The Big Read Germany

Investors take on Germany Inc

Guy Chazan in Berlin MAY 7, 2019

“Herr Baumann, what have you done to our Bayer?” The question, posed by Joachim Kregel of the German Association for the Protection of Investors, was just one of dozens of emotional tirades against Werner Baumann, Bayer’s chief executive, at the aspirin-to-crop chemicals conglomerate’s annual meeting in late April.

“Where is your humility and empathy for shareholders who have invested their savings in Bayer?” he added. Investors like Mr Kregel had reason to be angry. The German group’s share price has slumped 37 per cent since June, when it closed its $63bn acquisition of US agrochemical giant Monsanto.

That fury fuelled a rebellion unique in German corporate history. For the first time, shareholders delivered a vote of no confidence to the serving management of a Dax-listed company, an unprecedented act of defiance.

“It was an earthquake,” says Michael Wolf, professor of management at Göttingen university. “Investors in Germany have traditionally tended towards compromise and avoiding conflict. This is a turning point.”

Bayer is in many ways a special case. Last August, a US jury determined that Monsanto had not warned of the alleged cancer risks associated with using Roundup, a controversial weedkiller, and found Bayer liable. Since then, €30bn has been wiped off the company’s market value.

But it is not the only German company being punished by the stock market. Dogged by post-crisis misconduct investigations, ratings downgrades and stiff competition from Wall Street rivals, Deutsche Bank has seen its share price plunge more than 90 per cent in the past 12 years. Volkswagen is still struggling to restore the faith of investors four years after the diesel scandal broke. And shares in Wirecard, one of Europe’s leading financial technology groups, slumped earlier this year after allegations emerged of fraud and false accounting at its Singapore office.

The country has plenty of national champions untouched by scandal — companies such as insurers Munich Re and Allianz, the software giant SAP and its successful "Mittelstand" exporters.

But Germany Inc still has its fair share of corporate crises — and they are now increasingly being fought over in public. Shareholders, it seems, are far less willing to put up with bad management than they used to be. "Before, companies got away with making questionable decisions, but now they're being pilloried for them," says Jörg Rocholl, head of the ESMT Berlin business school.

It is a cultural change that has been building over the past decade or so but is now in full spate. "Shareholders are increasingly willing to articulate their concerns, via the press, through direct conversations with management or in their voting behaviour at AGMs," says one German investment banker. "A taboo has been broken."

Activists protest against the Monsanto merger before Bayer's annual general shareholders meeting in Bonn, Germany, in April 2017 © Reuters

Companies were often protected from pesky investors by Germany's two-tier governance system, under which a management board in charge of day-to-day business is overseen by a

supervisory board of investor and employee representatives. Relations between the two can be cosy, to say the least: for example, when Mr Baumann went to Munich for takeover talks with Monsanto boss Hugh Grant, he took Bayer's chairman Werner Wenning with him.

Shareholders are often critical of the way senior executives at German companies move seamlessly into jobs on supervisory boards: Hans Dieter Pötsch, VW's chief financial officer during the emissions scandal, was appointed chairman in 2015. At VW's 2016 AGM, one investor called him "the personification of a conflict of interest".

But supervisory boards "are becoming much more arm's-length in their dealings with management than before", says the investment banker. As a consequence, the two-tier board system "does not provide German corporates with anything like the level of protection from shareholders, activists and predators as it used to".

Shareholders were already shaking up the German corporate landscape even before Bayer's AGM in late April. Last year, activist investors Cevian Capital and Elliott Management successfully pushed German conglomerate Thyssenkrupp into splitting itself into two companies. It was a bitterly fought battle: Ulrich Lehner, the then-chairman, accused the activists of using "psycho-terror" tactics against senior executives.

There has also been trouble at the top at Deutsche Börse, whose chairman Joachim Faber said last week he was to step down early. He came under pressure from the exchange group's shareholders over an insider trading case against the company and former chief executive Carsten Kengeter.

Werner Baumann, chief executive of Bayer, left, with Werner Wenning, chairman, prior to the company's annual general meeting in Bonn in Apri © Bloomberg

Against this backdrop, Bayer's is unlikely to be the only AGM where tempers fray. "The sparks are definitely going to fly this year," says Ingo Speich, fund manager at Deka Investment, a German asset manager.

Shareholder activism has a relatively short history in Germany. The country was long dominated by the system known as Deutschland AG, an intricate web of cross-shareholdings between banks, insurers and big industrial companies that was in part designed to protect Germany's corporate jewels from predators. That led to a situation where, at one point, the directors of Deutsche Bank held more than 135 supervisory board positions at other companies.

The Deutschland AG model fuelled a perception by shareholders that the big corporate decisions were taken behind closed doors by a small group of insiders, often in cahoots with politicians and bureaucrats.

But that form of capitalism gradually changed this century. The 2001 decision to abolish capital gains tax on the disposal of cross-shareholdings triggered a wave of corporate restructuring, while a new governance code strictly limited the number of board seats that individuals can hold. Companies adapted to international norms of financial reporting and embraced value-based incentive packages for their managers. And as more international investors moved into the German market, the principle of maximising shareholder value began to take root. According to EY, 54 per cent of shares in Dax companies are now in foreign hands. In the case of Bayer, that figure is as high as 74 per cent.

"The cosy years are over, and the cold wind of the capital markets is now blowing on German companies," says Mr Rocholl.

At Deutsche Bank's AGM, chairman Paul Achleitner is likely to face questions from investors over his role in failed merger talks with Commerzbank © Reuters

Yet some critics believe there is still room for improvement. "A lot of the chairmen of German companies are still old-school, corporate titans who are not open to considering shareholders' interests, or at least not to the extent that is necessary," says Thomas Schweppe, a former Goldman Sachs banker who now runs 7 Square, which advises investors.

Those bosses are, however, coming under mounting scrutiny. At Deutsche Bank's AGM, chairman Paul Achleitner is likely to face searching questions from investors over his role in the failed merger talks with Commerzbank, a tie-up he is believed to have championed. Management will have to explain the continuing losses and falling revenues at Deutsche's investment bank. Influential proxy advisers Glass Lewis have recommended investors vote against ratifying Deutsche's management at the AGM, citing "loss of substantial shareholder value".

Carmaker Daimler could face criticism, too. Some investors are unhappy that the company has lined up Dieter Zetsche, the outgoing chief executive, to become chairman of its supervisory board in 2021.

Workers at the Mercedes-Benz plant in Sindelfingen. Its owner Daimler could also come under fire from investors © Getty

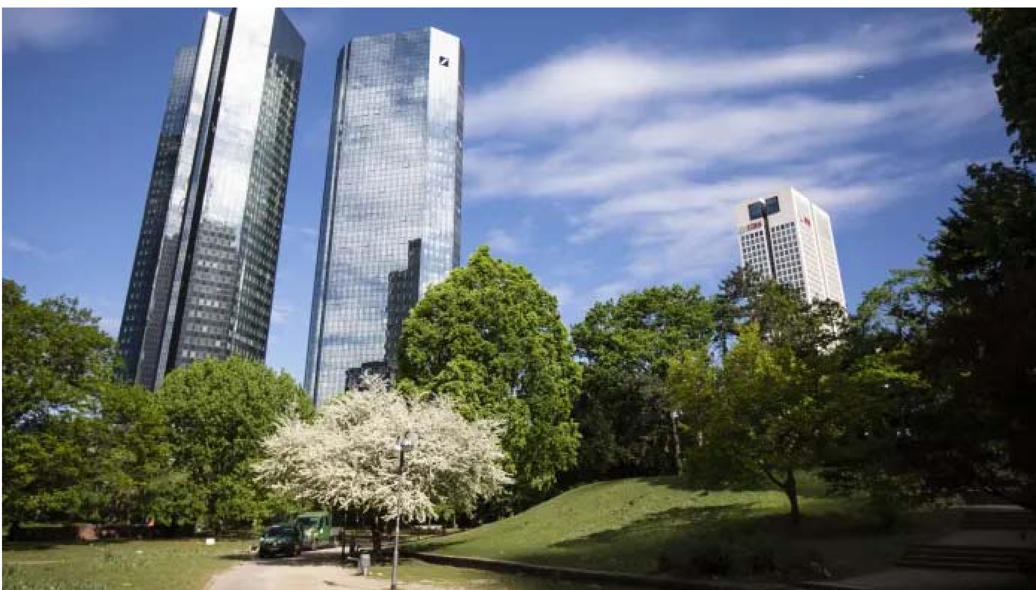
Christian Strenger, a founding member of Germany's corporate governance commission, says shareholders should get to decide in early 2021 whether Mr Zetsche is the right person for the job, when they'll "be in a better position to judge his long-term achievements".

"[Current chairman Manfred] Bischoff should not now predetermine himself whether Zetsche is the right chairman then," he says. "That's not good governance."

Sacha Sadan, director of corporate governance at UK-based Legal & General Investment Management, says there should be a five-year cooling off period for senior executives switching to supervisory boards. "While we can understand that companies may see benefits in choosing a former management board member, we find there is an inherent conflict," he says.

Meanwhile, Wirecard's shareholders, spooked by the accounting scandal, will want to hear more about how the company plans to improve its processes, following the announcement of new compliance measures in April.

Mr Strenger wants the company to put more professionals on its board, particularly experts in compliance and technology. Markus Braun, who is both Wirecard's chief executive and largest shareholder, "needs a stronger counterweight, with experts in [payments] and in auditing", he says.



The Deutsche Bank headquarters in Frankfurt © Bloomberg

The question of Wirecard's board reflects a broader concern. "There are a number of companies in Germany where the independence of the supervisory board can be strengthened," says Christoph

Berger, head of German equities at Allianz Global Investors. "We believe a third of board members should be independent, and when it comes to the audit committee, 50 per cent should be."

His definition of "independent" is strict. A board member does not qualify if he or she has been a director for longer than 12 years, was nominated by a controlling shareholder or was previously a senior executive at the same company — unless they observed a five-year cooling-off period. Many nominally "independent" directors in Germany might fail to meet those conditions.

Mr Sadan would also like to see more independent shareholder representatives on German boards, as well as "more diversity" in terms of "skills, nationality, ethnic origin and gender".

Insufficient diversity remains a big problem in German boardrooms, despite a legally mandated 30 per cent quota for women. According to a 2018 study by the IMU think-tank, 23 of the 160 companies in the Dax 30, MDax and SDax indices for small and medium-cap companies have no female directors at all.

The rise of investor power

The then Deutsche Bank co-chief executives Anshu Jain and Jürgen Fitschen pictured in 2013. Two years later they stepped down © EPA

2015

- 39 per cent of investors vote against "discharging" Deutsche Bank management. Shortly afterwards, co-chief executives Anshu Jain and Jürgen Fitschen step down

2016

- Proxy fight against German pharma company Stada, spearheaded by activist shareholder AOC, leads to the removal of the company's chairman
- Deutsche Bank shareholders vote down the company's proposed remuneration package for top managers

2017

- Attack by Guy Wyser-Pratte on OHB, a German technology firm, over alleged poor governance
- Bosnian business family Hastor launches attack on car seat maker Grammer over alleged mismanagement

2018

- Successful campaign to break up Thyssenkrupp launched by Cevian Capital and Elliott Management
- Deutsche Bank chairman Paul Achleitner faces a barrage of criticism from shareholders at the bank's AGM but survives a bid to unseat him

2019

- Bayer shareholders deliver unprecedented vote of no confidence against chief executive Werner Baumann and his team

Some companies have also been faulted for failing to fill boards with experts in the digital economy, at a time when German businesses are urgently trying to digitise their operations.

Others, however, stand out in this regard. Siemens earned praise in February for appointing Jim Hagemann Snabe, a Dane who is the former chairman of SAP, as its new chairman, replacing Gerhard Cromme, a captain of industry who had long served as chief executive and later chairman of Thyssenkrupp. Chemicals giant BASF made a similar move last year, nominating Alex Karp, the head of Palantir Technologies, a data analytics start-up, to its supervisory board.

They remain exceptions, though. German boardrooms are strikingly un-international and, as a result, too inward-looking, critics say. Mathieu Meyer, audit managing partner for Germany at EY, says 71 per cent of the supervisory board members overseeing German companies — and 64 per cent of executive board members — are German. And this is "despite the fact that these companies make most of their money abroad, and more than half of the funds invested in Dax companies comes from overseas," he says.

A successful campaign to break up Thyssenkrupp was launched by Cevian Capital and Elliott Management © Getty

That has fuelled a perception that Germany Inc. remains a closed shop for insiders. "Managers, directors, shareholders and regulators are too closely involved for any meaningful governance to take place," says Garen Markarian of the WHU Otto Beisheim School of Management. "It's a small private club with a lot of back-patting."

Still, shareholders are refusing to give up their struggle for more influence. Some want the right to approve big merger and acquisition deals, for example. "When a company is undertaking a transformational transaction, shareholders should be asked for their consent," says Mr Berger, particularly "in deals where their business model changes significantly".

Critics of Bayer's takeover of Monsanto say that if such a rule had been in place in 2016, the company might not be in the mess it is in now. Instead, as Deka's Mr Speich put it in his speech to

the Bayer AGM, it has seen "value destruction on a historic scale".

He added: "Management infected a healthy Bayer with the Monsanto virus and has no cure at its disposal."

Berlin fears increased competition from rivals

The problems at companies such as Bayer, Deutsche Bank and Wirecard have fed into a broader angst about the future of Germany Inc. Politicians, officials and business leaders have repeatedly highlighted the risk of the country losing its competitive edge and falling behind China and the US.

Peter Altmaier, economics minister, recently warned that Germany's technological lead "is slowly but perceptibly melting away" as emerging economies play catch-up.

"In nearly all areas of innovation, particularly digitalisation and artificial intelligence, big, new and globally successful companies are emerging with huge market power that dwarfs that of each individual Dax company," he said.

This concern is widely shared. Key industries face massive disruption: carmakers like VW, from the rise of electric vehicles; banking and insurance, from the emergence of financial technology; and machine engineering, from digitisation.

Meanwhile, Germany has only one private tech group valued at $1bn or more, compared with 184 such "unicorns" in the US and 153 in China. "To catch up, the German start-up ecosystem would need an additional $20bn in venture capital per annum," says Cornelius Baur, head of McKinsey Germany.

He adds that for its companies to properly digitise by 2023, the country will need 700,000 IT experts, ranging from data scientists to smart hardware and robotics developers. That will require an "education offensive" on a massive scale. Germany will also have to open itself up more to foreign experts, and reorient universities towards maths, science, informatics and tech-related subjects.

Mr Baur remains optimistic. "Technologically, German companies are doing very well," he says. They are "facing challenges but can master them".

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