Evidence from German Corporations:

How Corporate Managers in German Listed Companies Experience

the Role of Institutional Investors in Corporate Governance

Doctoral Thesis – An Empirical Study | July 2012

The Role of Institutional Investors in Corporate Governance

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VITA

Dr Petra Nix has experience in various management and entrepreneurial leadership functions.

Before she decided to run her own consulting company she was for several years Deputy CEO of a mid-sized consulting firm incorporate and financial communications. She has more than 10 years' experience in in various functions in the banking sector, including as an analyst at Bank Vontobel and Julius Baer in Zurich and Frankfurt. As Head of Investor Relations at Wella AG and VIAG AG (now E.ON), she was responsible for financial communications for seven years.

She studied business administration, holds an MBA from the University of Rochester and is the recipient of the 2012 Distinguished Alumna Award. Furthermore she attended several post-graduate programs at the London Business School, IMD and the University of St. Gallen. In 2012 she finished her doctoral thesis oft he University of Surrey (UK). Since 2009, she has served as a lecturer for financial communications at the University of Applied Science of Northwestern Switzerland in Olten, and as a guest lecturer at the University of St. Gallen. She has published numerous articles for professional journals.

"The proper governance of companies will become as crucial to the world economy as the proper governing of countries."

James D. Wolfensohn | Former President of the World Bank

ABSTRACT

___ **Corporate Governance** ___ has emerged as a decisive business issue. Less corporate governance research is undertaken in civil law countries like Germany. In this thesis, the role of institutional investors in Germany is studied with the aim of providing an answer to the following research question:

___ What role do independent institutional investors play in the corporate governance of listed German companies?

This study follows an inductive qualitative research approach. The research model is based on six variables
_ board oversight
_ board nomination
_ identifying weaknesses
_ making recommendations
_ introducing changes in corporate strategy
_ exercising institutional power
to determine the role of institutional investors and to provide answers.

___ **Responsibilities** ___ Overall, the results show that the participants of the research study experience the role and responsibilities of institutional investors in the German two-tier corporate governance system as weak to medium across all six variables. The handling of recommendations from institutional investors to companies is not structured or executed in a systematic way by the study participants. Moreover, the results indicate that the interviewees are convinced that institutional investors could be valuable partners in strengthening and improving corporate governance. They can play a role in corporate governance and can add value because they have a good understanding about the strategy and business model of the companies, expertise in research and analysis as well as a good sector expertise.

___ **Role of Owners** ___ The category of institutional investor matters in corporate governance. The strongest players are private equity and hedge funds. The weakest players are endowments and insurances. The most common company situations when institutional investors prompt change are
_ underperformance
_ special company situations | crisis
_ corporate finance issues
_ management remuneration.
The majority of the study participants expect a higher shareholder engagement in the future. Most of them have a positive point of view about the future role of institutional investors in corporate governance.

Communication The managerial implications of this study are that the investor relations function is well established and the programmes are sufficiently executed in German companies. Communication is the most appropriate measure. However, other typical and presumably more powerful measures like use of voting rights, engagement in the AGM, regular contact to the members of the supervisory board, taking a seat in the supervisory board, owning a meaningful company stake and collaboration with other shareholders seem to play a minor role.

Influence and Monitoring There is still potential for institutional investors to improve their role in corporate governance in German companies. In order to improve their influence in corporate governance institutional investors need to be prepared to pursue an escalation strategy. This encompasses for example to increase their stake to a meaningful and powerful level and/or they need to collaborate effectively and systematically with other shareholders to increase their acceptance vis-à-vis the company and to ask for a seat in the supervisory board. However, such an approach also needs a strong long-term commitment and investment perspective as well as an attitude that also considers the long-term interests of the company.

Independence and Expertise Conclusively that institutional investors with a high level of expertise can contribute to the widely discussed improvement of the competence and independence of German supervisory boards. Important prerequisites of institutional investors to play a role in corporate governance are no conflict of interest and a sufficient sector expertise. Therefore, disadvantages like conflict of interest and lack of expertise have to be addressed properly.

The results from this research can be used to draw lessons for:

1. *Principal agency theorie Members of supervisory boards, members of the management board (in particular CEOs, and CFOs), as well as investor relations officers of listed companies, who want to improve governance and the relationship with their institutional shareholders*
2. *Steward ship theory Institutional investors who want to enhance their engagement in their portfolio companies*
3. *Standard setters like institutions and commissions that want to improve corporate governance.*

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