continue to comply with "best practice" in good corporate governance or whether they need to be adjusted. In 2018, the government commission

presented a draft for a revised GCGC and gave interested members of the public the opportunity to comment in a consultation process.

2.2. Corporate Governance Reporting

In order to provide the capital market and other interested parties with a higher degree of transparency regarding companies' compliance with the recommendations, corporate governance reporting in Germany was further developed in parallel with the GCGC. With the introduction of § 161 (1) sentence 1 AktG in 2002, companies' reporting obligations described above were legally anchored. This subsequently led to the declaration of conformity being published through a large number of communication instruments. For example, the document could be published either as a single document on the company's website or as part of the corporate governance statement pursuant to § 289f HGB (German Commercial Code) as part of the management report, or as an independent part of the annual report. In order to reduce the lack of transparency introduced by the various communication instruments, in mid-2018, § 289f (2) No. 1 HGB stipulated that the declaration of conformity must be included in the corporate governance statement as part of the management report in accordance with § 289 HGB. Furthermore, the notes to the annual financial statements must contain the information required under § 285 No. 16 HGB, stating that the declaration of conformity has been submitted and made publicly available. The declaration of conformity is only part of what is required for corporate governance reporting; further components are regulated in § 289f (2) No. 2 to 6 HGB.

The focus of this article is on the part of corporate governance reporting dealing with declarations of conformity, but integrating the content of these declarations into the corporate governance statement, as described above, raises the question of what duty the supervisory board has in making the declaration. While the declarations of conformity pursuant to § 161 (1) sentence 1 AktG must be submitted jointly by the executive board and the supervisory board, the obligation to prepare a management report pursuant to § 264 HGB is incumbent on the legal representatives of a corporation; pursuant to § 78 (1) sentence 1 AktG, this is the executive board (cf. Buhleier et al. 2018, p. 2126). Moreover, pursuant to § 217 (2) sentence 1 HGB, a management report may also be under the purview of an external auditor tasked with performing an audit. For the purpose of the declaration of conformity (pursuant to § 217 (2) sentence 6 HGB), however, the audit is limited to determining whether the disclosures have been made (cf. Buhleier et al. 2018, p. 2126). Thus, auditors do not carry out a substantive audit in this regard.

The issuing and publication of declarations of compliance are monitored by the Federal Office of Justice. The office administers different fines in two different cases: one, when a company fails to submit a declaration of conformity at all, and the other, when a company fails to mention in their financial statements that they have submitted the declaration. In the first case, namely when a company's legal representatives have not disclosed the declaration of conformity or have not submitted it to the operator of the Federal Gazette, the Federal Office of Justice carries out an administrative fine procedure according to § 335 HGB. In this case, both the operator of the Federal Gazette and third parties may file a complaint, and the administrative fine is given repeatedly until the company has fulfilled its disclosure obligation. The goal here is to force the company to catch up with the reporting laws. In the second case, a fine is administered pursuant to § 334 (1) No. 1 d) HGB in conjunction with Section 285 No. 16 HGB when a company's executive board or supervisory board have failed to state in the notes to their annual financial statements that they have issued the declaration required by § 161 AktG and where it has been made publicly accessible. Failure to provide this information constitutes a breach of duty (Goette 2013, § 161 AktG recital 82), and the omission is sanctioned (cf. Schaal 2013, §161 AktG recital 113).

2.3. Declarations of Conformity for the Severance Cap Recommendation

The research performed here specifically focuses on declarations of conformity dealing with recommendation 4.2.3 (4) sentence 1 GCGC, which reads: "*When contracts are entered into with Management Board members, it shall be ensured that payments, including fringe benefits, made to a Management Board member due to early termination of their contract do not exceed twice the annual remuneration (Severance Cap) and do not constitute remuneration for more than the remaining term of the employment contract*". (Hereafter, we refer to this recommendation as "the recommendation".) If, an executive board member is prematurely terminated when the remaining term of his or her contract are only two years or less, the member's remuneration shall not exceed the remaining term of their employment contract. In this situation, the payment for the remaining term of the contract is the upper limit. In the case of contract terms of more than two years and up to five years, only two annual remunerations are to be paid, regardless of when the contract is terminated.

2.4. Legal Classification of the Recommendation

To better understand the legal basis of the above recommendation, we must consider the two separate legal relationships that are at play between the stock corporation and a member of the

executive board (cf. Hüffer and Koch 2016, § 84 AktG para. 2). The first legal relationship involves the establishment of an employment contract: At the level of the law of obligations, the supervisory board, as the representative of the stock corporation pursuant to § 112 AktG, agrees to an employment contract with the future executive board member, whereby this contract is limited to a maximum of five years pursuant to § 84 (1) sentence 1 and sentence 5 AktG in conjunction with § 611 BGB (German Civil Code). This agreement may be extended beyond the initial five years to a maximum of another five years and so on pursuant to § 84 (1) sentence 2 and sentence 5 AktG. The second legal relationship at play is that of a corporate appointment: In addition to agreeing on the employment contract, the supervisory board also appoints the future member of the executive board to be part of this board for a maximum term of five years, in accordance with § 84 (1) sentence 1 AktG. The supervisory board can again repeat the appointment or extend the term of office beyond the initial appointment to a maximum of another five years and so on pursuant to § 84 (1) sentence 2 AktG.

These two legal relationships – the employment contract and the corporate appointment – are particularly important in the event of premature termination of the contract at the request of the stock corporation. The employment contract can generally only be terminated without notice for an "important reason" as outlined in § 626 (1) BGB. Similarly, the appointment can only be revoked for an "important reason", but the definition of "important reason" in this case is pursuant to § 84 (3) sentence 1 AktG. The definitions in the BGB and the AktG are not identical (described in detail below). Further, pursuant to § 84 (3) sentence 4 AktG, the revocation of the appointment is effective until it has been legally determined to be invalid.

Both the BGB and the AktG use the same wording of "important reason" for early termination, but the two elements have different scopes. In any case, there are high standards to be met to achieve the required threshold. For example, an entrepreneurial failure does not meet this requirement. To terminate an employment contract according to § 626 (1) BGB, an important reason exists if, even when accounting for the circumstances of the individual case and weighing the interests of both contractual parties, certain facts make it unreasonable to expect that the terminating party should continue the employment relationship until its agreed termination. By contrast, to terminate an appointment according to § 84 (3) sentence 1 AktG, an important reason exists if "the continuation of the relationship between the members of the executive bodies until the end of the term of office is unreasonable for the stock corporation" (Hüffer and Koch 2016, § 84 AktG recital 34). § 84 (3) AktG mentions as important reasons a gross breach of duty, an inability to conduct business properly, and the withdrawal of confi-

dence at the annual general meeting. However, dissent about the strategic orientation of the company is not an important reason justifying the termination of the appointment (cf. Hüffer and Koch 2016, § 84 AktG recital 36).

An important reason for terminating the employment contract pursuant to § 626 (1) BGB is always also an important reason for revoking the corporate appointment pursuant to § 84 (3) sentence 1 AktG, but the reverse is not always true. This results in the following possible scenarios. If there is obviously an important reason for termination according to § 626 (1) BGB, then both the employment contract and the appointment end without payment of a compensation. However, if no important reason pursuant to § 626 (1) BGB is found or its existence is uncertain, the employment contract remains enforced, because in this case the supervisory board cannot unilaterally terminate the employment relationship prematurely (cf. Bayer and Meier-Wehrsdorfer 2013, p. 483). An contractual agreement of the right to premature termination upon conclusion of the executive board employment contract would constitute an inadmissible circumvention of § 84 (3) sentence 1 AktG because the executive board member would have to resign from this board without important cause after termination of the employment contract by the stock corporation (cf. Hoffmann-Becking 2007, p. 2106).

Therefore, when *pacta sunt servanda* applies, meaning the employment contract remains intact, the executive board member remains entitled to remuneration until his or her employment contract is terminated normally, as long as he or she continues to work or offers his or her work to the company, who must accept it by default. Nonetheless, the next question to ask is whether an important reason exists for revoking the appointment pursuant to § 84 (3) sentence 1 AktG. In this case, the stock corporation may revoke the appointment and give the former member of the executive board other tasks. Finally, if no important reason is found pursuant to § 84 (3) sentence 1 AktG or if its existence is uncertain, then both the employment contract and the appointment continue to exist. When an employment contract remains intact, the supervisory board may only enter into a termination agreement with the executive board member if both parties agree on the terms, including the amount of severance payment. In this respect, earlier agreements made in the employment contract are not binding (cf. Bauer and Arnold 2008, p. 1694).

Section 4.2.3 (4) sentence 2 GCGC stipulates that in the event of termination in accordance with § 626 (1) BGB no severance payment is paid at all (cf. Hoffmann-Becking 2007, p. 2105). This is according to the law. However, if there is no important reason for termination the GCGC recommends to limit the severance payment although the company cannot do this

unilaterally. Moreover, a severance payment cap cannot be effectively agreed on at the beginning when an executive board member's contract is concluded.

The recommendation is also in conflict with the German Stock Corporation Act (AktG), whereby, pursuant to § 84 (3) sentence 1 AktG, the corporate appointment of an executive board member can be revoked only for an important reason in order to protect the statutory independence of the executive board member pursuant to § 76 AktG for the duration of the appointment. Under this protection, which is mandatory (cf. Lutter 2009, p. 1874; Bauer and Medem 2014, p. 238), the executive board member has the freedom to make medium- or long-term decisions. However, the recommendation presupposes the possibility that an executive board member can be prematurely terminated (cf. Bauer and Arnold 2008, p. 1694; Lutter 2009, p. 1874; Hüffer and Koch 2016, § 84 AktG recital 34), which is only possible with his or her consent that could cost more than the recommended severance payment.

2.5. Corporate Governance Classification

Regarding the effect of regulations on corporate governance, one can derive a four-field matrix from Axel von Werder's definition of corporate governance by distinguishing between the legal and factual effects of regulations and between internal and external effects of regulations. When using this matrix to classify companies' reporting of their compliance with severance payment caps, the following becomes apparent: While the recommendation's corporate governance regulation on the upper limits of severance pay can only have a purely factual internal effect, the obligation to report this information has a legal effect both internally and externally. Internally, the executive board and the supervisory board are required by law to report this information by submitting a declaration of conformity. The external legal effect is that not submitting a declaration of conformity entails sanctions. Another potential external effect arises because the reporting obligation also provides this information to the capital market and the wider public. However, it is uncertain whether participants of the capital market actually react to this information by using it in their decisions to buy or sell shares.

3. Empirical Studies

Section 3.1 describes the objects and methods of analysis. Section 3.2 contains the results, where Subsection 3.2.1 reports results on the declarations of conformity for all CDAX companies and Subsection 3.2.2 gives the severance ratios in the case of severance payments to members of the executive board in DAX companies.

3.1. Objects and Methods of Analysis

We examine both the annual declarations of conformity of all CDAX companies and the actual severance amounts received by executive board members of DAX companies, and we also assess the relationship between the actual severance amount and the respective annual remuneration. Through a full survey, we examine the declarations of conformity of all companies listed on the CDAX in 2010 to 2014. The CDAX index consists of all German companies listed in the Prime or General Standard segment of the Frankfurt Stock Exchange on the respective reporting date (cf. Deutsche Börse AG 2018, p. 20). The declaration of conformity is examined to determine whether the company declared compliance or non-compliance with the recommendation. If a deviation was explained, the reasons for the deviation are also researched and documented.

To systematise the reasons for deviations, which can help point to possible improvements that would increase compliance with the recommendation, we use a concept introduced by Horst Steinmann. It suggests to distinguish between the question of legitimation, regarding the interests that determine an enterprise's objectives and policies, and the question of organisation, regarding the design of the formal structure of the enterprise to conform with the different interests of the enterprise owners and management (cf. Steinmann 1969, pp. 1 et seq.). Specifically, we distinguish between whether the reason for the deviation was that the general concept of a severance payment cap was not in the interests of the company (normative dissent) or whether the reason was organisational, meaning that the legal implementation was inadequate (organisational dissent). Organisational dissent occurred either when companies considered the existing recommendation to be insufficient or when they achieved a severance cap by other means (see Table 1).

If companies gave several reasons for their deviation, they are only taken into account on a *pro rata* basis. As the investigation is based only on the grounds described above, we cannot exclude a bias due to the fact that a company may not have stated their actual reasons for deviation.

Reason for the deviation	Relationship to the other type of dissent
Normative dissent: general cap not wanted	Organisational implementation is not applicable
Organisational dissent: existing recommendation inadequate	Normative dissent may exist at the same time (open question)
Organisational dissent: result achievable through other measures	No normative dissent: acceptance of the caps designed by the supervisory board

Table 1: Distinctions According to Steinmann

Subsequently, for cases in which members of the executive boards of DAX companies left the company prematurely, we examine the amount of severance pay, the respective relationship between severance pay and annual compensation and the content of the previous and subsequent declarations of conformity. The aim of the analysis is to gain insights into the actual internal impact of the regulatory instruments in two directions. For the first direction, we examine whether companies that had declared their compliance with the recommendation actually complied with the caps in the event of premature termination of the contract. To do this, for each case of premature termination of an executive board member's appointment in a DAX company between 1 January 2010 and 31 December 2014 without an important reason according to the law and at the request of the company, we establish the relationship between the severance payment and annual remuneration and we compare this with the requirements of the recommendation. Then, we compare each company's declaration of conformity with their actual compliance or non-compliance with the recommendation. For the second direction, we examine what impact arose in the next declaration of companies who had previously exceeded the severance cap described in the recommendation.

3.2. Research Findings

3.2.1. Declarations of Conformity of the CDAX Companies

Table 2 shows the number of companies that were listed in the CDAX on the reporting date. After removing the 7 companies in 2014 that left the CDAX during the course of the year, we calculate the number of companies subject to disclosure requirements. We then deduct from this the number of companies that did not issue a declaration of conformity to determine the adjusted population of all CDAX companies with declarations of conformity (see Schottmüller-Einwag 2018, p. 49).

	2010	2011	2012	2013	2014
Reference date	30.12.2009	03.01.2011	02.01.2012	02.01.2013	02.01.2014
Total share classes in the CDAX	624	595	571	530	497
– Number of companies with multiple quotations of different share classes	24	24	23	21	19
= Number of companies in the CDAX	**600**	**571**	**548**	**509**	**478**
Companies with declaration obligation	600	571	548	509	471
– Number of companies that did not make a declaration or whose declaration was not found	160	132	122	97	81
= Adjusted population	**440**	**439**	**426**	**412**	**390**

Table 2[1]: Adjustment of the Basic Population

Using the number of companies in the adjusted basic population, Table 3 shows the percentages of the companies that declared compliance, declared grandfathering, or declared deviations regarding severance payments caps to members of the executive board.

	2010	2011	2012	2013	2014
Declaring compliance / adjusted population	64.5%	65.4%	67.1%	67.5%	69.2%
Declaring grandfathering / adjusted population	5.0%	3.6 %	2.3%	2.4%	1.5%
Rate of deviation 1: declaring deviation from 4.2.3 (4) sentence 1 GCGC / adjusted population	27.0%	27.3%	26.8%	26.5%	24.6%
Rate of deviation 2: declaring deviation from all recommendations / adjusted population	3.4%	3.6%	3.8%	3.6%	4.6%
Rate of deviation 3: (rate of deviation 1 + rate of deviation 2) / adjusted population	30.4%	30.9%	30.6%	30.1%	29.2%

Table 3: Proportion of CDAX Companies Declaring Compliance, Grandfathering, or Deviation

The rate of compliance rose slowly from 64.5% in 2010 to 69.2% in 2014. As expected, the rate of grandfathering fell slowly from 5% in 2010 to 1.5% in 2014. The rate of deviation 1, which is the rate of all CDAX companies that deviate from recommendation 4.2.3 (4) sentence 1 GCGC in relation to all CDAX companies with a declaration of conformity, was well over 20% in the period under review. Even if this rate is seen as the result of a stochastic process, there are low error probabilities that the deviation is not over 20%, as shown in Table 4.

[1] Tables 2-6 and 8-10 are used with the permission of Springer Nature Customer Service Centre GmbH: Springer Fachmedien Wiesbaden GmbH, "Abfindungsobergrenzen für Vorstandsmitglieder: Wirkungen der DCGK-Empfehlung" by Ute Schottmüller-Einwag (2018).

	2010	2011	2012	2013	2014
Probability of error for $p \leq 0.2$	0.015%	0.009%	0.030%	0.062%	1.097%

Table 4: Probabilities of Errors for $p \leq 0.2$

Therefore, the recommendation under review is an "extremely critical" recommendation, because significantly more than 20% of all CDAX companies stated in their declaration of conformity that they do not comply with it.

Considering just the 30 DAX companies, Table 5 shows the percentages of these companies that declared compliance, grandfathering, or deviation.

	2010	2011	2012	2013	2014
Declaring compliance / adjusted[2] population	70.0%	73.3%	76.7%	73.3%	80.0%
Declaring grandfathering / adjusted population	10.0%	10.0%	6.7%	6.7%	3.3%
Deviation rate 1: declaring deviation of 4.2.3 (4) sentence 1 GCGC / adjusted population	20.0%	16.7%	16.7%	20.0%	16.7%
Deviation rate 2: declaring deviation of all recommendations / adjusted population	0.0%	0.0%	0.0%	0.0%	0.0%
Deviation rate 3: (rate of deviation 1 + rate of deviation 2) / adjusted population	20.0%	16.7%	16.7%	20.0%	16.7%

Table 5: Proportion of DAX Companies Declaring Compliance, Grandfathering, or Deviation

For the CDAX companies that declared deviations to the recommendation, their reasons for deviation are shown in Table 6. As can be seen, the most frequently cited reason in 2010 was "maximum scope for negotiation by the supervisory board and confidence in the supervisory board's decision in individual cases". In the years 2011 to 2014, the most frequently given reason was that the "legal validity of the provisions in the employment contract are questionable". Taken together, legal concerns represent one-quarter of all responses. More infrequent responses included the claims that existing contractual arrangements are sufficient without time limits and that a short contractual period between two and three years provides sufficient protection; "other reasons" were also cited. Interestingly, between 4% and 8% of the deviating companies did not justify their deviation, despite their obligation to do so.

[2] Since the declarations of conformity of all 30 DAX companies are available, adjusted and unadjusted quotas are identical for this group.

Content	2010	2011	2012	2013	2014
N	119	120	114	109	96
Legal validity of the provisions in the employment contract are questionable	15.8%	18.1%	18.1%	17.3%	17.5%
Regulations contrary to the legal nature of a fixed-term contract	9.9%	8.5%	8.0%	9.0%	11.3%
Regulations do not suit the partnership limited by shares	1.7%	1.7%	1.8%	0.9%	1.0%
Regulations inappropriate	4.2%	4.2%	4.4%	3.7%	2.1%
GCGC regulation restricting severance pay to two years is inappropriate	4.6%	6.3%	5.7%	5.5%	6.3%
GCGC regulation on limiting severance payment to remaining term is inappropriate	2.1%	1.7%	1.8%	1.8%	2.1%
Legal regulations offer sufficient protection	1.7%	1.7%	4.4%	2.8%	4.2%
Existing contractual arrangements offer sufficient protection	10.5%	8.5%	9.5%	14.5%	14.4%
Short contract term of a maximum of two years offers sufficient protection	4.2%	2.9%	2.6%	1.8%	2.1%
Short contract term of two to three years offers sufficient protection	8.0%	9.6%	8.8%	8.7%	6.8%
Maximum scope for negotiation by the supervisory board and confidence in the supervisory board's decision in individual cases	17.1%	17.7%	16.1%	16.5%	16.1%
Competition considerations regarding the labour market for board members	3.4%	2.5%	3.1%	0.9%	1.6%
Other	10.1%	8.3%	9.6%	10.1%	10.4%
Without giving a reason	6.7%	8.3%	6.1%	6.4%	4.2%

Table 6: Reasons Given for Deviating from the Recommendation

We then categorise the reasons for deviation according to Steinmann, shown in Table 7. Overall, the types and numbers of reasons given show that the companies examined the recommendation in a very detailed and differentiated way. During the investigation period, the percentages in each category were relatively constant. Normative dissent was used to justify at least one-third of all deviations, which corresponds to approximately 9% of all companies that issued a declaration of conformity. Next, organisational dissent in the form of shortcomings in the existing recommendation was used to justify one-quarter of all deviations. About one-fifth of all companies justified their deviation by the other organisational reason, namely

that a cap can be achieved by other measures such as shorter contract terms for executive board members.

Normative dissent: general cap not wanted	35.3%	37.1%	38.2%	33.0%	36.5%
Organisational dissent: existing recommendation inadequate	25.6%	25.8%	26.3%	26.6%	28.6%
Organisational dissent: result achievable through other measures	23.1%	21.3%	20.6%	23.9%	20.3%
Other / without giving a reason	16.0%	15.8%	14.9%	16.5%	14.6%

Table 7: Reasons for Deviation Categorised According to Steinmann

3.2.2. Severance Ratios of DAX Companies

Of the 117 cases where executive board members left DAX companies between 1 January 2010 and 31 December 2014, there were 25 in which executive board members were terminated prematurely with severance pay at the request of the company. Descriptive statistics for these cases are shown in Table 8.

	Number of cases	Minimum	Maximum	Mean	Standard Deviation
Annual remuneration in millions of euros	25	1.161	10.443	3.415	2.211
Severance payment in millions of euros	25	0.980	30.043	6.662	6.250
Remaining term of the employment contract in years	23[3]	0.250	4.750	2.344	1.328

Table 8: Descriptive Statistics for Premature Terminations of Executive Board Members from 2010 to 2014

In the group of 25 severance cases involving premature departure of an executive board member at the request of the company, the average severance payment amounted to 6.6 million EUR, the average annual remuneration was 3.4 million EUR and the average remaining contract term was 2.3 years. For the 23 transparent cases, the severance ratios were determined and compared with the upper limits of the recommendation. The severance payment

[3] In two cases, information about the regular duration of the contract was missing.

ratio is calculated as the sum of severance payments and pension payments for the period after the end of the appointment divided by the sum of annual remuneration and pension contributions. Only pension contributions paid are taken into account but not provisions. The number of companies that actually complied with and actually deviated from the recommendation is shown in Table 9.

	Declaration of conformity	**Declaration of deviation**
Actual compliance	9	1
Actual deviation	12	1

Table 9: Actual Compliance and Deviation of Severance Cases from 2010 to 2014

Figure 1 shows the caps recommended in the GCGC and the severance ratios of the 23 cases with complete data. The text for each data point contains the company name, the name of the departing member of the executive board, the year of departure and the severance payment ratio. Severance cases where compliance was declared and the upper limit was actually complied with are marked with a square, and the one where deviation was declared but the upper limit was complied with is marked with a triangle. Severance cases in which the upper limit was exceeded despite the declaration of compliance are marked with a diamond, and the one which exceeded the upper limit after the declared deviation is marked with a circle. These data show that in the ten cases where the cap was observed, nine observed the cap while declaring compliance, and one actually observed the cap despite having declared deviation. In the 13 cases where the recommended cap was exceeded, 12 exceeded the cap even though they had declared compliance, and one exceeded the cap while declaring a deviation. Thus, in 12 of the 21 severance cases – amounting to 57% – the cap was exceeded even when the companies had declared that they complied with the recommendation.

The data do not indicate that companies changed their severance payment amounts over time in the period under review to more closely approximate compliance. Since some companies nevertheless complied with the cap, this may be because of other factors related to low opportunistic behaviour, previously systematized by Werder (cf. Werder 2009, p. 11), such as general factors related to a company's governance atmosphere and culture or individual factors related to the personality and values of the departing executive board member. Such factors may strongly affect whether requirements are voluntarily met.

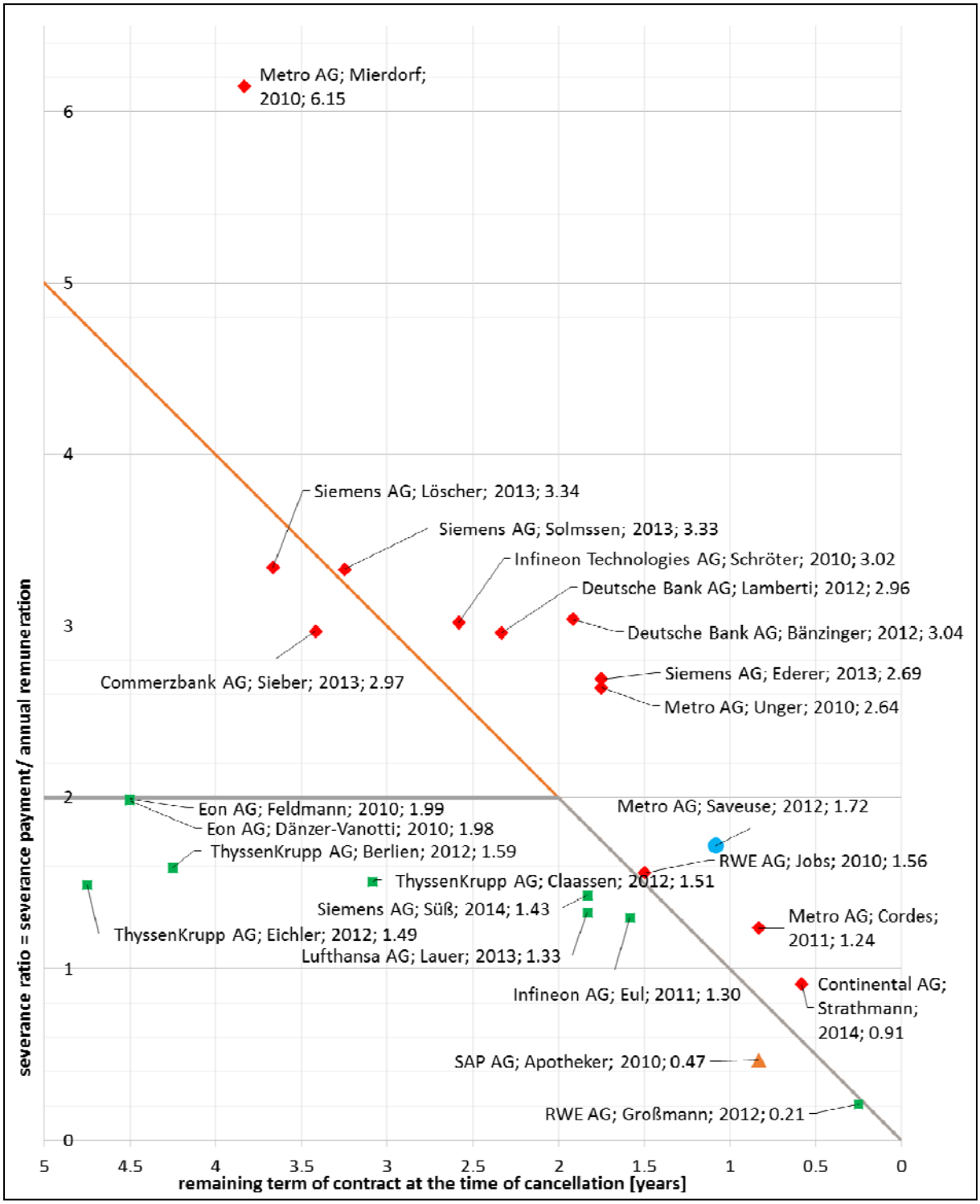

Figure 1[4]: Results of the Case Studies

While some companies met the cap recommendation, others did not. Specifically, the 57% that exceeded the recommended cap but then declared conformity should be analysed in de-

[4] The figure is used with the permission of Springer Nature Customer Service Centre GmbH: Springer Fachmedien Wiesbaden GmbH, "Abfindungsobergrenzen für Vorstandsmitglieder: Wirkungen der DCGK-Empfehlung" by Ute Schottmüller-Einwag (2018).

tail. Looking at the deviant companies' behaviour patterns, all 13 companies that exceeded the caps in their severance cases (12 declared conformity but one declared deviation) declared conformity in the following year. In these following-year declarations of conformity, all but one failed to mention the severance cases at all in the part of the declaration for describing past activities. The one exception, Siemens AG (2013, p. 124), declared for the year 2013: "The agreements concluded with Mr. Löscher and Ms. Ederer on the occasion of the premature termination of their executive board activities provide for severance payments that do not exceed the value of two years' compensation. In addition, further benefits were agreed with Mr. Löscher and Ms. Ederer that are not to be regarded as severance pay within the meaning of section 4.2.3 (4) sentence 1 of the Code. In particular, Mr. Löscher has committed himself to a two-year post-contractual non-competition clause. Details of the agreements will be set out in the Remuneration Report, which is part of the Annual Report 2013". Although further payments are mentioned here, they are definitively distinguished from severance payments. From these results, it can be concluded that exceeding the recommended caps has no effect on the following declaration. The declarations of conformity we examined deliberately signal that companies are declaring compliance with the recommendation but are not actually complying with it.

4. Discussion of the Results

The adjusted ratio of all CDAX companies declaring conformity rose from 64.5% to 69.2% between 2010 and 2014. Both the numbers and their development raise two questions: First, are these values high enough that researching this particular recommendation is unnecessary? One way to check is to compare companies' compliance rates for the specific recommendation of interest (in this study) with companies' general compliance rates for all recommendations mentioned in the literature. To do so, in Table 10 we show the average percentage of recommendations that DAX companies declared conformity for over the years 2011 to 2015, which was determined by the Center for Corporate Governance of the Leipzig Graduate School of Management.

Table 10 shows that the DAX companies have declared that they comply with more than 97% of all recommendations. However, only 70% to 80% of all DAX companies declare their conformity with this particular recommendation (see Table 5). Thus, the recommendation is one of the least followed recommendations of the Code, and it seems relevant to discuss its relatively low acceptance by companies.

Year	Percentage of declared conformity to recommendations by DAX companies	Reference
2011	98.1%	Kohl et al. 2012, p. 4
2012	97.7%	Kohl et al. 2013, p. 4
2013	97.4%	Kohl et al. 2014, p. 4
2014	97.4%	Kohl et al. 2015, p. 4
2015	97.5%	Beyenbach et al. 2016, p. 4

Table 10: Percentages of Declared Conformity by DAX Companies 2011 to 2015

The second question that arises is whether the share of companies declaring conformity will continue to grow such that compliance with the recommendation will eventually not be critical. However, most increases in the percentage of companies declaring conformity are attributable to companies with grandfathering arrangements. This means that the compliance rate is unlikely to increase much further in the future once the last companies have replaced their grandfathering arrangements with compliance. Thus, the percentage of companies declaring conformity will probably remain stable at around 70% in the future. Although deviation rate 1 decreased slightly in the period under review, it was well above the critical value of 20% and will probably also remain critical in the future.

Approximately 9% of all companies issuing a declaration of conformity consistently explained that they deviated from the recommendation based on normative dissent. This raises the question of at what approval level a recommendation can be considered "best practice" or "internationally and nationally accepted standard of good and responsible governance". Probably this recommendation "is at best a formulation of what, according to the subjective ideas of a majority of members of the government commission, would be good governance" (cf. Krieger 2012, p. 211). Since there is no theoretical foundation for what good corporate governance means, this is still an open question.

Of the companies who declared deviation, one quarter of all deviations was attributed to organisational dissent based on shortcomings in the current recommendation. This finding coincides with the analysis of the recommendation in Section 2.4, which concluded that it had no legal standing, and shows that these companies analysed the recommendation in a differentiated way. In Chapter 5, we offer some proposals on how this legal inconsistency can be reduced in order to increase the acceptance of the recommendation.

For the companies that declared compliance and had a severance case in play, only 43% respected the cap. In the majority of cases, therefore, issuing the declaration of conformity did not limit the actual amount of the severance payment to be within the cap. Thus, as a large discrepancy exists between corporate governance reporting and actual behaviour, the relevance of reporting as a decision-making aid for capital market participants is questionable. It is also worth mentioning the 9.4% of cases where executive board members left companies but the data were incomplete, such that compliance with the cap could not be determined. In 9 of these 11 cases, the severance amount was not known, which may have occurred for two possible reasons: Either the companies consciously or unconsciously imprecisely prepared the annual report, or they made use of their right to opt-out, pursuant to Section 286 (5) HGB, whereby the annual general meeting can agree to the opt-out with a majority of at least three quarters. Other information missing in two cases was knowledge of the regular duration of the contract.

An important limitation of this investigation is that the statements were only examined for one recommendation. A generalisation of the results to other GCGC recommendations is therefore inadmissible. Also, we restricted the case studies to those of premature termination of employment contracts for executive board members of DAX companies. Knowing the severance ratios of executive board members in companies not listed in the DAX but in the TecDAX, MDAX or SDAX would also be of great interest.

5. Conclusion and Recommendations

The corporate governance issues examined in this article can be classified into three layers on the basis of Steinmann's distinction. The inner layer deals with companies' normative decisions on how to reconcile the interests of the parties involved within the companies with the system of values represented within the framework of the current legal system. The middle layer relates to companies' decisions on how to legally and practically implement the values of the inner layer. As an outer layer, companies' behaviours, which reflect decisions related to the first two layers, appear in corporate governance reporting. Regarding the amount of severance payments to the members of the executive board, companies' decisions to follow (or not) the caps of the recommendation are part of the inner layer. The aim of this recommendation was to strengthen the shareholders' interests in relation to resigning members of the executive board. The deficient legal implementation discussed in detail in Section 2.4 represents the middle layer, while the annual declarations of conformity are part of the outer layer. If there is

an impairment or disturbance in the inner layer, it affects the middle and outer layers by reducing or destroying the effectiveness of the instruments in the outer layers. For the recommendation examined, this deficit is often described in the literature. The recommendation was introduced with a "compromise character" and as "imperfect" (Bachmann 2018, recital 1020). This insight is also reflected in numerous assessments from academia and practice, some of which openly deny that this regulation has any limiting effect. For example, the recommendation was described as "imperfect" (Lutter 2009, p. 1875; Bachmann 2018, recital 1025), as a "non-binding declaration of intent" (Mayer-Uellner 2011, p. 2; Bayer and Meier-Wehrsdorfer 2013, p. 483), as "not very effective" (Evers 2009, p. 373), and as a "pure marketing instrument" (Weiß 2011, p. 90). These difficulties associated with the recommendation also render corporate governance reporting with the aim of influencing the decisions of capital market participants ineffective. Thus, corporate governance reporting stands and falls with the quality of decisions made in the inner and middle layers. In summary, we conclude that during the period under review, although reports were made diligently, the recommendation was frequently not complied with, and this reality was not presented in the reports.

In the following, we make recommendations for the middle and outer layers, and we do not address the inner layer question of whether a cap is better suited to the interests of the parties involved than the current legal regulation. Rather, we assume that an effective cap should be implemented. To this end, the recommendation should be amended as follows: "When termination agreements are made with Management Board members, it shall be ensured that payments, including fringe benefits, made to a Management Board member due to early termination of his or her contract do not exceed twice the annual remuneration (Severance Cap) and do not constitute remuneration for more than the remaining term of the employment contract". The aim is to use corporate governance instruments to regulate the situation in such a way that effective monitoring and enforcement structures are available for incomplete contracts in the event of severance. The company will only declare conformity or deviation if a termination agreement has actually been concluded. If there is no premature termination of an executive board member's contract during the reporting period, the recommendation is not applicable.

The proposed solution would provide both companies and the government commission with an effective regime that has a high degree of flexibility. Companies would have the possibility to deviate from the recommendation and give higher severance payments in cases where they are legitimate. In this way, the supervisory board could change the balance of interests generally regulated in the recommendation in individual cases, but it would have to state this in the

following declaration. Further, the government commission could quickly adapt the recommendation to changes if necessary. The proposed amendment to the Code should be accompanied in the GCGC or the AktG by a definition of severance pay and a distinction between severance pay and other payments. This would bring more clarity to all participants, because in practice there are many kinds of compensations that are not described as severance (cf. Steltzner 2007, p. 11). The proposed amendment would enhance the currently worthless reporting on the recommendation, as a statement on this recommendation would only be made in the event of severance pay and would contain information on the actual severance ratio.

Another important aspect of corporate governance reporting on the recommendation is that it must enable the capital market to monitor compliance with the caps. To this end, companies should be required by law to publish the executive board members' terms of appointment in the annual report. In addition, both the individualised compensation and the individualised severance payments should be presented in a standardised manner in the annual report in order to make increasingly complex compensation and severance payment systems comprehensible (cf. Bayer and Meier-Wehrsdorfer 2013, p. 487). This would make the comply-or-explain mechanism work for this recommendation by making the actual behaviour transparent in the declaration, at least within the following year. Even knowledge of the mandatory transparency would presumably have a disciplining effect on the supervisory board. The currently inefficient declarations of conformity with the recommendation under consideration would eventually become important because they would explain that the recommended caps had actually been complied with. In this case, corporate reporting would also correspond to the reality of the issue under investigation and could therefore fulfil its function as an information and decision-making basis for capital market participants.

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