COMPLIANCE AND TRANSPARENCY OF GERMAN SUPERVISORY BOARD COMPENSATION

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Abstract

Due to some new developments in the German Corporate Governance Codex (GCGC) as well as the introduction of new laws several aspects of the supervisory board compensation are subject to change. In a first step we analyze the size and structure of DAX 30 companies' supervisory board compensation. One novelty of the article is that we perform this analysis on a person specific level instead of relying on firm level data. In a second step, we examine how well DAX 30 firms comply with the GCGC on supervisory board compensation both with regard to the recommended structure and with regard to the recommended detail in disclosure. We construct a compliance scoring model and find that overall a score of 70 % compliance has been reached.

Keywords: Executive compensation, supervisory board, compliance, transparency, corporate governance codes

JEL-Classification: G34, K20, M52

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1. Introduction

German stock corporations are governed by a two-board system. The members of the management board take the most important management decisions of the company. They will be referred to as management board members or executive directors in the course of this article. The supervisory board, whose members are referred to as supervisory board members in this article and represent the shareholders as well as employees, is not in charge of the company's active management, but supervises the company's strategic decisions.[24]

Another aspect that must be briefly introduced is the German Corporate Governance Code (Government commission German Corporate Governance Code, 2008). The GCGC is a set of rules and recommendations for good governance elaborated by the government commission that was appointed by the German minister of justice. The rules have to be followed and are directly taken from current existing legislature. The recommendations have to be followed on a *comply-or-explain-scheme;* i. e. either firms comply or write a passage into the annual report why they have chosen not to comply.

The topic of supervisory board compensation in Germany is currently of high interest, and it can be said that supervisory boards are moving more and more into the public eye. Over two years ago, the German human resource consulting firm Kienbaum Consultants International pointed out that supervisory board members are underpaid both in international comparison as well as in comparison to executive directors. While the ratio of supervisory board member compensation to executive director compensation was 1:8 in 1963, the same ratio shifted to 1:26 in 2007 (Kienbaum Consultants International, 2007). Karl-Friedrich Raible, manager at Kienbaum, claims that especially with the increased responsibility[25] of the supervisory board, its compensation in Germany is lagging behind. The increase in responsibility has become very evident, especially during the financial crisis when German supervisory boards moved more into the spotlight and were subjected to criticism. Schürmann (2009) criticises that supervisory board members hold too many mandates from different firms and thus often do not properly fulfill their responsibilities in monitoring the executive directors. He accuses supervisory boards of not having averted overpriced take-overs, such as Deutsche Bank /Postbank, Commerzbank/Dresdner or Continental/ VDO, nor scandals as in the case of the bribery incident at Siemens nor companies almost moving into

[24] For a more detailed analysis of the German corporate governance system see Elston & Goldberg (2003).

[25] Due to new legislations which will be explained at a later point of chapter 1.

bankruptcy such as in the cases of HypoReal estate or IKB. Prange (2009) notes that supervisory board members often lack the necessary qualifications to effectively control executive directors. Many supervisory board members have little knowledge of either accounting or the supervised firm's industry and business model. In this regard, the legislature recently acted with two laws: First, the law on the modernization of accounting (BilMoG), which includes a requirement that each supervisory board will have to comprise at least one financial expert who is "independent" and has "expert knowledge in accounting". Secondly, the law on the adequacy of executive compensation (VorstAG) contains elements expanding both the responsibility and liability of supervisory board members, i. e. the entire supervisory board has to decide on executive director compensation and each supervisory board member is personally liable if the agreed upon compensation turns out to be inadequate.[26] According to Proft et al. (2010) 30% of chairmen of the supervisory boards believe that due to this law, their work will change dramatically or become less attractive. One out of seven chairmen is even planning to step down from his office in the near future as a consequence of the law. In order to reflect the increased responsibilties and demand for expertise from the supervisory board members resulting from the introduction of these two laws, an increase in compensation should follow. This is also what chairmen of supervisory boards think: 86% regard higher compensation as being absolutely necessary or very helpful as a consequence of the law on the adequacy of executive compensation (Proft et al., 2010). Thus, the compensation of supervisory boards has subsequently become a part of public discussion.

Despite all the aforementioned issues, most researchers in the field of executive compensation have analyzed executive directors' remuneration (Brenner & Schwalbach, 2009; Ciscel & Carroll, 1980; Conyon & Schwalbach, 2000; Edwards, Eggert, & Weichenrieder, 2009, 2006; Elston & Goldberg, 2003; Kaserer & Wagner, 2004; Kraft & Niederprüm, 1999a, 1999b; Leonard, 1990; Schwalbach & Graßhoff, 1997; Stadtmann, 2009). Only very few researchers are concerned with supervisory board compensation. Since there has been significant development with regard to the level of supervisory board compensation (Kienbaum Consultants International, 2007), relative transparency and reporting also have become relevant issues. The German Corporate Governance Code addresses this issue with different recommendations, but so far it has not been analyzed in detail how well firms have complied with these recommendations. This subject constitutes further motivation for this article.

We answer the following two research questions:

1. What are the characteristics of supervisory board compensation schemes of DAX 30[27] firms? – What is the level of the current remuneration and of which components are supervisory board compensation comprised?
2. How well do DAX 30 firms comply with the demands of the GCGC, both with regard to the recommended structure and with regard to the recommended detail of disclosure of supervisory board compensation?

The remainder of this article is structured as follows: In the next chapter we discuss the related literature. Chapter three presents the data set, supervisory board compensation's different components as well as descriptive statistics about compensation structure and level. Chapter four develops the compliance scoring model along the recommendations of the GCGC. Chapter five discusses the results of the compliance scoring model and chapter six concludes the article.

2. Supervisory board compensation and compliance to governance codes in the literature

There are two lines of literature that are relevant: Firstly, studies regarding level and structure of supervisory board compensation. Secondly, studies regarding compliance with governance codes, particularly when examining compliance issues pertaining to structure.

As already noted, there are only a few studies that analyze supervisory board compensation. A very current and detailed study in this field is that of Andreas, Rapp and Wolff (2009). Looking at 330 German prime standard firms, they analyze a very large sample with regard to compensation structure and level. However, due to the fact that such a large sample is analyzed, the authors simplify the problem by not looking at each board member's individual compensation, but rather by dividing the entire supervisory board's compensation by the total number of board members. If board members leave the board mid-year, they are still considered on a full-year basis in the analysis. In our data set[28] 28% of the individual board member observations do not belong to the board for the entire year. As a consequence we have chosen a different design for our study and will concentrate on a small sample in order to conduct a more detailed analysis by considering

[26] For a more detailed discussion of the law on adequacy of executive compensation see Koch and Stadtmann (2010).

[27] DAX = German stock index, DAX 30 comprises of the 30 largest listed German companies.

[28] DAX 30 firms, years 2007 and 2008.

compensation on an individual level. Kienbaum Management Consultants (2007) look at the level of supervisory board compensation in relation to management board compensation. Ruhwedel and Epstein (2003) have conducted a survey among supervisory boards' chairmen. Regarding remuneration they found that variable compensation was a very infrequently used compensation component at that time and that especially value-oriented variable compensation hardly existed. Furthermore, study participants had clearly expressed the opinion about supervisory board compensation not being adequately high considering the elevated demands of this responsible function. Raible and Vaupel (2007) discuss different supervisory board compensation components regarding meaningfulness and size. Yet, their work's focus lies in normative advice on how supervisory boards should be structured. They point out that remuneration's focus mostly has to be on fixed compensation. Furthermore, they are of the opinion that overall compensation, especially that of chairmen and deputy chairmen, should be higher. Plagemann (2007) also discusses the different compensation components from an incentive but also from a legal point of view. We will add to his analysis by creating a more detailed scoring model for GCGC compliance that comprises all aspects, including disclosure related topics.

There are a number of studies investigating to what degree corporate governance codes are complied. The most relevant for our research is that of von Werder, Talaulicar and Kolat (2005). Using a questionnaire they ask German firms for each of the GCGC's recommendations, whether the firms do or do not comply with them and whether they plan to comply in the future. With regard to supervisory board remuneration, they find that recommendations are frequently not complied to, e. g. only about half of the firms grant the recommended long-term variable compensation. In a follow-up study, they conclude that this recommendation is one that the majority of firms still neglect (Werder, Talaulicar, & Kolat, 2009). Some researchers investigate the influence of code compliance on other variables. Using signaling theory after Spence (1973) and the 'cheap talk' model by Crawford and Sobel (1982) Nowak, Mahr & Rott (2006) test whether the declaration of conformity to the GCGC or the degree of compliance are good signals for a 'good governance type firm' and lead to the generation of abnormal returns. Using the event-study methodology they conclude that neither of the two can generate abnormal returns and thus the declaration does not matter to investors. Goncharov, Werner & Zimmermann (2006) find that good governance, which according to their definition is the case if the firm deviates less from the GCGC's recommendations than the median firm, has a positive influence on yearly returns and also on stock price. Similar research questions were investigated for different countries with mixed results (Alves & Mendes, 2004; Weir & Laing, 2000; Weir, Laing, & McKnight, 2002; Dedman, 2002; Fernández-Rodríguez, Gómez-Ansón, & Cuervo-García, 2004; Jong, DeJong, & Mertens, 2000). All of these studies look at a somewhat aggregate level of compliance. Goncharov et al. (2006) suggested that also individual recommendations should be analyzed. This has been done by Chizema (2008). He looks at just one recommendation, i. e. that management board members' compensation should be disclosed individually.[29] He then examines the compliance decision's determinants. With our scoring model we will also look at a subset of the overall GCGC recommendations, i. e. at all of those that are concerned with supervisory board remuneration. We will add to the research findings presented by Werder et al. (2009, 2005) by firstly going into every single aspect of each recommendation, as many recommendations contain more than one aspect. Secondly we will use a scoring model and judge every aspect ourselves to ensure that the decision of whether an aspect of a recommendation is viewed as complied to or not is taken consistently across all firms.

3. Empirical analysis of supervisory board compensation in Germany

The data set consists of the 30 largest German companies that are publicly listed (DAX 30). The data was extracted from the companies' annual reports for the years 2007 and 2008. These two years were selected in order to also see whether the financial crisis of 2008 had an effect of the level of supervisory board compensation. The data was collected on a personal basis. For board members who were not members for the entire twelve months, the remuneration was extrapolated to twelve months in order to make compensation comparable.

3.1 Descriptive statistics of supervisory board compensation's individual components

Supervisory board members' compensation typically consists of different components which shall briefly be described below. It will also be described how the components were taken into account for the descriptive statistics.

3.1.1 Fixed compensation component

[29] Since July 2005 this recommendation was replaced by the Law on the Disclosure of Management Board Remuneration (VorstOG), but Chizema analyzes the time before this change.

Fixed compensation constitutes a major part of supervisory board compensation and is paid independently of the company's success. Other compensation components that are paid independently of company success further committee compensation as well as attendance fees. Following the recommendation of the GCGC most companies pay the supervisory board's chairman and deputy chairman a multiple of an ordinary member's salary. Among those firms who report all analyzed compensation components separately, and thus provide full transparency[30], the fixed compensation component was on average € 36,667 in 2007 and € 35,139 in 2008, made up for 33% and 29% of total compensation respectively and was thus the second largest compensation component. The fixed compensation component will be fully taken into account in the following calculations.

3.1.2 Committee compensation

Committee compensation is aiming at making up for the additional work which committee members are facing. Committees work on designated issues such as for example executive directors' compensation, human resources, strategy, technology or corporate finance. Companies have found different ways to remunerate these committee memberships: While some companies provide an additional fixed compensation component for each committee membership or chair (in our sample between € 2,500 and € 45,000) other companies work with factors sometimes being applied only on fixed and sometimes on fixed and variable compensation. These factors range between 1.25 and 1.5 for committee members and between 1.5 and 2 for committee chairmen. Some companies let committee members accumulate committee compensation for different committee memberships while others only compensate for the highest, i. e. most highly remunerated, special function on the supervisory board. The average total fee per member per year was € 11,536 € in 2007 and € 10,743 in 2008. If one observes only companies actually paid out committee compensation, these averages come to € 13,053 and € 12,318 in 2007 and 2008 respectively. Committee compensation will be fully taken into account in the following calculations.

3.1.3 Attendance fee

Most companies pay an additional attendance fee for each supervisory board meeting attended. This component is not to be mixed up with the reimbursement of meeting-related expenses – these are paid in addition. Just like fixed compensation and committee compensation, attendance fees are a component that is independent of the company's performance. Some companies do not report this component separately, but include it in the fixed compensation component. For DAX 30 companies, attendance fees range between € 200 and € 2,000 per meeting. Among the companies that do publish attendance fees separately (or do not pay any), the average total fee per member per year was € 2,003 in 2007 and € 1,344 in 2008. If one observes only companies that clearly report attendance fees, these averages come to € 3,957 and € 6,943 in 2007 and 2008 respectively. Attendance fees will be fully taken into account in the following calculations.

3.1.4 Short-term incentive

Many, but not all companies provide their supervisory board members with a compensation component that is dependent on the company's success. This is here referred to as the short-term incentive as the basis for provision of this compensation component is only one year as opposed to components with a perennial assessment base which will be described in the following paragraph. The most common indicator for short-term compensation is the year's dividend (14 firms) followed by earnings per share (9 firms). Payment schemes related to the stock price must be viewed critically. Raible and Vaupel (2007) warn of aligning supervisory board members' payment schemes too closely to management board members' schemes as otherwise the supervisory boards' independent control function can be endangered. When considering only the fully transparent set as defined in the paragraph about fixed compensation, short-term variable compensation clearly constitutes the largest compensation component with 47% and 49% share of total compensation in 2007 and 2008 respectively. When observing all companies that separately publish their short-term variable compensation or do not pay any, the average value is € 44,191 and € 41,552 for 2007 and 2008 respectively. When considering only those companies that actually pay short-term variable compensation, these values rise to € 47,804 and € 45,707 respectively. Short-term incentives will be fully taken into account in the following calculations.

3.1.5 Long-term incentive

As opposed to the component short-term incentive, the payment of a long-term incentive is based on a

[30] This set of firms consists of Allianz, Fresenius, Fresenius Medical, Henkel, Infineon, K+S, Linde, MAN, RWE, Salzgitter, SAP, ThyssenKrupp in 2007 and 2008. In 2007 Commerzbank also provides the necessary transparency, but was not considered in order to ensure comparability for these two years.

perennial assessment base. This component is by far not as widely used as the short-term incentive and applied in quite different ways. Most companies introduced the long-term incentive with a backward-looking perspective, so that the performance over the past three years, for example from 2006 to 2008, are analyzed. If certain goals are met, the bonus is paid out for the accounting year 2008 in the beginning of the year 2009 to the current supervisory board members (e. g. Allianz, Deutsche Bank, Deutsche Börse). This has the effect that members who have newly joined and had yet no influence on the company's performance in the previous years will enjoy the long term incentive while others, who were responsible for the good development in 2006 and 2007 and have recently left the supervisory board, will not receive a bonus. One could argue that due to this, supervisory board compensation will be more attractive in boom years than in recession years.

Other companies such as Deutsche Post or Henkel have based this component on forward-looking reference years. For example, for the bonus concerning the accounting year 2008, the years 2008 to 2010 will be analyzed after the period has expired. If certain goals are met, the long-term incentive will be paid out to the sitting members of 2008 in beginning of 2011. In the meantime accruals are built up and the yearly value of accruals is published as part of supervisory board members' compensation. In this way, supervisory board members receive the bonus for those years that they were actually active.

A third way to deal with the long-term incentive is to provide appreciation rights, as for example Infineon AG does. In this case a certain amount of appreciation rights is provided in the relevant year and may be only exercised after a minimum of three years. This concept is more similar to the forward-looking approach, in that the bonus is realized in the future.

The interesting question that remains is how to deal with this compensation component in the calculations. Andreas, Rapp and Wolff (2008) argue that one should not take into account payments that were made on a backward-looking basis as described in the first case. They argue that these payments are provided for the performance spanning multiple years. Thus, they only take into account accruals for payments occurring in the future or estimated present values of appreciation rights. We have found a solution that differs from that of Andreas et al. (2008). In our view these payments are not for the achievements of several years, but are based on several years' performance, i. e. if 2006 to 2008 is taken as a basis, the compensation component reoccurs every year, i. e. 2009 with 2007 to 2009 as an assessment base.[31] Furthermore, we have decided to take all three kinds of long-term incentives into account, since this the way that firms pay their supervisory board members in reality, accepting the premise that for the sake of simplicity a recent joiner may also benefit from past achievements. When considering only the fully transparent set as defined in the paragraph about fixed compensation, long-term variable compensation accounts for a 7% and 9% share of total compensation in 2007 and 2008 respectively and is a smaller and less common compensation component than the short-term incentive. When observing all companies that separately publish their long-term variable compensation or do not pay any, the average value is € 8,998 and € 8,952 for 2007 and 2008 respectively. However, even when observing those companies that have chosen this instrument of compensation, this compensation component is still much smaller in size that short-term compensation components.

3.1.6 Other payments

These payments include provision of insurances, e. g. directors and officers liability insurance (D & O), provision of infrastructure such as a company car or a mobile phone and the reimbursement of expenses. In Germany supervisory board members are seen as entrepreneurs, so they are additionally reimbursed for the value of the value added tax. Furthermore in some cases supervisory board members receive payments for positions in affiliated companies *(Delegationszuschüsse).* In our analysis we only take the last aspect into account as all the other components can be seen as necessary expenditures for functioning as a supervisory board member. However, the position *other*s in which these payments are collected constitutes only a negligible share of total supervisory board compensation: It makes up for 0.3% and 0.7% in 2007 and 2008 respectively.

3.1.7 Personal benefits outside of the function as a supervisory board member

These personal benefits are payments that are typically granted for services outside the function as a supervisory board member. Thus, they will not enter into the analysis. Examples of these personal benefits are consulting services or intermediation fees.

[31] An exception here is Siemens, where actually a long-term incentive payment can only occur every five years, if a specific goal has been achieved. We have dealt with it by dividing the sum by the number of years that it referred to.

3.2 Descriptive statistics of supervisory board compensation's level and composition

First of all, we describe the actual remuneration paid out by DAX 30 companies. Here actual payments rather than the extrapolated data are used to show the average annual cost of the supervisory board. On average each DAX 30 firm spent € 2.22 Mio. on supervisory board compensation in 2007 and € 2.06 Mio in 2008, which constitutes a decrease of around 7%. The average number of supervisory board members was 17.6 (2007) and 17.4 (2008) members. When we turn to the extrapolated data[32], we can see that an average ordinary board member earned € 114,881 in 2007 and € 109,529 in 2008 (-5%). With earnings of € 190,228 and € 166,457 deputy chairmen of the supervisory boards earned on average 66% and 52% more than an ordinary member in 2007 and 2008 respectively. The chairmen of the supervisory board were granted with premia of 130% and 126% in 2007 and 2008 reaching average compensation levels of € 264,427 and € 247,307 respectively. The average compensation levels regarding function for 2008 can be seen in figure 1. Raible & Vaupel (2007) argue that this premium should be augmented to 100% for deputy chairmen and 200% for chairmen. Their reasoning is that these two positions are much more work intensive than those of ordinary board members. Thus, according to them a higher compensation is necessary in order to incentivize these positions adequately (Raible & Vaupel, 2007). Overall we can thus conclude that also supervisory boards' compensations are affected negatively by the economic downturn of 2008. However, the reduction is with 5-12% depending on function in the supervisory board not very drastic.

[Insert Figure 1 about here]

When we look at the set for which all compensation components are transparent (as already described in the paragraph about fixed compensation), we see that short-term variable compensation constituted 47% and 49% of supervisory board compensation in 2007 and 2008 (see figure 2), accounting for the largest share. Interestingly despite of the crisis, the short term incentive's share did not decrease in the recession year 2008. Most of the firms in the fully transparent set continue paying a short-term incentive of similar height, only Allianz paid out a short-term incentive in 2007 and refrains from doing so in 2008. K+S change their compensation systems and pay out a 2008 short-term incentive almost twice as high as that of 2007. RWE pays short term incentive depending on dividend and paid out a much higher dividend in 2008 than in 2007. The fact that supervisory board compensation is so heavily driven by short-term indicators might be surprising as one might think that supervisory board members cannot actively influence short-term indicators as the role is to supervise, but not to actively manage the firm. Both Plagemann (2007) and Raible & Vaupel (2007) criticize an overly strong focus on short-term variable compensation. Plagemann (2007) states that variable compensation can only develop its desired incentive effect when supervisory board members have sufficient possibilities to influence company success. Yet, according to § 111.4.1 stock corporation law, supervisory board members are explicitly excluded from company management. He further argues that resulting from the supervisory board's control function, a purely fixed compensation is to be favored while the consultation function has a lot to commend for a variable compensation. Thus, as a result of this two-fold function of the supervisory board, there is always some tension on whether a variable compensation component is sensible or not. Raible & Vaupel (2007) come to the conclusion that a variable component should be granted however that the lion's share should lie in fixed compensation.[33] The second largest remuneration component is fixed compensation constituting around one third of total compensation. With 12%, committee compensation also takes a mentionable share. Long-run compensation only constituted 7% and 9% of compensation in 2007 and 2008. Attendance fees and other components only make up for up to 2% and are negligible in size or only occur in a few cases (see figure 2).

[Insert Figure 2 about here]

4. Design of the compliance scoring model

In order to answer the second research question, we set up a compliance scoring model consisting of two parts: One part taking into account the level of compliance regarding structure and one part taking into account compliance regarding disclosure. Each part consists of a maximum score of 24 points, so that a maximum total score of 48 points can be reached as shown in detail in table 1. The aspects of the scoring model are designed very closely after Chapter *5.4 Composition and Compensation* of the GCGC 2008. The annual reports for 2008 were used in the evaluation of the scoring model. So first we will have a detailed look at GCGC's recommendations regarding supervisory board compensation. These can be structured into

[32] Compensation of members who were on the board for less than 12 months was extrapolated onto 12 months to ensure comparability.

[33] They specifically recommend a ratio of 3:1 between fixed and variable compensation.

- Aspects regarding compensation structure
- Aspects regarding compensation disclosure

4.1 Aspects regarding compensation structure

Here there are five different points that are demanded by the code.

1. Supervisory board members' compensation is specified by the resolution of the general meeting or in the articles of association.
2. Compensation takes the supervisory board members' responsibilities and scope of tasks as well as the economic situation and performance of the enterprise into account.
3. Chair and deputy chair functions in the supervisory board as well as the chair and membership in committees shall also be reflected in the compensation level.
4. Supervisory board members shall receive a fixed as well as a performance-related compensation.
5. Performance-related compensation should also contain components based on the long-term performance of the enterprise.

4.2 Aspects regarding compensation disclosure

With regards to disclosure the code demands three different issues.

1. supervisory board members' compensation shall be reported individually in the corporate governance report, subdivided according to components.
2. also payments made by the enterprise to the supervisory board members or advantages extended for services provided individually, in particular, advisory or agency services shall be listed separately in the corporate governance report.
3. if a supervisory board member took part in less than half of the supervisory board's meetings of the financial year, this shall be noted in the supervisory board's chairman's report.

All aspects mentioned in chapters 4.1 and 4.2 are only regulated by the code as recommendations and have to be followed with *comply-or-explain* accountability. In what respect each company chooses to comply must be published as regulated in § 161 of the stock corporation law (AktG). However, the grand total of supervisory board compensation has to be reported according to § 285 sentence 1 Nr. 9 letter a of the trade law (HGB).[34]

Regarding executive directors' compensation these recommendations were turned into binding law in 2005 as part of the law on Disclosure of Management Board Remuneration (VorstOG). It has been decided that for the supervisory board this is unnecessary, since its compensation is decided at the general meeting (German Bundestag, 2005). However, studies observe that there is an increasing tendency to report individualized compensation of supervisory board members although it is not legally binding (Andreas u. a., 2008).

4.3 Compliance regarding structure

Unless otherwise stated, all demands regarding compensation structure are regulated in and thus taken from chapter 5.4.6. GCGC. First of all, the code states that supervisory board members' compensation has to be specified by resolution of the general meeting or in the articles of association. If this information is given in the corporate governance report, which is part of the annual report, we awarded two points. It further demands that compensation takes into account the supervisory board members' responsibilities and scope of tasks as well as the economic situation and performance of the enterprise. This aspect was quite difficult to score. The aspect of the economic situation as well as that of the enterprises performance are seen to be included in the aspect demanding performance-oriented compensation (see treatment later on in this paragraph). Thus only the responsibilities were taken into account and proxied by the granting of an attendance fee, as special functions will be scored in a separate recommendation. Here we follow Raible & Vaupel (2007) who describe the attendance fee as a "time dependent variable compensation component". In total five points are possible for this aspect, two-thirds of which were given if a payment per attended meeting exists and one-third of which will be granted if overall compensation is be reduced in case of non-attendance. The code recommends that functions of chair and deputy chair as well as chair and membership in committees should be taken into account in the compensation system. Overall this aspect is valued with five points, one fourth of which is earned for each separate compensation component according to the abovementioned functions.[35] The score for taking into account the chair function in a committee is only granted if there is a differentiation from ordinary committee membership. Additionally the code recommends that supervisory board members shall receive a fixed as well as variable compensation component (five points). A full score is earned if there exists fixed and variable components, however 33% of

[34] HGB = Handelsgesetzbuch, i.e. trade law book; in the following only referred to as HGB.

[35] Chair, deputy chair, committee member, committee chair.

the score can still be earned if the non-compliant structure is explained, following the *comply-or-explain* setup of the GCGC. The code further suggests that performance-related compensation should also contain components based on the long-term performance of the enterprise (five points). The score is allocated using the same logic as with performance-based compensation in general. Another aspect that we have seen as part of the compensation structure is the directors and officers liability insurance that the company provides for its supervisory board members. Here the code recommends the agreement of a suitable deductible in case such an insurance is provided (chapter 3.8 of GCGC). This is scored with five points, 33% of which can still be achieved if the reason for non-compliance is provided. If nothing is written about D & O insurance, it is assumed that one exists without an adequate deductible and zero points are given.

4. 4 Compliance regarding disclosure

Like the recommendations and suggestions regarding structure, the aspects regarding publication are mainly taken from GCGC chapter 5.4.6 unless otherwise specified. Firstly, the supervisory board members' compensation shall be reported individually in the corporate governance report, subdivided according to components. The aspect of individual reporting is scored with 5 points. If non-compliance is explained, still 33% of the score is granted. The second aspect, the reporting subdivided according to components, is worth a total of 15 points and consists of seven levels of detail each worth one seventh of the total score, that can be observed in companies' reporting. The seven aspects are as follows:

1. Compensation component for participation in meetings reported separately
2. Performance-based compensation component in general reported separately
3. Short-term performance-based compensation component reported separately
4. Long-term performance-based compensation component reported separately
5. Compensation component for membership or chair in committees reported separately
6. Type of function (i. e. chairman, deputy chairman, membership in committees) mentioned in compensation report for better transparency
7. Fixed and variable committee compensation disclosed separately (if this is the structure)

Regarding these seven aspects it has to be mentioned that in the case that a certain component is not granted, it can also not be published. Thus, in these cases, the score for publication is automatically granted. The logic behind this decision is that non-provision of any compensation component is rather an issue of structure than of publication. The company has then already received a reduced score in the first part of the ranking if the component is not part of compensation.[36] The third aspect in the scoring model refers to whether other compensations granted to supervisory board members for consulting or intermediation are published individualized, or whether it is stated that there have been no such payments. If it is fulfilled, two points are given; if it is explained why it is not fulfilled, still one third of the score is earned. The last aspect of the scoring model refers to whether it is stated in the supervisory board's chairman's report if one supervisory board member participated in less than half of the meetings. Again two points are granted if it is fulfilled and still one third of the score is provided in case there exists an explanation why it is not fulfilled. An overview of the model's structure can be seen in table 1.

[Insert table 1 about here]

5. Results of the compliance scoring model

First of all, the overall results of the scoring model will be described. Secondly, the results are described in detail following the order of the scoring model as described in the previous chapter. All results can be seen in table 2.

Using a non-weighted average 70% of the available score was reached. Considering that the aspects on structure and publication were only recommendations, this can be seen as a high rate of compliance in our view. The models' disclosure part shows a slightly higher score than the structure part: The structure part shows a non-weighted average score of 66% while in the disclosure part 73% of the score was reached on average. It is important to keep in mind here, that if certain components do not exist and no credit was given in the structure part, the credit was automatically given in the publication part, as something non-existing can also not be published.

In the structure part, ThyssenKrupp receives the full score of 24, E.On, Deutsche Bank, Allianz and Deutsche Post also have a very high compliance regarding structure with above 20 points. The lowest compliance rates regarding structure appear at Merck, Fresenius Medical,

[36] In the cases of the companies Merck and Volkswagen very limited information was provided about the structure of supervisory board compensation. Since it was not even clear whether some compensation parts exist or not they received no score in the structure and the publication part.

Adidas, Volkswagen, Baiersdorf and Deutsche Lufthansa, all achieving less than 50% of the possible score.

The disclosure part is led by a different set of companies, except for ThyssenKrupp which received very high scores in both parts. Here Linde receives the full score of 24 points and MAN, Salzgitter, RWE, SAP, ThyssenKrupp and Deutsche Lufthansa realize scores above 20 points. Companies that score less than 50% in the publication part are Merck, Volkswagen, E.On and Deutsche Bank. In the examples of E.On and Deutsche Lufthansa it can be seen, that if a company has a high compliance in structure (E.On) it would need high transparency to also achieve a high score for publication, while with a little compliance with regard to structure and thus a simple compensation system (Deutsche Lufthansa), a high score in the publication part can be reached easily, since there is not much to publish.

5. 1 Structure

With regard to the detailed results it can be said that 25 of the 30 companies examined explicitly state in the compensation reports that the supervisory board's compensation is appointed either in the company's statues or by the shareholder's annual meeting. 16 out of the 30 companies pay an attendance fee. One company, namely ThyssenKrupp, even reduces the ordinary salary proportionally in case a supervisory board member does not attend a share of the ordinary meetings. The recommendations to pay separate compensation components for the chairman and the deputy chairman are followed by 27 of the 30 companies. In the case of the remaining three companies, Lufthansa, Merck and Volkswagen, it is not clear from the annual report whether such compensation components exists, so no score is granted. Accordingly, 27 companies pay for the membership in committees; Henkel, Merck and VW do not follow this recommendation (or at least do not make it clear in their annual report). The recommendation to also differentiate the pay between commission members and commission chairmen is only followed by 21 companies. 27 companies compensate their supervisory board members with a compensation package containing a variable part. Adidas and Daimler refrain from doing so and explain their decisions by retaining the independent control function of the supervisory board. Fresenius Medical does not provide an explanation for the decision. Of those 27 companies, only 13 also include a variable component aiming at long term company success.[37] Fourteen companies state that their D & O insurance for supervisory board members contains an adequate deductible. Six companies explain that they have chosen not to follow this recommendation, because these deductibles are internationally uncommon and there are no suitable insurance products on the market for such a solution.

5. 2 Disclosure

With the exception of Merck, all DAX 30 companies disclose supervisory board compensation on an individualized basis. Merck explains that with the help of the articles of association, each member's compensation can be determined, thus individualized reporting in a compensation report is seen as unnecessary. Out of the 16 firms paying a compensation component per meeting attended, ten also publish this compensation component separately.[38] Variable compensation is published separately by 26 out of the 27 firms which provide it. The exception here is Merck not publishing any compensation individually. Out of the 13 firms paying a long-term variable compensation component, twelve publish the amounts separately.[39] It has to be mentioned though, that in some firms payment of the variable compensation component does not occur in 2008, so that it is difficult to judge, how this compensation component would be published in phase of payment. 14 out of the 17 firms providing a compensation component for commission members publish the values for these components.[40] For more transparency five companies state the compensation report which function a supervisory board member fulfills.[41] Another 13 companies label at least their chairman and deputy chairman in the compensation report. 22 companies state in the supervisory board's chairman's report whether a member could not take part in at least half of the annual meetings.

[Insert table 2 about here]

6. Conclusion

In this article we have given an overview of the current status of supervisory board compensation. Despite the high degree of actuality, most

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[37] Allianz, Deutsche Bank, Deutsche Börse, Deutsche Post, E.On, Henkel, Infineon, Metro, Münchner Rück, Salzgitter, Siemens, Telekom, Thyssen Krupp.

[38] Allianz, BMW, Commerzbank, Deutsche Bank, Deutsche Post, Henkel, K+S, Linde, Salzgitter, Thyssen Krupp.

[39] Allianz, Deutsche Bank, Deutsche Börse, Deutsche Post, E.On, Henkel, Infineon, Metro, Salzgitter, Siemens, Telekom, Thyssen Krupp.

[40] Allianz, BASF, Deutsche Lufthansa, Fresenius, Fresenius Medical, Infineon, K+S, Linde, MAN, Münchner Rück, RWE, Salzgitter, SAP, Thyssen Krupp.

[41] Adidas, BASF, Daimler, Linde, Siemens.

researchers still focus on management board compensation.

As a first research question we have investigated what characteristics supervisory board compensation of DAX 30 firms show today including size and structure of the remuneration package. We are the first researchers to analyze supervisory board members' compensation data on an individual level. Our results regarding structure are that most firms provide compensation comprising of several components to account for functions as chairman, deputy chairman or committee member, attendance of meetings and economic situation of the company. While average compensation of an ordinary board member was € 114,881 (€ 109,529) in 2007 (2008), deputy chairmen and chairman received premia of around 60% and 130% respectively. Despite of the independent control function of the supervisory board the short-term incentive was the largest component in both years comprising around 40% of total compensation. Fixed compensation comprises around 29-36% and represents only the second largest part in the compensation mix. Long-term variable compensation is not very frequently used and even if used, it is much smaller in size than short-term incentive, so that it comprises only 7-9% of the compensation package. With 12-13% committee compensation plays an adequate role in the compensation mix.

As the second research question we have asked how well DAX 30 firms comply with the GCGC's demands on supervisory board compensation both with regard to the recommended structure and with regard to the recommended detail in disclosure. To solve this research question we have constructed a scoring model consisting of a structure and a disclosure section that follows the GCGC's recommendations on supervisory board compensation very closely. Since oftentimes more than one aspect is contained in one recommendation aspect, we have broken up recommendations in their individual issues if applicable. Previous research has not gone into this much detail. Our main results are that overall a score of 70% has been reached. With an average score of 73 % the disclosure section shows a slightly higher score than the structure section with an average score of 66%.

For further research we have several possible research questions to recommend. First of all it would be interesting to see what the determinants of a high compliance level with regards to supervisory board compensation are. The literature suggests several factors that drive an overall compliance level, using our scoring results it could be tested whether these determinants can also be applied when just analyzing this subset of recommendations. Similarly, the consequences of moving to a higher compliance level with respect to supervisory board compensation and its relevance to the market could be examined. We have seen in descriptive statistics what compensation components comprise supervisory board compensation. For further research we recommend to also test the determinants of supervisory compensation via econometric analysis to be able to also control for other factors.

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Figures & tables

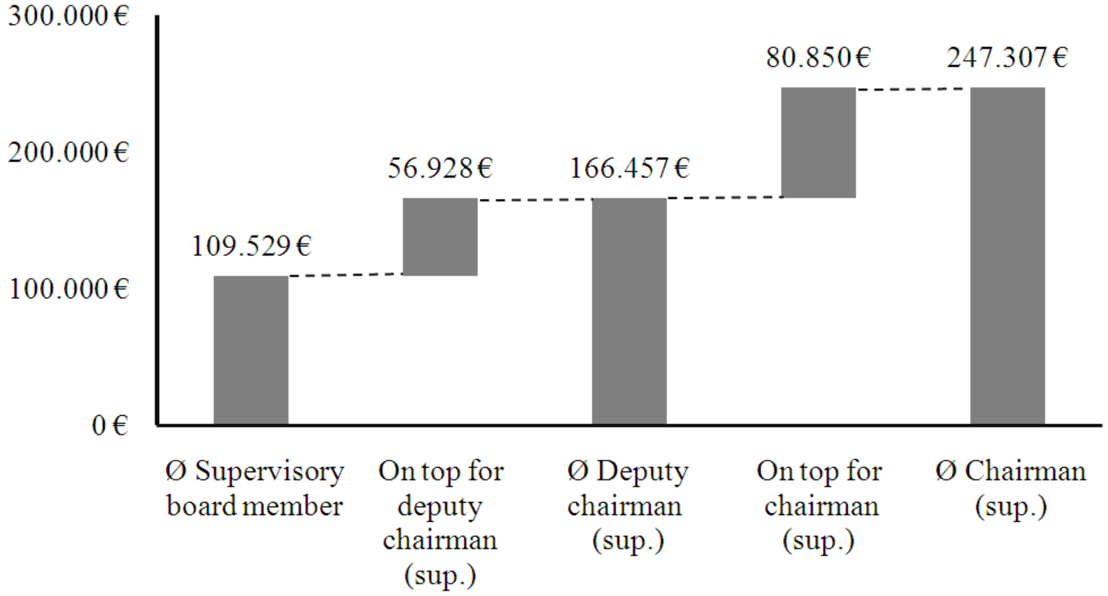

Figure 1. Average supervisory board compensation in 2008

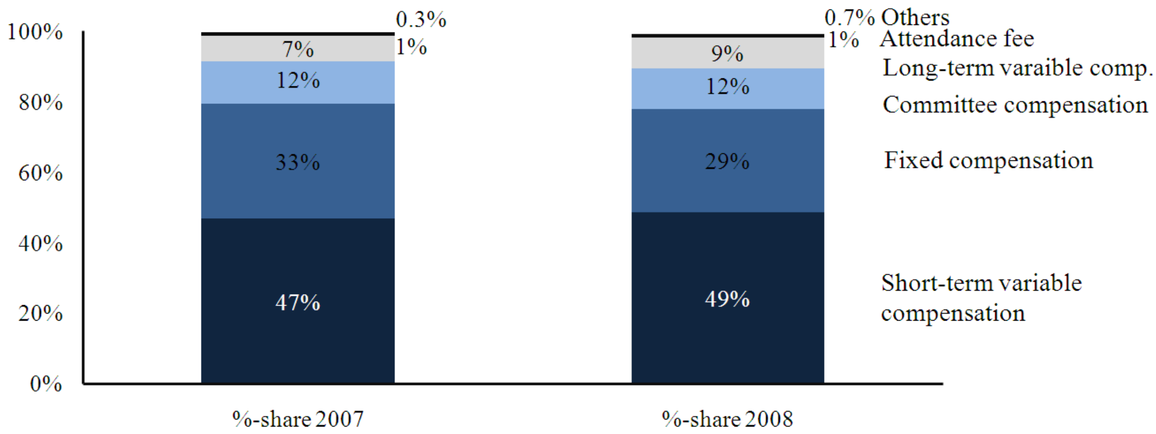

Figure 2. Composition of supervisory board compensation

Category	No.	Paragraph in GCGC 2008	GCGC Recommendation	Maximum Score
Structure	1	5.4.6	Compensation of the members of the supervisory board is specified by resolution of the general meeting or in the articles of association	2
Structure	2	5.4.6	Compensation takes scope of tasks into consideration	5
Structure	2.1	5.4.6	Attendance fee paid out	66,7%
Structure	2.2	5.4.6	Overall compensation will be reduced in the case of non-attendance of board meeetings	33,3%
Structure	3	5.4.6	Compensation takes economic situation and company sucess into consideration	Scored with aspect variable compensation
Structure	4	5.4.6	Also to be considered here shall be the exercising of the chair and deputy chair positions in the supervisory board as well as the chair and membership in committees	5
Structure	4.1	5.4.6	Chairman function compensated separately	25,0%
Structure	4.2	5.4.6	Deputy chairman function compensated separately	25,0%
Structure	4.3	5.4.6	Committe membership compensated separately	25,0%
Structure	4.4	5.4.6	Committe chairman compensated separately (only given score if compensation is higher than of ordinary committe member)	25,0%
Structure	5	5.4.6	Members of the supervisory board shall receive fixed as well as performance-related compensation	5
Structure	5.1	5.4.6	Performance-related compensation paid	100,0%
Structure	5.2	5.4.6	Explanation why performance-related compensation is not paid	33,3%
Structure	6	5.4.6	Performance-related compensation should also contain components based on the long-term performance of the enterprise	5
Structure	6.1	5.4.6	Long-run performance-related compensation paid	100,0%
Structure	6.2	5.4.6	Explanation why long-run performance-related compensation is not paid	33,3%
Structure	7	3.8	If a D & O insurance is provided, an adequate deductible is agreed upon	2
Structure	7.1	3.8	Deductible is the case	100,0%
Structure	7.2	3.8	Explanation, why ldeductible is not agreed upon	33,0%
Sum structure				24
Disclosure	7	5.4.6	The compensation of the members of the supervisory board shall be reported individually	5
Disclosure	7.1	5.4.6	Compensation reported individually	100,0%
Disclosure	7.2	5.4.6	Explanation why compensation not reported individually	33,3%
Disclosure	8	5.4.6	The compensation of the members of the supervisory board shall be reported subdivided according to components	15
Disclosure	8.1	5.4.6	Attendance fee disclosed separately	14,3%
Disclosure	8.2	5.4.6	Performance-related compensation disclosed separately	14,3%
Disclosure	8.3	5.4.6	Short-term performance-related compensation disclosed separately	14,3%
Disclosure	8.4	5.4.6	Long-term performance-related compensation disclosed separately	14,3%
Disclosure	8.5	5.4.6	Committe compensation disclosed separately	14,3%
Disclosure	8.6	5.4.6	Type of functions in committe is disclosed in the compensation report	14,3%
Disclosure	8.7	5.4.6	If committe compensation contains fixed and variable party they are disclosed separately	14,3%
Disclosure	9	5.4.6	Also payments made by the enterprise to the members of the supervisory board or advantages extended for services provided individually, in particular, advisory or agency services shall be listed separately in the corporate governance report.	2
Disclosure	9.1	5.4.6	Extra compensation is disclosed separately in the compensation report	100,0%
Disclosure	9.2	5.4.6	Explanation why extra compensation is not disclosed separately in the compensation report	33,3%
Disclosure	10	5.4.6	If a member of the supervisory board took part in less than half of the meetings of the supervisory board in a financial year, this shall be noted in the report of the supervisory board	2
Disclosure	10.1	5.4.6	This information is disclosed	100%
Disclosure	10.2	5.4.6	Explanation why low attendance is not disclosed	33,3%
Sum disclosure				24
Overall Sum				48

Table 1. Scoring model regarding structure and disclosure

1. Overall Score		2. Score structure		3. Score disclosure	
Thyssen Krupp	44,9	Thyssen Krupp	24,0	Linde	24,0
Salzgitter	42,0	E.On	22,3	MAN	22,9
Linde	41,3	Deutsche Bank	21,0	Salzgitter	22,9
Allianz	39,1	Allianz	20,3	RWE	20,9
Deutsche Post	39,0	Deutsche Post	20,3	SAP	20,9
MAN	38,6	Henkel	19,8	Thyssen Krupp	20,9
Infineon	37,6	Salzgitter	19,1	Deutsche Lufthansa	20,8
BASF	37,0	Telekom	19,1	Infineon	19,9
K+S	37,0	Commerzbank	19,0	Adidas	19,9
Henkel	36,6	Infineon	17,8	BASF	19,7
BMW	36,0	Siemens	17,8	Daimler	19,7
Metro	35,6	BASF	17,3	K+S	19,7
SAP	35,3	BMW	17,3	Allianz	18,8
Commerzbank	34,6	K+S	17,3	BMW	18,6
Deutsche Bank	34,4	Linde	17,3	Deutsche Post	18,6
Daimler	34,0	Metro	17,0	Metro	18,6
E.On	33,8	MAN	15,7	Deutsche Börse	17,7
Telekom	33,6	Deutsche Börse	15,7	Fresenius	17,7
Siemens	33,5	Müchner Rück	15,0	Fresenius Medical	17,7
Deutsche Börse	33,4	SAP	14,3	Henkel	16,8
RWE	32,9	Daimler	14,3	Siemens	15,7
Deutsche Lufthansa	32,4	Bayer	14,0	Baiersdorf	15,6
Fresenius	31,7	Fresenius	14,0	Bayer	15,6
Bayer	29,6	RWE	12,0	Commerzbank	15,6
Müchner Rück	29,5	Deutsche Lufthansa	11,6	Müchner Rück	14,5
Adidas	28,9	Baiersdorf	10,8	Telekom	14,5
Baiersdorf	26,3	Volkswagen	10,3	Deutsche Bank	13,4
Fresenius Medical	24,7	Adidas	9,0	E.On	11,4
Volkswagen	21,6	Fresenius Medical	7,0	Volkswagen	11,3
Merck	7,3	Merck	5,7	Merck	1,7
Durchschnitt	**33,4**	**Durchschnitt**	**15,9**	**Durchschnitt**	**17,5**
Durchschnitt %	**70%**	**Durchschnitt %**	**66%**	**Durchschnitt %**	**73%**
Median	**34,2**	**Median**	**17,2**	**Median**	**18,6**
Median %	**71%**	**Median %**	**72%**	**Median %**	**78%**

Table 2. Results of the scoring model