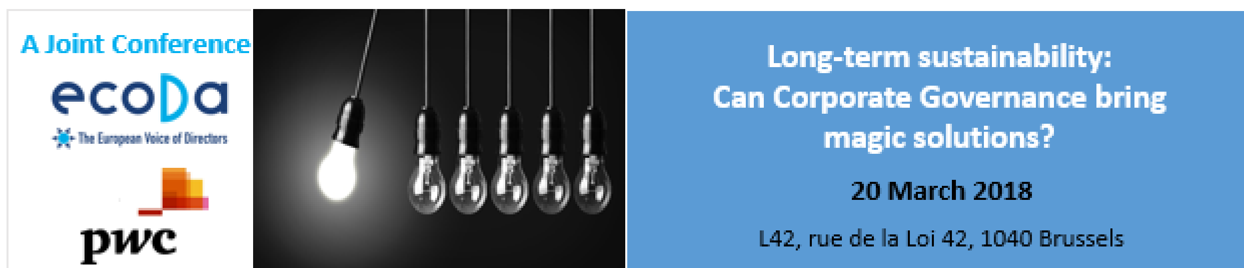


## Long-term sustainability: Can Corporate Governance bring magic solutions?

**ecoDa/PwC Conference - 20 March 2018**

# Wrap-up Report

On March 20, ecoDa and PwC organised a joint event on *"Long-term sustainability: Can Corporate Governance bring magic solutions?",* two weeks after the launch of the EC action plan on financing sustainable growth.

The conference opened with a welcoming speech of ecoDa's chair and a video message of professor Mervyn King. The King IV Code on Corporate Governance in South Africa is innovative in the way that it sets:

- A limit to the number of principles,
- Principles, valid for all types of organizations,
- "Apply and explain" instead of "comply-or-explain" approach and
- More focus on stakeholders and ethical issues.

As an intro to the two Panel discussions, the European Commission presented its action plan on sustainable growth, which notably aims at promoting a corporate governance that is more conducive to sustainable investments.

***Panel 1: What is the role of governance in fostering sustainable value? Should the board balance the interests of all stakeholders?***

There was a general consensus that it is time to link Corporate Governance to value creation, rather than looking at it as a mere compliance exercise. Sustainable value creation is key for the survival of the business and for the benefit of society.

Panellists discussed the role of investors versus the role of the board to foster sustainability:

- In a capitalistic world, shareholders are the 'principals' who take the final entrepreneurial risk but at the same time set the rules for the rest of the governance players. They are the final decision makers and they decide who should sit on the board.
- Therefore, companies cannot neglect to check whether shareholders have a long-term view.

- Certain investors (such as BlackRock) consider a long-term approach to corporate governance and shareholder engagement as a continuation of their fiduciary duties towards their clients, however not all shareholders may have the same approach.

The European Commission's intention to define the promotion of long term value creation as a duty of investors, is of course more straight forward for long term shareholders, like family shareholders or pension funds. Since the EU's focus of attention especially goes towards the institutional investors, one may not forget that there is a huge heterogeneity in their respective investment strategy and time horizon. Moreover, not all institutional investors require their clients to articulate their prospects for long term growth in their business strategy.
Also, it is worth considering two other types of shareholders who do not feature in the EC action plan, but might have a considerable impact on the long-term horizon: 1- Family shareholders who have a long-term horizon that spans over generations and for whom sustainability is embedded in all their decisions, 2- and on the other side of the spectrum, day traders and hedge funds, who may be less focused on the long-term sustainability goal, if this comes at the detriment of a short term higher cost and hence less profit.

Influencing investors' behavior is also difficult as sustainability may not be more attractive in terms of investment return.

When it comes to the board's fiduciary duties, it is obvious that the recognition of financial risks on the long term brings sustainability issues into the very core of Corporate Governance and the role of the board. Whereas shareholders are legally permitted to only foster their personal interest, directors are legally bound by the promotion of the corporate interest. Some panelists discussed that boards have not used the space that company law across jurisdictions gives them to integrate sustainability mainly because of the pressure to maximize returns to investors.

A key question is whether there is a need for more clarification on the board's fiduciary duties. How does the concept of stakeholders' inclusiveness relate to the directors' duty of care - company laws clearly say that the board's prior obligation is to always act in the best interest of the company? The problems come with stakeholders that don't have a positive interest on long term of companies. Whereas shareholders will focus on their and / or their clients' interest, this is not in the interest of the company, boards can't. Company Law should not abandon the principle of duty of care. Requiring the board to serve different masters might generate conflicts of goals which will be difficult to handle (Can boards be accountable to different masters at the same interest? How should boards be then appointed?). Short termism and traditionalism are the main reason why fiduciary duties are not always implemented in practice.

However, others argue there are "legal myths" on what the boards are meant to do. A good example that shows that these concepts are not self-evident is that while the definition of the 'firm' in the French civil code is somewhat limited to returns and profit, French companies in practice pay much attention to ESG risks. On the contrary, in the UK, the section 172 of the Companies' Act says that it is part of directors' duties to "have regard to" stakeholders' interests, the practice of UK companies around stakeholder considerations may not be consistently followed. An interesting example can be found in the Dutch system, where all shareholders and stakeholders have the right to ask the board what they have done to serve their particular interest. They would even recommend integrating the purpose of companies in their bylaws, as it should serve as a license to operate.

If Corporate Governance would be a box ticking exercise, we would not need experienced directors. The role of directors is to balance interests, and this is not an easy task. It has to be explicitly stated. Boards should be able to refer to existing articles of the company, the governance rules and existing regulation.

There was agreement that it would not be realistic for the European Commission to get a single definition of 'the corporate interest' since it considerably differs from one jurisdiction to another. Hence it is important to combine the promotion of sustainable finance and sustainable value creation with a more 'inclusive' approach towards the corporate interest (see the *Mervyn King* approach in S-Africa) and the complementary positioning of director duties. It is indeed easier to look who define corporate interest and who are the drivers.

As a final point, all the panelists found that the EC Action Plan provides a good opportunity to connect corporate law, Corporate Governance, and reporting with sustainability in a more comprehensive approach.

***A second panel discussed: Long-term value creation and innovation: Would a company specific approach in Corporate Governance be more efficient?***

In order to reach the goal of sustainable value creation, companies will have to innovate. The question was whether the EU approach towards governance has been facilitating or even promoting innovation?

The specific question panel 2 raised was whether the emphasis has not been overwhelmingly placed on the monitoring role of boards, on elements like audit and risk management, on diversity of boards, etc. The panellists questioned whether there should be Guidance in the CG Codes to promote entrepreneurship, innovation, business growth and sustainability.

A short introduction highlighted the main characteristics of innovative companies:

- Those entrepreneurs invest in activities with highly uncertain outcomes. The likely commercial return is difficult to quantify, and the risk of failure is significant,
- They tend to require a longer-term time investment horizon than many other kinds of business activity. They need shareholders that have a sustainability approach,
- They benefit from the availability of company specific skills, which may be highly specialised. Boards are highly dependent on technical skills,
- They have a different internal culture,
- There is a high level of information and expertise asymmetry between the people who are directly involved in innovation and those that are not (e.g. outside directors or external investors).

All speakers agreed that corporate governance needs to be tailored to the specific needs of those innovative enterprises. A one size fits all approach does not work. There should be a re-focus on the initial principle of comply "or" explain, instead of an expectation of full compliance. Shareholders, media and the EU regulator should accept deviations especially from the standard governance recipes for small and innovative companies. Best CG practices of mature listed companies might indeed not fit to scale-ups.

This does not mean that they should not be serious about Corporate Governance. Corporate Governance is key in promoting sustainable growth and it is better to get your house in order before getting listed. Once listed, well-governed innovative companies will gain in visibility, credibility, and they will be more able to attract the right people.

However old CG, the recipe might not always work. There has been too much emphasis on preventing the abuse of power rather than promoting creativity and new ideas, and CG was too oriented towards the short-term interests of minority shareholders rather than the long-term flourishing of the enterprise as a whole. But of course, the basis remains the same and the importance of having the right checks and balances is high.

CG Codes have to be perceived as benchmarks of best practices. There is no need to go into nitty gritty details. Overarching principles offer more flexibility as suggested in the King IV Report in South Africa.

The panelists then discussed the role of the board in those companies and agreed that:

- Directors have a coaching role,
- They need to be aware of the strategy and the ultimate goals,
- They have to keep a good eye on who is responsible for spending the money,
- They have to be prepared for surprises/errors,
- They have to foster the corporate interest and decide in an objective and independent way (being independent of mind),
- They should be aware that their liability is not different (even if they function more like a R&D committee),
- Shares may be a good remuneration instrument (mixed views),
- These boards may rely more on entrepreneurial skills instead of controlling skills – with the risk of getting more operational boards.

More general remarks were made:

- Regarding sustainability and innovation, the risk is that everyone (companies, investors, politicians, media) goes in the same direction and feels they know what the best things to do are. An example may be the car industry were all producers are instead of looking for other innovation developing electric cars at the same time knowing that the commodities for the batteries do not seem to be achievable in order to replace petrol cars.
- Europe should pay more attention to the next level and offer the right conditions to scale-up companies looking for more capital.
- To promote innovative companies, full transparency is better than regulation.

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***See the video recording of Mervyn King, Chair of the King Committee of Corporate Governance***

***And the video extract from the conference***

The conference was opened with a welcoming speech from Irena Prijovic, ecoDa chair and a recording speech from Mervyn King, Chair of the King Committee of Corporate Governance. The European Commission represented by Zsofia Kerecsen, Company Law, European Commission, Directorate-General for Justice made a short presentation of the EC Action plan on sustainable growth.

*Panel 1* moderated by Jean-Christophe Georghiou, the Assurance Policy leader for PwC in Europe gathered Prof. Lutgart Van den Berghe, ecoDa board member, Managing Director of GUBERNA, Prof. Beate Sjåfjell, University

of Oslo, Project Coordinator, The Sustainable Market Actors for Responsible Trade project (SMART), Anahide Pilibossian, Vice President, BlackRock, Per Lekvall, Member of the Swedish Corporate Governance Board, Henk Breukink, Member of the Supervisory Board of ING Group, chairman of the Remuneration committee, member of the Nomination/Corporate Governance committee.

Panel 2 moderated by Lutgart Van den Berghe, ecoDa board member, Managing Director of GUBERNA was composed of Cordula Heldt, Head of Corporate Governance and Company Law at Deutsches Aktieninstitut, Geert Glas, Partner, Allen & Overy, Vincent Van Dessel, CEO of Euronext Brussels, Luc Sterckx, President of the Board of Febeliec (Federation of Belgian Industrial Power & Gas Consumers).

*The conference was concluded by* Markus Ferber, Member of the European Parliament, Group of the European People's Party (Christian Democrats).

*We renew our sincere thanks to all our speakers*

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