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EVOLUTION OF CORPORATE GOVERNANCE IN AUTOMOTIVE INDUSTRY. STUDY CASE DAIMLER AG

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Abstract:
The purpose of the paper is to examine the evolution of the corporate governance in automotive industry. Corporate governance influences growth in financial markets and plays an important role in capital formation, corporate performance and maximization of shareholder value as well as protection of investors' rights. Corporate governance provides a greater assurance that there is implemented an effective control system within an entity, thus ensuring that business is developed in the interest of shareholders and stakeholders. The study case is applied on The Daimler Group, which is one of the biggest producers of premium cars and the world's biggest manufacturer of commercial vehicles with a global reach. I identified that Daimler, like others German companies follows the German Corporate Governance Code. It presents a set of principles and rules addressed to the supervision and management of German listed companies. It contains internationally and nationally approved standards in order to ensure a good and responsible corporate governance presented using recommendations and suggestions.
The paper starts with the principles of corporate governance. It briefly describes the main aspects related to how corporate governance is applied in Germany, which sets forth the scope of the issues the paper discusses. By reviewing the general evidence, the paper explores the role of corporate governance for the sustainable development in the automotive sector.

Key words: The Evolution of Corporate Governance, Daimler, German Corporate Governance Code

JEL classification: M41

1. INTRODUCTION

The Institute of Internal Auditors (IIA) defines corporate governance as a set of procedures used by company stakeholder representatives to provide an overview of risk and management control procedures. Organizational risk monitoring and ensuring that these controls reduce risks directly contributes to achieving and maintaining the value of the organization.

The main principles that represent a strong base for the corporate governance are transparency, fairness, accountability and responsibility. If these core principles are applied in any business, investors will come and it will conduct to stability and to finance growth.

The principle of corporate transparency requires an accurate disclosure of information made in time by a corporate company on all areas, even if we talk about its financial situation, performance or ownership.

An important principle of good corporate governance is that it should protect shareholders rights. Second, the corporate enterprise have to ensure fair treatment to all stakeholders including minority shareholders and foreign shareholders.

According to the accountability principle, the corporate governance system as shaped by the board of directors must ensure the monitoring of management and above all responsibility of the Board and top management to the shareholders and other shareholders for any transactions made and productive activities performed by the company.

Accountability match with responsibility. The Board of Directors should be made liable to the shareholders for the way in which the company has carried out its responsibilities.

2. CORPORATE GOVERNANCE IN GERMANY

The principles of corporate governance also differ from country to country. Most countries set their own standards and principles based on their cultural characteristics. However, corporate governance also depends on the type of industry. In many companies, it is essential to set up a department for corporate governance, since the system and the associated measures also involve considerable effort. The German companies follows the German Corporate Governance Code for their reporting.

The German Corporate Governance Code “contains principles, recommendations and suggestions for the Management Board and the Supervisory Board that are intended to ensure that the company is managed in its best interests” (German Corporate Governance Code , 2017). The Code focus on the obligation of Management Boards and Supervisory Boards to take care about the interests of the shareholders, the company personnel and the other groups related to the company (stakeholders) to assure the continued existence of the company as well the value creation on a sustainable base.

The company and its governing bodies have to be conscious of its role in the community and its responsibility related to the society. The company has to assure that the developed activities have a positive impact in community. Social and environmental factors have impact on the company success. Management Board and Supervisory Board have to assure that whenever there is an impact of these factors is discovered and analyzed.

The purpose of the Code is to bring transparency within the dual German corporate governance system and to make it intelligible. “The Code includes principles, recommendations and suggestions governing the management and monitoring of German listed companies that are accepted nationally and internationally as standards of good and responsible governance. It aims to promote confidence in the management and supervision of German listed companies by investors, customers, employees and the public.” (German Corporate Governance Code , 2017)

The Code is structured on chapters that contain in total 25 principles. For each principle, there are few recommendations. Companies may depart from the existing recommendations, but in this case, they must disclose and bring explanations for all departures each year (“comply or explain”); recommendations are mentioned in the text by using the word “shall”. The Code contains also suggestions that are added at the end of each chapter and from which companies may depart. In this case the companies do not have to bring explanations and there are mentioned in the text by using the word “should”.

Corporate Governance in automotive industry

The German automotive industry is vital in the German economy. It bring prosperity and growth of Germany as a business location. It assure “a high level of revenue safeguarding a high employment volume. It is estimated that one in seven German jobs depend on the auto industry”. (Becker, 2006)

Germany is a federal state made up of different states or "lands". Many aspects of social and economic life are decentralized in Germany and are the responsibility of these state governments. The most important German automotive corporations are Daimler, BMW, Audi, Porsche, Opel, and Ford.

The automotive companies that make up the German automotive industry “have strong regional connections to the German states in which they were established and in which they maintain their headquarters. Each of the German car companies, therefore, must deal with its own regional government, as well as the national German government. Because of these strong regional connections, each company can rely on its own state government to help represent its interests at the national level as well.” (Dankbaar, 2019).

Corporate Governance reporting – Daimler Group – a qualitative analysis

The Daimler Group "is one of the biggest producers of premium cars and the world's biggest manufacturer of commercial vehicles with a global reach. They provide financing, leasing, fleet management, insurance and innovative mobility services." (Daimler AG, 2020);

By analyzing the annual reports published on the official web page of Daimler starting with 1979, I identified that the details about Corporate Governance are published in the annual reports starting with 2003.

I decided to analyze the annual reports from last three years 2017, 2018 and 2019 to see the evolution in terms of reporting from one year to another and the entity follows the German Corporate Governance Code.

As I mentioned previously, Board of Management and Supervisory Board of a German listed stock corporation shall declare annually that the recommendations of the German Corporate Governance Code Government Commission, are in accord or not. If some recommendations are not applied they shall explain why. The declaration released by Daimler can be found on their official web page in a distinct section called "Corporate Governance". Here can be found information about the componence of The Board of Management, The Supervisory Board, Managers' Transactions, Declaration, Reports and Compliance.

According to the Annual Report from 2019 found on their webpage, Daimler "satisfies the recommendations of the German Corporate Governance Code published in the official section, with the exception of Clause 3.8 Paragraph 3 (D&O insurance deductible for the Supervisory Board) and Clause 5.4.5 Paragraph 1 Sentence 2 (maximum number of Supervisory Board mandates for members of the Management Board of a listed company)" (Annual Reports including combined Management Report. Daimler AG, 2019). I identified that the exception of Clause 3.8 Paragraph 3 (D&O insurance deductible for the Supervisory Board) is kept during the annual reports from the last three years, but the exception of Clause 5.4.5 Paragraph 1 Sentence 2 (maximum number of Supervisory Board mandates for members of the Management Board of a listed company) appeared starting with 2019, it is not present in 2017 or 2018.

As in previous years, "the Directors' & Officers' liability insurance (D&O insurance) also contains a provision for a deductible for the members of the Supervisory Board, which is appropriate in the view of Daimler AG. By reviewing the annual reports from the last years, I identified that, this deductible does not correspond fully to the legally required deductible for members of the Board of Management. Setting a deductible for Supervisory Board members for remuneration would have a disproportionate economic impact when compared with the members of the Board of Management, because the remuneration structure of the Supervisory Board is limited to function-related fixed remuneration without performance bonus components." (Annual Reports including combined Management Report. Daimler AG, 2019)

According to the recommendation from "Clause 5.4.5 Paragraph 1 Sentence 2- Maximum number of Supervisory Board mandates for members of the Management Board of a listed company, members of the Management Board of a listed company shall not accept more than a total of three Supervisory Board mandates in nongroup listed companies or on supervisory bodies of non-group entities that make similar requirements. Whether the number of mandates held by members of the Management Boards of listed companies still seems appropriate, however, to be evaluated closer on a case-by-case basis than by a rigid upper limit. The individual workload for a member of the Management Board does not necessarily increase in proportion to the number of the total number of mandates held." (German Corporate Governance Code , 2017)

In order to have sustainable business success for a long term, the goal of Daimler is to assure that all the activities are in conformity with the environment and society. Daimler has defined and implement the most important principles in the Integrity Code. This Code contains strong principles that are like a compass that guide all employees at Daimler and supports them in making the right decisions even in difficult business situations.

Daimler “prepares its consolidated financial statements and interim financial reports in accordance with the International Financial Reporting Standards (IFRS), as adopted by the European Union. The annual financial statements of this group are made in accordance with the accounting standards released and presented in the German Commercial Code (HGB). Daimler prepares both half-yearly and quarterly financial reports. The consolidated financial statements and the Group management reports are accessible via the Company’s website within 90 days from the end of the reporting year; the interim financial reports can be accessed in the same manner within 45 days from the end of the reporting period.” (Annual Reports including combined Management Report. Daimler AG, 2019)

The German Stock Corporation Act (AktG) oblige companies to apply a dual management system and functional separation between the Board of Management and the Supervisory. This rule is applied also to Daimler. The Board of Management manages the company while the Supervisory Board monitors and advises the Board of Management.

3. CONCLUSION AND FURTHER RESEARCH DIRECTION

This paper presented an overview of the German corporate governance system with focus on the automotive industry. I can say that an important feature of the German system is that the corporate governance in terms of efficiency is focused on the maximization of stakeholder value in place of shareholder value. The corporate Governance from Germany is based on EU regulations while keeping the roots in the local codes and legal doctrine.

Since it is announced that the new German Corporate Governance Code will be realized this year, the auditors recommended to the Supervisory Board to analyze “the overall requirements profiles for its own composition and the composition of the Board of Management.” (Annual Reports including combined Management Report. Daimler AG, 2019)

Material changes of the German Corporate Governance Code compared to the version dated 7 February 2017 particularly cover the following:

- “The introduction of principles to inform about material legal requirements on responsible governance;
- The specification of the independence requirement regarding shareholder representatives on the Supervisory Board, which is a focus for the Government Commission;
- A catalogue of criteria providing guidance to the question in which cases a shareholder representative in the Supervisory Board can no longer be regarded as independent. Another focus is set on the restatement of the recommendations regarding Management Board remuneration. The new recommendations reflect international best practices and meet the standards of Act to the Second Shareholder Rights Directive (ARUG II).
- Finally, corporate governance reporting is simplified by placing it exclusively into the Corporate Governance Statement.” (The German Corporate Governance Code, 2019)

German corporate governance, like all systems of corporate governance, has involved in its own unique way because of distinctive historical, political, social and economic developments.

Daimler business conduct is built on Group-wide standards. Those standards are not mandatory requested by specific legislation and the German Corporate Governance Code, but they are important and I think that this is the reason for the great evolution of Daimler. These standards have as base “four corporate values integrity, respect, passion and discipline” and represent a key factor in the success of Germany’s automotive industry. (Annual Reports including combined Management Report. Daimler AG, 2019)

Ultimately, the question of how the German system of corporate governance will develop over the next few years can only be answered after further investigations in the next period.

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