MANAGERIAL GOVERNANCE IN STOCK COMPANIES

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On the managerial obligations of the administrators of a German stock company with particular reference to issues of organisational law of modern corporate law.

Abstract: Major corporate scandals in the recent past have shown that the question of the supervisory responsibility of the public limited company concerns a problem area that is of great practical importance. Stock corporation law assumes the management competence of the executive board and the supervisory competence of the supervisory board. However, while the executive board comprises full-time members, the supervisory board mandate is only exercised in a "part-time" capacity. Because of this limited capacity of the supervisory board, the author explores the question of how to compensate for this control deficit.

Keywords: Control responsibility, Supervisory board mandate, Departmental responsibility, Obligations of conduct.

Introduction

The stock company law in the foreground for large corporations is characterised by a detailed definition of the functions and competences of the bodies acting within the company organization [1] which can be described as a system of distribution of power [2]. The executive board adopts the primary leadership task and carries the primary responsibility for the company sustaining its market presence. It forms the nexus of corporate leadership and power for the stock company at which all the threads of the company organisation converge [3]. In this, the statutory guiding principles of the executive board are characterised by the concepts of a collegiate body with a community of members, common management and agency and common responsibility [4]. Corporate practice generally differs from this due to the complexity of company leadership. Today's predominant divisional organisation leads to departmental independence and isolated departmental responsibility which only corresponds to the statutory guiding principles of the executive board in a limited way [5]. Ultimately, it is not seldom the case that an individual department encompasses an area of responsibility that effectively represents a company within the whole company [6]. The executive board is like an "orchestra of soloists being directed by the president of the board as conductor“, and ultimately this restructuring of the executive board leads to division of the board into different responsibility holders, each governed by their own legal fate [7]. This individual fate is linked on the one hand by an assignment of responsibility to the department leader in each case and by a discharge of responsibility from the other board members on the other [8].

Along with that, there arises a responsibility to the supervisory board which is not restricted to overseeing the leadership actions of the board and supporting the board, but could also adopt an entrepreneurial quality in the form of an obligation to pass an opinion and taking effective actions [9]. The most important task of the supervisory board is, however, selection of suitable candidates for the board, [10] and in setting the board remuneration, aligning the stimuli in the remuneration structure to sustainable and long-term company leadership [11]. This is because business leaders who focus their actions on achieving short-term goals, primarily the rise in share values, lose sight of sustained company growth. It is obvious that those who manage *other people's money* and receive bonuses related to deadlines without being involved in any subsequent worsening of the parameter, are “more prepared” to take irresponsible risks. This “behaviour control” of some managers recently led to the foundations of the finance market being shaken and having to be held on course by state assistance at the cost of the taxpayer.

The responsibility for liability of the members of the management of a share company for leadership and governance measures has been a focus of debate in stock law, not least due to recently discovered criminal activities like organised fraud or international corruption of leading DAX companies. Prime examples of this “organised law-breaking” were the diesel exhaust scandal, the involvement of Deutsche Bank in dubious mortgage business in the USA and the resulting actions for tens of billions by the US Justice Department and currently the events at Wirecard AG, which announce insolvency on 25th June 2020 after it became known that 1.9 billion Euro were “missing”, and which even shook the state financial supervisory authorities. These events made it clear that corporate governance of German businesses is still not good enough to prevent existential aberrations.

Corporate Governance

Presentation of the Problem

Qualification, independence and time requirement of supervisory board members

One of the most important tasks of the supervisory board is the continuous monitoring of business leadership. To ensure effective monitoring, the supervisory board must have a comprehensive picture of the situation and development of the business [12]. However, along with appropriate information from the board, this monitoring task of the supervisory board requires sufficient sector-specific qualification, dedicated time and attentiveness of the supervisory board. If the supervisory activity is to avoid erroneous leadership decisions due to incorrect, incomplete or wrongly interpreted grounds for a decision, the supervisory task will require necessary knowledge and understanding of the critical success factors of the company, e.g., in relation to the sector and the markets in which the business operates, its competition position and in relation to the company culture and leadership style. Only a "full-time" supervisory board could meet this demand. By contrast, the supervisory board mandate is in many respects legally time restricted. Together with the limitation of period of office in general, the generally little timeframe within which the mandate is exercised should also be considered [13]. In respect of the time frame of the supervisory board mandate, the legislation apparently also assumes, as can be seen in § 110 Abs. 3 AktG [company law], that consultations within the supervisory board only require little time. Consequently, it is indisputable, even if one includes the preparation time and any interim supervisory board activities, that this mandate is only a subsidiary office that does not require any input as a main professional role and thus is only occasionally carried out. However, if there is therefore only a limited capacity for governance, it is irresponsible to try to control e.g., a multi-area concern with a turnover of tens of billions in three to four meetings per year, each lasting only a few hours [14], especially as co-determination has not only led to an expansion of the governance committee which negatively affects efficiency but also to a flattening of the supervisory activity [15]. This control deficit is also confirmed by the fact that the supervisory board lacks the organisational foundation to ensure efficient and continuous supervisory activity [16]. Nor can it be argued that there are differences in the organisation and the efficiency of the supervisory board activity [17], as ultimately the legal organisational profile and legally advised amount of work and the supervisory board insight prevailing in practice are critical to assessing efficiency [18].

In respect of the personal requirements for supervisory board members it should be noted that the number of supervisory board meetings has sometimes risen considerably, especially in view of the demanding full-time professional activity of many mandate holders, which gives rise to the fear that it might not be possible to dedicate sufficient time to the office of the supervisory board [19]. Furthermore, it can be invoked for the failure of supervisory boards that supervisory board members, along with the minimum general, economic, organisational and legal knowledge, often do not have the required specialist knowledge for governing business leadership or advising the business leaders especially in times of crisis [20].

Result

The outcome of this is that the concentration of leadership governance with the supervisory board is incompatible with the limited material and personnel resources available to the supervisory board. It is much more that case that the supervisory board control should be primarily or additionally entrusted to another body due to the fundamental importance of company governance for business success and due to the time limitation of the supervisory board mandate and often lacking personal qualification of the supervisory board members and the associated lack of efficiency and completeness of the supervisory board control. As the annual general meeting would be over-burdened by it, only the executive board can be considered. The executive board has all the material and personnel resources to carry this kind of corporate governance [21].

The upstream governance responsibility of the executive board

The obligation of mutual supervision

Where a board member is assigned a specific task area as part of the department distribution, the other board members are relieved of a comprehensive responsibility for the area of work concerned. Nonetheless, all board members remain responsible as a consequence of the collective responsibility for the legality and expediency of the whole business operation [22]. They must maintain a running overview of the correct running of the other departments and intervene immediately, or apply the intervention law if necessary as soon as there is reason to think a board member has not fulfilled his or her duties [23]. Board members have to respond to data and information of all kinds that indicate a serious issue in another department [24], and if necessary, seek certainty through targeted questioning of board colleagues or employees or by random sampling checks [25].

Trust and mistrust amongst board colleagues

The Companies Act contains nothing about the extent of the supervisory duties of the individual board members. Organisational, task and personal parameters must be used to specify the intensity of monitoring

[26]. In the context of the company organisation, higher demands of monitoring quality can be made in a divisional organisation than by a functional business distribution due to the independently acting business areas. Another starting point is represented by the importance of the tasks assigned [27]. The more important a task is for the success or failure of the company, the higher the requirements of the level of monitoring of the board colleagues should be set. Finally, circumstances in the actual person of the board member concerned can affect the intensity of his or her colleagues [28]. The shorter a board member has been performing the tasks assigned to him or her, the higher the requirements for the intensity of monitoring. Conversely, the monitoring requirements are less if there is a proven long-standing work record, where blind trust is however never appropriate [29].

Scope of the duty of mutual supervision

If there is no indication of careless business leadership, there is no specific need for action for the individual board member in relation to the supervision of the neighbouring department so that governance of the neighbouring department is configured as a pure check of outcomes in the normal processes of business practice [30]. However, the individual board member does not meet his or her monitoring duties merely by being informed at meetings of the full board about the activities and events in the other business areas [31], as it often depends on a board member themselves whether his or her department is involved in relevant questions in a meeting of the whole board or not [32]. Mere “laissez faire“ does not suffice [33]. Every individual board member must always ensure that the reporting of the board colleagues does not omit any significant areas, shows the required transparency and plausibility, is made on time and that the necessary decisions on issues of fundamental importance are made on the basis of sufficient information obtained promptly by the whole board [34]. If these requirements are not met, measures identifiable as necessary are inadequately carried out, or delayed, or if there is significant worsening of the profit situation, not typical for the sector, this justifies a duty of intervention for the other board members [35].

Procedural obligations

If a board member identifies deficits in the departmental management of a board colleague that cannot be clarified by a discussion with the departmental owner concerned, it will be necessary to involve the other board colleagues in the decision. If a difference of opinion cannot be settled in this manner, then it must basically be brought before the full board for a binding decision [36]. In serious events [37] that cannot be resolved even by being dealt with by the full board, there is a duty of the Chair of the board or board spokesperson to report it to the supervisory board and request an attempt at mediation from them. The other board members are only obliged to also inform the supervisory board if this duty is not fulfilled are the other [38]. The supervisory board cannot, however, be empowered to decide differences of opinion in the executive board bindingly [39], as this would be acting executively contrary to § 111 Sect. 4 Paragraph 1 AktG [company law]. The supervisory board can however raise the prospect of recall of a board member [40] or ultimately actually carry this out to restore the necessary unity of the board in the interests of the company [41]. The disadvantage bound up with this is that the working climate in the board is significantly affected but this must be accepted in considering all the relevant circumstances [42]. Götz [43] correctly points out that objections of the management, especially to the chair of the board by other board members, and furthermore information of the supervisory board of serious issues against the will of the chair of the board require a high degree of courageous action of the intervening board member, since depending on the relationship between the chair of the board and chair of the supervisory board, that board member could be risking his or her own professional existence. Therefore, as Götz [44] correctly concludes, it is the task of the supervisory board to create working conditions for the board which prove their worth even in such critical situations to ensure that exercise of collective responsibility does not come up against too narrow limits of reasonable expectation by individual board members.

The downstream governance responsibility of the supervisory board

This relatively tightly knit governance network at the board level raises the question of the relation to the supervisory board governance regulated expressly in § 111 sect. 1 AktG [company law]. Under the applicable version [45], the regulation of § 111 sect. 1 AktG should not be understood in isolation, but from the interaction of the collectively responsible management competences and the collectively responsible management controls. Collectively responsible management means primary collectively responsible management governance. Therefore, since the board is in many respects regulating themselves, an entity is needed that does not have immediate leadership responsibility that can exercise company governance equitably from an external point of view. From this point of view, the supervisory board is obliged to further check the primarily responsible supervisors. Therefore, the relatively low involvement of the supervisory board members in the company is not only no disadvantage, it is a system-conform advantage. The more intimately the supervisory board members are involved in the company, the greater is the danger that they themselves are involved in important decisions and are therefore biased in governance. However, this advantage is countered by the disadvantage of the relatively low governance capacity of the supervisory board. It is therefore necessary to consider this circumstance appropriately in the context of § 111 sect. 1 AktG [company law], so that the conditions of § 111 Abs. 1 AktG regulate the governance function of the supervisory board only as a necessary enhancement to the primary responsibility for governance by the executive board. Consequently, the supervisory board only adopts a subordinate task in that it must monitor the business management, that is, the corporate governance practised by the management as [46]. The importance of this distribution or roles and functions lies not just in the delineation between the different responsibilities, but primarily in the increase in the management responsibility of the executive board. The board, that is the board members collectively, cannot claim that the governance of the company leadership is primarily an issue for the supervisory board. The executive board itself, which has the necessary governance resources available, has the primary responsibility of governance and it must therefore organise itself so that it can best meet its governance responsibility [47].

Conclusion

The corporate governance of share companies is certainly a subject of research that has been addressed over decades in both the legal and economic literature. In particular, scandals in large companies repeatedly reveal mistakes and faults in governance and risk management which rekindle the question of the "proper" organisation and governance structure. Ultimately, it safeguards the interests of the company that the company governance functions comprehensively and efficiently. Profitable and sustained company success can only be ensured by thorough and efficient governance because of the many and often serious predictable external and internal influences and because of the involvement of several persons. Because of the limited power of the supervisory board members only acting as a "side-line" and the associated governance deficit, the responsibility for governance begins at the executive board level. It is the executive board's own responsibility to organise itself so that self-governance is established and secured at the highest level of management, that all board members are informed of significant issues in a department area. All board members must be included in a comprehensive reporting and information system in order to be able to fulfil their monitoring and governance duties.

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