CORPORATE GOVERNANCE REPORTING WITH VALUE ADDED STATEMENTS: CONCEPTUAL ARGUMENTS AND EMPIRICAL EVIDENCE FROM GERMAN LISTED COMPANIES

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Abstract

The value added statement (VAS) is a monetary statement with a long history. Over time, it has been used for different purposes and at varying intensity across different countries. Unlike metrics like accounting profit and economic profit, the metric value added does not focus solely on shareholders but takes a multi-stakeholder perspective. Therefore, VAS fit very well into the concept of corporate governance reporting. An empirical analysis is performed among German listed companies to analyze the current use of VAS.

1. THE ROLE OF VALUE ADDED IN THE GERMAN CORPORATE GOVERNANCE CODE

The German corporate governance system relies on a few cornerstones: in addition to the dualistic corporate constitution with a management board and supervisory board, the decision was made to introduce a comply-or-explain rule analogous to the UK instead of the stricter regulation in the USA.

The German Corporate Governance Code (GCGC[1]) is one of the core sources of corporate governance in Germany. While its immediate applicability is limited to corporations whose shares and/or bonds are publicly traded, it can be considered the best practice for good and responsible governance in general. The GCGC was developed by an expert commission installed by the German federal government, and its first version was published in 2002, in the aftermath of the Enron scandal in the USA. Since then, the expert commission has published an updated version of the GCGC every one to two years, and the current version is as of 2022[2].

The GCGC can be considered soft law, as the German Stock Corporation Act[3] as well as the German Commercial Code[4] refer to it and require the affected companies to issue a declaration of conformity each year. The declaration needs to be included in the management commentary and published in the annual report of the single entity or group.

Based on the German dual board system, the GCGC covers various topics concerning the management board and/or the supervisory board. The regulations fall into three categories:

- Principles that need to be adhered to because they are copied from different laws into the GCGC.
- Recommendations that do not necessarily be adhered to, but in case of non-adherence, a justification has to be given (compliance or explain-rule).
- Suggestions that are non-binding.

Before the actual regulations, the GCGC is introduced by a foreword. In this preamble, the joint responsibility of the management board and the supervisory board is defined as follows:

"The Code highlights the obligation of Management Boards and Supervisory Boards — in line with the principles of the social market economy — to take into account the interests of the shareholders, the enterprise's workforce and the other groups related to the enterprise (stakeholders) to ensure the continued existence of the enterprise and its sustainable value creation (the enterprise's best interests)" (GCGC, 2022, p. 2).

The management board and supervisory board thus have to act in the best interests of the company to ensure its continued existence, which

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[1] The original German name of the GCGC is "Deutscher Corporate Governance Kodex".
[2] The current as well as all previous versions of the GCGC are publicly available both in German and in English on the following website: https://www.dcgk.de/en/home.html
[3] Aktiengesetz (AktG) §161.
[4] Handelsgesetzbuch (HGB) §289f (single entities) and §315d (groups) respectively. Both AktG and HGB are publicly available in German and English on the following website: https://www.gesetze-im-internet.de/

can be realized by sustainable value creation. The concept of value added[5] is therefore the fundamental and overarching idea of corporate governance. It has to be noted that value added is not limited to the narrow perspective of shareholders, but has to be understood from the broad perspective of all stakeholders of the company.

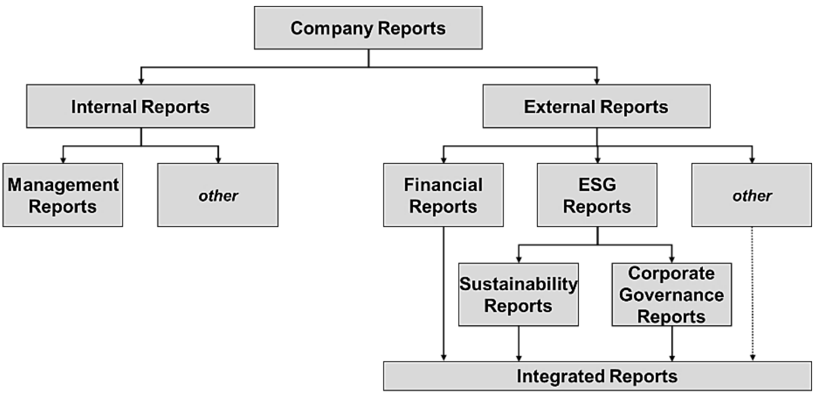
While well-established metrics like the Economic Value Added® (see Chapter 4) exist for quantifying value added from the shareholder perspective, the quantification of value added from a multi-stakeholder perspective is far more demanding. In the remainder of this article, the VAS will be presented as a suitable solution to this challenge.

2. CONCEPTUAL ARGUMENTS FOR THE USE OF VALUE ADDED STATEMENTS

2.1. Value added statements in the company reporting system

Companies are involved in various types of reporting, both to recipients inside and/or outside the company. Figure 1 provides an overview of the most important types of company reports.

Figure 1. Types of company reports



Source: Adapted from Freidank and Hinze (2014, p. 454).

VAS do not fall exclusively into one of those categories but can be used both in internal reports as well as in external reports (Haller & Stolowy, 1998)[6]. In Germany, VAS have been used both in management reporting as well as in financial reporting since the 1930s. The 1970s and 1980s have been the heyday for VAS in social reporting, which is today

[5] The term used in the original German version is "Wertschöpfung", which can be translated into English as value creation, added value or value added.
[6] Besides, VAS are also used in macroeconomic national reports.

considered a part of sustainability reporting. Indeed, the use of VAS in sustainability reporting has gained new attention recently (Haller et al., 2016). Moreover, VAS have also been discussed from the perspective of integrated reporting (Haller & van Staden, 2014). Despite the importance of value added for corporate governance reporting as explained above, we have not seen a discussion of VAS from the perspective of corporate governance reporting, with the notable exception of Lingnau and Kreklow (2011).

2.2. Ensuring connectivity of value added statements

As external recipients will typically read the reports published by a company in parallel, connectivity between those reports is an important requirement. Wagenhofer (2024) discusses the (missing) connectivity between sustainability reports and financial reports and explains that connectivity needs both consistency and coherence of assumptions and data.

The requirement of connectivity with financial reports has also to be fulfilled if VAS are to be used in corporate governance reports. In the case of VAS, however, connectivity can easily be reached as VAS are developed out of the profit and loss statements of financial reporting. Table 2 compares the positions of a (highly simplified) profit and loss statement with the positions of a (also simplified) VAS.

Table 2. Comparison of profit and loss statement and value added statement

	Positions of profit and loss statement (by nature)	
	Revenues	1
-	Material expenses	2
-	Personnel expenses	3
-	Depreciation and amortization	4
+	Other operating income	5
-	Other operating expenses	6
=	**Operating profit**	
+	Financial income	7
-	Financial expenses	8
-	Income tax expenses	9
=	**Profit**	

	Positions of value added statement	
	Revenues	1
+	Financial income	7
+	Other operating income	5
-	Material expenses	2
-	Depreciation and amortization	4
-	Other operating expenses	6
=	**Value added**	
-	Personnel expenses	3
-	Interest expenses	8
-	Income tax expenses	9
=	**Profit**	

It is obvious that VAS are generated by rearranging the positions of the profit and loss statement to create new meaning (which will be explained in the next chapter). It needs to be noted, however, that this is only true if the profit and loss statement is prepared by nature[7]. Indeed, the International Accounting Standard (IAS) 1.14 explicitly mentions

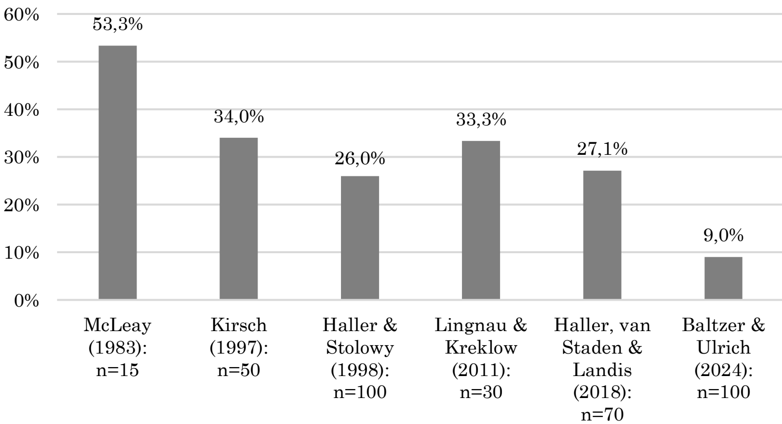
[7] Linking VAS to profit and loss statements by function is not completely possible.

the VAS as an example of reports that may be published next to the International Financial Reporting Standards (IFRS) financial reports.

3. DISCUSSION

It has to be stated that the use of VAS for corporate governance reporting among large public companies in Germany is quite limited. It suggests that the use of VAS among smaller, private companies will not be higher. When comparing this result with the results of previous studies among German companies (see Figure 2), it also needs to be stated that there seems to be a clear downward tendency[8]. As mentioned above, the publication of VAS was quite popular among German companies in the 1970s and 1980s, which explains the result by McLeay (1983) that more than every second company presented a VAS. While every third to every fourth company presented a VAS according to later studies, this number has declined to less than every tenth company in the current study.

Figure 2. Comparison of studies



From a conceptual point of view, companies are missing out on the possibility of providing relevant information to the external readers of their reports. Unlike much of the information that is typically presented in sustainability reports[9], VAS are fully connected to financial

[8] It needs to be noted that the data base of the studies is not completely comparable concerning number and type of companies that were analyzed.
[9] As main reasons, Wagenhofer (2024) lists missing aggregation, missing accruals, no limitation to the company, double counting and anticipation of distant effects.

reports as the information is generated by rearranging the positions of the profit and loss statement. One could argue then, that there is little additional information to be gained from preparing a VAS, as the information is already available in the profit & loss statement. This is not true, however, because VAS take a completely different perspective on the company’s performance. The profit & loss statement shows the profit as the bottom line and thus takes a shareholder perspective. The underlying message is that companies exist to generate shareholder value. Opposed that, the VAS presents value added as the key performance metric and shows how this value added is distributed to the stakeholder groups of employees, debt lenders, communities, and shareholders. Value added can thus be interpreted as a way to quantify stakeholder value. The underlying message is that companies are a ‘joint venture’ of stakeholder groups.

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