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"ÜBERHOLEN OHNE EINZUHOLEN"? – SIMILARITIES AND DIFFERENCES BETWEEN SME SUPERVISORY BOARDS IN EAST AND WEST GERMANY

Thomas Steger
Faculty of Business, Economics and Management Information Systems, University of Regensburg, Germany
thomas.steger@ur.de

Abstract

This paper explores the similarities and differences between SME supervisory board structures and processes in East and West Germany. On the basis of two separate exploratory surveys it is shown that the East German companies are not lagging behind their West German counterparts but have rather modernized their corporate governance structures towards a more liberal shareholder-oriented approach in recent years. The empirical findings are further discussed and interpreted with respect to cultural, historical or situational factors. By this, the paper contributes to a better understanding of the dynamic developments that the East German corporate landscape has experienced during the transformation process since 1989.

Keywords: *Corporate governance, supervisory boards, small and medium-sized enterprises, West Germany, East Germany*

1. INTRODUCTION

Although lagging somewhat behind compared to what has been done in the US and the UK, research about supervisory boards in Germany has well developed in recent years (e.g. Bresser & Valle Thiele, 2008; Grundei & Talaulicar, 2002; Helm, 2004; Werner & Zimmermann, 2005). However, existing research widely ignores the particular developments in East Germany since 1989. So, more than twenty years after the fall of the Berlin wall, relatively little is still known about the similarities and differences between East and West German companies' corporate governance.

This constitutes a veritable deficit since East Germany must still be considered a fairly special case according to its most recent history as a transforming country and emerging economy as well as with respect to the corporate governance developed in this context (Steger, 2005; Barton & Wong, 2006). For many years, East Germany has been mainly addressed in terms of deficits, compared to West Germany, and with a clear focus on measures to improve the situation and to catching up with what was perceived to be the (Western) role model (e.g. Randlesome, 1992; Frese, Kring, Soose, & Zempel, 1996; Meyer & Møller, 1998). Against this background, the question arises whether and how far the East German companies have managed to design and to modernize their corporate governance structures throughout the past two decades in order to compete with their West German counterparts.

This paper aims to (partly) close this knowledge gap by exploring the similarities and differences between small and medium-sized enterprises (SMEs) supervisory board structures and processes in East and West Germany. Further, the empirical findings will be critically discussed and interpreted with respect to cultural, historical or situational factors. By this, the paper contributes to a better understanding of the dynamic developments that the East German corporate landscape has experienced during the transformation process since 1989. Moreover, the paper's findings will shed new light on the question how formerly socialist countries have performed their running-up process in recent years. Thus, the underlying logic that has dominated most discussions in this respect in the past will be critically questioned and ways for alternative considerations will be described.

The paper starts by examining the existing literature on German supervisory boards. Then the methods of the survey will be presented in detail. The following chapter comprises the main findings of the paper's research. It closes by broadly discussing and interpreting the research findings. Moreover, some consequences and perspectives, both for companies and future (comparative) research work in the field are presented.

2. LITERATURE REVIEW

2.1 The general German framework

The German system of corporate governance has been widely discussed in the past. It can be characterized by four main aspects: First, the *two-tier board organization* comprises a management board (Vorstand) with the chief task of directing the company, and a supervisory board (Aufsichtsrat) assigned to appoint and control it. While the members of the management board are normally hired full-time managers, the supervisory board members often have different functions (e.g., top manager of another company, lawyer). Cross-memberships between the two bodies are excluded by law; however the chairperson of the supervisory board is often a former CEO of the same company (Schilling, 2001).

Second, the mandatory *co-determination* reserves half of the seats of the supervisory board of large corporations for employee representatives. To avoid impasses, the chairperson of the supervisory board, who is elected by the shareholders, is granted a casting vote. Moreover, co-determination is widely dispersed in smaller corporations and subsidiaries because of largely developed information, consultation, and co-determination rights of works councils (Müller-Jentsch, 2003).

Third, the large German banks are usually *universal banks* engaged in both investment banking as well as commercial banking. They hold a key position in the German system, which is based on their blocks of shares, the proxy votes they command, and their traditional role as lenders. Furthermore, the numerous seats top bankers hold on supervisory boards of large German corporations is a source and manifestation of their power (Hackethal, Schmidt, & Tyrell, 2005).

Fourth, among a lot of the largest German corporations, some veritable shares of stocks are held by other corporations. Additionally, those are often strongly connected with each other through interlinking directories. This traditional network is commonly referred to as the "*Deutschland AG*" (Germany Inc.). It also worked as a highly effective defense against unfriendly takeovers in the past. Although slowly decreasing, the "Deutschland AG" still enjoys a high level of economic and political power (Heinze, 2004).

In sum, the German corporate governance system must be perceived as highly co-operative, having a clear stakeholder orientation and target to ensure stability and growth rather than maximizing shareholder value. It was, thus, criticized for being cumbersome, cliquey, and less investor-friendly (Macharzina & Wolf, 2005).

2.2 The particular East German framework

The *transformation process* in East Germany of the past two decades must be considered a major background of the development of corporate governance in this region (MacLean, Howard, & Hollinshead, 2003; Steger, 2005). The economic situation of East Germany, therefore, still is highly problematic (e.g. unemployment rate 14%, productivity level 70% of West German level – Kailitz, 2008), sharply differing from West Germany.

The process of restructuring of the companies since 1990 resulted in two main characteristics of the East German company landscape: On the one hand, the privatization policy executed by the Treuhandanstalt, the state-owned privatization agency led to a *high dependency situation* of the East German economy, i.e. a high number of companies owned by West German or foreign investors (Geppert & Kachel, 1995; Windolf & Schief, 1999; MacLean, Howard, & Hollinshead, 2003; Sachsen Bank, 2009). This fact is accompanied by a considerable dominance of West German actors in the political and administrative institutions of East

Germany (Steger & Lang, 2003) and an ongoing financial support from West to East Germany (Busch & Schneider, 2000; Kailitz, 2008) making an independent development of corporate governance structures difficult.

On the other hand, the company restructuring processes in the 1990s were accompanied by some massive downsizing processes resulting in a very limited number of large (listed) companies (FAZ, 2005) and thus, in a company landscape strongly dominated by SMEs (Steger, 2005). Given the traditional economic, legal and organizational characteristics of *German SMEs,* a limited sensitivity for corporate governance aspects (Steger, 2006) as well as a high level of trust and consensual orientation between management and employees (Behr, Engel, Hinz, & Schmidt, 2005) can be expected among those companies.

2.3. Supervisory boards in German SMEs

Studies about supervisory boards in Germany have hardly focused on East-West differences up to now. One can assume that most samples also include some East German companies however the picture remains distinctively West German.

Several authors found that supervisory boards of SMEs differ in several aspects from those in larger companies: Regarding board structure, the supervisory boards usually consist of three persons only (Helm, 2004; Hausch, 2005). The percentage of women and foreigners remains quite low (Grundei & Talaulicar, 2002); for the most part they are owner representatives, venture capitalists (in the case of start-ups) and experts of distinctive topics (e.g. lawyers) (Hausch, 2005). Close friendship ties between the persons of the management board and the supervisory board are common (Grundei & Talaulicar, 2002). A considerable number of SMEs report to have no special board committees (Ergo Kommunikation, 2003; Werder. Talaulicar, & Kolat, 2005). Board remuneration is usually based on fix salaries or on salaries per meeting (Helm, 2004) although performance related forms of remuneration were also found (Ergo Kommunikation, 2003; Werder. Talaulicar, & Kolat, 2005).

2.4 Research questions

Based on the above literature review three research questions can be formulated to guide the further analysis.

1. How far do structures and processes of supervisory boards in East and West German SMEs differ from each other (RQ 1)?
2. How can those findings be explained with respect to cultural, historical or situational factors (RQ 2)?
3. Which future developments regarding corporate governance structures in German SMEs can be expected? (RQ 3)?

3. METHODOLOGY

In order to explore those questions and to more deeply understand the processes outlined above, I conducted two subsequent surveys. Consequently, they were intended to be definitively explorative in nature. The first one was launched in summer 2005. It included all joint-stock companies located in East Germany. Of 271 questionnaires 59 were returned (response rate: 21.8%). 54 questionnaires were found to belong to SMEs (= companies with 500 employees or less). The responding persons were usually members of the top management team (TMT) (81%).

The second survey started in winter 2006. It was focused on all joint-stock companies in Baden-Wurttemberg. This region can be considered one of the most prosperous regions of West Germany and is characterized by a traditionally strong SME sector. Of 809 questionnaires 71 were returned (response rate: 8.8%). 56 questionnaires could be attributed to SMEs. The responding persons were most often members of the TMT (83%).

All collected data were analyzed with the help of the SPSS 19 software. The two samples were compared using a t-test (where data can be assumed to be normally distributed) or a Mann-Whitney U-test (where normal distribution is in doubt) respectively (Lumley, Diehr, Emerson, & Chen, 2002).

4. RESULTS

4.1 General characteristics

Table 1 concludes the main characteristics of both samples. Interestingly, relatively small differences can be found between the two samples.

It is notable that the East German companies have their shares more often listed at the stock exchange and, consequently, significantly more often possess an investor relations department. Moreover, the role of venture capitalists sharply differs, owning 9% of the East German vs. 1% of the West German companies. In contrast to the above described dependency situation, the responding East German SMEs that belong to a larger corporation are more often the mother company compared to their West German counterparts.

4.2 Supervisory board structures and processes

The number of considerable differences regarding supervisory board structure is relatively limited as well (*Table 2*).

It is to note that managers from other companies form the largest group in both samples. East German supervisory boards do significantly more often conclude some full-time board members while white collar employees are stronger represented on West German boards. Although moves of the CEO to the chairperson position were found to be relatively rare, they significantly more often occur in West German than in East German SMEs. Interestingly, remuneration of supervisory board members is significantly more common in East German than in West German companies. In the former even remuneration with shares or stock options could be found.

Table 1: General sample characteristics

	East German sample		West German sample		Mean differences
Age:	24 years		29 years		ns
Branches:	Other services Other industries Chemical/Pharmaceut. IT/Software	24% 24% 17% 15%	Other services Other industries Banking/Insurance	50% 18% 15%	
Employees:	105		86		ns
Annual turnover:	14.8 Mio. €		11.5 Mio. €		ns
Stock exchange listing:	17%		9%		ns
IR department	23%		7%		**
Ownership pattern:	TMT and their families	41%	TMT and their families	48%	ns
	Domestic enterprises and private persons	19%	Domestic enterprises and private persons	17%	ns
	Supervisory board members	13%	Supervisory board members	16%	ns
	Domestic venture capitalists	9%	Domestic venture capitalists	1%	***
Part of a larger corporation:	32%		35%		ns
if yes, mother company	65%		38%		ns

*ns = non significant / *p < 0.1 / **p < 0.05 / ***p < 0.01*

Table 2: Main characteristics of supervisory board structure

	East German sample	West German sample	Mean differences
Size:	3.9 members	4.5 members	ns
- employee representatives	0.20 (9% of comp.)	0.37 (13%)	ns
- women	0.33 (28%)	0.25 (20%)	ns
- foreigners	0.22 (13%)	0.07 (7%)	ns
Member characteristics:			
- external manager	40% (81%)	30% (68%)	ns
- internal manager	10% (20%)	6% (20%)	ns
- lawyer	9% (33%)	5% (23%)	ns
- full-time board member	6% (15%)	2% (5%)	*
- academic	9% (28%)	12% (29%)	ns
- white-collar employees	4% (13%)	11% (20%)	*
Chairperson:			
- former CEO	4%	13%	*
- tenure	4.2 years	4.7 years	ns
Remuneration:	83%	66%	**
if yes,			
- fix salaries	80%	83%	ns
- salaries per meeting	34%	34%	ns
- shares/stock options	7%	0%	*
Committees:			
- no committee at all	85%	82%	ns
- audit committee	7%	11%	ns
- nomination committee	7%	5%	ns
- remuneration committee	6%	11%	ns
Self evaluation	34%	26%	ns

*ns = non significant / *p < 0.1 / **p < 0.05 / ***p < 0.01*

5. DISCUSSION AND CONCLUSION

Although East and West German SME supervisory boards were found to differ in fewer aspects as one might have expected, several significant differences and interesting details must be noted: Regarding board structures *(RQ 1)*, a stronger position of white collar employees and more former CEOs as chairpersons on West German boards could be found. Meanwhile, East German SME boards comprise more full time board members and they show a more diversified financial management and more widespread remuneration for board members.

Based on these findings and with reference to the wider context *(RQ 2)*, two main propositions can be made: *First*, the distinctive characteristics of the West German SMEs show that they follow a much more traditional corporate governance approach than the East German ones. Be it the better representation of white collar employees on the supervisory board, a financial management approach widely ignoring venture capitalists, stock markets and shares/share options as alternative remuneration instruments, a limited number of IR departments, the more usual move from CEO to chairperson, or a usual lack of remuneration for supervisory board members – those are all indicators of what is considered the traditional German SME corporate governance (Steger, 2006; Steger & Stiglbauer, 2016). Obviously, the modernization process of East German SMEs in the last 15 years has enabled them to overtake their Western counterparts (*"Überholen ohne einzuholen!"* – Passing without catching up!), as far as publicly propagated corporate governance best practices are concerned. Although the economic figures still show considerable deficits, the de-regulation and privatization process after 1989, mainly promoted by the Treuhandanstalt, the state-owned agency to privatize the companies inherited from the GDR times, also resulted in a distinctively different corporate governance design (Maclean, Howard, & Hollinshead, 2003). Geppert and Martens (2008) even speak about a "neo-liberal revolution" in East Germany.

Second, most other aspects of the East German framework (cf. 2.2) fail to explain the results of this study. The 'dependency argument' runs counter to these empirical results since only a minority of the SMEs observed are dominated by West German or international owners. Martens and Michailow (2003) also identified company ownership significantly more often among native East German managers than among West German managers leading East German firms. Moreover, the native East German CEOs (and not those transferred from West Germany) are incorporating and promoting shareholder orientated values (Martens & Michailow, 2003; Lang, 2008). Although the precarious economic situation of East Germany in general cannot be denied, the 'precarity argument' must be rejected too. The economic figures of the SMEs observed do not show any significant differences between East and West Germany. Also Martens and Michailow (2003) found no significant differences between their East and West German samples neither with respect to profitability nor with respect to equity capital quota. Even the often discussed cultural factors (e.g. the "heritages" of the socialist era) are of limited explanatory power. History definitively matters, however it was rather the post-socialist transformation process since 1990 that has impacted on the corporate governance structures and the supervisory boards of East German SMEs.

Regarding the convergence-divergence debate *(RQ 3)*, the data show a picture of a convergence process that has proceeded quite far. Given the overall (economic) trends of globalization and internationalization and the high dynamism of the German SME sector the SMEs of both East and West Germany can be expected to adapt to the growing external demand for modern corporate governance structures.

Moreover, these findings obviously bear some *theoretical contributions* that go beyond a mere description of differences between East and West German SMEs. Indeed, they challenge the traditional assumptions, mainly promoted by modernization theory, of a gradual running-up process of the formerly socialist countries of Central and Eastern Europe as a copy of the process Western countries have experienced some decades ago. In line with earlier criticism (e.g. Michailova, 2000; Depkat & Steger, 2015) this paper's findings may contribute to a more differentiated discussion of the transformation processes and their (potential) outcomes in different societies around the globe. Obviously some different development paths can be taken that lead to results that might not be necessarily inferior compared to the achievements made in Western industrialized countries. Taking into account the multitude and variety of emerging economies, this paper's findings also point to the wide opportunities these countries may have to become real competitors in the global economy in the future.

Furthermore, this paper's findings also have some *practical implications*. They can be perceived as a reminder for cross-national and cross-cultural sensitivity. Management practitioners, in particular expatriates and headquarter representatives of multinational companies, are well advised to carefully observe and consider the concrete structures and behaviors in foreign countries, be it with business partners, public institutions or subsidiaries. As one can see in the analysis above, feelings of superiority or arrogance are not only counterproductive but often not even justified.

Last but not least, some *limitations* of this study also need to be mentioned here: Notwithstanding the challenging message pointed out above, this study is still little more than a particular case or a remarkable anecdote. Of course, the samples explored in this paper are of limited size and East Germany cannot be perceived as being representative for the transforming countries in Central and Eastern Europe or beyond. Further research is definitively needed to deepen our understanding about transformation paths and processes in different national, cultural and economic contexts. This may include some comparative studies, both qualitative and quantitative, in and across different industries, regions and countries. Obviously, there is still a long way to go in order to successfully question and shake the dominant modernization-theory-based logic in this respect.

EXTENDED SUMMARY / IZVLEČEK

Članek raziskuje podobnosti in razlike med strukturami in procesi nadzornih svetov malih in srednje velikih podjetij v vzhodni in zahodni Nemčiji. Na podlagi dveh ločenih raziskav je razvidno, da vzhodno-nemška podjetja ne zaostajajo za zahodno-nemškimi podjetji, temveč so v zadnjih letih nekoliko bolj posodobila svoje strukture upravljanja podjetij na bolj liberalen pristop, usmerjen k delničarjem. Empirične ugotovitve so nadalje razložene na podlagi kulturnih, zgodovinskih in situacijskih dejavnikov. S tem članek prispeva k boljšemu razumevanju dinamičnega razvoja, ki ga je v procesu preoblikovanja od leta 1989 doživelo vzhodno-nemško korporacijsko okolje.

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