

WHICH CHARACTERISTICS DETERMINE THE QUALITY OF CORPORATE GOVERNANCE REPORTING? CONCEPTS, REPORTING PRACTICES AND EMPIRICAL EVIDENCE FROM GERMANY

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Abstract

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This study examines the factors influencing the quality of corporate governance reporting by listed German companies. Additionally, we analyse the development of corporate governance reporting practices in Germany over a three-year observation period. Using panel data regressions, we analyse the relationship between various corporate characteristics, performance characteristics, and corporate governance characteristics and the quality of corporate governance reporting. We quantify the reporting quality using a scoring model for the largest listed German companies in the period 2016-2018. Our results indicate that the quality of corporate governance reporting has improved steadily in recent years. This trend, however, should not detract from the fact that the quality of corporate governance reporting is dependent on corporate characteristics but not on firm performance, nor corporate governance characteristics. Our empirical findings elucidate these relationships.

Keywords: Corporate Governance, Reporting Quality, Germany, Monitoring Effectiveness

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1. INTRODUCTION

Corporate governance reporting encompasses the regular external reporting by the administrative bodies of companies (in Germany usually the management board and supervisory board) to the shareholders and other addressees of the organization, as well as the implementation of

corporate governance, management, and supervision in those companies or groups (Freidank & Weber, 2009; Bassen, Schiereck, & Thamm, 2016). Recently, corporate governance reporting has become increasingly important for the external assessment of companies, it supplements the financial accounting with its disclosure instruments (consolidated financial statements and management

reports) (Scholtz & Smit, 2015; Ceschinski, Buhleier, & Freidank, 2017). However, the various regulations on the publication of information under different laws and the German Corporate Governance Code (hereinafter GCGC, Code or Governance Code), as well as the abundance of disclosure instruments make it difficult for individual stakeholder groups to obtain useful information on the quality of corporate governance within a reasonable period of time and with sufficient reliability (Bassen, Kleinschmidt, & Zöllner, 2006; Freidank & Ceschinski, 2018). In addition, a large amount of key information is not subject to the auditor's audit obligation; the resultant "expectation gap" refers to the increasing disparity between stakeholder expectations and the compliant exercise of the audit mandate (Velte & Weber, 2011; Freidank, 2015).

Corporate governance refers to include all legal and economic institutions for managing and controlling private companies. The dualistic corporate governance system prevalent in Germany (two-tier system) is characterized by the separation of management (executive board) and control (supervisory board) (Velte, 2011; Gerum, Mölls, & Shen, 2018). The regulatory framework of corporate governance strives to reduce the agency conflicts resulting from the separation of ownership and control (Freidank & Weber, 2009). Good corporate governance may increase the value of the company in the long term, and thus, it is in the interest of the company and its stakeholders (Freidank, 2012). Corporate governance in the sense of the shareholder value approach according to Rappaport (2014) comprises management and monitoring of the company by the executive and supervisory bodies based on the value of the company (internal corporate governance), as well as monitoring by markets based on reliable corporate reporting (external corporate governance) (Freidank & Weber, 2009). Due to the increased information needs of various stakeholder groups, corporate governance reporting - as well as financial accounting, value reporting, sustainability reporting, and integrated reporting - has recently gained in importance; this applies in particular for capital market-oriented companies as defined by Section 264d of the German Commercial Code (HGB) (Freidank & Hinze, 2014). Corporate governance reporting includes both legally required and voluntary information from financial accounting and value reporting pertaining to the corporate governance of the company. Such qualitative (e.g., in accordance with Section 107 (3) AktG (German Stock Corporation Act)) and quantitative information (e.g., according to Section 285 No. 9 and Section 314 (1) No. 6 HGB) relates to both internal and external corporate governance (Velte & Eulerich, 2014). On the one hand, it covers the management and monitoring (control, audit, and supervision) by the administrative body (internal corporate governance). On the other hand, it also contains information on the monitoring by the enforcement body based on the (external) reporting system (e.g., audit, capital market supervision, and liability regime for the administrative body), as well as markets for raising equity and debt capital (external corporate governance). Furthermore, the auditor must be integrated into the system of internal corporate governance as a partner of the supervisory body

(Freidank, Velte, & Weber, 2009; Freidank & Hinze, 2014). The separation of ownership and control in companies, especially in capital market-oriented ones (according to Section 264d HGB), demonstrates the necessity of corporate governance and its reporting. Asymmetrical distribution of information results in the risk that management will use discretionary freedom of action to their advantage and to the detriment of stakeholders. This occurs in particular when the executive and supervisory bodies have information advantages over current and potential shareholders and have greater insights into the company. The establishment of a corporate governance reporting system that is tailored to the needs of the individual stakeholder groups eliminates such information asymmetries, as well as protects the interests of the various stakeholder groups. Ideally, the report content should be subject to a statutory audit by independent institutions (Freidank, 2015). Furthermore, such a system reduces the risk within the framework of (inter)national capital market communication and lowers the company's capital costs (Weber, Lentfer, & Köster, 2007). As a result, the information provided by corporate governance reporting must primarily concern the targeted management and monitoring

of the company. In detail, this information includes mechanisms for regulating competencies, creating incentives, installing control, monitoring, and reporting systems and processes, and coordinating external relations (Ceschinski et al., 2017). Consequently, a corporate governance report has to include the content of the internal corporate governance with regard to the management and supervision of the company, taking into account the support of the (group) auditor. In the German (insider) system of corporate governance, the auditor is highly relevant as an information basis for the stakeholders. Such a system is primarily characterized by stable shareholder structures and personnel interrelationships, as external corporate governance mechanisms (such as corporate publicity, enforcement, and control of the [equity] market, especially by external investors) have had only minor relevance in the past in the context of corporate governance reporting (Freidank et al., 2009; Freidank & Ceschinski, 2018). The outsider system of external corporate governance has recently become more critical as a result of the increasing importance of investor protection, institutional investor influence, international accounting standards, sustainability reporting, stronger shareholder rights and decreased shareholder concentrations and interrelationships. Hence, the components of internal and external corporate governance should be incorporated equally with regard to their content into an ideal-typical model of corporate governance reporting. Accordingly, information on internal corporate governance as well as external corporate governance must be integrated into the reporting. This applies regardless of whether the constitution of the reporting company is based on the traditional German dualistic or the Anglo-American monistic board structure (Eulerich, Haustein, Zipfel, & van Uum, 2013; Freidank & Sassen, 2015).

Corporate governance reporting in Germany for the 2019 reporting year is composed of the elements

of the “Declaration of Conformity” with the GCGC (Section 161 German Stock Corporation Act), the “Corporate Governance Statement” (Section 289f German Commercial Code) and the so-called “Corporate Governance Report” (Section 3.10 GCGC 2017) (Ceschinski, 2020). The “Declaration of Compliance” with the GCGC pursuant to Section 161 of the German Stock Corporation Act (AktG) must be submitted and published by the management board and supervisory board of listed companies. The declaration includes a statement on compliance with the GCGC recommendations in the past and in the future (declaration of intent). Deviations from the code’s recommendations must, therefore, be explained and justified in accordance with the comply-or-explain principle. The “Corporate Governance Statement” pursuant to Section 289f (2) No. 1-6 HGB must be prepared by listed stock corporations. In addition to the aforementioned “Declaration of Compliance” with the Governance Code (No. 1), the reporting obligations of the declaration include relevant information on corporate governance practices that are applied beyond the legal requirements (No. 2). In addition, the working methods and composition of the executive board and supervisory board as well as of committees of both bodies must be reported (No. 3). In addition, information must be provided on the achievement of the target figures for the proportion of women at management levels below the management board and supervisory board (No. 4) and on compliance with gender quotas on the supervisory board (No. 5). Reasons must be given for any deviations from this. Finally, details of the diversity concept (No. 6) with regard to the criteria for the appointment of supervisory, management, and administrative bodies are given. The “Corporate Governance Report” of the GCGC thus contains recommendations and suggestions of the Code; with regard to the recommendations, non-compliance would have to be explained in accordance with Section 161 AktG. In principle, there is flexibility in the content of the report. The Code only refers to two specific content components: Information on the objective of gender quotas for the supervisory board and the status of implementation (Section 5.4.1 (4) 2 GCGC) and information on stock option plans and similar incentive systems (Section 7.1.3 GCGC). The disclosure of the report is to be made in connection with the above-mentioned “Corporate Governance Statement”. With a reform of the German Code in 2020, the “Corporate Governance Report” of the Code will be abolished. Against this background, the study aims to systematically analyze the quality of corporate governance reporting for the German capital market. Based on this review, we identify the potential for improvement in the future. Our results indicate that the quality of corporate governance reporting varies considerably between companies but has improved overall over the evaluation period and is dependent on a multitude of factors.

This article is organized as follows: Section 2 defines the terms “corporate governance” and “corporate governance reporting” and introduces theoretical background and the development of hypotheses. Section 3 explains the research design, including sample selection, variables used, and methodology applied. Section 5 presents our findings from descriptive and regression analysis. We close with a conclusion.

2. LITERATURE REVIEW AND HYPOTHESIS DEVELOPMENT

2.1. Research on corporate governance reporting in Germany

What follows is an overview of previous research on aspects and effects of German corporate governance reporting. Goncharov, Werner, and Zimmermann (2006) examine whether there is a pricing effect connected to the declared degree of the Governance Code of listed publicly-traded German companies. They find that the degree of compliance is value-relevant after controlling for endogeneity bias. According to the authors, this shows that the capital markets find the rules in the Code meaningful and that there is capital market pressure to adopt the regulation.

Andres and Theissen (2008) examine the characteristics of the firms that complied with the GCGC requirements. Their results indicate that firms that paid higher average remunerations to their management board members were less likely to comply, whereas firms with higher Tobin’s Q were more likely to comply. Additionally, they document a non-monotonic relation between ownership concentration and the probability of compliance that is consistent with standard corporate governance arguments.

Talaucar and Werder (2008) investigate whether the form of compliance with the recommendations of the Governance Code appears to be idiosyncratic to a specific company or features similarities across firms. Based on seven dimensions of code compliance, cluster analysis is used to identify discrete groups of companies with similar patterns of code observance. They determine eight patterns of compliance that are characterized by distinct forms of code conformity.

Chizema (2008) seeks to understand why the disclosure of individual executive compensation, as recommended by the Governance Code, met with resistance in some firms while being a welcome innovation for others. The paper identifies the characteristics of a firm likely to embrace or resist the imported code idea. The study shows that institutional ownership, dispersed ownership, state ownership, prior adoption of shareholder value-oriented practices, and firm size are positively and significantly associated with the disclosure of individual executive compensation. In contrast, the size of the supervisory board and firm age are negatively and significantly associated with individual disclosure of executive compensation.

Velte (2009) investigates the supervisory board reporting in the corporate governance system regarding the external auditor in the German Prime Standard. The study states that essential deficits exist in the supervisory boards’ reporting on their independence, financial expertise, and audit methods. Furthermore, an analysis of correlation states a significant positive link between the reporting of the job profile of the supervisory board (independence and financial expertise) and selective performance measures.

The study of Bassen, Prigge, and Zöllner (2009) contributes to research that investigates the relation between performance and components of broad corporate governance aggregates (governance codes and ratings). For large listed German stock

corporations, compliance with the GCGC at large is significantly negatively associated only with one of their performance measures. Individual analysis of eleven code recommendations reveals that for three of them, association with all performance measures is insignificant. Four components are significantly connected (positively or negatively) with at least one performance measure.

Stiglbauer (2010) tests a simultaneous equation system on the relationship between corporate governance disclosure and firm performance for listed firms underlying the highest standards of transparency and disclosure of the Frankfurt Stock Exchange and receiving the strongest analyst coverage. The study finds evidence that there is a significantly positive relationship between voluntary corporate governance disclosure and market-to-book value and total shareholder return.

Based on the global debate on the development of executive pay and a lack of transparent information Behrmann, Ceschinski, and Scholand (2018) investigated the quality of voluntary remuneration reporting of top management. This study comes to the result that reporting quality differs heavily and depends on ownership and remuneration structure. The results indicate that a high share of fixed remuneration and the existence of family shareholders show a negative impact on reporting quality. In contrast to this, a high percentage of the free float as well as highly variable compensation influence voluntary remuneration reporting in a positive way. Simultaneously, performance correlates significantly negative while company size and leverage ratio show no effect at all. This paper extends upon prior research that has identified determinants of the voluntary individual disclosure of management remuneration in Germany (Andres & Theissen, 2008; Chizema, 2008). It is apparent that many of the previous German studies examine only the reported degree of compliance with the GCGC and other studies do not cover the complete corporate governance reporting, but only selected aspects (e.g., remuneration reporting).

A disadvantage often associated with corporate governance reporting is that high procurement costs are offset by the limited usefulness of the information for decision-making (Ceschinski, Buhleier, & Freidank, 2018). Consequently, the reform of corporate governance reporting appears necessary (Freidank, 2019). Finally, in practice, there is a lack of suitable rating instruments that would allow a qualitative assessment of corporate governance reporting - especially of listed companies - and benchmarking (Graf & Stiglbauer, 2008). With the aim of creating a suitable rating instrument, we develop a data collection form that enables us to measure the quality of published information on a company's corporate governance. The rating instrument, developed as a scoring concept, is based on publication-relevant regulations on corporate governance under German commercial and company law and the Governance Code. In our study, we systematically analyze the quality of corporate governance reporting in the DAX over a period of three years (2016-2018) and identify changes in the quality of corporate governance reporting through year-over-year comparison.

Our analysis focuses on the externally observable quality of corporate governance reporting. This distinguishes our approach from

other rating methods, which aim to assess the corporate governance performance of a company and, thereby, assist investment professionals. In order to gain a deeper understanding of corporate governance reporting practices, we empirically investigate the determinants that influence these practices. While the published literature has already addressed the determinants of voluntary corporate reporting, there remains a lack of empirical evidence regarding corporate governance reporting. Furthermore, not only the growing importance of corporate governance reporting but also the current lack of uniform standards leading to a heterogeneous design of corporate governance reporting underscores the relevance of closing this research gap.

2.2. Theoretical foundations and hypothesis development

The agency theory is considered the leading explanatory approach in corporate governance research (Drobetz, Schillhofer, & Zimmermann, 2004; Schmidt & Brauer, 2005; Eulerich, Lohmann, Haustein, & Tunger, 2014). Moreover, research uses the theory in combination with the signaling theory to theoretically justify voluntary corporate governance disclosures (Cotter, Lokman, & Najah, 2011). The agency theory evaluates contractual relationships in which a principal delegates decision-making authority to an agent (Fama & Jensen, 1983; Hochhold & Rudolph, 2009). The fact that the agent makes decisions without having to bear the resulting risk underscores the differing benefit functions of the actors and may lead to the incurrence of agency costs by the principal (Jensen & Meckling, 1976). When this theory is applied to the dualistic corporate governance system, the executive board acts as the agent of the stakeholders (principal) who delegates the management of the company to them. The separation of ownership and control provides the management with a certain degree of discretion, which it can use to pursue its own interests (Jensen & Meckling, 1976). Opportunistic behavior of management manifests itself, for example, in the pursuit of higher power or remuneration (Tebben, 2011; Freidank, 2012). The company has various corporate governance mechanisms in place to control the executive board with the aim of minimizing the self-serving behavior of the executive board and thus agency costs. In the dualistic corporate governance system, the supervisory board acts as the supervisory body established by the company owners (Oehmichen, 2011). The degree to which the supervisory board effectively fulfills its control function can be assessed by the extent to which it minimizes opportunistic behavior by the executive board. This, in turn, results in a second mandate relationship in which the shareholders also act as principal and the supervisory board as agent (Freidank & Sassen, 2013). The supervisory board - like the executive board - is able to exploit its position to pursue its own objectives. According to Tirole (1986), these relationships create a tiered principal-supervisor-agent structure in which the supervisory board and the executive board each act as agents of the owners.

The signaling theory is concerned with the reduction of information asymmetries that arise

from the separation of ownership and control (Cotter et al., 2011; Hochhold & Rudolph, 2009). Because the supervisory board has an information advantage over the company owners, it can “signal” its information to the owners and thereby reduce agency costs. Corporate reporting in general and corporate governance reporting, in particular, can be understood as a signaling mechanism of the executive and supervisory board to the shareholders. Comprehensive corporate governance reporting can thus reduce the opportunistic behavior of the agents (executive and supervisory board) and lower the risk of the principals (shareholders) (Mallin & Ow-Yong, 2012). The executive and supervisory bodies also have an incentive to reach potential investors and improve the company’s image by publishing voluntary information (Sun, Salama, Hussainey, & Habbash, 2010). Reduced information asymmetries result in lower costs of debt financing through lessened information risks. This is in alignment with the relevant literature, which assumes that corporate governance performance and financial performance are closely related (Collett & Hraskey, 2005).

What follows is a discussion on the factors that determine the quality of corporate governance reporting based on the literature published to date. There exists only a small number of relevant published studies, and thus studies concerning voluntary reporting are referenced. The discussion is based on three features: company characteristics, performance characteristics, and corporate governance characteristics.

Company characteristics: Almost all applicable studies postulate an empirical connection between the size of the company and the quality of reporting. The theoretical assumptions and empirical evidence suggest that larger companies tend to report better. On the one hand, it is assumed that larger companies have more extensive resources (e.g., financial and human capital) that enable good and more comprehensive (corporate governance) reporting, despite high procurement costs (Donnelly & Mulcahy, 2008; Mallin & Ow-Yong, 2012). On the other hand, it is argued that larger companies are increasingly in the public eye and thus under greater pressure to reduce information asymmetries through their corporate governance reporting (Healy & Palepu, 2001; Donnelly & Mulcahy, 2008; Mallin & Ow-Yong, 2012). The latter claim is corroborated by Scholtz and Smit (2015), Bujaki and McConomy (2002), and Labelle (2002); they empirically documented the positive relationship between company size and the quality of reporting.

H1: The company size is positively associated with the quality of corporate governance reporting.

Analogously to large companies, companies with a high level of debt are also more dependent on the capital market and, in line with the signaling theory, have an incentive to reduce information asymmetries for (potential) investors through extensive reporting (Depoers, 2000). Based on this theoretical assumption, the investigations by Scholtz and Smit (2015) as well as Bujaki and McConomy (2002) also provide empirical evidence supporting that the scope of corporate governance reporting increases with the level of indebtedness of the company.

H2: The debt ratio of a company is positively associated with corporate governance reporting quality.

It is also assumed that dominant owners who hold a significant share in the company have both the power and the incentive to reduce information asymmetries between themselves and the management and control bodies of the company; therefore, it is a logical implication that they expect extensive reporting. Huafang and Jianguo (2007) demonstrate that the existence of a blockholder has a positive effect on the extent of voluntary reporting. Mallin and Ow-Yong (2012), on the contrary, cannot prove a significant connection.

H3: A blockholder ownership in the company is positively associated with the quality of corporate governance reporting.

Performance characteristics: While almost all published studies in this field assume a connection between corporate performance and corporate governance reporting-quality, there are sometimes divergent theories and empirical evidence regarding the causal relationship between the two parameters. It is argued that – analogous to companies with a high level of debt – companies with low corporate performance are under greater pressure from the capital market. They have a stronger incentive to persuade shareholders and potential investors with good corporate governance reporting and reduce information asymmetries (Bujaki & McConomy, 2002). Moreover, through targeted reporting, executive and supervisory boards can justify low corporate performance; improve the company’s reputation and their own reputation (Collett & Hraskey, 2005). Bujaki and McConomy (2002) documented this inverse relationship between corporate success and corporate governance reporting. Scholtz and Smit (2015) also assumed a negative link between corporate growth and corporate governance reporting but failed to prove it. On the contrary, company bodies have an incentive, especially when the company’s financial performance is high, to emphasize and report extensively on their activities (Labelle, 2002). Empirical evidence supporting this has been provided by Labelle (2002) as well as Collett and Hraskey (2005).

H4: The financial performance of a company is positively/negatively associated with the quality of corporate governance reporting.

Corporate governance characteristics: There are also different opinions regarding the influence of the supervisory board and its composition on the quality of corporate governance reporting. In particular, there is no conclusive evidence of the extent to which the size of the supervisory board has an impact on its activities and ultimately on the corporate governance report. On the one hand, assumingly shorter information paths and thus faster decision-making processes prevail in smaller boards (Donnelly & Mulcahy, 2008). In addition, the risk of free-rider behavior decreases with the number of supervisory board members (Laksmana, 2008). On the other hand, Mallin and Ow-Yong (2012), for example, document that larger supervisory boards, with their cumulative experience and competence, the more efficient supervisory bodies are.

H5: The size of the supervisory board of a company is positively/negatively associated with the quality of corporate governance reporting.

Capital markets consider the number of supervisory board meetings a company holds an indicator of that company's current situation. According to this, an above-average number of meetings signals problems within the company (Prinz, 2006). We assume that these companies make an effort - as do highly indebted companies or companies with poor performance - to use good reporting to steer the perception of the report addressees away from such problems and towards the positive aspects of the company. In addition, it is suggested that supervisory boards that meet more frequently also have a more intensive exchange of information, which, in turn, promotes better reporting (Laksmna, 2008; Liao, Lin, & Zhang, 2018). Empirical evidence, related to this is, are not yet available.

H6: The number of supervisory board meetings is positively associated with the quality of corporate governance reporting.

Furthermore, we assume that corporate governance reporting is not only influenced by the composition and work intensity of the supervisory board, but also by its monitoring effectiveness. We approximate the monitoring effectiveness by the excess pay of the board of directors, which we determine based on previously published studies (Winkler & Behrmann, 2019; Handschumacher, Behrmann, Ceschinski, & Sassen, 2019). The literature assumes that inefficiencies of the supervisory board are reflected in excessive remuneration of executive board members who pursue their own interests and incur agency costs despite the control of the supervisory board (Boyd, 1994; Coles, Daniel, & Naveen, 2014). The opportunistic behavior of executive board members can be reflected in excessive remuneration, which in turn is attributable to low monitoring effectiveness of the supervisory board (Winkler & Behrmann, 2019; Handschumacher

et al., 2019). Excessive compensation represents that portion of the executive board's compensation that cannot be explained by the company- and market-specific determinants (Carter, Li, Marcus, & Tehranian, 2016). According to the signaling theory, an altruistic supervisory board - one which acts in the interest of the shareholders and therefore has high monitoring effectiveness - strives to keep its information advantage over the shareholders low and to reduce agency costs. For this reason, we assume that high remuneration-related monitoring effectiveness of the supervisory board, measured in terms of the appropriateness of the executive board's remuneration, inevitably fosters good corporate governance reporting.

H7: The monitoring effectiveness of the supervisory board is positively associated with the quality of corporate governance reporting.

3. RESEARCH DESIGN

3.1. Regression model

We test the empirical determinants of corporate governance reporting using the following regression model: $Corporate\ Governance\ Reporting = f(\text{firm characteristics, performance characteristics, corporate governance characteristics})$. The OLS regression model is used to test the hypotheses formulated in the previous section. Therefore, the model composes firm characteristics (company size, leverage ratio, ownership structure, and industry dummies), performance characteristics (a measure of firm performance), and corporate governance characteristics (supervisory board size and meetings as well as a measure of the supervisory boards' monitoring effectiveness). Table 1 describes all used variables more detailed.

Table 1. Operationalization of variables

<i>Variables</i>	<i>Explanation</i>	<i>Units</i>
<i>Dependent variable</i>		
CGR	Quality of corporate governance reporting Report quality based on a survey questionnaire	%
<i>Independent variables</i>		
SIZE	Company size Logarithmized number of employees	ln(number)
LEVERAGE	Leverage ratio Ratio of total liabilities to balanced sheet total	%
BLOCKHOLDER	Blockholder = 1, if a shareholder holds > 25% of the shares in the company, = 0, otherwise	1/0
SECTOR	Industry dummies = 1, if company is active in one of 18 industries, = 0, otherwise	1/0
PERFORMANCE	Firm performance Earnings before interest and tax to total assets	%
SBSize	Supervisory board size Number of supervisory board members	number
SBMeetings	Supervisory board meetings Number of meetings held in the financial year	number
EXCPAY	Excess pay Non-determinable component of CEO remuneration (CEOCOMPENSATION)	residual

The regressions were based on the assumption that there are no multicollinearity and no autocorrelation. We performed the above-mentioned regression with fixed effects to control for unobservable company characteristics. Firm fixed effects capture the effect of all time-invariant variables such as industry affiliation on firms' quality of corporate governance reporting. The fixed-effects-model controls for omitted variable bias.

3.2. Dependent variable

We use the quality of corporate governance reporting (CGR) as the dependent variable in our empirical study. The data on the variable were collected using a scoring model. The financial reports of the companies listed in the DAX for the financial years 2016-2018 (cut-off dates: 12/31/2016,

12/31/2017, and 12/31/2018) collectively provide the starting point of the study. The basis of evaluation for all companies are the corporate publications available on 01/07/2017 (annual reports, corporate governance reports, declarations of compliance, and annual financial statements). The analysis is based exclusively on publicly available information. In terms of content, the data entry form reflects the GCGC and takes into account the statutory provisions of the German Commercial Code and the German Stock Corporation Act. The structure of the Governance Code (in the version dated 05/05/2015 or 02/07/2017) establishes the framework for the division of the data entry form into six subject areas: Shareholders & Annual General Meeting (A), Cooperation of Executive Board & Supervisory Board (B), Executive Board (C), Supervisory Board (D), Accounting & Audit (E), Transparency & Reporting (F). The last subject area is supplemented by questions regarding the type of reporting (Ceschinski et al., 2017). The total score for measuring the quality of a company's overall corporate governance reporting will be determined by 74 questions for 2016 and 87 questions for 2017; these will then be converted into a grading system (%) over intervals of the proportion of the maximum achievable score. The questions generate individual survey points, which are in turn given weights based on a fixed scheme. The achieved score per question can be determined by multiplying these points by the degree of fulfilment. The weighting for calculating the overall result is based on the scope, score, and relevance of the subject areas. The data entry form is based on an Excel file, the design of which cannot be presented in the following due to lack of space. Relevant publications on corporate governance reporting (annual reports and any further reporting) support that the degree of fulfilment is assessed by labeling the relevant proficiency (extensive/good/medium/reference and little/not) and determining the score per survey point by multiplying the proficiency by the weighting. Subsequently, a partial score per subject area and the total score are calculated by weighting the individual subject areas. In addition, we distinguish between questions that are clearly verifiable and those in which the specification of the proficiency is based on a discretionary assessment of the surveyor.

3.3. Independent variables

The selection of independent variables is based on the developed hypotheses and is divided into three areas: firm, performance, and corporate governance characteristics.

Corporate characteristics: As a proxy for the company size (*SIZE*), we use the natural logarithm of the number of employees (Handschumacher et al., 2019). The debt ratio (*LEVERAGE*) corresponds to the ratio of debt to total capital (Scholtz & Smit, 2015). We measure the influence of dominant shareholders (*BLOCKHOLDER*) by means of a dummy variable that takes on the value of one if one shareholder holds at least 25% of the shares in the company (Mallin & Ow-Yong, 2012). All regressions also include sector (*SECTOR*) and period dummy variables (*YEAR*).

Performance characteristics: Following Cornett, Marcus, and Tehranian (2008) we measure firm

performance in terms of the ratio of earnings before interest and tax (*EBIT*) to total assets (*PERFORMANCE*).

Corporate governance characteristics: To approximate corporate governance characteristics, we use several established proxies of good corporate governance; this is in line with previous research findings which proclaim that the relationship between a company's corporate governance and its agency costs should be examined using various corporate governance mechanisms (Donnelly & Mulcahy, 2008).

We consider the size of the supervisory board using the variable *SBSize*, which measures the number of supervisory board members; the scope of monitoring activity is represented by the variable *SBMeetings*, which quantifies the number of supervisory board meetings in the fiscal year. To investigate the relationship between the remuneration-related effectiveness of the supervisory board's monitoring and the quality of corporate governance reporting, we determine the excessive executive board remuneration (*ExcPay*) as the residual of the regression of the company's size (*TotalAssets*), growth (*TobinsQ*), and success (*TotalReturn*) to the logarithmic fixed CEO-remuneration (*CEOCompensation*)¹. This corresponds to the average fixed remuneration of the CEO. In order to concentrate on the differences in the size of the salaries between the companies, we use the natural logarithm of the remuneration (Usman, Zhang, Wang, Sun, & Makki, 2018).

3.4. Sample selection

The sample of our empirical study is comprised of the 30 German companies that were listed in the largest German share index (DAX) between 2015 and 2017. Thus, the sample features the largest German companies in terms of stock exchange turnover and market capitalization. The data were drawn from the financial publications of the companies between 2016 and 2018 as well as from the *Thomson Reuters Datastream* database. Taking the publicly available corporate publications (annual reports, corporate governance reports, declarations of compliance, and annual financial statements) into consideration, we determine the quality of the corporate governance reporting of the companies. In particular, the annual reports served as a data basis for corporate governance characteristics (supervisory board size, supervisory board meetings, and monitoring effectiveness), while the *Thomson Reuters Datastream* provided information on company and performance characteristics.

3.5. Methodology

We conduct several panel regression analyses to empirically investigate the determinants of the quality of corporate governance reporting. We perform the regression with fixed effects to control for unobservable company characteristics. Firm fixed effects capture the effect of all time-invariant variables such as industry affiliation on firms'

¹ Excessive executive compensation (*ExcPay*) serves as a variable for empirical analysis and as a proxy for monitoring effectiveness. *ExcPay* represents the portion of the compensation that cannot be explained by market and company-specific determinants (Winkler & Behrmann, 2019).

monitoring effectiveness. The regressions were also based on the assumption that there is no multicollinearity and no autocorrelation (the residuals should not be correlated with the population). To preclude multicollinearity, the pairwise Pearson correlation coefficients are calculated. If the coefficients are below the critical value of 0.8, multicollinearity is unlikely (Gujarati & Porter, 2010). In addition, we estimate the inflation factor of variance (VIF) for each regression analysis. The VIFs should be as low as possible and below 10.0 in order to assume that there is no multicollinearity (Schneider, 2009). The subsequent regressions never exceeded a VIF of 2.0. To avoid distortions due to heteroscedasticity, we estimate all regression analyses with robust standard errors. Furthermore, endogeneity in the variables can distort the estimation results. A correlation between the independent variable (*CGR*) and the residual [$E(\mu | X) = 0$] makes it difficult to clearly identify the interdependency of the dependent and independent variables (Börsch-Supan & Köke, 2002; Proppe, 2009). For this reason, in our empirical study, we use firm fixed effects to methodically reduce endogeneity problems (Adams & Ferreira, 2009; Sassen, Hinze, & Hardeck, 2016). Nevertheless, the potential of reverse causality in the observed context can never be completely avoided.

We estimate several alternative specifications of the empirical model to check the robustness of our results (not tabulated). We vary our basic model by substituting alternative measures for some independent variables. As an alternative proxy for firm size, we use the natural logarithm of the number of employees rather than the logarithmic revenues, and we consider the return on equity (ROE) instead of EBIT to total assets as an alternative performance indicator. The modifications essentially provide equivalent results.

4. RESULTS

4.1. Descriptive statistics

The data collected from the three years of investigation paint a principally heterogeneous picture of the quality of corporate governance reporting. The average score of all companies in 2018 was 82%. This result has improved slightly compared to the previous year (81%) and significantly compared to 2016 (75%). It is also apparent that the quality of corporate governance reporting has generally converged between companies (Ceschinski et al., 2019). While the range of the findings was still 42 percentage points (std. dev. = 0.08) in 2016, it has fallen to 22 percentage points (std. dev. = 0.05) in 2017 and 19 percentage points (std. dev. = 0.05) in 2018. In addition, the minimum score reached has increased considerably over these years: it was 47% in 2016, 72% in 2017, and 73% in 2018. The three-year comparison demonstrates that corporate governance reporting is driven by new developments and adjustments. As Figure 1 depicts, the quality of corporate governance reporting has improved - these improvements are particularly visible within the individual categories. Two companies are included in the 2018 survey for the first time and currently have a below-average result (2018: both 73%). Time will tell whether the quality of their corporate governance reporting will continue to improve with their ascent to the DAX. An electric utilities company has, fundamentally changed its corporate governance reporting from 2017 onwards and has also improved significantly in 2018 (2016: 47%/2017: 79%/2018: 88%).

Figure 1. Rating by category 2016-2018

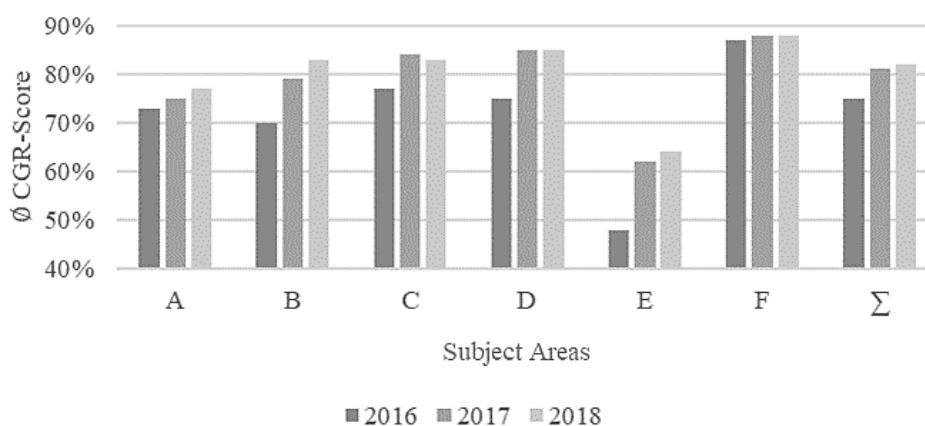
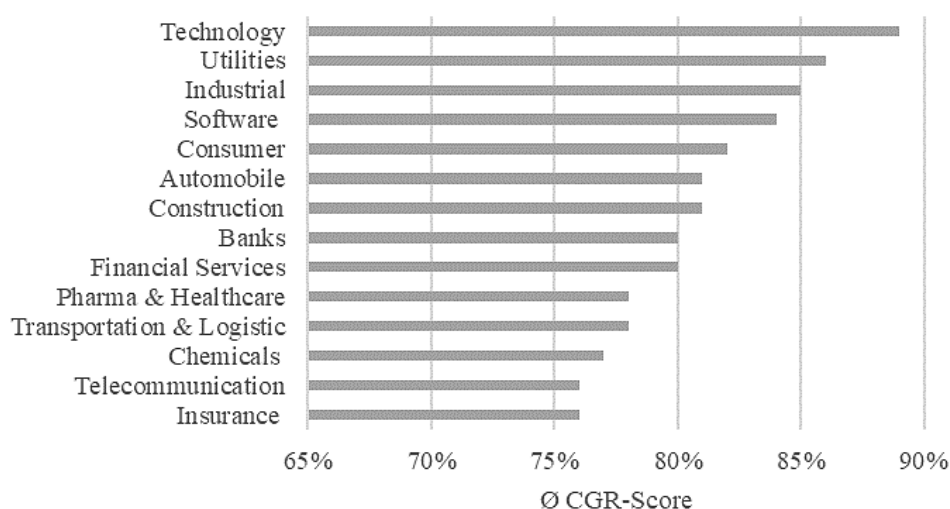


Figure 2 indicates that the results of the quality of corporate governance reporting vary significantly across individual sectors. The Utilities

and Technology sectors were the best performers during the analysis period.

Figure 2. Rating by sector 2018



In a three-year comparison, the scope of corporate governance reporting has also increased on average. Both the lowest (Min.) and the highest (Max.) page counts have increased (2016: Ø 10.5; Min. 2; Max. 33/2018: Ø 17.9; Min. 5; Max. 43). Furthermore, the share of corporate governance

reporting in the overall annual report has increased from 4.5% in 2016 to 6.9% in 2018. This indicates that the report preparers are attributing greater importance to corporate governance topics. Table 2 presents descriptive statistics.

Table 2. Descriptive statistics

Variables	Obs.	Mean	Std. Dev.	Min.	Max.
CGR	88	0.791	0.071	0.474	0.939
SIZE	88	11.302	1.162	8.552	13.407
LEVERAGE	88	44.300	21.89	1.170	91.700
BLOCKHOLDER	88	0.216	0.414	0.000	1.000
PERFORMANCE	87	0.070	0.048	-0.066	0.248
SBSize	88	9.205	2.139	4.000	14.000
SBMeetings	88	7.000	2.568	4.000	16.000
ExcPay	88	-0.002	465,316.400	-922,020.400	1,562,866.000

4.2. Multivariate analysis

Table 3 depicts the results of the correlation analysis. The analysis illustrates that corporate governance reporting-quality only correlates significantly and positively with firm performance (*PERFORMANCE*). Firm performance is also positively associated with the size of the supervisory board (*SBSize*) and significantly and negatively linked with the firm (*SIZE*) and leverage ratio (*LEVERAGE*) of the company. The leverage ratio is

significantly and positively correlated with the size of the supervisory board and the number of supervisory board meetings (*SBMeetings*). The size of the supervisory board is also positively related to the size of the company, the monitoring ineffectiveness (*ExcPay*) as well as the number of supervisory board meetings and negatively related to the ownership structure (*BLOCKHOLDER*). None of the variables reach a critical value of 0.8, which is why multicollinearity is unlikely (Gujarati & Porter, 2010).

Table 3. Pearson correlation matrix

Variables	CGR	SIZE	LEVERAGE	BLOCKHOLDER	PERFORMANCE	SBSize	SBMeetings	ExcPay
CGR	1.000							
SIZE	0.044	1.000						
LEVERAGE	0.023	0.052	1.000					
BLOCKHOLDER	-0.061	0.227	-0.145	1.000				
PERFORMANCE	0.201	-0.119	-0.551	0.267	1.000			
SBSize	-0.091	0.169	0.327	-0.219	-0.304	1.000		
SBMeetings	0.042	-0.180	0.424	0.043	-0.297	0.188	1.000	
ExcPay	0.004	0.204	0.068	-0.130	-0.033	0.222	0.118	1.000

5. DISCUSSION OF THE RESULTS

Table 4 presents the results on the factors influencing the quality of corporate governance reporting. Due to the high coefficient of

determination R^2 , the model has sound explanatory power. The independent variables can explain 57.6% of the variance of the dependent variable. The examination of the regression coefficients of our investigated determinants conveys that - contrary to

our assumption - corporate governance reporting-quality is negatively and highly significantly associated with company size (*SIZE*) ($p = 0.00$). *H1* is thus rejected. Collett and Hrasky (2005) have already found a comparable result, although their correlation is not significant. In contrast to this, the correlation between the debt-equity ratio (*LEVERAGE*) and the reporting-quality proves to be positive and significant ($p = 0.06$). This result supports our *H2* - that indebted companies publish a more comprehensive corporate governance report to reduce information asymmetries and improve their reputation on the capital market. This result is consistent with the studies by Scholtz and Smit (2015) and Bujaki and McConomy (2002). Furthermore, we can confirm *H3*, which states that the existence of a blockholder (*BLOCKHOLDER*) has a positive impact on corporate governance reporting ($p = 0.00$). The result is in alignment with the findings of Labelle (2002) as well as Huafang and Jianguo (2007), which showed that a dominant

ownership structure has a beneficial effect on (corporate governance) reporting-quality. With regard to corporate performance, *H4* cannot be confirmed. Although the quality of corporate governance reporting increases when corporate performance also increases (*PERFORMANCE*), the effect is not significant ($p = 0.18$). We, therefore, reject *H4*. Another corporate governance characteristic examined, the size of the supervisory board (*SBSIZE*), appears to have no influence on the quality of corporate governance reporting ($p = 0.38$). This result, which is in line with that of the 2008 study by Donnelly and Mulcahy, enables us to reject *H5*. We also reject *H6*, as it is found that the reporting quality is not significantly correlated with the number of meetings (*SBMEETINGS*) ($p = 0.30$). Analogously, the monitoring effectiveness, which we approximate by the excessive executive compensation (*EXCPAY*), has no significant connection to the reporting quality ($p = 0.26$). According to these findings, we have to reject *H7*.

Table 4. Regression of the factors influencing the quality of CGR

<i>Variables</i>	<i>Prediction</i>	<i>Coef.</i>	<i>Std. Err.</i>
<i>SIZE</i>	+	-0.256***	0.066
<i>LEVERAGE</i>	+	0.003*	0.001
<i>BLOCKHOLDER</i>	+	0.651***	0.013
<i>PERFORMANCE</i>	+/-	0.878	0.643
<i>SBSize</i>	+/-	-0.004	0.005
<i>SBMeetings</i>	+	-0.004	0.003
<i>ExcPay</i>	-	-0.000	0.000
<i>CONSTANT</i>		3.499***	0.661
Sector		yes	
Year		yes	
Observations		86	
R ²		0.576	
F (12,43)		5.310***	

6. CONCLUSION

Corporate governance reporting is gaining in importance. Nonetheless, various requirements on the publication of corporate governance information under different laws and regulations as well as the abundance of disclosure instruments make it difficult for individual stakeholder groups to obtain decision-useful information on the quality of corporate governance. Finally, in practice, there is a lack of suitable rating instruments for the qualitative evaluation of corporate governance reporting.

The study on the quality of corporate governance reporting over a period of three years serves the systematic analysis of the quality of corporate governance reporting in the DAX, detects changes in quality in annual comparison, and empirically examines the determinants of reporting quality. With its focus on the externally observable quality of corporate governance reporting, this study differs from other rating approaches, which aim to provide a picture of a company's corporate governance performance and, thereby, prove conducive to investment professionals. In this light, the purpose of the study is to systematically analyze the quality of corporate governance reporting and its influencing factors for the German capital market in order to identify potential future improvements based on this review. Using the agency theory and the signaling theory as a basis, we first theoretically

substantiated the determinants of corporate governance reporting quality and then analyzed them empirically. These theories are used in corporate governance research as leading explanatory approaches for the theoretical justification of voluntary corporate governance disclosures. According to these theories, executive and supervisory boards can use their (corporate governance) reporting in a targeted manner to reduce information asymmetries company owners are faced with.

The systematic examination proves that establishing the quality of corporate governance reporting is difficult, as it is influenced by myriad factors. Still, the results reveal the potential for improvement. In a three-year comparison, the rating results demonstrate an increase in the quality of corporate governance reporting for the DAX. However, an in 2018 overall good score regarding the quality of corporate governance reporting as well as the consistency compared to the previous year should not detract from the fact that the results between companies are continuing to diverge and that some companies in certain areas as well as of many companies on individual issues are producing very weak results. Almost all companies have been able to improve their corporate governance reporting quality over the years, but sector-specific differences and potential for improvement still exist. One potential reason for the different results could be that corporate governance reporting is not yet in the focus of practitioners. Our results show that the

quality of corporate governance reporting varies greatly between companies, has improved as a whole over the review period, and depends on a variety of factors. The combination of the voluntary nature of compliance with the Governance Code and the statutory obligation to disclose the declaration of compliance creates a tension that results in the acceptance of the Governance Code as a reaction of the capital market. The crucial factor here is that the declared compliance manifests itself in the companies and that the recommendations are not merely formally checked off (Ceschinski et al., 2017).

This study naturally has some limitations. Firstly, the results cannot be generalized to the entire prime standard of the German capital market. Although the sample consists of the companies with the highest market share, the final sample contained only 30 companies involving 90 observations. The German Stock Index (DAX) was examined as the stock market index of the thirty largest companies. Future studies could follow on from this and determine results for the German mid-cap and small-cap indices. This would allow a comparison between the indices and cover almost the entire prime standard. Additionally, limitations from the potential of reverse causality in the observed context can never be completely avoided.

Our empirical analysis indicates that only firm characteristics determine corporate governance reporting quality. Indeed, our results indicate that companies that are smaller and indebted as well as companies with a dominant owner exhibit high quality of corporate governance reporting. Regarding the latter, however, our results fail to provide any empirical evidence about performance characteristics and corporate governance characteristics. Prospectively, changes in corporate governance reporting are expected. The introduction of a board remuneration report, the implementation of the EU's Shareholder Rights Directive II (SRD II), and the subsequent enforcement of the new version of the German Corporate Governance Code in 2020 will likely also be reflected in an expansion of corporate governance reporting. In regard to content, the expansion of the Code may affect the topics of executive board compensation and the independence of supervisory board members in particular. The (forthcoming) normative changes and the new Governance Code constitute opportunities for additional empirical research and an expansion of the data collection framework presented here. Future research projects should investigate whether the new version of the Code will lead to increased transparency.

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